Trade Secrets/Non-Compete Quarterly Update

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As past readers know, 2021 was an active year for trade secret and restrictive covenant law as several states enacted changes to their restrictive covenant statutes, the United States Senate and Federal Trade Commission (at the request of the President) waded into the restrictive covenant space, and the Department of Justice ("DOJ") followed through on a five-year promise to criminally prosecute no poach agreements (Click here to read our 2021 Year-End Review). Given everything that happened in 2021, it should come as no surprise that this flurry of activity continued into the first quarter of 2022. In fact, at the time of this writing, there are already 67 restrictive covenant bills pending in 21 different states, the DOJ has launched additional criminal no poach cases (with mixed success), and the DOJ and Department of Labor ("DOL") have joined forces to "strengthen and coordinate enforcement efforts in labor markets" with respect to, and among other things, no poach agreements and restrictive covenants. In addition, the reduction in COVID restrictions has led to the gradual re-opening of courts and a couple of significant criminal and civil trial results in the first quarter of 2022. Below is a more thorough update of what happened over the last three months.

The District of Columbia's ban on non-competition covenants is now delayed until at least October 1, 2022.

The District of Columbia's non-competition statute has been on the books since January 11, 2021. (You can read our analysis of the D.C. statute by clicking here). The statute essentially bans non-competition agreements for any employee who works in the District or any prospective employee who the employer reasonably expects to work in the District. The statute also requires employers to provide specific notice to their District employees, or those who will provide services in the District, that non-competition provisions in the District are banned.

The statute contains a controversial provision that allows employees to engage in competitive activities while still employed with their employer. After passage of the statute, several District council members expressed concerns about allowing employees to compete with their employer during employment. As a result, enactment of the statute has been placed on hold while Council members discuss removing this provision in order to allow employers to restrict competitive employment while the employee is working for their company. As of now, the statute is on "hold" until at least October 1, 2022. We will continue to provide updates on the statute.

More states are considering a complete ban on restrictive covenant agreements but most of the new legislation is focused on low-wage employees.

Illinois, Maryland, Maine, Massachusetts, Oregon, Nevada, New Hampshire, Rhode Island, Virginia, and Washington have specific legislation that bans restrictive covenants on low-wage employees and workers. Colorado, Iowa, and West Virginia introduced similar restrictive covenant legislation (i.e. restrictive covenant bans on low-wage employees) in the first quarter of 2022. New York and

Minnesota took this ban a step further by introducing legislation in the first quarter of 2022 that bans restrictive covenants on anyone who makes below the "*median* wage" of their respective state. Although negotiations as to what constitutes the "median wage" appear to be ongoing, the most common/likely definition would be the median income of a family of four. The Minnesota legislature is also considering restrictive covenant legislation that would allow a company to enforce a restrictive covenant, regardless of an employee's income, if the employer agrees to pay 50% of the employee's salary during the length of the restrictive period. Lastly, Wyoming is currently considering a complete restrictive covenant ban and, as discussed below, the Wyoming Supreme Court has abolished the "blue penciling" of restrictive covenant agreements. We will continue to monitor restrictive covenant legislation and provide periodic updates.

The West brings us the first significant restrictive covenant rulings of 2022.

In addition to the Wyoming legislature taking a serious look at completely banning restrictive covenants, the Wyoming Supreme Court, on February 25, 2022, essentially abolished the "blue penciling" of restrictive covenant agreements. Specifically, in *Hassler v. Circle C Resources*, 2022 WY 28 (WY S. Ct February 25, 2022), the Wyoming Supreme Court erased over 20 years of restrictive covenant law by forbidding trial courts from rewriting, modifying, or "blue penciling" restrictive covenant agreements. Hence, from now on restrictive covenants in Wyoming will be judged on their specific terms/restrictions and, if the terms/restrictions do not comply with Wyoming law, the trial court will be required to render the terms/restrictions null and void.

Yet, the most significant restrictive covenant case in the first quarter of 2022 came out of the Ninth Circuit Federal Court of Appeals. As companies with California employees know all too well, California Labor Code § 925 states that an employment agreement with a California employee is voidable if the agreement requires the employee to adjudicate disputes outside of California, or "deprives the employee of protections afforded by California law," unless the employee is represented by counsel in negotiating the agreement.

Section 925 conflicts with many employment agreements that contain choice of law and venue provisions. For example, a New Jersey company may require all of its employees, including its California employees, to sign an employment agreement that contains enforceable restrictive covenants and requires all disputes to be litigated in New Jersey and under New Jersey law. Smart companies also have "consent language" in their employment agreements that have employees consent to New Jersey state or federal court with respect to any dispute arising under the employment agreement. Thus, if a California employee violates the restrictive covenants found in the employment agreement, the New Jersey company files a Complaint and Injunction Motion in New Jersey Federal court seeking to enjoin the California employee from violating the restrictive covenants. Assuming that the restrictive covenants are enforceable under New Jersey law, the New Jersey Federal court then issues an order enjoining the California employee from violating the restrictive covenants.

The California employee, on the other hand, can attempt to void the forum and choice of law provisions found in the employment agreement by notifying the New Jersey employer that the provisions are void under California Labor Code § 925 and the restrictive covenants found in the employment agreement are void under California Business Code § 16600. The employee can then file a declaratory judgment action in California state or federal court seeking to void the restrictive

covenants and employment agreement. Not surprisingly, there is often a race between the New Jersey employer to file its Complaint and Injunction Motion in New Jersey and the California employee to file his/her declaratory judgment action in California.

The Ninth Circuit Federal Court of Appeals recently emphasized the importance of winning the "first to file" race and delivered a harsh message to companies that lose the race. In *DePuy Synthes Sales v. Howmedica Osteonic's*, (Case No. 21-55126) (9th Cir. March 14, 2022), Waber, a California citizen, had a one-year non-compete agreement with Howmedica. The agreement contained forum selection and choice of law clauses that required all disputes arising under the agreement be resolved in New Jersey and under New Jersey law. Waber subsequently left Howmedica and obtained similar employment with a new employer, Depuy, in California. Howmedica then threatened legal action because Waber's employment with Depuy violated the one-year non-compete. Waber countered Howmedica's threat by notifying Howmedica that the employment agreement (and the restrictions contained therein) was void under California Labor Code § 925. Waber and DePuy also immediately filed a declaratory judgment action in California federal court seeking to enjoin enforcement of the non-compete based upon California Labor Code § 925 and California Business Code § 16600.

Howmedica responded by attempting to transfer the declaratory action to New Jersey. The district court denied Howmedica's transfer request and Howmedica then appealed. On appeal, Howmedica argued that the forum selection clause was enforceable under established federal law and the case, therefore, should be transferred to New Jersey. In its decision, the Ninth Circuit agreed that federal law governed the issue of enforceability of a valid contract but, before tackling that question, the 9th Circuit must first determine "which state law governs the contract" at issue. The Ninth Circuit concluded that California's strong public policy prohibition on restrictive covenants, combined with California Labor Code § 925's requirement that California employees receive the benefit of California law, resulted in California law, not New Jersey law, governing Waber's agreement with Howmedica. As a result, the Ninth Circuit upheld the trial court's denial of the transfer request and affirmed the trial court's ruling that the restrictive covenants found in Waber's agreement with Howmedica were null and void.

In reaching its ruling, the Ninth Circuit emphasized the fact that the case was initially brought in California and noted that a New Jersey court may have reached a different conclusion (i.e. New Jersey law applied and the non-compete was enforceable). Accordingly, for those companies who have forum and choice of law provisions in their employment agreements with California employees, it is important to understand the importance of "filing first" when seeking the enforcement of a restrictive covenant. Here, Howmedica would have likely received a different result if it had filed a Complaint and Injunction Motion against Waber in New Jersey state or federal court before Waber filed his declaratory judgment action in California. Instead, by waiting, Howmedica not only lost the advantage of litigating in a forum selected by Howmedica, but also ran into a hostile trial court and appellate court that were more than willing to invalidate Howmedica's agreement.

The DOJ remains criminally and civilly active in the trade secret and no poach space but not with the success it was hoping for.

As we mentioned in our December 27, 2021 article, 2021 saw significant activity by the DOJ in the trade secret and no poach space. Most significantly, the DOJ followed through on its 2016 warning/threat to investigate and criminally prosecute no poach agreements between competitors. It

also increased its activity with respect to criminal prosecution of trade secrets, especially in situations where the theft involved a foreign company or an individual attempting to steal trade secrets on behalf of a foreign company or state. For example, Chinese radio maker Hytera was criminally charged with stealing Motorola Solutions' source code and hardware designs for developing digital communication products. The criminal Complaint, which charges Hytera with one count of conspiracy to commit trade secret theft and 20 counts of illegal possession of trade secrets, also names a number of former Motorola employees who went to work for Hytera as defendants.

The DOJ also obtained two significant criminal convictions in the first quarter of 2022, although one of the convictions may be short-lived. First, a former scientist for Monsanto who tried to board a flight to China with a Monsanto algorithm on his electronic devices pled guilty to conspiring to steal trade secrets from Monsanto and was sentenced to 29 months in prison and ordered to pay a $150,000 fine. Second, a University of Kansas professor was found guilty on three counts of wire fraud and one count of making a false statement with respect to concealing his ties to a Chinese university. At trial, the DOJ argued, and the jury agreed, that the Kansas professor concealed his ties to the Chinese university in order to steal trade secrets and other intellectual property from the University of Kansas. After the jury was released, however, the trial judge noted "significant issues" with the government's case and expressed skepticism that the professor's "concealed" ties to the Chinese university amounted to fraud. As a result, the judge declined to set a sentencing date and, instead, ordered briefing on the professor's motion for acquittal.

The DOJ's antitrust division also remains active with respect to no poach agreements. The DOJ's activity in the no poach space consists of both attempting to intervene in civil lawsuits as well as bringing its own criminal actions. With respect to intervention, the DOJ has had mixed results. For example, the DOJ recently filed a statement of interest in a Nevada state court action that backed the plaintiffs' requests to invalidate non-compete agreements between a large medical group and its physician employees on antitrust grounds. In *Beck et al. v. Pickert Medical Group, P.C., et al.*, CV 21-92 (2nd Judicial Dist. Nev.), several anesthesiologists located in Northern Nevada maintain that Pickert Medical Group is engaging in anti-competitive and monopolistic behavior by enforcing a two year non-compete. The DOJ siding with the anesthesiologists is not surprising but what is notable about the DOJ's intervention is that the DOJ's intervention papers argue that Pickert's agreement with the anesthesiologists should be characterized as a "horizontal" agreement between competing healthcare providers because the agreement essentially prohibits two-thirds of the anesthesiologists in Northern Nevada from competing with Pickert. If the court agrees with the DOJ and determines that Pickert's agreement with the anesthesiologists is a "horizontal agreement," then the agreement is a "per se" antitrust violation, and Pickert's defenses against the alleged antitrust violations are significantly reduced. In contrast, if Pickert's agreement with the anesthesiologists is viewed as a "vertical agreement," then the agreement (and the restrictive covenants contained therein) is subject to the much more relaxed "rule of reason" standard and Pickert can make several arguments to support the restrictive covenants. For example, under the rule of reason standard, Pickert can argue that there is no antitrust violation because the intent and purpose of the restrictions is to protect its legitimate business interests and trade secrets. If, on the other hand, the court determines that the agreement is a horizontal agreement, then these arguments are irrelevant and cannot be used as a defense against the antitrust allegations. We will continue to monitor the *Pickert* case and will provide timely updates.

Unlike in Nevada, the DOJ received a professional but not so friendly reception in the United States District Court for the Northern District of Illinois. In *Deslandes v. McDonald's et al.*, 17 C 4857 (N.D. Ill), an ex-manager of a McDonald's restaurant challenged the no poach clause found in the McDonald's franchise agreement on antitrust grounds. McDonald's eventually moved for summary judgment and the DOJ asked to intervene in the case so that the DOJ could "outline its stance" on no poach agreements. The district court denied the DOJ's request by noting that Supreme Court precedent and the Constitution demand that the judiciary "stay independent and that its independence be zealously guarded." The court also noted that it could rule on McDonald's motion "based on the facts before it" and without the DOJ's assistance.

On the direct enforcement front, the DOJ indicted four Maine owners/managers of home healthcare agencies on January 28, 2022 for participating in a conspiracy to suppress wages and the mobility of their employees by, among other things, agreeing to not hire each other's workers. The more significant action, however, involved the DOJ's no poach trial against DaVita, Inc. and its former chief executive officer, Kent Thiry.

According to the DOJ, DaVita entered into three illegal no poach agreements with outpatient surgery chains Surgical Care Affiliates, LLC ("SCA"), Hazel Health, Inc. ("Hazel"), and Radiology Partners ("RP"). The agreements prevented the companies from affirmatively soliciting each other's workers and, if a worker from one company applied to the other company on their own volition, then the recipient company had to instruct the applicant to tell their current company that they were looking for new opportunities before proceeding with the recipient company. The no poach agreements were, according to the DOJ, the brainchild of Thiry who is known to have a strong and colorful personality. The CEOs of SCA, Hazel, and RP were former DaVita employees who had a strong relationship with Thiry and some of the CEOs testified that they felt "bullied" into the no poach agreements. The CEO of SCA further testified that the purpose of the no poach agreements was to "reduce" the movement of employees between the companies and that the agreements were largely created as a result of the litigiousness of DaVita and Thiry.

DaVita and Thiry responded to the DOJ's allegations by calling the allegations a "witch hunt" and maintaining that there was no evidence that the no poach agreements prevented competition. Although Thiry did not testify at trial (DaVita acknowledged that Thiry's behavior and language "did not look great"), DaVita and Thiry did call an expert witness who testified that there was no evidence or data to support the DOJ's claims that the no poach agreements resulted in suppressed wages or a reduction in employee mobility. After two days of deliberation, the jury agreed with, and acquitted, DaVita and Thiry. The acquittal is a significant blow to the DOJ and it will be interesting to see what the DOJ does next with respect to its criminal no poach case in Texas against SCA. SCA has already filed a motion with the Texas federal court asking the court to dismiss the indictment against SCA because of the decision of the DaVita/Thiry jury.

The DOJ and DOL join forces in the no poach and non-compete space

On March 10, 2022, the DOJ and DOL announced a Memorandum of Understanding ("MOU") to "strength and coordinate enforcement efforts in labor markets." In the MOU, the DOJ and DOL a) emphasize "a shared interest in protecting workers who have been harmed or may be at risk of being harmed as a result of anti-competitive conduct" and b) reaffirm their commitment "to protect workers from employer collusion, ensure compliance with the labor laws and promote competitive

labor markets and worker mobility." The MOU covers a wide range of labor issues but specifically mentions no poach agreements and restrictive covenants. Through the MOU, the DOJ and DOL acknowledge that they will now share enforcement information, collaborate on policies, and work together to "ensure that workers are protected from cohesion and unlawful employer behavior." Based on the MOU and the above-discussed activity, it is safe to say that we will continue to see the DOJ, and now the DOL, increase their presence in the restrictive covenant and no poach space.

Trade secret jury awards continue to increase.

Several jury research and consulting firms have noted that post-COVID jurors appear to be "angrier than normal" and have strong opinions about defendants who engage in activities that jurors consider "theft." In simpler terms, jurors appear to have a lot of pent-up anger and frustration, and are not afraid to take their anger and frustration out on those who steal. This "anger/frustration" may have been seen recently in a March 21 jury verdict where Comet Technologies was awarded $40 million in damages by a jury who found that rival XP Power misappropriated Comet trade secrets relating to the manufacture of semiconductor chips. Of the $40 million verdict, the jury awarded $20 million in compensatory damages and another $20 million in punitive damages. With COVID restrictions lifting and jury trials starting, and with 3,127 trade secret cases filed in 2021 and 3,258 trade secret cases filed in 2020, we will likely see more trade secret verdicts in 2022.

Remember to be vigilant when trusting third parties with your trade secrets.

A Complaint recently filed in the federal court for the District of Columbia is a not-so-friendly reminder of the need to make sure that confidential information shared with a third party is properly protected *and monitored*. In its Complaint, Aristotle International Inc., a company that mines voter data for political campaigns, alleges that direct competitor GB Group PLC ("GB") obtained Aristotle's confidential information when it merged with Aristotle customer Acuant. Acuant, through a reseller agreement with Aristotle, received Aristotle's confidential information and then used the information to perform fraud services on behalf of its clients. In 2021, Acuant was looking to be sold and found a potential merger partner in GB. During the due diligence phase of the potential merger, Acuant disclosed Aristotle's confidential information-including Aristotle's methodologies, security structures, and performance data-to GB. The merger between Acuant and GB occurred in November 2021. Aristotle found out about the merger through a press release.

Naturally, Aristotle became more than a little concerned after learning that a competitor merged with its customer and was now in possession of its confidential information. After failing to receive acceptable assurances from Acuant that it did not and would not share Aristotle's confidential information with GB (a likely impossible feat given the merger), Aristotle filed a Complaint against GB and Acuant in "order to protect [Aristotle] trade secrets." The case is still in the beginning stages but provides an important lesson (and cautionary tale) about examining and understanding the confidentiality obligations of a third party. For example, if Aristotle's agreement with Acuant required Acuant to notify Aristotle as to who would receive Aristotle confidential information, or forbade Acuant from sharing the information with any outside party absent the knowledge and consent of Aristotle, then Aristotle could have addressed Acuant's sharing of Aristotle's confidential information during the diligence phase instead of after GB had allegedly reviewed and incorporated Aristotle confidential information into the merged company.

The Aristotle case provides a cautionary tale for acquiring companies, as well. In situations where confidential information of a third party may or could be disclosed during the due diligence phase, it is important to analyze the third-party agreements that cover the confidential information in order to understand what can and cannot be disclosed. And if certain information cannot be disclosed, then it is important to develop and institute measures that will prevent the unauthorized disclosure of confidential information (clean rooms, separate servers, attorneys' eyes only review, etc.).

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. For the second quarter of 2022, the Group is offering CLE seminars on best practices for handling a trade secrets audit, drafting restrictive covenant agreements, and preparing for, or defending against, a restrictive covenant and/or trade secret case. Please contact any member of the Group if you would like to hear more about these offerings.

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