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Buyers Beware: FTC's Proposed Rule Banning Noncompetes Has Enormous Implications for M&A

If enacted in its current form, the Federal Trade Commission's (FTC) proposed rule (Proposed Rule), would, with very limited exceptions, prohibit all employers in the United States from entering into or enforcing noncompete agreements with workers. It also would change the landscape of merger and acquisition (M&A) practice dramatically by eroding a key protection afforded to buyers and a key value driver for sellers in sale-of-business transactions, particularly in the competitive market involving healthcare and life sciences companies. The Proposed Rule defines "worker" broadly to include any individual who works, whether paid or unpaid, for an employer, including, without limitation, an employee, an independent contractor, an extern, an intern, a volunteer, an apprentice or a sole proprietor who provides a service to the employer or a customer of the employer.

Although a small number of states do essentially ban all noncompete agreements, most states permit enforcement subject to reasonableness in time and geographical scope and/or limited to certain types of workers and pay levels. Moreover, even those states that will not uphold a noncompete in the employment context will uphold a noncompete in the context of the sale of a business. The Proposed Rule significantly departs from this precedent by imposing a standard that would categorically *deem virtually all noncompetes unfair competition in violation of Section 5 of the FTC Act*, which prohibits "unfair or deceptive acts or practices in or affecting commerce." The potential impact on M&A transactions is enormous.

The Proposed Rule provides a limited exception to the ban on noncompetes, permitting them between the worker-seller and the buyer of a business only if the person restricted by the noncompete clause is an owner, member or partner holding at least a 25 percent ownership interest in the business. Under this framework, a buyer will have to search for a mechanism other than a contractual noncompete restriction to prevent a worker-seller with up to a 24.99 percent ownership interest from taking sale proceeds and historical knowledge and opening up a competing business.

Additionally, in practice, the Proposed Rule goes even broader than it would first appear, because its prohibitions extend not only to business noncompetes themselves in their various forms *but also to other related restrictive covenants*, such as nonsolicitation and nondisclosure agreements, if those agreements would de facto serve to prevent workers from taking jobs with competitors. The Proposed Rule, in effect, would permit a whole class of workers with substantial economic interest in a sale transaction to evade restrictive covenants entirely even if such workers are the beneficiaries of actual equity or sale bonuses and shadow equity payouts in their various forms.

Finally, the Proposed Rule requires employers that entered into noncompetes with workers prior to the rule's compliance date to rescind the noncompetes no later than the compliance date. Buyers that recently negotiated and paid for certain noncompete protections may therefore be stripped of those protections and deprived of the full value of the deal that was bargained for at closing.

Likely due to the enormous impact the Proposed Rule would have if implemented and the strong public reaction, the deadline for submitting comments has been extended from March 20 to April 19. It remains to be seen where the lines will be drawn when the dust settles. While the Proposed Rule impacts all industries, it could have a chilling effect on M&A activity in the healthcare and life science sectors, where such restrictions are standard and necessary to protect buyers. If you are interested in submitting comments on the Proposed Rule or have questions on structuring post-closing protections in connection with an M&A transaction, our healthcare and life sciences attorneys are available to assist.

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