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Trends in noncompete laws may affect trade secret litigation

By Amelia L.B. Sargent

Trade secret litigation may see some new defenses in favor of employee mobility this year as the Federal Trade Commission (FTC) considers a nationwide ban on noncompete clauses, and two new California laws take effect that adjust the scope of California's public policy in favor of employee mobility, Business & Professions Code section 16600 ("Section 16600").

Outside of California and a handful of other states, some employers routinely include noncompete clauses in their employment contracts to prevent or delay individuals from working for a competing employer, or starting a competing business after employment ends. This practice can protect trade secrets because workers who gain access to trade secrets and confidential information are forbidden from taking that information to a competitor, where it might be disclosed or used. But overuse of noncompete clauses can not only harm an individual's ability to practice a lawful trade or profession, but also hinder companies from freely hiring talented workers. The Federal Trade Commission (FTC) reports that one in five American workers, or about 30 million people, are bound by noncompetes.

Since 2008, the California Supreme Court has held noncompete clauses violate California's public policy in favor of employee mobility as codified in Section 16600, which provides that "every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void." *See Edwards v. Arthur Andersen LLP* (2008) 44 Cal.4th 937. Thus, California employers have had to use different methods to protect their trade secrets, up to and including litigation under the California Uniform Trade Secrets Act, or the federal Defend Trade Secrets Act.

Now the rest of the nation may follow suit. In 2021, President Biden issued an executive order to promote competition in the economy, directing the FTC to seek to "curtail the unfair use of non-compete clauses . . . that may unfairly limit worker mobility." On Jan. 5, 2023, the FTC proposed a draft rule that would largely ban the use of noncompete clauses.

The Proposed Rule would provide that entering into a contract containing a noncompete clause, or maintaining a worker subject to a noncompete clause, constitutes an "unfair method of competition" and therefore a violation of Section 5 of the FTC Act. Interestingly, the Proposed Rule applies to "workers," not just employees – and defines a worker broadly as a person "who works, whether paid or unpaid, for an employer." Further, while the Proposed Rule only applies to noncompete clauses, and not other restrictive covenants such as NDAs or non-solicits, it provides that a "functional test" is to be used to determine whether a clause is a de facto noncompete. In other words, if a contractual term "has the effect of prohibiting the worker from seeking or accepting employment" after their employment ends, that clause is a de facto noncompete and

banned under the Proposed Rule. This could happen, for example, if an employer interprets a confidentiality clause so broadly that a worker cannot work for any new employer without violating it – as happened in a California case in which the Court of Appeal held a confidentiality agreement was a de facto unlawful noncompete. *See Brown v. TGS Management Co., LLC* (2020) 57 Cal.App.5th 303.

The FTC received over 26,000 comments on the Proposed Rule and is now reviewing those comments. Bloomberg Law has reported that the FTC will vote on the final version in April 2024. If it looks anything like the Proposed Rule, then employers and litigators accustomed to enforcing noncompetes will need to adjust quickly to a new legislative and legal landscape in order to protect their trade secrets. California jurisprudence could play a major role in providing a model for litigating trade secret protection across the nation.

Meanwhile, California enacted two new bills that took effect this year to modify Section 16600 and strengthen California's noncompete ban. A.B. 1076 codifies the *Edwards v. Arthur Andersen* decision into a new §16600(b) to expressly void "any noncompete agreement in an employment context, or any noncompete clause in an employment contract, no matter how narrowly tailored, that does not satisfy an exception in this chapter." A new §16600(c) provides that the noncompete ban is not limited to contracts where the person being restrained in a party to the contract – potentially reaching, for example, non-solicit agreements or business-to-business no-poach or no-hire agreements.

Finally, A.B. 1076 created a new subsection 16600.1, which makes inclusion of a prohibited noncompete clause unlawful, requires employers to affirmatively notify employees of invalid noncompete clauses by Feb. 14, 2024, and – similar to the FTC proposed rule – makes violations "an act of unfair competition" within the meaning of California's Unfair Competition Law, Business & Professions Code section 17200 et seq.

S.B. 699, meanwhile, created another entirely new subsection of Section 16600: Section 16600.5. According to the legislative history, this section is intended to apply California's public policy to incoming workers from other states who might be subject to noncompetes. 2023 Cal. Legis. Serv. Ch. 157 (S.B. 699). Section 16600.5(a) states that contracts "void under this chapter" – i.e., noncompetes – are unenforceable regardless of where and when they were signed, and forbids employers from enforcing them even if the employment was maintained outside of California. Sections 16600.5(c) and (d) forbid employers from imposing noncompetes and provide that doing so consists of a civil violation. And, importantly for litigators, Section 16600.5(e) grants a private right of action and attorneys' fees to an employee, former employee, or prospective employee to enforce the chapter.

Taken together, these new laws codify and add enforcement mechanisms to California's already-existing prohibition on widespread noncompetes. For example, employees defending against an imposition of a noncompete already had a cause of action for declaratory relief on the basis of Section 16600 – but now, they have a direct cause of action under Section 16600.5(e), and may be awarded attorneys' fees if they prevail. Further, companies whose efforts to hire talented workers – including out-of-state workers – have been stymied by a competitor's enforcement of noncompetes may now find they could bring a UCL claim against the practice under Section 16600.1(c). These may prove to be valuable tools in the litigator's toolkit when defending against trade secret misappropriation claims involving the hiring of employees from a competitor.

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