"Drop That Thumb Drive, and Get Back Here!" – Using Non-Competes and the Law of Trade Secrets to Protect and Maintain Your Competitive Advantage

33rd Annual Labor & Employment Conference

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WHAT WE'LL COVER

- What's the latest on enforcing non-competes or non-solicitation agreements?

- Who should have them?

- What other tools can I use to protect confidential and proprietary information?

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BACKGROUND

Recent empirical study of 500 randomly-selected "S&P 1500" companies, which included 874 CEO employment contracts, revealed:

- 80% contained noncompetes, generally 1-2 years in length with a wide geographic scope

- 38% of these barred the CEO from working in any jurisdiction the company operates

- 76% contained nonsolicitation of employees, generally 1-2 years

- 51% contained nonsolicitation of customers or clients, generally 1-2 years

- 87% contained a nondisclosure agreement

- 70% contained three or four restrictive covenants

- 80% included express language permitting the company to seek an injunction to enforce

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BACKGROUND

- Nearly 40% of Americans have signed a non-compete agreement* and about 20% are currently "bound" by one

- President Obama issued call to ban or limit non-competes

  - Proposed action in the states

  - Suggested wage threshold

  - Suggested they apply only to those likely to possess trade secrets

  - Suggested limits for cases of layoff, or cases of termination "without cause"

*Sources: www.pbs.org/newshour/making-sense/know-non-compete-agreements/ and www.shrm.org/resourcesandtools/legal-and-compliance/employment-law/pages/white-house-noncompetes-.aspx
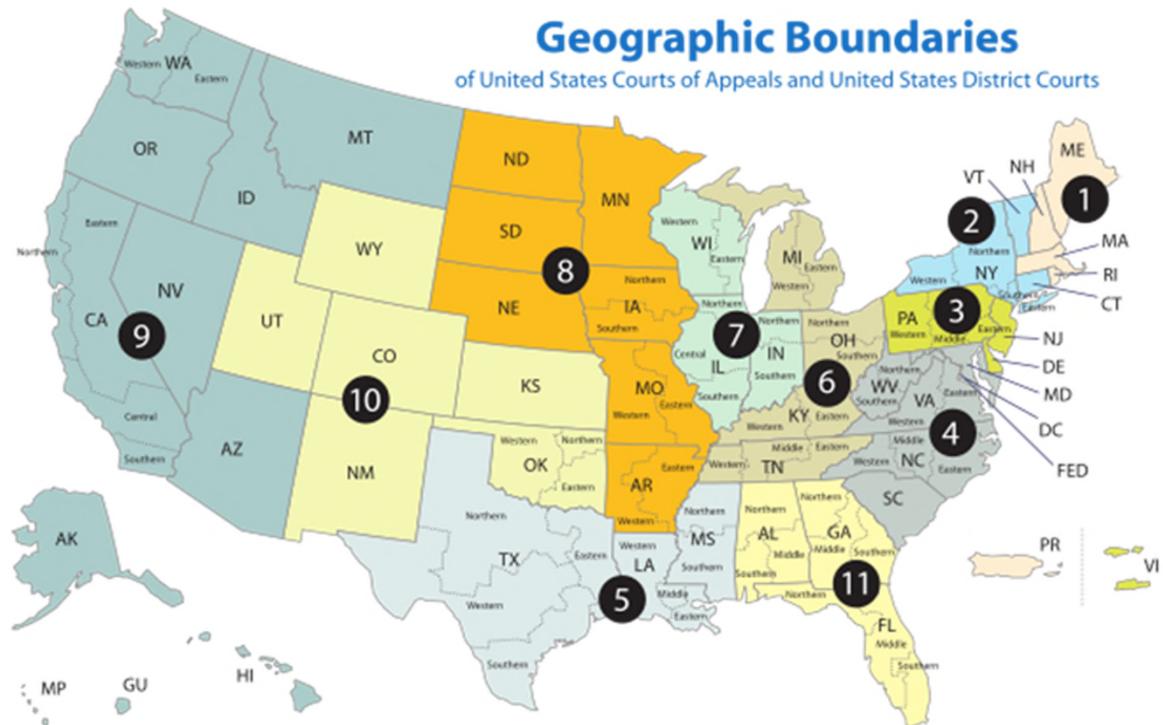
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BACKGROUND

- Non-competes – selected states

- General "bans" on blanket non-competes:

  – California

  – North Dakota

- Newer state laws:

  – Oregon (2016) – 18-month limit

  – Utah (2016) – one-year limit

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SPECIAL CONSIDERATIONS FOR ENFORCEMENT

- Where do you operate, and which state law should apply to you?

- Choice of law?

- Forum Selection?

Geographic Boundaries of United States Courts of Appeals and United States District Courts

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HOW CAN I DRAFT AN ENFORCEABLE RESTRICTIVE COVENANT?

▪ Under Michigan law, a restrictive covenant (such as a non-compete or non-solicitation agreement) is enforceable to the extent it is reasonable as to its:

– Duration

– Geographical scope

– The type of employment or line of business

See MCL 455.774a(1)

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WHAT IS "REASONABLE"

- "To be reasonable in relation to an employer's competitive business interest, a restrictive covenant must protect against the employee's gaining [of] some unfair advantage in competition with the employer, but not prohibit the employee from using general knowledge or skill"

  – *St. Clair Med., P.C. v. Borgiel*, 270 Mich. App. 260 (2006)

- It is the *employer's burden* of demonstrating the validity of the agreement

- Even if a court ultimately determines that a provision in a restrictive covenant is "unreasonable," the court has the power (though is not required) to revise the provision to render it reasonable "in light of the circumstances in which it was made." MCL 455.774a(1)

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CASE STUDY: *DELPHI AUTOMOTIVE V. ABSMEIER*

▪ The facts:

- The employee was an engineer who began working at Delphi in 1999. Throughout his employment, the employee received several promotions and worked in various Delphi offices throughout the world.

- In June 2014, Delphi promoted the employee to Director of Delphi Labs @ Silicon Valley. In this position, the employee managed 23 engineers and programmers to work on advanced vehicular technology and autonomous driving.

- Delphi also required the employee to sign a "Confidentiality and Noninterference Agreement" as a condition to receive an Executive Restricted Stock Award

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CASE STUDY: *DELPHI AUTOMOTIVE V. ABSMEIER*

- The Confidentiality and Noninterference Agreement:

  - **Confidentiality:** "You acknowledge and agree that you will keep in strict confidence, and will not, directly or indirectly, <u>at any time during or after your employment with Delphi</u>, disclose, furnish disseminate, make available or use Confidential Information of the Company or its customers or suppliers…."

  - **Non-Compete:** "During your employment and for <u>twelve (12) months</u> after the termination of your employment by you or Delphi for any reason, you will not directly or indirectly engage in Competition (as defined below) with Delphi

    - "Competition" was generally defined as working with "any other business or organization <u>anywhere in the world</u> that competes, directly or indirectly, with Delphi…."

CASE STUDY: *DELPHI AUTOMOTIVE V. ABSMEIER*

2. Definitions.

(a) For purposes of this Agreement, "**Competition**" by you shall mean your engaging in, or otherwise directly or indirectly being employed by or acting as a consultant or lender to, or being a director, officer, employee, principal, agent, shareholder, member, owner or partner of, or permitting your name to be used in connection with the activities of any other business or organization anywhere in the world that competes, directly or indirectly, with Delphi in the Business; provided, however, it shall not be a violation of this Agreement for you to become the registered or beneficial owner of up to five percent (5%) of any class of share of any entity in Competition with Delphi that is publicly traded on a recognized domestic or foreign securities exchange, provided that you do not otherwise participate in the business of such corporation.

(b) For purposes of this Agreement, "**Business**" means the creation, development, manufacture, sale, promotion and distribution of vehicle electronics, transportation components, integrated systems and modules, electronic technology and other products and services which Delphi engages in, or is preparing to become engaged in, at the time of your termination.

CASE STUDY: *DELPHI AUTOMOTIVE V. ABSMEIER*

▪ The Confidentiality and Noninterference Agreement:

– **Non-Solicitation:** During your employment and for <u>twenty-four (24) months</u> after the termination of your employment by you or Delphi for any reason, you will not directly or indirectly:

  i. Solicit "business or the same or of a similar nature as the Business (as defined below) from any <u>customer</u> that is doing business with Delphi…."

  ii. Otherwise interfere with the Business of Delphi, including, but not limited to, any relationship or agreement between Delphi and any <u>supplier</u> to Delphi during the term of your employment…."

  iii. Solicit the "employment or services of, or hire or engage, any <u>individual</u> known to be employed or engaged by Delphi during the term of your employment…."

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CASE STUDY: *DELPHI AUTOMOTIVE V. ABSMEIER*

- Events giving rise to the lawsuit:

  - In May 2015, Samsung began to express an interest in Delphi's vehicle technology and allegedly stated that it was "looking for partners to collaborate with in automotive"

  - On October 30, 2015, Samsung offered the employee a position with the company

  - On November 10, 2015, the employee notified Delphi of his intent to terminate his position two weeks later

  - On November 11, 2015, Delphi chose to end the employee's employment

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CASE STUDY: *DELPHI AUTOMOTIVE V. ABSMEIER*

- Events giving rise to the lawsuit:

  - On November 30, 2015, the employee began his employment with Delphi as "Vice President, Smart Machines Initiative, Samsung Strategy and Innovation Center"

  - Delphi also alleged that the employee downloaded documents and files from his work computer onto external hard drives on May 14, October 15, October 28, and November 3, 2015

  - Delphi argued that these files contained Delphi's proprietary information

- In light of these facts, Delphi filed a lawsuit and motion for preliminary injunction against the employee in the United States District Court for the Eastern District of Michigan

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CASE STUDY: *DELPHI AUTOMOTIVE V. ABSMEIER*

- The Court's decision:

    - Duration (1-2 years):

        o "The Agreements' duration of one to two years lies squarely within the allowable time span within Michigan"

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CASE STUDY: *DELPHI AUTOMOTIVE V. ABSMEIER*

▪ The Court's decision:

– Geographical limitations (worldwide):

  o "Geographic limitations in non-competition agreements must be tailored so that the scope of the agreement is no greater than is reasonably necessary to protect the employer's legitimate business interest"

  o "Although the specific facility [the employee] directed – Delphi Labs @ Silicon Valley – was entirely within California's borders, autonomous vehicle technology is a small and specialized field that is international in scope"

  o "Thus, the global restriction in the present case was not necessarily unreasonable under Michigan law"

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CASE STUDY: *DELPHI AUTOMOTIVE V. ABSMEIER*

▪ The Court's decision:

  – Scope of prohibited activity (Delphi's "Business")

    o "Under the Agreements, [the employee] may not engage *in any activity* that directly or indirectly competes with a *broad array* of goods and services currently offered or proposed to be offered in the future by Plaintiff"

    o "It does not appear that there was any attempt to tailor the restrictions to only encompass [Delphi's] 'reasonable competitive business interests,' with respect to the work [the employee] performed for [Delphi]"

  – *The Court found that the restriction on the type of business the employee was able to engage unreasonable and thus, unenforceable *as written*

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CASE STUDY: *DELPHI AUTOMOTIVE V. ABSMEIER*

- The Court's decision:

  - Scope of prohibited activity (Delphi's "Business")

    o "However, the Court may modify the terms of an unreasonable non-compete agreement to render it reasonable" MCL 455.774a

    o "The briefs and arguments at the motion hearing demonstrated that [the employee's] duties at the time the Agreements were signed involved growing his office team and developing technology at Delphi Labs @ Silicon Valley, as well as facilitating customer relationships and developing international autonomous vehicle business strategy"

    o "Accordingly, the Court will limit the non-compete to only prohibit [the employee] from working in the same area of autonomous vehicle technology…."

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CASE STUDY: *DELPHI AUTOMOTIVE V. ABSMEIER*

- The takeaways:

  - A non-compete/non-solicitation clause of 1-2 years is reasonable under Michigan law

  - A worldwide prohibition may be permissible when the facts suggest it is reasonable to protect a legitimate business interest

  - The restricted activity must be reasonably tailored to protect a specific business interest

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MAKING A FEDERAL CASE OUT OF IT? – THE DEFEND TRADE SECRETS ACT

- DTSA (2016)

- Provides access to federal court for the lawsuit for trade secret misappropriation

- Early remedies include possible quick, injunctive relief (may need to provide a "surety")

- Modeled after state trade secrets law, including:

  - The definitions of "trade secret" and "misappropriation," (18 U.S.C. § 1839)

  - Provisions relating to remedies (e.g., for injunctive relief, actual damages, damages for unjust enrichment, a reasonable royalty in lieu of damages, exemplary damages (capped at two times actual damages) and attorneys' fees (18 U.S.C. § 1836)

- Explicitly precludes the use of the inevitable disclosure doctrine to support injunctions under the DTSA. 18 U.S.C. § 1836(b)(3)(A)(i)(I)

MAKING A FEDERAL CASE OUT OF IT? – THE DEFEND TRADE SECRETS ACT

- The DTSA creates a **new whistleblower immunity** for disclosures made solely for the purpose of reporting and investigating a suspected violation of law

- Employers must provide notice to their employees and individual contractors of this immunity in their respective contracts (in any contract with an employee or individual contractor that imposes confidentiality obligations on him/her and is either entered into or updated after May 11, 2016). 18 U.S.C. § 1833(b)(3)(A)

- Employers can also comply with this notice requirement if they provide "a cross-reference to a policy document provided to the employee that sets forth the employer's reporting policy for a suspected violation of law." 18 U.S.C. § 1833(b)(3)(B)

- The term "employee" in this section of the law includes contractors and consultants. 18 U.S.C. § 1833(b)(4)

- **Note:** An employee handbook will not reach independent contractors; consider including the notice in the relevant agreements, for clarity and more certain compliance

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OTHER REMEDIES & TOOLS

- The Computer Fraud & Abuse Act

- Conversion

- Breach of contract

- Arbitration agreements and their scope?

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TAKEAWAYS

- Use agreements that fit the person/work

- Update your agreements & handbooks to comply with the DTSA

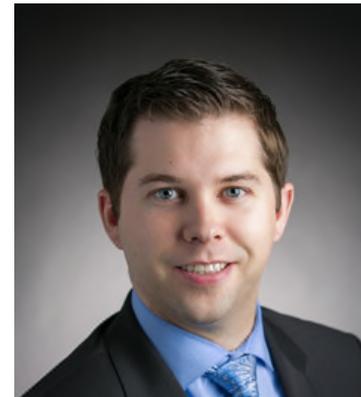- When trouble hits, engage counsel early; move for court help to protect

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THANK YOU

Legal Disclaimer: This document is not intended to give legal advice. It is comprised of general information. Employers facing specific issues should seek the assistance of an attorney.

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