Reuters Legal News

FTC's new final rule on noncompetes: implications for physician practices

By Erin Whaley, Esq., Barbara Sicalides, Esq., and Emma Trivax, Esq., Troutman Pepper

AUGUST 6, 2024

In May, the Federal Trade Commission (FTC) issued a final rule banning post-employment noncompete agreements as "unfair methods of competition" under the FTC Act — a development that could have a vast impact across the health care sector.

Absent a court-issued injunction or an unlikely agency implemented delay, the rule would go into effect Sept. 4, 2024 (Effective Date) and would have significant legal implications for physician practices, where noncompete clauses have become an essential component of the business economics and private equity investment strategies and are frequently incorporated into employment agreements, shareholder agreements, and buyout agreements.

However, the ban itself is already under fire. On July 3rd the Northern District of Texas issued a much-anticipated order preliminarily enjoining the Effective Date of the rule. While the stay is currently limited to the plaintiffs in the case and is temporary pending the court's final ruling, it suggests that a permanent and nationwide injunction is still possible. This possibility is further illustrated by the Eastern District of Pennsylvania's denial of a preliminary injunction of the noncompete ban on July 23rd. Therefore, companies should continue to prepare for potential implementation of the rule on the Effective Date.

Prohibition of noncompete agreements

The final rule prohibits employers from restricting or penalizing an employee in the United States for taking employment with a different employer or starting or operating their own business post-employment. This rule is applicable to all noncompete agreements entered into or enforced for violations accrued on or after the Effective Date, except for those noncompetes that were in place with "senior executives" prior to the Effective Date. Some exceptions exist for this noncompete ban, but they are fairly limited.

Noncompetes are particularly important to physician practices, which rely on them to ensure patient retention and recoup a practice's investment in the ongoing training and development of its physician and professional employees. In this way, noncompetes are an essential tool for private equity and physician investors to protect their financial interest in the practice.

In light of the upcoming Effective Date, practices and their investment partners should reevaluate their noncompete agreements and reconsider their risk mitigation strategies.

Physician owners may still be subject to existing noncompetes

The rule would still permit the enforcement of noncompete agreements with senior executives entered into prior to the Effective Date, while noncompetes entered into with senior executives after the Effective Date would not be permitted. However, the definition of the term "senior executive" appears to be very limited and is particularly ambiguous in a physician practice setting.

The rule defines a senior executive as an individual who: (1) held a policy-making position, such as the president, CEO, or any other person with "policy making authority;" and (2) received total annual or annualized compensation of at least $151,164 per year.

Noncompetes are particularly important to physician practices, which rely on them to ensure patient retention and recoup a practice's investment in the ongoing training and development of its physician and professional employees.

"Policy-making authority" is the final authority to make policy decisions that control significant aspects of the company or common enterprise and does not include authority limited to advising or exerting influence over policy decisions or having final authority to make decisions for only a subsidiary of or affiliate of a common enterprise.

The final rule explains that physician partners or owners in an independent medical practice may be classified as senior executives, provided they hold the authority to make policy decisions over significant aspects of the business and do not require the approval of a more senior partner or official.

In contrast, a physician who works within a hospital system but does not have policymaking authority over the organization as a whole would not qualify. While this means a senior executive could possibly include a physician practice owner with voting rights in the practice, it will nonetheless require a case-by-case determination due to the highly variable organizational structures of physician practices. Importantly, physicians with authority over treatment decisions alone would not qualify as senior executives.

Noncompetes may not be permitted in connection with a buy-sell agreement

Physician practices commonly use buy-sell agreements to govern how a physician's ownership interest in a business may be sold or otherwise divested. Most often, buy-sell agreements stipulate that the ownership interest of a departing physician (whether departure is voluntary or involuntary) must be sold to remaining owners or redeemed by the company pursuant to a pre-determined price or pricing formula.

The noncompete prohibition does not extend to confidentiality or patient and employee non-solicitation agreements, but this does not necessarily mean these restrictive covenants will not trigger a violation of the rule, or antitrust laws more generally.

While noncompetes are permitted if they are entered into pursuant to a "bona fide" sale of a business, a person's ownership interest, or all/substantially all of a business entity's operating assets, there is language in the rule which may impact the noncompete if it arises out of repurchase rights or a mandatory stock redemption program.

As a result, noncompetes that are related to a buy-sell agreement entered into when the physician purchases their ownership should be carefully constructed and reviewed to maximize the likelihood of enforcement under the new rule. Otherwise, if a sale is negotiated at the time of the physician owner's departure, the practice is free to attempt to negotiate a noncompete based on the economic realities present at that time.

The purpose behind a buy-sell agreement matters

It's also important to consider that a buy-sell agreement, standing alone, could be deemed to functionally operate as a noncompete agreement in violation of the final rule.

In a situation where the buy-sell provision acts to potentially decrease the price for a buyout, it may be construed as a penalty for competition. For example, some agreements mandate a 6-month notice period when an owner intends to sell their ownership interest, and may decrease the buyout price if the owner fails to provide adequate notice.

If the price reduction is deemed a penalty for the owner's departure to a competitor, it could violate the new rule. However, if the price reduction is viewed as necessary to allow the practice sufficient time to replace the owner (key to protecting equity value), it is more likely to be permitted.

Therefore, if the new rule were to go into effect, investors and practices should consider drafting buyout agreements that tie the buyout price to fair market value at the physician's time of departure to maximize enforceability.

Are non-solicitation, confidentiality, or training repayment agreements permitted?

The noncompete prohibition does not extend to confidentiality or patient and employee non-solicitation agreements, but this does not necessarily mean these restrictive covenants will not trigger a violation of the rule, or antitrust laws more generally. The FTC has said that any agreement that *functionally operates* to restrict or penalize an employee's pursuit of employment with a different employer could be deemed a prohibited noncompete.

With respect to non-disclosure or confidentiality agreements, post-employment restrictions should be tailored to track the types of confidential information received by the physician during their employment to maximize enforceability under the new rule. Such agreements should not use a broad prohibition on use of all information the individual may have learned or information that the physician would not be able to identify if asked.

Similarly, non-solicitation agreements cannot restrain such a large scope of activity that they function to prevent a worker from seeking or accepting other work or starting a new business after their employment ends. Accordingly, a non-solicitation agreement that prevents a specialist physician from soliciting patients in need of their specialty in a broad geography, or that would require the physician to move their primary residence, would carry significant risk of being barred by the rule.

Much the same, training-repayment agreements requiring that a physician or employee remain at a practice for a particular time or reimburse a practice for training would be permitted under the rule, but only so long as the required payment is reasonably related to the costs that the employer actually incurred to train the departing physician.

As physician practices and investors implement new strategies to address the noncompete ban, they should expect additional government scrutiny of these restrictive covenants and other potential back door noncompetes.

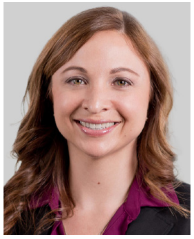
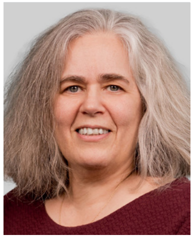
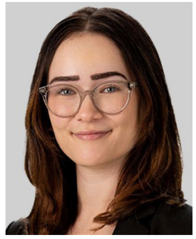
Key takeaways for physician practices

Physician practices and their investors — whether physician owners or private equity firms — need to consider the potential for an entirely new legal landscape for noncompetes. The prohibition of noncompete agreements, if it goes into effect this September, would necessitate a reevaluation of existing contracts, particularly the structure of buy-sell provisions in operating agreements, bylaws, and other agreements.

Ongoing legal disputes may delay or prevent the FTC rule's implementation, but physician practices and their owners should still prepare for the possibility that the rule could become effective.

Erin Whaley is a regular contributing columnist on health care regulatory challenges, transaction structuring and compliance strategies for Reuters Legal News and Westlaw Today.

About the authors

Erin Whaley (L) is a partner at **Troutman Pepper** where she represents health care providers and payers on the full spectrum of legal issues. Her regulatory experience includes advising clients on compliance with federal laws that govern the health care industry, including Stark, the Anti-Kickback Statute (AKS), the False Claims Act, and HIPAA, as well as state laws including state licensure, corporate practice of medicine, and certificates of need. She also assists clients with investigations and resolving compliance concerns. She is based in Richmond, Virginia, and can be reached at erin.whaley@troutman.com. **Barbara Sicalides** (C) is a partner at the firm. Her practice covers the range of antitrust and competition matters. She routinely handles antitrust litigation, conduct and merger investigations, and counseling, as well as distribution disputes and arrangements, for domestic and international companies. She is located in Washington, D.C., and Philadelphia, and her email is barbara.sicalides@troutman.com. **Emma Trivax** (R) is an associate at the firm. She represents a range of health care providers, including pharmacies, physician practices, management service organizations, dental service organizations, hospitals, clinical laboratories, skilled nursing facilities, ambulatory surgical centers, DMEPOS suppliers, and behavioral health providers. She is located in Detroit, and her email is emma.trivax@troutman.com. Jeremy Levy, a partner at the firm, contributed to this article.

This article was first published on Reuters Legal News and Westlaw Today on August 6, 2024.