A group of physicians who have built a considerable family practice after working together for ten years decides to hire an additional physician. Recognizing the loyalty that many patients possess for their family physicians, the group realizes the possibility that this physician will one day leave the practice and take some of its patients with her. Moreover, when she leaves, she may have established a reputation in the community which could divert prospective patients away from the practice. Finally, her resignation will most likely mean the loss of the practice’s investment in the physician’s recruitment, education and training. For these reasons, the group requires the physician to sign a covenant under which the physician promises that she will not establish a new practice within a five-mile radius for a period of two years if she leaves voluntarily. Five years later, the doctor does leave, and sets up a new practice about five blocks away. Is the covenant which she previously signed enforceable?

In truth, most physician contracts include a restrictive covenant limiting the physician’s right to practice in a certain area for a certain period of time. Primarily, the purpose of the covenant is to protect the employer’s asset base (i.e., patients) by prohibiting the physician from competing with it after the physician leaves. The covenant also serves to protect the employer’s investment in a physician-employee (i.e., recruiting costs, moving expenses, opportunity costs) by encouraging the physician to remain in the employ of the employer. An attorney should take special heed in drafting the covenant to serve these goals in the least restrictive manner, as the covenant’s language could make the difference between whether a court will ultimately enforce it or whether it will be eliminated from a contract altogether.

Despite the prevalence of restrictive covenants, courts have found significant drawbacks to their inclusion in a physician’s employment agreement. Primarily, the covenant disrupts physician-patient relationships by severing the relationship altogether or requiring a patient to travel farther to see his or her chosen physician. Moreover, the covenants are often broad and overreaching and effect a hardship on a physician who will no longer be able to practice in a large area or treat patients who still desire that physician’s services. Particularly because of the restriction on a patient’s freedom of choice with respect to his or her medical provider, courts subject restrictive covenants among physicians to close scrutiny. Some state legislatures, such as Alabama and Colorado, have enacted statutes prohibiting a restrictive covenant in a physician’s contract altogether. At this point, New Jersey has no such statute.

Recently, the Supreme Court of Arizona invalidated a seemingly reasonable restrictive covenant which prohibited a physician from treating any of the employer’s patients within five miles of
one of the employer’s offices for a period of three years. One of the court’s concerns regarding the restriction was that a five-mile radius of each office actually amounted to an aggregate 235-mile prohibition of the physician’s practice. Moreover, the agreement did not provide any exception for the doctor to treat patients in emergency situations, nor was it limited to pulmonology, the employer’s specialty. Labeling the covenant as overbroad and contrary to public policy, the court refused to enforce it and struck it entirely from the agreement.

Despite Arizona’s decision, most courts, including New Jersey, will uphold a reasonable restrictive covenant unless there is a statute or regulation prohibiting it. For example, in Karlin v. Weinberg, the New Jersey Supreme Court’s most recent case regarding restrictive covenants with respect to physicians, the court upheld a restrictive covenant prohibiting a physician-employee from practicing dermatology within ten miles of the employer’s office for five years. In examining the validity of the covenant, the Supreme Court, like most other courts, considered whether the covenant was reasonable using the following factors:

- Whether the covenant was more restrictive than necessary to protect the legitimate interests of the employer;
- Whether the covenant imposed an undue hardship on the employee; and
- Whether the covenant was injurious to the public interest.

Unfortunately, there are no set guidelines as to what constitutes a reasonable and enforceable restrictive covenant. Various cases suggest, however, that the most important factors to consider when drafting a physician’s restrictive covenant are: (1) the length of time needed for the medical practice to regain the confidence of a patient, (2) the area from which the practice obtains the majority of its patients, and (3) how easily the patients will be able to visit the departing physician if they wish to continue their relationship. Clearly, a covenant containing a blanket restriction forbidding the treatment of any of the practice’s existing or former patients, regardless of whether any patient wishes to continue his or her relationship with the departing physician, would be against public policy because it restricts the patient’s freedom of choice. Additionally, a covenant requiring a patient with the flu to travel 45 miles to visit a family practitioner with whom he has established a close relationship would also be unreasonable.

Despite the opinions of some commentators, the New Jersey Supreme Court will probably never adopt a \textit{per se} rule invalidating restrictive covenants among physicians, unless the New Jersey legislature or the Board of Medical Examiners adopts such a rule or regulation. In Karlin, the Supreme Court stressed that neither New Jersey’s statutes nor the regulations of the State Board of Medical Examiners governing physicians prohibited physicians from entering into restrictive covenants. Since Karlin, the American Medical Association adopted an ethical opinion declaring non-competition agreements among physicians to be against the public interest. Quite strongly, the American Medical Association now “discourages any agreement between physicians which restricts the right of a physician to practice medicine for a specified period of time or in a specified area upon termination of employment or a partnership or corporate agreement.” Nevertheless, the AMA left open the possibility of allowing some restrictive covenants by including the following language in its opinion: “Restrictive covenants are unethical \textit{if they are}
excessive in scope or duration in the circumstances presented, or if they fail to make reasonable accommodation of patients’ choice of physician.” This statement is no different than the holding by the New Jersey Supreme Court that a covenant will be enforceable to the extent that it is reasonable and does not violate the public interest.

In the event that a covenant is unenforceable, basic contract law allows a court to rewrite the covenant to conform to the law. Some courts, however, refuse to take this action, and instead choose to eliminate the covenant from a contract altogether. In Valley Medical Specialists, the Arizona Supreme Court reasoned that for every agreement that makes its way to court, many more do not. Thus, the words of the covenant have an in terrorem effect on departing employees, allowing employers to create overly burdensome covenants with the knowledge that, if the words are challenged, a court will modify the agreement to make it enforceable. Rather than encourage this practice, the Arizona court refused to rewrite the covenant and instead voided it entirely.

New Jersey courts, however, have no similar aversion to rewriting a restrictive covenant which otherwise would be unenforceable. In Karlin, the court acknowledged that “[i]t is well settled that restrictive covenants in employment contracts which fail to include reasonable geographical or temporal restrictions are partially enforceable to the extent that they are reasonable under the circumstances.” The Karlin court also acknowledged that “this ‘blue-pencil’ rule of limiting the geographical areas or temporal scope would apply to restrictive covenants among physicians.” In fact, New Jersey trial courts commonly rewrite restrictive covenants to ensure their validity.

Another means of protecting an employer’s legitimate business interest involves the employee’s “purchase” of the right to practice within a certain area for a certain time after the employee leaves the medical practice. For example, an employment agreement which prohibits a physician from practicing within five miles of the employer’s offices for a period of two years after his employment terminates may also allow that physician to practice in that area within that timeframe if the physician pays the employer a certain amount of his gross receipts or salary.

Unfortunately, there is no New Jersey case law regarding the legitimacy of a buy-out provision with respect to a physician’s restrictive covenant. Nevertheless, such a buy-out provision was enforced against an accounting firm in Schuhalter v. Salerno. There, two accountants created a dissolution agreement which allocated specific clients to each accountant. If, within two years of the dissolution, a client expressed a wish to be represented by the other accountant, the receiving accountant would compensate the designated accountant by paying the previous years’ billings for that client. The court upheld the buy-out provision, concluding that it was a reasonable method in which to protect each accountant’s legitimate interests in maintaining their respective client relationships, which the court deemed “the most significant assets of their partnership.”

Despite the overall validity of a reasonable buy-out provision in a restrictive covenant, it is possible that such a buy-out provision among physicians could implicate the federal or state fraud and abuse laws and regulations. For example, the federal anti-kickback statute, which can lead to criminal prosecution if violated, prohibits remuneration of any kind for the referral of an individual for any service or item for which payments may be made by a federal health care program. Paying another physician or a medical practice for a patient could be viewed as
remuneration for a referral of that patient. Nevertheless, a strong argument exists that there is no actual referral because critically, the medical practice is not referring the patient. Rather, the patient is making the independent choice to visit the terminated physician. The payment from the medical practice is simply for the business that it lost to the terminated physician. The possibility of over-utilization of medical services, on which the fraud and abuse statutes are predicated, simply does not exist.

Consequently, restrictive covenants among physicians and medical practices are enforceable in New Jersey, provided that they are reasonable. Even if unreasonable, New Jersey courts have, in the past, rewritten restrictive covenants to allow for their enforcement on a more reasonable scale. Regardless, the public interest in a patient’s freedom of choice would be best preserved by including a buy-out provision in the covenant allowing the physician to continue to practice for a certain fee. Whatever the decision, the purposes for and motives behind the covenant should be carefully and extensively documented to ensure enforceability. Attached to this article is a chart which should help an attorney or employer draft a reasonable and enforceable restrictive covenant.
## POINTS TO CONSIDER PRIOR TO DRAFTING A RESTRICTIVE COVENANT

<table>
<thead>
<tr>
<th><strong>What type of medical practice is it?</strong></th>
<th>The restrictive covenant should be limited to only those specialties which directly compete with the employer.</th>
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<tbody>
<tr>
<td><strong>What is the demand for services in the area?</strong></td>
<td>The greater the demand, the less likely the covenant will be enforceable. For example, if there is a high demand for cardiologists in the area, and only two cardiologists exist, the covenant will most likely be considered to work against public interest by restricting a patient’s medical treatment.</td>
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<td><strong>How frequently do patients visit the practice?</strong></td>
<td>The more frequent the visits, the less time the restrictive covenant should encompass. The covenant should only be for a length of time that the employer (or any new associate) may need to demonstrate his or her effectiveness to patients.</td>
</tr>
<tr>
<td><strong>What was the experience or reputation of the practice prior to the physician’s employ?</strong></td>
<td>The more established the practice, the more likely that a restrictive covenant will be enforceable.</td>
</tr>
<tr>
<td><strong>What was the experience or reputation of the physician prior to being employed?</strong></td>
<td>If the physician is relatively inexperienced or new to the area and does not have a large patient base, the restrictive covenant will more likely be enforceable to protect the employer’s patients.</td>
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<td><strong>What are the reasons for the geographical area of restriction?</strong></td>
<td>Generally, if the restriction is limited to an area surrounding the practice, it will be upheld, provided that the area accurately represents the distance that patients travel to visit the practice. The restriction could also be justifiable where numerous competitors already exist within a certain area. The restriction should only be within a certain mileage of existing (not future) practices, and should be limited to those offices or hospitals where the physician actually saw patients.</td>
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<tr>
<td><strong>How long was the physician employed?</strong></td>
<td>A restrictive covenant generally should not encompass more time than the actual employment of the physician.</td>
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<td>Question</td>
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<td>Under what circumstances will the employment terminate?</td>
<td>If the employment terminates because of a breach by the employer, or the employee leaves because the employer’s actions were detrimental to the public interest, the restrictive covenant will be more likely characterized as an undue hardship on the employee. Conversely, if the employee decided to terminate or discontinue the relationship independently and not because of the employer’s wrongdoing, a court will be less likely to find an undue hardship on the employee.</td>
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<tr>
<td>How easily will the physician be able to find work outside of the restricted area?</td>
<td>If the physician can easily establish a practice or join an existing practice outside of the restricted area, the covenant will generally be enforceable.</td>
</tr>
<tr>
<td>Will patients reasonably be able to continue their relationship with the physician despite the covenant?</td>
<td>For example, if the patient need only travel ten miles, it might serve as a deterrent while still allowing freedom of choice in the medical field.</td>
</tr>
<tr>
<td>How personal or sensitive is the relationship between the physician and the patient?</td>
<td>For example, a gynecologist or family practitioner might develop a stronger bond with a patient because of the continuing relationship as compared to an anesthesiologist who generally only sees a patient once or twice.</td>
</tr>
<tr>
<td>Can the covenant be satisfied by a reasonable buy-out (liquidation) clause? If so, do the liquidated damages serve only to reasonably compensate the employer for the fees it will be losing?</td>
<td>There must be some nexus between the buy-out amount and the actual benefit received by the terminated employee or the benefit lost by the employer. Examples include: recovering an amount equal to the prior years’ fees that the employer received from treating the patient or a percentage of the actual fees collected from the patient. (It is possible but unlikely that such a payment runs afoul of federal or state fraud and abuse laws. Query whether such payments equal payments for a referral of the patient to the terminated employee. Most likely, there is no referral because the patient has decided to leave on his own and not at the direction of the employer or employee).</td>
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</tbody>
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This discussion is not intended to constitute legal advice regarding any client’s legal problems or specific questions and should not be relied upon as such.

This article first appeared in the New Jersey State Bar Association Health & Hospital Law Section Newsletter, Volume 15, No. 1 (February 2000).

ENDNOTES

1 See Valley Medical Specialists v. Farber, 950 P.2d 1184 (Ariz. 1997).
2 77 N.J. 408 (1978).
3 See also Solari Industries, Inc. v. Malady, 55 N.J. 571 (1970) (New Jersey’s seminal case regarding factors to consider when reviewing the validity of restrictive covenants).
6 Id. (emphasis added).
7 Regardless of the AMA’s policy change, the New Jersey Supreme Court did not afford the association’s original policy much weight, reasoning that the policy was written by a private professional organization and had not been adopted by any governmental body or court. Consequently, while a New Jersey court may take the AMA’s pronouncement under consideration, it should not be a deciding factor in the determination of whether a restrictive covenant within the medical field is enforceable.
8 Karlin, supra note 3, 77 N.J. at 420, n.4 (citing Solari Industries, supra note 4, 55 N.J. at 585).
9 See, e.g., Coskey’s Television & Radio Sales and Service, Inc. v. Foti, 253 N.J. Super. 626, 634 (App. Div. 1992) (trial and appellate courts limited covenant restricting competitive trade for three years in employer’s existing or future marketing area).
111 Id. at 512.