CMS Finds Non-Compete Provision In Physician Recruitment Agreement Permissible Under the Stark Law

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In Advisory Opinion AO-2011-01, the Centers for Medicare and Medicaid Services (CMS) examined a proposed three-party physician recruitment agreement with a non-compete provision, and determined that the agreement meets the physician recruitment exception under the Stark Law.

The physician in question was a pediatric orthopedic surgeon who was needed to replace the sole such surgeon in the area, who had retired. Under the proposed agreement, the physician would receive an income guarantee loan with repayment and forgiveness incentives. The physician would be restricted from establishing, operating, or providing professional medical services at any medical office, clinic, or other health care facility at any location within a 25-mile radius of the hospital for a period of one year following either the termination or expiration of the agreement. The hospital certified that the practice determined the non-compete complied with state and local laws, and was “reasonable and appropriate in order to protect its investment in new physicians and appropriately incentivize a recruited physician to stay employed with the [p]ractice.” The hospital also certified that the physician practice regularly imposes non-compete provisions on all physician employees, and would not modify such policy in this case. CMS determined that the non-compete provision did not prevent the agreement from meeting the criteria under the Stark Law physician recruitment exception.

In its most basic form, the Stark Law prohibits a physician from making a referral to an entity for the furnishing of a designated health service for which payment may be made under Medicare or Medicaid if the physician (or an immediate family member) has a financial relationship with the entity, unless an exception applies. 42 U.S.C. § 1395nn. An exception is available for physician recruitment arrangements. 42 C.F.R. § 411.357(e).

The Stark Law physician recruitment exception allows a hospital to pay a recruited physician certain remuneration to induce the physician to “relocate his or her medical practice to the geographic area served by the hospital [and] become a member of the hospital’s medical staff.” Id. However, in order to comply with the Stark Law, the recruitment arrangement must satisfy all of the conditions set forth under the physician recruitment exception; otherwise, the recruited physician is prohibited from referring Medicare or Medicaid beneficiaries to the recruiting hospital for any health care service subject to the Stark Law.

The conditions set forth under the physician recruitment exception are as follows: (i) the arrangement must be in writing signed by the parties; (ii) the arrangement may not be conditioned on referrals to the hospital; (iii) the hospital may not determine (directly or indirectly) the amount of remuneration to the physician based on actual or anticipated volume of referrals or business generated between the parties; and (iv) the hospital must allow the physician to establish staff
privileges at, and refer to, other facilities. 42 C.F.R. § 411.357(e)(1). If the physician is joining an existing physician practice, additional conditions must be met. 42 C.F.R. § 411.357(e)(4). Among other conditions, a physician practice may not impose any unreasonable practice restrictions on the recruited physician. 42 C.F.R. § 411.357(e)(4)(vi).

The original physician recruitment exception under the Stark Law required that a physician practice not impose “additional restrictions on a recruited physician other than conditions related to the quality of care.” 69 Fed. Reg. 16054, 16095-96 (March 26, 2004). At that time, CMS indicated that “additional practice restrictions” included non-compete provisions. Id. If a physician practice insisted on including a non-compete provision in its employment agreement with the recruited physician, the hospital could not bill Medicare or Medicaid for any designated health services referred to the hospital by the recruited physician.

In the Stark Law Phase III rulemaking, CMS stated that it now believes that categorically prohibiting non-compete provisions from recruitment arrangements makes it difficult to recruit physicians, and that physician practices may be unable to hire physicians despite receiving a hospital’s financial assistance in compliance with the Stark Law physician recruitment exception. 72 Fed. Reg. 51012, 51054 (September 5, 2007). As a result, CMS modified the physician recruitment exception to state that a physician practice “may not impose on the recruited physician practice restrictions that unreasonably restrict the physician’s ability to practice medicine in the geographic area served by the hospital.” 42 C.F.R. § 411.357(e)(4)(vi) (emphasis supplied). Accordingly, key factors for determining whether a physician recruitment arrangement with a non-compete provision meets the physician recruitment exception under the Stark Law are whether the restrictions are reasonable, and also whether the covenant complies with state and local laws.

In the Advisory Opinion AO-2011-01, CMS provides several factors for determining whether a non-compete provision imposes practice restrictions that “unreasonably restrict” a physician’s ability to practice medicine in the hospital’s geographic service area. Specifically, CMS found the one year time period restriction and 25 mile distance reasonable. In particular, CMS found that the 25 mile limit still would permit the physician to practice at several hospitals both within and close to the hospital’s service area during the one year time period restriction. Finally, CMS was persuaded by the hospital’s certification that the non-compete provision complies with applicable state and local laws.

The enforceability of non-compete restrictions in Kentucky is based on a case-by-case determination of whether the clause is reasonable. While there have been several reported Kentucky cases on this issue, each case is decided on its own facts. Non-competes of limited duration (e.g. 1 year) and geographic limitation (e.g. 7 to 10 miles) should pass muster readily. Further, liquidated damages clauses, requiring payment by the restricted physician to free himself or herself to compete, should also be enforceable if reasonable in amount compared to the scope of the covenant not to compete.

If you have questions regarding the CMS Advisory Opinion, please contact any member of Greenebaum’s Health and Insurance Team.

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