



Trade Secret Quarterly

January 2023

FTC's Proposed Noncompete Ban Highlights Importance of Protecting Trade Secrets

On January 5 the Federal Trade Commission (FTC) issued a proposed rule on noncompetes that has a breathtaking scope. The rule, as written, would ban the use of noncompete agreements for all employees, except for those in a very few excluded industries. It has no exceptions for highly compensated or high-level employees and is not only prospective in nature. The proposed rule would also invalidate all existing noncompetes and require employers to provide notice to employees with such agreements that they are no longer valid.

The public comment period is open until March 20. The FTC is specifically seeking comments on topics such as whether there should be a different regulatory structure for senior executives and the impact of venue selection clauses.

The proposed rule does **not** prohibit the use of nonsolicitation agreements or nondisclosure agreements unless they are so broadly written as to effectively function as noncompetes. The ability to retain a nonsolicitation agreement, however, will not provide much comfort for a company that cannot stop an executive with national or global knowledge of its most critical information from going to work for a competitor. Suddenly it is more important than ever for companies to take appropriate steps to identify and protect their trade secret information.

The FTC, in fact, referenced the Defend Trade Secrets Act (DTSA) as an alternative vehicle employers can use to protect their sensitive information. The DTSA provides for injunctive relief, damages and attorneys' fees against an employee who misappropriates a former employer's trade

secret information. The best time to prepare for this scenario is before such an employee leaves, especially with the potential noncompete ban looming.

Companies should audit their practices to ensure that trade secrets are properly identified and protected. This includes asking employees to acknowledge that they have exposure to trade secrets and a duty to protect them and establishing appropriate monitoring policies and a robust protocol for exiting key employees.

The proposed rule is not a certainty yet. The FTC may alter it following the public comment period, and any final rule will be subject to legal challenges. The U.S. Chamber of Commerce has already announced plans to challenge any FTC rule on noncompetes, including through litigation. Nonetheless, employers should not delay reviewing their practices regarding the use and disclosure of trade secrets to ensure that they are protected if noncompetes become a thing of the past.

Are You Protecting Your Negative Trade Secrets?

On any company's way to developing important trade secret information, it no doubt faced countless failures. There often are a lot of mistakes made while developing an innovative formula, method or process. Discovering information about what does **not** work could allow a competitor to develop an even better version. The concept of protecting "negative trade secrets" is intended to safeguard the secret know-how a company gleans from its research investment about those failures.

A recent case in California involving pharmaceutical competitors highlights the potential value of negative trade

secrets. The court granted the plaintiff's request for injunctive relief after it demonstrated that the individual defendants downloaded and provided their new employer with hundreds of confidential documents filled with proprietary information about product development failures. The court rejected arguments that the two companies' protocols for competing drugs were different, finding that the negative know-how provided the defendants "the benefit of steering clear of fruitless development pathways, thereby saving precious time and resources." The documented failed formulas were determined to be protectable negative trade secret information.

Convincing a court that a trade secret exists is no easy task. Proving that there is a protectable negative trade secret is even more challenging. Courts sometimes scrutinize the breadth of alleged negative trade secrets to determine if they would effectively prevent others from competing in the particular field. Negative trade secret claims are best postured for success when a company can identify specific documents or data that include the negative knowledge and illustrate its importance.

The lesson here is that when a company embarks on developing a new product, process, method, formula or other trade secret, it should not discard information relative to its mistakes. Instead, that information should be preserved and protected just like the ultimate trade secret information.

Combining Public Information to Create a Trade Secret

The U.S. Court of Appeals for the Sixth Circuit recently upheld a jury verdict finding a dietary supplement company liable for misappropriating another company's research and development under a "combination" trade secrets theory.

In *Caudill Seed & Warehouse Co., Inc. v. Jarrow Formulas*, Caudill alleged that Jarrow misappropriated its trade secret information related to broccoli-seed derivatives. Jarrow had hired Caudill's head of research and development, who had spent nine years researching the development of broccoli-seed derivatives and assembling a large body of research related to broccoli seeds. Caudill claimed that when he joined Jarrow, he delivered a library of broccoli product research to the company and helped it bring its own

competing broccoli-seed extract supplement to the market in just four months.

At trial, the jury agreed with Caudill and awarded it more than \$2 million in actual losses, more than \$400,000 in unjust enrichment damages, and exemplary damages.

Jarrow raised several arguments on appeal, including one that Caudill improperly asserted a "kitchen-sink theory" of trade secrets by broadly defining all its research activities as a single trade secret.

The Sixth Circuit first found that Caudill properly defined its alleged trade secret as its "research and development on supplements, broccoli, and chemical compounds." The court treated Caudill's information as a "combination" trade secret, rejecting Jarrow's argument that there were no trade secrets at issue because most of the elements individually consisted of materials that are in the public domain. Instead, the court found that Caudill demonstrated that it had assembled a unique collection of processes and information relating to its research and development activities, and that therefore, the entire research process qualified as a trade secret.

The court also rejected Jarrow's argument that Caudill should not prevail because it could not show that Jarrow had acquired and used the entire compilation of trade secrets. It noted differing authority on whether a plaintiff must show acquisition and use of the entire combination when relying on a compilation theory. But the court ultimately found that Caudill demonstrated that Jarrow had acquired "vast quantities of information" concerning its research and development process and held that such evidence supported a finding of misappropriation. The court reasoned that trade secret law does not require proving acquisition of "each atom" of the compilation, as a defendant will always be able to identify some detail of the combination that it did not use.

While relying on a combination trade secret theory can be challenging, this decision provides helpful guidance for determining when a compilation of publicly available information can achieve trade secret status based upon the way in which that information is combined.

FOR MORE INFORMATION

For more information, please contact:



Deborah S. Brenneman

513.352.6638

Deborah.Brenneman@ThompsonHine.com

Debbie represents management in all areas of employment law, with a focus on trade secret and non-compete cases. She has a wealth of experience in successfully litigating and resolving these matters in state and federal courts across the country.

This newsletter may be reproduced, in whole or in part, with the prior permission of Thompson Hine LLP and acknowledgement of its source and copyright. This publication is intended to inform clients about legal matters of current interest. It is not intended as legal advice. Readers should not act upon the information contained in it without professional counsel.

This document may be considered attorney advertising in some jurisdictions.

© 2023 THOMPSON HINE LLP. ALL RIGHTS RESERVED.