



RESTRICTIVE COVENANTS IN PHYSICIAN EMPLOYMENT AGREEMENTS

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PHILADELPHIA OFFICE
170 S. Independence Mall West
The Curtis Center, Suite 400E
Philadelphia, PA 19106-3337
215-922-1100

HARRISBURG OFFICE
P.O. Box 932
Harrisburg, PA 17106-0932
717-975-8114

SCRANTON OFFICE
220 Penn Avenue
Suite 305
Scranton, PA 18503
570-342-4231

WESTERN PA OFFICE
983 Third Street
Beaver, PA 15009
724-774-6000

MARGOLIS EDELSTEIN

Jason G. Wehrle
525 William Penn Place
Suite 3300

Pittsburgh, PA 15219

(412) 355-4923

FAX (412) 642-2380

Jwehrle@margolisedelstein.com

CENTRAL PA OFFICE
P.O. Box 628
Hollidaysburg, PA 16648
814-224-2119

MT. LAUREL OFFICE
100 Century Parkway
Suite 200
Mt. Laurel, NJ 08054
856-727-6000

BERKELEY HEIGHTS OFFICE
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Suite 5400
Berkeley Heights, NJ 07922
908-790-1401

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750 Shipyard Drive
Suite 102
Wilmington, DE 19801
302-888-1112

RESTRICTIVE COVENANTS IN PHYSICIAN EMPLOYMENT AGREEMENTS

As medical practices continue to become more specialized and lateral movement of physicians becomes more commonplace, restrictive covenants, otherwise known as covenants not to compete or non-compete agreements, have become an integral part of virtually all physician employment contracts. More often than not hospitals and clinics will require newly hired physicians to sign a restrictive covenant as a condition to employment.

Recently, because of public policy concerns regarding the limiting of a physician's ability to earn a living and disruption of the physician-patient relationship, courts in Pennsylvania have been more inclined to limit the duration and geographic scope of restrictive covenants. Additionally, restrictive covenants are more closely scrutinized due to what the courts believe to be the inherently unequal bargaining positions of employer and employee. *Reading Aviation Serv., Inc. v. Bertolet*, 454 Pa. 488, 311 A.2d 628, 630 (Pa.1973). Nonetheless, this does not mean restrictive covenants are a thing of the past.

On the contrary, restrictive covenants are typically enforceable if:

- They are incident to an employment relationship between the parties;
- The restrictions imposed by the covenant are reasonably necessary for the protection of the employer; and
- The restrictions imposed are reasonably limited in duration and geographic extent.

The reasonableness of a restrictive covenant in a physician employment contract requires a factual analysis of the following questions:

- Is there a protectable interest in the employer?
- Is the restrictive covenant narrowly tailored to further that interest?
- Is the restrictive covenant prejudicial to the public interest?

Protectable Interest of the Employer

A restrictive covenant is reasonably necessary for the protection of an employer when it is narrowly tailored to protect an employer's legitimate interests. Interests that a covenant may legitimately protect include trade secrets, confidential information, proprietary business techniques, goodwill of the practice, and any unique or extraordinary skills the physician(s) may have. *See, Wellspan Health v. Bayliss*, 869 A.2d 990, 995 (Pa. Super. Ct. 2005). (Affirming a permanent injunction against the health system's former physician employee). Goodwill can be protected even if it has been acquired through the efforts of an employee. *Id.* Pennsylvania courts have also regularly enforced restrictive covenants in order to protect specialized training the employee received from the employer. *Pa. Funds Corp. v. Vogel*, 399 Pa.1, 159 A.2d 472, 475 (Pa.1960). If an employer expends significant money and time into providing a specialized and continuous training program to an employee physician, the courts will tend to find a protectable interest in that training thereby warranting the imposition of restrictive covenants.

On the other hand, restrictive covenants predominantly designed to eliminate competition or to gain an economic advantage are not legitimate business interests. *Sidco Paper Co.v. Aaron*, 465 Pa. 586, 351 A.2d 250 (Pa.1976)

Narrowly Tailored

In addition to establishing a protectable business interest, an employer must also show that the covenant is no more restrictive in the scope of the activities, geography or time than necessary to protect the legitimate interests at stake. *Insulation Corp. Of Am., v. Brobston*, 446 Pa.Super 520, 667 A.2d 729, 733 (Pa.Super.Ct.1995). Whether specific restrictive language is reasonable depends heavily on the facts surrounding the specific employment arrangement. Even when a protectable interest exists, Pennsylvania courts may decline to enforce a restriction that is broader than necessary to protect the legitimate business interests of the employer. Overly broad restrictions suggest an intent to oppress the employee and/or foster a monopoly, which the courts have found to be illegitimate purposes. *Pharmethod, Inc. v. Caserta*, 382 Fed.Appx. 214, 220 2010 WL 2180777 (C.A.3 (Pa.))(quoting, *Sidco Paper*, 351 A.2d at 254, 257.).

Geographic Scope and Time Limitations

The reasonableness of a specific geographic limitation depends in great part on the demographics of the area. As in the case illustrations below, it is not uncommon for employers in heavily populated areas such as Pittsburgh or Philadelphia to set the geographic restriction at a two to five-mile radius of a specific practice or hospital location. Whereas in a more rural area, an employer may set the geographic restriction at a 25 to 50-mile radius of the employer's practice or hospital location. Courts will often look to the number of patients in the area, as well as the proximity of other physicians in the same practice area when assessing the reasonableness of a geographic restriction.

Restrictive covenants must also expire within a reasonable period of time to be enforceable. Virtually all restrictive covenants will restrict the activities of the physician during the period of employment as well as a specified period of time thereafter. If the restriction lasts longer than necessary to protect the legitimate business interests of the employer, it will likely be unenforceable. As with the reasonableness of geographic limitations, the reasonableness of a time limitation is determined on a case-by-case basis.

Examples of Geographic Scope and Time limitations

In order for a restrictive covenant to be enforceable, it should be written in a way that is reasonable from the perspective of the employer and the employee and narrowly drawn to protect only the legitimate business interests of the employer. If the proposed restrictions are too broad, an employer risks having the Court modify the restrictions or nullify the covenant in its entirety.

For example, a reasonable geographic limitation will only take into consideration the facilities at which the physician actually worked for the employer and the services that were

provided at that particular location(s). On the other hand, an attempt by an employer to restrict the employee's ability to work in proximity to all of the employer's facilities even if the employee had never worked in all of the facilities will likely be construed as unreasonable.

The following examples of restrictive covenants in physician employment agreements strike a balance between the competing interests of the employer and the employee:

Example A - Urban. Physician acknowledges and agrees that he or she will not engage in the practice of medicine, directly or indirectly, personally or with an association of others, within a radius of two (2) miles of any premises of the clinic in which the physician maintains his or her principal office for the purpose of practicing medicine. Principal office shall include any clinic location where the physician was assigned for at least thirty (30) days during the last twelve (12) month period preceding termination of employment.

Example B - Rural. Physician acknowledges and agrees that he will not be involved in any of the following activities other than in accordance with the terms of his employment agreement, at any location within twenty-five (25) miles of the hospital ("Geographic Area"). Physician covenants and agrees that during the term of this employment agreement, and for a period of two (2) years following termination of this employment agreement, he or she shall not directly or indirectly, as an employer, employee, principal, agent, consultant, partner, stockholder, creditor or in any other capacity, engage or participate in any business or practice within the Geographic Area that is in competition in any manner whatsoever with the hospital.

It should be noted that the burden of establishing that the limitations imposed by a restrictive covenant are unreasonable lies with the employee. *John G. Bryant Co. v. Sling Testing & Repair, Inc.*, 471 Pa.1, 369 A.2d 1164, 1169 (1977). This is a significant burden due to the factually intensive analysis required in each individual situation.

Public Interest

Due to the nature and importance of the role a physician plays in a community setting, courts in Pennsylvania will closely analyze the potential impact a restrictive covenant may have on the community at large. In considering the interests of the public in the context of whether to enforce covenants restricting the practice of physicians, Pennsylvania courts look to the effect on the patient community, and whether there would be a shortage of physicians or specialists in the area such that "the potential pool of clients far exceeds the . . . ability to serve them." *New Castle Orthopedic Assoc. v. Burns*, 481 Pa. 460, 392 A.2d 1382, 1387 (Pa. 1978) (measuring public interest as a quantitative sufficiency of physicians practicing in the restricted area); *W. Penn Specialty MSO, Inc. v. Nolan*, 737 A.2d 295, 301 (Pa.Super.Ct.1999)("in the context of non-compete agreements amongst physicians, our Supreme Court has defined the public interest as a function of the availability of appropriate medical service to the community should an injunction be imposed.")

In analyzing the public interest factor, the Supreme Court of Pennsylvania in *New Castle Orthopedic* stated:

Paramount to the respective rights of the parties to the covenant must be its effect upon the consumer who is in need of the service. This is of particular significance where equitable relief is being sought and the result of such an order or decree would deprive the community involved of a desperately needed service.

New Castle Orthopedic, 392 A.2d at 1387-88.

In this regard, restrictive covenants that may potentially deprive the public of medical services, harm the physician-patient relationship, and/or decrease the ability of patients to see the physician of their choice may be deemed invalid as against public interest. There can be no doubt that having more physicians practicing in a community benefits the public by providing greater access to healthcare. Nonetheless, courts must balance this justifiable public interest with the equally justifiable interest of an employer in protecting its business.

Non-solicitation of Patients and Employees

Virtually all physician employment contracts contain language restricting the solicitation of patients. Typically, this will take the form of language restricting the physicians ability to solicit, directly or indirectly, any patient that has received medical services from the physician for a specified period. In most circumstances, there will also be accompanying language restricting the departing physician's ability to solicit fellow employees of the practice or hospital.

For example, a physician's contract with a clinic may prohibit any actions by the physician to convert patients of the clinic to patients of the physician's new practice. The contract may even detail the types of conduct that would be prohibited. The prohibited conduct may include (prior to the termination of a physician's employment) handing out new business cards, accessing the clinic's computer database to obtain patient and vendor lists, copying patient medical records for use in the physician's new practice, and/or directing patients to contact the physician's new practice in order to make future appointments.

The contract may also cover post-employment conduct as well. This may include language restricting the physician from contacting patients to inform them that the physician has left the practice or to suggest that they contact the physician at his or her new practice location. Post-employment restrictive covenants are subject to a more stringent test of reasonableness than covenants ancillary to the sale of a business. *Missett v. Hub Int'l Pa. LLC*, 6 A.3d 530, 538 (Pa. Super. Ct. 2010) (citing, *Brobston*, 667 A.2d at 733).

Pennsylvania courts have been more reluctant to enforce any contracts in restraint of free trade particularly where they restrain an individual from earning a living at his trade. *Id.* A determination of whether a post employment restrictive covenant is reasonable, and enforceable, is a factual one requiring consideration of all relevant facts and circumstances. *Id.*

Enforceability of Restrictive Covenant When Employer Terminates Employee or Otherwise Breaches Employment Agreement

Some Pennsylvania courts have shown a reluctance to enforce restrictive covenants against an employee who leaves employment involuntarily. *Brobston*, 667 A.2d at 735. In *Brobston*, the Superior Court explained that once the employer has terminated an employee, the employer's "need to protect itself from the former employee is diminished by the fact that the employee's worth to the corporation is presumably insignificant. Under such circumstances, [the court] conclude[d] that it is unreasonable as a matter of law to permit the employer to retain unfettered control over that which it has effectively discarded as worthless to its legitimate business interests." *Id.* Additionally, if the termination of the physician breached the terms of the employment agreement, the court will weigh the severity of the breach to determine whether the employee should be relieved of his or her obligations under the restrictive covenant, and/or whether the employee is entitled to damages for the breach. *See, Carlson v. Arnot-Ogden Mem. Hosp.*, 918 F.2d 411, 414 (3d Cir.1990).

Reformation of Restrictive Covenants

When a restrictive covenant fails to meet the reasonableness standards required for validity, courts may utilize their general equity powers to reform the covenant. *See, Vector Security, Inc. v. Stewart*, 88 F. Supp.2d 395 (E.D. Pa.2000) Therefore, just because a court finds that a particular limitation contained in a restrictive covenant is unreasonable in scope or duration, does not mean that the entire covenant is void. A court may modify the specific limitations in a effort to protect the employers business interest, while still allowing the employee to practice medicine. This modification may include removal of an offensive term or provision, or potentially adding additional language or provisions to the covenant in order to make it reasonable under the circumstances presented. *Bell Fuel Corp. v. Cattolico*, 375 Pa. Super. 238, 544 A.2d 450 (1988).

Regardless of whether a physician is negotiating his or her first employment contract after completing residency or a senior physician is leaving his or her current employer for another opportunity, the validity and enforceability of any restrictive covenant contained in the employment contract must taken into consideration by both the physician and prospective employer before the parties agree to enter into an employment contract. Failure to do so may bring about dire consequences for the physician, as well as his new practice. The physician who does not abide by the terms of his restrictive covenant will likely find himself named as a defendant in a lawsuit seeking injunctive relief, as well as monetary damages along side his new prospective employer.

While this article provides a general overview of the issues surrounding restrictive covenants and physician employment contracts, the enforceability of a restrictive covenant is determined on a case-by-case basis. Prior to entering into or terminating an employment relationship, both parties to the physician contract should consult with their legal advisers to discuss the potential consequences of the decision.



Jason G. Wehrle concentrates his practice in commercial litigation, consumer litigation and professional liability defense. His broad practice experience includes complex civil and construction litigation; real estate and commercial bankruptcy law; professional liability actions, including claims against attorneys and accountants, as well as director and officer liability claims. Mr. Wehrle counsels businesses and professionals on how to implement compliance and risk management programs or other measures to help avoid, or at the very least limit potential exposure to litigation.

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