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The Legal Challenges Ahead and the Practical Steps Employers Might Consider in Light of the Federal Trade Commission's Proposal to Ban Non-Competes

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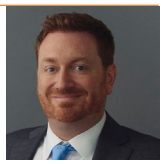

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INTRODUCTION

The Federal Trade Commission grabbed headlines after the new year by proposing a rule that categorically bans most employee non-compete agreements, which are employment provisions that prevent workers from working for or starting a competing business within a period of time after leaving a job. The proposed rule, which would displace many states' laws that permit reasonable non-competes, has far-reaching consequences to numerous businesses. Firms have long used them as contractual instruments to avoid losing valuable personnel in whom the business has made training and other investments or who, upon departure, may walk away with intellectual property that could be used by a competitor. Yet, as forecasted by one dissenting commissioner, the proposed rule faces stiff legal headwinds, which we analyze below.

Regardless of how the inevitable protracted litigation is resolved, non-competes are facing increasing skepticism from the federal and state governments, and there are material steps employers might take now to protect their interests. Lessons from jurisdictions that ban non-competes, such as California, and specific guidance from the Commission itself offer some relief to employers, even if these solutions aren't as satisfying as non-competes. Specifically, employers might consider (1) posting comment on the proposed rule, (2) preparing to protect their trade secrets through the inevitable disclosure doctrine, and (3) adding or strengthening alternative provisions in employment agreements aimed at protecting intellectual property.

The inevitable disclosure doctrine, in particular, has been used to prevent former employees from working at competitors when they cannot help but draw upon information learned in their previous employment to the detriment of their former employers. In addition, employers might consider other contractual provisions to protect their investments. Such provisions range from common contracts, like non-disclosure agreements, to less common provisions, like garden leave policies or post-employment financial obligations to reimburse training costs and bonuses or even to pay liquidated damages for the loss of goodwill caused by the employee's departure. We address all these considerations in turn.

BACKGROUND

The proposed "Non-Compete Clause Rule" would make it an "unfair method of competition" under Section 5 of the Federal Trade Commission Act,[1] for an employer to enter, attempt to enter, or maintain an agreement with a worker "that prevents the worker from seeking or accepting employment with a person, or operating a business,

[1] *See* 15 U.S.C. § 45.

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after the conclusion of the worker's employment with the employer."[2] The proposed rule also would bar any contractual term that functions as a *de facto* non-compete clause, for instance a broadly written non-disclosure agreement that would essentially prevent the worker from working in the same field or a requirement that the employee or the new employer reimburse training costs that are "not reasonably related" to the actual cost of training the worker.[3] However, the proposed rule exempts non-compete clauses entered into in connection with the sale of an entity, an ownership interest in an entity, or the operating assets of an entity, when the person restricted by the non-compete clause holds "at least a 25 percent ownership interest" in the entity.[4] Employers who currently maintain any non-exempt, non-compete clauses with any workers must rescind those clauses and provide notice to any affected current or former employees that the clauses are no longer in effect.[5] Finally, although many states currently allow or regulate non-compete clauses,[6] the proposed rule would preempt any inconsistent state laws that afford lesser protections to workers.[7]

The Commission voted 3-1 to publish the proposed rule, with Commissioner Christine S. Wilson voting against publication and issuing a dissenting statement.[8]

LEGAL CHALLENGES AHEAD

The proposed rule is certain to face legal challenges before coming into effect. Commissioner Wilson's dissenting statement previews some of the legal arguments that opponents of the rule will likely raise.[9]

First, Wilson questioned the Commission's authority to promulgate substantive rules prohibiting particular practices as "unfair methods of competition" under Section 5.[10] She opined that the Commission must instead address individual unfair methods of

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[2] Proposed 16 C.F.R. §§ 910.1(b)(1); 910.2(a); *see also* Notice of Proposed Rulemaking, *Non-Compete Clause Rule*, Fed. Trade Comm'n, RIN 3084-AB74 ("NPRM"), *available at* https://www.ftc.gov/system/files/ftc_gov/pdf/p201000noncompetenprm.pdf (proposing text of the rule).

[3] Proposed 16 C.F.R § 910.1(b)(2); *see also infra* Part II (discussing alternative protections).

[4] Proposed 16 C.F.R §§ 910.1(e); 910.3.

[5] *See id.* § 910.2(b).

[6] *See* NPRM Part II.C (discussing states' laws regarding non-competes).

[7] Proposed 16 C.F.R. § 910.4.

[8] NPRM at 216; Fed. Trade Comm'n, Dissenting Statement of Comm'r Christine S. Wilson Regarding the Notice of Proposed Rulemaking for the Non-Compete Clause Rule, Comm'n File No. P201200-1 (Jan. 5, 2023) ("Wilson Dissent"), *available at* https://www.ftc.gov/system/files/ftc_gov/pdf/p201000non-competewilsondissent.pdf.

[9] *See* Wilson Dissent at 10-13.

[10] *See id.* at 10. Section 5 provides, in relevant part, that "[u]nfair methods of competition in or affecting commerce … are hereby declared unlawful" and "empower[s] and direct[s]" the Commission to "prevent" persons and entities (with some exceptions) "from using unfair methods of competition." 15 U.S.C. § 45(a)(1)–(2).

competition on a case-by-case basis. In her view, the sections of the FTC Act on which the Commission relies for its rulemaking authority allows the Commission to adopt only "procedural rules."[11] This interpretation of the Commission's substantive rulemaking authority has scholarly support,[12] but although the Supreme Court has never directly addressed the Commission's rulemaking power, the D.C. Circuit has long held that it does have the power to promulgate substantive rules under Section 5.[13]

Second, Wilson predicted that the proposed rule would face challenge under the "major questions" doctrine, which holds that a court should "hesitate before concluding that Congress" meant to give an agency the power to promulgate broad rules regarding questions of major "economic and political significance" without a clear statutory statement conferring such authority.[14] The Supreme Court has relied on the major questions doctrine (or the principles underlying it) to block administrative overreach in multiple contexts, including the FDA's attempt to regulate and ban tobacco products, the CDC's attempt to impose an eviction moratorium during the COVID-19 pandemic, and the EPA's efforts to regulate greenhouse gas emissions.[15] The doctrine may apply here, according to Wilson, because "Congress has considered and rejected bills significantly limiting or banning non-competes on various occasions," non-compete clauses affect "a significant portion of the American economy" ("approximately one in five workers—or approximately 30 million workers"), and "regulation of non-compete agreements has been the particular domain of state law."[16]

Third, Wilson raised the possibility that the proposed rule might be struck down for violating the non-delegation doctrine, which requires Congress to set out "an intelligi-

[11] *See* Wilson Dissent at 10. Section 5 authorizes the Commission to charge a person or entity with using an unfair method of competition, hold an adjudicative proceeding, and, upon finding the conduct complained of an unfair method of competition, issue a cease-and-desist order, subject to judicial review by a court of appeals. *See* 15 U.S.C. § 45(b)–(c). Section 46(g) also provides that the Commission has the power "[f]rom time to time [to] classify corporations and … to make rules and regulations for the purpose of carrying out the provisions of this subchapter." 15 U.S.C. § 46(g).

[12] *See, e.g.*, Thomas W. Merrill & Kathryn Tongue Watts, *Agency Rules with the Force of Law: The Original Convention*, 116 Harv. L. Rev. 467 (2002).

[13] *See Nat'l Petroleum Refiners Ass'n v. FTC*, 482 F.2d 672 (D.C. Cir. 1973). The Supreme Court has stated, without analysis, that similar language in the National Labor Relations Act provided the National Labor Relations Board with the authority to promulgate a substantive rule. *See Am. Hosp. Ass'n v. NLRB*, 499 U.S. 606, 609–10 (1991) (opining that language granting the NLRB the power "to make, amend, and rescind … such rules and regulations as may be necessary to carry out the provisions" of the statute was "unquestionably sufficient to authorize the rule at issue").

[14] *See* Wilson Dissent at 11 (quoting *West Virginia v. EPA*, 142 S. Ct. 2587, 2608 (2022)).

[15] *See West Virginia*, 142 S. Ct. at 2608–10 (citing cases).

[16] Wilson Dissent at 12.

ble principle to which the person or body authorized to fix [rules] is directed to conform" for a delegation of rulemaking authority to be valid.[17] A challenger might argue, for instance, that Congress has not provided any intelligible principle to guide the Commission in determining what constitutes an "unfair method of competition." The nondelegation doctrine has long been dormant, however, and the Supreme Court has not invoked it to strike down a statute in almost ninety years.[18] Nevertheless, several justices on the Court have expressed interest in reviving the doctrine.[19]

It remains to be seen whether any of the legal theories for challenging the proposed rule just mentioned will gain traction with reviewing courts. Already, the U.S. Chamber of Commerce has expressed an intention to sue to strike down the rule,[20] and others undoubtedly will follow.

WHAT MIGHT EMPLOYERS CONSIDER DOING NOW?

Today, while the enforceability of non-competes varies greatly among the states, only a few ban them outright.[21] Aware of the disruptive effects to states' laws and overall business practices, the Commission has invited public comment on its proposed rule. These comments could walk the Commission back on its proposed sweeping changes. And even if they do not, and the proposed rule becomes a final rule that broadly bans non-competes, there are concrete steps employers might take now to protect their investments. After all, the rule would require rescission of existing non-competes, and the effective and compliance dates for the rule are 60 and 180 days after the final rule is published in the Federal Register, respectively.[22]

I. Consider Posting Comment On The Proposed Rule And Its "Alternatives" To Protecting Valuable Investments

The comment period is open through March 10, 2023. The Commission is especially interested in comments concerning "several alternatives" to its proposal, "including whether non-compete clauses between employers and senior executives should be subject to a different standard" and whether the Commission should adopt a rebuttable presumption instead of a categorical ban to non-competes.[23]

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[17] *Id.* at 12–13 (quoting *J.W. Hampton, Jr. & Co. v. United States*, 276 U.S. 394, 409 (1928)).

[18] Clinton T. Summers, *Nondelegation of Major Questions*, 74 Ark. L. Rev. 83, 83 (2021).

[19] *See* Wilson Dissent at 12–13 n.61.

[20] *See Chamber Vows to Sue FTC Over Non-Compete Ban If Rule Goes Ahead,* Bloomberg (Jan. 12, 2023), *available at* https://tinyurl.com/mukh3sv7.

[21] *See* NPRM Part II.C (discussing states' laws regarding non-competes).

[22] NPRM at 134 (discussing effective and compliance dates).

[23] NPRM at 6; *id*. at Part VI.A.1.

Given the proposed rule's potential effect on the national economy, the importance of public comment cannot be understated. First, to the extent that the Commission proposes alternatives *after* public comment, it might adopt one of those alternatives for its final rule as a "logical outgrowth" of the current process. This means that there might not be any further opportunity for public comment on alternatives, such as how to treat "senior executives," even though the final rule will dramatically affect numerous businesses.[24] Moreover, the Commission believes that final rules for different categories of workers (*e.g.*, "senior executives," "highly skilled," *etc*.) would be severable if a court were to invalidate any of the provisions in the final rule. For these reasons and others, Wilson stressed in her dissent that "***this solicitation for public comment is likely the only opportunity [that interested parties] will have to provide input not just on the proposed ban, but also on the proposed alternatives***."[25] Specifically, employers might consider commenting on:

- Whether the Commission should adopt a "rebuttable presumption of unlawfulness" for non-competes "instead of a categorical ban"[26];
- Whether "senior executives," or those "highly paid or highly skilled workers," should be treated differently under the proposed rule[27];
- How should tribunals identify "senior executives," "highly paid" employees, or "highly skilled workers"?;
- What are the benefits and drawbacks of the proposed ban compared to the proposed alternative rule that would find a presumption of unlawfulness, including the role of procompetitive justifications in rebutting a presumption?;
- Discuss the academic literature that addresses procompetitive justifications for non-compete provisions[28]; or

"[T]his solicitation for public comment is likely the only opportunity [that interested parties] will have to provide input not just on the proposed ban, but also on the proposed alternatives."

- Commissioner Wilson, dissenting

[24] *See, e.g.*, *Owner-Operator Indep. Drivers Ass'n v. Fed. Motor Carrier Safety Admin.*, 494 F.3d 188, 209 (D.C. Cir. 2007) (explaining that a rule arising as a "logical outgrowth" of the proposed rule complies with notice requirements under the Administrative Procedure Act).

[25] Wilson Dissent at 2 (emphasis in original).

[26] NPRM Part VI.A.1 (describing the "rebuttable presumption").

[27] NPRM Part IV.A.1.b (concluding that, although "[n]on-compete clauses for senior executives are unlikely to be exploitative or coercive," there are still reasons to ban them as to those workers); *id*. Parts VI.B.2–VI.C (describing alternatives based on different classes of workers, including either a categorical ban or a rebuttable presumption).

[28] *See, e.g.*, Jonathan M. Barnett & Ted Sichelman, *The Case for Non-competes*, 87 U. Chi. L. Rev. 953, 963 (2020).

- Discuss the importance of choice-of-law provisions in non-competes and similar employment agreements.[29]

II. Prepare To Protect Your Trade Secrets Under The "Inevitable Disclosure" Doctrine

Protecting sensitive information is essential to a company's capacity to develop products and provide services. Those who wrongfully disclose such information often cause "irreparable harm."[30] Employers might respond with legal action, but monetary remedies are often inadequate, because the damage done by disclosure is irreparable or difficult to calculate. Injunctive relief preventing an employee from going to work for a competitor, on the other hand, might prevent confidential information from ever slipping into competitors' control. The Commission's ban on non-competes would impair an employer's ability to prophylactically protect sensitive information, but it will not eliminate that ability entirely. The inevitable disclosure doctrine is another means by which employers can protect certain information classified as trade secrets.

The inevitable disclosure doctrine holds that, for some employees, the nature of their new position would necessarily require that they use their former employer's trade secrets. [31] Courts must therefore enjoin the former employee from working in his new role for a time. The theory can be used to prevent not only misappropriation of trade secrets but also the mere threat that such misuse will occur.[32] The doctrine often arises after an employee, unbounded by a non-compete, joins a competitor.[33]

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[29] *See* NPRM at 60–61 (requesting comment on employers' use of choice-of-law provisions).

[30] *See EarthWeb, Inc. v. Schlack*, 71 F. Supp. 2d 299, 308, 310 (S.D.N.Y. 1999) ("[I]rreparable harm may be presumed if a trade secret has been misappropriated.").

[31] The inevitable disclosure doctrine is not recognized in all states. *See, e.g.*, *Whyte v. Schlage Lock Co.*, 101 Cal. App. 4th 1443, 1446–47 (2002) ("reject[ing] the inevitable disclosure doctrine").

[32] *See* 18 U.S.C. § 1836(b)(3) (permitting an injunction "to prevent any actual or threatened misappropriation"). There is conflicting authority on whether this provision can be used under the doctrine. *Compare Packaging Corp. of Am., Inc. v. Croner*, 419 F. Supp. 3d 1059, 1069 n.7 (N.D. Ill. 2020) (yes), *with Kinship Partners, Inc. v. Embark Veterinary, Inc.*, 2022 WL 72123, at *7 (D. Or. Jan. 3, 2022) (no).

[33] *See* Tracy Bateman Farrell, *Applicability of Inevitable Disclosure Doctrine Barring Employment of Competitor's Former Employee*, 36 A.L.R.6th 537 (2008) (chronicling cases in which courts addressed the use of the doctrine to prevent a former employer from working for a competitor).

There are several factors that courts consider in assessing whether injunctive relief is appropriate under this doctrine. Courts assess whether the employers are direct competitors[34]; whether the former employee's new position is identical to the old one[35]; whether the trade secrets at issue are highly valuable[36]; whether the new employer took efforts to safeguard the former employer's trade secrets[37]; or whether the employee acted deceptively to the former employer before departing.[38] In short, the employer must successfully argue that it will be harmed because the employee "could not operate or function" in his new position without relying on its trade secrets.[39]

PepsiCo v. Redmon shows how employers can prevent trade secrets from sliding into competitors' hands without non-competes.[40] There, an employee signed a confidentiality agreement, but not a non-compete, in the highly competitive sports-drink industry. As a general manager, the employee had access to highly sensitive information, such as marketing strategies. A competitor, Quaker Oats, successfully recruited the employee, but the court enjoined him under Illinois's trade secret law from working there for six months. The court reasoned that the "defendant's new employment will inevitably lead him to rely on the plaintiff's trade secrets," because the former employee "possessed extensive and intimate knowledge about [PepsiCo's] strategic goals."[41] And the former employee "cannot help but rely" on that information, the court found, as he helps Quaker Oats plot a "new course."[42] Without an injunction, PepsiCo's "secrets will enable" Quaker Oats "to achieve a substantial advantage by knowing exactly how [PepsiCo] will price, distribute, and market its" product.[43] "In other words, PepsiCo finds itself in the position of a coach, one of whose players has left, playbook in hand, to join the opposing team before the big game."[44] The court prevented this from happening for six months notwithstanding the absence of any non-compete.

PepsiCo v. Redmon shows how employers can prevent trade secrets from sliding into competitors' hands without non-competes.

[34] *See EarthWeb*, 71 F. Supp. 2d at 310 (applying New York law); *Packaging Corp.*, 419 F. Supp. 3d at 1070; *Marietta Corp. v. Fairhurst*, 301 A.D.2d 734, 737-38, 754 N.Y.S.2d 62 (N.Y. App. Div. 3d Dep't 2003); *RKI, Inc. v. Grimes*, 177 F. Supp. 2d 859, 875 (N.D. Ill. 2001).

[35] *See Packaging Corp.*, 419 F. Supp. 3d at 1070.

[36] *See EarthWeb*, 71 F. Supp. 2d at 310.

[37] *See RKI*, 177 F. Supp. 2d at 874.

[38] *See Merck & Co., Inc. v. Lyon*, 941 F. Supp. 1443, 1461 (M.D.N.C. 1996).

[39] *Packaging Corp.*, 419 F. Supp. 3d at 1070 (collecting cases).

[40] 54 F.3d 1262 (7th Cir. 1999); *accord Lumex, Inc. v. Highsmith*, 919 F. Supp. 624 (E.D.N.Y. 1996) (finding inevitable disclosure based on the employee's access to highly sensitive information concerning manufacturing costs, pricing structure and new products").

[41] 54 F.3d at 1269.

[42] *Id*. at 1270.

[43] *Id*.

[44] *Id*.

All this said, while *PepsiCo* remains good law, the inevitable disclosure doctrine is not recognized in all states.[45] And many courts, even within the Seventh Circuit that are bound by *PepsiCo*, have declined to follow that case on the facts. The Commission also called the doctrine "highly controversial" even while recognizing that, "[i]n some states, under the 'inevitable disclosure doctrine,' courts may enjoin a worker from working for a competitor of the worker's employer where it is inevitable the worker will disclose trade secrets in the performance of the worker's job duties."[46] It remains to be seen in a world without non-competes whether courts will more forcefully reinvigorate this doctrine to protect employers' trade secrets. Employers should nevertheless consider using it in applicable jurisdictions to protect their most sensitive information.

III. Consider Adding Or Strengthening Alternative Provisions In Employment Agreements To Protect Employer Investments

The inevitable disclosure doctrine is invoked primarily to protect trade secrets, which enjoy special status under state and federal law. By contrast, firms often must rely solely on contractual obligations to protect confidential information that does not meet the definition of a "trade secret." To continue protecting such information without non-competes, employers might consider adding or strengthening other contractual provisions, with the understanding that the utility of each provision below is limited by the requirement of showing something beyond the employee working for a competitor:

- An assignment of invention agreement, which obligates employees to agree in writing to an assignment to the employer of all work product that the employee creates in relation to the employer's business;
- A non-disclosure agreement, which prohibits workers from ever disclosing or using certain information;
- A non-solicitation agreement, which prohibits workers from soliciting former or current customers; and
- A no-business agreement, which prohibits workers from doing business with former clients or customers, whether or not solicited by the workers.

Employers in jurisdictions that already ban non-competes, moreover, have taken additional steps outside of those common provisions just listed: garden leave policies and post-employment financial obligations.

[45] *See* NPRM at 95 n.310.
[46] *Id*. at 95 (citing *PepsiCo*).

A. Consider "Garden Leave" Policies In Employment Agreements

"Garden leave" provisions have been gaining traction as another tool employers can use to protect their confidential information at the end of an employment relationship. Garden leave is a notice provision whereby, after an employee notifies an employer of an upcoming resignation, the employee is relieved of work responsibilities for a specified period while still collecting a paycheck. In other words, to protect an employer's confidential information for a period of time, the employer will pay the departing employees to "tend to their garden" for some agreed-upon time before joining a competitor, thus technically extending the employment relationship. These provisions are commonly used in financial services but are just as applicable elsewhere.[47]

Garden leave provisions have historically been tied to non-competes. Courts have reviewed these provisions and, so long as the policy is conspicuous and the leave period reasonable, they have enforced these provisions in non-competes.[48] Yet, garden leave isn't restricted to non-competes. Garden leave could be included with offer letters, terms of employment (such as any of the agreements listed above)[49], or termination agreements. The contractual provision ordinarily contemplates (1) employee responsibilities during leave; (2) length of leave; (3) compensation; and (4) employee access to corporate information and systems. Because employees remain employed at the employer during leave, the employees still owe a duty of loyalty (and, for some employees, a fiduciary duty).

Although garden leave policies are similar to non-competes by preventing employees from working at competitors for a period of time, there are crucial differences that could make garden leave provisions enforceable even if the Commission generally bans non-competes. For one, because the employee is paid during the period, courts should be less concerned over covenants that unduly restrict the former employee's earnings. For another, because the employer is making substantial payments for no work, these policies are used more selectively and only when they are truly beneficial to the employer. This means that, for employees subject to the provision, courts will be much more likely to believe employers when they seek judicial assistance to prevent their confidential information from falling into the wrong hands.

Although garden leave policies are similar to non-competes by preventing employees from working at competitors for a period of time, there are crucial differences that could make garden leave provisions enforceable even if the Commission generally bans non-competes.

[47] *See, e.g.*, Charles A. Sullivan, *Tending the Garden: Restricting Competition Via 'Garden Leave'*, 37 Berkeley J. Emp. & Lab. L. 293, 322 (2016).

[48] *See, e.g.*, *Bear Stearns & Co. v. Sharon*, 550 F. Supp. 2d 174, 175 (D. Mass. 2008) (granting temporary restraining order preventing broker from going to work for a competing firm before denying preliminary injunction; nevertheless, found employer likely to succeed on breach of contract claim).

[49] *See, e.g.*, *Citizens Bank, N.A. v. Baker*, 2018 WL 4853318 (W.D. Pa. Oct. 5, 2018) (enforcing garden leave in non-solicitation agreement).

Moreover, while courts have been reluctant to specifically enforce notice or garden leave provisions because doing so "impos[es] what might seem like involuntary servitude,"[50] they are inclined to issue injunctive relief for a breach.[51] Injunctive relief here might mean preventing a former employee from joining a competitor for a period of time when joining the competition would violate a legitimate purpose undergirding the garden leave policy, such as to protect confidential information.[52]

At bottom, while there is little case law interpreting these provisions outside the bounds of non-competes, there are strong reasons to think that courts will be receptive to enforcing them, at least through injunctive relief, even if non-competes are generally banned. Nevertheless, the question of enforceability, for future courts to decide, will largely turn on whether the leave provision operates as a *de facto* non-compete, which the Commission seeks to prevent,[53] or whether the leave provision serves an independent purpose aside from limiting competition.

B. Consider Post-Employment Financial Obligations In Employment Agreements

Finally, employers might consider post-employment obligations to protect their investments. Employers can demand payment from departing employees in the form of reimbursements for training, bonuses, and more. Employers can also use a liquidated damages provision, which requires the worker to pay a substantial sum of money if the worker engages in certain conduct, to protect their valuable information.

Most states, and the Commission itself, recognize the legitimacy of post-employment obligations. "For example," the Commission proffered, "if an employer wants to prevent a worker from leaving right after receiving valuable training, the employer can

[50] Restatement (Second) of Contracts § 367 (1981); *see also Smiths Grp. PLC v. Frisbie*, 2013 WL 268988, at *3 (D. Minn. Jan. 24, 2013) (similar).

[51] *See, e.g.*, *Ayco Co., L.P. v. Feldman*, 2010 WL 4286154, at *10 (N.D.N.Y. Oct. 22, 2010).

[52] *See Aitkin v. USI Ins. Servs., LLC*, 2021 WL 755475, at *4-5 (D. Or. Feb. 26, 2021) (granting temporary restraining order preventing broker from worker for a competitor); *see also Bear Stearns v. Arnone*, No. 103187 (Sup. Ct. Ny. 2008) (prohibiting former employee from customer communications during garden leave).

[53] *See* Proposed 16 C.F.R § 910.1(b)(2).

sign the worker to an employment contract with a fixed duration" to "recoup its training investment."[54] Both scholars[55] and courts[56] have endorsed this practice.

Employers can also recoup commissions or bonuses from departing employees. In *Lindell v. Synthes, USA*, for instance, the court ruled that "an employer may make an advance on commissions to employees 'and later reconcile' any overpayments by deductions from future commissions.'"[57] California courts have also held that "the obligation to pay a commission may be contingent on events that occur after the sale . . ., and amounts advanced to the salesperson may be deducted at a later date if the contingents are not satisfied," so long as those conditions are "clearly expressed" to the employee and "relate to the sale."[58] Judicial treatment of employer claims for recoupment of bonus payments similarly turns on the contractual terms and conditions governing when the bonus is earned.[59]

In some instances, especially for senior executives, simply recouping training or relocation costs, or even bonuses, is insufficient if the employee possesses unique information as a result of training or position. In these situations, if the employee engages in certain prohibitive conduct, employers might consider adding a provision for liquidated damages in one of the employment agreements listed above that could provide an alternative remedy to injunctive relief.[60] The provision might also serve as a prophylactic measure to prevent the breach in the first place.

Liquidated damages are "damages flowing from a breach" of an agreement to refrain from certain conduct that are too "difficult to ascertain."[61] Parties can agree, by contract, to the amount of damages ahead of time. These damages nonetheless must be

Liquidated damages have long accompanied non-competes as an alternative remedy to injunctive relief. In the absence of non-competes, however, liquidated damages might claim newfound prominence in protecting employers' interests.

[54] NPRM at 99–100.

[55] *See, e.g.*, Brandon S. Long, *Protecting Employer Investment in Training: Noncompetes vs Repayment Agreements*, 54 Duke L. J. 1295, 1297 (2005) (identifying repayment agreements as a more sensible alternative to non-competes); Katherine V.W. Stone, *Knowledge at Work: Disputes Over the Ownership of Human Capital in the Changing Workplace*, 34 Conn. L. Rev. 721, 755 (2002) (describing training repayment agreements as an alternative to covenants not to compete).

[56] *See, e.g.*, *Heder v. City of Two Rivers, Wisconsin*, 295 F.3d 777 (7th Cir. 2002) (likening repayment agreements to other valid employment incentives); *City of Oakland v. Hassey*, 163 Cal. App. 4th 1477 (Cal. Ct. App. 2008) (concluding that former worker failed to establish that the reimbursement agreement was unlawful).

[57] 155 F. Supp. 3d 1068, 1085, 1088 (E.D. Cal. 2016).

[58] *Davis v. Farmers Ins. Exch.*, 245 Cal. App. 4th 1302, 1332–33 (Cal. Ct. App. 2016).

[59] *See, e.g.*, *DHR Int'l Inc. v. Charlson*, 2014 WL 4808752 (N.D. Cal. Sept. 26, 2014) (declining to claw back bonus because the bonuses were paid as compensation for the work the employee had already finished).

[60] California law, unsurprisingly, is unkind to liquidated damages in employment contracts. *See Golden v. Cal. Emer. Phys. Med.B Grp.*, 782 F.3d 1083, 1090–91 (9th Cir. 2015).

[61] *BDO Seidman v. Hirschberg*, 93 N.Y.2d 382, 396 (N.Y. 1999).

"compensatory" rather than "punitive."[62] They also must be "reasonable in light of the anticipated or actual loss caused by the breach and the difficulties of proof of loss."[63] Otherwise, "grossly disproportionate" damages "will not be enforced."[64]

Liquidated damages have long accompanied non-competes as an alternative remedy to injunctive relief. In the absence of non-competes, however, liquidated damages might claim newfound prominence in protecting employers' interests. In *Mathew v. Slocum-Dickson Medical Group, PLLC*, the defendant did not want to enforce its non-competes with the plaintiffs, who were specialists in the field of cardiology, but rather sought liquidated damages from the harm the plaintiffs caused when they departed.[65] Affirming the enforceability of the liquidated damages clause, the court reasoned that the defendant had suffered "damages caused by the loss of intra-organizational referrals, the loss of good will caused by the departure of critical members of its professional staff, the investment made by defendant in the development of plaintiffs' practices[,] the cost associated with recruitment of replacement physicians[,] and the development of those new practices."[66] And although the court asserted those reasons in the context of a non-compete, they could apply equally to any other agreement between an employer and employee as outlined above.[67]

Another example, which drew media attention, concerns news anchors from Sinclair Broadcast Group. Given their unique situation as the face of the company, and all the intangibles arising from television stardom, the employees' contracts obligated those who voluntarily quit outside of a limited time window to "immediately pay to [Sinclair] as liquidated damages (and not as a penalty) an amount equal to forty percent (40%) of [their] then annual compensation" plus a percentage of the years remaining in the contract, along with bonuses, *etc*.[68] The clause further recited that the payment is "[i]n consideration of [Sinclair's] expenditure of considerable money, time and effort in training, promoting and assimilating" the television personalities into the employer's

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[62] Restatement (Second) of Contracts § 356, cmt. a (1981); *see also* 24 Williston on Contracts § 65:1 (4th ed) (2022) (discussing validity of provisions for liquidated damages).

[63] Restatement (Second) of Contracts § 356 (1) (1981).

[64] *Compare BDO Seidman*, 93 N.Y.2d at 396 *with Baugh v. Columbia Heart Clinic, P.A.*, 738 S.E.2d 480, 492–93 (Ct. App. 2013) (finding stipulated damages provision "not a penalty" because it "reasonably attempted to provide a conservative estimate of damages sustained by Columbia Heart when a shareholder-physician departed and competed").

[65] 160 A.D.3d 1500, 75 N.Y.S.3d 738 (N.Y. App. Div. 4th Dep't 2018).

[66] *Id*. at 1503; *see also Kent State Univ. v. Ford*, 26 N.E.3d 868, 876–77 (Oh. Ct. App. 2015) (enforcing a liquidated damages clause in a coach's contract).

[67] *See, e.g.*, *Blase Indus. Corp. v. Anorad Corp.*, 442 F.3d 235, 238 (5th Cir. 2006) (discussing liquidated damages provisions in no-hire agreements).

[68] Stuart Lichten & Eric M. Fink, *"Just When I Though I Was Out . . . .": Post-Employment Repayment Obligations*, 25 Wash. & Lee J. Civil Rts. & Soc. Just. 51, 55 (2018).

"business and operations."[69] This provision and others, which the employer had inserted to protect its investments, made it costly for the employees to leave before the end of their contractual period, thus making retention more likely.

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The Commission seeks to displace centuries-old reasonableness standards that govern almost all non-competes. Firms use trade secrets laws and contractual instruments to avoid losing their most valuable personnel, who necessarily know their most valuable information, to competitors who might use that information. Although the proposed rule might never become a lawful final rule given the legal challenges ahead, there is no question that legislatures and regulators around the country are increasingly cynical of non-competes, and indeed some states are actively chasing California to ban them. Whatever the future holds, there are other mechanisms employers might take now to protect their trade secrets and information.

[69] *Id.*