FEATURE
LITIGATION

FTC RULING: PRACTICAL INSIGHTS ON LITIGATING NON-COMPETES

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The purpose of this article is to discuss: (1) historical case law and treatment of covenants governing competition; (2) summarize and provide an analysis of the Federal Trade Commission's April 23, 2024 ruling on covenants governing competition (the "Rule"); and (3) the best practice for employers and practitioners to enforce covenants governing competition in a post-FTC ruling landscape.

While covenants governing competition have become an issue in today's political landscape, Ohio generally favored reasonable restrictive covenants before the FTC's seminal ruling earlier this year. *Rogers v. Runfola & Assocs.*, 57 Ohio St.3d 5, 8, 565 N.E.2d 540 (1991). For nearly 50 years, "[i]n determining the validity of a covenant or agreement in restraint of trade ... a covenant restraining an employee from competing with his former employer upon termination of employment is reasonable if it is [1.] no greater than is required for the protection of the employer, [2.] does not impose undue hardship on the employee, and [3.] is not injurious to the public." *Raimonde v. Van Vlerah*, 42 Ohio St.2d 21, 325 N.E.2d 544, 547 (1975).

Despite often being lumped together, it is important to remember that there are critical differences between a "non-compete" and a "non-solicitation" provision. A non-compete provision restricts an employee from working for a competitor or starting a competing business within a specified geographic area and for a certain period after leaving the employer. Meanwhile, a non-solicitation provision prevents an employee from soliciting or recruiting the former employer's clients, customers, or employees for a specified period after leaving the company. As a general proposition, courts scrutinize non-competes more closely than non-solicitation provisions.

To determine whether a particular non-compete restriction is reasonable, courts examine several factors, including "the absence or presence of limitations as to time and space" and "whether the employee is possessed with confidential information or trade secrets." *Id*. at 25; *see also Rogers v. Runfola & Associates, Inc.*, 57 Ohio St. 3d 5, 8, 565 N.E.2d 540 (1991) (same). The balancing act allows employers to craft non-compete provisions that are narrowly tailored to protect their specific business interests while remaining fair to employees.

Employers may legitimately use post-employment covenants as a means of "limiting not only a former employee's ability to take advantage of personal relationships the employee has developed while representing the employer to the employer's established client, but also in preventing a former employee from using his former employer's customer lists or contacts to solicit new customers." *UZ Engineered Prods. Co. v. Midwest Motor Supply Co.*, 147 Ohio App. 3d 382, 396, 770 N.E. 2d 1068 (10th Dist. 2001).

However, when faced with a non-competition provision that has excessive restrictions in terms of geography or duration, a judge or arbitrator will *not* simply throw out the entire covenant. Rather, Ohio law permits a court, tribunal, or panel to "modify or amend" restrictive covenants to make their restrictions reasonable rather than refuse to enforce them altogether. *See Kaeser v. Adamson*, 5th Dist. Ashland No. 773, 1982 Ohio App. LEXIS 15183, at *9 (Dec. 14, 1982), citing *Raimonde*; also see *Bobcat Enters., Inc. v. Duwell*, 67 Ohio App. 3d 571, 587 N.E.2d 905 (1990) ("the Ohio Supreme Court empowered lower courts to modify or amend employment agreements"). This is commonly called "blue-penciling," an employment agreement — a practice where a court modifies or strikes out unenforceable or overly broad parts of a non-compete agreement while allowing the remaining enforceable portions to stand. This allows the court to tailor the agreement so that it is reasonable and enforceable under the law.

On April 23, 2024, the Federal Trade Commission passed its long-awaited final rule on non-competes. The Rule was to go into effect on September 4, 2024. The Rule would apply nationally and control over state laws if the Rule is upheld in litigation.

The Rule defines non-competes broadly encompassing any contractual term or condition of employment that prevents a worker from (1) seeking or accepting work in the United States with a different person and/or company after the end of the worker's engagement with an employer or (2) operating a business in the United States after the end of the worker's engagement with an employer.

A worker is considered any natural person who works or previously worked, whether paid or unpaid, without regard to the worker's status under any State or Federal Laws. Workers include both employees and independent contractors.

In essence, irrespective of the title of the restriction, term, or condition (i.e. non-compete, non-solicit, confidentiality or otherwise), if it prevents a worker from seeking or accepting employment elsewhere or operating a business, the restriction is subject to the Rule.

There are important exceptions to the Rule. For example, an exception for "senior executives" exists in connection with the sale of a business. This exception would allow the enforcement of non-compete clauses entered into with qualifying employees before the effective date of the Rule. An additional exception is for pre-existing causes of action which would be important to assess in terms of potential litigation.

As one may expect, the Rule has been challenged in multiple courts around the country and perhaps the most notable challenge resulted in Judge Ada Brown's broad ruling prohibiting the FTC from enforcing its non-compete rule anywhere in the country.

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See the U.S. District Court for the Northern District of Texas in *Ryan LLC v. Federal Trade Commission*, 3:24-cv-986. That same court had previously put in place a preliminary injunction in July 2024 but only as to the named plaintiffs involved in that litigation. The current ruling is now more broad and may lead to a possible appeal by the FTC.

Until a decision is made as to whether or not the Rule will be upheld, there is nothing for employers to do.

However, if the Rule, as it exists, is upheld and goes into effect, the question becomes — what should an employer do? The answer starts with employers would need to stop entering into and enforcing non-competes, subject to certain exceptions. For starters, an employer identifying lists of workers that would need to be notified.

In addition, from a litigator's standpoint, one should consider causes of action that survive whether or not the Rule is upheld, including the following:

Breach of Non-Disclosure and Non-Solicitation Agreements

Generally speaking, non-disclosure and non-solicitation agreements are not prohibited under the Rule. The FTC acknowledged that these types of agreements do not, by their terms, prohibit a worker from seeking or accepting other work or starting a business after they leave their job. Therefore, employers should plan to continue to enforce their rights under non-disclosure and non-solicitation agreements.

However, it is important to note that non-disclosure or non-solicitation agreements could be prohibited under the Rule if they are so restrictive that they function as non-competes by preventing a worker from seeking or accepting employment or operating a business.

Misappropriation of Trade Secrets

Furthermore, state and federal trade secret laws remain in place, and employers retain the same rights to protect trade secrets when an employee leaves for a competitor. Ohio has enacted the Uniform Trade Secrets Act (OUTSA), while the Defend Trade Secrets Act, 18 U.S.C. § 1836 *et seq.* (DTSA) exists at the federal level.

While some differences exist, the substantive requirements to establish a misappropriation claim under both the DTSA and OUTSA are largely similar. Both require the plaintiff to demonstrate the existence of a trade secret, the acquisition of the trade secret through improper means or a confidential relationship, and the unauthorized use of the trade secret. *Int'l Petro. Prods. & Additives Co. v. PXL Chems. BV*, 2022 U.S. Dist. LEXIS 176951. Both statutes define a trade secret similarly, requiring that the information derives independent economic value from not being generally known and is subject to reasonable efforts to maintain its secrecy. *See James B. Oswald Co. v. Neate,* 98 F.4th 666

Regardless of whether the Rule ultimately goes into effect or not, the OUTSA and the DTSA are two mechanisms by which an employer can ensure that a former employee does not take confidential information to a competitor to gain an unfair advantage.

Tortious Interference with Business Relationships

In addition, an employer may pursue claims for tortious interference with a business relationship against a former employee. A tortious interference claim may exist when an employee, without privilege to do so, induces or otherwise purposely causes a third person not to enter into or continue a business relationship with his current or former employer. *Fred Siegel Co., L.P.A v. Arter & Hadden*, 85 Ohio St. 3d 171, 707 N.E.2d 853, paragraph one of the syllabus (1999). This scenario often occurs when an employee, in anticipation of leaving an employer, persuades clients, vendors, or even other employees to end their relationship with the employer and join the departing employee with their new employer.

Breach of Duty of Loyalty

In a similar vein, employees owe a duty of good faith and loyalty to their employers regardless of whether any written employment agreements exist. Breaches of this duty can include competing with the employer, misusing company property, or conspiring to leave the employer without notice. *Staffilino Chevrolet, Inc. v. Balk*, 158 Ohio App. 3d 1; *U.S. Xpress, Inc. v. Hub Grp., Inc.*, 2020 Ohio Misc. LEXIS 4207, *United States Xpress v. Hub Group*, 2020 Ohio Misc. LEXIS 5162.

While it remains an open question whether the Rule will go into effect, what is clear is that there are several viable causes of action, outside of the enforcement of a non-competition agreement, that can and should be utilized when an employer is harmed by a departing employee.

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