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Protecting Company Secrets After the FTC's Noncompete Rule

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In April 2024, the Federal Trade Commission voted to adopt a new rule that limits noncompete clauses/agreements (the rule). The rule is slated to go into effect on Sept. 4, 2024. This article summarizes the rule, some pending challenges to the rule, and strategies that businesses should consider implementing today to protect their interests.

What Does the Rule Cover?

Beginning on Sept. 4, the rule will generally prohibit employers from entering new noncompete clauses with workers. The rule treats existing noncompete agreements differently depending on whether the worker is a "senior executive," which includes workers who (1) earn more than $151,164 and (2) are in a "policy-making" position. For these, existing noncompete clauses remain valid and enforceable. For all other workers, existing noncompete clauses will no longer be enforceable. Additionally, employers must inform such other workers that any existing noncompete clauses are no longer enforceable.

The rule contains several exceptions. For example, the rule does not apply to noncompete agreements related to a bona fide sale of a business entity. The rule also does not apply where a cause of action related to the noncompete accrued prior to Sept. 4, 2024. It also does not apply to entities outside the FTC's jurisdiction, including certain banks, nonprofits, and state and local government agencies. The rule also provides a "good faith" exception, which provides that it is not unfair competition for a company to enforce or attempt to enforce a noncompete clause if it believes in good faith that the rule is inapplicable.

Courtesy photos

Adam Powell left, and Daniel P. Hughes right, of Knobbe Martens.

Notably, however, the rule does not contain an exception for workers with access to trade secrets, which has been adopted by some jurisdictions that had previously banned noncompete clauses. The FTC determined that such an exception was unnecessary in view of other less-restrictive alternatives that companies can implement.

Notable Legal Challenges

The rule is currently being challenged in several jurisdictions across the country. Such challenges received a recent boost from the U.S. Supreme Court's June 28, 2024, opinion in *Loper Bright Enterprises v. Raimondo*. That decision struck down "*Chevron* deference," which required courts to defer to agency interpretation of ambiguous statutes governing that agency if the interpretation is reasonable. As a result, courts now have more flexibility in addressing the rule.

One such decision came less than a week later in *Ryan v. Federal Trade Commission*. There, the

Northern District of Texas entered a preliminary injunction banning enforcement of the rule against the plaintiffs. Various trade organizations intervened and urged the court to issue a broader injunction barring enforcement of the rule against other entities. In response, the court expedited briefing and stated that it will issue a merits decision by Aug. 30—about one week before the rule will go into effect.

What Should Companies Do to Prepare for the Rule?

Companies need to be prepared to implement the rule if it is not struck down before Sept. 4. Before that date, companies will need to analyze their existing agreements for noncompete clauses and determine whether the agreements are with "senior executives." For non-senior executives, companies must provide clear notice to current and former employees that the noncompete clauses will not be enforced.

Companies should also carefully consider how else they can protect their interests without using noncompete clauses. Although the rule is a significant event, it follows a growing trend at the state level diminishing the availability and applicability of noncompete clauses. For example, states like California have long limited the scope and enforceability of noncompete clauses. In such circumstances, companies can rely on contract clauses prohibiting improper use of confidential information and intellectual property such as patents to protect their interests. Companies should conduct a careful review of their non-disclosure agreements and invention assignment agreements. Indeed, the FTC's commentary on the rule explains that NDAs can be used to "protect all information defined as confidential," including information that may not qualify as a "trade secret" under state or federal law. Thus, NDAs can help companies protect trade secrets and information that may not qualify as a trade secret.

Companies should also pursue comprehensive intellectual property strategies for protecting their interests, including creating a strategic plan for protecting trade secrets. In general, trade secrets can protect any information that has value because it is not generally known in the industry. Trade secret law can protect anything from customer information and buying patterns to complex technical requirements and formulas. To both prevent misappropriation and help ensure success in any later litigation, companies need to take "reasonable efforts" to protect those trade secrets. Requiring execution of agreements (e.g., NDAs) and educating employees about their obligations can be reasonable efforts. Companies can also take additional measures, including by restricting access to certain physical buildings and network files to employees with a "need to know." A variety of companies also offer software that can be used to detect or prevent employees from absconding with electronic data. Companies should also consider special procedures for departing employees with knowledge of particularly sensitive trade secrets. Such procedures can include having legal counsel attend exit interviews to discuss trade secrets, writing warning letters to new employers, or even conducting a proactive investigation of the employee's electronic devices upon their departure. Of course, such investigations should be done in consultation with experienced counsel and computer forensic consultants to ensure the results can be validated and evidence is preserved.

Conclusions

Though the rule may appear to be a major blow for companies who have previously relied on noncompete clauses, its effects can be mitigated. The rule is being challenged in many jurisdictions, which could lead to it being struck down or limited. If the rule goes into effect, companies are well advised to pursue comprehensive intellectual property strategies for protecting their interests, particularly when employees learn proprietary information that could benefit a competitor.

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