How Cos. Can Protect IP In Light Of FTC Noncompete Rule

By **Thomas Duston** (May 3, 2024)

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On April 23, the Federal Trade Commission approved a proposed rule banning noncompetition agreements.[1]

The rule will become effective four months after it is published in the federal register, an event expected to occur later this summer. While several groups have already challenged the rule in federal court, including the U.S. Chamber of Commerce, employers should begin planning other ways to protect their valuable trade secrets, confidential information and other intellectual property.

Of course, before taking any action, businesses will need to evaluate the potential that courts may ultimately enjoin implementation of the rule in the pending challenges.

Indeed, the possibility that the rule will be enjoined should not be discounted, given the current judicial hostility to the so-called administrative state. The Chamber chose to file its suit in the U.S. District Court of the Eastern District of Texas, appeals from which are initially heard by the conservative U.S. Court of Appeals for the Fifth Circuit.

The Fifth Circuit is a leading promoter of the major questions doctrine, a statutory interpretation principle that presumes Congress has not delegated issues of major political or economic significance to executive agencies.

Questions concerning its authority clearly concerned the FTC, which devoted more than 25 pages of its commentary to preemptively defending its power to invoke its ban.

Businesses, however, cannot safely assume the rule will not eventually take effect. There are steps they should consider.

First, it is advisable to compile an inventory of unexpired noncompete agreements with current and former employees. At a minimum, such an inventory will be necessary to meet the notification requirements of the FTC's rule, which requires that all current and former employees bound to unexpired noncompetes be advised in writing that those agreements will not be, and cannot legally be, enforced against them.

Even more importantly, however, the inventory permits an assessment of the impact should these noncompete agreements become unenforceable and will inform appropriate remedial actions.

Second, except in narrow exceptions discussed below, noncompetes will no longer protect against misuse of trade secrets and confidential information. The FTC was untroubled by this prospect, declaring simple nondisclosure agreements and existing trade secrets laws sufficient to protect these valuable assets.

Indeed, in seeking to minimize the negative impacts of its rule, the FTC cited the availability in some jurisdictions of injunctive remedies for the threatened inevitable disclosure of trade secrets. Such injunctions can prohibit competitive employment to an extent not dissimilar to a noncompete.

The irony that the ban on noncompetes was justified because the same restrictions are available for trade secret misappropriation appears to have been lost on members of the FTC.

Nevertheless, such injunctive relief is hardly assured. Without the protection of noncompetes, businesses need to focus more than ever on preventing overly broad disclosure of confidential information, and on taking steps designed to prevent its misuse in circumstances where disclosure is unavoidable.

Physical and electronic restrictions that silo information access to only those who must have access are even more important if noncompetes are no longer available.

Businesses should redouble vigilance of unauthorized access, such as by prohibiting cell phone cameras, portable storage media, and recording devices and by taking other precautions. The current remote work environment will no doubt complicate these efforts.

It may be prudent to reexamine and, if necessary, bolster procedures that document employee access to confidential information, should it become necessary to establish a predicate for a later injunction against misuse.

While the FTC suggests the use of nondisclosure agreements as an alternative to noncompetes, the FTC cautions that such agreements might still run afoul of the rule's prohibitions if they nevertheless function to prevent an employee from seeking or accepting competitive employment.

Businesses should not shy away from protecting their valuable intellectual property through such agreements, but they may wish to carefully examine the language of those agreements to determine if they might face challenges under the FTC's new rule.

Unfortunately, the FTC offers little guidance beyond observing that such agreements will be subject to case-by-case adjudication.

The FTC has also indicated that nonsolicitation agreements and training repayment agreement provisions, which require employees to reimburse training expenses under certain circumstances, may remain enforceable despite the rule. You may wish to consider whether such agreements are appropriate and permissible in your circumstances.

Again, however, if such agreements are deemed the equivalent of a noncompete in a particular set of circumstances, they may run afoul of the rule, notwithstanding the FTC's favorable statements.

The FTC also suggests employers consider fixed-term employment agreements rather than at-will arrangements.

Apparently, the FTC believes threats to legitimate, protectable business interests are best addressed by indenturing employees. It is not clear how the FTC believes such provisions could be enforced to retain workers. Nevertheless, it may be worth considering whether extended-term agreements could serve to mitigate the harms noncompetes once did.

The FTC's suggestion may have greater application in protecting investments in customer relationships. Longer-term commitments with key customers may offer a modicum of protection, provided such contracts are consistent with other federal and state laws

governing competition.

Third, the rule exempts the enforcement of actions accruing before its effective date. Thus, it may be essential to identify any present violations of existing noncompetes and consider whether litigation is warranted.

Fourth, evaluating existing noncompetition agreements may be advisable to ascertain if and to what extent you have committed to compensation in exchange for the noncompete.

In light of the looming unenforceability of such agreements, modification or termination of your obligations thereunder may be prudent if permitted. This is particularly true if the agreements include severability clauses.

Fifth, noncompete agreements with senior executives will remain enforceable after the rule's effective date. You may wish to examine whether you may legally secure such agreements from persons who do or who could qualify. Be forewarned, however, the rule's definition of senior executive is very narrow, significantly limiting this option.

Senior executives are only those in a policymaking position whose total annual compensation exceeds $151,163. Policymaking positions are limited to the president, CEO or equivalent, or persons who have final authority to make policy decisions that control significant aspects of the business.

Policymaking does not include merely advising or exerting influence over such decisions, nor does it include persons having final authority for decisions related to only a subsidiary or affiliate of a common enterprise.

Finally, if you are purchasing a business that relies on the retention of key personnel and the existence of noncompetition agreements, you may need to reassess whether those key employees will remain bound by these commitments following the acquisition.

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[1] https://www.ftc.gov/system/files/ftc_gov/pdf/noncompete-rule.pdf.