

FTC Noncompete Rule's Impact On Healthcare Nonprofits

By **Ben Shook and Tania Archer** (May 16, 2024)

The Federal Trade Commission recently approved a final rule prohibiting companies nationwide from enforcing new and existing noncompete agreements on anyone other than senior executives.

Unless the effective date is stayed, the FTC's noncompete rule will become effective Sept. 24.

This article addresses the potential effects of the noncompete rule on healthcare entities, particularly nonprofit or tax-exempt healthcare entities that ostensibly fall outside the reach of both the FTC and the noncompete rule.

The rule finds that noncompete agreements create an unfair method of competition and therefore violate Section 5 of the FTC Act.[1]

The bipartisan federal entity does carve out senior executives subject to existing noncompete agreements from the rule, but these senior executives are estimated to be fewer than 1% of workers.[2]

This means that the FTC's noncompete rule will ban all existing or future noncompete agreements for a majority of employees across the entire U.S., categorized into two groups: (1) existing, non-senior-level employees and (2) all new job candidates.

However, the FTC's jurisdiction is limited to preventing persons, partnerships or corporations from engaging in unfair methods of competition.[3] As noted by the FTC in the noncompete rule, "[t]o fall within the definition of 'corporation' under the FTC Act, an entity must be 'organized to carry on business for its own profit or that of its members.'"[4]

This means that the FTC lacks jurisdiction over nonprofit organizations, including nonprofit hospitals and other healthcare entities, thereby excluding them — or at least appearing to exclude them — from the reach of the FTC's noncompete rule.

Assuming it becomes effective,[5] the FTC's noncompete rule raises some confusion and risk for nonprofit healthcare entities, and also potentially creates an uneven playing field between for-profit healthcare entities subject to the FTC's noncompete rule, and nonprofit healthcare entities — which are excluded from the rule.

Given these potential risks and effects, nonprofit healthcare entities need to focus now on determining whether they are, in fact, subject to the FTC's noncompete rule and, if so, ensure they are prepared to comply with the rule by the effective date — defined below.

Moreover, nonprofit healthcare entities that are not subject to the FTC's noncompete rule need to evaluate the risks and benefits of continuing to require current or prospective employees to sign noncompetition agreements when their for-profit counterparts can no longer do so under the rule.

The FTC Noncompete Rule



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The scope of the FTC's activity includes enforcement of federal consumer protection laws to prevent fraud, deception and unfair business practices[6]. Corollary to this focus, the FTC enforces federal antitrust laws and pursues anti-competitive conduct in business practices under Section 5 of the FTC Act and other relevant laws.[7]

Traditionally, the FTC has targeted individual businesses or even discrete sectors of the business industry by:

- Collecting reports from consumers about fraudulent activity or deceptive business practices committed by an identified company;
- Suing and blocking large mergers and acquisitions among particular companies;
- Targeting and weighing in on certain landmark antitrust cases; and
- Obtaining federal court orders to ban specific companies or people from fraudulent or deceptive activity.

However, the FTC's noncompete rule expands this scope far outside of the FTC's historical consumer protection activity, adopting a comprehensive ban on noncompete language in new and existing employment agreements across the U.S. business industry, including the healthcare sector.

Under the FTC's noncompete rule, as of the effective date, it will be an unfair method of competition to enter into any new noncompetition agreements, to enforce or attempt to enforce a noncompetition agreement, or to represent to a worker that he or she is subject to a noncompetition agreement.

The FTC's noncompete rule excludes existing noncompetition agreements with senior executives in place prior to the effective date but prohibits the entry of any new noncompetition agreements with senior executives after the effective date.

Importantly, the FTC's noncompete rule imposes a notice requirement on employers that currently have noncompetition agreements in place.

Prior to or on the effective date, any employer that is party to a noncompetition agreement subject to the rule must provide notice to workers, with the exception of "senior executives," with existing noncompetition agreements of its pending lack of enforceability.

This notice requirement will apply to all employers with existing noncompetition agreements subject to the rule, including for-profit and potentially nonprofit healthcare entities.

Implication of FTC's Noncompete Rule on Nonprofit Healthcare Entities

As mentioned, the FTC lacks statutory authority over nonprofit organizations, which could include nonprofit or tax-exempt healthcare entities. As such, those nonprofit entities are exempted from the noncompete rule. But of course, it is not that simple.

In the FTC's noncompete rule, the FTC stressed that "not all entities claiming tax-exempt status as nonprofits fall outside the [FTC's] jurisdiction" and that not all such tax-exempt entities, therefore, fall outside of the reach of the FTC's noncompete rule.[8]

While that is a factor to consider, in the words of the FTC: "Merely claiming tax-exempt status in tax filings is not dispositive." [9]

Instead, the FTC will apply a two-part test to determine the nonprofit status of a corporation, and whether it is subject to the noncompete rule.

Under this test, the nonprofit jurisdictional exemption "requires both that there be an adequate nexus between an organization's activities and its alleged public purposes and that its net proceeds be properly devoted to recognized public, rather than private, interests." [10]

Within the FTC's noncompete rule itself, the FTC highlights several examples where tax-exempt healthcare entities were nonetheless found to be subject to the FTC's jurisdiction under this two-part test. These include independent physician associations and a physician-hospital organization, which consisted of over 100 private physicians and one nonprofit hospital.

Unfortunately, there is no bright line to determine whether, under this two-part test, an entity will be considered by the FTC to be a nonprofit exempted from the noncompete rule. Instead, the inquiry will be a fact-specific, case-by-case determination.

What is clear, though, is the FTC's intent to stringently analyze the operations, goals and charitable purpose of an organization seeking to enforce noncompetition agreements, with an eye toward expanding the reach of the noncompete rule within the healthcare sector as far as possible.

As a result, tax-exempt or nonprofit healthcare entities face a difficult decision. Do they rely on their tax-exempt, nonprofit status to disregard the FTC's noncompete rule and face the risk that the FTC could determine that they are subject to, and in violation of, the noncompete rule?

Alternatively, should nonprofit healthcare entities eliminate this risk altogether by proactively complying with the FTC's noncompete rule, including by providing the required notice to employees on or before the effective date?

To answer those questions, nonprofit healthcare entities should proactively analyze their own nonprofit status in light of the FTC's two-part test to determine the level of risk they face in potentially being subject to the FTC's jurisdiction and the scope of the noncompete rule.

The FTC appears poised to employ a heightened level of scrutiny regarding the nonprofit status of certain entities within the healthcare sector as part of its effort to enforce the noncompete rule to the maximum extent possible. Indeed, the FTC seems intent on reaching into the business practices of an unexpected category of business entity.

Nonprofit healthcare entities would be wise to conduct self-audits or to conduct a deeper assessment to both understand the risk of potentially being subject to the FTC's noncompete rule and establish a basis, if necessary, for exclusion from the FTC's noncompete rule if their nonprofit status is challenged.

Impact on Employee Recruitment and Retention in the Healthcare Industry

For both for-profit and nonprofit healthcare entities, the FTC's noncompete rule will have a significant impact on employee retention and recruitment. While the FTC claims that banning noncompete agreements will result in reduced healthcare costs, the ban may simultaneously result in increased healthcare worker attrition at both for-profit and nonprofit hospitals.

Nonprofit organizations, including health and human service groups, often struggle to offer compensation and benefits comparable to that offered by their for-profit counterparts,^[11] and, as such, may lose qualified candidates seeking greater financial stability and perks.

If exempt from the FTC's noncompete rule, nonprofit hospitals would potentially be allowed to continue using noncompete agreements while their for-profit counterparts are prohibited from doing so.

However, new job candidates and existing nonsenior level executives may become further deterred from employment with nonprofit hospitals if such employment is contingent on entering noncompetition agreements — a requirement they can avoid through employment with for-profit hospitals.

If nonprofit hospitals continue to impose noncompetition obligations on current or prospective employees, the current comparative shortfall of qualified candidates applying for positions in the nonprofit healthcare sector may become even steeper.

As for-profit hospitals will be banned from imposing noncompetition obligations on employees, those for-profit hospitals may gain a further advantage in attracting a larger portion of highly qualified healthcare employees.

In considering these practicalities, nonprofit hospitals may elect to abandon the use of noncompetition agreements in order to remain competitive in recruiting and retaining their employees.

As a result, the practical implications of the FTC's noncompete rule, whether it applies to nonprofit healthcare entities or not, may nonetheless result in the effective elimination of noncompetition agreements throughout the healthcare sector.

Simultaneously, for-profit hospitals are likely to experience higher turnover, as new job candidates and existing, nonsenior level employees change positions more frequently, taking advantage of new, unrestricted opportunities to perform the same or similar healthcare duties at other hospitals or competing healthcare service provider locations regardless of proximity to the current for-profit hospital.

Existing nonsenior level employees may terminate their employment more quickly and more frequently, which could drive a continued cycle of resignations and recruitment, with greater opportunity for the employee to negotiate other contractual terms to their advantage.

Assuming it becomes effective, the FTC's noncompete rule will have significant ramifications on the healthcare sector, affecting employment retention and recruitment at both for-profit and nonprofit healthcare entities.

Given the upcoming effective date, healthcare employers should begin planning for this potential disruption by evaluating their existing employment agreements and pursuing other available options to minimize the challenges likely to be faced in employee recruitment and retention.

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[1] Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45(a)(1).

[2] 16 C.F.R. § 910.1.

[3] 16 C.F.R. § 910(E)(2)(b).

[4] *Id.*

[5] *Ryan LLC v. FTC*, No. 3:24-cv-00986-E (N.D. Tex. May 10, 2024), seeking a stay and a preliminary injunction on the effective date of the Final Rule, with a decision expected by July 3, 2024.

[6] See Federal Trade Commission website, Enforcement at <https://www.ftc.gov/enforcement>.

[7] The Federal Trade Commission Act, 15 U.S.C. §§ 41-58.

[8] *Id.*

[9] *Id.*

[10] 16 C.F.R. § 910(E)(2)(b).

[11] Nonprofit Workforce Shortages: A Crisis That Affects Everyone (July 2023), https://www.councilofnonprofits.org/files/media/documents/2023/july-update-nonprofit-workforce-shortage_1.pdf and The Nonprofit Hiring Crisis (June 7, 202), <https://www.philanthropy.com/article/the-nonprofit-hiring-crisis?>