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PRIVATE EQUITY

PRIVATE EQUITY BULLETIN
TRADE SECRETS AND NON-COMPETE AGREEMENTS IN THE UNITED STATES

Welcome to the first Dorsey Private Equity Bulletin. Through this quarterly bulletin we will aim to keep you up to date on legal issues that may affect your portfolio companies operating in the United States. This particular bulletin focuses on protecting trade secrets as well as enforcement of non-compete agreements in the U.S.

Should you have any queries on anything that we discuss in this bulletin or otherwise, please do not hesitate to get in touch with Eric, Fabrizio or Carsten. Please also let us know if you have any suggestions for topics you would like us to cover in future bulletins.

FEDERAL PROTECTION OF TRADE SECRETS

Introduction of the Defend Trade Secrets Act 2016

On 11 May 2016, President Obama signed the Defend Trade Secrets Act 2016 ("DTSA") into law, thereby wrapping up a lengthy cross-party effort to bring trade secrets within federal law. The other common forms of intellectual property – patents, copyrights and trademarks – all have federal civil causes of action as well as federal registration. Trade secrets, however, while the subject of a federal criminal statute, were otherwise only protected at a state level. As such, the DTSA has been heralded as the most significant expansion of federal intellectual property law in the U.S. for 70+ years.

Key points to note

- The DTSA provides a federal private right of action, which means that an employer is now able to bring a federal claim even where the defendant competitor and/or former employee is in the same state as the employer. This should ultimately lead to a relatively uniform body of case law when bringing trade secret disputes.
- Under the DTSA, a concerned company can petition a federal court to order the seizure of materials by federal marshals, without notice to the defendant. It should be noted that this remedy is only available in "extraordinary circumstances".
- There is a "whistleblower immunity" provision in the DTSA, which protects individuals from liability if they disclose trade secrets in confidence to a government official or lawyer solely for the purposes of a government investigation or on the order of a court. Employers are required to give notice of this immunity to their employees and consultants in any contract or policy that governs the use of a trade secret or other confidential information. If an employer does not provide such notice to an employee, then they will not be able to claim exemplary damages or recovery of legal fees under the DTSA in a claim against such employee.

Does the DTSA benefit your portfolio companies?

The short answer is yes. Since existing state law will continue to run concurrently, employers now have much greater flexibility and are able to choose the system that will be most advantageous to them. Additionally, the remedies afforded under the DTSA are more favourable than under state law. The DTSA provides a harmonised system which should provide a simpler body of case law and principles that can be used to protect trade secrets.

What action should you take now?

If you have any portfolio companies with significant operations in the U.S. and trade secrets that emanate from such operations, you should consider asking each of them to take the following steps:

- Identify the portfolio company's trade secrets in the U.S.;
- Take appropriate steps to protect such trade secrets, e.g. ensure adequate policies are in place, ensure all computers are password protected, shred hard-copies of old sensitive documents, etc.; and
- Amend U.S. employment contracts and handbooks/policies to ensure that the whistleblower immunity notice is included.

NON-COMPETE AGREEMENTS

Why is this relevant to you?

You may think that getting a new employee or director to sign a stand-alone non-compete agreement is a drastic or unnecessary action; however, it is important to note that employment in most U.S. states is considered to be "at-will." This means that you can terminate an employee for any reason (or for no reason), provided the termination is not connected to such employee's membership in a "protected class" (for example race or disability). At the same time, at-will employment also means that the employee can leave your employ for any reason. A recent survey conducted in the U.S. showed that half of employees who left or lost their jobs in the last year kept confidential corporate data and 40% planned to use this information in their new jobs.

Key points to consider when drafting non-compete agreements for employees in the U.S.

- First and foremost, you need to understand the specific state's view on the enforceability of non-compete agreements. Some states, for example California and North Dakota, refuse to enforce non-compete clauses, or will only enforce them in extremely limited circumstances.
- Make sure that your non-compete agreement is tailored for the individual level and nature of the employee's role. You need to demonstrate that the aim is to protect your legitimate business interests. For example, a broad non-compete stating that your employee cannot approach any clients in the equities industry with no specified duration is unlikely to be enforced by the courts; however, a non-compete stating that your employee cannot approach any of your clients or your employees in the oil sector of the equities industry in New York for a six month period is more likely to be enforced.
- For a non-compete agreement to be legally valid and enforceable, consideration must be provided. In some U.S. states, simply paying the employee a salary is enough. However, in other states, for example Washington, this would only be sufficient where a non-compete agreement is entered into at the outset of an employee's employment and another form of consideration would be required if the non-compete agreement is entered into at a later stage of an employee's employment. In other states (such as Minnesota), simply paying an employee's salary will not constitute sufficient consideration for a non-compete agreement to be legally valid and enforceable.
- Consider the duration of the non-compete agreement and ensure that the period stipulated is reasonable. Some U.S. states have statutory presumptions regarding the reasonableness of non-compete periods. It is advisable to observe these periods when drafting non-compete agreements, other than in exceptional circumstances that would justify a longer period.
- The courts in some U.S. states are willing to reform or revise non-compete agreements, i.e. reduce the restrictions down to what the courts deem reasonable in the circumstances (a process referred to as "blue penciling"). However, a recent high-profile case shows that this should not be relied on – here the court felt that the provisions in the non-compete agreement were so broad that it would be outrageous for them to reform the agreement and therefore the entire agreement was deemed to be unenforceable.

Is there any other way to protect your portfolio companies in U.S. states that do not enforce non-compete agreements?

- As previously mentioned, some U.S. states do not recognise non-compete agreements; however, every state recognises a company's right to protect its trade secrets (and indeed trade secrets are now protected on a federal level by the Defend Trade Secrets Act 2016 referred to above). You may therefore be able to draft a non-disclosure agreement which in practical application would function as a non-compete agreement. Whilst a non-disclosure agreement will never have the same level of protection as a non-compete agreement, it is more likely to be enforced by the courts in certain U.S. states.

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