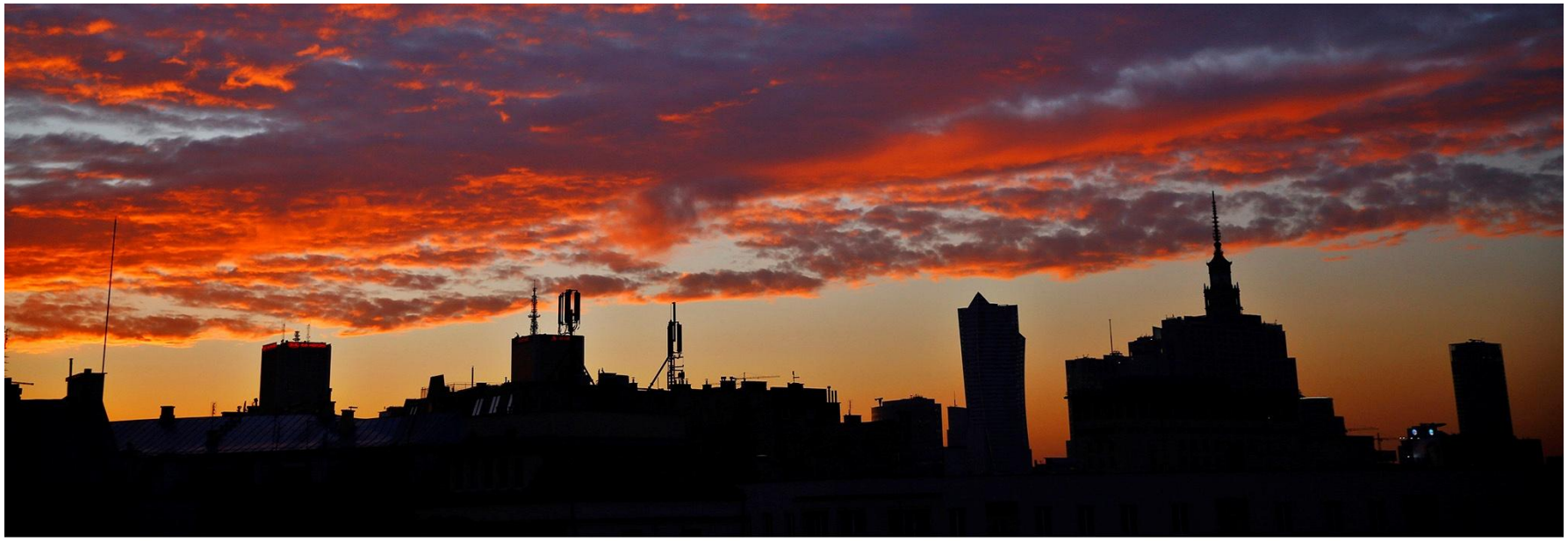

REUTERS/Kacper Pempel

Recent Developments in the World of Trade Secrets and Non-Competes

May 7, 2015

Presenters:

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Agenda

- Developments Regarding Restrictive Covenants and Trade Secrets
- Legislative and Administrative Agency Update
- Other State Law Issues and Choice of Law Provisions
- Questions and Answers

Adequate Consideration

What is Adequate Consideration for a Restrictive Covenant?

Illinois

***Fifield v. Premier Dealer Services, Inc*.**
(Ill. App. 1st Dist. 2013)

- Absent other consideration, **two years of employment** is the minimum consideration for *any* restrictive covenant to be enforceable, even where the employee:
  - signed the restrictive covenant as a condition to his employment offer; and
  - voluntarily resigned.
- The Illinois Supreme Court declined to weigh in.

What is Adequate Consideration for a Restrictive Covenant?

Illinois

- Federal district judges in Illinois disagree as to **whether *Fifield* is binding**:
  - *Bankers Life and Casualty v. Miller (N.D. Ill. Feb. 6, 2015)* (Shah, J.) – **is not** binding (rejecting bright-line test).
  - *Cumulus Radio Corp. v. Olson (C.D. Ill., Feb. 13, 2015)* (McDade, J.) – **is not** binding (21 months is sufficient).
  - *Montel Aetnastak, Inc. v. Miessen (N.D. Ill. Jan. 28, 2014)* (Castillo, J.) – **is not** binding (15 months is sufficient).
  - *Instant Tech., LLC v. DeFazio (N.D. Ill. May 2, 2014)* (Holderman, J.) – **is** binding.
- **BUT,** the only other Illinois state appellate court to address *Fifield* found that it **is binding**, and held that 19 months of continued employment was not enough (*Prairie Rheumatology v. Maria Francis (Ill. App. 3d Dist. Dec. 11, 2014)*).

Stay tuned.

What is Adequate Consideration for a Restrictive Covenant?

Kentucky

Creech v. Brown
(Ky. 2014)

- 18-year at-will employee worked as a driver, dispatcher and salesperson.
- Employee signed a restrictive covenant, but was given no consideration other than continued employment and getting the owner's daughter "off his back."
- Employee was given no promotion, raise, or specialized training in exchange for signing.
- Court held that mere **continued at-will employment is not sufficient consideration.**

What is Adequate Consideration for a Restrictive Covenant?

Pennsylvania

Socko v. Mid-Atlantic Sys. of CPA, Inc. (Pa. Super. 2014)

- At-will salesperson in the basement water proofing industry signed a non-compete after he was already employed.
- Court reiterated that "when the restrictive covenant is added to an existing employment relationship, . . . to restrict himself the employee must receive a corresponding benefit or a change in job status."
- Court refused to enforce the agreement because mere **continued at-will employment is not sufficient consideration** under Pennsylvania law.

NOTE: The issue is currently under review by the Pennsylvania Supreme Court, which heard oral argument on the case on May 6, 2015.

Stay tuned!

What is Adequate Consideration for a Restrictive Covenant?

Wisconsin

Runzheimer Int'l, Ltd. v. Friedlen
(Wisc. 2015)

- Continued employment of a current at-will employee is sufficient consideration to support a covenant not to compete.
- However, if the at-will employee is terminated shortly after signing, the employee "would likely have a voidable contract, subject to rescission" and such a firing might violate "the doctrine of good faith and fair dealing."
- So, as a practical matter, some period of continued employment post-signing is required; the open question is, how much?

Again, stay tuned!

What is Adequate Consideration for a Restrictive Covenant?

The Bottom Line:

- There is some movement by various states toward requiring consideration in addition to continued at-will employment (or new employment, at least in Illinois) in exchange for signing a non-compete.
- This is a developing issue to watch.

Declaratory Judgment Actions

Viability of Declaratory Judgment Actions in Non-Compete Context

Brunner v. Liautaud and Jimmy John's, LLC, et al. (N.D. Ill. Apr. 8, 2015)

- Facially broad non-competes were signed by all Jimmy John's employees.
- Jimmy John's disclaimed any intention to enforce the non-competes, but employees sued, seeking declaratory judgment that they were unenforceable.
- The court held the dispute was not judiciable because plaintiffs:
  - lacked "reasonable apprehension" of any actual litigation by defendants; and
  - failed to allege with adequate specificity that they were preparing to engage or actually engaging in contractually prohibited conduct.

Jimmy John's "Take Aways"

- Standard for declaratory relief in federal court *may* be stricter than in a given state court.
- In federal court, sufficient facts must be pled to show reasonable apprehension of litigation.
- Regardless of the jurisdiction, anticipatory "self-modification" of overly broad restrictive covenants may be tactically wise.

Other Restrictive Covenants

"No Future Employment" Provisions in Employment Litigation Settlement Agreements May Violate California Law

Golden v. Cal. Emerg. Phys. Med. Group
(9th Cir. Apr. 8, 2015)

- Doctor practicing with a medical consortium in California and other mostly western states challenged the enforceability of settlement agreement's "no future employment" provision.
- Cal. Bus. & Prof. Code Section 16600 prohibits nearly all restrictive covenants in California.
- 9th Circuit held that Section 16600 applies to *every* contract that restrains someone from working.
- 9th Circuit remanded for a determination of whether the "no future employment" with the consortium facilities was a restraint of substantial character to plaintiff's medical practice.

Limits on Corporate Competition: Different Analysis?

Owens Trophies, Inc. v. Bluestone Designs & Creations, Inc. (N.D. Ill. Jan. 14, 2014)

- Company agreed not to provide Emmy Awards to any other person or entity.
- When it did so anyway, it was sued for violating the non-compete.
- Defendant argued that the non-compete was unenforceable because it was not supported by a legitimate business interest.
- Court held that an agreement between corporations not to engage in certain competitive activities is not analyzed like an employer/employee non-compete.
- Rather, because there was no imbalance of power, contract enforceability is analyzed like any other arms-length transaction.
- Court found the agreement enforceable.

Solicitation: Distinction Between Officers and Non-officers?

Xylem Dewatering Solutions, Inc. v. Szablewski (Ill. App. 5th Dist. Sept. 8, 2014)

- Defendants asked customers and suppliers of their current employer "what they 'thought' about" the defendants' formation of a new, competitive business.
- But, defendants never "actually solicited any business or sold goods and services" to their then-employer's customers on behalf of their new business until they had resigned and started the new business.
- Defendants "agreed that those conversations were intended to persuade" customers and suppliers "to eventually do business with" their new business.

Solicitation: Distinction Between Officers and Non-officers?

- The Illinois Appellate Court held that it was not an abuse of discretion for the trial court to conclude that these conversations were merely “preliminary actions” that did “not rise to the level of a breach of an *ordinary* employee’s duty of loyalty.” (*Emphasis added*.)

Solicitation: Distinction Between Officers and Non-officers?

Distinction drawn between the duty of loyalty owed by ordinary employees and corporate officers.

Ordinary employees are permitted “to plan and outfit a competing corporation so long as they do not commence competition.”

Corporate officers are prohibited from “actively exploit[ing] their positions within a corporation for their own personal benefit” or “hinder[ing] the ability of a corporation to continue the business for which it was developed.”

Injunction Bonds

Injunction Bonds: Federal Court

- The *Federal Rules of Civil Procedure (FRCP)* give courts great discretion when setting amount of injunction bond:
  - "[t]he court may issue a preliminary injunction or a temporary restraining order only if the movant gives security *in an amount that the court considers proper* to pay the costs and damages sustained by any party found to have been wrongfully enjoined or restrained." (*FRCP 65(c)*.)

Injunction Bonds: Different State Approaches

- States take different approaches:
  - **Illinois:** no bond is required
  - **Indiana:** bond is required in an amount sufficient "for the payment of such costs and damages as may be incurred or suffered by any party who is found to have been wrongfully enjoined or restrained."
- ***Donald Moss v. Progressive Design Apparel, Inc. (Ind. App. Ct. 2014)***
  - Reversed token injunction bond of only $100.
  - Court enforced literal words of the applicable Indiana rule of civil procedure.
- **Moral of the story:** Be prepared to argue about the bond.

Legislative and Administrative Agency Developments

2015 Federal Legislative Update

- Momentum is building: Is 2015 the year for a federal private right of action for trade secret theft?
- The *Defend Trade Secrets Act of 2014* (S. 2267) and *Trade Secrets Protection Act* (H.R. 5233): What happened?
- Possible outcome?

(Republican-controlled Congress)

+

(Broad business support)

+

(Increased public awareness due to high profile hacking cases)

=

A strong chance of federal legislation.

The Computer Fraud and Abuse Act ("CFAA"): Still No Consensus Among Federal Circuits

Interpretation No. 1:

The CFAA is limited to "hacking" cases and is not applicable to employees who had authority to access a computer, even if the employees abused that access by stealing information.

OR

Interpretation No. 2:

The CFAA applies any time employees ***exceed*** their authorization by using information unlawfully or in violation of company policy, even if the employees were otherwise authorized to access the computer.

The Computer Fraud and Abuse Act ("CFAA"): Still No Consensus Among Federal Circuits

- In the wake of the Sony hacking scandal, President Obama seeks to amend the CFAA to impose tougher penalties against hackers.
- Meanwhile, "Aaron's Law" – named after a student-hacker who committed suicide after facing criminal charges under the CFAA – seeks to limit enforcement of the CFAA by tightening the definition of "access without authorization" to exclude violations of private agreements, including employment agreements and terms of service.
- If passed, Aaron's Law could eliminate the debate over "authorized access" but at the same time remove one of the tools used by employers to combat employee misappropriation.

The SEC, NLRB *and* EEOC May Have a Problem With Your Employee Confidentiality Agreements

- On April 1, 2015, the SEC announced the settlement of a whistleblower enforcement action against KBR, Inc., which had employed a confidentiality agreement as part of its internal investigation process.
- The SEC claimed that the confidentiality policy violated the SEC's prohibition against taking "any action to impede an individual from communicating directly with the Commission staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement…with respect to such communications."
- The SEC fined KBR $130,000 and KBR amended its confidentiality statement for internal investigations to make clear that nothing prohibits its employees from reporting possible violations of federal law or regulation to any governmental agency.

The SEC, NLRB *and* EEOC May Have a Problem With Your Employee Confidentiality Agreements

- The NLRB and the EEOC are similarly challenging standard confidentiality provisions in employment agreements, separation agreements and settlement agreements that could be interpreted as preventing employees from reporting wrongdoing or engaging in other protected activity.
- What Can Employers Do?
  - At a minimum, employers should consider including an affirmative statement in all written confidentiality agreements and policies that expressly acknowledges that the confidentiality provisions do not limit the employee's right to communicate with a governmental agency.

Other State Law Issues and Choice of Law Provisions

States Still Grappling with Non-Compete Legislation

- Proposed legislation limiting enforceability:
  - Massachusetts (Prior legislation supported by Gov. Deval Patrick died in 2014, but 6 new bills were introduced in 2015. Gov. Charlie Baker is noncommittal.)
  - Washington (Proposed bill would mirror California's ban.)
  - Michigan (Bill has no co-sponsors.)
  - New York (Bill has been introduced to limit enforceability.)
- Proposed legislation favoring enforceability:
  - Wisconsin (Existing statute would be replaced by new statutory language making it easier to enforce non-compete agreements.)

Choice of Law Provisions In Restrictive Covenants

- Drafting
  - What choice of law to designate in the restrictive covenant agreement?
  - Is there a nexus to the chosen state law?
  - Is the chosen state law consistent with the public policy of other states where employees reside?
- Tactics
  - Where to file suit to enforce restrictive covenant?
  - Forum selection provisions may help increase likelihood of enforceability.

Choice of Law Provision Is Not a Guarantee – Even in Employer-Friendly Delaware

Ascension Ins. Holdings, LLC v. Underwood (Del. Ch. Jan. 28, 2015)

- Delaware law has traditionally favored enforcement of restrictive covenants and non-compete agreements.
- But in *Ascension Ins.*, the Chancery Court refused to enforce an explicit Delaware choice of law provision in a non-compete agreement executed by an employee who resided in California.
- The Court found that the Delaware choice of law provision circumvents the public policy of California (which essentially prohibits non-competes).
- The Court applied California law and invalidated the restrictions because:
  - the contract was negotiated and signed in California;
  - the contract was limited geographically to California;
  - and the employer's principal place of business was in California.

New York Appellate Court Finds Florida Restrictive Covenant Statute "Truly Obnoxious"

Brown & Brown v. Johnson
(N.Y. App. Div. 4th Dep't Feb. 7, 2014)

- NY employee, NY employer and Florida parent company entered into an employment agreement with restrictive covenants and a Florida choice of law provision.
- Even though Florida law bore a reasonable relationship to the parties, the court refused to enforce choice of law provision because:
  - Florida statute prohibits consideration of hardship imposed on employee and provides covenant must be construed in favor of party seeking enforcement; and
  - under New York law, restrictive covenants will not be enforced if they impose an undue hardship on the employee.
- The Court held that Florida choice of law provision violated New York public policy and refused to enforce the agreement.

Suing Employee in Home State of Corporate Headquarters Is Not Always Easy

Baanyan Software Services, Inc. v. Kuncha
(N.J. Super. App. Div. Dec. 19, 2013)

- Former employer with NJ headquarters sued Illinois resident in NJ for breach of a non-compete.
- Court lacked personal jurisdiction over Illinois resident because she:
  - never actually worked in or visited NJ; and
  - did not perform work for any NJ-based clients.
- Court held she had insufficient contacts with NJ because:
  - the contacts about hiring took place in California; and
  - the alleged breach took place in Illinois.
- **NOTE**: The contract had no forum selection clause.

Unlimited Geographic Restrictions Can Still Invalidate Non-Compete Agreements

NanoMech, Inc. v. Suresh (8th Cir. Feb. 6, 2015)

- Project engineer for NanoMech signed a non-compete that contained no geographic restriction and applied worldwide.
- The employee was privy to confidential information regarding NanoMech's proprietary product concepts and prototypes and research regarding NanoMech's lubrication product. Two years later, she resigned from NanoMech to work for BASF, a competitor.
- In *NanoMech*, the Court recognized that other courts have in the past enforced non-competes with no geographical restriction if the substantive scope of the restriction is reasonably limited.
- However, the Court struck Suresh's non-compete as overbroad because it prohibited her from working:
  - had no geographic restriction;
  - did not limit the types of activities that could be performed; and
  - was not customer-specific.

Can Your Cease and Desist Letter Lead to a Tortious Interference Claim?

Rick Bonds v. Philips Electronic North America (E.D. Mich. January 23, 2014)

- Employee sued Philips, his former employer, for tortious interference based on a cease and desist letter Philips sent to the employee's new employer that resulted in employee's termination.
- Employee had been working for both employers (who were competitors) simultaneously, unknown to Philips.
- The Court dismissed the employee's tortious interference claim against Philips because the cease and desist letter was sent in furtherance of a legitimate business interest.

Boudreaux v. OS Restaurant Services, L.L.C. (E.D. La. Jan. 23, 2015)

- Employee stated claim for tortious interference and violation of Louisiana's Unfair Trade Practices Act based on employer's stated intention to enforce non-compete.

Can Your Cease and Desist Letter Lead to a Tortious Interference Claim?

- Many responsible companies that receive a cease and desist letter promptly investigate and return any confidential material that are found.
- Lessons: *Bonds v. Philips* reaffirms that employers should feel comfortable sending appropriate cease and desist letters to former employees and, when appropriate, subsequent employers, as long as there is a good faith basis for the letter and a legitimate business interest at stake. There are still risks, however, if a cease and desist letter is sent to an employee residing in a state that is hostile to non-compete agreements.
- Cease and desist letters must be carefully drafted to avoid opening the door to claims for defamation or tortious interference.
- Avoid gratuitous or disparaging comments that could evidence malice and emphasize the business interest that is at stake.

Be Careful When Pleading Trade Secret Misappropriation Claims That Could Be Preempted by the Copyright Statute

Jobscience, Inc. v. CV Partners, Inc.
(N.D. Cal. Jan. 9, 2014)

- Plaintiff sued software licensee and newly formed company for theft of proprietary software code.
- In addition to a misappropriation claim, plaintiff also asserted a copyright infringement claim.
- After finding that plaintiff stated a valid claim under the Copyright Act, the Court *dismissed* the trade secret misappropriation, unfair competition and conversion claims on preemption grounds.
- As a result, the plaintiff was limited to a copyright infringement claim which provides limited monetary relief unless the stolen material was registered with the Copyright Office *at the time of infringement*.

Trade Secrets Claims May Preempt State Law Claims

Stolle Machinery Co., LLC v. RAM Precision Indus. (6th Cir. Mar. 16, 2015)

- Ohio's UTSA preempted state-law claims for tortious interference and conspiracy to misappropriate trade secrets.
- Stolle recognizes that courts are divided as to the scope of UTSA preemption.
- The Sixth Circuit adopted broad approach that the UTSA "should be understood to preempt not only causes of action for misappropriation of trade secrets but also causes of action that are based in some way on misappropriation of trade secrets.

Possible Preemption of Trade Secrets Claims

- Lessons: Employers should be aware of other IP claims that might preempt state law misappropriation and other state law claims.
- Preemption might be avoided by including alternative state law claims that are qualitatively different than a copyright claim, such as breach of duty of loyalty, or based on different facts.
- Employers can also avoid preemption by asserting misappropriation claims based on material outside the scope of the Copyright statute, such as customer lists, business strategies and customer preferences.
- Employers should also consider whether certain proprietary material (e.g., software code, proprietary material) can be registered with the Copyright Office to preserve its ability to recover damages under the Copyright Act if the material is taken.

Be In The Know

EPSTEIN BECKER GREEN health care & life science CLIENT AL

OIG Warns Pharmaceutical Manufacturers of Improper Part D Beneficiary Coupon Use

by Constance Wilkinson, Alan Arville, and Benjamin Zegarelli

October 2014

On September 19, 2014, Inspector General ("OIG") safeguards to prevent M coupons may not be comp 30 pharmaceutical compa and the pharmacy claims study found that these s written disclaimers and w pharmacy, and (2) while manufacturers use inaccu

Simultaneously with the is stating that manufacture programs do not induce f drugs over generics.[2] The

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Whistleblowers Rewarded Again by SEC and the Judiciary

September 10, 2014

By Stuart M. Gerson; Frank C. Morris, Jr.; and Meghan F. Chapman*

On August 29, 2014, two whistleblower developments of particular interest to health care and life science entities emerged from the Securities and Exchange Commission ("SEC") and the Eighth Circuit Court of Appeals, respectively. The SEC, through its whistleblower program, awarded more than $300,000 to a compliance professional who acted as a whistleblower for providing information that led to an enforcement action ...ts the first time that the agency has ... a compliance prof...

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ACT NOW ADVISORY

Massachusetts Now Requires Employers to Provide Domestic Violence Leave

September 18, 2014

By Barry A. Guryan and Kate B. Rhodes

Massachusetts has enacted a law requiring employers with 50 or more employees to grant employees "domestic violence leave." The law, entitled "An Act [R]elative to [D]omestic [V]iolence," was approved by Governor Deval Patrick on August 8, 2014, and took effect immediately.

Under this new law, employers with 50 or more employees must provide employees with up to 15 days of paid or unpaid leave in any 12-month period if:

- the employee, or a family member of the employee, is a victim of "abusive behavior";
- the employee is not the perpetrator of the abusive behavior against the employee's abused family member; and
- the employee is using the leave from work to do any of the following:
  - seek or obtain medical attention, counseling, victim services, or legal assistance;

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LABOR AND EMPLOYMENT

... July 2014 issue of *Take 5*, "Five Labor and Employment Issues Faced by Health ...e Employers," was written by **Michael F. McGahan**, a Member of the Firm, and ...ociates **D. Martin Stanberry** and **Daniel J. Green**.

Michael F. McGahan

D. Martin Stanberry

Daniel J. Green

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EPSTEIN BECKER GREEN immigration

CLIENT ALERT

September 2014 Immigration Alert

Sixth Circuit Expands the Liability of Health Care Employers for Sponsorship Costs

USCIS Expands H-1B Eligibility for Nurses

Obama Administration Warns ACA Sign-Ups to Provide Proof of Legal Status

California Supreme Court Expands Rights of Immigrants Working in that State

OSC Issues Technical Assistance Regarding Employer's Receipt of Excess Documentation During the Form I-9 Process

OSC Settles Immigration-Related Discrimination Claims Against Staffing Agency

Colorado Employers Must Use New Affirmation Form Starting October 1, 2014

Silicon Valley Man Receives 10-Month Sentence for H-1B Fraud

DOS Issues October 2014 Visa Bulletin

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I. Sixth Circuit Expands the Liability of Health Care Employers for Sponsorship Costs

On August 20, 2014, the U.S. Court of Appeals for the Sixth Circuit issued its decision in *Kutty v. U.S. Department of Labor*, No. 11-6120 (6th Cir. 2014) ("*Kutty*"). In *Kutty*, several foreign physicians sued the

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www.tradesecretsnoncompetelaw.com

Relevant Practical Law Resource

- Practice Note, Protection of Employers' Trade Secrets and Confidential Information
- Practice Note, Non-compete Agreements with Employees
- Practice Note, Preparing for Non-compete Litigation
- Practice Note, Trade Secrets Litigation
- Standard Document, Employee Non-compete Agreement
- Standard Document, Employee Confidentiality and Proprietary Rights Agreement

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