AIPLA
American Intellectual Property Law Association

April 19, 2023

Federal Trade Commission
600 Pennsylvania Avenue, N.W.
Washington, D.C. 20580

Submitted via:
https://www.regulations.gov/document/FTC-2023-0007-0001

Re: Non-Compete Clause Rulemaking, Matter No. P201200: *Written Submission of the American Intellectual Property Law Association (AIPLA)*

Dear Commissioners:

We are responding to the Federal Trade Commission's published notice on Non-Compete Clause Rulemaking, 88 FR 3482, January 19, 2023, to offer our perspective on the potential impacts of the proposed rule on protecting trade secrets and, consequently, on the businesses, economy, and national security of the United States.

Founded in 1897, the American Intellectual Property Law Association ("AIPLA") is a national voluntary bar association of approximately 7,000 members who are engaged in private or corporate practice, in government service, and in the academic community. AIPLA members represent a wide and diverse spectrum of individuals, companies, and institutions involved directly or indirectly in the practice of patent, trademark, copyright, trade secret, and unfair competition law, as well as other fields of law affecting intellectual property ("IP"). Our members represent both owners and users of IP. Our mission includes helping establish and maintain fair and effective laws and policies that stimulate and reward invention while balancing the public's interest in healthy competition, reasonable costs, and basic fairness.

The value and importance of intellectual property rights, including trade secrets, to promoting competition and the national security of the United States are widely recognized. U.S. intellectual property, including trade secrets, is key to preserving U.S. technological leadership globally. They are the backbone of U.S. national security. A proposed rule that effectively forbids throughout the United States the use of a common and, in most states, accepted method of protecting trade secrets raises substantial concerns about what impact the inevitable unintended consequences caused by it will have on American businesses, economy, and national security,

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which depend heavily on trade secrets. Trade secret misappropriation costs the U.S. economy an estimated hundreds of billions of dollars a year. And, while employee misconduct does not cause all trade secret misappropriation, we have reason to believe that misappropriation by employees is responsible for a significant portion of it.

We acknowledge that non-compete agreements with employees can be misused and overused and that they may not be appropriate for many types of employees and businesses. On the other hand, non-compete agreements are the only effective tool in certain circumstances to protect sensitive and valuable trade secrets. Although a few states made their use with employees illegal, we believe our view is generally consistent with the approach taken in most states.

We are also concerned that the Commission's findings fail to consider or give due weight to the effects of eliminating all non-compete agreements with all employees. We disagree with several of the Commission's findings. Non-compete agreements can be procompetitive. In some situations, no other forms of protection are adequate. The *per se* rule proposed by the Commission goes well beyond what is reasonably justified by the misuse and overuse of non-compete agreements and any burden on competition they might have.

We, therefore, urge the Commission to withdraw the proposed rule and consult and coordinate with other agencies, as called for by the Executive Order on Promoting Competition in the American Economy (July 9, 2021). Should it proceed with rulemaking, we urge it to put away its broad brush and consider a less radical, more modest approach to investigating and addressing possible unfair business practices involving non-compete agreements with employees by considering their scope and the type, importance, and value of the information being protected. Such an approach is much more likely to curb any anticompetitive effects those agreements might have without damaging competition and economic and national security interests.

1. Our Concerns

1. Employees Are a Major Source of Trade Secret Loss

By one estimate published in 2017, the theft of trade secrets costs the U.S. economy hundreds of billions of dollars a year.[1] We believe that competitive hiring and employee migration are substantial contributors to the loss of trade secrets by American businesses.

[1] Update to the IP Commission Report, The Theft of American Intellectual Property: Reassessments of the Challenge and United States Policy, The National Bureau of Asian Research on behalf of The Commission on the Theft of American Intellectual Property (2017), available at https://www.nbr.org/wp-content/uploads/pdfs/publications/IP_Commission_Report_Update.pdf.

Available data suggest that misappropriation by an employee is involved in most trade secret misappropriation cases. One survey[2] found that a majority of employees who left or lost their jobs in 2008 admitted to stealing confidential company information, such as customer contact lists. Another survey from 2013 found that "[h]alf of the survey respondents say they have taken information, and 40 percent say they will use it in their new jobs."[3] These surveys obviously do not account for respondents unwilling to admit that they took company information. Therefore, the actual percentages could be higher. Consistent with the surveys, a well-regarded study found that in over 85% of misappropriation cases, the person alleged to have misappropriated was either an employee or business partner, with employees representing an increasing share (up to 59 percent) of the misappropriation over the course of the period reviewed by the study.[4]

Our members who are involved with trade secret cases report similar experiences. Employees pose the greatest threat to companies' trade secrets.

While distinguishing between employees with access to sensitive trade secrets and those without that access might be reasonable, there is no apparent basis for the Commission to distinguish between employees and nonemployees, as its findings do when weighing alleged benefits and harms of noncompetition obligations.

2. Alternate Forms of Protection Are Not Always Adequate

We respectfully disagree with the Commission's findings that non-compete agreements with employees have no benefits and that other forms of protection are "adequate."

One of the most challenging aspects of protecting trade secrets is competitive hiring, when an employee leaves for a similar job at a competitor and remembers a former employer's trade secrets that are relevant to his or her new employer. While the remembered trade secrets are protectable, the employee often cannot meaningfully perform their new job without using the information in some way. Such information may include avoiding blind alleys or developing business or technical strategies to anticipate their former employer's plans.

A prudent business with important trade secrets will rely on a nondisclosure agreement, even with low-level employees, to ensure that it has taken the reasonable precautions necessary to have a protectable trade secret. Nondisclosure agreements put employees on notice that the company has information that may be confidential in general, and those agreements are often drafted broadly as a precaution. They are an important building block in a company's efforts to demonstrate that it has taken reasonable measures to protect its information.

However, a claim for misappropriation or breach of a nondisclosure agreement (at least to the extent not preempted by applicable state trade secret laws) is not adequate to address the potential harm in these circumstances.

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[2] Press release, "More Than Half of Ex-Employees Admit to Stealing Company Data According to New Study," Available at https://cisp.cachefly.net/assets/articles/attachments/19634_symantec.pdf. (Announcing the results of a 2009 survey conducted by the Ponemon Institute and Symantec Corporation.)

[3] See also "What's Yours Is Mine: How Employees are Putting Your Intellectual Property at Risk," Symantec Corporation (Feb. 6, 2013), available at https://www.ciosummits.com/media/solution_spotlight/OnlineAssett_Symantec_WhatsYoursIsMine.pdf.

[4] David S. Almeling, Darin W. Snyder, Michael Sapoznikow, Whitney E. McCollum, Jill Weader, A STATISTICAL ANALYSIS OF TRADE SECRET LITIGATION IN FEDERAL COURTS, 45:2 Gonzaga L. Rev. 291, 302-03 (2010), available at http://blogs.gonzaga.edu/gulawreview/files/2011/02/Almeling.pdf. The results found by this research are consistent with surveys conducted around the same time. See, e.g., More Than Half Of Ex-Employees Admit To Stealing Company Data According To New Study, Ponemon.

A non-compete agreement is likely the only way to prevent an employee from working for a competitor in a role in which they are likely, even if unintentionally, to rely on their former employer's trade secrets. It can be very difficult, if not impossible, for a former employer to discover misuse of its trade secrets by a former employee, much less prevent the misuse. A simple obligation not to disclose or use a trade secret will not usually provide a basis for enjoining an employee from working for a competitor, even if a significant risk of misuse of trade secrets can be proven, unless there is proof of a breach.

Absent extenuating circumstances, actions for misappropriation can only provide for an after-the-fact remedy that is likely inadequate to compensate for the harm. It is often difficult to prove damages caused by a former employee disclosing or using trade secrets at a competitor. Once out, a trade secret can quickly disseminate to other employees or others outside the new employer who have no relationship with the former employer and have no knowledge the information is a trade secret. Trade secrets can often be used in undetectable ways. Thus, even if further dissemination to others is discovered, it is difficult, if not impossible, to enjoin them or obtain damages from the harm caused.

Though they attempt to protect their trade secrets from such eventualities through nondisclosure agreements and other tools, businesses often turn to the only tool capable of preventing employees from taking trade secrets to a competitor in the first instance: non-compete agreements. A non-compete agreement might be the only reasonable option for preventing substantial harm to a former employer from an employee disclosing and using valuable secret information for the benefit of a competitor and the benefits to the former employer of continuing to maintain its secrecy.

Neither misappropriation actions nor nondisclosure agreements provide the level of protection, deterrence, and clarity non-compete agreements provide. Noncompetition agreements therefore can be a critical tool to prevent the harm caused by information exfiltration, and to help employees avoid new employment relationships that will tempt, or create the very real prospect of their breach of confidentiality obligations. Rather than putting the parties and the court to the expense and uncertainty of litigation, non-compete agreements can operate to temporarily prevent an employee from taking a role with a competitor that would put the former employer's trade secrets and other confidential business information at risk of being relied upon or disclosed.[5]

In at least some circumstances, non-compete agreements are the best and possibly only practical approach to prevent a former employee from disseminating trade secrets to a competitor, who could be located outside the United States, and the subsequent untraceable dissemination of that information.

3. Not All Noncompetition Agreements Burden Competition; Some Promote It

We respectfully disagree with the Commission's conclusion that all non-compete agreements cause "considerable harm to competition."

Trade secrets are generally recognized as valuable and important assets of a business. Yet, without reasonable precautions to maintain secrecy, there can be no trade secret.

The common law recognized both legal and equitable remedies for the acquisition of trade secrets through "improper means" — in other words, "misappropriation." Forty-nine

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[5] States vary on the other interests that can be protected through noncompete agreements. See Beck, 50 State Noncompete Survey, available at https://beckreedriden.com/50-state-noncompete-chart-2/.

states have adopted a version of the Uniform Trade Secrets Act (UTSA), which codifies the common-law tort of misappropriation with proper clarification of rights and remedies. Remedies may include injunctive relief and damages, including actual loss and unjust enrichment. When passing the Defend Trade Secrets Act of 2016, Congress found that trade secret theft harms the companies that own the trade secrets and their employees.

Reasonable precautions taken by businesses to maintain secrecy should be presumed to promote competition and not, as suggested by the Commission, to constitute a "burden" on competition. We believe that a non-compete agreement with a former employee with knowledge of sensitive and valuable trade secret information will promote—not burden—competition when the use of or reliance on the trade secret information to the benefit of a new employer is likely or inevitable. Eliminating the option to use non-compete agreements in this situation would have the anticompetitive effect of harming the former employer and unfairly aiding the new employer.

On the other hand, unnecessary or overly broad non-compete agreements might burden competition where, for example, a business or industry routinely uses noncompetition agreements with employees not posing a significant risk of loss of valuable trade secrets.

As the Commission finds, the concern over the potential improper disclosure and use by a former employee is not of the same magnitude for every former employee. AIPLA agrees that some employees will not have access to valuable, sensitive information and thus pose far less risk than employees who have access to the former employer's most valuable trade secret information. However, some employees, such as those in positions of managing and developing critical business and technical strategies, and development plans, can pose a real risk of substantial harm. These groups should not be treated the same way by an employer or by the Commission.

The Commission's one-size-fits-all treatment of non-compete agreements fails to account for these critical distinctions and material differences.[6] AIPLA, therefore, respectfully submits that the Commission's broad brush analysis and findings that every non-compete agreement is doing "considerable harm" is not supported and does not support its finding that all uses of non-compete agreements constitute a method of unfair competition.

4. Unintended Consequences

Should the currently proposed rule take effect, AIPLA foresees several possible unintended consequences that the Commission should consider.

The proposed rule would weaken protection for trade secrets, the disclosure of which could adversely affect the competitiveness of American businesses. It also conflicts with national security policy and risks harming U.S. national security interests. Economic espionage efforts compromise intellectual property, trade secrets, and technological developments critical to U.S. national security.[7] The Protecting American Intellectual Property Act of 2022[8] recognizes that

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[6] We note in this regard that the Commission relies on a study establishing that 53 percent of all people bound by noncompete agreements are hourly workers. NPRM at 16. Based on that estimate alone, the Commission could meet more than half of its objective by narrowing the ban to apply only to hourly workers, i.e., the people who the Commission believes are likely to benefit most from it. Further, to address the problem that may ignore a rule that is not a complete ban, the Commission can address another large swath of the problem by making it unlawful (subject to monetary penalties) to use a noncompete for such hourly workers.

[7] See Office of the Director of National Intelligence, Economic Espionage, https://www.dni.gov/index.php/ncsc-what-we-do/ncsc-threat-assessments-mission/ncsc-economic-espionage.

[8] S. 1294, Protecting American Intellectual Property Act of 2022 https://www.congress.gov/bill/117th-congress/senate-bill/1294/text.

U.S. trade secrets are key to preserving U.S. technological leadership and U.S. national security and seeks to deter theft of trade secrets in the United States by foreign actors through the imposition of sanctions. Weakening legal protection for trade secrets work against this policy.

Depriving employers of the use of such a critical tool may encourage unfair competition through well-known hiring practices aimed at disrupting business operations and obtaining competitive information.

As has happened in California,[9] businesses will turn to a more aggressive, yet imperfect, trade secret-based enforcement strategy. However, because trade secret litigation is more costly, more disruptive, and involves less certain outcomes, companies and workers will suffer.

The proposed "functional test" will exacerbate this problem and further weaken trade secret protection by impairing the use and effectiveness of nondisclosure and other types of agreements to protect trade secrets. The Commission's functional definition of "noncompetition clause" as any contractual term prohibiting the worker from seeking or accepting employment with another in the same field creates substantial uncertainty as the effects of a nondisclosure agreement will be unpredictable. For example, it could make any nondisclosure agreement with a worker in a highly specialized and very narrow field a "de facto" noncompetition agreement. The risks created by uncertainty over what the Commission might consider to be a de facto noncompetition agreement will have a chilling effect on the use of nondisclosure agreements and thus erode the effectiveness and use of a form of protection the Commission deemed to be "adequate" for protecting a business's interests in its trade secrets.

5. Authority to Issue Rule

We are aware that several commentators and observers contend that, notwithstanding the decision in *National Petroleum Refiners Association v. FTC*,[10] the Commission does not have rulemaking authority under Section 6(g) for unfair methods of competition. Their arguments do not appear to be unfounded. Though we do not have a position on whether the Commission does or does not have authority, we urge the Commission to consider the uncertainty that a challenge to its authority would create for many businesses critical to the economy and national security when deciding whether to issue a final rule and the form it takes.

2. Recommendations

1. Withdraw and Reconsider

The Commission should withdraw and reconsider its proposed rule. The FTC has issued only one stand-alone competition rule under Section 6(g) in its decades-long history. That was more than fifty years ago. Compared to the earlier rule, the proposed rule has a striking breadth. It would affect all employers and employees in the United States. Further consideration of its impact is, we believe, warranted for the reasons stated above.

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[9] See California Trade Secrets Litigation Supplants Noncompete Litigation, available at https://www.faircompetitionlaw.com/2017/06/25/california-trade-secrets-litigation-supplants-noncompete-litigation/.

[10] National Petroleum Refiners Ass'n v. F.T.C., 482 F.2d 672 (D.C. Cir. 1973).

2. Consult with Other Agencies

Consistent with the 'whole of government' approach recognized in the 2021 Executive Order on Promoting Competition in the American Economy,[11] the Commission should consider the potential national security implications of the proposed rule. It should also consult with other agencies and offices handling intellectual property issues, such as the United States Patent and Trademark Office, and organizations, such as the National Academies, on other approaches that will not harm the American economy or its national security interests.

The Commission should also consider the policies of the various states, which generally strongly favor the protection of trade secrets, and resist supplanting its judgment for theirs. Although a few states have chosen to prohibit non-compete agreements with employees, most have not. The courts in many states already curb unfair use of non-compete agreements in a manner considering the reasonableness of the non-compete agreement.

3. Employ a Rule-of-Reason Approach

Should the Commission determine that it needs to act and has the authority to issue a rule, we urge the Commission to be judicious and narrowly tailor the rule only to situations in which a business may be using non-compete agreements to compete unfairly. This would enable the Commission to properly balance competing interests and reduce the risk of impairing trade secret owners' ability to protect their trade secrets using something like a rule-of-reason analysis.

Such an analysis could, for example, consider the sensitivity and value of the information to which an employee has access relative to the scope and duration of the proposed restraint to assess whether the non-compete agreement is reasonable in the circumstances. It would recognize that not all employees have the same level of access to an employer's trade secret information, and that not all trade secret information is equally sensitive or valuable. Thus, noncompetition agreements might be unreasonable for low-level employees who either have no access to sensitive information or who have access only to low-value information, the disclosure or use of which would not substantially harm the employer. With senior level employees having access to critical information, reasonable non-competes may be the only viable way to prevent unfair competition.

The analysis might also consider the reasonableness of how the competition agreement is structured. For example, an employee agreement has a "springing" (or "time-out") non-compete clause, which is only enforceable if the employee engages in certain unlawful behavior, should be considered reasonable. Massachusetts and Rhode Island (copying Massachusetts) have new non-compete laws expressly allowing courts to prohibit the employee from engaging in certain work when, based on the employee's breach of certain enforceable obligations, the individual cannot be trusted to perform the work without violating their other obligations.

The Commission should also consider when enforcing any rule the three general approaches taken by states to overly broad non-compete agreements: reformation, sometimes called "judicial modification," in which the court essentially rewrites the language to conform the agreement to a permissible scope; blue pencil, in which the court simply crosses out the offending language, leaving the remaining language enforceable; and red pencil, also referred to as the "all or nothing" approach, which, as its name implies, requires a court to void any

[11] Executive Order on Promoting Competition in the American Economy (July 9, 2021) https://www.whitehouse.gov/briefing-room/presidential-actions/2021/07/09/executive-order-on-promoting-competition-in-the-american-economy/.

restriction that is overly broad, leaving nothing to enforce. Most states have historically used the reformation approach. However, Massachusetts now takes an equitable, middle-ground approach, which one Massachusetts state senator dubbed the "purple pencil." This is a hybrid of the reformation and red pencil approaches, requiring the adjudicating entity to strike the non-compete in its entirety unless the language reflects a clear good-faith intent to draft a reasonable restriction, in which case the adjudicating entity may reform it.

3. CONCLUSION

AIPLA appreciates in advance your consideration of this submission. Should you have any questions, we will be pleased to meet with you for further discussion.

Sincerely,

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