Trade secrecy might solve your noncompete problem

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On January 5, 2023, the Federal Trade Commission (FTC) proposed a rule that would ban US employers from imposing noncompete clauses on workers.

It is unclear whether, and to what extent, the proposed FTC rule will become final, but the proposed rule should not come as a surprise. Some states already ban noncompetes while others limit their use, and courts have generally been skeptical toward enforcing noncompetes.[1] Considering these trends and the proposed rule, how else might companies protect their most valuable business interests? Trade secrecy may be the answer.

Noncompetes are typically designed to protect intangible assets that provide a competitive advantage. As such intangibles are highly portable, noncompetes focus on preventing an employee with access to sensitive company information from sharing that information with a competitor after leaving, thereby eroding the original company's competitive advantage.

What kinds of information might a company try to protect under a noncompete? It varies by industry, but can include information such as:

Business information such as pricing, the details of agreements with third parties, customer contact lists, marketing plans, pipeline information, or supply chain operations.

Technical information such as R&D roadmaps, in-process innovations that are not mature enough for patenting, data/algorithms/models, or other important know-how.

Given the current discourse around noncompetes, companies may consider turning to trade secrecy as an alternative and more robust way to protect these critical business assets.

Trade secrecy is a form of Intellectual Property (IP) that is not as well-known as patents but is quickly growing in prominence. Many of a company's most important intangible assets may not qualify for patent protection or may be better protected as trade secrets – consider the same categories of assets above. Like noncompetes, trade secrecy aims to protect a company against losing sensitive information to competitors.[2] Given the convergence of objectives, and the fact that trade secrecy is well established as a reliable form of protection, companies might consider using trade secrecy instead of noncompetes to protect themselves.

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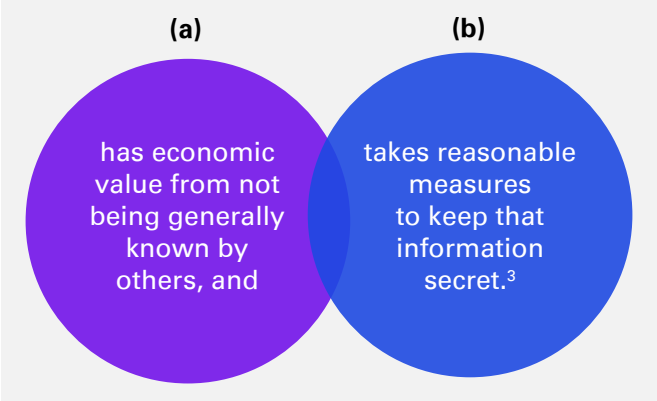
[1] See, for example, Abigail Shechtman Nicandri, *The Growing Disfavor of Non-Compete Agreements in the New Economy and Alternative Approaches for Protecting Empoyers' Proprietary Information and Trade Secrets,* 13 J. Bus. L. 1003 (2011).

[2] See, for example, Matt Marx and Lee Fleming, *Non-Compete Agreements: Barriers to Entry…and Exit?* 12 Innovation Policy and the Economy 39 (2012).

How might a company use trade secrets instead of noncompetes? In general, a company can protect information as a trade secret if it:



Unlike the highly structured patent system, trade secrecy is a less-defined area of the law, thus providing asset owners with greater flexibility, yet also ambiguity.[4] There is no one right way to leverage trade secrecy, and the form used usually varies by industry and by the type of asset being protected.

Consider an example. Imagine a company produces a product according to industry-standard processes. The company suspects they could improve that process, significantly reduce production costs, and gain an advantage over competitors. The company recruits a prominent process engineer to solve the problem. The engineer joins the company, signs a noncompete, and then delivers a breakthrough innovation, solving the company's problem beyond their expectations. The company consults IP counsel and determines, however, that the innovation is not patentable. What happens if that employee leaves and joins the competition?

Consider the same scenario with trade secrets instead of a noncompete. The engineer joins the company and acknowledges the company's policy on trade secrets and IP. Because the company recognizes the strategic value of this innovation exercise, it treats the project as a trade secret from the beginning. The company knows it has to take "reasonable measures of secrecy" to qualify for trade secrets protection, and so it implements measures such as governance (making someone from the team responsible for overseeing the trade secret activities), limiting access (ensuring that only employees with a need to know can access the project and its associated information), educating associated staff about their secrecy obligations, carefully maintaining records in a secure location about the ongoing innovations and marking everything appropriately. As in the prior example, the engineer decides to leave. However, before the engineer's final day, HR formally counsels the employee about trade secrets, reminds the engineer that the process information is considered a company trade secret, and explains the civil and criminal penalties associated with misappropriation. The company is now in a much stronger position to protect itself against the competitor. The company's diligence in handling the information as a trade secret may be sufficient to deter the employee from stealing information. That diligence should also help it qualify for additional remedies, both against the employee and potentially against the new employer, should it be required.

The keys to effectively using trade secrets are proactivity and having a plan. Trade secret rights do not arise on their own; a company must be diligent to gain trade secret benefits. Beyond that, a company needs to develop a plan on how it will achieve – and maintain – "reasonable measures of secrecy" that are consistent with the company's culture, operations, and best practices under trade secret law.

To learn more, please contact the authors.

[3] See, for example, the US Defend Trade Secrets Act (18 U.S.C. § 1836).
[4] See, for example, Julie Piper, I Have a Secret? Applying the Uniform Trade Secrets Act to Confidential Information That Does Not Rise to the Level of Trade Secret Status, 12 Intellectual Property L. Rev. 359 (2008).

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