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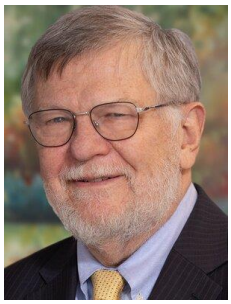
Physician Noncompetes May Get Federal Antitrust Treatment

By **John Zen Jackson and Jessica Carroll** (September 20, 2022, 4:03 PM EDT)



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Over the last year and a half, noncompete agreements and restrictive covenants have become the subject of increasing scrutiny. The health care industry is not immune to this scrutiny and use of these agreements is a highly litigated issue.

The American Medical Association has had a long-standing policy of discouraging physician noncompete agreements as a matter of professional ethics because they can "disrupt continuity of care, and may limit access to care."

While interpretation and enforcement of these restrictive covenants have traditionally been viewed as a matter of state law, there is a developing movement to seek resolution of the controversies concerning health care noncompete agreements at a national level.

In fact, health care noncompete agreements were the subject of an August article in the New England Journal of Medicine titled "Noncompete Agreements — The Need for a Refresh," for precisely this reason.[1]

By way of background, on July 9, 2021, President Joe Biden issued the Executive Order No. 14036 on competition that directed federal agencies to enhance regulatory scrutiny of anticompetitive business practices, including specific reference to using the Federal Trade Commission's rulemaking power to curtail the use of noncompete agreements.

The scope of the executive order is broad enough to include health care. Indeed, the American Hospital Association took a position opposing the president's action. It also opposed a proposal before the Uniform Law Commission in 2021 that included a specific provision prohibiting noncompete agreements with health care providers.

As adopted, the Uniform Restrictive Employment Agreement Act eliminated the section that specifically focused on health care providers and instead included more general provisions concerning legitimate business interests that could be protected, while limiting the duration of post-employment agreements.

In addition to the federal actions, recent state actions underscore the scrutiny that noncompete agreements may be expected to receive. As a baseline, in 2003, the New Jersey Supreme Court ruled in Community Hospital Group Inc. v. More[2] that hospital and physician employment agreements may

restrict the right of a physician to practice after an employment relationship is terminated.

In so doing, the court declined to reconsider its 1978 ruling in Karlin v. Weinberg,[3] where it held that a post-employment restrictive covenant contained within an employment contract between physicians, or between a physician and hospital, is not, per se, unreasonable and unenforceable.

The court reiterated that enforceability is assessed using several factors to determine the reasonableness of the restriction with the agreement subject to judicial review and revision known as blue penciling.

Changes to the Karlin paradigm may be implemented following the introduction of legislation referred to as A.B. 3715 in the New Jersey Assembly in May.[4] This bill limits noncompete agreements. It is the most recent in a series of legislative attempts to restrict noncompete agreements going back to at least the 2016-2017 legislative session.

While A.B. 3715 specifically addresses certain types of employees, such as students, and low-income or seasonal workers, there is no explicit focus on health care professionals. However, the bill seemingly applies to them because it permits the use of noncompete agreements only if they comply with the provisions of the act.

These requirements cover a collection of 10 categories — and mostly codify the rules developed in Karlin and its progeny. The duration of an agreement restricting competitive activities with the former employer is limited to no more than 12 months.

The proposed legislation has a significant requirement. Except when termination is for misconduct within 10 days, the employer is required to notify the employee, in writing, if the employer intends to enforce the agreement.

Although litigation to enforce the restrictive agreement need not be commenced within that time period, the failure to provide this notification renders the agreement void and unenforceable.

On the other hand, an employee may bring a civil action against the employer if the employer violated the act. Significantly, A.B. 3715 empowers the court to void any agreement and seemingly eliminates the remedy of modifying or blue-penciling the agreement since there is no mention of the court being empowered to take such action.

The Assembly Labor Committee considered A.B. 3715 and reported favorably on the bill on May 19. Prior versions of legislation to limit restrictive covenants had similarly been reported out of the Assembly Labor Committee but did not proceed further. There is quite a distance for this bill to go before becoming law and the New Jersey Business and Industry Association has suggested that there may be amendments such as one to limit the bill's applicability to workers earning less than $65,000.

The New England Journal of Medicine article noted that opposition to restricting noncompete agreements is premised on preventing former employees from poaching patients, sharing trade secrets or disrupting patient care — means that are necessary to sustain stable practices, and encourage investment for equipment and facility enhancement.

It considers changes in the landscape resulting from the COVID-19 pandemic where the widespread development of telemedicine became accepted as the location of where care was delivered shifted from

hospitals to people's homes.

Finding that applying the language of many noncompete agreements to virtual care "would yield unproductive and nonsensical results," the Journal of Medicine article authors advocate for a functional approach to interpretation of noncompete agreements rather than a narrow textual methodology.

In other words, the article posits looking at legitimate objectives justifying a noncompete and then interpreting the agreement narrowly. Calling for common sense interpretations by courts, the authors also advocate for the public interest as well as the well-being of patients and the maintenance of competitive labor markets. This is in line with how New Jersey courts have applied Karlin in assessing enforcement of noncompete agreements.

In Karlin, the court stated that "a physician (like any other employer) has no 'legitimate' interest in preventing competition as such"; rather the appropriate focus was on an ongoing relationship between the patients. It further reasoned that a post-employment restrictive covenant would be unenforceable to the extent it prevented an employed physician from engaging in activities that are not in competition with those of his former employer.

The anticompetitive effects of restrictive covenants has commonly been downplayed; however, since the issuance of Biden's Executive Order No. 14036 there has been enhanced scrutiny of these anticompetitive effects with the FTC injecting an analysis under the Sherman Antitrust Act into these cases.

On Feb. 25, the U.S. Department of Justice filed a request to appear in a proceeding commenced in the state court of Nevada involving a health care noncompete agreement.[5]

In Beck v. Pickert Medical Group, the plaintiffs were anesthesiologists who had been employed by a medical group that employed two-thirds of the anesthesiologists in the northern part of the state. Their employment contract provided that, for a two-year period following termination of employment, they could not provide anesthesiology services within 25 miles of the hospital or any other facility at which they had worked during the two years before their employment terminated.

After notice of intent to terminate their employment, plaintiffs sought an injunction against enforcement of the noncompete agreement because the hospital was the only trauma center in the region and the major provider of complex surgical care.

While taking no position on the merits of the state law claim between the parties, the DOJ contended that the state court in assessing the validity of these agreements should be guided by the principles of federal antitrust law because noncompete agreements and post-employment restraints can violate the Sherman Act.

Noncompete agreements can be a form of horizontal restraint of trade among competitors. Since the employed anesthesiologists were licensed and board-certified specialist physicians at the time the employment agreement was signed, they were actual or potential competitors with the employer.

The noncompete agreements also had characteristics of a vertical restraint whereby an employee was not yet able to act as a competitor, but the agreement prevented the employee from working for a different employer that was a competing practice. The DOJ outlined the necessary steps to evaluate a horizontal restraint as per se unlawful or through a rule-of-reason analysis, which involves a fact-specific

evaluation of the restraint's actual effect on competition.

There have been several challenges to the justifications for noncompetitive, post-employment restrictive covenants. For one, some have argued that trade secrets of confidential information could be protected by specifically focusing restrictions without precluding a former employee from other employment. Additionally, others have debated whether it is necessary to protect investment in human capital.

In this regard, the DOJ relied on recent empirical scholarship within the human resources field that called into question the long-held assumptions in light of the physicians having already completed their medical education and training before being employed by a medical practice.

The statement of interest addressed the need to consider the scope of post-employment restrictions and evaluate any language that acknowledges the employee as a potential competitor. Unlike employment in a standard commercial setting, professional health care agreements present situations where an employee is a potential competitor because the same services are more readily available. Therefore, a restriction that effectively prevents a health care professional from practicing their chosen field of medicine will require careful assessment.

In the end, the Nevada court did not accept the DOJ's statement of interest.

Concisely stated, this remains a controversial topic and will continue to evolve in the upcoming months.

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[1] S. Mulligani, M. Agrawal & B. Richman, "Noncompete Agreements — The Need for a Refresh," 387 New Engl. J. Med. 486 (Aug. 11, 2022).

[2] Community Hospital Group v. More, 176 N.J. 70 (2003).

[3] Karlin v. Weinberger, 77 N.J. 408 (1978).

[4] https://www.njleg.state.nj.us/bill-search/2022/A3715.

[5] Beck v. Pickert Medical Group, Case No. CV21-02092 (Washoe County, Nevada, Feb. 25, 2022).