Title: Are Noncompetes Really Going Away?
Tagline: Dr. Cotton discusses the FTC's recent ruling that eliminates most noncompetes on September 4, 2024.

Welcome to the law and medicine podcast. Today's topic is the Federal Trade Commission's recent decision that bans noncompetes in the context of employment relationships. As you probably heard, a few months ago, the FTC issued a ruling that's slated to go into effect on September 4, after which noncompetes will be illegal for most workers, including many physicians. A number of lawsuits have been filed to stop the implementation of this ruling. And, to this point, one lawsuit was successful in Texas and another was unsuccessful in Pennsylvania. So, what does all of this mean to you?

Before I answer that question, I want to first provide my personal perspective on noncompetes so that you can factor any bias that I might have into the remarks I'm going to make.

In my opinion, physician noncompetes are bad for doctors, bad for patients, bad for competition, bad for healthcare cost containment, and fundamentally unAmerican. The idea that after you leave a job, your former employer can prevent you from working for someone else, where you would be paid more and treated better borders on a violation of the 13th Amendment, which has made slavery illegal since 1865.

So, with my bias disclosed, here is my assessment of this situation. This is an election year and politicians are doing things to earn your vote. In this case, the Biden/Harris Administration is showing us that they care about the American worker. However, this is an illusion because the FTC's ruling will ultimately not survive and in my opinion the sooner it's struck down, the better it is for doctors and patients.

Why? Because as long as this ruling is in place, all of our other political initiatives will be put on a hold. And, those political initiatives will lose momentum while we wait to see what happens. And, when the FTC's ruling is eventually struck down, which it will be, we'll have to start all over, by which point the election will be over and no one will be interested in pretending to help us. So, if you're in favor of eliminating non-competes, which I definitely am, this FTC ruling is a negative.

So why is it doomed to fail? Well, it has nothing to do with the FTC's reasoning or moral position, both of which are very compelling. To show you what I mean, her ere are some the reasons that the FTC gave in support of this ruling:

1. Noncompetes are a widespread and often exploitative practice that prevent workers from taking a new job or starting a new business.

2. Noncompete clauses keep wages low, suppress new ideas, and rob the American economy of dynamism.

3. Banning noncompetes will ensure Americans have the freedom to pursue a new job, start a new business, or bring a new idea to market.

4. This rule is expected to result in higher earnings for workers and will lower health care costs by up to 194 billion dollars over the next decade.

And finally, my personal favorite,
Noncompetes often force workers to either stay in a job they want to leave or bear other significant harms, such as being forced to switch to a lower-paying field, being forced to relocate, being forced to leave the workforce altogether, or being forced to defend against expensive litigation.

Absolutely positively correct.

The moral argument here is very compelling. And, not surprisingly 95% of the comments that the FTC received since they first proposed banning noncompetes have been supportive of doing so.

So, the first thing we can say is that the FTC has a strong moral argument and overwhelming popular support. The problem is that the FTC's doesn't have the legal authority, the power, to issue this ruling. And, this problem is multifaceted.

The first shortcoming is that the FTC does not have any authority over nonprofit organizations. When the FTC was created by an act of Congress back in 1914, some organizations were exempted from the FTC's jurisdiction, meaning that the FTC does not have any power over these entities, and nonprofit organizations are on the list.

And because the FTC doesn't have any authority over nonprofits, the first thing we can say is that this rule even if it survives legal challenge, does not apply to nonprofits. If you're wondering what this means to physicians, according the American Hospital Association, 56% of hospitals are nonprofits and another 21% are government entities, federal, state and county hospitals, over which the FTC has no authority either. So, we can start by

saying that this ruling, this ban doesn't even apply to 77% of hospitals and it therefore is of no value to all of the doctors who are employed by those hospitals.

Now, the FTC didn't come right out and say this. Instead, they obfuscated the issue and this has created some confusion about whether this ruling actually applies to nonprofits. So, let me explain what's going on. The FTC took the position that this ruling could apply to some nonprofits. Which ones? According to the FTC, if an entity claims to be a nonprofit but is actually a for profit organization, then that entity would be subject to the FTC's authority and the ban on noncompetes would apply.

And this is absolutely true. If someone claims to be a nonprofit and they're not, then they would be a for profit company and the FTC's rule would indeed apply. Of course, if someone claims to be a nonprofit and they actually are a nonprofit, then this ruling does not apply. And, there is nothing controversial or uncertain about any of this.

The FTC then went on to say that it could challenge an organization's status as a nonprofit. In other words, if an organization such as a hospital system claimed to be a nonprofit, but they were actually a for profit, the FTC could challenge the organization's classification and potentially negate its nonprofit status. And it is true that the FTC could do this, but it's not going to happen.

You see, if you're a nonprofit health system, you're reaping a lot of benefits from your nonprofit status. You don't pay any income tax, you don't pay any real estate tax on the hundreds of buildings that you own, you can borrow money at a lower interest rate by using municipal bonds, and if someone donates money to your organization, that person can take a tax deduction for the donation, which creates a financial incentive for people to donate money to your institution, which is why every new cancer wing is named after someone. And, when you add it all up, these benefits, all of which stem from your nonprofit status, are worth millions of dollars.

Now, with that much money on the line, you better believe these health systems have a team of lawyers making sure they cross every T and dot every I to ensure that their status as a nonprofit is absolutely bulletproof. Because if they don't, the IRS is going to eat them alive.

So, while it's true that the FTC could theoretically negate the nonprofit status of a health system, if the IRS hasn't been able to pull it off with millions of dollars to be had, the FTC isn't going to do it either. The end result is that this rule does not apply to 77% of hospitals, meaning that all of these entities can continue to use noncompetes against physicians.

And, when this occurs, it will result a two tiered system in which the nonprofit health systems will continue to use noncompetes, while everyone else, including every private practice will be prohibited from using them. And this will have a very negative affect the marketplace.

Because, in any given town, the nonprofit hospital will continue to use noncompetes to prevent its physicians from going across the street to join a private practice, but the private practice cannot use noncompetes to prevent its physicians from going across the street to the hospital, which puts private practices at a significant disadvantage, even bigger than the disadvantages they already have by being the only ones who are paying taxes. And, in my opinion this will be the last nail in the coffin for many private practices.

And the irony here is that the FTC's mission is to ensure fairness in the marketplace, to ensure a level playing field, but then they issue this ruling that creates massive unfairness in the healthcare marketplace, and heathcare is the biggest sector of the economy. So, an entity, the FTC, which is supposed to ensure a stable market does something that upends the largest part of the economy. And, based on just this alone, the FTC's ruling should be struck down.

But paradoxically, even if it's allowed to stand, it will quickly render itself ineffective. Because here's what's going to happen. Nonprofit health systems already enjoy numerous advantages. And when we give them yet another advantage it's going to eliminate many of the for profit entities, primarily private practices.

And, once those entities are gone, we'll be left with a rule that prohibits for profit entities from using noncompetes, but we won't have any for profit entities left. Everyone who remains will be a nonprofit to whom the rule does not apply and we'll be right back where we started with almost every healthcare employer using noncompetes. And the only thing different is that we'll have even less competition because we'll have eliminated most of the private practices.

Fortunately, I'm optimistic that this is not going to happen because there are multiple reasons that this ruling should be struck down. The first is something known as the major questions doctrine.

The major questions doctrine was developed by the Supreme Court and its based on the Constitutional principle that each branch of government has certain powers. Congress has the power to pass the law, the President and the various agencies have the power to apply the law, and the Supreme Court has the power to interpret the law.

Now in this situation, Congress passed a law that created the FTC. And that law gave the FTC the power to police the marketplace and ensure that competition was fair. However, Congress did not give the FTC any authority to pass a law, only Congress can pass laws.

A here's simple example to demonstrate this point. The IRS, the internal revenue service, is a federal agency just like the FTC is a federal agency. And, the IRS has the power to collect taxes. If the tax rate is 10%, the IRS can make you pay 10%. However, the IRS does not have the power to raise the tax rate to 20%. Raising the tax rate requires someone to pass a law and only Congress can pass laws. So, if the IRS commissioners voted to increase the tax rate to 20%, the IRS would have exceeded its authority, and the tax increase would be invalid.

My point here is that agencies, like the IRS and the FTC, do not have the power to change the law and there is no argument about this. However, there is some nuance here. You see, when Congress passes a law, there are often some grey areas simply because it's hard for any law to cover every possible scenario. And, it's therefore common for Congress to give the agencies some rule-making authority so that the agency can fill in the gaps and apply the law on a day to day basis.

So, the question that often arises is: How far an agency can go with its rule-making before it crosses the line and infringes on Congress' authority to make law. And, the standard that the Supreme Court uses to make this determination is the major questions doctrine.

If something is a major question, then the decision belongs to Congress. And, if the issue does not involve a major question, then the FTC can pass a rule to address it. So, the question here is whether banning noncompetes is a major question. To help us make this determination, the Supreme Court outlined 3 scenarios that qualify as major questions. And, if the situation fits any one of these 3 scenarios, then only Congress can decide it.

The first is a question of great political significance or a question that ends debate across the country;
And, I think noncompetes meet this standard because they're a matter of great political significance and they're being debated across the country.
And, as such, we could stop right here and say that the FTC exceeded its authority and its ban on noncompetes is therefore invalid.

The second situation that meets the major questions standard is
If the agency seeks to regulate a significant portion of the economy
And, we meet this standard as well because banning noncompetes affects the entire economy.

And, the third situation that meets the standard is:
If the agency seeks to intrude in an area that is traditionally the province of state law.

> And, we meet this one as well because the employer-employee relationship has traditionally been a matter of state law and more than a dozen states have already passed some type of restriction on noncomptes.
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> So, the major questions doctrine says that an agency exceeds its authority when the situation meets any one of these 3 criteria. And, I think the FTC's ruling meets all 3 of them.
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> And, I'm not the only one who feels this way. You might recall that when the FTC issued this ruling, they announced that the vote was 3 to 2. And, what's significant here is that the two Commissioners who voted against this ruling did so because they believed the FTC was violating the major questions doctrine.

In fact one of these two Commisioners publicly stated his belief that all three of the major question criteria were met due to the intense political interest in non-competes, the millions of contracts that would be invalidated, the billions of dollars at issue in those contracts, and the power of the states to regulate employment contracts. He went on to say, the fact that the FTC announced that its ruling would produce billions of dollars in savings demonstrates that the rule has a sweeping impact on a wide swath of the economy and it is thus a violation of the major questions doctrine. And, I completely agree.

So, at this point we can say that the FTC's ban on noncompetes does not apply to nonprofits, which makes it unfair, and it violates all three standards of the major questions doctrine, which makes it invalid.

However, even if you manage to get over all of these hurdles, we've got more problems. The next one arises from the fact that the FTC's rule doesn't just prohibit noncompetes in new contracts going forward, it also retroactive eliminates noncompetes in existing contracts. And, this is terribly problematic.

And, here's an example. I've had situations where a physician was negotiating an employment contract and there was some back and forth about the noncompete. And, the employer eventually said, if the physician is willing to accept the noncompete, we will pay him an additional $20,000. The physician accepted the deal, the contract was signed and the money was paid.

Now, a few months later the FTC comes along as says that this noncompete which was bought and paid for, is invalid, which means that the employer paid 20,000 dollars for a restriction, the government makes the employer release the restriction, and the physicians gets to keep the $20,000 because the ruling

doesn't say anything about him having to give the money back. And, as much as I hate noncompetes, this is completely unfair.

If you bought a car for $20,000, paid the money, and took the car home. Could the FTC pass a rule that makes you give the car back and not make the seller refund your money? According to this ruling, Yes, the FTC could do that as well.

Fortunately, this is blatantly unconstitutional. The Fifth Amendment, which is widely known as providing us with the right to remain silent, also prevents the government from imposing retroactive burdens that "deprive citizens of legitimate expectations and upset settled transactions."

And this is directly on point. The Fifth Amendment prevents the government, the FTC in this case, from imposing retroactive burdens that "deprive citizens of legitimate expectations and upset settled transactions, which is exactly what's going on here.

And, this is so blatant that you have to wonder whether it was intentional. You see, if they would have issued a prospective ban on noncompetes, it would have eventually accomplished the same purpose without violating the 5th Amendment. But, when they made it retroactive, it directly violates the 5th Amendment. So, on the major questions doctrine, the FTC went 3 for 3 with violations, and for good measure they also made a direct assault on the 5th Amendment. And, as I said, it makes me wonder whether it was intentional, pretending to do something to earn your vote, but layering it with enough self-sabotage to ensure that it will eventually fail.

The FTC's ban also violates multiple other Constitutional principles, some of which are much more technical. So, I'm going to stop here because I think I've made the point that this ruling is not going to survive. And, because its implementation will be so disruptive to the healthcare marketplace, I'm optimistic that the Supreme Court will step in and put an end to it. And, hopefully this will occur sometime soon so that we can refocus our efforts on legislative solutions that can actually benefit doctors and patients.

Thanks for listening to me today.