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PHYSICIAN'S PRACTICE DIGEST
THE PHYSICIAN'S GUIDE TO PRACTICE MANAGEMENT

FOR THE MEMBERS OF THE MARYLAND, DC, AND VIRGINIA MEDICAL SOCIETIES

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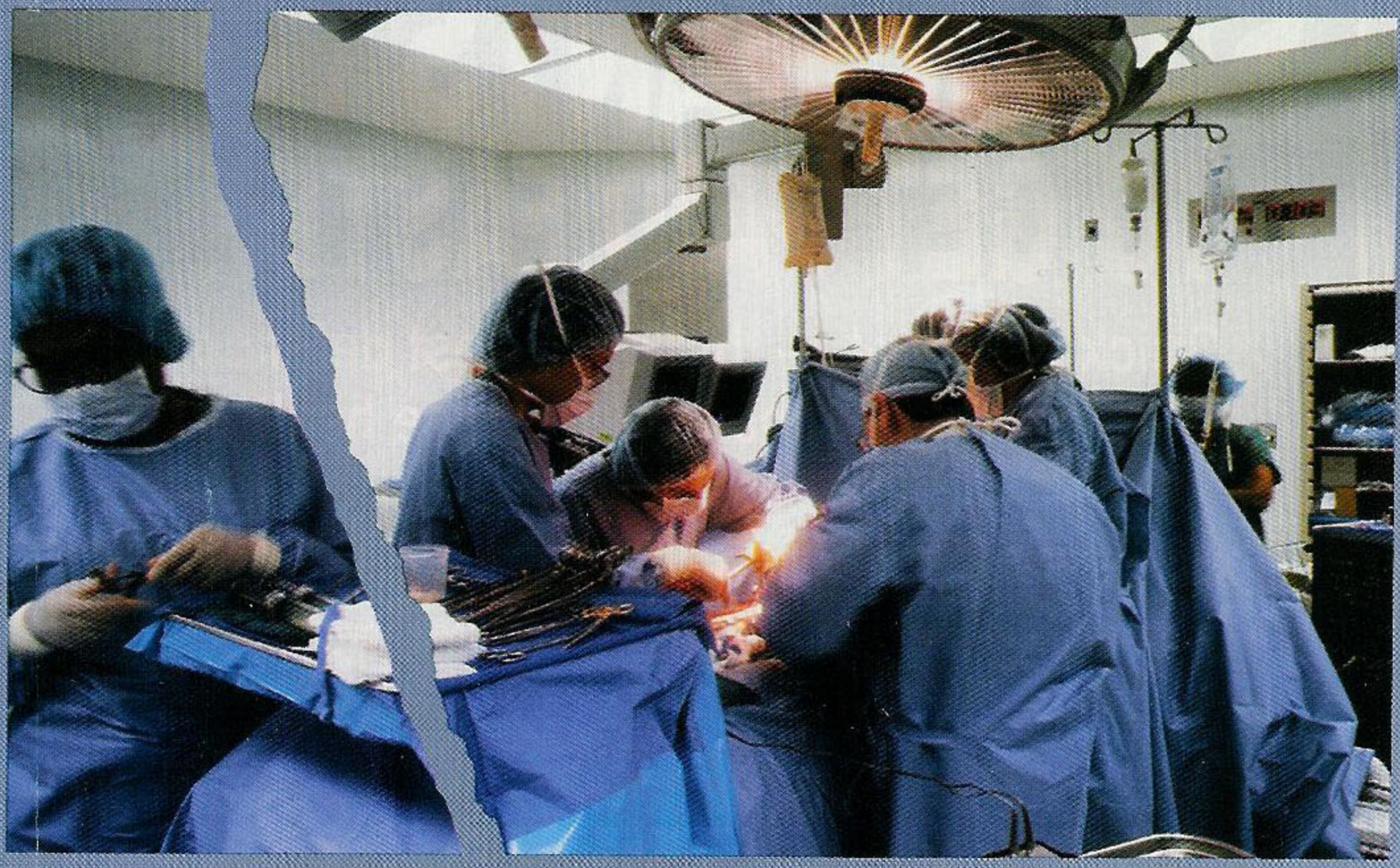
NETWORK OR NO WORK



THE PERILS OF SELECTION AND DESELECTION

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On The Line

Important Elements of Physician Employment Agreements

by DANIEL ALAN LINDENFELD

◆ EXECUTIVE SUMMARY

As you enter a new employment environment, here are some tips for avoiding common pitfalls.

A physician employment agreement is necessary for employers and employees because it protects both parties' interests and sets forth the parties' expectations of each other.

The negotiation process is an excellent method to obtain a sense of the partnership potential of the employee, and by which the employee can ascertain whether the practice can be a long-term home in which to grow financially and professionally.

The physician employee shouldn't worry that questions will antagonise the employer or be viewed as adversarial by the employer. The manner in which the employer responds is an important indication as to how the employee and his potential are viewed by the employer. The employer, as well, can gauge the caliber, seriousness and potential of the employee by the tone, nature and substance of the inquiries, and whether the employee will fit into the needs and goals of the practice.

Some of the most significant elements of the Physician employment agreement that need to be in place and understood are:

- ❖ Restrictive covenants
- ❖ Liquidated damages
- ❖ Direction of patient care
- ❖ Termination of Agreement
- ❖ Outside activities-best efforts
- ❖ Successors and assignment of obligations
- ❖ Buy-in, equity participation

Restrictive Covenant

A restrictive covenant, also known as non-competition, covenant not to compete, non-solicitation and limitation of practice clauses should be a fixture in every physician employment agreement.

The purpose of the restrictive covenant is to prevent the employee, upon termination of his employment from using "trade secrets," the patient list, and referral contacts to the detriment of the employer, or by establishing a practice or working for a practice that is in competition with the employer. The restrictive covenant is enforceable for a "restrictive period" and in a "restricted (geographic) area."

The employer seeking to enforce the restrictive covenant must ensure that the restricted period and restricted area are valid and enforceable. This means that the restrictive covenant should not be too onerous or burdensome for the employee both in the length of the time restriction and the geographic area that it covers.

There is no pat answer as to the precise length of time and scope of the geographic area that is enforceable. The "restricted area" and "restricted period" will depend on the locale of the employment and the type of specialty involved. The restrictive covenant may not be so burdensome, unconscionable, and against the public policy as to prevent the employee from earning a living and from providing medical services to the public in his chosen field.

Liquidated Damages

A "liquidated damages" clause is normally inserted into a physician employment agreement for several reasons. First, in the event that there is a breach of a restrictive covenant the damages might be difficult, if not impossible, to fully quantify and an amount previously agreed to by the

parties is inserted. Second, liquidated damages are used as a deterrent to the employee breaching the restrictive covenant.

To be enforceable, the liquidated damages amount must bear some relationship to the potential losses to be sustained by the practice if the restrictive covenant is breached, yet at the same time, must be significant enough to deter any possible breach.

Direction of Patient Care

Understandably, physician employers desire to exercise as much control as possible over the physician employee and the manner in which care is rendered. However, in drafting such a clause it is essential to note that in the area of patient care, the employee as physician and medical care provider has legal obligations, professional responsibilities, and a code of ethical conduct that are paramount and which render null and void any overly restrictive provision of the contract.

A physician has the right and obligation to make his own judgments as to the manner and nature of how to treat a particular patient.

Termination of the Agreement

Depending on the nature of the clause used, a physician employment agreement may be terminated without cause, for cause, or upon the end of the stated employment term.

Termination for "cause" occurs when a physician's employment is terminated upon the employee's performance or non-performance of certain specific acts. An employer may always terminate a physician employee for cause. The only issue is what constitutes cause. In a physician employment agreement what constitutes cause must be specifically listed in the agreement.

An obvious cause termination is the revocation by the state licensing authorities of the physician employee's license to practice medicine. However, some cause elements may be specific to the particular employer practice and absent their specific listing in the agreement would not otherwise be objectively considered cause.

THE PURPOSE OF THE RESTRICTIVE COVENANT IS TO PREVENT THE EMPLOYEE, UPON TERMINATION OF HIS EMPLOYMENT FROM USING "TRADE SECRETS," THE PATIENT LIST, AND REFERRAL CONTACTS TO THE DETRIMENT OF THE EMPLOYER, OR BY ESTABLISHING A PRACTICE OR WORKING FOR A PRACTICE THAT IS IN COMPETITION WITH THE EMPLOYER.

It is essential if employing a for cause provision in the agreement to be as specific as possible so as not to omit certain key elements deemed by the parties to be cause, for if the elements are not specifically set forth, upon an adjudication of this issue at the behest of the parties the courts will employ an objective standard that may conflict with the parties' original intent.

Termination at the end of the employment stated term is clearly understood and in the absence of a new agreement or an extension agreement, the employment relationship will cease on the last day of the stated term. The obligations that will survive the termination at that time will be those obligations specifically enumerated in the agreement such as the restrictive covenant.

Termination without cause is the most problematic for the employer and the employee. A unilateral termination without cause provision on the part of the employer from the employee's perspective clearly negates the purpose of the employment agreement and if not drafted properly to deal with the issue of when the restrictive covenant is enforceable, may place the physician employee in an untenable position. From the employer's view, such a clause may be beneficial because it allows for the termination of the employee (almost at any time usually upon 30 days notice) for any reason at all. For example, the employer may terminate without cause" if the employer practice merges with another practice which already maintains excessive staffing.

In utilizing such a clause usually the employee is not on an equal footing with the employer, because in many cases it is the employee who has had to move to another city; to develop new professional contacts and to deal with the emotional stress of moving to a new environment and is now set adrift by the employer. One manner of limiting the downside effect is for the employer to pay a six or twelve month salary termination fee to the employee.

In some agreements there is a provision where either the physician employer or physician employee may terminate the agreement without cause upon ninety days notice to either side. In this manner both sides are bearing the risk that either party may terminate at any time for any reason, while giving the non-terminating party some time to adjust.

Outside Activities-Best Efforts

A standard fixture in these agreements is some form of a requirement that the physician employee utilize his best efforts in working for the practice. That is, that the employee will devote all of his professional time, contacts and resources in treating the patients of the practice and bettering the reputation of the employer. In addition, it is understood that all fees and hono-

rariums generated (unless otherwise set forth) by the employee are the property of the employer practice.

Despite the fact that the term "best efforts" appears to be vague, its meaning is understood within the medical community and is interpreted within that context. However, if the physician employee is intent on pursuing interests in academia, lecturing, writing or working as an attending in an emergency room for a late night shift, this intention must be specifically set forth in the agreement as an exception to the "best efforts" clause. In addition, the employer for malpractice insurance purposes will desire to have these outside activities specifically listed in the agreement.

Successors and Assignment of Obligations

While in most commercial contracts, the rights and obligations of any and/or all parties may be assignable (i.e. a contract for the manufacture and delivery of machinery) the assignability of personal employment agreements (and most importantly, the assignability of the obligations of the employee) is questionable, and unless a compelling reason is advanced and set forth for so doing, may not be valid and enforceable.

The employer may desire such a clause in the event that the employer practice is "sold" (which is a subject that requires an in depth analysis) to another practice or medical institution, who would then be the employee's new employer. The new employer may have different policies and a different philosophy than the assigning practice, which originally hired the employee. A physician's skills are not fungible and therefore such an assignment would in all likelihood be viewed as invalid and unenforceable.

A way of remedying such a potential problem is to allow for the employee to grant his permission to the assignment. The employee must also ensure that such an assignment by the employer will not throw the employee off the "partnership track" with the new employer that he established with the assigning employer.

"Buy-in" Equity Participation

Most physician employers and physician employees when entering into employment agreements are seeking long term benefits. Although both sides understand that the agreements must have safety valves, in the event it becomes clear relatively early in the employment term that the relationship is not working, both sides are looking past that stage for long term benefit.

THE EMPLOYER DESIRES A LONG TERM PHYSICIAN EMPLOYEE WHO WILL ADD TO THE PROFESSIONAL REPUTATION OF THE PRACTICE WHILE ALSO ADDING TO THE REVENUES OF THE PRACTICE.

The employer desires a long term physician employee who will add to the professional reputation of the practice while also adding to the revenues of the practice. The employee desires the opportunity to prove himself and become, depending on the structure of the employer, a partner, shareholder or equity participant in the employer practice sharing the decision making responsibilities and the profits (and/or losses) of the practice.

The employer in giving its input into the drafting of such a clause must strike a balance between its desire to delay as long as possible the employee's ascendancy to partnership, (to evaluate as long as possible the potential of the employee) and the need not to cause the employee to jump ship as a result of an inordinate delay. The employee in giving his input must also strike a balance between his desire to become a partner as soon as possible (to also prevent his loss of other partnership opportunities outside the employer practice) and an understanding of the employer's need to test and evaluate the employee over time.

There are numerous ways of structuring an employee's equity participation in a practice. One manner is whereby, if the employment term is four years, and in the event the employee is still employed by the practice after two years, upon the beginning of the third year of employment he becomes (if the employer is a professional corporation) a non-voting shareholder, at percentages to be negotiated. At the beginning of the fourth year of the employment term the "employee shareholder" becomes a full voting shareholder and he commences his scheduled "buy-in" payment.

Space precludes an in depth analysis in this article of arriving at the buy-in amount. However, some of the factors to be considered are the book value of the hard assets, gross revenues of the practice and the employee's contribution to the growth of the revenues and the referral base. In this era of increased managed care plans and organizations the valuation of a practice and a particular partnership share has undergone radical change.

Another method utilized is, that once the midpoint in the employment term has been reached, as soon as the employee reaches a target of a certain revenue amount attributable to his work he may begin the buy-in process. Whatever the financial terms of the buy-in are, the parties must ensure that the amount and the time schedule of the payments are not so burdensome to the employee as to make the buy-in economically unfeasible.

There are always unique issues that must be addressed in each individual situation. It is essential that such an agreement be drafted with an understanding of the legal complexities as well as with a sensitivity to the unique human aspects of the relationship. **PPD**

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