

Final FTC Noncompete Rule

Implications for Not-for-Profit Health Care Organizations



On April 23, 2024, the Federal Trade Commission (FTC) issued its Final Non-Compete Clause Rule (“Final Rule”), which bans most post-employment noncompete clauses after the effective date. Barring any delays, the Final Rule will go into effect on September 4, 2024. This is 120 days after its initial publication in the Federal Register.¹

The Final Rule is broad and covers noncompete arrangements with all workers, including employees, independent contractors and volunteers. The FTC is already facing several legal challenges asserting that the agency lacks the authority to issue the Final Rule. Further questions regarding the scope of the FTC’s purview over certain not-for-profit organizations also have arisen. Nevertheless, the Final Rule could have significant implications for employment and independent contractor arrangements with executives, physicians, advanced practice providers (APPs) and other workers. Health care organizations are well advised to understand the parameters of the Final Rule, assess its implications, and identify potential actions to take before the effective date.

This article provides some initial guidance for consideration.

OVERVIEW OF THE FTC NONCOMPETE RULE

The provisions of the Final Rule include the following:

- **Prohibits all new post-employment noncompete agreements** after the effective date for any worker regardless of title, job function, or compensation.
- **Bans almost all existing post-employment noncompete agreements** after the effective date:
 - Formal rescission is not required; however, individual notice that agreements are no longer enforceable is required by the effective date.
 - **Exception for existing Senior Executive noncompete agreements** – such agreements will remain enforceable even after the effective date; new Senior Executive noncompetes are prohibited.
 - “Senior Executive” is defined as a worker who (a) receives annualized compensation over \$151,164 and (b) is in a policy-making position for the business as a whole.
 - The exception is likely to be narrow and applicable to the most senior leaders of the enterprise. For example, the FTC indicates that a hospital-employed physician who leads a surgical or internal medicine practice would not be a Senior Executive.

¹“Employment” is defined by the FTC as “work” completed for a person. Thus, as used in this article, employment includes both employer-employee relationships and independent contractor relationships.

- **Defines a “noncompete clause” broadly:**
 - Goes beyond an explicit noncompete provision and applies whether documented in a contract or policy.
 - Defined in the Final Rule as “a term or condition of employment that prohibits a worker from, penalizes a worker for, or functions to prevent a worker from (i) seeking or accepting work in the United States with a different person where such work would begin after the conclusion of the employment that includes the term or condition; or (ii) operating a business in the United States after the conclusion of the employment that includes the term or condition.”
- **Other restrictive covenants (e.g., nonsolicitation, confidentiality) are not categorically banned:**
 - However, if they are so broad as to prevent a worker from seeking other work after their employment ends, such restrictive covenants may fall within the definition of a noncompete.

Application of the Final Rule to Tax-Exempt Health Care Organizations. Under the FTC Act, an organization must be “organized to carry on business for its own profit or that of its members” in order to fall within the purview of the FTC. The FTC takes the position that a portion of tax-exempt entities will fall within its jurisdiction and the Final Rule’s purview. In its commentary on the Final Rule, the FTC explicitly notes that tax-exempt status is one factor to be considered, but that this status is not dispositive when determining the FTC’s jurisdiction. Furthermore, the FTC referenced the negative impact of noncompetes in health care and declined to provide a blanket exemption to the industry. Thus, some tax-exempt health systems may fall within the Final Rule’s purview. In addition, at least a portion of a health system’s business could be impacted by the Final Rule by virtue of its application to employees of for-profit entities within a tax-exempt health system (e.g., health plans, joint ventures, hospital-physician organizations, for-profit subsidiaries, etc.). Based on the FTC’s position, the Final Rule’s application to tax-exempt health care organizations is likely to face legal challenges.

IMPLICATIONS AND CONSIDERATIONS FOR HEALTH CARE ORGANIZATIONS

The Final Rule could have significant implications for tax-exempt health care organizations. In addition to its potential application to health systems and their constituent businesses, the Final Rule’s application to broader for-profit organizations may impact tax-exempt health systems’ ability to effectively recruit and retain employees in a competitive marketplace for talent. When hiring a physician, for example, not-for-profit health systems will need to consider the effect a noncompete provision may have on a candidate – especially if that candidate is considering an alternative offer from a for-profit organization without noncompete restrictions. Similar considerations may apply to executives and other employees.

While the ultimate application of the Final Rule is still uncertain, tax-exempt health systems should take the following actions to be prepared:

- **Inventory Current Noncompete Arrangements.** Assess the existing use of noncompete agreements and other restrictive covenants for current and former executives, physicians, other employees, and contractors.
 - The inventory should be broad and include the health system and medical group, as well as any for-profit businesses (e.g., health plans, for-profit subsidiaries, joint ventures, staffing companies).

- Noncompete arrangements may be found in a variety of documents, including employment contracts, deferred compensation arrangements, severance agreements, program documents and policies.
- Agreements with independent contractors (e.g., Medical Directors) also should be reviewed.
- Consider establishing a noncompete arrangement if one does not exist for any Senior Executive.
 - The Final Rule bans organizations from entering into any noncompete agreements *after* the effective date but will preserve the enforceability of arrangements that pre-date the effective date for Senior Executives.
- Draft and plan for notification prior to the effective date to all individuals restricted by noncompetes about their unenforceability.
- **Assess Risks if Noncompetes are Unenforceable.** Understand the potential business and retention risks if noncompetes are unenforceable. As part of this review, determine if other legal compliance issues are implicated. For example, striking a noncompete provision could impact the taxability of deferred compensation agreements that use noncompetes to establish a “substantial risk of forfeiture.”
 - Once the risks are inventoried, prioritize those with the greatest impact where alternative actions may be appropriate to protect the organization.
- **Work with Legal Counsel to Assess the Potential Application to Tax-Exempt Entities.** The application of the Final Rule to each tax-exempt organization will require careful consideration of the individual circumstances of the entity. The conclusion will be impacted by the organization’s business model and structure, among other factors.
- **Consider Alternative Restrictive Covenants and Termination Notice Provisions.**
 - Assess the use of nonsolicitation and confidentiality/nondisclosure restrictions as alternatives to noncompete clauses.
 - Nonsolicitation restrictions may be critical in situations where physicians transitioning to competitive employment situations are likely to take patients with them.
 - Ensure that such restrictions are appropriately tailored to ensure they do not fall within the definition of a noncompete provision.
 - Determine if reasonable termination notice provisions can be incorporated into an agreement to allow for continued employment prior to termination.
 - The Final Rule does not apply to “garden leave,” where a worker remains employed to provide limited duties while continuing to receive pay.
 - Organizations may consider utilizing such notice provisions to delay departure (and thus the time when “competition” can begin).
- **Consider Actions in the Context of the Broader Talent Strategy; Evaluate the Use of Retention and Other Pay Arrangements.**
 - Articulate the organizational purpose of noncompetes and the rationale for using them with certain employees (e.g., risk of trade secret disclosure, preserving investments in training/development, protecting against loss of patients, etc.).

- Identify the employees who are critical to retain and consider appropriate interventions:
 - Organizations can reorient their strategies to provide a reward for remaining with the organization rather than a penalty for departure.
 - Examples include compensation adjustments, retention bonuses or other deferred compensation that is contingent on continued employment, and professional development opportunities.
- **Monitor the Status of Legal Challenges.** Challenges to the FTC’s authority to promulgate and enforce the Final Rule may take some time to be adjudicated. Action plan timelines should be adapted as the legal challenges unfold.

CONCLUSION

The ultimate enforceability of the Final Rule is subject to significant legal challenges and may be delayed or limited. In the meantime, tax-exempt and other health care organizations should ensure they understand the potential implications of the Final Rule and determine actions that may be taken to protect critical business interests.

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