Trade Secrets/Non-Compete YEAR IN REVIEW

2023

Welcome to our 2023 Trade Secret and Restrictive Covenant Year in Review. 2023 was a busy year in this space, but not as busy as many expected. Although multiple states introduced restrictive covenant legislation, the most significant shock waves through the legal and business community concerned legislation and administrative activity that never materialized. Still, there were plenty of significant jury verdicts and court decisions to keep us "noncompete and trade secret geeks" entertained, and we can expect 2024 to be more active than 2023 as the FTC and other federal agencies, as well as several state legislatures, continue their assault on restrictive covenants.

I. Two significant pieces of legislation and two major legislative actions fail to happen (for now).

Approximately 93 restrictive covenant bills were introduced in 37 states in 2023. Most of the bills did not make it out of committee and terminated when the 2023 state legislative session ended. Of the bills that were enacted, Minnesota's noncompetition statute and two California statues reinforcing, and imposing new requirements regarding, California's ban on restrictive covenants were the most significant. As discussed here, the Minnesota statute, which took effect on July 1st, bars all noncompetition agreements with Minnesota residents but does allow for the enforcement of customer and employee nonsolicitation agreements. The statute also allows for the enforcement of noncompetition restrictions involving the sale of a business so long as the restrictions are "reasonable." Notably, the statute does not define what is a "reasonable" restriction.

New California Business and Professions Code Section 16600.5, which took effect Jan. 1, 2024, reinforces California's prohibition on restrictive covenant agreements by declaring "any contract that is void under this chapter is unenforceable regardless of where and when the contract was signed … [and] regardless of whether the contract was signed and the employment was maintained outside of California." In other words, an employee who signs a restrictive covenant agreement in another state, performs services for his/her employer in another state and then takes residence in California will not be subject to the restrictive covenant agreement. Section 16600.5 also creates a private right of action that allows an employee to obtain injunctive relief, actual damages and attorneys' fees if the employee seeks to have the restrictive covenant agreement declared void and unenforceable under California law. Approximately one month after passing Section 16600.5, California further amended California Business and Professions Code Section 16600 by requiring employers to notify current and former employees, in writing and by **Feb. 14, 2024**, that any noncompete clause or agreement signed by the California employee is void.

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The bill that garnered the most attention in 2023, however, was a New York bill that effectively banned all forms of restrictive covenants. The bill quietly made it to the Governor's desk out of a special legislative session but ran into significant roadblocks when Wall Street firms and other New York business leaders launched a full-scale lobbying effort to have the Governor reject or modify the bill. Their lobbying efforts paid off and, on December 23rd, Governor Kathy Hochul officially vetoed the bill. In doing so, Governor Hochul noted that she is not open to "a one-size-fits-all-approach" for restrictive covenant agreements but would be "open to future legislation that protects middle-class and low-wage workers." Given Governor Hochul's comments, we predict that a restrictive covenant statute with compensation thresholds will be part of the New York legislature's 2024 agenda.

The Federal Trade Commission's ("FTC") proposed ban on noncompetition agreements will also be front and center in 2024. Although the FTC conducted various "sessions" regarding the impact of noncompetition agreements and received more than 24,000 comments about its proposed Rule banning noncompetition agreements, the FTC surprisingly did not attempt to enact the Rule in 2023. Consequently, we can expect the FTC to enact the Rule sometime in 2024. Lawsuits seeking to enjoin and strike down the Rule will follow immediately thereafter. Accordingly, the real fight over the FTC's Rule (i.e. the court fight) has not yet started.

Although it did not attempt to enact its noncompete ban, the FTC did seek to have at least four companies void their noncompete agreements in 2023. In one case, the FTC ordered manufacturing company Anchor Glass Container Corporation to drop noncompete restrictions signed by more than 300 workers. The FTC also entered into a memorandum of understanding (MOU) with the U.S. Department of Labor (DOL) to "protect workers by promoting competitive U.S. labor markets and putting an end to unfair, deceptive, and other unlawful acts and practices, as well as unfair methods of competition, that harm workers." The MOU enables the DOL and FTC to collaborate by sharing information, conducting cross-training for staff and partnering on investigative efforts.

Not to be outdone, the National Labor Relations Board ("NLRB") filed its own complaint against Ohio spa company Juvly alleging that Juvly violated the National Labor Relations Act ("NLRA") by forcing its employees to sign restrictive covenants that preclude employees from "practicing aesthetic medicine" and "providing other services" within 20 miles of any Juvly location for a period of two years following employment, and by requiring employees to repay initial ($75,000) and supplemental ($30,000) job training costs if they leave Juvly within one year (the amount is prorated if the employee left within two years). The NLRB's action coincides with a May 2023 memo from NLRB General Counsel Jennifer Abruzzo that claims restrictive covenants chill workers' organization and collective bargaining rights "when the provisions could reasonably be construed by employees to deny them the ability to quit or change jobs by cutting off their access to other employment opportunities that they are qualified for based on their experience, aptitudes, and preferences." Importantly, both the FTC and NLRB actions target restrictive covenant agreements that would likely be declared unenforceable in a court of law. As of today, neither the NLRB, nor the FTC, has attempted to challenge a restrictive covenant that would likely be upheld in a court of law.

II. The NBA has a trade secret rift, Elon Musk goes after a former employee, an important decision from Georgia and companies need to continue watching Delaware.

Perhaps the two most salacious trade secret cases in 2023 involved Elon Musk and the NBA. X Corp., formerly known as Twitter, accused a former employee of leaking trade secrets to the New York Times and other media companies to embarrass Elon Musk. In the NBA, the New York Knicks sued the Toronto Raptors, their new head coach and a former Knicks scouting employee, claiming the defendants conspired to steal thousands of videos and other scouting secrets, as well as a prep book and valuable software. The lawsuit seeks unspecified damages and a ban on the further spread of Knicks' trade secrets. Both lawsuits are in their initial litigation stages and will obviously be closely watched.

In *North American Senior Benefits, LLC v. Wimmer*, a Georgia Appellate court ruled that employee non-solicitation covenants must have an explicit geographic limitation in order to be enforceable under the Georgia Restrictive Covenants Act. Although the ruling seems to contradict the Act's language that provides courts with the discretion to modify over broad restrictive covenant agreements, companies with Georgia employees must now make sure that their employee nonsolicitation restrictions contain a specific geographic territory in order to be enforceable.

Finally, trade secret/restrictive covenant lawyers *and corporate transactional lawyers* need to keep an eye on Delaware. At the end of 2022 and into 2023, the Delaware Court of Chancery issued a series of decisions a) narrowing the scope of permissible noncompete agreements and b) declining to "blue pencil" overly broad restrictive covenants. Importantly, three of the decisions concern the sale of a business.

In *Kodiak Building Partners, LLC v. Adams*, Vice Chancellor Zurn declined to enforce a restrictive covenant agreement between the buyer of a business (Kodiak) and a minority shareholder and key employee (Adams) of the target (Northwest) because the noncompete applied to all of Kodiak's business lines and geographic areas rather than just the areas where Adams and Northwest did business. Vice Chancellor Zurn also threw out the nonsolicit provision because it covered all of Kodiak's customers, clients or prospective customers and clients rather than those it had acquired from Northwest or that Adams had business relationships. The Vice Chancellor then put the final nail in Kodiak's restrictive covenant coffin by declining to blue pencil the restrictive covenants even though the agreement expressly authorized the court to do so.

Vice Chancellor Zurn delivered a similar ruling four months later in *Ainslie v. Cantor Fitzgerald L.P. Ainslie* involved financial services firm Cantor Fitzgerald and several of its former partners whose partnership agreements restricted them from engaging with a competing business for a period of one year following their withdrawal from the partnership. In striking down the restrictive covenants, Vice Chancellor Zurn found that the worldwide geographic scope in the restrictive covenants was over broad and the scope of prohibited activities was unreasonable because the restrictive covenants covered activities competitive with any affiliated entity of Cantor Fitzgerald as opposed to competition with only the business line(s) that the partners had been involved with at Cantor Fitzgerald. And just like her decision in *Kodiak*, Vice Chancellor Zurn declined to blue pencil the restrictive covenants.

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In case companies thought that Vice Chancellor Zurn's opinions in *Kodiak* and *Ainslie* were outliers, Vice Chancellor Will struck a noncompete on similar grounds in *Intertek Testing Systems v. Eastman*. In this case, Eastman was the co-founder, major stockholder and CEO of Alchemy Investment Holdings, Inc., when it was acquired by Intertek. The stock purchase agreement contained several restrictive covenants, including a noncompete that restricted Eastman from engaging with any business or person competitive to any portion of Alchemy's business "anywhere in the world." Vice Chancellor Zurn determined that the noncompete was over broad because the covenant was not "tailored to the competitive space reached by the seller." Put another way, the noncompete was over broad because it covered the entire world as opposed to the markets covered by Alchemy when Eastman was CEO. Furthermore, Vice Chancellor Will followed Vice Chancellor Zurn's lead from *Kodiak* and *Ainslie* and declined to blue pencil the restrictive covenants.

Vice Chancellor Zurn struck again, in *Centurion Service Group LLC v. Wilensky*, when she dismissed an Illinois-based medical equipment supplier's noncompete suit against a former employee because the noncompete violated Illinois' "fundamental policies and material interests." The Vice Chancellor made this determination even though the noncompete contained a Delaware choice of law provision. In issuing her ruling, Vice Chancellor Zurn found "no basis to disturb the employment agreement's choice of Delaware law" but stated that "where a different state's law would govern in the absence of a choice of law provision, where that state has a fundamental public policy regarding restrictive covenants and where that state has a materially greater interest in the matter, this court will defer to that state's law even in the face of a Delaware choice of law provision." The Vice Chancellor then found that Illinois had "a greater interest in this matter" and, since the restrictive covenants violated Illinois law, the restrictive covenants were unenforceable and the Complaint should be dismissed.

Vice Chancellor Will then stepped back into the fray by blocking a software company's attempt to stop two former employees from working for a competitor because the restrictive covenants at issue only applied to the holding company parent, not its operating subsidiary. In *Frontline Technologies Group LLC and Frontline Technologies LLC v. Murphy and Holbrook*, Vice Chancellor Will found that the relevant equity agreements were only between Murphy/Holbrook and Frontline Technologies LLC, the parent company. Since the equity agreements did not contain any reference to the operating subsidiary, Frontline Technologies Group LLC, (and likely did not contain an assignment clause for the restrictive covenants), the noncompete provisions did not cover the operating subsidiary and, as such, Murphy and Holbrook were free to compete with Frontline Technologies Group LLC (i.e., their former employer).

Given the above cases, the days of a Delaware court giving a free pass to restrictive covenants involving the sale of a business and/or automatically blue penciling over broad restrictive covenants may be a thing of the past.

III. Civil jury verdicts and criminal prosecutions

Although jury verdicts for trade secret cases did not achieve the numbers/results we saw in 2023, there were still significant monetary awards, including:

- A $62 million award for Skye Orthobiologics and Human Regenerative Technologies after a jury found a former employee breached his fiduciary duties and loyalty when he started a competing business using the plaintiffs' trade secrets.
- A $ 210 million award for Computer Sciences Corporation ("CSC") after a jury found rival Tata Consultancy Services Ltd liable for willfully misappropriating CSC's trade secret source code.
- A $46 million award by a jury to a urologist whose implant trade secrets were stolen by a competitor.

On the criminal side, the Department of Justice ("DOJ") charged a former Siemens Energy Inc. executive in Virginia federal court with stealing trade secrets from GE and Mitsubishi in order to use the trade secrets to undercut GE's and Mitsubishi's bids for the construction of a gas turbine plant. And in California, a federal judge sentenced a former employee of a NASA contractor who smuggled aeronautics software to a sanctioned Chinese university to 20 months in prison.

Lastly, several of our Quarterly Reports have discussed the DOJ's attempts to prosecute companies who enter into "no poach" agreements. At the end of 2023, the DOJ Antitrust Division has yet to obtain a single jury conviction on any of the no poach criminal cases that it began filing in late 2020. In fact, the only "wins" so far for the DOJ has been a conviction for lying to investigators and a pair of plea deals. In a not so nice slap from the court, in June 2023, U.S. District Judge Victor A. Bolden (D-Connecticut) stopped a no poach case from going to the jury before closing arguments by ruling that no reasonable jury could convict the defendants based on the evidence presented by prosecutors. Another no poach case, over Las Vegas home health agency nurses, is currently set for trial in March 2024. It will be interesting to see if the DOJ continues to prosecute these cases after the March 2024 trial.

CONCLUSION

Benesch's Trade Secret, Restrictive Covenants and Unfair Competition Group will continue to monitor important activities in, and changes to, the trade secret and restrictive covenant space. The Group will also provide periodic updates regarding new statutes, government actions and case opinions that may impact the ability to enforce restrictive covenants or protect trade secrets.

The Group is also offering a flat fee review of restrictive covenant agreements to assess whether the agreements comply with the recent changes to restrictive covenant law. In addition, the Group will host a Webinar, "2023 Restrictive Covenant and Trade Secret Year In Review – What happened and what is likely to happen," on Jan. 11, 2024. To register for the webinar, please click here. Also, if you would like to hear more about these offerings, please contact **SCOTT HUMPHREY** at 312.624.6420 or shumphrey@beneschlaw.com