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AAHKS® AMERICAN ASSOCIATION OF HIP AND KNEE SURGEONS

MEMORANDUM

To: AAHKS

From: Epstein Becker & Green, P.C.

Date: January 10, 2023

Re: Federal Trade Commission Proposed Ban of Noncompete Clauses

On January 5, 2023, the Federal Trade Commission (FTC) released a proposed regulation ("proposed rule") that would ban employers from using noncompete clauses. This summary covers elements of the proposed rule that may be relevant to AAHKS members, as well as the hospital and the health care industry more broadly.

I. Provisions of Proposed Rule

a. Noncompete Clauses Banned

Under the proposed rule, all post-employment noncompete clauses would be considered an unfair method of competition and would therefor become unlawful. Employers would be required to rescind any existing noncompete clauses and to notify employees who had been subject to such clauses, in writing, of the rescission.

b. Definitions

The FTC proposes a straightforward explanation that a "non-compete clause" is "a contractual term between an employer and a worker that prevents the worker from seeking or accepting employment with a person, or operating a business, after the conclusion of the worker's employment with the employer." The proposed definition goes further by also providing that it encompasses any "contractual term that is a *de facto non-compete clause*" and sets forth a functional test for whether a contractual term is a "non-compete clause."

c. Preemption

The proposed rule would preempt any inconsistent state or local law, noting that state and local laws are not "inconsistent" with the rule if they afford workers any protection that "is greater than the protection provided [under the proposed regulation]."

d. <u>Limited Exceptions</u>

The proposed rule would not apply to:

- noncompete agreements with a person who is selling or otherwise transferring ownership of a business entity or its operating assets, if the restrictions apply to the seller or a substantial partner in the business entity at the time the noncompete agreement is entered;
- customer or coworker non-solicits;
- reasonable "advance notice of resignation" requirements (clauses that require an employee to give notice of their resignation, during which time they remain an employee and owe their employer a duty of loyalty); or
- routine confidentiality agreements.

II. Rationale – Arguments for and Against the Proposed Rule

The four FTC commissioners voted 3–1 to advance the proposed regulations. In a statement accompanying the release of the proposed rule, FTC Chair Lina Khan listed the following reasons in support of the proposed regulation:

- Noncompetes reduce competition in labor markets, suppressing earnings and opportunity even for workers who are not directly subject to a noncompete;
- Locking workers in place reduces innovation by decreasing the flow of information and knowledge among firms;
- Some employers continue to use noncompetes even in states that have declared them null and void (workers in states where noncompetes are unenforceable are about as likely to have one in their contract as workers in other states);
- Workers face confusion and uncertainty about whether they are bound by an enforceable noncompete, which dissuades them from seeking another job; and
- Many labor markets and product markets are spread across multiple states so the use of noncompetes in one state can harm workers and consumers in others.

FTC Commissioner Christine Wilson dissented from issuing the proposed regulation and likewise issued an extensive statement noting that the proposed rule departs from FTC precedent of conducting fact-specific inquiry into whether a particular non-compete clause is unreasonable in duration or scope, given the business justification for the restriction. She notes that recent FTC actions on this issue have not found demonstratable harm to consumers and competition. She urged affected parties to participate in the open comment period.

III. Discussion of Health Care Within the Proposed Rule

In justifying the proposed regulation, the FTC cites and discusses the following evidence:

- 45% of physicians worked under a non-compete clause in 2007. Use of non-compete clauses among physicians is associated with greater earnings (by 14%) and greater earnings growth.[1]
- While non-compete clauses allow physician practices to allocate clients more efficiently across physicians, this comes at the cost of greater concentration and prices for consumers. In one study, the authors claim that researching the direct link between changes in law governing non-compete clauses and changes in concentration allows them to identify a causal chain starting with greater enforceability of non-compete clauses, which leads to greater concentration, and higher consumer prices.[2]
- Based on economic analysis, the FTC estimates the proposed rule may increase physicians' earnings.

IV. Next Steps

a. Opportunity to Comment on the Proposed Rule to the FTC

The FTC will accept comments on this proposed regulation for 60 days after it is published by the Federal Register (*projected deadline of early-March 2023*). The FTC specifically asks for stakeholders to comment on the following questions:

- Should the rule apply different standards to noncompetes that cover senior executives *or other highly paid workers*? How should such a category of workers be defined and what standards should be applied?
- Should the rule cover noncompetes between franchisors and franchisees?
- What tools other than noncompetes might employers use to protect valuable investments, and how sufficient are these alternatives?

[1] Kurt Lavetti, Carol Simon, & William D. White, *The Impacts of Restricting Mobility of Skilled Service Workers Evidence from Physicians*, 55 J. Hum. Res. 1025, 1042 (2020).
[2] Naomi Hausman & Kurt Lavetti, *Physician Practice Organization and Negotiated Prices: Evidencefrom State Law Changes*, 13 Am. Econ. J. Applied Econ. 258, 284 (2021).

b. Likelihood of Litigation if the Proposed Rule is Finalized

If the FTC processes the regulation as quickly as possible, it could be finalized and enforceable in late-2023. That being said, there are serious questions about the FTC's authority to regulate noncompetes under Section 5 of the Federal Trade Commission Act, especially following the Supreme Court's 2022 decision in *West Virginia v. Environmental Protection Agency*, which applied the "major questions doctrine" to strike down an environmental regulation on the basis that the EPA did not have "clear congressional authority" to issue a rule concerning an issue of "great political significance" that would affect "a significant portion of the American economy."

Accordingly, it is widely anticipated that, once finalized, the rule will be challenged in court on various jurisdictional and substantive grounds.

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