

HOW THE FTC MAY RESHAPE M&A TRANSACTIONS BY BANNING NON-COMPETE AGREEMENTS

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ABSTRACT

Buyers to merger and acquisition transactions frequently utilize non-compete agreements that bind important employees who possess knowledge or skills integral to the business. The use of non-competes in this manner has prompted the Federal Trade Commission (FTC) to propose a controversial rule banning the use of most non-compete clauses. A final rule was later passed, and as written, includes several key employees to a seller's business. While the FTC rule's enforceability is in question, the prohibition on non-compete clauses will impact mergers and acquisitions in a transformative way. The FTC rule may have a significant detriment to capital mobility of buyers, not just in the clear employment context. The author notes the potential disadvantages, including losing business growth benefits, to the merger and acquisitions industry with adherence to the rule. In contracts, the author proposes that the FTC consider expanding the exceptions to the rule to include senior executives. A more effective solution combines state laws incorporating salary thresholds, reasonableness standards, and scope limitations. The FTC can still achieve a balance of protecting employees and the business interests of buyers.

INTRODUCTION

When transacting to purchase, merge, or add-on to a business entity, buyers must protect various interests to maintain and increase the value of

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the newly acquired entity. One contracting mechanism frequently used in mergers and acquisitions (M&A) are non-compete agreements (non-competes). Non-competes restrict the seller and its affiliates from engaging in a business that competes with the buyer and the newly acquired entity for a designated period and within a specific geographic area.¹ Buyers may seek non-compete provisions that bind key personnel through new employment agreements with employees that are negotiated for during a sale-of-business transaction.² It is particularly important to include non-compete agreements where the sellers or key employees possess knowledge or skills that were integral to the development of the business,³ and where an individual is continuing as an employee of the target company.⁴ However, the use of these contracts in the employment context has faced growing resistance, prompting the Federal Trade Commission (FTC) to pass a broadly sweeping rule banning the use of all non-compete agreements.⁵ The rule has a narrow

1. See Ryan M. Mardini, *To Compete or Not to Compete: The Importance of Non-Competition Agreements in M&A Deals*, ATT'Y AT LAW MAG. (July 29, 2022), <https://attorneyatlawmagazine.com/public-articles/business-law/mergers-acquisitions/to-compete-or-not-to-compete-the-importance-of-non-competition-agreements-in-ma-deals> [<https://perma.cc/P6ST-RY34>].

2. See Timothy R. Lavender et al., *The FTC Proposes Ban on Non-Competes: The Implications for M&A Transactions*, KELLEY DRYE & WARREN LLP (Jan. 19, 2023), <https://www.kelleydrye.com/viewpoints/client-advisories/the-ftc-proposes-ban-on-non-competes-the-implications-for-m-a-transactions> [<https://perma.cc/LWF5-HMYN>]; see also Curtis Farrow, *Value of Non-Competes: What Business Owners and Advisors Need to Know*, GBQ CONSULTING (Apr. 2015), <https://gbq.com/wp-content/uploads/2015/04/Value-of-Non-Competes-What-Business-Owners-and-Advisors-Need-to-Know.pdf> [<https://perma.cc/R94C-7M7A>] (“In an effort to retain the key personnel in a sale of a business, an acquiring firm will often include non-competition provisions within an employment agreement and/or as a separate non-competition agreement. In absence of an agreement, an employee would be free to engage in a competing business resulting in potential reduced cash flows for the acquiring company.”).

3. See Mardini, *supra* note 1 (“Including non-competition agreements in M&A transactions is especially important where the seller’s owner’s and/or key personnel’s involvement in the acquired business was integral to the business’ overall success. Without such an agreement in place, the owner or key employees could, hypothetically, form a new entity and utilize their knowledge of the industry to compete with the business that the buyer acquired, reducing the value of the overall business.”) (emphasis added); see also Lavender et al., *supra* note 2 (“Many corporate acquisitions, particularly in the small-cap and mid-market space, are as much about acquired talent as they are about acquired brands or products.”).

4. See Mardini, *supra* note 1 (“It is important to note that employer/employee non-competition agreements are often also relevant to M&A transactions to the extent the buyer desires to retain certain employees of the seller who have special talents, knowledge, and experience with business operations to help develop the business post-sale.”).

5. See Leah Nylen, *FTC Proposes a Ban on Non-Compete Contracts for Employees (1)*, BLOOMBERG L. (Jan. 5, 2023, 1:23 PM), <https://news.bloomberglaw.com/antitrust/ftc-proposes-a-ban-on-non-compete-contracts-for-employees>.

exception that allows their use in connection to “a non-compete clause that is entered into by a person pursuant to a bona fide sale of a business entity, of the person’s ownership interest in a business entity, or of all or substantially all of a business entity’s operating assets.”⁶ Furthermore, the rule applies to *all* workers.⁷ It makes no exception for the use of non-competes with senior executives,⁸ except for those who are subject to existing non-competes.⁹ A senior executive is defined as a worker who “was in a policy-making position” and earned a total annual compensation of at least \$151,164.¹⁰

Although the M&A industry would be significantly affected by the FTC rule, the debate surrounding the rule and the use of non-compete agreements has focused on the employment context rather than the sale-of-business context. Key arguments against non-competes contend that they suppress wages, hamper innovation, block entrepreneurs from starting new businesses, and inhibit workers from bringing innovative ideas to new companies.¹¹ The foundation of these arguments focus on labor mobility and non-competes as a barrier to competition—making it more difficult for employees to bargain for better-paying options.¹² Despite the negative effect non-competes may have on the market, proponents of the FTC rule overlook effects that the ban may have on *capital* mobility. Not only do *both* labor mobility and capital mobility drive the economy, but they both also contribute to competition and innovation.¹³

6. 16 C.F.R. § 910.3(a) (2024).

7. *See id.* at § 910.1 (“*Worker* means a natural person who works or who previously worked, whether paid or unpaid, without regard to the worker’s title or the worker’s status under any other State or Federal laws, including, but not limited to, whether the worker is an employee, independent contractor, extern, intern, volunteer, apprentice, or a sole proprietor who provides a service to a person.”).

8. *See id.* at § 910.1.

9. *See id.* at § 910.2(a)(2).

10. *Id.* at § 910.1.

11. *See* Press Release, Fed. Trade Comm’n, FTC Proposes Rule to Ban Noncompete Clauses, Which Hurt Workers and Harm Competition (Jan. 5, 2023), <https://www.ftc.gov/news-events/news/press-releases/2023/01/ftc-proposes-rule-ban-noncompete-clauses-which-hurt-workers-harm-competition> [<https://perma.cc/4JBD-QQ44>].

12. *See* *FACT SHEET: Executive Order on Promoting Competition in the American Economy*, WHITE HOUSE (July 9, 2021), <https://www.whitehouse.gov/briefing-room/statements-releases/2021/07/09/fact-sheet-executive-order-on-promoting-competition-in-the-american-economy/> [<https://perma.cc/85AV-EWK7>].

13. Capital mobility is defined as “[t]he extent to which capital can be shifted between different uses and, in particular, between different countries.” *See* A DICTIONARY OF ECONOMICS, OXFORD UNIV.

In the M&A context, “the ownership of the business is not always a reliable indicator of who holds sensitive information or has the capacity to compete.”¹⁴ Therefore, if buyers become unable to restrict senior executives through non-compete agreements under the proposed FTC rule, capital mobility will decrease as confidence in their ability to protect their investments diminishes.

The FTC’s proposed rule raises important questions since the exception has the potential to disrupt current industry practices built upon established state law precedent. The shift may stifle the willingness of buyers to enter transactions when they cannot protect their interests. Further, buyers will account for this increased risk of competition by decreasing what they are willing to pay for a business entity. This note analyzes the effects of the FTC’s proposed rule on mergers, acquisitions, and capital mobility. It proposes that the rule should be expanded so that non-competes can be used to bind senior executives going forward, *rather than* only allowing existing non-competes with senior executives to run until their expiration.

Part I of this note provides an overview of the history of the regulation of non-compete agreements and their general use in the employment context, as compared to the M&A context. It will also detail the development of state laws banning the use of non-competes, which preceded the FTC’s newly passed rule. Part II of this note analyzes the issues created by the FTC rule and proposes a broader exception to the rule so that senior executives and key employees may be bound by non-competes going forward. Finally, this note concludes that the FTC should redefine the exception because buyers in M&A transactions have interests at stake that are threatened by high-level employees who do not possess equity, but do possess other valuable assets, such as knowledge, skill set, and clientele.

PRESS (4th ed. 2013) <https://www.oxfordreference.com/display/10.1093/acref/9780199696321.001.0001/acref-9780199696321-e-345> [<https://perma.cc/62QB-J3H8>]. Labor mobility is defined as “the ease with which laborers are able to move around within an economy and between different economies.” See Brent Radcliffe, *The Economics of Labor Mobility*, INVESTOPEDIA (Aug. 27, 2023), <https://www.investopedia.com/articles/economics/09/labor-mobility.asp#:~:text=Labor%20mobility%20refers%20to%20the,the%20concept%20of%20occupational%20mobility.> [<https://perma.cc/43ZL-5CUV>].

14. See Laura A. Méndez Rodríguez & Rebeca Sanchez, *Analyzing the Impact of the FTC’s Non-Compete Ban on M&A and Compliance*, LINKEDIN (Feb. 24, 2023), <https://www.linkedin.com/pulse/analyzing-impact-ftcs-non-compete-ban-ma-compliance-rebeca-sanchez/?trackingId=A%2BKdxkYJQfW2AQzE%2BeUCQ%3D%3D> [<https://perma.cc/F58K-AKY8>].

I. HISTORY

A. General Background and Early Case Law

A non-compete agreement is “a promise, usually in the sale-of-business, partnership, or employment contract, not to engage in the same type of business for a stated time in the same market as the buyer, partner, or employer.”¹⁵ In the sale of a business, the purpose of a non-compete is to protect the goodwill or ownership interest acquired by the buyer.¹⁶ Conduct that is prohibited by a non-compete may include: divulging trade secrets or privileged information acquired while working under the employer or while working under or owning the target company of a buyer, entering employment with the employer’s or target company’s competitors, or affiliating with a competing business within the same market after leaving employment or closing the sale-of-business.¹⁷

The first recognition of a non-compete agreement, although not named as such, was in *Dyer’s Case*.¹⁸ The plaintiff (a master tradesman) sought to enforce a promise that the defendant (John Dier) would refrain from his trade of dying for six months in the town where he had been trained.¹⁹ The plaintiff claimed that Dier had engaged in the trade for seven days within

15. See Sneha Solanki, *Noncompete agreement – Legal glossary*, THOMSON REUTERS (July 19, 2024), <https://legal.thomsonreuters.com/blog/what-is-a-noncompete-agreement/#:~:text=According%20to%20Black's%20Law%20Dictionary,buyer%2C%20partner%2C%20or%20employer> [https://perma.cc/K2GM-8T9Z].

16. Nina L. Flax et al., *Non-Compete Covenants in M&A: Current Use, US State Rules, and an FTC Proposal*, MAYER BROWN (Jan. 24, 2023), <https://www.mayerbrown.com/en/perspectives-events/publications/2023/01/non-compete-covenants-in-ma-current-use-us-state-rules-and-an-ftc-proposal#:~:text=In%20connection%20with%20a%20sale,interest%20acquired%20by%20the%20buyer> [https://perma.cc/MG5Y-9JZW].

17. See *Noncompetition Agreement*, CORNELL L. SCH.: LEGAL INFO. INST., https://www.law.cornell.edu/wex/noncompetition_agreement [https://perma.cc/7EHN-MLVC]; see also *M&A Non-Compete Agreement: A Complete Guide*, MORGAN & WESTFIELD M&A ENCYCLOPEDIA, <https://morganandwestfield.com/knowledge/non-compete-agreement/> [https://perma.cc/6P92-85KM].

18. John Dier’s name is spelled two different ways in varying sources (Dyer and Dier). It is possible that the spelling reflects or was confused with his trade as a dyer, or that the exact spelling of his name is unconfirmed. See *A Brief History of Noncompete Regulation*, FAIR COMPETITION L. (Oct. 11, 2021), <https://faircompetitionlaw.com/2021/10/11/a-brief-history-of-noncompete-regulation/#:~:text=Noncompetes%20Have%20Been%20Around%20Since,he%20had%20been%20trained%20in> [https://perma.cc/32E6-E588].

19. See *id.*

the prohibited timeframe.²⁰ The judge refused to enforce the agreement due to its invalidity under the common law against restraints of trade—famously exclaiming “by God . . . if the plaintiff were here, he would go to prison, until he has made a fine to the king.”²¹ Following this case, the English common law fully embraced that all restraints of trade were void.²²

Two centuries later, courts began to address the enforceability of some non-competes with the first recorded judicial enforcement in *Broad v. Jollyfe*. There, the court held that a contract not to use a certain trade in a particular place was an exception to the general rule against restraints of trade and was *not* void.²³ The court reasoned that the promise was suitable because “it is but the selling of his custom and leaving another to gain it.”²⁴ However, the exception created in *Jollyfe* did not become the standard framework for non-competes until 1711 in the landmark case *Mitchel v. Reynolds*.²⁵ Notably, *Mitchel* involves not only a non-compete agreement but its use in connection to the lease of a business.²⁶

In *Mitchel*, the defendant (Reynolds) was a baker who allegedly violated a restrictive covenant he had signed when he leased his bakery to the plaintiff (Mitchel).²⁷ When Reynolds violated the restrictive covenant, he argued that the covenant was void because he was a baker by trade and

20. *See id.*

21. *Dyer's Case*, BOSTON UNIV. LEGAL HISTORY Y.B. 5b, <https://www.bu.edu/phpbin/lawyearbooks/display.php?id=16494> [<https://perma.cc/WPD9-GT3G>].

22. *See Alger v. Thacher*, 36 Mass. 51, 52 (1837) (“Among the most ancient rules of the common law, we find it laid down, that bonds in restraint of trade are void. As early as the second year of Henry V. (A. D. 1415) we find by the Year Books, that this was considered to be old and settled law.”).

23. *See Broad v. Jollyfe* (1621) 79 Eng. Rep. 509, 509 (holding a promise by a trader not to keep a shop in a particular place—in consideration that plaintiff would purchase his old stock at a prime cost—will support damages, but a promise which goes to a total restraint of trade is void).

24. *See* Gabriel A. D. Preinreich, *The Law of Goodwill*, 11 THE ACCOUNTING REV. 317, 317 (Dec. 1936), https://archive.org/details/sim_accounting-review_1936-12_11_4/page/317/mode/1up [<https://perma.cc/65QS-HG9F>] (defining sale of goodwill as “nothing more than the probability that the old customers will return to the old place.”) (citation omitted).

25. *See* FAIR COMPETITION L., *supra* note 18 (“Almost 100 years later, the exception became the rule with the 1711 watershed case of *Mitchel v. Reynolds*, which established the modern framework for the analysis of the enforceability of noncompetition agreements.”).

26. *See Mitchel v. Reynolds*, (1711) 24 Eng. Rep. 347, 347; *see also* Catherine L. Fisk, *Working Knowledge: Trade Secrets, Restrictive Covenants in Employment, and the Rise of Corporate Intellectual Property, 1800–1920*, 52 HASTINGS L.J. 441, 456 (2001) (“[*Mitchel's*] approach to the validity of restrictive covenants shaped the nineteenth-century courts’ approach to the issue in the employment relationships even though *Mitchel* did not concern employment but, rather, the sale of a business.”).

27. *See Mitchel*, 24 Eng. Rep. at 347.

had served an apprenticeship in baking.²⁸ Reynolds's argument largely rested on the pre-industrial concern with the power of masters and guilds to restrict trade, which had been the primary public policy reason against such practices.²⁹ The court upheld the covenant³⁰ and established a multifaceted analysis of reasonableness³¹ that has since become the dominant approach to analyzing the validity of contractual restraints of trade.³² The court held that restraints of trade are presumed to be void, but carved out an exception to the rule allowing a non-compete agreement to be valid if it is made with adequate consideration, "so as to make it a proper and useful contract."³³ A "just and honest contract" not-to-compete should be limited as necessary to benefit the person seeking enforcement³⁴ and not used for mischief or be unduly injurious to the public.³⁵ To be limited as necessary, the non-compete should be limited in: time, geographic scope, and specific occupations.³⁶ The court also implied that a refusal to enforce reasonable restraints in connection to the transfer of a business "would result in unnecessary hardship or loss to a craftsman ready to retire but forced to continue to trade, or sell out at a lower price because no one would risk the purchase of his business without the protection of an enforceable covenant not to compete."³⁷

In 1831, *Mitchel*'s "reasonableness" test to assess restraints of trade was

28. *See id.*

29. *See Fisk, supra* note 26, at 453–54 ("*Mitchel*'s hostility to restrictive covenants was a response to the guild tradition that skilled artisans could practice only a single trade in a single area."); *see also* William L. Letwin, *The English Common Law Concerning Monopolies*, 21 U. CHI. L. REV. 355, 375 (1954) ("The whole guild system, therefore, made it nearly impossible for a tradesman to earn his living if he did not practice his own trade in his own town, and this was the main reason why, as long as the guilds maintained their power, contracts in restraint of trade were held void.").

30. *See Mitchel*, 24 Eng. Rep. at 348.

31. *See id.* at 351 ("[A]ll contracts, where there is a bare restraint of trade and no more, must be void; but this taking place only where the consideration is not shewn . . . so as to make it a reasonable and useful contract.").

32. *See Fisk, supra* note 26, at 456.

33. *Mitchel*, 24 Eng. Rep. at 349.

34. Letwin, *supra* note 29, at 376 ("Among voluntary restraints [Lord Macclesfield] distinguished between those 'where the restraint is general not to exercise a trade . . . and where it is limited to a particular place.' . . . Macclesfield's rule, therefore, was that a contract in restraint of trade can be good only if the restraint is particular and the contract 'appears to be made upon a good and adequate consideration' . . .") (discussing *Mitchel v. Reynolds*, (1711) 24 Eng. Rep. 347)).

35. *See Fisk, supra* note 26, at 457.

36. *See id.*

37. Harlan M. Blake, *Employee Agreements Not to Compete*, 73 HARV. L. REV. 625, 629 (1960).

clarified in *Horner v. Graves*.³⁸ In that case, the court held a restraint upon a dental assistant was unreasonably broad when the restraint required the employee not to practice dentistry within 100 miles of his employer's town while the employer was practicing.³⁹ The judge ruled that the element of reasonableness was not limited to the consideration stated in the contract, but should consider all facts pertaining to "whether the restraint is such only as to afford a fair protection to the interests of the party in favor of whom it is given, and not so large as to interfere with the interests of the public."⁴⁰

Around the same time, a reasonableness test similar to *Mitchel* and *Horner*'s had been adopted in the United States in *Pierce v. Fuller*.⁴¹ In that case, the defendant (Fuller) ran a stage and the plaintiff (Pierce) wanted to open a stage on the same road.⁴² Pierce paid consideration of one dollar in exchange for Fuller's agreement that he would not run a stage on that road, in opposition to Pierce's stage—if Fuller did so, there was a penalty of \$229.⁴³ The court stated that the general rule regarding restraints of trade is that they "may be good, if executed for a sufficient and reasonable consideration . . . where it appears from the special circumstances that the contract is reasonable and useful, shall be good, [a]nd the consideration must always be shown."⁴⁴ Notably, the court considered the parties' competency in the transaction, stating "[t]he parties were competent in law to make a contract imposing a limited restraint on the defendant's trade for the plaintiff's benefit, and without injury to the public."⁴⁵ The court ultimately held that one dollar *was* sufficient consideration for the sale of the defendant's stage and stage horses.⁴⁶

B. Modern Approaches & Overview of State Laws

Historically, the majority of states have taken the approach that non-compete agreements should be enforced both in the employment context

38. See *Horner v. Graves* (1839) 131 Eng. Rep. 284; Blake, *supra* note 37, at 639.

39. See Blake, *supra* note 37, at 639.

40. See *id.*

41. *Pierce v. Fuller*, 8 Mass. 223 (1811).

42. See *id.* at 226.

43. See *id.* at 227.

44. *Id.* at 226.

45. *Id.* at 228.

46. See *id.*

and sale-of-business context. Even in states that have narrowed the permissibility of non-competes, it is common to have minimum salary thresholds to ensure that higher-level employees may continue to be subject to the contract.⁴⁷ Furthermore, courts have recognized that an imbalance of bargaining power is less prevalent with senior executives and that such employees possess unique skills that pose a greater threat of competition.⁴⁸

A non-compete agreement with the seller and their employees in connection to the sale-of-business will typically be in exchange for a specified payment, which may be accounted for in the purchase price.⁴⁹ “The value of a non-compete agreement is represented by the present value of the cash flows that would be lost if the covenanter were to compete, adjusted for the effective probability that the covenanter would compete, and compete successfully.”⁵⁰ Even if a non-compete agreement is not given an explicit allocation in the purchase price, “[n]on-competes have always been important . . . to avoid having the seller compete with the buyer using a portion of the purchase price.”⁵¹

Typically, a merger or acquisition will include a non-compete agreement in the letter of intent (LOI) or the purchase and sale agreement and will be formed between the buyer, the seller, and the seller’s affiliates.⁵² The seller in a merger or acquisition is the person(s) selling the equity securities or assets and liabilities.⁵³ The non-compete that appears in the purchase and sale agreement does not cover every important interest in the

47. *See 50-State Noncompete Survey*, EPSTEIN BECKER & GREEN (2023), https://20754472.fs1.hubspotusercontent-na1.net/hubfs/20754472/50-STATE-NON-COMPETE-SURVEY.pdf?%20hstc=62337523.22f9adb435435a90100ca1f97dfb3ab3.1695239922866.1695239922866.1695239922866.1&__hssc=62337523.1.1697213774858&__hsfp=2096224371&hsCtaTracking=64076bf7-bad3-4f1e-9ef9-70bc5ef813dc%7C60b36b86-d361-4fb0-b413-2efdab4c4411 [https://perma.cc/79AV-SFLF] (stating 46 states recognize employee non-competes as permissible and 10 of these states allow their use above a specified minimum salary threshold).

48. *See* *Sunder Energy, LLC v. Jackson*, 305 A.3d 723 (Del. Ch. 2023).

49. *See Non-Compete Agreements in the Sale of a Business*, LUBIN AUSTERMUEHLE (last visited Nov. 3, 2024), <https://www.thebusinesslitigators.com/non-compete-agreements-in-the-sale-of-a-business.html> [https://perma.cc/RNQ2-49W9].

50. Farrow, *supra* note 2.

51. Méndez Rodríguez & Sanchez, *supra* note 14.

52. *See Purchase Agreement: Non-Compete and Non-Solicit Provision*, PRAC. L. CORP. & SEC. (2024), <https://us.practicallaw.thomsonreuters.com/8-383-9978?view=hidealldraftingnotes> [https://perma.cc/5EBM-A79T].

53. *See* Erik Lopez, *Who are the key M&A deal participants, and what do they do?*, THE M&A L. BLOG, <https://thelawyer.com/who-are-the-key-ma-deal-participants-and-what-do-they-do/> [https://perma.cc/989H-78HD].

transaction, as there will likely be high-level executives and other employees without any ownership interest or authority to sell the company—but who possess assets that are important to the buyer including proprietary knowledge, trade secrets, talents, and clientele.⁵⁴ For many types of acquisitions, it is the current industry standard to not only bind sellers with a non-compete in the purchase and sale agreement, but also to negotiate employment agreements between key employees and the acquiring entity.⁵⁵ The acquirer will typically seek employment agreements with key employees who bring value to the business through specializations, knowledge, and experience that they hold within the business.⁵⁶ The employment agreement terms will be negotiated concurrently with the terms of the purchase and sale agreement.⁵⁷ Assets possessed by these key employees have material implications on how buyers structure the purchase price and other terms, such as the seller’s post-closing rights and obligations (e.g., continued employment of certain individuals).⁵⁸

For over 200 years, the regulation and validity of non-compete agreements have been a matter of *state* law.⁵⁹ Throughout this period of non-

54. See, e.g., Lavender et al., *supra* note 2 (“Many corporate acquisitions, particularly in the small-cap and mid-market space, are as much about acquired talent as they are about acquired brands or products. Sometimes that means software engineers, but it also applies to deals like rollups of financial advisories or professional services practices.”).

55. See *id.* (“In such cases [small-cap and mid-market space], non-compete agreements are the current industry standard.”).

56. See *M&A, Clause Description – Closing Conditions: Employment Agreements*, BLOOMBERG L., <https://www.bloomberglaw.com/document/X4EHR198000000>; see also Mardini, *supra* note 1 (“[E]mployer/employee non-competition agreements are often also relevant to M&A transactions to the extent the buyer desires to retain certain employees of the seller who have special talents, knowledge, and experience with business operations to help develop the business post-sale.”); Lavender et al., *supra* note 2 (“Many corporate acquisitions . . . are as much about acquired talent as they are about acquired brands or products.”).

57. See BLOOMBERG L., *supra* note 56.

58. See Jose Sariago, *The FTC and Non-Competes – Impact on M&A Transactions*, BILZIN SUMBERG (June 22, 2023), <https://www.bilzin.com/insights/publications/2023/06/the-ftc-and-non-competes> [<https://perma.cc/5PNQ-VJTD>].

59. See Erik W. Weibust et al., *After 200+ Years Under State Law, FTC Proposes to Sweep Away All Noncompetes in Unauthorized Federal Power Grab*, 38 LEGAL BACKGROUNDER 2 (Jan. 12, 2023), <https://www.wlf.org/2023/01/11/publishing/after-200-years-under-state-law-ftc-proposes-to-sweep-away-all-noncompetes-in-unauthorized-federal-power-grab/> [<https://perma.cc/TYE5-ETD2>] (citing *Acordia of Ohio, L.L.C. v. Fishel*, 133 Ohio St. 3d 356, 363 (Ohio 2012) (Pfeifer, J., dissenting) (“Since the early 18th century . . . many jurisdictions have allowed noncompete agreements to be enforced when they are reasonable.”)); see also FAIR COMPETITION L., *supra* note 18 (“For the 200-plus-year period that noncompetes have been regulated in the United States (*i.e.*, since at least as early as 1811), noncompetes have been the province of state regulation.”).

compete regulation in the United States,⁶⁰ the majority approach has consistently been to permit the use of non-competes to restrict employees—both in the general employment context and in the sale-of-business context.⁶¹ For example, in Delaware—a historically business-friendly state—non-compete agreements are generally enforceable.⁶² When assessing the enforceability of non-competes with senior executives, the Delaware Court of Chancery has also recognized that the concern of unequal bargaining power “appl[ies] with less force to sophisticated, highly compensated executives . . . [s]enior executives can retain counsel, bargain effectively . . . and bargain for sufficient compensation to offset the potential cost of having to sit out.”⁶³ Due to Delaware’s reputation of being a business and contract friendly state, they “[are] frequently seen as the ‘default’ choice for the contractual choice of law in M&A transactions, assuring the parties will receive what is stated in the contract.”⁶⁴ While the state was previously incredibly deferential to contracts as written, its courts have re-emphasized its limits and shifted toward a more scrutinous analysis.

More recently, Delaware courts have re-emphasized that non-compete agreements must: be reasonable in scope and geographic area, advance a legitimate economic interest of the party seeking its enforcement, and survive a balancing of the equities.⁶⁵ For example, in *Kodiak Building Partners, LLC v. Adams*, the court denied the plaintiff company’s (Kodiak)

60. See Weibust et al., *supra* note 59, at 1 (“For over 200 years, the regulation of noncompetition agreements . . . has been entirely the province of state law.”).

61. See EPSTEIN BECKER & GREEN, *supra* note 47 (stating forty-six states recognize employee non-competes as permissible and 4 states prohibit their use with a narrow exception in connection with the sale or dissolution of a business).

62. See *id.*

63. *Sunder Energy, LLC v. Jackson*, 305 A.3d 723, 753 n. 66 (Del. Ch. 2023).

64. See Abraham Y. Skoff & Allan Grauber, *A Changing Landscape in Delaware on M&A Non-Compete Enforcement*, MOSES SINGER (Nov. 3, 2023), <https://www.mosessinger.com/publications/a-changing-landscape-in-delaware-on-ma-non-compete-enforcement> [perma.cc/KGX9-U5XE] (“Delaware courts have consistently followed a “contractarian” view of contract interpretation, generally enforcing agreements as drafted, rather than importing and imposing external policy concerns.”). See also Abraham Y. Skoff, *Look Past Delaware for ‘Sale of Business’ Non-Compete Enforcement*, BLOOMBERG L. (Oct. 4, 2023), <https://www.mosessinger.com/publications/look-past-delaware-for-sale-of-business-non-compete-enforcement> [perma.cc/TES4-7DZZ] (“There long has been a general expectation that post-closing non-competes . . . will be enforced largely as written, without greater judicial scrutiny that would be given in an employment context or by another jurisdiction.”).

65. See *Kodiak Building Partners, LLC v. Adams*, No. 2022-0311-MTZ, 2022 WL 5240507, at 4 (Del. Ch. Oct. 6, 2022).

request for a preliminary injunction against defendant (Adams), a previous stockholder in Northwest Building Components, Inc. (Northwest) and Mandere Construction, Inc. (MCI).⁶⁶ Northwest and MCI were two companies Kodiak had acquired.⁶⁷ Northwest was a manufacturer and seller of lumber-based building materials and roof trusses.⁶⁸ MCI was a manufacturer and seller of roof trusses.⁶⁹ Adams was a general manager at MCI, a Northwest stockholder—and was defined as a seller in the purchase agreement.⁷⁰ Through the acquisition, Kodiak acquired Northwest and MCI's company capital stock and “all of the assets, properties, rights licenses, interest, [c]ustomer [d]eposites, [c]ontracts and business.”⁷¹ The transaction included a non-compete agreement binding Adams, which included a clause waiving Adams's right to raise any issue of reasonableness as a defense.⁷² Post-closing, Adams resigned from his position of general manager at Northwest and began working as a general manager for Builders FirstSource, Inc.⁷³ FirstSource was a supplier of roof trusses and lumber-based building materials, and its facilities were located twenty-four miles away from Northwest.⁷⁴ The court held the non-compete agreement was overbroad because it included clauses disclaiming Adams's rights to challenge the reasonableness and enforceability of the agreement.⁷⁵

Delaware courts have also become more scrutinous of contracts containing choice of law provisions used to work *around* non-compete laws in the default state. In *Sunder Energy, LLC v. Jackson*, plaintiff (Sunder Energy) sought a preliminary injunction against the defendant and former head of sales (Jackson)—who also owned incentive units in Sunder—after he and nine regional managers resigned from Sunder to work for another solar power company.⁷⁶ Under the Sunder LLC Agreement, incentive unit holders were bound by certain restrictive covenants, including “a restriction prohibiting the holder from soliciting, selling to, accepting any business

66. *Id.* at 1.

67. *Id.*

68. *See id.* at 2.

69. *Id.*

70. *Id.* at n.15.

71. *Id.* at 2.

72. *See id.*

73. *See id.* at 3.

74. *Id.*

75. *See id.* at 1.

76. *See Sunder Energy, LLC v. Jackson*, 305 A.3d 723, 729, 746 n. 66, (Del. Ch. 2023).

from, or engaging in any business relationship with any of Sunder's customers."⁷⁷

The court re-emphasized Delaware's application of the Restatement (Second) of Conflict of Laws, under which Delaware courts will not blindly enforce choice of law provisions "when doing so would circumvent the public policy of another state that has a greater interest in the subject matter."⁷⁸ The court concluded that Delaware's law on the enforceability of non-compete agreements could apply because it was only marginally different than Utah and Texas law; however, the court emphasized that the case would have been better filed in Utah or Texas, where Sunder was headquartered and where Jackson worked.⁷⁹ Ultimately, the court held that the non-compete provision was unenforceable—even under Delaware law—because it was unreasonable and overbroad on its face.⁸⁰

Despite Delaware's movement away from almost complete deference to contractual agreements not to compete, Delaware has still maintained the permissibility of non-competes against employees *and* in connection to the sale-of-business. This approach has also been maintained by other states with active merger and acquisition markets such as New York and Texas. In New York, a non-compete is enforceable if it:

(1) is necessary to protect the employer's legitimate interests, (2) does not impose an undue hardship on the employee, (3) does not harm the public, and (4) is reasonable in time period and geographic scope. An employer's legitimate interest may include protecting an employer's trade secrets and confidential information and preventing employees from taking specialized skills they gained on the job to a competitor.⁸¹

Most recently, New York Governor Kathy Hochul vetoed a law that would have prohibited the imposition of a non-compete on a "covered

77. *Id.* at 729.

78. *Id.* at 747.

79. *See id.* at 747, 731.

80. *See id.* at 758.

81. Letitia James, *Non-Compete Agreements in New York State Frequently Asked Questions*, N.Y. STATE LAB. BUREAU (2022), <https://ag.ny.gov/sites/default/files/non-competes.pdf> [<https://perma.cc/7FTW-4AJR>].

employee,”⁸² defined as “any . . . person who . . . performs work or services for another person on such terms and conditions that they are, in relation to that other person, in a position of economic dependence on, and under an obligation to perform duties for, that other person.”⁸³

Furthermore, New York courts may “blue-pencil” (modify) an unreasonable or overbroad restriction to make it enforceable⁸⁴ if the “the employer demonstrates an absence of overreaching, coercive use of dominant bargaining power, or other anti-competitive misconduct, but has in good faith sought to protect a legitimate business interest, consistent with reasonable standards of fair dealing.”⁸⁵ Although New York exercises this judicial practice, its courts will hesitate to find an employer acted in good faith when non-competes are overbroad and vague. One instance is the case *Flatiron Health, Inc. v. Carson*, where a non-compete agreement was invalid and unmodified when it encompassed entities who were *not* competitors and prohibited any form of employment with such companies—including low-level positions such as janitorial roles.⁸⁶

In Texas, non-compete agreements are generally disfavored, as the Texas Free Enterprise and Antitrust Act of 1983 states: “[e]very contract, combination, or conspiracy in restraint of trade or commerce is unlawful.”⁸⁷ However, the same law also states,

a covenant not to compete is enforceable if it is ancillary to or part of an otherwise enforceable agreement at the time the agreement is made to the extent that it contains limitations as to time, geographical area, and scope of activity to be restrained that are reasonable and do not

82. Christopher P. Maugans et al., *What NY State Employers Need to Know about 2024 Employment Law*, GOLDBERG SEGALLA (Jan. 26, 2024), <https://www.goldbergsegalla.com/news-and-knowledge/knowledge/what-ny-state-employers-need-to-know-about-2024-employment-law/> [<https://perma.cc/BZE7-WZDS>].

83. S.B. 3100, 205th Leg., 244th Sess. (N.Y. 2023) <https://legislation.nysenate.gov/pdf/bills/2023/S3100A> [<https://perma.cc/83MB-Y4RB>] (unpassed).

84. See Robert N. Holtzman, *When Blue Penciling Fails to Come to the Rescue: New York Federal Court Refuses Partial Enforcement of Restrictive Covenant*, KRAMER LEVIN NAFTALIS & FRANKEL LLP (July 1, 2020), <https://www.kramerlevin.com/en/perspectives-search/when-blue-penciling-fails-to-come-to-the-rescue-new-york-federal-court-refuses-partial-enforcement-of-restrictive-covenant.html> [<https://perma.cc/6RUA-T8QF>].

85. BDO Seidman v. Hirshberg, 93 N.Y.2d 382, 394 (1999).

86. See Holtzman, *supra* note 84; see also *Flatiron Health, Inc. v. Carson*, 2020 U.S. Dist. LEXIS 48699, at *60–64 (S.D.N.Y. Mar. 20, 2020).

87. TEX. BUS. & COM. CODE ANN. § 15.05(a) (West 1983).

impose a greater restraint than is necessary to protect the goodwill or other business interest of the promisee.⁸⁸

Therefore and *again*, non-compete agreements are permissible if they are reasonable and limited in time, geographical area, and scope of activities.⁸⁹ Furthermore, Texas courts have also applied the blue-pencil rule. Its precedent states that “[a]n agreement not to compete which is not appropriately limited may be modified and enforced by a court of equity to the extent necessary to protect the promisee’s legitimate interest, but may not be enforced by a court of law.”⁹⁰ Overall, the majority of states—especially those with larger markets—currently enforce non-competes. They do so both in connection to the sale-of-business and in the employment context as long as the contract is reasonably limited in duration, geographical area, and scope of restricted activities.

A minority of states—such as California, Minnesota, North Dakota, Oklahoma, and Colorado—have aggressively scrutinized and largely prohibited non-compete agreements with narrow exceptions.⁹¹ Colorado law makes non-compete and non-solicitation agreements generally void *unless* they fall within a certain salary threshold and are reasonably necessary for the protection of trade secrets.⁹² California, the largest

88. TEX. BUS. & COM. CODE ANN. § 15.50(a) (West 1983).

89. See, e.g., *DeSantis v. Wackenhut Corp.*, 793 S.W.2d 670, 681–82 (Tex. 1990) (“The extent of the agreement not to compete must accordingly be limited appropriately as to time, territory, and type of activity.”).

90. *Id.* at 682 (citing *Weatherford Oil Tool Co. v. Campbell*, 340 S.W.2d 950 (Tex. 1960)).

91. See Zachary Folk, *Which States Have Banned Non-Compete Clauses? Here’s What To Know As New York Could Be Next.*, FORBES (Dec. 6, 2023, 5:00 PM), <https://www.forbes.com/sites/zacharyfolk/2023/12/06/which-states-have-banned-non-compete-clauses-heres-what-to-know-as-new-york-could-be-next/?sh=3d19747195c0> [perma.cc/42M3-G3Q4] (“Five states have fully banned non-compete clauses: California, Colorado, Oklahoma, North Dakota, and Minnesota.”); see also THE WHITE HOUSE, *Non-Compete Agreements: Analysis of the Usage, Potential Issues, and States Responses* 3 (May 2016) https://obamawhitehouse.archives.gov/sites/default/files/non-competes_report_final2.pdf [https://perma.cc/QC7A-3HGT] (“In the large majority of states, non-compete agreements are enforcement for workers across all income brackets, and many states do not have restrictions around the geographic or temporal limitations of non-competes.”).

92. See Folk, *supra* note 91; see also Katherine M.L. Pratt et al., *Non-Compete Agreements in Colorado*, *A New Era*, COLO. LAW., at 31 (Nov. 2022), <https://cl.cobar.org/features/non-compete-agreements-in-colorado/> [https://perma.cc/H67W-6GHC].

economy in the United States,⁹³ has banned all non-compete clauses.⁹⁴ The state allows one narrow exception in connection to the sale of goodwill of a business or ownership interest in the operating assets of a business entity, division, or subsidiary.⁹⁵ Similar to states that *do* permit non-compete agreements, the contractual restriction must still be limited to “a specified geographic area in which the business [is] sold, or that . . . the business entity, division, or subsidiary has been carried on, so long as the buyer, or any person deriving title to the goodwill or ownership interest from the buyer, carries on a like business therein.”⁹⁶

Although non-competes in employment contracts with senior executives *and* in connection to the sale-of-business are extremely common, the small coalition of states described have adopted a policy disapproving of non-compete agreements because they have been shown to “stifle economic development, limit firms’ ability to hire, and depress innovation and growth.”⁹⁷ For instance, the California legislature has suggested that prohibiting non-compete agreements “fuel[s] competition, entrepreneurship, innovation, job and wage growth, equality, and economic development.”⁹⁸ Labor organizations, public interest groups, and legal scholars—such as The Open Markets Institute and the American Federation of Labor & Congress of Industrial Organizations (AFL-CIO)—also advocate for the free labor movement.⁹⁹ The groups highlight the fact that non-competes “substantially reduce[] labor market mobility.”¹⁰⁰ Opponents

93. See *U.S. Gross Domestic Product 2023, By State*, STATISTA RSCH. DEPT. (July 5, 2024), <https://www.statista.com/statistics/248023/us-gross-domestic-product-gdp-by-state/> [<https://perma.cc/FX2S-YVNK>] (“The gross domestic product (GDP) of California was about 3.23 trillion U.S. dollars in 2023, meaning that it contributed the most out of any state to the country’s GDP in that year.”).

94. See CAL. BUS. & PROF. CODE § 16600.1(a) (West 2023) (“It shall be unlawful to include a noncompete clause in an employment contract, or to require an employee to enter a noncompete agreement, that does not satisfy an exception in this chapter.”).

95. See CAL. BUS. & PROF. CODE § 16601 (West 2023).

96. *Id.*

97. See Tony Oncidi & Jennifer McDermott, *California Expands Prohibition Against Non-Competes*, PROSKAUER ROSE LLP (Sept. 11, 2023), <https://calemploymentlawupdate.proskauer.com/2023/09/california-expands-prohibition-against-non-competes/> [<https://perma.cc/F53A-SJ7W>].

98. *Id.*

99. Open Markets Institute et al., *Petition for Rulemaking Before the FTC* (2019), <https://static1.squarespace.com/static/5e449c8c3ef68d752f3e70dc/t/5eaa04862ff52116d1dd04c1/1588200595775/Petition-for-Rulemaking-to-Prohibit-Worker-Non-Compete-Clauses.pdf> [<https://perma.cc/RZ5W-VL6M>].

100. See *id.* at 26.

of non-competes emphasize that they “contribute to racial and gender wage gaps . . . even to the very top of the income scale . . . [and] depress compensation for chief executive officers.”¹⁰¹ Opponents further maintain that “[e]ven in states where non-compete clauses are unenforceable, workers are subject to non-competes at roughly the same rate as workers in states where non-competes are enforceable” because employers still condition employment on acceptance of non-compete clauses even if they cannot be enforced in state court.¹⁰² Based on these concerns, the organizations called on the FTC to classify non-compete clauses as per se illegal, making them prohibited—as opposed to merely unenforceable in state court.¹⁰³

On the other hand, proponents of non-competes argue that they are essential to encourage firms to invest in cultivating intellectual and human capital,¹⁰⁴ which is heavily sought after and bargained for in the value of a target business. Economic scholars in this camp argue that non-competes are important tools to protect firm-specific human capital assets¹⁰⁵—“the narrow[] set of technical, managerial, and other skills and knowledge that have value (or have greater value) only at a particular firm.”¹⁰⁶ M&A attorneys also strongly advise the use of non-compete agreements, as they ensure to buyers “that the newly acquired employees are not going to start working for a competitor or set up a competing business if they quit . . . [and] preclude employees from exploiting confidential information such as customer/client lists, upcoming products and marketing plans.”¹⁰⁷ Furthermore, because many states have crafted reasonableness standards and required limitations in scope, duration, and geographic region—it is now standard within the practice of law to *define* the target business and its activities, the geographic region, and period to be restricted to help increase

101. Sandeep Vaheesan, *The Fight Over Non-Competes Is Heating Up. The FTC Must Stand Strong*, TIME MAG. (Jan. 23, 2023, 4:47 PM), <https://time.com/6249347/fight-over-non-compete-clauses/> [<https://perma.cc/CY96-7ASX>].

102. Open Markets Institute, *supra* note 99, at 26–28.

103. *See id.* at 52–53.

104. *See* Jonathan M. Barnett & Ted Sichelman, *The Case for Noncompetes*, 87 U. CHI. L. REV. 953, 953 (June 2020).

105. *See id.* at 971 (“[T]he noncompete clause can result in joint efficiency gains by enabling employment transactions (and associated knowledge transfers) that otherwise would not take place.”).

106. *Id.* at 968.

107. Roy Maurer, *Noncompete Agreements: How to Protect Your Company During an M&A*, SOC’Y HUM. RES. MGMT. (Apr. 8, 2015), <https://www.shrm.org/topics-tools/news/talent-acquisition/noncompete-agreements-how-to-protect-company-ma> [<https://perma.cc/95HZ-BZKU>].

the likelihood of enforceability if challenged in court.¹⁰⁸

C. FTC's Non-Compete Rule

In response to the growing controversy surrounding non-competes, the FTC proposed to add a new rule, titled “Rules Concerning Unfair Methods of Competition Part 910 – Non-Compete Clauses.”¹⁰⁹ On April 23, 2024, the FTC issued a final rule banning non-competes and the rule went into effect September 4, 2024.¹¹⁰

The final rule makes it “an unfair method of competition for a person to enter into or attempt to enter into a non-compete clause; maintain with a worker a non-compete clause; or represent to the worker that the worker is subject to a non-compete clause.”¹¹¹ Under the rule, a non-compete clause is defined as “[a] term or condition of employment that prohibits a worker from, penalizes a worker for, or functions to prevent a worker from: seeking or accepting work in the United States with a different person . . . or operating a business in the United States after the conclusion of the employment.”¹¹² The definition of “workers” covers all employees going forward from the effective date, including senior executives.¹¹³ As for senior executives, the rule declares that,

it is an unfair method of competition for a person to enter into or attempt to enter into a non-compete clause; to enforce or attempt to enforce a non-compete clause entered into after the effective date; or to represent that the senior executive is subject to a non-compete clause, where the non-compete clause was entered into after the effective date.¹¹⁴

The final rule makes an exception for non-compete clauses currently in

108. See Flax et al., *supra* note 16.

109. Rules Concerning Unfair Methods of Competition, 88 Fed. Reg. 3482, (proposed Jan. 5, 2023) (to be codified at 16 C.F.R. §§ 910, 912 (2024)).

110. See Press Release, Fed. Trade Comm’n, FTC Announces Rule Banning Noncompetes (Apr. 23, 2024), <https://www.ftc.gov/news-events/news/press-releases/2024/04/ftc-announces-rule-banning-noncompetes> [https://perma.cc/5BZV-JNB7].

111. 16 C.F.R. §910.2(a)(1)(i-iii) (2024).

112. *Id.* at § 910.1.

113. See *id.*

114. *Id.* at § 910.2(a)(2)(i-iii).

place with senior executives, allowing them to be enforceable until their expiration¹¹⁵ and would supersede any State statute, regulation, or interpretation.¹¹⁶ Like the California statute, the rule would provide a narrow exception for the use of non-compete clauses in connection with the sale of a business, stating that “non-competes in connection to the bona fide sale of a business, of a person’s ownership interest in a business, or of all or substantially all of a business’s operating assets” are also exempt.¹¹⁷

Since the FTC announced the passing of the rule, there have been several legal challenges to its enforceability. This has delayed enforcement and may prevent the rule from being valid and enforceable at all. In *Ryan LLC v. Federal Trade Commission*, the FTC was temporarily blocked from the ability to enforce the rule.¹¹⁸ The court ruled that the plaintiffs are likely to succeed on their claims that the FTC lacks statutory authority to pass the rule and that the rule was arbitrary and capricious.¹¹⁹ However, this injunction only applies to the *specific* plaintiffs in the action and *does not* apply nationwide.¹²⁰ Legal challenges to the final rule have also been brought by the U.S. Chamber of Commerce in Texas¹²¹ and a company in Pennsylvania.¹²² Furthermore, the Supreme Court’s recent decision in *Loper Bright Enterprises v. Raimondo* may significantly impact whether the FTC will even have the ability to enforce such a rule, as the FTC relied on *Chevron* Deference in its enactment.¹²³

115. See 16 C.F.R. §§ 910(a)(2)(ii) (2024) (“With respect to senior executives, it is an unfair method of competition for a person . . . [t]o enforce or attempt to enforce a non-compete clause *entered into after the effective date*”) (emphasis added).

116. See *id.* at § 910.4(a).

117. *Id.* at § 910.3(a).

118. See *Ryan LLC v. Fed. Trade Comm’n*, No. 3:24-CV-00986-E, 2024 WL 3297524, at *32 (N.D. Tex. July 3, 2024).

119. See Rosa M. Morales et al., *Texas Federal Court Preliminarily Enjoins FTC’s Non-Compete Ban, But Declines to Issue Nationwide Preliminary Injunction*, CROWELL & MORING LLP (July 8, 2024), <https://www.crowell.com/en/insights/client-alerts/texas-federal-court-preliminarily-enjoins-ftcs-non-compete-ban-but-declines-to-issue-nationwide-preliminary-injunction> [<https://perma.cc/7XM3-FUSU>].

120. See *id.*

121. See *Ryan LLC*, 2024 WL 3297524, at *1.

122. See *generally* *ATS Tree Servs., LLC v. Fed. Trade Comm’n*, No. CV 24-1743, 2024 WL 3511630 (E.D. Pa. July 23, 2024).

123. See Rachel Powitzky Steely, *Too Little, Too Late—The Death of the Federal Trade Commission Noncompete Rule May Be Near*, FOLEY & LARDNER LLP (July 15, 2024), <https://www.foley.com/insights/publications/2024/07/federal-trade-commission-noncompete-rule/> [<https://perma.cc/9CTJ-7Z7D>] (“The FTC relied on [the *Chevron* Deference] doctrine in enacting the Noncompete Rule. . . [w]ithout the *Chevron* deference, agencies now face a higher burden of proof in demonstrating that their regulatory actions are justified.”).

Although the rule’s enforceability is yet to be decided, it is important to consider the implications of such a rule if it were to succeed in application. If it becomes enforced, the FTC’s prohibition on non-compete clauses would hugely impact most states and will also likely impact the M&A industry in a transformative, sticky way.¹²⁴

II. ANALYSIS & PROPOSAL

Although the FTC’s final rule may be a beneficial step toward protecting the mobility of many employees—state statutes, precedent, and market practices are consistent with the fact that even high-level executives who possess important knowledge and clientele pose a different threat of competition than “average” employees. Analyses regarding non-competes thus far have focused on the potential effect of prohibiting their use completely, but are lacking on what effect the rule’s exception may have—an exception which goes much further than regulations businesses have faced in the majority of the United States.¹²⁵

Since the earliest exception was created in *Mitchel v. Reynolds*, the main concerns and justifications for non-competes have been discussed and weighed by the courts—even the 1711 court in *Mitchel* discussed how “presumption of invalidity [of non-competes] stems from the ‘mischief’ the restraints may cause . . . in the possible loss of the covenantor’s means of earning a livelihood and . . . in the loss to society of the services of a useful member . . . [and] may be used as a means of monopolization.”¹²⁶ In the same breath, the court also recognized,

to refuse to enforce reasonable restraints *accompanying the transfer of a business* would result in unnecessary hardship or loss to a craftsman . . . [by causing a seller] to sell out at

124. See Dan Forman, *FTC Waging War on Non-Compete Restrictions in Employment*, JD SUPRA (Apr. 13, 2023), <https://www.jdsupra.com/legalnews/ftc-waging-war-on-non-compete-2829254/> [<https://perma.cc/2FGQ-VKX3>]; see also Flax, *supra* note 16 (“Going further than even California’s restrictions, no seller/owner who is continuing as an employee of the target, the buyer, or any of the buyer’s affiliates can be bound unless that seller/owner owns 25 percent or more of the target company.”).

125. See EPSTEIN BECKER & GREEN, P.C., *supra* note 47 (only four of the fifty states ban employee non-compete agreements entirely, while ten states have enacted minimum salary thresholds for employees who may be subject to non-compete agreements).

126. See Blake, *supra* note 37, at 629; see also *Mitchel v. Reynolds*, (1711) 24 Eng. Rep. 347, 350.

a lower price because no one would risk the purchase of his business without the protection of an enforceable covenant not to compete.¹²⁷

Modern state laws have continued to grapple with how to balance these interests. States have consistently taken the approach that non-competes should be permissible as long as they are reasonable to protect the interests of a business and are limited in geographic scope, time,¹²⁸ and for certain types of employees or activities.¹²⁹ On the other end of the spectrum, even the most business-friendly states like Delaware will not defer to *every* non-compete agreement.¹³⁰ Therefore, buyers are *not* free to contractually protect themselves from any risk of competition. Due to this seemingly settled area of law, “[b]uyers and sellers in M&A and investment transactions routinely use non-competes to protect the interests of the relevant businesses (and buyer) and for which separate and valuable consideration is received by the individual agreeing to the non-compete clause.”¹³¹ If the FTC’s proposed rule were adopted, it would supersede these historic business and legal practices. As a result, it will slow mergers and acquisitions since buyers will be more hesitant to purchase risky investments and will account for such risk in the purchase price.¹³²

For example, this will likely create negative impacts in the private

127. See Blake, *supra* note 37, at 629 (emphasis added).

128. For examples of state statutes that allow non-compete agreements in employee and sale-of-business contexts with limitations on time and geographic scope to establish reasonableness. See, e.g., TEX. BUS. & COMM. CODE § 15.50(a) (West 1983); FLA. STAT. ANN. § 542.335 (West 2024); MO. ANN. STAT. § 431.202 (2001); NEV. REV. STAT. § 613.195(1) (2021).

129. For state statutes with income thresholds, see e.g., COLO. REV. STAT. ANN. § 8-2-113(1)(b) (West 2024); D.C. CODE ANN. § 32-581.03 (2022); ME. REV. STAT. ANN. tit. 26, c. 7 § 599-A (3) (2023); MD. CODE ANN., LAB. & EMPL. § 3-716(a) (West 2024); N.H. REV. STAT. ANN. § 275:70 (2014); OR. REV. STAT. § 653.295 (2022); 28 R.I. GEN. LAWS § 28-59-3 (2019); VA. CODE ANN. § 40.1-28.7:8 (2020); WASH. REV. CODE § 49.62.020(1)(b) (West 2024). For state statutes with restrictions based on type of occupations, see GA. CODE ANN. § 13-8-51(5) (2011) (limiting the definition of employees who may be bound under noncompetes).

130. See, e.g., Kodiak Building Partners, LLC v. Adams, 2022 WL 5240507, 1, 5 (Del. Ch. Oct. 6, 2022) (holding a noncompete was overbroad when including clauses disclaiming right to challenge reasonableness or enforceability of the agreement); Hightower Holding, LLC v. John Gibson, C.A. No. 2022-0086-LWW, memo. op. 5–6, 10 (Del. Ch. Feb. 9, 2023) (applying Alabama law despite a Delaware choice of law provision and holding a noncompete was overbroad in duration and geography).

131. Lavender, *supra* note 2.

132. See Lavender, *supra* note 2 (“Buyers and sellers in M&A and investment transactions routinely use non-competes to protect the interest of the relevant businesses (and buyer) and for which separate and valuable consideration is received by the individual agreeing to the non-compete clause.”) (emphasis added).

equity space. The primary purpose of private equity firms is to “comprise[] companies or investment managers that acquire capital from wealthy investors to invest in new or existing companies”¹³³ for the purpose of increasing the productivity, efficiency, and overall value of the business with the end goal of selling the business again in the future for a profit benefiting the investors.¹³⁴ Although there is a larger debate surrounding the role of private equity which will not be discussed here, private equity purchases are one of the primary forces in the M&A market. In fact, “private equity’s share of the overall M&A volume is approximately 36%.”¹³⁵ In 2019, “[private equity] firms accounted for 40% of all private capital raised worldwide and made about 3,600 acquisitions for a total deal value of \$551 billion and 1,078 exits (sales) valued at \$405 billion.”¹³⁶

Private equity firms diversify their industry involvement when building their portfolios, but many corporate acquisitions in the small-cap and mid-market space are aimed at buying the *talent and services* the target business offers.¹³⁷ In this scenario, it is the current industry standard for buyers to include non-compete agreements to bind not only key owners, but also long-term, high-level employees and small shareholders.¹³⁸ As many M&A attorneys advise: “[i]ncluding non-competition agreements in M&A transactions is especially important where the seller’s owner’s and/or key personnel’s involvement in the acquired business was integral to [its] overall success.”¹³⁹ For example, a private equity firm may have a portfolio that is built on acquiring consulting businesses, software businesses, and technology businesses. Notably, consulting and software businesses are attractive investments because of these companies’ client base, network, talent, and knowledge of the industry. Without a non-compete agreement in place to protect from the risk of competition by high-level employees, “key

133. Scott Powell, *Equity Firm*, COR. FIN. INST., <https://corporatefinanceinstitute.com/resources/career/equity-firm/> [https://perma.cc/R292-69EZ].

134. *See id.*

135. Leslie M. Smith, *Private equity’s growing role in M&A has clear benefits*, DENTONS (Aug. 7, 2023), <https://www.dentons.com/en/insights/articles/2023/august/7/private-equitys-growing-role-in-m-and-a-has-clear-benefits> [https://perma.cc/5GT7-K2RC].

136. Shankar Parameshwaran, *How Private Equity Has Evolved to Compete in Global M&A*, KNOWLEDGE AT WHARTON (Nov. 14, 2023), <https://knowledge.wharton.upenn.edu/article/how-private-equity-has-evolved-to-compete-in-global-ma/> [https://perma.cc/UZ75-6GBN].

137. *See* Lavender, *supra* note 2.

138. *See id.*

139. Mardini, *supra* note 1.

employees could, hypothetically, form a new entity and use their knowledge of the industry to compete with the business that the buyer acquired, reducing the value of the overall business.”¹⁴⁰ As a result, buyers will be less willing to acquire businesses that could potentially have low returns on investment due to competing businesses. Sellers may also be less willing to engage in transactions that they feel undervalue their business.

Private equity involvement in mergers and acquisitions has evolved to focus on a buy-to-sell strategy, which is most successful “when a business hasn’t been aggressively managed and so is underperforming . . . [or] with businesses that are undervalued because their potential isn’t readily apparent.”¹⁴¹ Some attractive private equity targets include businesses with: weak managerial incentives, the need for shareholder restructuring, and difficulties in depressed markets or in financial distress.¹⁴² Overall, the role of a private equity firm is not only to capture value when buying businesses—it involves *creating* value as well.¹⁴³ Furthermore, because of how private equity deals are structured,¹⁴⁴ acquired businesses are under pressure to perform well.¹⁴⁵ Therefore, the buyer is incentivized to follow through on improving management, increasing productivity, driving efficiency, and “making a more complete suite of products that may better serve . . . a specific customer market.”¹⁴⁶

By looking at just one segment of the M&A market, we can begin to see important aspects the FTC’s rule overlooks. First, when a buyer is looking to purchase a business, the talent, knowledge, and clientele of its *employees*—not just its owners—are considered when determining the value of the target business. Second, although non-compete agreements can

140. *Id.*

141. Felix Barber & Michael Goold, *The Strategic Secret of Private Equity*, HARV. BUS. REV. (Sep. 2007), <https://hbr.org/2007/09/the-strategic-secret-of-private-equity> [https://perma.cc/T64N-9S2S].

142. See Parameshwaran, *supra* note 136.

143. See *id.* (“[V]alue creation and capture” [is defined] . . . as the difference between the future sales price of a business and its present buying price.”).

144. See *Private Equity’s Impact on Mergers & Acquisitions*, SMITH, GAMBRELL, & RUSSELL LLP, <https://www.sgrlaw.com/private-equitys-impact-on-mergers-and-acquisitions/#:~:text=Although%20initially%20dominated%20by%20industry,of%20acquirers%20involved%20in%20M%26A> [https://perma.cc/T78C-HN9V] (“The operating model focuses on making a smart purchase and then increasing the acquisition’s value over an established time frame to realize a financially lucrative exit . . . private equity owners have a shorter plan of business development and transformation.”).

145. See Barber & Goold, *supra* note 141.

146. Parameshwaran, *supra* note 136.

and do hamper competition, innovation, and efficiency in some ways—they are useful and necessary steppingstones for key players like private equity firms. These firms contribute to the growth of businesses through acquisitions with the goal of increasing their efficiency and ability to compete in the market. If the FTC were to prohibit the use of non-compete agreements in the manner proposed, private buyers and investors—whose entire business model is built on improving a business to achieve a quick exit¹⁴⁷—would be less eager to acquire and develop businesses.¹⁴⁸ One can predict that buyers will offer lower purchase prices to account for the inability to enter a non-compete agreement or include other contractual protections, such as installment payments.¹⁴⁹ In turn, sellers may experience “reduc[ed] bargaining power and ability to secure a high sale price with a large cash payout at closing.”¹⁵⁰

The FTC exception that only allows the use of non-competes for owners of a business entity is not enough to subdue this risk of competition because the ownership of a business is not a reliable indicator of who holds sensitive information or who could compete with the business.¹⁵¹ Key employees in the company may continue with the acquired business for a short time, or not at all. This makes non-compete agreements with such individuals important for buyers to pursue.¹⁵² According to the FTC’s reasoning, there

147. *See id.* (“A PE firm’s goal when buying a business is ultimately to profitably exit that investment . . . [i]n order to achieve that, PE firms must be able to buy the asset at a price greater than that offered by the best alternative corporate buyer today, and then exit the asset at some point (potentially five to ten years) in the future.”).

148. *See, e.g., Non-Compete Agreements: The Sale-Of-Business Exception in California and as Proposed in New FTC Rule*, HANSON BRIDGETT (July 18, 2023), [https://www.hansonbridgett.com/publication/230718-0400-non-compete-california-exception#:~:text=The%20California%20exception%20also%20requires,and%20as%20such%20the%20geographic\[https://perma.cc/S7FP-YM99\]](https://www.hansonbridgett.com/publication/230718-0400-non-compete-california-exception#:~:text=The%20California%20exception%20also%20requires,and%20as%20such%20the%20geographic[https://perma.cc/S7FP-YM99]) (“The 25% ownership threshold of the proposed rule represents a major change to California’s sale-of-business-exception and has the potential to disincentivize buyer parties in M&A transactions.”).

149. *See id.*

150. *Id.*

151. *See* Méndez Rodríguez & Sanchez, *supra* note 14.

152. *See* Benjamin Ferrucci et al., *What the FTC’s New Rule on Non-Competes Means for M&A and Private Equity Transactions*, MINTZ, LEVIN, COHN, FERRIS, GLOVSKY AND POPEO, P.C. (May 23, 2024), [https://www.mintz.com/insights-center/viewpoints/2226/2024-05-23-what-ftcs-new-rule-non-competes-means-ma-and-private#:~:text=Sale%2Dbased%20non%2Dcompetes%20are,business%20the%20buyer%20just%20aquired \[https://perma.cc/V2EB-S6XK\]](https://www.mintz.com/insights-center/viewpoints/2226/2024-05-23-what-ftcs-new-rule-non-competes-means-ma-and-private#:~:text=Sale%2Dbased%20non%2Dcompetes%20are,business%20the%20buyer%20just%20aquired [https://perma.cc/V2EB-S6XK]) (“In addition to equity holders, buyers and private equity sponsors often seek reassurances that the recently acquired employees will not leave the business and compete.”).

could be other means to address these concerns, such as trade secret law.¹⁵³ However, those areas of law do not offer mechanisms to protect buyers from losing the value of client networks and skill sets.¹⁵⁴

To balance the interests of employers and employees—as well as the investors who back the companies in the first place—the FTC’s final rule should, at the very least, expand the exceptions to the rule and continue to allow non-competes with senior executives to be entered into after the effective date. Under the current exception, many key employees continuing with a potential acquirer will be excluded from the exception, which will cause buyers to offer lower purchase prices or decline to invest at all. A more effective approach combines elements of various state laws (such as: reasonableness, salary thresholds, limitations on scope, etc.).

For example, several states have narrowed the permissibility of non-compete agreements to employees above a minimum salary threshold. These states include Colorado and Washington.¹⁵⁵ The FTC’s rule already established a higher minimum salary for the current exception, and such a rule would affect a minimal amount of employees—such as senior executives who represent less than 0.75% of workers.¹⁵⁶ Even the FTC itself has acknowledged “this subset of workers is less likely to be subject to the acute, ongoing harms currently being suffered by other existing non-competes” and that the principal harm is not the exploitation or coercion of

153. See Non-Compete Clause Rule, 89 Fed. Reg. 38342, at 38425 (May 7, 2024) (arguing that businesses have sufficient, less restrictive alternatives, such as NDA’s and protection under trade secrets law).

154. See Méndez Rodriquez & Sanchez, *supra* note 14 (“The proposed ban raises a critical concern in that it fails to distinguish between skilled and highly skilled workers . . . some of these concerns may be justified as non-compete agreements are instrumental in upholding confidentiality and safeguarding investments in specialized training. However, according to the FTC’s reasoning, there could be other means to address these concerns . . . if the rule is approved, companies will face significant compliance difficulties in devising and implementing legal instruments to address the void left by the absence of non-compete agreements.”).

155. See, e.g., COLO. REV. STAT. ANN. § 8-2-113(1)(b) (West 2024); WASH. REV. CODE § 49.62.020(1)(b) (West 2024); 820 ILL. COMP. STAT. 90/10(a) (2022). Other states with salary thresholds include Maine, Maryland, Massachusetts, Nevada, New Hampshire, Oregon, Rhode Island, Virginia, and the District of Columbia. See *Employment and Labor Insight: 2024 Salary Thresholds and Notice Requirements for Non-Competition and Non-Solicitation Provisions in Employment Agreements*, GUNDERSON DETTMER STOUGH VILLENEUVE FRANKLIN & HACHIGIAN, LLP (Feb. 15, 2024), <https://www.gunder.com/en/news-insights/insights/employment-and-labor-insight-2024-salary-thresholds-and-notice-requirements-for-non-competition-and-non-solicitation-provisions-in-employment-agreements> [<https://perma.cc/L9H5-9Q9P>].

156. See Non-Compete Clause Rule, 89 Fed. Reg. 38342, 38413 (May 7, 2024).

such employees.¹⁵⁷ Furthermore, the Delaware Court of Chancery has acknowledged that senior executives do *not* face the same risks of unequal bargaining power *and* they have the ability to negotiate.¹⁵⁸ Even in 1811, the court in *Pierce v. Fuller* considered the sophistication of the employee when determining the reasonableness of a non-compete agreement.¹⁵⁹ If the FTC simply (1) extended its current exception for existing non-competes with senior executives and (2) made such an exception allow such agreements to be entered into going forward—they could achieve a balance of both their own interest in protecting employees *and* the business interests of buyers that have continuously been acknowledged by the majority of states.

CONCLUSION

In a transaction to sell or merge a business entity, buyers—who also contribute to market activity and innovation—rely on the ability to contract to protect the value of their newly acquired business through non-compete clauses and agreements.¹⁶⁰ Despite the growing aversity to non-competes, the majority of state laws have not gone so far as to restrict their use to only sellers of businesses like the proposed FTC rule does. This standard is consistent with the historical “rule of reason” approach underpinning modern law on restrictive covenants¹⁶¹ developed as early as 1711 in *Mitchel v. Reynolds*.¹⁶²

The FTC's proposed rule and narrow sale-of-business exception swaps

157. *Id.* at 38342.

158. *See* *Sunder Energy, LLC v. Jackson*, 305 A.3d 723, 753 n.66 (Del. Ch. 2023) (“These consider[ation]s apply with less force to sophisticated, highly compensated executives where, if anything, the bargaining power imbalance is on the other foot. Senior executives can retain counsel, bargain effectively with employers, and reach bespoke agreements. They also can bargain for sufficient compensation to offset the potential cost of having to sit out due to a competition restriction.”).

159. *See* *Pierce v. Fuller*, 8 Mass. 223, at 225 (1811).

160. *See* Lavender, *supra* note 2.

161. *See* Cloutier et al., *Buyer (and Seller) Beware: The FTC Is and Will Come for Your M&A Non-Competes*, JD SUPRA (June 22, 2022), <https://www.jdsupra.com/legalnews/buyer-and-seller-beware-the-ftc-is-and-4756655/> [<https://perma.cc/78AM-V7SP>].

162. *See* Fisk, *supra* note 26, at 455 (“*Mitchel* established a multifaceted analysis of reasonableness that has ever since dominated the law’s approach to contractual restraints on the practice of trade and thus to the dissemination of workplace knowledge.”). As the court laid out in *Mitchel*, a valid non-compete agreement must be (1) supported by adequate consideration, (2) limited in time, geographic scope, and in the occupations that are prohibited, and (3) not unduly injurious. *Id.* at 456.

one extreme for another without accounting for the important role that non-competes with high-level employees play in the negotiation for the sale of a business. By crafting the rule's exception to be so narrow as to only include owners of a business, many key employees will be excluded from the coverage of the exception. As a result, the FTC's proposed rule will hamper the M&A market as buyers and sellers are disincentivized to engage in transactions that both sides determine are fair. Buyers will feel less protected and thus deduct from the purchase price; and sellers may accept a lower value than they normally would have been able to achieve and will experience less bargaining power. The proposed rule fails to account for the "complex trade-offs between employers' training and R&D incentives (generally favored by noncompetes) and employee mobility (generally disfavored by non-competes). While the latter is important for innovation, *so is the former.*"¹⁶³ Without a non-compete agreement in place, investors—such as private equity firms—will no longer be interested in investing in underperforming and undervalued businesses with the goal of making them more productive and profitable. Ultimately, not only will the M&A market slow *more* than it already has, but the overall economy will suffer from losing the business growth benefits that these transactions and their use of non-compete agreements reap.

163. Barnett & Sichelman, *supra* note 104, at 963 (emphasis added).