Reining In Overbroad M&A Noncompetes Amid FTC Scrutiny

By **Greg Heltzer and Alex Grayson** (June 30, 2022)

Greg Heltzer

Alex Grayson

Signaling its continued commitment to cracking down on overly broad mergers and acquisitions noncompete provisions, the Federal Trade Commission recently made significant limitations to a noncompete in an acquisition agreement for 60 gas stations.[1]

The enforcement action reaffirmed the importance of narrowly tailoring such M&A noncompetes by limiting the scope of the provision in terms of duration and geographic radius affected.

This is not a one-off FTC enforcement action. The FTC has challenged overly broad noncompetes several times recently[2] and will continue to do so in the future.

FTC Chair Lina Khan warned that "firms may not use a merger as an excuse to impose overbroad restrictions on competition or competitors" and that "[t]he Commission will evaluate agreements not to compete in merger agreements with a critical eye."[3]

What Happened

Arko Corp.'s GPM Investments subsidiary acquired 60 gas stations from Corrigan Oil. As part of the acquisition agreement, Corrigan agreed not to compete for a period of time with the gas stations purchased from Corrigan.

In addition, Corrigan agreed not to compete with GPM for another 190 gas stations that GPM already owned. Few of the 190 existing GPM locations were "anywhere near an acquired Corrigan" gas station, according to the complaint.[4]

Because the transaction would reduce the number of competitors from three to two or fewer in five areas, the FTC required divestitures in those areas. Additionally, the FTC determined that the noncompete was overbroad, noting that the noncompete was "untethered to protecting goodwill acquired in the acquisition" because it affected gas stations in "areas geographically distinct from the acquired" gas stations.[5]

For this reason, the noncompete was highly suspect and warranted FTC scrutiny.[6] The FTC required the parties to revise the transaction agreement noncompete such that it was in duration no longer than three years and affected an area no greater than 3 miles from each acquired gas station.

What's Next

Khan confirmed that some noncompete agreements that are part of a transaction agreement are "necessary to protect a legitimate business interest in connection with the sale of a business, such as the goodwill acquired in a transaction."[7]

Here, the noncompete terms were determined, however, to be "facially" overbroad in scope and unrelated to protecting any goodwill GPM was acquiring with the Corrigan stations.[8]

The FTC's action suggests that it is on the lookout for overbroad noncompetes that are not reasonably related to a legitimate purpose even if part of a legitimate transaction agreement.

The action by the FTC provides sellers with an example to argue that onerous noncompetes demanded by buyers have the potential to raise antitrust issues that could slow deal timelines, particularly if a noncompete is overbroad in relation to the products affected, the duration of the noncompete, and/or the breadth of the geography covered.

Mitigating Risk

The purpose of a noncompete in M&A transactions is to protect the buyer's investment in the acquired business by preventing the seller from immediately reentering the business following the sale.

In short, the noncompete protects against the risk that the seller will appropriate the goodwill it is selling to the buyer. There is no dispute that noncompete provisions are valuable, necessary and legitimate protections for buyers in commercial transactions.

Nonetheless, we anticipate that these provisions will be increasingly scrutinized by antitrust enforcers, particularly where the companies remain competitors in the same industry post-merger.

Thus, beyond ensuring that noncompetes do not impose facially broad restrictions — e.g., covering unlimited geographic territory indefinitely — M&A parties should make sure there is a reasonable basis for the scope of the noncompete and how it ties with the preservation of the transaction. In particular:

- A noncompete should be narrowly tailored to protect the buyer's legitimate business interest in the goodwill, acquired assets, property or customer relations connected to the acquisition. For example, a noncompete protects a legitimate business interest when it safeguards against the prospect of the seller immediately reentering the business after the sale.

- The geographic scope covered by the noncompete and its duration must be reasonable. While a measurement of reasonableness in M&A transactions typically demands a fact-specific inquiry, the general rule is that noncompetes that contemplate products and services and markets that are unrelated to the deal are unreasonable. Noncompetes that cover geographic radii spanning into geographies not implicated by the deal or that restrict the sale of products unrelated to the deal are likely to draw enhanced scrutiny from antitrust enforcers.

Because noncompetes are not always memorialized in the purchase agreement, counsel should ask the deal team whether there is a noncompete in ancillary documents to the purchase agreement.

In the event that a noncompete draws the attention of antitrust enforcers, the parties should expect the reasonableness analysis to include government enforcers reviewing internal documents given that recent cases have relied on hot internal documents and/or

testimony detailing the parties' views regarding the impact of the noncompete.

Conclusion

For M&A parties, the scope that is needed to reasonably protect the investment should be the central consideration in drafting noncompete provisions. Counsel should pressure-test such provisions, particularly when the scope of the noncompete appears to affect assets or businesses that are independent of the transaction.

Gregory Heltzer is a partner and Alex Grayson is a summer associate at McDermott Will & Emery LLP.

[1] See generally Complaint,In re Matter of ARKO Corp., GPM Investments, LLC, GPM Southeast, LLC, and GPM Petroleum, LLC, No. 211-0087, available at https://www.ftc.gov/system/files/ftc_gov/pdf/2110087GPMComplaint.pdf.

[2] See, e.g., Complaint, In the Matter of DTE Energy Co., No. 191-0068 (F.T.C. filed Dec. 13, 2019), available at https://www.ftc.gov/system/files/documents/cases/191_0068_c-4691_dte-enbridge_complaint.pdf; Complaint, In the Matter of Axon Enterprise, Inc., https://www.ftc.gov/system/files/documents/cases/d09389_administrative_part_iii_-_public_redacted.pdf; Complaint, Altria Group, Inc., No. 191-0075 (F.T.C. filed Apr. 1, 2020),https://www.ftc.gov/system/files/documents/cases/d09393_administrative_part_iii_complaint-public_version.pdf.

[3] Statement of FTC Chairwoman Lina M. Khan regarding In re Matter of ARKO Corp., GPM Investments, LLC, GPM Southeast, LLC, and GPM Petroleum, LLC (Jun. 10, 2022), available at https://www.ftc.gov/system/files/ftc_gov/pdf/2110187GPMExpressKhanStatement.pdf [hereinafter, "Statement of FTC Chairwoman Lina M. Khan"].

[4] Complaint, supra note 1, at ¶ 8.

[5] Statement of FTC Chairwoman Lina M. Khan, supra note 3, at 1.

[6] Analysis of Agreement Containing Consent Order to Aid Public Comment at 4, In re Matter of ARKO Corp., GPM Investments, LLC, GPM Southeast, LLC, and GPM Petroleum, LLC, No. 211-0087, available at https://www.ftc.gov/system/files/ftc_gov/pdf/2110087GPMAAPC.pdf.

[7] Statement of FTC Chairwoman Lina M. Khan regarding In re Matter of ARKO Corp., GPM Investments, LLC, GPM Southeast, LLC, and GPM Petroleum, LLC, supra note 3, at 1.

[8] Id.