What you should bargain for in a restrictive covenant

Don't be afraid to ask for what you want. And if you're hiring, be flexible and know what's reasonable and what's not.

By David J. Schiller, J.D.

Everywhere you look in medicine, professional alliances are shifting. Hospitals are swallowing up practices. Soloists and groups are merging to stay competitive.

If you're caught up in this maelstrom, you'll probably be a party to—or maybe a victim of—a restrictive covenant. And you'd better stay aware of what these sometimes-tricky agreements might mean to you in a changing medical marketplace.

Suppose you sell your practice to a hospital and become its employee, only to discover you hate the arrangement. Can you back out? Or maybe you're merging with a large group. What about the patients you bring with you? Could you retain "rights" to them if you break away later? Or maybe you and your partner will be signing on with an HMO. Must a restrictive covenant be part of the entry fee?

To many doctors, it may seem that the side demanding a covenant—a group, clinic, hospital—has most of the power. But that can work for you, especially today. In this area, judges may favor the little guy against the big bully; that's most often the case, though, when the doctor who'll be facing a covenant's restraints is not a former partner or owner, but an ex-employee. And in the current medical marketplace, you're more likely than ever to be working as an employee.

Before you start feeling too warm and fuzzy toward the courts, however, be aware of three things. First, even the most soft-hearted judge is constrained by rules and precedents. Second, at some point

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in your professional life, you may well be on the apparent "bully" side—but you'll see yourself as seeking justified protection against unfair competition. Finally, it's better not to go to court at all if you can avoid it. For all three reasons, your safest course is to be aware of how things look from both sides of the bargaining table.

To do that, you may have to go through some shifts in perspective. Those could stand you in good stead in your own negotiations.

The side that grabs too much may get nothing

"So if you leave the group, the contract you signed cuts you off from practicing in almost all of Trenton?" I asked the young dermatologist. He nodded. "Don't worry," I told him. "That may be good news."

The doctor looked puzzled. He'd come to me because he was dissatisfied with practicing in a large group, but his contract said that if he left, he couldn't practice for two years within a 12-mile radius. That hadn't seemed to me too onerous, until he'd added, "But we practice out of three offices, and those restrictions apply to each of the three." He'd brought a map and drawn circles around each office, showing that if he left the group, a large piece of the city would be a forbidden zone.

How was that good news? Because that strict a covenant probably wasn't fully enforceable—or perhaps wasn't enforceable at all.

Here's why: A restrictive covenant is an agreement not to compete in a certain area for a certain length of time. In other words,

A covenant hits you very harshly? Don't give up; that may turn out to be good news.

it's a restraint-of-trade agreement, and our laws generally favor competition. That doesn't mean covenants won't ever be enforced. They can be upheld if they're reasonable, and even states that restrict covenants sharply may allow them in some cases—but not necessarily just as written. Often, despite what an agreement says, courts will pay heed to what actually fits the situation.

That's what I told the dermatologist. "Out in the countryside, a group might need to draw patients from a wide area to survive—from as far as 40 or 50 miles away. But Trenton is a midsize city. Keeping you out of a large district here won't seem reasonable or necessary to a judge."

The young doctor's specialty favored him too. "Maybe patients will travel eight or 10 miles or more to a doctor they'll see for just a few visits—a surgeon, for example," I said. "But people often see a dermatologist regularly for long periods. They want someone close by. So you're likely to draw mainly from people living near your office, and so are your partners. That's another good argument against the restriction."

A too-strict covenant may even backfire, I told the dermatologist. If there's a 6-mile restriction around a clinic when 4 miles might seem fairer, a judge may simply cut down the mileage limitation. But if the protection seems way out of line, as in this case, a judge may throw out the whole covenant.

Limiting a doctor's activities unnecessarily may fail also. Let's say a gastroenterologist going to work for a hospital is asked to sign a covenant restricting his right to practice his subspecialty. That's reasonable. But if the covenant seeks to restrict his practice of general internal medicine, it will try any court's patience.

The courts may grant less protection to bigger organizations because they generally need it less than individual doctors do. Moreover, courts today are increasingly protecting patients' right to choose medical providers. Keep those points in mind when you negotiate with a clinic, hospital, or large group. And if you're on the side that's insisting on a covenant? Better limit it to the narrowest protection that you really need.

That's why I had no quarrel with the two-year time limit in the dermatologist's agreement. I think two years is fair. Many covenants ask for three to five years; that's overkill. If a doctor doesn't treat patients for two years, I'd assume those patients will find another practitioner. Moreover, doctors have to eat; a two-year period is certainly enough to ensure that a physician will become established elsewhere.

As for my dermatologist client, we quickly negotiated his mileage limit down to a more reasonable

6 miles, and his practice—in Trenton—is doing fine.

What's the penalty? Think this out carefully

Besides time and area restrictions, a covenant's other essential element is its penalty. What happens to a doctor who violates the covenant?

That may be negotiable too, as another of my clients found out when we worked out details of his buy-in agreement. He was a Pennsylvania urologist who had started working for a partnership a few years earlier. Under his employment contract, he'd agreed to a routine covenant in case he left the group. No penalty for violation was specified, but none was needed. Pennsylvania allows injunctions.

By the time of the buy-in discussions, the urologist was in a far stronger bargaining position, with a local following. We quickly whittled the covenant's penalty clause down to a splinter: A breach would mean paying $25,000.

My client was then netting about $150,000. So after a falling-out with his partners a couple of years later, he set up shop nearby and happily paid the penalty as a start-up cost. After all, he was spending more than that for his new computer, and now he'd have plenty of old names to punch into it.

In short, the urology group blew it. Reviewing our proposed "penalty," the doctors' attorney should have asked them, "Would you agree to sell a big piece of your practice for $25,000? That's what you're doing." That goof points up a standard rule: A covenant doesn't amount to much without real teeth in it.

What should the group have done instead? Maybe it should have stuck with the injunction. That certainly has a lot of scare value. You can almost see the cigar-chomping sheriff rushing in and nailing the door shut. Even a temporary injunction might have held the urologist up for a couple of years, until the matter got to trial.

But some states won't permit a remedy as radical as an injunction. Even in those that do, courts may not go along when it appears an established group is trying to squelch competition. The group would usually have to show that by breaching the covenant, the departing doctor would cause harm that no money could compensate for. That's a tough case to make, especially for a powerful group or institution.

Even the easier option of suing for money damage may prove fruitless, when heavyweight plaintiffs have a large market share. A judge may have trouble staying awake as a lawyer tries to show how much patient loss a lone doctor can inflict on a 30-doctor group or a 300-bed hospital.

That's all good news, if you're the doctor who'd be impeded by a covenant. Yet consider what you'd have to go through if you had to defend yourself in a covenant lawsuit, especially one brought by a deep-pockets plaintiff like a hospital or big clinic. You'd have papers to file, answers to prepare, meetings with lawyers—and fees to pay. Even if you were confident of winning, that would be exhausting emotionally, not to mention financially. You might be tempted to throw in the towel. So negotiate a

covenant carefully, and before signing, think hard about whether you could live with it if you had to.

Now let's look at the covenant from the other side. Suppose your group is trying to specify the covenant's penalty. A dollar figure for damages—like that urological group's $25,000—may be absurd, and even a sensible one may look quaint in a few years. Some agreements contain formulas based on the estimated value of good will or actual practice receipts, but those add unwieldy complications. My suggestion: Use a percentage of the exiting doctor's W-2 income for a stated period. That leaves nothing to argue about and stays up to date—and it's hard to juggle without taking on Uncle Sam.

As for enforcement, getting litigation under way is a powerful weapon. It can win a case long before you get to court. Even the serious threat of litigation can be potent.

Filling in the blanks: There's a lot to cover

Beyond the basics, covenants involve plenty of other angles. Don't overlook the key ones.

For example: What might a covenant exclude? One of my clients, an overworked pediatrician, was eager to water down his covenant to attract a likely associate. First, we minimized the employee doctor's limits on time and space. "And if he leaves," the pediatrician added, "he wants the right to take along any patients he's brought with him."

That exclusion is common, so I concurred. But the prospective partner also mentioned inquiries about his practice from pregnant women. "If they later come in with newborns," my client said, "he wants to count the infants as patients he brought in." That was a new one to me, but it wasn't unreasonable, so we also excluded those babies-to-be. Ultimately, we even excluded the office staffer who'd be coming in with the new partner. He could invite her along, too, if he ever left.

There's a moral here. Be like this new doctor when you negotiate. Don't be afraid to ask for what you want. And if you're hiring and want good people, be flexible and

don't insist on unreasonable covenants.

Here are more issues to explore:

▶Geographic limits. That New Jersey dermatology group with three offices overreached, yet its basic concept wasn't out of line. Any group writing a covenant might attempt to cover satellite offices, including future ones. But an employee doctor shouldn't agree automatically. Like my client, he might at least cut down the mileage in a multiple-office situation. Another client even got her covenant limited to the main office, where she'd be seeing most patients.

▶Free tryout. When negotiating an employment contract, some doctors ask for a trial period during which they can walk away with no restrictions. When I represent employers, I caution them that granting this is risky; yet some feel that a 30- or 60-day "window" is reasonable. If you're the employee, try for such a provision.

▶Firing "without cause." Contracts often give an employer the right to terminate a doctor without cause. That sounds harsh, but it's really just a pressure valve. It lets a group terminate a young associate when, for example, they simply don't get along. However, a doctor employee should insist on separation pay after a "without cause" firing. He or she should also negotiate for a trade-off—say, easing or even canceling other restrictions in the covenant. Failing that, the employee should argue for a quid pro quo: that the covenant be canceled if the employee quits "with good reason."

▶Fencing off the covenant. Suppose a doctor's contract with a

group says she must be informed about termination three months in advance, but the group slips up, and actually gives her only 10 weeks' notice. Can that nullify the covenant? It might.

But the group might be protected anyway, if its covenant says that its obligations are separate from the rest of the employment agreement.

►Extending a covenant. Doctors often neglect to renew their formal agreements. So an employer is wise to include language in a covenant stating, for instance, it will apply "during the term of this contract and thereafter." If the agreement doesn't specify this sort of automatic extension of the covenant, an employee is better off not raising the issue. Once alerted, the employer will probably insist on such language. But if an agreement says nothing about extending the term of the covenant, a court may well favor the employee in a disagreement.

►Piracy. A group's ex-associate sets up shop outside the contractually proscribed region. All seems within the covenant agreement until the group finds that its patients are receiving lovely four-color flyers inviting them to "visit Dr. X's new office." That sort of thing explains why covenants usually stipulate that a departing doctor can't solicit patients left behind. Covenants also routinely specify that listings of patients and referring doctors are confidential and proprietary and can't be removed or copied. A doctor might agree to all that, yet ask for the right to treat patients who follow of their own accord.

►Consideration. That's a legal term meaning "what you get for agreeing to a contract." A covenant isn't good unless the person accepting the restrictions has gotten *something*. If you sign a covenant as part of an employment agreement, for example, the covenant's good. Your "consideration" was the employment itself. But when you're already at work in a practice, your employment deal has obviously been closed. If you're asked to sign a covenant then, it won't be valid unless you get something additional for it.

Having a penalty for violation that's too low is like selling part of a practice—cheap.

Say you're an employer who forgot to have a physician agree to sign a covenant when you hired him. Too bad. You can't just ask him nicely to sign it now. You'll have to provide something to make the agreement valid—maybe a bonus or a raise. And if you're the physician who's asked to sign without receiving anything in exchange, decline politely and explain why. Then decide what to ask for.

Different settings? Look into different deals

When signing on as a hospital employee, don't let covenant complications throw you. Doctor-hospital employment contracts often say, for instance, that termination means you have to give up staff privileges. Then why fight over a covenant, you might think, if you may not be practicing nearby anyway?

But don't let the threat of losing hospital privileges intimidate you. Doctors successfully reapply for staff privileges all the time. In fact, in negotiating with a hospital, you might get aggressive. Hospitals eager to sign doctors up often bend the terms considerably. Some will even eliminate a covenant altogether.

HMO agreements may demand the tightest restrictions of all—with probably the least justification. An HMO, after all, controls the reimbursement purse strings. Obviously, you can't easily compete with an HMO, which gives you a good case against any tough covenant that the organization wants you to sign. Still, some HMOs maintain a "take it or leave it" attitude when a doctor tries to discuss terms. But others, realizing their power over patients, don't worry much about covenants. Don't ever assume you won't be able to negotiate; try for what you want, and you may get all you aim for.

When you work out a covenant, bargain carefully and hard, no matter who the employer is. You can't blithely assume the covenant won't be utilized. As a lawyer, I've seen plenty of professional honeymoons end in professional divorce. If that happens to you, the terms hammered out in negotiations may determine how you practice medicine for the foreseeable future. ■