The Ties that Bind

A Legislative Change to Noncompetition Restrictions

By Thomas A. Lerner

Noncompetition restrictions in physician employment agreements preclude a physician from practicing in a defined geographic area for a stated period of time. For example, a physician who has been employed in Seattle may be prevented from accepting a new position on the west side of Lake Washington between a north/south boundary defined by I-90 and the Snohomish County line. Enforcement of these provisions may be accomplished by obtaining an injunction, or by the requirement that the departing physician pay an agreed amount ("liquidated") damages, or both.

In most cases, disputes arising from noncompetition agreements revolve around negotiations for the payment of liquidated damages. Such damages are supposed to serve as a surrogate for proof of actual damages in circumstances where establishing such proof would be difficult. Liquidated damage provisions are enforceable, provided that the amount is not actually a penalty. In reality, most liquidated damage provisions are drawn with the intention of being onerous, but just short of being a conspicuous, unenforceable penalty provision.

The legitimate purpose of noncompetition restrictions is to protect the investment of the former employer in their business goodwill and business relationships. For example, it is reasonable that an employer may not want to have a salesman nurture relationships with customers, and then set up shop in competition and trade on those relationships. One of the leading appellate cases in Washington enforcing competition restrictions arose from an insurance agency, where the former employees pursued the insurance customers with whom they had developed relationships during their employment.

Washington enforces employment noncompetition agreements that are reasonable in time and geographic scope, where "reasonableness" is evaluated by determining what is reasonably necessary to protect the former employer's interests. This general rule is modified by the further qualification that the restrictions must not violate public policy. The public policy qualifier lacks express definition, but generally the courts look for some legislative expression of the state's policy priorities.

In 1998, the AMA Council and Ethical and Judicial Affairs published its position on noncompetition agreements:

> "Covenants-not-to-compete restrict competition, disrupt continuity of care, and potentially deprive the public of medical services. The Council on Ethical and Judicial Affairs discourages any agreement which restricts the right of a physician to practice medicine for a specified period of time or in a specified area upon termination of an employment, partnership or corporate agreement. Restrictive covenants are unethical if they are excessive in geographic scope and duration in the circumstances presented, or if they fail to make reasonable accommodation of patients' choice of physician."
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> —AMA Council on Ethical and Judicial Affairs, Op. E-9.02 (1998).

In the wake of that, litigation arose in a number of states where a departing physician (or group) relied upon the AMA's position to argue that these post-employment restrictions violated public policy, and should not be enforced. The delivery of health care services is not, after all, like the sale of insurance. Almost without exception, however, these challenges failed, with the courts deferring instead to the legislature for an expression of public policy.[1] If the law governing physician post-employment restrictions is to change in Washington and elsewhere, it will require legislative action rather than reliance on a judicial decision.

No physician pursued a career in health care because of an enthusiasm for learning CPT coding, or from a passion for spending time on the phone with health insurers. No health care provider enthuses to evaluating whether a piece of durable medical equipment can be economically put to use without violating byzantine

1. A Florida pediatrician successfully defeated his noncompetition restrictions due to their geographic scope. Enforcement of the 10-mile radius in that case would have left a community without any pediatricians. The more arcane the medical specialty or the absence of practical alternatives bolsters the argument that a noncompetition restriction should not be enforced in particular circumstances, but that is an individual solution rather than a systemic remedy.

STARK regulations. The evolution of health care economics in a world driven by health insurance contracts and government regulations has become the principal driver for changes in how health care services are delivered, and has likely been one of the greatest contributors to physician dissatisfaction.

One of the consequences of the evolution of health care economics has been that physicians have managed the business side of their practices from a defensive posture. In the halcyon past days when a senior physician would take on a junior colleague for training, collaboration, and transition, now those relationships commonly commence with a contract that places restrictions on the junior colleague to preclude them from striking out on their own. This changes the relationship at the outset, from one of collaboration to one of apprenticeship, with all that implies.

Medical schools offer little or no training to new physicians with regard to understanding their prospective employment contracts. New physicians are eager to get started in practice and shift their thinking from their debt burden to debt reduction and income. There is an inherent imbalance in their ability to negotiate noncompetition restrictions, and those provisions are often accepted as a necessary evil. In practices where the physician aspires to partnership at the commencement of the employment relationship little attention is paid to the costs and terms of the buy-in. The result can be that a physician is left with no practical alternative to an onerous buy-in other than to pay or relocate, because of the noncompetition restriction. For a new physician, attention should be paid to both of these provisions at the outset, so that an appropriate decision can be made or alternatives explored.

Certainly one can appreciate the interests that a small group practice would have in not bringing in a new physician, training him or her, nurturing the relationship between the physician and the patient, and then have that physician leave the group and open a competing practice across the street. The practice may have made substantial capital investments to accommodate the growth of the practice with the addition of a new physician; that investment and the financial viability of the practice are placed at risk by the departure of the physician. A restriction on competition serves a legitimate interest there, but one which is best served by a mutually satisfactory employment relationship rather than by the threat of litigation.

Of course, not every new employment relationship leads to partnership. Where the employment is mutually satisfactory, noncompetition restrictions are insignificant. There is much to be said for tying enforcement of a noncompetition restriction to the decision to terminate the employment relationship. Thus, if the employer chooses to end the relationship without cause, or chooses not to offer partnership on the schedule and terms anticipated in the contract, a good argument exists for the noncompetition restriction to be waived. The employer has decided, after all, that the employee does not offer continued value to the practice or does not contribute constructively enough that partnership is warranted. In that light, the employee should not represent a competitive threat and should be able to freely pursue other opportunities.

On the other hand, if noncompetition restrictions are to be enforceable, then it is reasonable to apply them to the employee who ends the employment relationship without cause. If there is a material breach of the employment contract or a termination for cause, the onus of enforcement (or nonenforcement) should fall on the party at fault.

The departure of a physician who is subject to a noncompetition restriction disrupts the physician-patient relationship instead of nurturing it. An established practice seeks to defend its revenue stream from the patient population who have come to it based upon the evolution of personal relationships with the providers. Noncompetition restrictions impede those relationships. While a patient can choose to follow a physician to a new practice, geographic inconvenience deters that, and it is often difficult for the patient to find out where the physician's practice is now located.[2]

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2. Noncompetition contract provisions are typically accompanied by restrictions on direct solicitation of patients. Even absent such restrictions, HIPAA limits access to patient contract information for a departing physician.

The consolidation of "Big Health Care" has exacerbated the problem. In the last 15 years, the Puget Sound area has seen multiple independent hospitals consolidated into outposts of the University of Washington, Swedish Hospital (or carrying the Swedish brand), or the Providence Health System. A physician employed by one of those systems may be subject to post-employment restrictions that effectively preclude his or her departure unless the physician is willing to also leave the area. This consolidation has created an atmosphere of zero-sum competition, where any gain by one is perceived as a loss by another. Physicians who are unhappy in their current work environment feel trapped—faced with the prospect of the threat of litigation or an expensive buyout of their post-employment restrictions, or continued period of employment in an unpleasant environment. It is odd that so much energy is devoted to enforcement of post-employment restrictions rather than addressing the reasons for physician attrition and dissatisfaction.

Similarly, in the small group practice, the relationships within the group are likely to be more collaborative and constructive if the glue that binds is professional satisfaction rather than financial jealousy. Now, the prospect of a voluntary or involuntary departure by a physician from a group often begins with a discussion of how the sword of the noncompetition restriction will be wielded. Doctors who would be happier practicing elsewhere are bound together by these restraints. It takes great effort to restore the relationship when ending it may be a better course.

Moreover, the necessity of such restrictions is doubtful. California has broad prohibitions to enforcement of employment noncompetition restrictions, which does not appear to have had a negative effect on their delivery of health care services. In other professions dependent upon training, acumen, and personal relationships—notably, law—restrictions on competition are unenforceable as violations of public policy.[3]

Legislation is now pending before the state House Health Care & Wellness Committee that would make unenforceable a contract provision that would prevent physicians from practicing in a defined geographic area for a period of time—the typical model for a noncompetition restriction. The pending legislation would allow the former employer to recover actual damages arising from the termination of a physician employment contract and would require those damages to be proven by "clear and convincing evidence." This is a higher legal standard than in the typical civil case, where proof has to be shown merely by a preponderance of the evidence. If the bill now under consideration becomes law, well-drawn physician employment contracts will describe the components that will form the basis of the damages analysis so that the economic claims can be quantified relatively easily. Restrictions on competition will not disappear, but the consequence will be financial only and should be a reasonable number. No court will be able to enjoin a physician from opening a practice or changing employment. Physician mobility will become easier.

Elimination of physician noncompetition agreements will restore greater balance in the workplace for physician employees. Employers will have to be more attentive to employee satisfaction rather than rely on post-employment restrictions as a means of control. This should lead to better working environments. Resentments will not fester because the physician feels trapped by the contract.

Ultimately, a change in the law governing post-employment restrictions is likely to lead to an improvement in the patient experience. A physician who can freely negotiate with his or her employer for improvements in how the practice functions can more easily focus on meeting the patient's needs. After all, that's what it's all about. ■

3. A cynic may suggest that lawyers always take care of themselves first, but the rationale is that access to the courts should not be impeded, which would be a consequence of noncompetition restrictions. While perhaps not an obvious risk in Seattle, it could be a meaningful concern in smaller communities.

About the Author

Thomas Lerner is an attorney with Stokes Lawrence, P.S., and has been working with physicians on business and employment issues for more than 25 years. He can be contacted at 206-626-6000 or *Tom.Lerner@stokeslaw.com*.