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# GAMING & HOSPITALITY LEGAL NEWS



## THE MORE THINGS CHANGE, THE MORE THEY ... CHANGE: RECENT DEVELOPMENTS IN TRADE SECRETS PROTECTION AND NON-COMPETITION LAW

*by David J. Houston and Angelina Irvine, with contributions by Sara H. Jodka, Kenneth K. Ching, and David G. Bray*

### *Executive Summary and Takeaway:*

***Trade secrets*** *and confidential information are receiving increasing protection in many states, and as more states perceive this as a "business friendly" issue, this trend will continue and expand.*

***Non-competition*** *provisions, while generally enforceable, are being scrutinized more closely by state legislatures and courts. The best way to ensure that your enterprise is in as strong a position as possible is to review relevant policies and contracts to this specific end.*

***Specifics of these changes are outlined for all states in which Dickinson Wright has offices. If you have questions, please contact your Dickinson Wright lawyer or the authors.***

### Introduction – Why Do You Care?

"There are only two categories of companies affected by trade-secret theft: those that know they've been compromised and those that don't know yet ...."

—Eric Holder, former U.S. Attorney General

"Uber and Waymo Settle Trade Secrets Suit [for $245M]" – *New York Times*, Feb. 9, 2018

Trade secret and non-competition laws are closely related, and those tools may work synergistically for the enterprise seeking maximum protection from unfair trade or business practices. Establishing a protectable interest in a "trade secret" typically requires a high proof threshold involving the business significance of the information or material and its consistent treatment by the owner as a business secret.

A non-competition provision, also known in lawyer parlance as a "restrictive covenant," may in many states be enforceable on lesser, but still rigorous, proofs. Additionally, however, a good and appropriate non-compete restriction may have more broad prophylactic impact, preventing a departing executive or key employee, or employee with critical business knowledge

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including sales or technical knowledge, from competing *even where the knowledge does not qualify as an otherwise protectable "trade secret."* A solid understanding of these principles and related issues will assist your enterprise in your competitive environment.

### Enter, the Federal "Defend Trade Secrets Act"

Courts of each of our nation's fifty states, and federal courts, exist in obviously similar but different realms. "Subject matter jurisdiction" is a lawyer's term for describing what types of disputes can be considered by what courts. Under our federal Constitution, federal courts have "limited jurisdiction" and can only handle limited types of cases, one such type involving the interpretation and application of specific federal laws or regulations.

Outside of matters involving the protection of intellectual property such as trademarked, copyrighted, or patented materials and ideas, little federal protection against unfair competition existed until passage in 2016 of the Defend Trade Secrets Act ("DTSA"). Accordingly, trade secret and non-competition litigation historically has occurred at the state level where that law therefore developed.

Initially at least, it looks like passage of DTSA will not change that situation. So far, DTSA seems to be having little impact on these areas of the law. Experience with that Act shows generally that:

- Federal courts are appropriately *looking to state law* to define the proof elements that must be met by a plaintiff seeking injunctive relief to protect trade secrets.
- Due to the absence of applicable federal jurisprudence (caselaw), federal courts are *looking* to state caselaw to determine what may or may not constitute "trade secret" information. And,
- Federal courts have shown great reluctance to issue "*ex parte*" orders allowing the plaintiff to seize pirated trade secret property or information if "necessary to prevent the … dissemination of the trade secret," as is allowed specifically by DTSA.

Accordingly, it appears that trade secret protections and non-competition law will continue to develop primarily at the state-law level. Our Founding Fathers wisely intended on inventing, as they did, a republic of limited federal authority. Thus, those fifty states will continue to serve as the "laboratories" of innovation identified by Supreme Court Justice Louis Brandeis in *New State Ice Co. v. Liebmann*, each seeking its own path to reasonably protect the rights of trade secret property owners and employers whose businesses include possession and use of confidential business information in our dynamic free enterprise economy and society.

### So, what are the states doing?

In the area of *non-compete restrictions* on workers, we are starting to see some pushback by courts declining to enforce restrictions, or legislatures affirmatively granting protection for workers to "level the playing field" somewhat. It seems that in some states the pendulum is perceived to have swung too far, or to have been pushed to excess advantage, by employers seeking unfair competitive business advantage as opposed to legitimate protection for their business assets. *We believe that this trend will continue. The forward-looking enterprise will adapt to relevant changes to continue to benefit from protections afforded by enforceable non-compete and related restrictions.*

Contrariwise, the trend is to expand legal protection of trade secret information, either by greater enforcement of existing property-owner rights, or the occasional loosening of evidentiary or procedural hurdles to obtaining recognition of those rights or to the award of remedies. Again, these changes are occurring through both judicial rulings and legislative action. By comparison to non-compete rules, much of state trade secret law is based upon the so-called "Uniform Trade Secrets Act." The UTSA is not actually a statute, but rather, is a model statute developed by judges and scholars for individual states to adopt, with or without modification, based on each state's existing common law and policy concerns. All states but New York and Massachusetts have adopted some form of the UTSA. *The forward-looking enterprise will review its policies and procedures in light of increasing protections to leverage full advantage promptly.*

### Nevada

A contentious issue in the enforcement of restrictive covenants is whether the court in the particular state will "blue pencil" an overly restrictive covenant such as where the scope of the prohibited work activities is too inclusive or the geographical restriction is too large. This is more than a mere technical issue, for in a state where the "blue pencil" rule exists, employers do not risk wholesale invalidation of overly broad written covenants. On the other hand, in states where the rule does not exist, employers must be far more careful in drafting and implementing non-compete restrictions, failing which they may find themselves with no enforceable restrictions at all.

The July of 2016 ruling of the Nevada Supreme Court rejecting the "blue pencil" rule was a major shake-up in light of prior apparent support for that rule. *See, Golden Road Motor Inn, Inc. v. Islam and Grand Sierra Resort.*

In reaction, in June of 2017, Nevada enacted a new statute effecting significant changes to previously existing judicial principles. Interestingly, and contrary to the trend we perceive of limiting the scope of non-competes in many states, the statute makes enforcement of non-competes easier in some regards, while tightening up other aspects of those elements.

The resulting law imposes a reasonably standard rubric that a non-competition provision must meet, including proof of adequate "consideration" in exchange for the employee's agreement to the restriction, a requirement that no non-compete may impose a greater restriction than is required to protect the employer's recognized business interest, nor may one impose undue hardship upon the affected worker. The first "consideration" requirement is contrary to many states, such as Michigan and Ohio, where mere "continued employment" is considered to be adequate consideration flowing from the employer to the employee.

Interestingly, the Nevada statute carves out specific exceptions protecting workers. Under those provisions, where the departed employee has voluntarily left the employer, has not solicited customers for whom services are to be provided, and meets other criteria, an otherwise valid restriction may be unenforceable. Also, in order to be enforceable, the employer must provide "valuable consideration" in exchange for the worker's non-compete commitment. While seemingly an obvious question for legislative definition, the statutory meaning of "valuable consideration" was unaddressed.

This statute is quite involved and while addressing many relevant issues, leaves many unanswered.

### Tennessee

While Tennessee courts do not identify non-competition restrictions as "disfavored," Tennessee jurisprudence is generally hostile. These restrictions are often characterized as undesirable agreements in "restraint of trade," as opposed to legitimate protections of employer investment in key workers or executives. Practitioners' experience at the trial court level thus often is that unless presented with evidence of significant employee misconduct or relevant disloyalty, many or most state court judges are reluctant to enforce these types of restrictions. While in many states a winning employer justification would be that non-enforcement would present a clear business risk, in Tennessee, "something more" is often expected before an otherwise valid contractual restriction will be enforced.

Tennessee courts follow a general "equitable remedy" proof rubric that seeks to weigh and balance all competing factors, including:

- The extent of the restriction and impact on the person to be restricted;
- The "reasonableness" of the restriction in light of salient facts and circumstances;
- The risk to the employer if the covenant is not enforced;
- The significance or insignificance of the knowledge or experience of the employee to the company or to a competitor;
- The scope of the geographical restriction;
- The duration of the restriction; and,
- The harm or value to the public from enforcement or non-enforcement.

Tennessee courts seem not enthusiastic about "reforming" overbroad or overly restrictive covenants when presented with those under the so-called "blue pencil" rule discussed above. However, in cases where a restriction is seen as being only modestly offensive, the Courts appear more open to doing so.

Tennessee, as many other states, has adopted the "Uniform Trade Secrets Act," which sets forth legal standards for:

- The establishment of the existence of information or material constituting trade secrets;
- The existence or use of "improper means" in connection with improper use or transmittal of trade secrets;
- The standards for "injunctive relief;" and,
- Remedies including the recovery of attorney fees.

Tennessee has not experienced recent material changes to its laws.

### Michigan

Michigan law generally recognizes the enforceability of reasonable unfair competition protections.

Indicative of efforts to limit the impact of non-competes, in 2016 and 2017, legislation was proposed including variously some of the following: (1) a prohibition on employers preventing them from requiring non-compete covenants for low-wage workers, (2) imposition of a requirement on employers to inform workers in advance of the terms of any restriction to which they may be subjected, (3) prohibition of so-called "choice of laws" provisions that ordinarily allow employers to enforce or defend a non-compete action in their home state or locality, and (4) creation of a statutory right allowing an employee to recover attorney fees and lost income from employer actions to enforce an improper restriction on competition. These proposals follow the emerging trend in other states, noted above, where such restrictions have been adopted, such as New Hampshire and Oregon.

### Kentucky

Kentucky law took a hard and unexpected turn in June of 2014 when the state Supreme Court held that continuing the employment of a worker is not sufficient "consideration" to support a workers' agreement to a restrictive covenant. *See, Charles T. Creech, Inc. v. Brown*. Accordingly, and by comparison to Michigan and many other states, in Kentucky agreements, whether executed before or during the worker's tenure with the employer seeking to enforce the restriction, such covenants are now unenforceable unless adequate "consideration" has been provided by the employer. The Court in this case suggests that changes in employment conditions, possibly such as an increase in compensation, could justify the enforcement of the restriction. While the full meaning and scope of impact of the *Charles T. Creech* decision is yet not known, the somewhat extreme facts of that case, suggesting employer overreach and a possibly innocent worker, may have colored the Court's opinion of the merits of the issue of enforcement of the restrictive covenant.

Separately from the above, non-compete law in Kentucky otherwise generally follows the "fact based" analyses of other states such as Tennessee.

### Ohio

Ohio adopted its version of the Uniform Trade Secrets Act in 1994. An interesting decision of the Ohio Supreme Court allows an employer to recover damages against departed sales persons who had *memorized* confidential trade secret information (customer names).

Ohio considers "continued employment" as sufficient consideration to create an enforceable non-competition restriction. Ohio courts also allow non-competes to be made a mandatory condition of employment or continued employment. So in practice, if an employee, whether newly hired or with seniority, refuses to sign a non-compete agreement, the employer may terminate the employee's employment for that reason alone, so long as no other employment agreement or statutory protection (such as anti-discrimination law) makes that termination unlawful.

Ohio follows the general rule of "reasonableness" in terms of appropriateness and extent of subject matter of restriction, duration of restriction, and geographical scope. Ohio courts generally will not enforce any non-compete that is longer than two years absent the restriction being related to a corporate merger or sale. Finally, an Ohio non-compete agreement must strike a fair balance between protection of the employer's legitimate business interests from an unfair competitive advantage and the employee's right to work. Ohio courts finding restrictive covenants unreasonable have either invalidated them or, to the extent possible, used the "blue pencil" rule to narrow otherwise overbroad restrictions.

### Arizona

Arizona law follows common restrictive covenant principles, including the "legitimate business interest" requirement (recognized as customer goodwill and confidential/trade secret information) and the limitation that any restriction must be reasonably necessary to protect that interest and not contrary to public policy. Arizona applies a modified version of the "blue pencil" rule. Arizona Supreme Court precedent establishes that where the severability of an overbroad or unreasonable term is apparent, any unreasonable but "grammatically severable" portions of a restrictive covenant may be stricken and the remaining terms of the agreement enforced. On the other hand, the Court cautions that outside of this narrow rule, a trial court may not "rewrite the agreement for the parties." So, for example, if an employment agreement contains a true non-compete covenant and a separate customer anti-piracy covenant and the court finds the former restriction is overbroad but the latter separate restriction reasonable, it may strike the overbroad covenant while enforcing the "grammatically severable" and reasonable covenant. By comparison, if a court were to find that evidence presented to it establishes that a six-month non-compete term is necessary to protect the employer's legitimate interests, but the term of the otherwise reasonable restrictive covenant specifies a period of one year, that provision may not be rewritten to conform the period of restriction to the shorter six-month period. Instead, the entire covenant will be found to be unenforceable as unreasonable in duration.

**Florida**

Florida has taken an interesting statutory approach to non-competition agreements, making enforcement of an otherwise valid restriction significantly easier, at least procedurally but likely, in a given case, on the merits as well.

Florida statutes require that "[t]he person seeking enforcement of a restrictive covenant shall plead and prove the existence of one or more legitimate business interests justifying the restrictive covenant." Fla. Stat. § 542.335(1)(b). If that showing is made, the burden of proof "shifts" to the party seeking to avoid enforcement of the non-compete (typically the employee) to show that the restriction is unreasonable, not necessary under the circumstances, overbroad, or that some other cognizable and sufficient reason for non-enforcement exists. Fla. Stat. § 542.335(c).

Under the proof "elements" of enforcement claims in many or probably most states, the most difficult hurdle is for the *employer* to prove adequately that "irreparable harm" is likely to be caused by a breach of an otherwise enforceable restrictive covenant. Florida law, however, instructs the court to "presume" that a violation results in irreparable harm and requires the *employee* to prove the *absence* of a likelihood of irreparable harm resulting. Fla. Stat. § 542.335(1)(j). One Florida court has ruled that "a party seeking to enforce a restrictive covenant by injunction *need not directly prove* that the defendant's specific activities will cause irreparable injury if not enjoined."

Continuing its policy of creating a strong business environment, in February of 2016, Florida passed amendments to the existing trade secret statute. The effects of those amendments are to expand the definition of a trade secret to expressly include financial information and to limit the scope of the state public records act to increase protection from disclosure of trade secrets.

**Texas**

In June of 2013, Texas enacted the Texas Uniform Trade Secrets Act ("TUTSA"). Contemporaneous commentary states that this law primarily codifies Texas' current trade secret law, while strengthening trade secret protections and providing greater certainty to misappropriation claims. Significant changes the TUTSA makes to Texas common law include the following:

- Apparent elimination of the "continuous use" requirement for information deemed a "trade secret";
- Recognition of the appropriateness of injunctive relief for threatened trade secret misappropriation; and
- Granting courts discretionary authority to award attorneys' fees to the "prevailing party" in certain cases.

Effective as of September of 2017, Texas passed amendments to the TUTSA, which while somewhat technical are nevertheless, of course, important.

The amendments expanded the prior definition of a protected "trade secret" to follow the similar definition in the federal Defend Trade Secrets Act, discussed at the beginning of this article, to cover confidential and proprietary "business, scientific, technical, economic, or engineering information." Going further than federal law, and importantly, the Texas statute also protects as a trade secret a "list of actual or potential customers or suppliers."

The amendments also adopted and included into statutory law an important procedural decision of the Texas Supreme Court setting out a seven-factor balancing test concerning when and under what circumstances a litigation party may be excluded from receiving arguably confidential information developed during the litigation of a case brought under the TUTSA.

These initiatives by the state indicate its commitment to extend broad protection to secret or proprietary information, means, and customer identities used by forward-looking individuals and enterprises located or doing business within the state.

Texas jurisprudence, founded in historical and statutory animus against restrictive covenants, is similarly developing a more business-friendly approach to the enforcement of those tools.

The "Texas Free Enterprise and Antitrust Act of 1983," consonant with its openly declarative title, states without qualification that "every contract, combination, or conspiracy in restraint of trade or commerce is unlawful." Contemporaneous jurisprudence was similarly hostile. *See, Hill v. Mobile Auto Trim, Inc., Bergman v. Norris of Houston, DeSantis v. Wackenhut Corp.,* and *Martin v. Credit Protection.*

However, in 1989, the legislature passed the "Covenants Not to Compete Act," generally permitting as an exception to the blanket prohibition against contracts in restraint of trade, qualifying agreements that contain "limitations as to time, geographical area, and scope of activity to be restrained that are reasonable and do not impose a greater restraint than is necessary to protect the goodwill or other business interest of the [employer]." It is the expressly declared policy of the State that the purpose of these statutory provisions is to "maintain and promote competition in trade and commerce," 99 Tex. Bus. & Com. Code § 15.04.

### Utah

Participating in the trend toward greater legislative scrutiny of restrictive covenants, Utah passed its "Post-Employment Restrictions Act" in March of 2016.

The Act applies to all non-compete agreements executed on or after May 10, 2016. Restrictions longer than one year from the date of the worker's departure are void, with two exceptions: (1) those that are legitimately part of a severance agreement and (2) agreements that arise in the course of a business sale transaction. The latter is a common area of judicial or legislative deference to the actions of selling business owners, due to the inherent risk to a buyer of a business from its seller who otherwise would be free to "open shop" immediately "across the street" from the sold business or otherwise engage in direct competition undermining the value of the purchased enterprise.

Further protecting employees, the Utah Act provides that "if it is determined that the post-employment restrictive covenant is unenforceable" the employer may be liable for the employee's "attorney fees and court (or arbitration) costs," and "actual damages."

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## U.S. TAX REFORM 2018 – WHAT IT MEANS FOR THE GAMING AND HOSPITALITY INDUSTRY

*by Peter J. Kulick*

Against all odds, Congress, on a straight party-line vote, enacted the most significant tax reform the U.S. has witnessed in more than 30 years. The tax reform legislation, known as the "Tax Cuts and Jobs Act," significantly alters the tax law landscape for businesses. This article offers a high-level overview of some of the tax law changes that may specifically impact the gaming and hospitality industry.

### Corporate Tax Rates Slashed to 21%

A hallmark of the Tax Cuts and Jobs Act is adoption of a flat 21% corporate income tax rate. Under prior law, the U.S. had one of the highest corporate tax rates of the industrialized world, topping out at 35%. The new 21% corporate tax rate is effective for tax years beginning after December 31, 2017.

### Immediate Expensing of Capital Investments

The Tax Cuts and Jobs Act expands bonus depreciation to permit 100% expensing of the costs of qualified property. "Qualified property" is generally defined to consist of tangible personal property with a recovery period of 20 years or less. Personal property, such as machinery and equipment, may be eligible for 100% expensing. The provision, however, is only temporary. The 100% expensing is available until 2022 and is then followed by a 5-year phase-out period.

### Repeal of the Corporate AMT

The much-maligned corporate federal alternative minimum tax was repealed, effective for tax years beginning after December 31, 2017.

### Base-Broadening Provisions

As is typical with reductions in tax rates, the "tax base" is broadened. The tax base is simply the items of income that are subject to taxation. Although the Tax Cuts and Jobs Act significantly simplified and reduced corporate income tax rates, the Act also included several other important changes that limit many deductions available under prior law. The base-broadening measures include the following:

- The ability to deduct business interest is severely restricted. Under the Tax Cuts and Jobs Act, a business may now deduct only its business interest in an amount not exceeding 30% of its adjusted taxable income. Real property businesses and businesses with gross receipts of $25 million or less are excepted from the limitation on the deduction of interest.

- Net operating loss ("NOL") deductions are also limited by the Tax Cuts and Jobs Act. Under the Act, NOLs may be deducted only in an amount equal to 80% of taxable income. Businesses may no longer "carryback" an NOL to offset the tax liability of an earlier year. Businesses can continue to "carryforward" unused NOLs to offset tax liability arising in future years. Unused NOLs can now be carried forward for an unlimited number of years.

- The Tax Cuts and Jobs Act eliminates the deduction for entertainment, amusement, and recreation expenses. The Tax Cuts and Jobs Act preserved the deduction for food and beverage expenses related to business activity. As was the case with prior law, the deduction for food and beverage expenses is capped at 50% of the expenses incurred.

- Under prior law, gains from the sale or other disposition of self-created patents, inventions, and similar property were characterized as capital gains. This favorable treatment under prior law allowed inventors to significantly reduce tax liability upon the sale of a patent or other intellectual property rights. The Tax Cuts and Jobs Act eliminates this favorable tax treatment by characterizing the gain upon the disposition of self-created intellectual property rights as ordinary income.

- The Tax Cuts and Jobs Act limits the ability of taxpayers to deduct local lobbying expenses. Under the Act, lobbying costs incurred to lobby a local governmental unit or an Indian Tribe are no longer deductible.

- Penalties, fines, and expenses paid to investigate a violation or potential violation of law are no longer deductible under the Tax Cuts and Jobs Act. The denial of the deduction is implicated when a government, or similar entity, is a complainant or investigator with respect to the violation or potential violation of a law.

### International Tax

Another hallmark of the prior U.S. tax law was taxation of the worldwide income of U.S. taxpayers. The Tax Cuts and Jobs Act adopted several changes to the U.S. international tax regime. The Act largely attempts to shift away from the worldwide taxation philosophy to a more territorial tax system. Significant changes include adopting a 100% dividend-received deduction for dividends received from certain foreign corporations owned by a U.S. corporation shareholder. Under the new law, post-1986 accumulated foreign earnings will be subject to immediate taxation – cash and cash equivalents will be taxed at a 15.5% rate, while illiquid assets will be taxed at an 8% rate.

### Conclusion

The Tax Cuts and Jobs Act significantly modifies the U.S. tax law. For the gaming and hospitality industry, the reduced corporate rates and availability of a 100% bonus for qualified property may prove to be highly beneficial. On the other hand, limitations on the deduction of local lobbying expenses and costs associated with government investigations may increase taxable income.

Additionally, the tax law changes may be an opportunity for gaming and hospitality businesses to revisit organizational and intercompany structures to assess whether more tax-efficient approaches can be implemented.