Physician Non-Competes: Things to Consider

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Types of “Restrictive Covenants”

- Non-Competition Agreement
- Non-Interference
  - Employee Relationships
  - Customer/Patient Relationships
- Non-Solicitation
  - Of Employees
  - Of Customers/Patients
- Non-Disclosure/Confidentiality

Most Restrictive
Least Restrictive

When are restrictive covenants used?

- Sale of practice
- Initiation of employment relationship (i.e., hiring of new employee)
- Promotion to new position
- During employment relationship
- Termination of employment relationships
- Beginning of independent contractor relationship
Non-Competition Agreements

- Prevents bound party from competing with the business for some limited period of time in a defined geographic region
- Generally disfavored by courts – burden on party enforcing agreement
- Different state laws treat these agreements very differently
- Generally subject to high level of scrutiny, as they restrain trade, competition, and an individual’s livelihood
- Must be narrowly tailored pursuant to state law and business interests
- Some states generally prohibit the use of non-competition agreements (e.g., California)
- Other states generally will not enforce non-competition agreements for physicians (e.g., Delaware)

Non-Compete General Requirements

- Legitimate Business Interest to Protect
  - Confidential Information
  - Marketing processes
  - Pricing
  - Information about the business itself
  - Does not include generally accepted medical techniques or patient health records
- Investment in Specialized Training
  - More than just standard “on the job” training – must go above and beyond industry norm
- Customer Relationships
  - Only where employee is the “face of the customer”

- Reasonable Restrictions
  - Geographic Scope
    - Consider size of practice
    - Market in which the practice operates (urban areas will likely require tighter geographic limitations than rural)
    - Where do the patients come from and where is the competition?
  - Duration
    - 1 year safe in many states but not all (e.g., Arizona only allows non-competes for the period of time it takes to find a replacement employee and to allow the employee to continue the customer relationships)
  - Prohibited Activities
    - Cannot extend beyond the duties of the employee at the employer
### When are Non-Competition Agreements Appropriate?

- Depends on applicable state law
- Appropriate during sale of business
- Buyer of practice will often want assurance that seller will not open new practice down the street
- Appropriate for employees with substantial amounts of proprietary information
- Proprietary information includes: Marketing efforts, unique business insights, unique pricing structures
- Proprietary information does <em>not</em> include: Generally used medical techniques
- Occasionally appropriate for business generators (e.g., customer contacts)
- Not appropriate for other types of staff (e.g., nurses, receptionist, technicians), as there is no protectable business interest

### Court Reformation of Unenforceable Non-Competes

- Blue Pencil Rule: In some states, courts will strike offending provisions (blue pencil), and will enforce whatever is left (e.g., Arizona and Florida)
- Example: Engage in any activity which may affect adversely the interests of the Company, including, without limitation, the solicitation or diversion of customers of the Company.
- Reformation: Some state courts will reform the restrictive covenant to make the restrictions enforceable (e.g., Delaware)
- Example: the court may reduce a 3 year non-compete to 1 year
- Step Down: Some state courts will allow the restrictive covenant to contain “step-down” provisions, which provide alternative restrictions for the court to enforce if the primary restriction is found unenforceable (e.g., Arizona)
- Many states do not permit any of these “saving” options, and will simply decline to enforce the unenforceable restrictions (e.g., Virginia)

### Considerations Particular to Physicians

- Important to consider applicable state law – many states even further restrict or prohibit the use of non-competes for physicians
- You’re not alone: non-competes for attorneys are prohibited by the rules of professional ethics in all 50 states
- American Medical Association disfavors non-competes on the basis that they deprive the public access to and disrupt continuity of medical care
- Some states generally permit the use of non-competes but not for physicians (e.g., Delaware and Massachusetts)
- Other states apply stricter standards to physician non-competes (e.g., Virginia, Tennessee, and Texas)
- Courts in these states may consider additional factors, like: availability of alternative care in the particular specialty and the desire of patients to continue the doctor-patient relationship
- In some states (e.g., TN) the agreement can prevent physician from owning or operating a particular medical practice, but cannot prevent the physician from seeing patients or practicing medicine (i.e., with another employer)
Non-Interference Agreements

- Prohibit employees from doing business with their former employer’s customers and clients (patients) for some period of time after termination
- Less restrictive alternative to non-competes
  - Permit employees to compete generally, but prohibit the diversion of clients and customers (patients)
- Same patient freedom of choice and access concerns apply
  - Many states will still scrutinize these types of agreements with respect to physicians, as they restrict the physician from treating patients
- Must still be seeking to protect a reasonable business interest
  - Easier to justify because business always has an interest in its client relationships
- Restriction must still be reasonable in scope and duration
- Appropriate for employees who are the “face of the business”

Non-Solicitation Agreements

- Prohibit employees from actively soliciting clients and customers away from former employer
  - Examples: Requesting that the customer follow the employee to the new employer; offering discounts to follow employee; in some states, merely providing the name and contact information for the new employer directly to the customer
- Less restrictive alternative to non-compete and non-interference restrictions
  - Permit employees to continue to service clients and customers (patients), but only to the extent the employee is sought out by the client/customer
- These restrictions do not present the same kinds of patient freedom and access concerns as non-compete and non-interference restrictions
- Must still be seeking to protect a reasonable business interest
- Restriction must still be reasonable in scope and duration

No-Hire of Employees

- Prohibit employees from hiring away other employees post-termination
- Generally enforceable against supervisors to protect employee poaching, and potential resulting client/customer/patient diversion
- Restriction must still be reasonable in scope and duration
- Appropriate for supervisors and upper-level staff (e.g., physicians, office managers)
Non-Solicitation of Employees
- Prohibit employees from soliciting other employees post-termination
- Generally enforceable to protect employee poaching, and potential resulting client/customer/patient diversion
- Restriction must still be reasonable in scope and duration
- Appropriate for all employees

Non-Disclosure/Confidentiality
- Prohibit employees from disclosing confidential information obtained during the course of employment
- Always enforceable to protect confidential information
- Appropriate for all employees

General Contract Considerations
- Restrictive covenants must be written
- Restrictive covenants must be supported by “consideration”
  - Initiation of employment relationship
  - Some states recognize “continued employment” as consideration
  - In states that do not recognize “continued employment” as consideration, restrictive covenant executed after the initiation of the employment relationship must be in exchange for some other reward (e.g., bonus, raise)
- Choice of law provisions
  - Parties can choose which state law applies to the restrictive covenant, so long as there is a relationship between the chosen state and the employment relationship (e.g., employee works in offices in two states or corporate headquarters is in a different state than the employee)
  - When possible, select favorable state law
### General Contract Considerations

- **Forum selection clauses:** parties can choose which state courts have jurisdiction to adjudicate disputes over the agreement
  - state chosen must have reasonable relationship to the parties and the subject of the agreement
  - “first to file” problem – party might try to avoid a forum selection clause and choice of law clause by filing in a jurisdiction with more favorable law and argue the restriction violates the “public policy” of the state (must be the jurisdiction where the employee is employed)

- **Arbitration clause:** requires disputes be adjudicated in arbitration
  - Proceedings are confidential
  - Some believe arbitration is quicker and less expensive (less discovery) but arbitrations have the tendency to balloon into full-scale litigation, plus parties have to pay attorneys and arbitrators (who only get paid their hourly rate if the case continues)
  - Difficult for parties to subpoena witnesses – presents challenge to employers who have the burden of proving violation of restrictive covenant

### General Contract Considerations

- **Fee Shifting Provisions**
  - **Employer-friendly provision:** Employer shall be entitled to collect attorneys’ fees and costs incurred in enforcing the provisions of this agreement
    - deteres violation, as employee is potentially on the hook for substantial fees
    - employee should never agree to such a provision
  - **Mutual provision:** The prevailing party collects attorneys’ fees and costs incurred in bringing or defending a suit for breach of the agreement
    - deteres suits by employer seeking extort settlement sums on bad facts
    - party pursuing or defending suit better be sure they will win
  - **No fee shifting provision:** parties pay their own way
    - Pursuing non-compete claims is often very costly, with little potential for monetary reward (difficult to prove and quantify money

### General Contract Considerations

- **Damages**
  - Very difficult to prove damages
  - Consider including “liquidated damages provisions” – parties agree on a set formula for calculating damages for breach (e.g., $1,000 per diverted patient) or a set sum for each breach ($50,000 per breach of the agreement)
  - Some states prohibit the use of liquidated damages
  - Most states that permit liquidated damages require the damages to bear a relation to the anticipated breach (e.g., not purely a penalty provision)
  - Usually expert must opine on damages
  - Punitive damages not permitted in breach of contract
  - Injunctive relief: court prohibits party from continuing the breach
    - Temporary Preliminary: during the pendency of litigation
    - Permanent: as a result of final judgment
General Contract Considerations

- Buy-Out Provisions
  - Permits employee to buy his/her way out of the restriction for a predetermined price (e.g., $1,000 per customer or $50,000)
  - Permissible in some states that prohibit other forms of physician non-compete (Delaware and Colorado)
  - Buy-out price must have some reasonable relationship to the restriction
- For-cause v. without cause terminations
  - Employees might ask that the restrictions fall away if termination is “without cause” → if such a term is incorporated into the agreement, there must be a clear definition of “cause”
  - Some states apply stricter rules when enforcing a restrictive covenant against an employee terminated without cause
- Terminations “for good reason”
  - Employees might ask that the restrictions fall away if employee terminates for “good reason” → if such a term is incorporated into the agreement, there must be a clear definition of “good reason” (e.g., non-payment of wages, reduction in wages, demotion)

Other contract provisions to include

- Blue pencil/reformation clause → permits courts to blue pencil or reform unenforceable restriction in states where blue penciling or reformation is permissible
- Severability → where a provision of the contract is found unenforceable, the remaining provisions remain in effect
- Construction → rebut presumption against drafter (usually employer) in cases of ambiguity
- Third parties
  - Possible to pursue new employer if it had knowledge of the restriction but permitted the breach to continue (tortious interference with contract)

Practical Implications

- There are no guarantees – take other precautions (e.g., limiting access to information)
- Be sure to consult with specialized legal counsel when drafting these restrictions
- REVIEW AND UPDATE restrictive covenants frequently
- Duties and responsibilities of employees change over time
- Agreements get stale