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FTC Action Highlights Antitrust Scrutiny of Non-Competes in M&A Deals

In a September 13, 2019 enforcement action, the Federal Trade Commission required the parties in a sale of a natural gas pipeline to revise their agreement to eliminate a non-compete covenant that the FTC determined was not reasonably limited in scope. The FTC did not express any antitrust concerns about the underlying transaction, but still prohibited the parties from consummating the deal until the purchase agreement was amended. The FTC's enforcement action is a reminder that the antitrust agencies will closely scrutinize non-competes. These investigations can delay the closing of M&A transactions, even in deals that otherwise present no significant antitrust risk.

Background

Nexus Gas Transmission LLC, a joint venture between DTE Energy Company and Enbridge Inc., agreed in January 2019 to a \$160 million purchase of the Generation Pipeline, a natural gas pipeline serving the Toledo, Ohio area, from a group of sellers that included North Coast Gas Transmission LLC ("NCGT"), a minority owner. NCGT also owns the North Coast Pipeline, which serves the Toledo area as well but which was not included in the sale to Nexus. The sale agreement contained a non-compete provision prohibiting NCGT from competing with Nexus for three years in a region that included certain parts of Lucas, Ottawa, and Wood Counties, which all surround Toledo.

The FTC did not allege that the combination of the Generation Pipeline and Nexus's existing pipeline assets raised any antitrust concerns. In fact, the transaction resulted in eliminating a common owner of the North Coast and the Generation pipelines, which the FTC stated were key competitors for certain customers in the Toledo area.¹ However, the FTC determined that the geographic scope of the non-compete was "broader than reasonably necessary, because it prevents NCGT from competing for *any opportunity* in the restricted area, *even for opportunities that were unforeseen at the time of the transaction.*"² Thus, the non-compete prevented NCGT from using its retained assets to compete for future customer opportunities, even those opportunities that were unrelated to its ownership interest in the Generation pipeline. In addition, the FTC emphasized that the non-compete did "not protect any

¹ Cf. Complaint *In re DTE Energy Co. et al.* ¶ 12 [hereinafter, "Complaint"] (describing Generation and North Coast as "the best natural gas pipeline transportation alternatives for certain existing or potential customers located reasonably close to both pipelines"), available at https://www.ftc.gov/system/files/documents/cases/06_dte-enbridge_complaint_redacted.pdf.

² *Id.* ¶ 15 (emphasis added).

intellectual property, goodwill, or customer relationship necessary to protect Nexus' investment."³ Therefore, the FTC determined that the non-compete provision was not reasonably limited in scope to protect a legitimate business interest.

While the FTC voted unanimously to challenge the transaction, three Commissioners issued two concurrences. Commissioners Chopra and Slaughter, both Democrats, issued a joint statement expressing the view that too many firms impose non-compete clauses "to avoid the discipline of a functioning marketplace," and that the FTC should be skeptical of non-competes.⁴ Commissioner Wilson, a Republican, stated that while "this particular non-compete was broader than necessary to protect the legitimate interests of the parties," many non-competes are lawful and enforceable because they are necessary to protect the value of the purchased business or assets.⁵

Key Takeaways

While non-compete clauses in M&A deals are common, transacting parties should be aware that they may be reviewed by the antitrust agencies to assess whether the provisions are no broader than necessary. This is particularly the case in the current regulatory environment, where non-competes in other contexts (e.g., employee non-competes) are subject to intense scrutiny.⁶ The HSR Act requires parties to submit non-compete covenants with their initial merger filings, even when the non-compete is separate from the main transaction agreement or remains in draft form at the time of filing. To avoid prolonged investigations, transacting parties should be prepared to demonstrate that the non-compete is narrow and supported by legitimate business justifications, such as ensuring that the seller does not use IP, goodwill, or customer or supplier relationships that will be sold to the buyer to compete with the business shortly after the sale, thereby depriving the buyer the benefit of the bargain. The FTC has stated that a "mere general desire to be free from competition is not a legitimate business interest."⁷ With careful planning and drafting, parties can craft non-compete provisions that will withstand scrutiny and avoid delays to closing of transactions.

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³ *Id.*

⁴ Statement of Commissioners Rohit Chopra and Rebecca Kelly Slaughter, *In the Matter of DTE Energy Co. et al.*, at 1, available at https://www.ftc.gov/system/files/documents/public_statements/1544138/joint_statement_of_chopra_and_slaughter_dte_energy-generation_pipeline_9-13-19.pdf.

⁵ Concurring Statement of Christine S. Wilson, *In the Matter of DTE Energy Co. et al.*, at 1, available at https://www.ftc.gov/system/files/documents/public_statements/1544152/wilson_concurring_statement_dte_9-13-19.pdf.

⁶ See, e.g., Letter from Rohit Chopra to Makan Delrahim (Sept. 18, 2019) (urging DOJ to prosecute wage collusion criminally, and for the FTC to initiate rulemaking on the use of non-competes in worker contracts); *Hearing on Oversight of the Enforcement of the Antitrust Laws Before the Antitrust, Competition Policy and Consumer Rights Subcomm. of the S. Comm. on the Judiciary*, 116th Cong. (Sept. 17, 2019) (statement of FTC Chairman Joseph Simons that the FTC will have a "workshop to see if we can have other sources [outside of existing economic literature] to justify" a rulemaking on employee non-competes); Letter from Sen. Blumenthal et al. to Joseph Simons (Mar. 20, 2019) (urging FTC rulemaking to "combat the scourge of [employee non-compete] clauses."); Michael Murray, *Deputy Assistant Attorney General Michael Murray Delivers Remarks at the Santa Clara University School of Law* (Mar. 1, 2019) (describing DOJ's enforcement interest in no-poach agreements and their 2019 amicus filings on the same).

⁷ See Complaint ¶ 15.

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