

The Legal Intelligencer

THE OLDEST LAW JOURNAL IN THE UNITED STATES 1843 - 2010

PHILADELPHIA, MONDAY, OCTOBER 25, 2010

VOL 242 • NO. 81 \$5.00 An **ALM** Publication

Physicians and Covenants Not to Compete: Neglect Is Not an Option



Mark Stadler

Health care attorneys often prepare or review physician employment contracts containing covenants not to compete. It is striking how often physicians ignore or dismiss these covenants as being worthless or unenforceable; this attitude can lead to catastrophic results.

Since at least the early 18th century, the common law has recognized the enforceability of these covenants. In addition, the courts of virtually every state, including Pennsylvania, have consistently enforced these covenants against physicians, who ignore these covenants at considerable risk. The more reasoned approach is to carefully negotiate the language of these covenants, minimize them to the greatest extent possible, and attempt to secure a release from them upon terminating an employment contract which contains a covenant.

NEGOTIATING THE COVENANT

When presented with a contractual non-compete provision, the physician has a handful of choices: reject the contract and seek employment elsewhere; demand removal of the covenant; attempt to negotiate changes to the covenant; or (failing all of the above) sign the contract with the covenant.

A number of factors generally drive this process, including the physician's bargaining power (how desperately does the physician want or need the offered position versus how desperately does the employer want or need the physician); the strength of the physician's practice (are they bringing an established practice and established referral relationships to the employer?); the size of the employer (small practice, a large multi-practice group or health system); and the physician's ability to offer certain specialty services that are otherwise unavailable in the employer's market area, etc.

While every situation is unique, some general rules apply, including the following:

- A physician entering the workplace for the first time has limited ability to negotiate away a proposed covenant.

- If all of the employer's physician-employees are subject to a covenant, it is highly unlikely that a new hire can avoid one.
- The larger the prospective employer, the more likely it is that the employer will insist on a covenant.
- If the physician is expecting the employer to introduce the physician to patients and referral sources and to otherwise assist the physician in developing a new practice, it is more likely that the physician will have to live with a covenant.
- Conversely, if the physician has an established practice and well-developed referral sources, the physician may be able to avoid a covenant or negotiate away some of the covenants more onerous provisions.

A fairly typical covenant not to compete would preclude the physician from practicing medicine anywhere within a 25-mile radius of the employer's offices for a period of two years after termination of the physician's employment, with the employer possessing the right to enforce the covenant by injunction.

What aspects of the covenant are negotiable, or how might the physician be able to narrow the covenant? The most successful strategy is usually to break the covenant down into its various components and negotiate concessions on each of them. For example:

- Request that the covenant be enforceable only if the physician terminates the contract without cause. Pennsylvania courts have indicated that enforcement of a non-compete covenant is questionable if the employer has terminated the contract without cause (especially where only a limited written notice is required) or fails to renew the contract.
- Demand reduction of the timeframe. A six-month or one-year covenant is always better than a two-year covenant.
- Reduce the geographical scope of the covenant. Where the physician will primarily work out of one site, it is reasonable to request that the radius of the covenant use that site as its sole starting point.
- Limit the type of practice that will be deemed to violate the covenant. If upon leaving the employer the physician is willing to change the nature of their practice (say from pain management to anesthesiology), it is arguable that the employer has no protectable interest in precluding the physician from working in this new field. Also, it is fairly typical for large health systems to permit a departing physician to go into or return to private practice so long as the physician does not do so as an affiliate of a competing health system.

- Negotiate a buy-out of the covenant. As discussed below, litigating enforcement of a covenant by injunction is expensive and unpredictable. The physician will have much greater flexibility if the contract allows the physician (or a future employer) to make a predetermined payment to the employer to eliminate the covenant.

Many other strategies can be explored. The important point is to negotiate away as much of the covenant as possible.

CONFRONTING ENFORCEMENT OF THE COVENANT

When a physician, who signed a contract with a covenant, faces termination (either voluntarily or involuntarily), what are the recommended actions? First and foremost, it is foolhardy to assume that the covenant is unenforceable or that the employer will ignore it or forget about it. The more productive approach is to carefully analyze and select among various available options.

- Take a new position outside the geographic limits of the covenant. Obviously, this is often much easier said than done, as this choice usually means starting the physician's practice anew and generating new patients and referral sources in an unfamiliar community. Remember, this is exactly what the covenant is intended to accomplish.

- Negotiate a release from the covenant. Typically, there are unresolved issues whenever a physician's employment relationship terminates. The physician may have potential claims for severance compensation, vacation pay, formula-based bonus compensation, breaches of stated or presumed contract rights, and employment discrimination.

Employers often want to make a clean break and move on without worrying about future claims and litigation. This mindset presents an excellent opportunity to negotiate a global resolution of all employment-related claims, including the covenant. In return for a release of the physician's claims, the employer may be willing to provide a release from the covenant or, at least, more narrowly define its scope and applicability. If the physician intends to pursue future employment within the restricted area, these negotiations should be vigorously pursued.

- Take a new position within the restricted area and persuade the new employer to indemnify and defend the physician against enforcement of the covenant. While not unheard of, this option is generally available only when the physician is in incredibly high demand, and the new employer is willing to pay almost any price to secure the physician's services.

In most instances, the new employer will be extremely reluctant to provide this indemnification. If it does, the physician's original employer will usually add the new employer as a defendant to its suit to enforce the covenant, typically claiming contractual interference. This immediately subjects the new employer to the substantial cost of fighting a preliminary injunction action and exposes it to an unpredictable amount of damages. This is all in addition to the possibility that the new employer may be deprived of the physician services for a substantial period of time if the covenant is ultimately enforced. Not many prospective new employers are willing to bear this risk.

The more typical scenario is that the new employer will attempt to temporarily place the physician at a practice site beyond the scope of the covenant until the covenant expires, or the new employer will insist that the physician provide a contractual representation to the effect that the physician is not subject to an enforceable covenant, and demand that the physician agree to indemnify and defend the new employer against the enforcement of any such covenant.

If these options are not viable, the physician will be forced to address the great uncertainty of litigation and bear the attendant costs. Will the employer attempt to enforce the covenant? When? Are there meaningful defenses to enforcement of the covenant? How much will it cost to defend the employer's claims? Typically, there are no clear answers to any of these questions.

An employer rarely refuses to pursue enforcement of a covenant unless it is convinced that it cannot win or it perceives no value in enforcing the covenant (i.e., it does not view the physician's new practice as an economic threat to the employer's existing practice.) When the employer pursues enforcement, the physician must decide whether any meaningful defenses exist. Was there adequate consideration for the covenant? (This is rarely an effective defense unless the employer forced the employee to sign the covenant after employment commenced and no additional consideration was provided for the covenant.)

Are there circumstances that render enforcement of the covenant unreasonable, e.g. the physician was terminated without cause, the covenant is overly broad as to time and geography, the employer was guilty of some misconduct, enforcement does not protect any legitimate interest of employer, or enforcement of the covenant conflicts with some well-established public policy?

Often, physicians believe that their unique relationship with their patients should preclude enforcement of the covenant. This defense rarely works unless the physician is the only available specialist in the community and enforcement of the covenant would result in great inconvenience to patients requiring those specialty services. While it is almost always possible to fashion a colorable defense, it is generally impossible to predict the success of any stated defense.

Covenants are usually enforced through injunction proceedings. The employer files a complaint and then moves for a preliminary injunction. This entails a flurry of activity, including a compressed discovery period, before there is a hearing on the motion. The hearing is essentially a short form trial, with the judge either granting or denying the preliminary injunction soon after conclusion of the hearing. While the judge's ruling is "preliminary," it almost always ends the case.

In order to grant the injunction the judge must find that the employer has a "substantial likelihood of success" in enforcing the covenant. Once such a finding is made (or not made, as the case may be) it is extremely difficult to reverse it at a final hearing unless new evidence is discovered in the interim. The benefit of the preliminary injunction process is that it yields a reasonably prompt resolution. On the other hand, the process is extremely time- and resource-intensive, i.e., costly.

A physician who ignores the existence of a covenant not to compete (or concludes that the covenant will not be enforced) may end up paying tens of thousands of dollars defending enforcement of the covenant. If the covenant is ultimately enforced, the physician may also have to suspend a newly established practice until the covenant expires. This is a steep price to pay, especially when some effective negotiations on the front end or when the prior employment was terminated could have made these issues disappear.

Mark Stadler is a partner in the Pittsburgh office of Cohen Seglias Pallas Greenhall & Furman, where he is a member of the business transactions group. Stadler focuses his practice on the representation of health care providers, charities and related enterprises in all aspects of their operations. He can be reached at 412-434-5530 or mstadler@cohenseglias.com.