

Managing Competition in the Medical Profession

By Timothy M. Holly

The medical profession always has been viewed as more than a business. Patients often view their physician as a counselor or friend, in whom they entrust their health and to whom they often reveal the most private matters. As with other relationships involving trust (*e.g.*, attorney-client and priest-penitent), the law even recognizes a special privilege for communications between doctors and patients. Due in part to this special relationship, Delaware's Court of Chancery has, at times, only reluctantly applied laws protecting businesses to medical practices.¹

The simple truth is that the practice of medicine is in part a business. In business, profitability matters. As medical practices evolve, business mergers and divorces occur, and physicians, like other employees, come and go. Physician departures often raise thorny issues regarding the patient base that is the practice's life blood. This article offers some guidance as to how, through

proper planning and careful navigation of employment competition laws, medical practices can strike the proper balance between protecting patient and business interests.²

STATUTORY AND COMMON LAW PROTECTIONS

Various statutes provide some protection to businesses – including medical practices. For example, Delaware's Uniform Trade Secrets Act protects categories of information falling within a definition of "trade secrets."³ Delaware law also proscribes conduct falling within the meaning of a "deceptive trade practice."⁴ Common law also guards against other wrongs such as defamation, conversion (*i.e.*, theft of property), and unfair competition. However, only specific conduct is proscribed by statutes, and certain elements

1. See *Dickinson Medical Group, P.A. v. Foote*, 1984 WL 8208, at *2 (Del. Ch. May 10, 1984) (stating, "[p]rior to this application, I never had reason to equate a list of persons suffering from cancer and other illnesses with a proprietary 'customer list' as that term is normally employed in the world of commerce. But I guess business is business, regardless of the form it takes").

2. Because the laws differ by jurisdiction and are themselves evolving, and because a legal analysis must always be made in the context of the particular circumstances, this article does not purport to provide legal advice as to any given situation.

3. See 6 *Del. C. § 2001 et seq.* "Trade secret" is defined to including a formula, pattern, compilation, program, device, method, technique or process, that: (a) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use; and (b) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy. Customer/patient lists may not necessarily fall within the definition of "trade secrets." However, lists that identify which of tens of thousands of potential customers have interest in purchasing a product/service may be trade secrets because they require expenditure of time and money to generate (and thus have economic value). *NuCar Consulting, Inc. v. Doyle*, 2005 WL 820706 (Del. Ch. April 5, 2005), *aff'd* 913 A.2d 569 (Del.)

4. See 6 *Del. C. § 2531 et seq.*

must be established to prevail under common law theories.⁵

CONTRACTUAL PROTECTIONS

One of the most powerful tools to protect business interests is the private contract, which can be as varied in substance as imagination might allow. Common types of private contracts include business purchase agreements (e.g., acquiring a practice), service agreements (e.g., outsourcing from a hospital certain services), and employment agreements. These contracts often contain provisions regarding employee and temporary worker rights (e.g., wages, wage supplements, severance, etc.) and the employer's duties.⁶ Contracts also impose duties, or covenants, on workers that can be both affirmative (e.g., to serve diligently, maintain licensure, follow billing guidelines, etc.) and restrictive. Common restrictive covenants include non-competition, non-solicitation (of patients or medical practice personnel), and confidentiality, which are discussed below.⁷ However, medical practices must start with an understanding of statutory limits to restrictive covenants in the medical profession.

UNDERSTANDING INDUSTRY-SPECIFIC LIMITATIONS

In Delaware, a covenant not to compete in an employment, partnership or corporate agreement

between and/or among physicians that restricts the right of a physician to practice medicine in a particular locale and/or for a defined period of time, upon the termination of the principal agreement of which the said provision is a part, shall be void. However, all other provisions of such an agreement shall be enforceable at law, including provisions which require the payment of damages in an amount that is reasonably related to the injury suffered by reason of termination of the principal agreement. Provisions that require the payment of damages upon termination of the principal agreement may include, but not be limited to, damages related to competition.⁸

LIQUIDATED DAMAGES PROVISIONS CAN OFFSET LOSSES TO REVENUE

While contract provisions prohibiting physicians from practicing medicine are void and, therefore, unenforceable, employment agreements may include clauses that provide for damages for certain competition. Such clauses often include statements acknowledging the purpose for the provision, such as "Physician will develop relationships with referring physicians and patients. Physician understands that Employer has devoted substantial effort to establishing and increasing its patient base." However, rather than equitable relief (e.g., a temporary restraining order or injunction), post-employment competition often is tied to a pre-determined damage amount for violating activity.⁹

5. For example, proximate causation is an element of the tort of unfair competition. Many employers believe that a history of service to a customer establishes an expectation of business in the future, or that past referrals should be expected to continue in the future absent some outside interference. However, courts recognize that incumbency often does not prevail over price and service competition. See *American Homepatient, Inc. v. Collier*, 2006 WL 1134170 (Del. Ch. April 19, 2006) (finding for company providing medical equipment where industry "enjoys robust competition" and "any expectation of business relationships might be a bit unreasonable without a written contract with the customer").

6. Employers must perform each of the duties owed to employees under employment agreements. For example, non-payment of guaranteed wages or wage supplements (e.g., vacation time in some cases) can lead to legal action under state statute (e.g., 19 Del. C. § 1101 *et seq.*), which imposes penalties and remedies that include double damages and mandatory attorneys' fees. Moreover, a material breach of such provisions can excuse an employee's subsequent non-performance of their duties – even restrictive covenants. See *L & W Insurance, Inc. v. Harrington*, 2007 WL 809512 (Del. Ch. March 12, 2007) (finding employer's unilateral decision not to pay earned compensation constitutes a material breach of an employment agreement).

7. One threshold question that an employer should consider in determining whether to enter into an employment agreement with restrictive covenants is whether such restrictions are necessary to protect legitimate business interests. A restrictive covenant that is unnecessary will not be enforced. *Elite Cleaning Company, Inc. v. Capel*, 2006 WL 4782306 (Del. Ch. June 2, 2006) (finding that where employee is at will with no access to sensitive information and employee is only slightly above minimum wage, restrictive covenants may be unenforceable). The enforceability of a restrictive covenant can also depend on whether the worker is an employee or contract worker – particularly when dealing with non-physician personnel. *EDIX Media Group, Inc. v. Mahani*, 2006 WL 3742595, at *7 (Del. Ch. Dec. 12, 2006) (recognizing distinction between employees and independent contractors), *aff'd on other grounds* 935 A.2d 242 (Del.). The topic of properly classifying workers and employee or independent contractor and exempt/non-exempt requires a discussion of its own.

8. See 6 Del. C. § 2707.

9. An example of such provision might be: "Physician agrees to pay Employer \$500,000 in liquidated damages if the Physician competes with the Employer within a year after the termination or expiration of his employment agreement within thirty miles of the Employer."

Liquidated damage provisions can be tricky to draft properly and the amounts provided for can be challenging to determine (and difficult to agree on). Indeed, Draconian liquidated damages provisions can frighten away talented applicants from accepting positions with medical practices, for fear that there is more to lose than gain by accepting employment. In any event, liquidated damages generally cannot be a “penalty” or “punishment for default.”¹⁰ If it is unconscionable, it will not be enforced. Thus, a liquidated damage must be rationally related to a measure of damages a party might conceivably sustain.¹¹

In some cases, liquidated damages clauses are drafted to apply not only to competition clauses but also solicitation and/or confidentiality clauses. However, where adequate remedies exist at law (i.e., by an award of money damages), employers may be unable to obtain equitable relief (e.g., an injunction).¹² Thus, additional provisions are often drafted that make clear that for such violations (but not for matters of competition), the employer shall be entitled to obtain from a court of competent jurisdiction (e.g., the Delaware Court of Chancery) preliminary and permanent injunctive relief *as well as* damages (such as liquidated damages).¹³

BEWARE OF RECRUITING/HIRING RESTRICTED EMPLOYEES

Absent a covenant to the contrary, employees (including physicians) are permitted to engage in actions in good faith even if those actions are outside their employment and even though such actions may adversely affect a principal’s business; and employees are not prohibited from

making arrangements or preparations to compete with a principal before terminating agency, provided employees do not act unfairly or injure the principal.¹⁴ Similarly, competitors generally are free to hire (and even aggressively recruit) competing company employees. However, if recruits are contractually restricted, new employers may be restricted also. Indeed, employers who hire employees who are contractually restricted from working for them can be sued (sometimes successfully) for aiding and abetting and/or tortiously interfering with employment agreements – even where employment agreements provide for at-will employment.¹⁵

BEWARE OF ACQUIRING EMPLOYEES FOR THE INFORMATION THEY POSSESS

Patient lists can be a gold mine for business development. While information that can be acquired lawfully with relatively minimal expense or effort does not rise to level of a statutory trade secret, contact lists can still be contractually-protected confidential information. If the possession and use of confidential information is contractually restricted, employers who draw out such information from recruits may face the same kind of aiding and abetting and/or tortious interference claims as discussed above. Sometimes, contact lists can even constitute trade secrets, which might be protected by statute even in the absence of a contract. This is true where such information has economic value and where significant time, money, and effort is required to compile the information and effort is made to keep the information secret.¹⁶

10. *S.H. Deliveries, Inc. v. Tristate Courier & Carriage, Inc.*, 1997 WL 817883, at *2 (Del. Super. Ct. May 21, 1997).

11. *Brazen v. Bell Atlantic Corp.*, 695 A.2d 43, 48 (Del. 1997) (finding clause was enforceable because it was not unconscionable where it represented 2% of the market capitalization); *Tropical Nursing, Inc. v. Ingleside Homes, Inc.*, 2006 WL 3579075, *2 (Del. Super. Ct. Dec. 11, 2006) (finding liquidated damages provision was a penalty).

12. *Gradient OC Master, Ltd. v. NBC Universal, Inc.*, 930 A.2d 104, 131 (Del. Ch. Jul. 12, 2007).

13. Because litigation can be very expensive, an additional remedy provision often included in employment agreements is an attorneys’ fee-shifting provision (e.g., “Physician agrees to pay to Employer all costs and expenses incurred by Employer relating to the enforcement of the terms of this Agreement, including reasonable fees and disbursements of counsel (both at trial and in appellate proceedings)”). When such clause exists, an award of attorneys’ fees can be awarded even when such amount significantly exceeds damages proven at trial. See *EDIX Media Group, Inc. v. Mahani*, 2006 WL 3742595 (Del. Ch. Dec. 12, 2006), *aff’d* 935 A.2d 242 (Del.).

14. *Beard Research, Inc. v. Kates*, 2010 WL 1644177 (Del. Ch. Apr. 23, 2010).

15. *Great Am. Opportunities, Inc. v. Cherrydale Fundraising, LLC.*, 2010 WL 338219 (Del. Ch.) (granting preliminary relief and finding for plaintiff on several claims notwithstanding fact that underlying employment agreement provided for at-will employment).

16. *Id.*; *NuCar Consulting, Inc. v. Doyle*, 2005 WL 820706 (Del. Ch. Apr. 5, 2005), *aff’d* 913 A.2d 569 (Del.) (denying preliminary relief but granting permanent injunction and ordering unjust enrichment damages on misappropriation of trade secrets claim).

UNDERSTAND WHEN EQUITABLE RELIEF IS AVAILABLE

Both temporary restraining orders and preliminary injunctions are considered extraordinary remedies. Before investing in litigation, employers should manage their expectations. Part of this exercise involves learning the standards for equitable relief. In order to justify a temporary restraining order, plaintiffs must establish a “threat of imminent, irreparable injury”; a “colorable claim”; and that “the injury it will suffer if the remedy is not granted is not outweighed by the possible injury defendants may suffer if the remedy is granted.”¹⁷ Similarly, a preliminary injunction will be granted only where the moving party demonstrates a reasonable probability of success on the merits at a final hearing; that the failure to issue a preliminary injunction will result in immediate and irreparable harm; and that, after balancing the equities, the harm to the plaintiff if relief is denied will outweigh the harm to the defendant if relief is granted.

WHEN EQUITABLE RELIEF IS DESIRED, TREAT TIME AS OF THE ESSENCE

Cases involving trade secrets, confidential information, solicitation, and competition often move very fast. Sometimes, for example, motions for temporary restraining orders are scheduled for a hearing (often by teleconference) so soon after being filed that those who are sued hardly have enough time to find counsel and pull together pleadings that set forth their side of the story. Looking at the matter from the other side, when rights are being violated (often by a competitor), there often is no time to waste. Indeed, a request for temporary restraining order may be denied if a moving party does not proceed as promptly

as s/he might. In such a case, the moving party is often found to have contributed to the emergency nature of the application and is guilty of laches.¹⁸ For these reasons, employers should have on the ready (and call early) employment counsel who can assist with business competition cases. Because these cases typically require counsel to drop all else and turn all attention to the business competition matter, which usually means several very long nights, employers should be prepared to pay a significant retainer fee for these cases.

BE FRUGAL WITH CAUTION

Employers should avoid the temptation of using off-the-shelf agreements or engaging someone to draft employment agreements on the cheap, especially where possibility exists for the employee later to do harm to the company (e.g., through competition, solicitation, or destructive use of confidential information or trade secrets). There is an art to drafting good employment agreements. Law firms with sections dedicated to employment law often offer both litigation and transactional employment services. Where such law firms also have business competition attorneys, a flat fee can often be offered for customizing an employment agreement, a form of which might already exist at the firm, the terms of which the attorneys often are already familiar. The built in bells and whistles and institutional knowledge of the terms can provide significant cost saving to employers. Moreover, employers can maximize value by using the same attorneys who drafted their employment agreements to litigate disputes that might arise out of such agreements.

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17. *Lewmor, Inc. v. Fleming*, 1986 WL 1244, at *2 (Del. Ch. Jan. 29, 1986) (denying a temporary restraining order requested pursuant to a covenant not to compete partly because “no legitimate economic interest of plaintiff is being impacted by defendant's current activities”).

18. *Moor Disposal Service, Inc. v. Kent County Levy Court*, 2007 WL 2351070, at *1 (Del. Ch. Aug. 10, 2007) (finding that “emergency nature of plaintiff's complaint is a self-inflicted wound that does not justify the commencement of the heavy machinery of expedited injunctive proceedings”).