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The Antitrust Implications of Non-Compete Agreements

The Federal Trade Commission's (FTC) recent settlement in *In the Matter of Oltrin* prohibiting use of a geographic non-compete by two companies in the bulk bleach industry is a reminder that the antitrust agencies look closely at non-competes, especially when the parties to the non-competes have market power.

What Is a Non-Compete Agreement?

Non-compete agreements are typically found in employment contracts, agreements for the purchase of a business or certain assets of a business, or in service provider agreements. For example, an employer may require an employee – particularly if highly skilled – to sign a non-compete agreement restricting the employee from competing against the employer for a limited period of time after the employee leaves the company and within a certain geographic area. Similarly, a company purchasing the assets of a competitor may include a provision in the purchase agreement prohibiting the competitor from competing in the relevant geographic or product market for a period of time.

Treatment of Non-Competes Under the Antitrust Laws

The primary federal antitrust statutes, the Sherman Act (15 U.S.C. § 1 et *seq.*) and the Federal Trade Commission Act (15 U.S.C. § 41 et *seq.*), prohibit contracts, agreements, and conduct that unreasonably restrain trade (as well as monopolization and attempted monopolization). Non-competes are generally analyzed under the rule of reason, which balances the procompetitive benefits of the conduct against the potential anticompetitive harm to determine the likely overall effect on competition.

The competitive analysis typically involves a review of the reasonableness of the non-compete's duration, geographic coverage, and whether the restraint is reasonably related to a legitimate purpose. Legitimate purposes include, among other things, protecting a purchaser's ability to reap the benefits of a purchased business and protecting an employer's valuable personal contacts or trade secrets.

Although non-compete agreements have been treated by some as "lower risk" under the antitrust laws, the FTC and Department of Justice (DOJ) may well challenge non-compete agreements that are unreasonable in scope or duration, or otherwise have an anticompetitive effect on balance in the market. In *Oltrin*, for example, the FTC challenged as anticompetitive Oltrin Solutions, LLC's purchase of a customer list from JCI Jones Chemicals, Inc. for $5.5 million along with JCI's agreement not to compete in the bulk bleach industry in North or South Carolina for six years. *See* FTC, Complaint, available at http://www.ftc.gov/os/caselist/1110078/130118oltrincmpt.pdf. According to the FTC, the market was highly concentrated with high barriers to new entry. Applying the rule of reason, the FTC alleged that the non-compete eliminated actual, direct and substantial competition between Oltrin and JCI in the relevant market; substantially increased the market concentration for bulk bleach sales; and increased

Oltrin's ability to raise bulk bleach prices. Critically, it appears that there was no legitimate business purpose advanced by the transaction.

The settlement agreement requires Oltrin to release JCI from the non-compete, transfer a minimum volume of bulk bleach contracts back to JCI, and provide JCI a short-term backup supply agreement to facilitate JCI's re-entry into the North Carolina and South Carolina markets.

When and How to Use Non-Competes

To minimize antitrust risk, companies should consider the following when using non-compete agreements.

For employment agreements:

- Limit the duration of the non-compete to a reasonable length (this is fact specific, but up to three years is a good rule of thumb); limit the scope of the non-compete to match the type of work performed by the employee; and limit the geographic scope of the non-compete to a reasonable distance. Each of these restrictions should be tied to the business justification for the restraint.
- Determine whether the non-compete involves a profession or set of skills that are scarce in the market. Federal and state antitrust enforcers may be more aggressive in cases where there is a limited supply of replacement workers (think physicians) or where the restrictions are not otherwise in the public interest.
- Don't agree with your competitors not to recruit each other's employees. (This is the case in a recent DOJ complaint against eBay Inc. and Intuit Inc. See http://www.justice.gov/opa/pr/2012/November/12-at-1376.html).

For purchase / service agreements:

- Follow the same general guidance noted above on duration and geographic scope (i.e., reasonableness).
- Any non-compete agreement should be narrowly designed to further a legitimate business justification, such as ensuring that the purchaser is able to put the assets purchased to productive use or the service provider is able to protect their investment in building their products and services.
- The non-compete should be tied to a particular economic activity or line of business – avoid overly broad non-competes that prohibit competition outside the scope of the transaction.

In either case, don't forget about state laws – almost every state has its own unique laws governing the use of non-compete agreements. California, for example, has very strict non-compete laws, whereas many other states allow non-competes that are reasonable in scope and duration (as set forth above). *See*, e.g., http://www.venable.com/enforcing-non-compete-provisions-in-california-01-13-2012/ (for additional information on California's non-compete laws).

Finally, any company considering the use of a non-compete clause in an employment, purchase, or service agreement should consult with antitrust counsel early in the process, including review of the agreement's terms and conditions, to ensure that the proposed non-compete complies with the antitrust laws.