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Not the Last Word: Restrictive Covenants Can be Liberating

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In April 2024, the Federal Trade Commission (FTC) published a "Non-Compete Clause Rule" [5], which bans restrictive covenants in contracts between employers and their employees regarding the employee's future employment. One leading commentator has suggested that "the FTC rule will be a boon for U.S. physicians" [2].

Before readers start celebrating, however, keep in mind that this rule may not apply to many orthopaedic surgeons. For one thing, the rule exempts nonprofit institutions, and many orthopaedic surgeons are employed by universities and teaching hospitals in that category. Further, the Chamber of Commerce has sued to block the rule's implementation, claiming that the FTC has usurped Congress's authority—a plausible argument, I believe. *[Editor's update: On August 20, 2024, after the column was written, Judge Ada Brown of U.S. District Court for the Northern District of Texas upheld the challenge to the FTC ban* [7]*.]*

Yet there is still another reason to keep the champagne on ice: Banning non-compete clauses may harm orthopaedic surgeons.

Yes, non-compete clauses constrain the movements of employees, but that's not the whole story. As Bastiat teaches, a complete analysis examines "that which is seen, and that which is not seen" [3]. In the realm of minimum wage laws, for example, what is seen is the higher pay for workers; what is not seen is the unemployment these laws may create for people who don't produce enough to justify the higher pay [6]. In the realm of non-compete clauses, what is seen is the restriction of movement after employment; what is not seen includes the opportunities these clauses allow.

Consider this example. You live in Los Angeles, CA. Your friend in Philadelphia, PA invents an operation to treat ankle sprains [4]. This procedure is technically complex, and you'd like to learn how to do it. You send a note to your friend asking to spend 3 months as his apprentice. He writes back the following: "I'd love to have you! But I am concerned about competition. Right now, there are about 150 patients in town who need this operation each year, and I do all of them. If you stayed in town after your apprenticeship and took half my business, I would regret inviting you. So do come, but first sign the attached one-line contract my lawyer wrote up in which you promise to move back to Los Angeles after working with me."

This seems like a wonderful solution. One doctor gets to teach, the other gets to learn. More patients get to benefit from this novel operation. Knowledge spreads across the country.

But maybe not. The FTC says this shouldn't happen. That one-line contract is, after all, a non-compete agreement, and such agreements are *verboten*.

Contrived example? Guilty as charged. Besides, my ankle sprain procedure is not yet ready for prime time. But even so, mutual benefits from non-compete clauses are common. Without non-compete clauses to protect them, university-based practices may be reluctant to hire surgeons who may soon depart the group, only to stay local and advertise their university experience and its reflected glory. Employers of all types may offer lower starting salaries to offset the higher pay that would now be needed at contract-renewal time. In Bastiat's terms, "that

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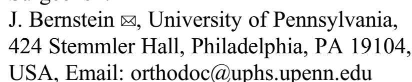

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Non-Compete Agreement Addendum to Employment Contract

This Non-Compete Agreement ("Agreement") is made and entered into as part of the Employment Contract ("Contract") by and between [Employee Name] ("Employee") and [Employer Name] ("Employer"), collectively referred to as the "Parties."

1. Duration The Employee agrees not to engage in competitive activities as defined in this Agreement for a period of [specify duration, e.g., two years] following the termination of employment with the Employer, regardless of the cause or nature of termination.

2. Location The non-compete restriction applies to the Employee within a radius of [specify radius, e.g., 25 miles] from the primary place of business of the Employer located at [Employer's Address]. This geographic limit is intended to protect the legitimate business interests of the Employer while not unduly restricting the Employee's ability to earn a livelihood.

3. Vocation During the duration of this Agreement, the Employee shall not engage in the practice of [specify field or specialty, e.g., orthopedic surgery, or specific procedures, e.g., ankle sprain surgeries], either independently or in association with any other individual, group, or entity that provides similar services as the Employer.

4. Breach Penalties In the event of a breach of this Agreement by the Employee, the following penalties shall apply: The Employee shall be liable to pay the Employer a predetermined amount of [specify amount, e.g., $100,000] as liquidated damages. This amount has been agreed upon by both Parties as a reasonable estimate of the damages the Employer would incur in the event of a breach.

5. Non-Interference with Doctor-Patient Relationships Nothing in this Agreement shall be construed to prohibit or limit the Employee's communication or interaction with any patient for the purposes of providing medical care. This Agreement specifically excludes any restriction that might interfere with the professional and ethical obligations the Employee has towards patients.

Fig. 1 A sample non-compete agreement with "duration, location, and vocation" specified and breach penalties defined, as generated by ChatGPT at my request. A clause has also been added to make it clear that the doctor-patient relationship trumps all contractual agreements.

which is not seen" includes lower offers in initial contracts, or no initial contract offered at all. To assume that everything else will remain constant despite the FTC Rule is almost as naïve as assuming that poverty can be eliminated by raising the minimum wage to $195/hour.

Despite all that, I'm not a big fan of non-compete clauses as they are currently used. These clauses can be vague, and employers take advantage of their relative wealth (and, with that, access to bullying lawyers) to ensure that the lack of clarity redounds to their favor.

Here's one example where the terms may not be obvious. A new hire may agree to be restricted from working within 25 miles of the employer. Yet a clause that bans working for another employer who has a presence within 25 miles of the current employer's presence—which sounds like the same thing to a layperson—might effectively ban an employee of the University of Pennsylvania in Philadelphia from seeking employment at the University of Pittsburgh, a city that is 300 miles away, because both academic institutions have outposts within 25 miles of each other near Harrisburg, PA, in the middle of the state.

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Additionally, young professionals might sign non-compete clauses without fully realizing the substantial expenses involved in having these clauses enforced if contract renewal negotiations fail. If relocation involves selling real estate, the costs associated with moving can easily exceed USD 100,000, but even without that, there is the emotional toll of making new friends, choosing new schools for children, and the like.

I support non-compete clauses, but with two provisos (Fig. 1). First, precise definitions must be given to what I call the "duration, location, and vocation" trio. That is, the contract must specify how long the terms last, their geographic limits, and which specific job functions are covered. (In my earlier hypothetical example, perhaps only ankle sprain surgery would be limited under the non-compete clause, but conceivably, all surgical procedures, or even administrative tasks, can be barred by the contract.)

The second requirement would be that every non-compete clause lists the amount due if the clause is violated—the so-called "liquidated damages." This amount would define the "buyout" price, allowing surgeons to make sound calculations as to whether violating the contract is an "efficient breach." Also, defined damages should reduce litigation, as there will be no room for dispute about the economic sums involved.

The traditional argument justifying non-compete clauses is that without them, employers would not reveal their trade secrets to their employees and would not invest in their training. This argument really doesn't apply to physician employment agreements. There are few trade secrets in medicine (ankle sprain surgery notwithstanding), and physicians join practices only after their education is complete. Rather, non-compete clauses are typically just economic hammers used by employers to tamp down physician leverage when renegotiating contracts. Non-compete clauses are effective at keeping salaries lower because they take advantage of employees' misperceptions and employers' asymmetric economic power. If my plan were implemented, these advantages would vanish. With that, abusive non-compete clauses will also vanish, without the necessity of coercive government intervention.

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Today, approximately 77% of U.S. physicians are employed by hospitals, health systems, or corporate entities [8]. This highlights a trend that has been evolving over many decades, with the most recent decade of data (2012-2022) showing how—for the first time—physicians are less likely to work in private practice [1]. Some of the factors driving the migration to an employed model include the desire to realize more favorable payment rates with payers, improved access to costly resources, and the need to manage the regulatory and administrative requirements so pervasive in medicine today. While entering into an employment agreement can mitigate these perceived practice stressors, there can be unforeseen consequences of this decision.

I have trained many residents and fellows in my 28 years of practice and have been asked to review many of their employment contracts. Almost without exception, there are non-compete clauses in their contracts, and few—if any—have been able to modify the language in those restrictive covenants. If most of the employment opportunities require signing an employment contract with non-compete language, there is no meaningful negotiation possible. I find it even more troublesome when these agreements are linked to employment in a corporate-run practice.

Dr. Bernstein takes the position that restrictive covenants can be liberating. But the devil is in the details: The language of non-compete clauses can be opaque, and the financial and logistical difficulties of leaving employment under a non-compete agreement might not be fully understood. I believe that individuals should be free to enter into contractual agreements without external interference by the government. A key concept in contract negotiations is the ability to reach terms that are mutually agreeable to both parties. If most of your employment opportunities exist within the corporate practice of medicine and there is no option to alter these agreements, you are left with the difficult choice of either signing the agreement or finding a practice that is struggling with the issues that are driving physicians to these corporate entities in the first place.

I agree with Dr. Bernstein that there may be unforeseen consequences of banning non-compete clauses. However, when viewing this rule through the narrow scope of healthcare, this rule empowers physicians to work in a setting that values the critical work they do and compensates them appropriately. The population is aging, and there are not enough physicians to meet their healthcare needs. The ability to freely change employment will realign the supply-demand curves. In a free market, when the labor force is in scare supply and the demand for their

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services is exponentially increasing, salaries and autonomy should likewise increase. However, we know this is not the reality we live in, due in large part to the market constraints that are imposed by non-compete clauses.

Appropriately, the FDA Non-Compete Clause Rule provides exceptions, including senior-level executives that make over USD 151,164 and hold policymaking positions. It has been argued that tax-exempt organizations, like nonprofit entities, are generally not under the jurisdiction of the FTC. However, in the final rule, the FTC stressed that "both judicial decisions and Commission precedent recognize that not all entities claiming tax-exempt status as nonprofits fall outside the Commission's jurisdiction. As the Eighth Circuit has explained, Congress took pains in drafting § 4 [15 U.S.C. 44] to authorize the Commission to regulate so-called nonprofit corporations, associations, and all other entities if they are in fact profit-making enterprises" [5]. It remains to be seen if the Commission's stated jurisdiction over nonprofit entities will withstand legal challenge. But the final rule clearly indicates the intention to enforce this rule on nonprofit entities that are demonstrated to be profit-making enterprises.

Healthcare has transitioned from a physician-led profession that was focused on patient care to a big business model, where consolidation and vertical integration constantly threaten the physician-patient relationship. In this evolution, the critical role of the physician in patient care has become subservient to profit and growth. This has led to more-frequent physician burnout and moral injury. Non-competes only act to strengthen the power imbalance between physicians and the boardroom that prioritizes profits over patient care. By banning non-compete agreements, physicians have the ability to find employment that values the critical role we play in patient-focused healthcare.

There are already countless lawsuits challenging this rule, and the courts will ultimately decide where this goes. I, for one, am in support of the FTC rule banning non-compete clauses. It just might allow us to refocus healthcare on the patient and away from the boardroom.

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Whenever there is an intersection of business and medicine and no clear path forward, we must use the patient as the North Star for guidance. In this situation, the question is fairly simple: Does the patient benefit from surgeons being bound by non-compete covenants? The answer is no. The most obvious detriment to patients is that if physicians cannot leave untenable employment situations and remain in that region, they will be forced to abandon their patients. It also dehumanizes the surgeon, suggesting that most patients choose health systems to perform their surgery rather than the individual surgeon who has dedicated his or her life to the mission of patient care.

Non-compete agreements are designed and built for employers to maintain power over surgeons by controlling their options. In a time when large systems and private equity companies are acquiring smaller hospitals and group practices, the landscape of a system can drastically change very quickly, with little to no surgeon input. When this occurs, it removes the employer's burden to keep their surgeons "happy." One can define happiness in many ways, but operating room time, advanced technology, support personnel, referrals, call burden, and salary can be largely controlled and manipulated in an employed model.

In the first situation explored by Dr. Bernstein—where one physician teaches a novel ankle surgery technique to another, so long as that physician leaves town afterward—asking the trainee to sign a non-compete is still harmful to patients and not in line with the Hippocratic oath we take. We have an obligation to train others for the betterment of our society. Arguing that a skill or knowledge is somehow something to be guarded for business purposes works against the advancement of medicine and the field of medicine in general, as there isn't a single surgeon who learned his or her skills in isolation. Do we ask trainees to sign non-competes? Each generation of surgeons works to educate the next one, so if one surgeon develops a particular operation that is useful, passing on this information—without restrictions—is how we improve our society. Being the best surgeon for patients should be the goal, not being the only option for patients.

Non-competes limit patients' choices and the ability of surgeons to find the best fit in their community, and they do not promote the key driver of ingenuity and excellence: competition. I'm afraid it's time to end this unfairly weighted control over surgeons. I am not afraid of a little competition—not as a surgeon, and certainly not as a patient.

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