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ARE RESTRICTIVE COVENANTS BETWEEN HEALTH CARE PROVIDERS AND THEIR EMPLOYEES CONTRARY TO PUBLIC POLICY*

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ABSTRACT

Many people believe that increased competition between health care providers is the key to effective health care reform. Nevertheless, health care providers are increasingly employing anticompetitive employment agreements to limit competition. This research examines court decisions applying relevant common law principles to determine the contours of legally enforceable restrictive covenants between health care providers and their employees.

More and more medical professionals are joining existing medical practices as employees rather than establishing their own practices. For many of these individuals, the terms and conditions of their employment are governed by individual employment contracts. Others serve at the will of their employers. In either case, restrictive covenants, which preclude them from competing with their employer during their employment and for a period of time thereafter, are increasingly being made a condition of their employment. Because these anticompetitive employment agreements are in restraint of trade, they have generated a great deal of social, political, and legal debate.

Restrictive covenants between health care providers and their employees are particularly controversial because they involve numerous competing interests. Employers are interested in protecting their practices against unfair competition.

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Employees are interested in protecting their rights to practice medicine and to earn a living. The public is concerned with ensuring the availability of sufficient medical care and with protecting the parties' freedom to contract. Perhaps the most controversial aspects of anticompetitive agreements today are their tendency to limit competition between providers and to restrict patients' rights to choose who will provide their medical care, both of which are contrary to the prescriptions of health care reformers.

The purpose of this investigation was to delineate the contours of legally enforceable restrictive covenants between health care providers and their employees [1]. To accomplish this objective, relevant court decisions rendered throughout the United States were analyzed. The cases presented herein were selected because they effectively articulate and illustrate the relevant common law principles under diverse circumstances [2].

ELEMENTS OF ENFORCEABLE RESTRICTIVE COVENANTS

Historically, agreements not to compete constituted unlawful restraints of trade. Today, courts in many jurisdictions still view them with disfavor. But the weight of authority holds that reasonable restrictive covenants are enforceable [3]. To be reasonable, the covenant must be ancillary to a valid employment relationship and supported by sufficient consideration. In addition, the restraint must not exceed that which is required to protect the employer's legitimate interest, impose an undue hardship on the employee or be injurious to the public [4]. Each of these elements is discussed in detail below.

Ancillary Agreements

For a promise to refrain from competition to be reasonable, the employer must have an interest worthy of protection that can be balanced against the hardship to the employee or the likely injury to the public. Accordingly, the restraint must be ancillary to an otherwise valid employment relationship. A restraint that is not subsidiary to such a relationship is necessarily unreasonable [5]. For example, one month after Enabnit began working for the Coronado Chiropractic Clinic, he was presented with an employment contract that included an anticompetitive agreement. Instead of signing the contract, he resigned his position with the Clinic and opened his own practice within the restricted area. The court denied the Clinic's request for a temporary injunction because the restrictive covenant was not ancillary to a valid employment contract. There was no meeting of minds by the parties to enable the formation of a contract. That is, mutual intent to carry out the terms of the contract was lacking, thereby precluding enforcement of the anticompetitive agreement [6].

Consideration

Restrictive covenants that are ancillary to valid employment relationships can be made a condition of employment at any time prior to the termination of employment. As with any contract, however, they must be supported by sufficient consideration. What constitutes sufficient consideration depends on the circumstances. In Pennsylvania, Dr. DiCuddio signed an employment contract, including a restrictive covenant, when he began his employment with the Geisinger Clinic. The court held that the covenant was enforceable because the parties exchanged mutual promises. Dr. DiCuccio accepted the terms of the contract, including the covenant, in exchange for employment. That is, employment per se was sufficient consideration for the restrictive covenant [7].

In New York, a restrictive covenant was added to the terms of an at-will employment relationship after the employee had been employed for a substantial period of time. No additional benefits were provided by the employer to support the covenant. The court, nevertheless, held that continued employment was sufficient consideration [8]. In an at-will employment relationship, employers have the right to terminate their employees without cause. Consequently, forbearance of that right is a legal detriment that stands as adequate consideration for a restrictive covenant. The detriment would have little meaning if the employer exercised its right to fire the employee shortly after the agreement was executed. But where, as here, the employment continues for a substantial period of time after the covenant is made a condition of employment, the forbearance is real, not illusory.

A Texas court similarly held that continued employment constitutes sufficient consideration for a covenant not to compete. But the consideration was lost when the employer terminated the employee without notice, contrary to the terms of his employment contract. That is, the restrictive covenant was unenforceable for lack of adequate consideration because the termination breached the employee's contract [9].

In Minnesota, Dr. Freeman signed a new employment contract three years after he was hired, without negotiation, even though other department heads refused. Unlike his initial contract, this one contained an anticompetitive agreement. He received no additional compensation, benefits, or authority for signing. The court explained that parties may, by mutual consent, modify existing employment contracts. Where the modification adds a restrictive covenant, however, it is viewed as a separate agreement. The mere continuation of employment can support these covenants. But the agreement must be bargained for and it must provide the employee with real advantages. In this case, the covenant was not bargained for. Nor was any distinction made, with respect to compensation or other benefits, between those who signed the new contract and those who did not. The court concluded that adequate consideration was lacking, thereby rendering the restrictive covenant unenforceable [10].

Employers' Interests

Covenants not to compete must serve employers' legitimate business interests. They are not entitled to protection against legitimate and ordinary competition of the type a stranger could provide. But reasonable restraints are permissible if employees present substantial risks to employers' relationships with their patients or to other confidential business information [11, 12]. For example, the restrictive covenant at issue in a Georgia case allowed a dentist to practice wherever she wanted and to treat former patients. But it precluded her from soliciting any of her former patients and prospective patients living in two specified ZIP code areas. Because patient lists and patient goodwill are protectable business interests, the covenant was reasonable [13].

The Hygeia Facilities Foundation required Dr. Gant and all other physicians to sign restrictive covenants to protect the goodwill of its patients. According to the Foundation, disallowing these covenants would enable doctors to work for the Foundation until they build substantial practices and then establish private practices. Moreover, the revenues that would be lost if doctors "robbed" the foundation of its patients would eventually jeopardize its ability to assure quality health care for the people of its service area. Dr. Gant failed to demonstrate that a narrower restriction would protect the foundation's interest in the goodwill of its patients equally well. Accordingly, the covenant was enforceable [14, 15].

Not all business interests are protectable. In *Hunke v. Wilcox* [16], Wilcox violated a restrictive covenant that prohibited him from practicing pediatric dentistry within a specified area. He did not solicit any of his former patients. But Hunke sought to protect the sources of those patients, not his relationship with individual patients. Hunke introduced Wilcox to many key people in the community who previously and continuously referred patients. That is, he opened many doors for Wilcox that enabled him to obtain new patients much faster than if he had been forced to make these contacts himself. The court held that the flow of new patients would be diluted whenever a newcomer is introduced into the group of local professionals. Sources of professional referrals of this type, however, do not form a proprietary interest protectable by a restrictive covenant. Protecting the cultivation of these professional relationships would constitute an unreasonable restraint of trade.

Even if employers have protectable interests, the scope of restrictive covenants must not exceed that which is necessary to protect them. Whether or not a covenant is excessive depends on its duration, the geographical area in which the employee may not practice, and the activities proscribed. In Wisconsin, for example, Pollack agreed to refrain from competing with his employer within twenty miles of Racine during the course of his employment and for one year thereafter. Regarding the temporal restriction contained in this agreement, the court explained that what is reasonable depends on the period of time required to

obliterate, in the minds of the patients, the identification formed between the employee and the employer during the period of employment. The evidence indicated the clinic's patients received long-term therapy and rehabilitation for the treatment of chronic pain. In addition, Pollack was popular with his patients. For these reasons, the time limit was reasonable. In fact, longer restraints are reasonable in Wisconsin [11, 17, 18].

Even a covenant not to compete that is temporally unlimited may be reasonable. The employment contract executed when Dr. Ingrasci was hired provided, in pertinent part, that while the agreement was in effect, and forever thereafter, Dr. Ingrasci will never practice dentistry and/or oral surgery in five specified counties unless it is in association with Dr. Karpinski. Dr. Ingrasci resigned and immediately opened his own practice within the restricted area. The court held that the covenant would not be stricken merely because it is unlimited in duration, given that it is reasonable geographically. The five small, rural counties encompassed by the covenant comprise the very area from which Dr. Karpinski obtained his patients and in which Dr. Ingrasci would be in direct competition with him. That is, Dr. Karpinski made no attempt to extend his influence beyond the area from which he drew his patients [19, 11, 17].

In *Fumo v. Medical Group of Michigan City* [20], the parties executed a contract that prohibited Fumo from practicing medicine within twenty-five miles of Michigan City following the termination of his employment. Geographically, the restriction encompassed the area served by the medical group. But that area also included hospitals that were not served by the medical group. The court held that where individuals travel to obtain offered services, an employer may have a protectable interest extending over a geographical region greater than that previously served. This suggests that the location of employers' patients is the primary determinant of what is geographically reasonable.

In Texas, the parties executed an employment contract that prohibited Slayter from practicing the chiropractic art of healing in Harris County during his tenure as an employee and for one year thereafter. The court held that the territorial restriction contained in the anticompetitive agreement was unreasonable. Harris County, which includes Houston, is too inclusive. As such, the prohibition is too harsh and contrary to public policy [9].

Generally, the activities proscribed by restrictive covenants must be those in direct competition with, and likely to inflict damage upon, the employer. Dr. Burns violated a restrictive covenant by opening his own practice in the same county as his former employer, New Castle Orthopedic Associates, immediately following his registration. The court refused to enjoin Dr. Burns' practice, however, because the covenant was excessive. New Castle's president testified that the number of patients treated by his group had not changed, despite Dr. Burns' independent practice. In addition, Dr. Burns did not solicit his former patients. In fact, he actively counseled them to remain under New Castle's care and treatment.

Finally, a shortage of orthopedic specialists existed in the restricted area. For these reasons, the court held that Dr. Burns' practice would not jeopardize New Castle's operation, thereby rendering the covenant not to compete unreasonable and unenforceable [21, 17, 19].

In *Wilson v. Clarke* [22], the court similarly held that restrictive covenants that proscribe noncompetitive activities are overbroad. Clarke was hired by Wilson Associates as a professional psychologist. The employment contract executed by the parties obligated Clarke to pay Wilson a specified sum of money if he provided professional psychological services to one of its clients or prospective clients within five years following the termination of his employment. Clarke was hired by International Telephone and Telegraph (ITT), one of Wilson's clients. The court found that Clarke's position with Wilson was a springboard from which his ITT association was launched. Had he joined ITT as a consulting psychologist, the situation would have been different. But he took over a management function. As such, he hired and directed people to do what he had done for Wilson. Limitations placed on a former employees' activities that are not in competition with, and do no damage to, the employer, are excessive. For these reasons, the court concluded that the restrictive covenant was unenforceable.

Employees' Interests

Restrictive covenants that are oppressive, or unduly burdensome on employees are unreasonable, even if their scope does not exceed that which is necessary to protect employers' legitimate interests. Employers can prevent employees and former employees from using trade secrets and other confidential information gained during their employment. They can also prevent employees and former employees from enticing away customers. But they have no right to prevent employees or former employees from using the skill and general knowledge acquired through experience or instruction during their employment. Unlike trade secrets, confidential information, and special influence with customers, this experience becomes part of employees' personal equipment [23]. The dental technician in this case did not have access to trade secrets or other confidential information. Nor was it likely that customers would follow her to other labs. Accordingly, the restrictive covenant, which precluded her from working in a similar capacity in the same vicinity for two years, unduly interfered with her right to work in her chosen occupation and to earn a living.

In *Phoenix Orthopaedic Surgeons v. Peairs* [24], the anticompetitive agreement at issue was not oppressive. The covenant allowed Dr. Peairs to practice anywhere in the Phoenix metropolitan area, as long as it was not within five miles of the employer's three offices. Likewise, he could practice at any of the eight hospitals in the Phoenix metropolitan area that were not in the restricted area. No evidence was presented indicating that these facilities were inferior. Instead, Dr. Peairs

simply was not interested in them. Because the covenant did not prevent him from working at his chosen profession, it was enforceable.

Public's Interest

The final element considered by the courts when deciding whether restrictive covenants are reasonable is their impact on the public. In this context, the public interest involves the availability of needed medical services. If enforcing the anticompetitive agreement will not deprive the public of needed medical services, the courts have generally held that they are reasonable [15, 24]. In *Pollack v. Calimag* [11], for example, the court found that the anticompetitive agreement did not create a shortage of doctors providing the type of medical services at issue. Nor did it eliminate competition or create a monopoly. For these and other reasons, the agreement was not contrary to public policy.

Many courts have refused to enforce restrictive covenants when there is a shortage of practitioners providing the services in question [17, 21, 25, 26]. In *Dick v. Geist* [27], the Idaho court found that enforcing the restrictive covenant at issue would deprive Twin Falls and the surrounding area of needed pediatric care, particularly neonatal intensive care. In addition, the neonatal unit at the Magic Valley Memorial Hospital would suffer without the services of these two physicians. The court concluded that the serious impairment to the welfare of the people in the restricted area outweighed the public interest in enforcing the otherwise valid contract.

CONCLUSION

Many health care reformers believe that competition among and between providers is the key to effective cost containment. In addition, many people believe they should have at least some choice regarding who provides their medical care. Anticompetitive employment agreements limit both competition and choice. Consequently, they are scrutinized very carefully by the courts to ensure they are reasonable. The common law principles governing restrictive covenants are well-established. The courts' interpretations and applications of these principles, however, vary. As such, it is not possible to draw definitive conclusions regarding what constitutes a reasonable restrictive covenant throughout the United States. It is possible, however, to draw general conclusions.

Restrictive covenants must be ancillary to valid employment relationships, including at-will relationships. They must also be supported by adequate consideration. If they are made a condition of employment at the time of hire, employment per se typically constitutes sufficient consideration. That is, acceptance of

employment includes acceptance of the covenant not to compete. If the covenants are made a condition of employment after employees have been working for a substantial period of time, continued employment is usually sufficient. Again, agreeing to continue working constitutes acceptance of the new condition of employment. But employment or continued employment may not be sufficient if similarly situated employees are treated differently. If an employer requires some physicians or dentists to sign restrictive covenants, but exempts others, it should provide those who are required to sign with additional benefits. Otherwise, their covenants are likely to be deemed unreasonable for lack of sufficient consideration.

Employers must also have an interest that is worthy of protection to justify the restrictive covenant. Patient goodwill, including patient lists, is a protectable interest. Likewise, special skills acquired from the employer, trade secrets, and other confidential information are protectable. Even if employers have protectable interests, however, the restrictions must not be overbroad. Temporally, two- and three-year restrictions are commonly upheld. Geographical restrictions are reasonable if they are limited to the area served by the employer. Proscribing noncompetitive activities is unreasonable. That is, activities should not be restricted unless they are likely to damage the employer or former employer.

Covenants not to compete are unenforceable if they preclude employees from working in their chosen profession. Under these circumstances, the detriment to employees outweighs employers' legitimate interests. Similarly, if these restrictions preclude employees from using the general knowledge or skills acquired through experience or instruction with their employers, as opposed to trade secrets, confidential information, or special influence with former patients, they are probably unreasonable.

Finally, restrictive covenants must not be unduly detrimental to the welfare of the public. One of the factors to consider when assessing the enforceability of anticompetitive employment agreements is their effect on the interests of society as a whole. In an era where the availability and the rising cost of medical care are matters of national concern, the law must consider the impact of these covenants on the problem. Paramount to the respective rights of the parties must be the covenant's effect on the consumer who is in need of the service. If enforcing the restrictive covenant would deprive the community involved of needed medical services, it constitutes an unreasonable restraint of trade [21].

The availability and affordability of medical are key concerns of health care reformers. Covenants not to compete engender the same concerns. The initiatives of health care reformers, therefore, are likely to include federal legislation that attempts to delineate the contours of enforceable restrictive covenants and the circumstances in which these covenants may be made a condition of medical professionals' employment. Many states have already enacted such legislation [28].

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ENDNOTES

1. The scope of this investigation was limited to restrictive covenants that are ancillary to valid employment relationships. Covenants that are ancillary to partnership or sales agreements were not addressed.
2. This investigation examined cases applying common law principles, as opposed to statutory provisions, to determine the enforceability of anticompetitive employment agreements.
3. *Ohio Urology v. Poll,* 594 N.E.2d 1027 (Ohio 1991).
4. *Restatement of the Law 2d, Contracts, Section 186, 1981.*
5. 62 ALR3d 1027, 1975.
6. *Larock v. Enabnit,* 812 S.W.2d 670 (Texas 1991).
7. *Geisinger Clinic v. DiCuccio,* 606 A.2d 509 (Pennsylvania 1992).
8. *Zellner v. Conrad,* 589 N.Y.S.2d 903 (New York 1992).
9. *Parker v. Slayter,* 238 S.W.2d 814 (Texas 1951).
10. *Freeman v. Duluth Clinic, Ltd.,* 334 N.W.2d 626 (Minnesota 1983).
11. *Pollack v. Calimag,* 458 N.W.2d 591 (Wisconsin 1990).
12. *Ballesteros v. Johnson,* 812 S.W.2d 217 (Missouri 1991).
13. *Cobb Family Dentistry v. Reich,* 383 S.E.2d 891 (Georgia 1989).
14. *Gant v. Hygeia Facilities Foundation,* 384 S.E.2d 842 (West Virginia 1989).
15. *Isuani v. Manske-Sheffield Radiology Group,* 805 S.W.2d 602 (Texas 1991).
16. *Hunke v. Wilcox,* 815 S.W.2d 855 (Texas 1991).
17. *Ellis v. McDaniel,* 596 P.2d 222 (Nevada 1979).
18. *Ladd v. Hikes,* 639 P.2d 1307 (Oregon 1982).
19. *Karpinski v. Ingrasci,* 268 N.E.2d 751 (New York 1971).
20. *Fumo v. Medical Group of Michigan City,* 590 N.E.2d 1103 (Indiana 1992).
21. *New Castle Orthopedic Associates v. Burns,* 392 A.2d 1383 (Pennsylvania 1978).
22. *Wilson v. Clarke,* 470 F.2d 1218 (5th. Cir. 1972).
23. *Lessner Dental Laboratories, Inc. v. Kidney,* 492 P.2d 39 (Arizona 1971), citing *Roy v. Bolduc,* 34 A.2d 479 (Maine 1943) and *Ridley v. Krout,* 180 P.2d 124 (Wyoming 1947) with favor.
24. *Phoenix Orthopaedic Surgeons v. Peairs,* 790 P.2d 752 (Arizona 1990).
25. *Damsey v. Mankowitz,* 339 So.2d 282 (Florida 1976).
26. *Nalle Clinic Co. v. Parker,* 399 S.E.2d 363 (North Carolina 1991).
27. *Dick v. Geist,* 693 P.2d 1133 (Idaho 1985).
28. *Individual Employment Rights Manual,* Section 531:304 et seq. Washington, D.C.: Bureau of National Affairs. Alabama, California, Colorado, Florida, Georgia, Hawaii,

Louisiana, Massachusetts, Michigan, Nevada, North Dakota, Oklahoma, Oregon, South Dakota, Texas and Wisconsin have enacted statutes governing restrictive covenants.

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