HEALTH CAPITAL Topics
Volume 17
Issue 8
August 2024
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Federal Judge Strikes Down Noncompete Ban

Introduction

On August 20, 2024, a Texas federal judge stopped the FTC's ban on noncompete agreements from going into effect on September 4, 2024. This decision comes after the FTC issued a final rule on April 23, 2024, that bans employers from imposing noncompetes on their employees. The FTC asserted that this exploitative practice kept wages low and suppressed new ideas.[1] While the FTC's ban will affect all industries – not just healthcare – it comes at a time when healthcare employers across the U.S. are struggling with staffing shortages.[2] This Health Capital Topics article reviews the court's ruling and discusses the FTC's ban on noncompete agreements.

Noncompete Background

Noncompete agreements are defined as "employment provisions that ban workers at one company from going to work for, or starting, a competing business within a certain period of time after leaving a job."[3] Approximately 30 million Americans are bound by noncompete clauses, which restrict them from pursuing other employment opportunities.[4] Further, workers in states where noncompete enforcement is easier typically experience lower wages.[5] Specific to healthcare, the FTC reports that noncompetes increase healthcare costs, and estimates that banning noncompetes would result in upwards of $194 billion in reduced healthcare spending over a ten-year period.[6]

The presence, or absence, of noncompete agreements can impact the value of a business by:

(1) Restricting the ability of owners or workers to leave and start a competing business or work for a competitor;
(2) Impeding a potential buyer's ability to employ key personnel or enter specific markets; and/or,
(3) Providing the business a competitive advantage.

If a noncompete agreement is too restrictive, it could also lower the value of a business by limiting its ability to retain and attract new employees, and by reducing the business's ability to develop and expand.[7] It is important to note that the FTC's ban does not apply to noncompetes entered into by a person pursuant to a "bona fide" sale of a business entity, of the person's ownership interest in a business entity, or of all or substantially all of a business entity's operating assets.

Under the final rule, existing noncompetes for the majority of workers would have been unenforceable beginning September 4, 2024.[8] Notably, noncompetes for senior executives would have remained in force, but employers could not have entered into, or attempted to enforce, any new noncompetes, even for senior executives.[9] Notably, the rule does not apply to non-profit entities, as the FTC acknowledged that it has no jurisdiction over these entities.[10] Nevertheless, the agency reserves the right to evaluate any entity's non-profit status, noting that some "entities that claim tax-exempt nonprofit status may in fact fall under the Commission's jurisdiction."[11] The FTC specifically stated that "some portion of the 58% of hospitals that claim tax-exempt status as nonprofits and the 19% of hospitals that are identified as State or local government hospitals… likely fall under the Commission's jurisdiction and the final rule's purview."[12]

Cases Addressing the FTC's Ban

In *Ryan LLC v. FTC*, the plaintiff, a tax company, as well as the U.S. Chamber of Commerce, Business Roundtable, Texas Association of Business, and Longview Chamber of Commerce (which parties intervened in the lawsuit), filed a lawsuit in the U.S. District Court for the Northern District of Texas to block the FTC from implementing its ban on noncompete agreements. On July 3, 2024, the court granted a limited preliminary injunction in the case, staying the FTC's ban only for the plaintiffs involved in the case (i.e., the ruling did not extend to other businesses in the U.S.).[13] In that decision, the court stated that the FTC "lacked substantive rule-making authority with respect to unfair methods of competition" and noted that "the plaintiffs were likely to succeed on the merits of their challenge."[14]

Then, in its August 20, 2024 ruling on the plaintiffs' motion for summary judgment, the court struck down the FTC ban in its entirety, and applied its ruling nationwide, finding that the FTC exceeded its statutory authority in promulgating its final rule banning noncompetes.[15] The court also found the rule to be arbitrary and capricious, stating that the FTC's ban is "unreasonably overbroad without a reasonable explanation."[16] The court stated that "[t]he Rule imposes a one-size-fits-all approach with no end date, which fails to establish a 'rational connection between the facts found and the choice made.'"[17] Notably, the court cited multiple times to the recent

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Loper Bright case, wherein the U.S. Supreme Court overturned *Chevron* deference.[18] As a result of the court's order, the FTC's ban can no longer take effect starting September 4th, or be enforced.[19]

Notably, this decision from the Northern District of Texas has created a federal circuit split with the Eastern District of Pennsylvania that may ultimately need to be resolved by the U.S. Supreme Court.[20] The Pennsylvania federal district court previously declined to block the FTC's ban in July 2024. In *ATS Tree Services, LLC v. FTC*, the plaintiff filed a motion for a preliminary injunction, requesting that the court stay the FTC ban's effective date.[21] In their complaint, ATS argued (similar to Ryan LLC) that the FTC did not have the authority to impose such a ban, claiming it violates the Administrative Procedure Act (APA) and the U.S. Constitution.[22] ATS also alleged that the FTC overstepped their statutory authority under the FTC Act, arguing that the agency could only make such decisions on a case-by-case basis rather than by implementing a broad ban.[23] However, the court declined to stop the ban from taking effect, ruling that the employer plaintiff failed to demonstrate that the FTC ban would cause irreparable harm or that the Plaintiff was likely to win the case.[24]

Healthcare Implications of the FTC's Ban

In the event that the FTC's ban is later allowed to become effective, not only will it have implications on the revenue stream of healthcare services, by banning noncompetes, but physicians would be able to move between jobs with more freedom, and compensation could potentially increase.[25] This may impact the expense structure of healthcare entities and necessitate further contemplation by compensation valuation professionals when considering historical market compensation data that were subject to noncompetes for the purposes of analyzing prospective arrangements that are not subject to noncompetes.

In healthcare, the medical profession has grown from small practices comprised of just a few physicians to mega-practices totaling a few hundred physicians, especially in urban settings. Noncompetes in healthcare have traditionally been utilized as a tool to limit the harm that a physician may inflict upon departing a practice. While these large practices need to protect their investments, noncompete clauses may make it difficult for a departing physician to seek employment within the same geographic area.[26] Noncompete clauses in specialty practices further complicate the ability for physicians to seek employment, as specialists only serve a subset of the population (i.e., there may be fewer outside opportunities for specialists).[27]

Conclusion

For now, the FTC's noncompete ban is blocked and will not take effect for the foreseeable future. However, multiple states have provisions that wholesale ban, or place a limit on, non-compete agreements, some of which are specific to physicians or other healthcare professionals.[28] States that ban such clauses include Alabama, Arkansas, California, Colorado, Delaware, Massachusetts, New Hampshire, New Mexico, Rhode Island, and South Dakota.[29] Some states, such as Arkansas, allow noncompetes, but have exceptions carved out for medical professionals.[30] Other states, such as Florida, impose limitations on healthcare noncompetes, banning agreements for physician specialists in a county when all those within the specialty are employed by a single entity.[31]

Employers would be well-served to keep up to date on future developments related to the FTC's ban. The FTC has stated that the agency is "seriously considering" an appeal,[32] and may be able to leverage the Pennsylvania district court's ruling in any responses in the Texas case. In other words, the fight over noncompete agreements is not over.

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Todd A. Zigrang, MBA, MHA, FACHE, CVA, ASA, ABV, is the President of **HEALTH CAPITAL CONSULTANTS** (HCC), where he focuses on the areas of valuation and financial analysis for hospitals, physician practices, and other healthcare enterprises. Mr. Zigrang has over 28 years of experience providing valuation, financial, transaction and strategic advisory services nationwide in over 2,000 transactions and joint ventures. Mr. Zigrang is also considered an expert in the field of healthcare compensation for physicians, executives and other professionals.

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