Podcast

Enforceability of Physician Non-Compete Agreements

By William L. Davis, Mary A. Smith & Justin E. Theriault

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Meet the Authors

William L. Davis
Principal
(972) 728-3297
William.Davis@jacksonlewis.com

Mary A. Smith
Principal
212-545-4002
Mary.Smith@jacksonlewis.com

Justin E. Theriault
Principal

Details

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Non-compete covenants in physician employment and shareholder agreements are common practice. Whether they are legally enforceable as drafted varies from state to state. Some states have broad interpretations of reasonableness — and there's a growing trend to disallow these types of agreements completely.

Jackson Lewis P.C. · Prevention Against Physician Non-compete Agreements

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Transcript

Alitia (00:06):

Welcome to Jackson Lewis' podcast, We get work™. Focused solely on workplace issues everywhere and under any circumstances, it is our job to help employers develop proactive strategies, strong policies, and business oriented solutions to cultivate a workforce that is engaged, stable, and diverse. Our podcast identifies the issues dominating the workplace and its continuing evolution, and helps answer the question on every employer's mind; how will my business be impacted?

Non-compete covenants contained in physician employment and shareholder agreements are common practice in the healthcare industry. Whether they are legally enforceable as drafted however, varies from state to state. Some states have broad interpretations of reasonableness, others restrict non-compete covenants through legislative action, and there's a growing trend to disallow these types of agreements completely. On this episode of We get work™, we explore how hospital systems and medical groups can protect their goodwill and legitimate business interests. Our hosts today are Mary Smith, Bill Davis and Justin Theriault, principals in the White Plains, Dallas and Hartford offices of Jackson Lewis

(860) 331-2588
Justin.Theriault@jacksonlewis.com

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respectively.

In addition to helping employers with the often competing state regulations on non-competes, they will be spending the next 23 minutes vying for your attention to make sure you know what is legal and what is not. Mary, Bill and Justin, the question on everyone's mind today is what do employers of physicians need to know about non-compete agreements to ensure that the employer-physician relationship remains healthy, and how will that impact my business?

Bill Davis (01:54):

Justin and Mary, we all frequently get calls from clients in many different industries asking us for assistance with what many people refer to as non-compete agreements. I know both of you do a lot of work in the healthcare field and in particular with physician agreements. When we're talking about non-competes or restrictive covenants in physician agreements, what types of restrictions are normally at issue?

Justin Theriault (02:19):

Thanks Bill. That's a great question to start because as we discuss these things, it's very important that everybody understands what we mean when we use different terms of art when it comes to types of legal agreements that we might ask our employees, including physicians, to sign. When it comes to a restrictive covenants in the physician area, we're typically talking about a couple of different kinds of covenants. We're talking about non-competition covenants, which affect where somebody is able to work and how long after the employment relationship they were restricted by, or that they would be restricted. Non-solicitation convenants, which cover physicians who might try to lure patients away from their former employer. And we'll also often see non-solicitation of employees covenants, which is intended to prevent poaching or rating, and it's a particular concern where an individual physician might have the ability to hollow out an office to start their own competitive business. And it's worth mentioning that there was a previous episode of We get work™ where Cliff Atlas and Erik Winton of our non-compete group address this very issue discussing poaching and how employers can prevent it.

Those are generally the three main kinds of agreements that you're talking about. There may be some other situations where you're talking about non-interference with vendor relationships and things of that nature, but primarily we're talking about non-competes with respect to work and non-solicitation with respect to patients in the case of physician restrictive covenants.

Mary Smith (03:58):

That's right. I would agree with Justin, Bill. What we see really in New York and New Jersey, we see non-compete covenants directed specifically at physician specialty areas, restricting the physician from going out and working across the street or opening an office directly across the street. So they usually have geographic limitations, they have time constraints. We do also see in the technical areas, so physicians that might have technical specialists that are contained within their practice area, we have some focus non-solicitation of employee covenants.

But I think really the non-compete and the non-solicitation covenants are geared

towards making sure that the physicians don't develop a practice in a very close geographic region to where they currently work.

Bill Davis (04:48):

In a lot of our clients' businesses, the concern is with key employees leaving and taking a lot of business with them. So the restriction the business is focused on is the non-solicit provision. The departing employee agrees not to solicit customers or take business to the company. How do you address this in physician agreements?

Mary Smith (05:10):

In the physician agreements that we have worked on in New York and New Jersey, we primarily really address that in an outline for physicians departures with respect to patient records. It's contained frequently in a non-solicitation covenant, but really what there is there's a very specific process in the physician agreement that explains how the patients will be notified of the physician's departure, the time periods that will apply for that notification and then requests from the patients in writing that their files be moved from the existing practice to maybe the new practice that the physician is going to.

So it's really a very specific written process that the doctor and the group agree on when the doctor's entering the group about how that doctor may depart from the group at a later point in time. I don't know Justin if you see it differently in Connecticut, but that's really what we see primarily in New York and New Jersey.

Justin Theriault (06:05):

I would definitely agree that setting up the logistics and establishing expectations that are uniform on all sides of the agreement is really important. Aside from that, the only thing I would add is that aside from the logistics of the actual departure, you obviously want to pay attention to the scope of the non-compete and how it's going to affect the physician moving forward. What are the time restrictions that are involved there, how lengthy are they? As well as establishing whether you're going to, if you're talking about the non-solicitation of patients, how you describe what they are and are not allowed to do, and making sure that somebody can't accomplish indirectly what you would be prohibiting them from doing directly.

Mary Smith (06:50):

That's right, because as you all know, patients do have the right to choose their doctor, and that is really well-founded within the medical profession and in the practice. So there's an attempt to work out the logistics without imposing or indicating to anybody, including the patients, that they can't choose their own physician. I think that's important to keep in mind in all of the covenants and in all of the agreements that we work on.

Justin Theriault (07:17):

I think that's a good point to make, not even from a legal perspective, but from a patient relationship perspective, because the business doesn't want to be caught telling patients where they can and can't go as that could go over very poorly if a

patient is being denied access to a physician that they want to see.

Bill Davis (07:34):

Are you seeing any changes in the way healthcare is being delivered and that having an impact on these types of agreements?

Mary Smith (07:43):

I will mention in New York, we have seen a real shift in the case law in the state courts in New York, with respect to the fact that smaller medical practices have really been acquired by larger medical groups, whether those are professional groups or whether they're hospital associations. The courts have responded to those acquisitions by looking at the covenants a lot more closely, looking at the geographic restriction, looking at how large the new employer is, and I have been reading into some of those decisions and expectations by the courts that the covenants be revised. That they be limited in scope and in time really to where that particular physician works, as opposed to all the locations in which that new group may have offices.

Justin, I'm sure you've seen the same thing in Connecticut.

Justin Theriault (08:31):

Agreed. It's a trend that we're seeing more and more individual physician practices and small physician practices being bought up our larger organizations or entering into agreements for those organizations to manage them essentially. And in that kind of a situation, these networks of physician offices that are all affiliated often with the same trade name, creates a potential for the drafting of restrictive covenants that can end up being entirely too broad and really impact the physician's ability to continue in their profession after they leave employment. In those kinds of situations, a court is going to look at it very, very carefully because when you have a network of physicians offices that are all affiliated with one another and you take something that might sound reasonable like 10 or 15 miles, but then all of a sudden you have five or six locations and before you know it, you're covering the better part of a region, it could get out of hand.

For that reason we do, in these sorts of cases, often advise our clients to look at restructuring that geographic restriction and that's particularly the case, and I think we're going to be getting to this in a little bit, where you have state laws that address specific restrictions very specifically. They talk about what the maximum geographic restriction or temporal restriction can be in one of these agreements, and you want to make sure that you're very familiar as a business with the local law wherever you operate, because those specific restrictions can really create problems if you're not prepared for them when you're drafting these restrictive covenants at the outset.

Mary Smith (10:17):

That's right. In New York, we have some really good cases on restrictive, non-covenants in the medical profession, and almost all of those cases are from the 1990s. What we've seen starting in about 2010 is a shift in the court system with what Justin said, with an expectation that the groups will really take a hard look at what they're restricting and modify, even in very slight ways, amend and modify

those restrictions to be more in line with what's going on, the reality of the network and the breadth and scope of the restriction.

Bill Davis (10:51):

A lot of our clients operate in different states and particularly larger companies. For our listeners who do operate in a number of different states, and some of them may be considering a one size fits all agreement, how does state law impact these types of agreements?

Justin Theriault (11:13):

I don't think it can be overstated how much state law can impact these types of agreements and how difficult it is to have a one size fits all agreement if you operate in multiple states. The reason for that is multiple. You have different bodies of case law in each state, where courts may be applying the same test but coming to different conclusions. And as we know in the common law system in the United States, one decision leads to another and they cite each other, so sometimes you'll have a very different line of thought based on the same analysis in two different states, just by virtue of the fact that different people are looking at similar questions and coming to conclusions.

In addition to that, you have more specific statutes that address non-competes and in some states, those statutes are of general application, like Massachusetts and Illinois, but in other states like Connecticut, where I practice, they have specifically targeted the area of physician practice as an area that they want to regulate specifically, even though there is no statute that says it applies to non-competes in all industries.

So physicians, at least in my experience in looking at the trends nationwide, we're seeing a focus on high skilled professions like physicians as the subject of legislation. There's a lot of statutes that have been proposed in many states to even prohibit physician non-competes altogether, though we haven't seen too many of those as of yet that actually have passed. But in a place like Connecticut where I practice, we have strict geographic and temporal limitations on what employers can do and it's really important that an employer understand that and understand that every jurisdiction where they operate could have these kinds of restrictions and making sure they prepare for it at the time of drafting.

Mary Smith (13:07):

That's right. So for instance, in New York Bill, we don't have a non-compete statute directed towards physicians, but we do have in neighboring states, in New Jersey, there's actually a statute that is directed towards psychologists, interestingly enough, and in Pennsylvania, there's a bill right now that's pending that is directed towards physicians.

What I think we see with all of the statutes, and even in those states where they're not just solely directed towards physicians, we do see the legislature indicating I think pretty clearly where they think reasonableness should lie, so they focus on a couple of different things. They focus on the geographic range, they focus on the time period, and they also sometimes focus on, within the geographic range,

whether you're allowed to extend beyond one location, one office or another office. So I think in drafting for our clients, in drafting an agreement that is likely to be somewhat enforceable in most locations, you need to really be mindful of your geographic location, your time period.

We don't really see anything more than two years in most locations, one year is really more likely to be enforceable. And restricting where that geographic location starts from, whether it's from the primary office that that physician was working out of, as opposed to some other offices that the group may have had, but that the physician really wasn't affiliated with. And if an employer can draft, if a group or a healthcare organization can draft an agreement that is generally reasonable in all those areas, then Justin, I would probably say it's likely to be enforceable in most states. Not every state, but in most states. But I think it's understanding you have to really approach this very reasonably in your drafting

Justin Theriault (14:48):

And Mary, that point that you made about the site of the physician's practice is really important specifically with respect to the statutes that legislatures have been passing with respect to restricting physicians from continuing their practice after employment, because in a state like mine in Connecticut, there's a statutory requirement that you need to pick a site, and if there is no obvious primary site, which is a term of art, it can be agreed upon, but really you're only supposed to pick one site.

That really has major effects when you have a one size fits all agreement with an organization that has multiple offices, because then you're starting from a point where the geography appears to be a real problem when you're trying to enforce it. So being prepared for those conversations at the outset is really key in making sure that clients seek legal counsel and make sure that they're up to date on all the applicable laws in the jurisdictions where they're operating.

Mary Smith (15:45):

Then the only other thing I will mention Bill before we move on, on that issue is that a lot of our clients assume that if you're in a blue pencil state, which New York is, that even if an agreement or a covenant is over-broad, the court will work with us on modifying it and will recognize that in that particular situation, the covenant should apply.

What we have seen in states like New York is a reluctance by the courts to do that. A couple of cases where the courts have said, "We've been asked to blue pencil, but we decline to do so." And I think that's the court system sort of sending a clear message to the drafters of the agreements that we don't want a one size fits all, we want you to be thoughtful and mindful when you're drafting agreements that are going to somehow restrain individuals from going out and continuing in their profession.

Bill Davis (16:37):

When you're drafting these agreements and deciding how far you can go, does it make any difference in how you approached them, whether the physician has an ownership interest in the practice or the business at issue?

Mary Smith (16:49):

I would say in New York, it does make a significant difference. It is much, much easier. We see the courts are much more willing to enforce the covenants when they are the result of a shareholder agreement, which has been negotiated. Most shareholder agreements are negotiated with counsel on both sides. That also can be a factor that weighs in favor of enforcement of the covenants.

When it's not a shareholder, when it's just an employee agreement, we see the courts much less inclined to enforce a broad restrictive. They're more willing to say that this is over-broad and this more junior physicians should have the ability to go out and work elsewhere without restriction.

Justin, I don't know if you see the same thing in Connecticut.

Justin Theriault (17:35):

I think there is a distinct difference when you're talking about a situation where a physician has an ownership interest in the business, and it's part of a partnership agreement or something similar like that. That's something that is sometimes contemplated in these statutes as well, that the position status as an owner or the restrictive covenant being entered into as part of a partnership agreement puts it in a different status than your second year out of medical school physician who's going to work in your office or for your health system for a couple of years, and then move on.

There is a legitimate interest on the part of businesses and making sure that those people who, for a lack of better term, have keys to the kingdom and understand how the business runs could have the ability to cause some major damage if they were to try and leave and take talent and patients with them. There's a very different level of legitimate business need on the part of an office or employer when it comes to controlling for that versus those younger physicians that may not have the same routes, may not have the same ability to cause damage to the business as they move on to their next venture.

Bill Davis (18:55):

Are there challenges or maybe opportunities to address these issues in mergers or consolidations?

Justin Theriault (19:02):

I think so. In the case where you have these mergers and acquisitions, and we've discussed this a little bit earlier in the podcast when we're talking about these organizations that are getting involved in purchasing the rights to manage or purchasing physician practices, that is the key nexus point where you can address these issues upfront so that you don't run into unexpected problems later.

Jackson Lewis actually just launched a new client services group for transactional services. We don't do M&A here at Jackson Lewis, but one of the services that we can provide is to work hand in hand with a company's M&A attorneys to make sure that they have the employment law resources that are necessary for them to make

sure that if they have an acquisition that applies in multiple jurisdictions, that they know what they're getting into in each specific one, and that they structure their agreements accordingly so that they make sure that they don't run into any unexpected stumbling blocks when one of those physicians involved in this transaction leaves and wants to start their own practice down the street.

Mary Smith (20:04):

That's right. In New York, we do encourage our clients to at least bring in the employment lawyers to give some insight both on the existing agreements, because if the existing agreements present some stumbling blocks and the acquisition doesn't go as planned, sometimes they're looking to enforce an agreement that they themselves didn't draft, but still want to be able to enforce it.

The flip side of it is the merger or acquisition really does provide the group with an opportunity to look at their agreements and realign them with maybe what's really protectable and narrowing the scope and the geographic regions so that they can feel pretty certain that the new agreements are enforceable and don't have to worry so much about updating those agreements anytime soon. So I think it does present an opportunity for reviewing those agreements.

Bill Davis (20:54):

I'm seeing a lot of advertising for telehealth, where the doctor visit is online. Is that having any impact on how you draft restrictions and physician agreement?

Mary Smith (21:05):

In New York, we have not seen a tremendous impact on drafting of those agreements, but that's mainly because I think telehealth was very restricted in the state of New York prior to the pandemic. So as we've seen a little bit of loosening with respect to telehealth, we do see some more opportunities, but I would say the majority of practices, at least in New York, limit the amount of telehealth visits any of their physicians, whether they be shareholders or employees, can actually perform.

So I don't know that it would really impact the covenants right now. Justin?

Justin Theriault (21:39):

Yeah. It's a new frontier, particularly if businesses starts to have doctors that work exclusively remotely, and aren't working from a centralized office location. As you see more and more of that, I think it's going to be really essential that businesses look very carefully at their business model and try and strike a balance where the individual still, after they leave employment, is able to make a living, but protecting the business.

We haven't seen a lot of cases involved in this. As Mary mentioned, the pandemic really brought this to the fore, and we're probably going to see that moving forward in the next couple of years, that doctors who may have entered into restrictive confidence during this period are now doing an extensive amount of telehealth work and employers need to adjust and make sure that they protect themselves while also

not drafting agreements that end up being so broad the person isn't able to continue working as a physician.

Bill Davis (22:37):

A lot of the calls we get, unfortunately, are after the employee has been working for the company for some time, there's no agreement in place, no agreement made at the time of hire, and some involve unfortunately the company, having reason to believe the employee is about to leave. They pick up the phone and they call us and want to know if there's anything they can do.

Does the timing of when someone signs a non-compete agreement affect the ability to enforce the agreement?

Justin Theriault (23:09):

In most places, that's a big yes. The best time to sign a non-compete is at the outset of employment. And many states, particularly if an employee is at will, may not allow an agreement to be based on simple continued employment of the same employee in the same position. In that kind of case, a business needs to look at independent consideration for the agreement, like a bonus or something like that.

But if you've waited that long, you also have the possibility that that employee is going to reject that additional consideration and say, "No, I think I'm okay. Thanks very much."

So setting this up as a situation where you're bringing somebody in the door and signing it then is absolutely the best practice I would say, regardless of jurisdiction.

Mary Smith (23:56):

With respect specifically to physicians, I think that one of the main protectable interests that we end up debating with respect to the non-compete covenants is the goodwill. For a lot of physician groups, they are a specialized profession, they have a specialty, and sometimes they even bring with them a certain patient base. But what they gain by joining a group frequently is access to other physicians, referrals, back office, and all of that goes into the goodwill, so that really provides a lot of the consideration for the non-compete covenant after their relationship with the physician group ends, as opposed to a traditional employment where maybe the employer is sharing confidential information. It's not quite the same I think in a physician non-compete scenario.

So to really develop that goodwill, that agreement really should be entered into when they enter the group. And you can establish that over these years they've grown with the group, their practice has grown. And as a result, you have this protectable interest that you can then hold on to at least for some period of time after they leave that physician group.

That at least in New York is really, really important to enforcement of the non-compete covenants.

Bill Davis (25:05):

Justin and Mary, thank you very much. It's a very interesting area. A lot going on, a lot to think about, and I hope our listeners have found this to be helpful.

Mary Smith (25:17):

Well, you're welcome. I think it's a fascinating area, and I do think over the next couple of years, we're going to see lots of changes in this particular area of the law.

Justin Theriault (25:25):

Agreed. And thanks Bill for helping facilitate this conversation.

Alitia (25:31):

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