



DEATH SENTENCE FOR NONCOMPETES?

What the FTC rule
proposal means to you

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On January 5, 2023, the Federal Trade Commission (“FTC”) proposed a new rule, which would impose a near-complete ban on the use of non-competes by employers. The FTC’s mission is to protect the public from deceptive or unfair business practices and from unfair methods of competition through law enforcement, advocacy, research, and education.¹

In its current form, the proposed rule would take effect 60 days after it is published in the Federal Register, and employers will have until 180 days after its publication to comply with its requirements.

By eliminating the noncompete, the agency estimates that the new proposed rule could increase wages by nearly \$300 billion per year and expand career opportunities for about 30 million Americans. “The freedom to change jobs is core to economic liberty and to a competitive, thriving economy,” said Chair Lina M. Khan. “Noncompetes block workers from freely switching jobs, depriving them of higher wages and better working conditions, and depriving businesses of a talent pool that they need to build and expand. By ending this practice, the FTC’s proposed rule would promote greater dynamism, innovation, and healthy competition.”²

As part of its study, the FTC looked at four specific types of workers: (1) high-tech workers, (2) physicians, (3) workers paid on an hourly basis, and (4) CEOs. The FTC found that noncompete clauses dampen competition in several ways, such as earnings growth, a collaboration of ideas, and employment shifts.

According to one study, high-tech workers in Hawaii without a non-compete clause could potentially increase their earnings by 4.8%. The Hawaii study focused only on new hires since their ban did not void previously signed noncompete agreements. However, the proposed ban would void all existing noncompete agreements as well as ban future agreements.

In a study that focused on physicians it was found that those **without** a noncompete clause would have an estimated 89% earnings growth over a ten-year period versus an estimated 36% for a physician **with** a noncompete clause, which in summary means a physician **with** a noncompete clause would have earnings approximately 39% higher than a physician **without** a noncompete.

Another study focused on the impact of Oregon’s 2008 prohibition on noncompete clauses for hourly workers and its impact on wages. The study estimated that the prohibition on noncompetes increased hourly workers’ earnings on average by 2.3% and by 4.6% in industries/jobs that typically utilize noncompete agreements.

Lastly, the FTC noted that eliminating noncompete agreements would increase the level of earnings by 12.7% for CEOs.

“Research shows that employers’ use of noncompetes to restrict workers’ mobility significantly suppresses workers’ wages — even for those not subject to noncompetes, or subject to noncompetes that are unenforceable under state law,” said Elizabeth Wilkins, Director of the Office of Policy Planning. “The proposed rule would ensure that employers can’t exploit their outsized bargaining power to limit workers’ opportunities and stifle competition.”³

The FTC argues that the Ban will:

- Increase Competition in the Labor Market
- Increase Wages
- Increase Innovation and Entrepreneurship

¹ <https://www.ftc.gov/about-ftc/mission>

² <https://www.ftc.gov/news-events/news/press-releases/2023/01/ftc-proposes-rule-ban-noncompete-clauses-which-hurt-workers-harm-competition>

³ Ibid.

I. NONCOMPETES

Useful Life		Value as Percentage of Total Intangible Assets	
# Observations:	21,033	# Observations:	3,589
Average:	4.4 years	Average:	39.2%
25th percentile:	3.0 years	25th percentile:	2.5%
Median:	5.0 years	Median:	10.0%
75th percentile:	5.0 years	75th percentile:	33.3%
Mode:	5.0 years		
Value as Percentage of Identifiable Intangible Assets		Value as Percentage of Business Selling Price	
# Observations:	2,041	# Observations:	3,729
Average:	64.9%	Average:	10.1%
25th percentile:	12.9%	25th percentile:	1.6%
Median:	100.0%	Median:	5.0%
75th percentile:	100.0%	75th percentile:	13.9%
<i>Note:</i>			
<ul style="list-style-type: none"> Particularly helpful to analysts requiring more benchmarking information on valuing noncompetes is the section on industry data slices. 			

II. AVERAGE INTANGIBLE VALUE AS A PERCENTAGE OF SOLD BUSINESS VALUE

Arts, Entertainment, and Recreation	13.40%
Mining, Quarrying, and Oil and Gas Extraction	12.10%
Administrative and Support and Waste Management and Remediation Services	11.60%
Accommodation and Food Services	11.60%
Retail Trade	11.40%
Other Services (except Public Administration)	11.40%
Transportation and Warehousing	10.90%
All Industries	10.10%
Professional, Scientific, and Technical Services	9.60%
Health Care and Social Assistance	9.40%
Wholesale Trade	8.90%
Manufacturing	8.70%
Educational Services	8.70%
Construction	8.60%
Real Estate and Rental and Leasing	8.00%
Utilities	7.70%
Consulting	7.30%
Information	6.70%
Technology	5.40%
Finance and Insurance	4.70%
Pharmaceuticals	4.10%
Software	3.60%
Agriculture, Forestry, Fishing and Hunting	2.60%
Management of Companies and Enterprises	2.20%

* The total number of observations is the total number of purchase price allocations for each industry. The figure does not necessarily reflect the number of observations for each intangible asset class in the summary information. The count of observations excludes those for noncompetes; there were over 21,000 observations of noncompete lives and values.

The purchase price allocations are organized by sector, according to the North American Industry Classification System. For more information, visit www.census.gov.

Source: BVR Benchmarking Identifiable Intangible Assets and their Useful Lives in Business Combinations, Third Edition. Reprinted with permission.

The FTC proposal allows for an exception to the ban in connection with the sale of a business. A seller of a business who is selling 25% or more would continue to be able to enter a noncompete agreement with the buyer. If this is the only exception, then key employees who are non-owners or who own less than 25% of the business will have a harder time transferring their personal goodwill because buyers of businesses that are dependent on the personal goodwill of such employees rely on the ability to enter into a noncompete agreement for a certain amount of time to allow them to convert it into their own enterprise goodwill. It's important to note that personal goodwill is different from enterprise goodwill, which is the overall value of the business beyond individual employees.

The restriction of noncompete agreements in an acquisition setting could also reduce merger and acquisition activity and the prices that buyers are willing to pay to acquire companies. According to a BVR study, noncompete agreements comprise a median of 5.0% and an average of 10.1% of a business' selling price. The abolition of noncompete agreements could limit or eliminate business sellers' ability to realize this value in a sale. (See *diagram I, page 8.*)

A majority of noncompetes occur in industries with high-skilled, high-wage jobs such as finance, technology, insurance, and real estate. However, they are also found in average, middle-wage jobs. (See *diagram II, page 8.*)

If the ban becomes effective, the industries that could see a slowdown in merger and acquisition activity are those where specialized talent, knowledge, skills, or personal relationships are essential. Businesses in fields such as Arts, Entertainment and Recreation, Mining, Quarrying, and Oil and Gas Extraction, Investment Advisory, Life Sciences, and Healthcare Providers could see an impact.

Companies that rely heavily on noncompete agreements to safeguard their proprietary information and customer relationships may find it harder to attract potential buyers or merge with other firms. Moreover, companies that acquire other businesses for their talent pool may face difficulties in retaining key employees.

One area where a noncompete ban could be immediately felt is the calculation of amounts subject to the golden parachute rules of Section 280G, which imposes a 20% employee-paid excise tax and disallows a corporate tax deduction for certain compensation payments made in connection with a change in control event.

Currently, the value of payments associated with an enforceable non-compete is excluded from Section 280G. In many cases, this exclusion can be a key factor in mitigating or eliminating exposure under Section 280G. Companies that have engaged in recently closed transactions could face a scenario where they might need to rerun 280G calculations to remove reliance on noncompete covenants to reduce the value of parachute payments and reevaluate their 280G tax position. Companies that are involved in an acquisition where 280G is triggered may be losing a key exclusion because under current rules the fair market value of noncompete agreements with these employees is excluded from the 280G payment calculations.

A noncompete ban could also trigger accelerated recognition of taxable income for employees who have deferred compensation arrangements that rely on Section 83 to defer taxation and FICA withholdings because it is subject to a

“substantial risk of forfeiture” due to a noncompete agreement.

The proposed noncompete ban has both advantages and disadvantages. On the positive side, it has the potential to promote competition, improve job mobility, and foster entrepreneurship. It could also prevent employers from imposing unreasonable restrictions on employees and hampering their career growth. However, the proposed ban could reduce merger and acquisition activity and the prices that buyers are willing to pay to acquire companies. Companies that rely heavily on noncompete agreements to safeguard their proprietary information and customer relationships may find it harder to attract potential buyers or merge with other firms. Moreover, companies that acquire other businesses for their talent pool may face difficulties in retaining key employees.

Overall, while the proposed noncompete ban has its pros and cons, its ultimate impact on the labor market and industry dynamics remains to be seen.

The FTC public comment period closed March 20, 2023. To stay abreast of the latest news on this proposed rule, you can subscribe to press releases from the FTC on their website.



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