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Antitrust Advisory: Golf Superstore Falls into Trap with Non-Compete Agreement

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On October 9, 2008, the Federal Trade Commission ("FTC") announced a consent agreement with Golf Galaxy, a subsidiary of Dick's Sporting Goods Inc., in *In the Matter of Dick's Sporting Goods, Inc., a Corporation* (FTC File No. 071 0196), which settled charges of illegal territorial market division. The consent agreement prohibits Golf Galaxy from enforcing a non-compete agreement with Golf Town Canada Inc. ("Golf Canada"), a potential competitor in the retail golf merchandise market.

Why This Case Is Important

This case serves as a reminder that the FTC is vigilant in challenging non-compete provisions that serve no pro-competitive purpose. Agreements between competitors to stay out of each others' markets are treated by the courts as presumptively anticompetitive, or inherently suspect, even when part of a larger set of agreements. Failure to advance a legitimate efficiency justification for such non-compete agreements will likely result in antitrust liability. As discussed below, an initial non-compete tied to a consulting agreement was not challenged by the FTC, who recognized it as reasonably necessary. However, when the consulting arrangement ended but the non-compete was extended, without being connected to other efficiency-enhancing activities, the FTC stepped in to condemn it.

Let's Play Another 18 Holes

In 1998, Golf Galaxy, an operator of chain golf superstores in the United States, entered into a consulting agreement (the "1998 Agreement") with Golf Canada under which Golf Galaxy agreed to provide various services to help Golf Canada launch a chain of golf superstores in Canada. In exchange for these consulting services, Golf Galaxy received cash, shares of Golf Canada, and a seat on the board of directors of Golf Canada. Under the 1998 Agreement, Golf Canada was also restrained from competing with Golf Galaxy in the United States for a certain period of time beyond the term of the 1998 Agreement.

In 2004, Golf Galaxy sold its shares of Golf Canada, and all consulting obligations under the 1998 Agreement ended. The parties then entered into a new agreement (the "2004 Agreement") which extended and added to the non-compete for a period of time beyond the dates contemplated by the 1998 Agreement.

The Federal Trade Commission's Complaint and Consent Agreement

Importantly, The FTC did not challenge the 1998 Agreement and affirmatively indicated that the restraints on competition under that agreement were "reasonably necessary to the formation and/or efficient operation of the parties' collaboration." The FTC found that the 1998 Agreement enabled Golf Canada to benefit from Golf Galaxy's experience and expertise, which was a legitimate and competitive purpose that justified the need for the non-compete.

However, once the consulting relationship ended, the FTC argued that the 2004 Agreement became a naked agreement to divide and allocate markets in violation of Section 5 of the Federal Trade Commission Act ("FTC Act") because it "served only to provide Golf Galaxy's shareholders with additional protection from competition, with no advantage to U.S. consumers."

In analyzing this case, the FTC followed the analytical framework articulated in the FTC's *PolyGram*[1] case, which was affirmed by the DC Circuit. "When an agreement is deemed inherently suspect, the parties can avoid summary condemnation under the antitrust laws by advancing a legitimate (cognizable and plausible) efficiency justification for the restraint."[2] The FTC found that the competitive restraints in the 2004 Agreement served no pro-competitive purpose because they were not reasonably necessary for the formation or efficient operation of the collaboration between Golf Galaxy and Golf Canada (because no further cooperation was contemplated after 2004). Lacking an efficiency rationale, the 2004 Agreement was an unreasonable restraint on trade in violation of Section 5 of the FTC Act.

The consent agreement prohibits Golf Galaxy from dividing or allocating markets for the retail sale of golf merchandise. The consent agreement further prevents Golf Galaxy from enforcing any non-compete provision beyond the date originally provided for in the 1998 Agreement.

Endnotes

[1] *PolyGram Holding, Inc.*, 136 F.T.C. 310 (2003), *aff'd*, 416 F.3d 29 (D.C. Cir. 2005).

[2] *PolyGram Holding, Inc. v. FTC*, 416 F.3d 29, 35–35 (D.C. Cir. 2005).

Please feel free to contact us if you wish to receive a copy of the FTC's Complaint or Consent Agreement, or if you would care to discuss the appropriate use of agreements not to compete for your business.

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