Are Non-Competition Agreements Enforceable or Not?

Non-competition agreements usually bar doctors both from encouraging patients to follow them to a new practice and from practicing medicine for a certain period of time within a certain distance of the current employer's location.[1] Most healthcare practices now use non-competition agreements and other restrictive covenants to shield their patient bases and referral sources from competition when a doctor leaves the practice, but these agreements also have drawbacks. There is much debate in the healthcare and legal communities over the extent to which these non-compete clauses are enforceable – if at all. The truth is that non-competition agreements are sometimes enforceable and sometimes not, depending on their specific restrictions and circumstances.

Advantages

Employers often consider non-compete clauses as a legitimate condition of employment since a doctor will develop skills, knowledge, and reputation because of his or her association with the employer practice.[2] These agreements also serve to protect the employer's investment in employees by discouraging them from leaving the practice in the first place.[3] It seems disingenuous for a doctor to receive the long-term benefits of working in an established practice only to subsequently compete against the practice for the same patients upon leaving.[4] Employers may also be concerned about a doctor working with a group solely to develop a patient base and referral sources in order to open his or her own practice.[5] Non-competition agreements, along with other restrictive covenants, can alleviate employers' concerns and prevent this from occurring.

Disadvantages

One important consideration in using non-competition agreements is the hardship that they can cause the leaving doctor. First, a geographic restriction may force the leaving doctor to relocate outside the restricted area, which could entail a major, life-altering move.[6] Some in the medical community are wary of what seems to be an "inherent unfairness" in requiring a doctor to give up his or her future right to work as a condition of current employment.[7]

---

[1] Derek W. Loeser, *The Legal, Ethical and Practical Implications of Noncompetition Clauses: What Physicians Should Know Before They Sign*, 31 J.L. MED. & ETHICS 283 (2003).
[2] Loeser, *supra* note 1, at 289.
[3] AMA Opinion 9.02 – Restrictive Covenants and the Practice of Medicine.
[4] Loeser, *supra* note 1, at 289.
[5] *Id.* at 290.
[6] *Id.* at 289.
[7] *Id.* at 287.

There may also be some less obvious effects of a non-compete on a doctor's work environment before he or she leaves a practice. Because the employer knows that the employee will be reluctant to leave the practice, it may not be very concerned with employee retention. For instance, an employer who knows it has a non-competition agreement in place may be less sensitive to an employee doctor's needs and concerns or may be less likely to offer pay increases.[8] Doctors who are worried about the adverse effects of non-competition agreements should negotiate with their employers for the narrowest possible restrictions, and also consider negotiating for additional compensation or severance in exchange to agreeing to the non-compete.[9]

Non-competition agreements may also have an adverse effect on some patients. When a patient is forced to stop seeing his or her doctor because of a non-competition agreement, it may result in increased costs for the patient, decreased quality of care, and lowered satisfaction with the doctor.[10]

The American Medical Association does not encourage non-competition agreements.[11] However, employers who wish to balance their own interests in protecting their investments and resources can still use non-competition agreements in accordance with AMA's ethics opinions if they are reasonable. According to the AMA, restrictive covenants are only unethical "if they are excessive in geographic scope or duration in the circumstances presented, or if they fail to make reasonable accommodation of patients' choice of physician.[12] The AMA's position does not have much legal impact, however, as it merely imitates the standard for reasonableness that most courts already apply.[13]

Enforceability

Employers should make sure they attempt to enforce non-competition agreements in a consistent, timely manner. If an employer only enforces the agreements some of the time, a court may refuse to enforce any isolated one.[14] Enforcing these non-compete agreements can be problematic, though, since courts construe the agreements narrowly and determine their enforceability on a case-by-case basis, considering all of the attendant circumstances.

Arizona courts generally disfavor non-competition agreements, especially those among doctors. Thus, courts read the restrictions in a non-compete as narrowly as possible, with any

---

[8] *Id.* at 289.
[9] *Id.* at 290.
[10] *Id.* at 287.
[11] AMA Opinion 9.02 – Restrictive Covenants and the Practice of Medicine.
[12] *Id.*
[13] Loeser, *supra* note 1, at 287.
[14] BRENT A. OLSON AND LISA C. THOMPSON, BUSINESS LAW DESKBOOK § 12:12 (2009-2010 ed.).

ambiguities being interpreted in favor of the employee rather than the employer.[15] To be enforceable, a non-compete agreement must protect "some legitimate interest beyond the employer's desire to protect itself from competition."[16] According to the Arizona Supreme Court, the legitimate purpose of non-competes is to prevent a leaving employee from using information or relationships that belong to the employer or where acquired because of the employer for a limited amount time.[17]

The courts outline two factors that make a non-compete clause unreasonable: "(1) the restraint is greater than necessary to protect the employer's legitimate interest; or (2) if that interest is outweighed by the hardship to the employee and the likely injury to the public."[18] In making the determination of reasonableness, a court will look at all of the circumstances surrounding the non-competition agreement.

The first factor, whether the restraint is greater than necessary to protect the employer's interest, depends on the scope of the agreement. The scope has two factors of its own: the duration of the agreement and its geographic limitations. Courts will find that the restraint is too great if they think the limitations last too long or cover too great a geographic area.

The second factor, whether the employer's interest is outweighed by the hardship to the employee and the public, has been the focus of recent Arizona court decisions. In *Valley Medical Specialists v. Farber*, the Arizona Supreme Court expressed its wariness of non-competition agreements between doctors. The court held that patients are entitled to be seen by the doctor of their choosing, regardless of the contractual obligations between their doctor and his or her former employer, because the harm to patients who could lose the option to see their chosen doctor is greater than the employer's economic interest in enforcing a non-competition clause.

Because of the *Farber* decision, non-competition agreements between doctors and other medical professionals and their employers are read very narrowly, and each agreement is considered on case-by-case basis to determine if the public policy considerations at play outweigh the employer's interest in protecting its investment through enforcing the non-compete clause.[19]

Non-competes are less scrutinized when it comes to the sale of a practice. When a doctor sells a practice, the value of the practice's goodwill and its existing patient base usually figures

---

[15] *Id.* at § 12:11.
[16] Valley Med. Specialists v. Farber, 194 Ariz. 363, 367 (1999) (citing Amex Distrib. Co. v. Mascari, 150 Ariz. 510 (App. 1986)).
[17] *Id.* (citing Harlan M. Blake, *Employee Agreements not to Compete*, 73 HARV. L. REV. 625, 647 (1960)).
[18] *Id*. at 369 (citing RESTATEMENT (SECOND) OF CONTRACTS § 188 cmt. a).
[19] OLSON AND THOMPSON, *supra* note 6, at § 12:11.

prominently in into the purchase price, so the buyer of the practice is allowed some protection from competition from the former owner.[20]

The Blue Pencil Doctrine

"Blue penciling" occurs when a court decides not to enforce certain sections of a non-competition agreement that it considers too broad, but still enforces the rest of the agreement. Instead of declining to enforce the entire agreement altogether or rewriting unenforceable provisions, the court will literally cross out gramatically severable, unreasonable provisions but keep the rest of the agreement intact.[21]

A key component of the blue-pencil doctrine in Arizona is that courts can strike out unenforceable parts of the contract, but it cannot otherwise add to or change the terms. In the 2002 case *Varsity Gold, Inc. v. Porzio*, which represents the current law on non-competes in Arizona, the court stated that a judge could not try to reform or soften the contract not to compete in any way other than using the blue-pencil rule to strike a severable provision.[22] The court wrote, "Although we will tolerate *ignoring* severable portions of a covenant to make it more reasonable, we will not permit courts to *add* terms or *rewrite* provisions."[23]

Some courts disfavor the practice of blue penciling because it tends to encourage employers to draft non-competition agreements with broad or additional terms (such as step-down provisions, discussed below) that can have the effect of scaring an employee doctor into never leaving the practice in the first place.[24] This is known as the "*in terrorem* effect."[25]

Step-Down Provisions

Step-down provisions, combined with severability clauses, are the best way to make sure a non-competition agreement is enforceable. These terms provide alternative time and area restrictions that allow a court using the blue-pencil rule to strike restrictions it considers too broad while enforcing a less restrictive provision. These provisions help courts sever unenforceable provisions and enforce the remainder of the agreement.[26] A sample step-down provision might be similar to the following:

---

[20] 194 Ariz. at 368 (citing Harlan M. Blake, *Employee Agreements not to Compete*, 73 HARV. L. REV. 625, 647 (1960)).

[21] Ray K. Harris and Ali J. Farhang, *Non-Compete Agreements with Step-Down Provisions: Will Courts in "Blue-Pencil" States Enforce Them?*, 23 COMPUTER & INTERNET LAW 3 (July 2006).

[22] Harris and Farhang, *supra* note 21, at 2 (citing Varsity Gold, Inc. v. Porzio, 202 Ariz. 355, 45 P.3d 352 (App. 2002)).

[23] Varsity Gold, Inc., 202 Ariz. At 356, 45 P.3d at 358.

[24] Loeser, *supra* note 1, at 285.

[25] Harris and Farhang, *supra* note 21, at 2.

[26] *Id.* at 1.

1. NONCOMPETITION. For the TIME PERIOD set forth in paragraph 2, Employee shall not, directly or indirectly, own, manage, operate, participate in or finance any business venture that competes with the Company within the AREA. . .

2. TIME PERIOD. TIME PERIOD for purposes of paragraph 1 shall mean the period beginning as of the date of Employee's employment with the Company and ending on the date of death of the employee; provided, however, that if a court determines that such period is unenforceable, TIME PERIOD shall end five (5) years after the date of termination; provided, however, that if a court determines that such period is unenforceable, TIME PERIOD shall end six (6) months after the date of termination.[27]

Because different courts rule differently on what provisions are overly broad, it is important to have an attorney draft these provisions to ensure that they are not stricken altogether.

Remedies for Breach

The remedies available to an employer when a leaving doctor breaches the non-competition agreement include injunctive relief and money damages. Injunctive relief is usually the most desirable option for the employer, as it allows the employer to immediately stop the competitive behavior before very much damage is done.[28] Other forms of relief, such as money damages, may take one to two years or more to realize.[29] Injunctions, however, can be the most difficult form of relief to get, as courts consider them an especially extreme form of relief. This does not mean that injunctive relief provisions are always unenforceable. "Although consent to injunctive relief does not guarantee that the relief will be entered by a court, it goes a long way to increasing a court's comfort level with the remedy."[30] Money damages may be available if the leaving doctor's breach of the non-compete was the actual cause of the monetary harm to the employer.

Conclusion

Non-competition agreements can be a useful tool for healthcare practices, but making sure those agreements will be enforced can be extremely difficult and requires a high level of precision. On the other hand, a doctor who is struggling to work around a non-compete

[27] *Id.* at 1.
[28] Loeser, *supra* note 1, at 284 .
[29] *Id.*
[30] *Id.*

agreement can rarely know for sure if it is truly enforceable or not, since courts consider each one on a case-by-case basis, considering all of the attendant circumstances. The best way to deal with non-competition agreements is to find an attorney with a thorough understanding of the law regarding these restrictive covenants.

Edward O. Comitz, Esq. *heads the healthcare and disability insurance practice at the Scottsdale-based law firm, Comitz | Beethe, earning a national reputation for prosecuting claims on behalf of individuals based on fraud and unfair practices in the insurance and healthcare industries. Mr. Comitz has extensive experience in disability insurance coverage and bad faith litigation, representing dentists, physicians and other professionals in reversing denials of their disability claims, principally in federal courts. He can be reached at ecomitz@cobelaw.com, (480) 998-7800. Karla Baker is a Summer Associate with Comitz | Beethe. For more information about disability insurance issues, please visit www.disabilitycounsel.net.*