# Physician Employment Agreements in the 21st Century

Critical elements you should consider to help ensure that your agreement suits your specific needs.

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One of the more perplexing issues physicians confront as they transition from fellowship to practice is their employment agreement. These agreements can vary from an informal offer and acceptance conveyed over a phone call to a complex written contract the size of a small novel. This article addresses the question of when a written employment agreement is appropriate, the advantages and disadvantages of entering into a comprehensive employment agreement, and several provisions critical to providing physicians with the legal protection necessary in their employment relationship.

## LIMITATIONS OF ANALYSIS

This article is intended to familiarize the reader with several of the pertinent issues they may choose to address in their employment agreements. It is not a review of all legal issues that will impact your respective agreement. In the United States, employment agreements are governed by the law of the state with the most significant contacts with the contracting parties. In this context, contacts refers to the state in which the contracted employment is to take place, but (as with most legal rules) there are exceptions. A physician may agree to work for a practice with offices in two neighboring states that have conflicting laws regarding the relevant provisions of the employment agreement. Because it is not possible to provide a dissertation on the employment laws of all 50 states within the context of this article, I strongly recommend that any physician preparing to enter into an employment agreement meet with an attorney familiar with the employment laws in the state governing your contract.

## WHEN IS AN EMPLOYMENT AGREEMENT APPROPRIATE?

Under the law in many states, an employee hired without an agreement is considered to be an "employee at will," meaning that the employer can fire the employee without cause, notice, or compensation (aside from compensation already earned) at any time. Although various federal and state statutes protect employees from age, sex, racial, and disability discrimination in the workplace, unless there is a verbal or written agreement to the contrary, an employee working for a business organization has no additional legal rights concerning dismissal.

Therefore, the first issue to address is whether it is in an employee's best interest to have a written agreement. The most obvious benefit of a written employment agreement is evidence of the terms of employment (see Table 1 for a list of the terms that are likely to be addressed). Although

**TABLE 1. TERMS TO BE NEGOTIATED IN AN EMPLOYMENT AGREEMENT**

- Salary
- Profit sharing
- Partnership track
- Vacation, personal, and sick days
- Length of employment
- Termination
- Malpractice insurance (during and after employment)
- Health insurance
- Disability insurance
- 401(k) plans
- Any other fringe benefit programs you wish to incorporate

a verbal employment agreement is valid and enforceable, the parties may subsequently dispute the exact nature of those terms, and the only evidence of the details will be the parties' own conflicting testimony. A written agreement can address a wide range of terms and provide the employee with certainty regarding his or her position at the practice. On the other hand, the ambiguity of a verbal agreement has advantages: some terms contained in a written agreement (such as a noncompete agreement) may be against the best interest of the employee. An employee who is planning on a short stay at a particular medical facility before moving to another job in the same geographic area may prefer a verbal agreement, trading a degree of uncertainty regarding the specific terms of employment for the freedom to change jobs.

## NONCOMPETE AGREEMENTS

A medical practice that has an existing patient base may wish to restrict a new hire from competing with the practice when the employee terminates employment. It is not a question of if, but when the employee will terminate. In every employee/employer relationship, the employee will ultimately terminate employment, whether due to death, disability, termination (voluntary or involuntarily), retirement, or finding another job.

### Enforceability

The enforceability of restrictive covenants presents an excellent example regarding the disparity of the states' treatment of employment agreements. In some states, restrictive covenants are enforceable; in other states, the courts deem these covenants contrary to public policy and unenforceable. A third group of states will enforce such covenants subject to certain limits. In these states, the restriction must be limited as to time (often 1 to 2 years) and to a geographical area that bears a significant relationship to the actual business interests of the medical group. For example, a cardiologist in central Illinois whose practice serves a 50-mile radius of his office may be able to enforce a restrictive covenant that covers that 50-mile radius for a 2- or 3-year period. On the other hand, a cardiologist working within the Chicago city limits may only be able to enforce such a covenant within a 3- to 5-mile radius, and a cardiologist leaving that practice may only lose hospital staff privileges at one or two hospitals.

In addition to the limitations on enforceability, these agreements often face other stumbling blocks. Most states provide that any ambiguity in an agreement should be construed against the party who drafted the agreement (usually the employer). In addition, a restrictive covenant may not be enforced if the employer has materially breached the employment agreement (ie, not paid compensation or kept other promises, such as setting up a promised 401[k] plan). If an employer has failed to meet its contractual obligations, the employee can argue that the restriction would be unfair to enforce. Therefore, it is critical therefore that an employer strictly honor its promises if it wants to enforce a restrictive covenant. Finally, if an employee wants to break a restrictive covenant, the employee should seek legal counsel first to determine whether the state honors such agreements and whether the employer has met all of its contractual obligations.

### Damages for Breach of Restrictive Covenant Not to Compete

Depending on how the restrictive covenant is drafted, the consequences of such a breach may be monetary damages, an injunction, or both. Monetary damages are generally a dollar award determined by the court or mediator to compensate the employer for lost revenue caused by the breach of agreement. An injunction would prohibit the terminated party from establishing a competing medical practice. Some parties agree in the employment contract to "liquidated damages," which represent the sum that the parties estimate that the employer would likely suffer if the employee were to breach the restrictive covenant. These liquidated damages are generally upheld (in those states that enforce restrictive covenants) so long as it is not perceived as a punitive amount. I recommend liquidated damages to my clients because these provisions reduce the likelihood of future court proceedings regarding the actual business loss incurred by the employer.

### To Sign or Not to Sign?

When I represent employers, I encourage them to have a restrictive covenant to protect their patient base. It is unfair for a junior physician to move into a community, be introduced to the patient base and financially supported by the established medical practice, and then leave the medical practice and significantly damage it by taking a large number of patients. When I rep-

**TABLE 2. RESTRICTIVE COVENANTS—ITEMS TO CONSIDER**

*Employee*
- Avoid if possible

*Employer*
- Limit geographic range and time
- Consider liquidated damages

resent an employee joining a medical practice, I advise them to not enter into an employment agreement with a restrictive covenant unless they clearly intend to honor it or unless the restrictive covenant has a pre-arranged liquidated damages provision that will allow them to "buy out" of the restriction (Table 2). The costs to both parties in any litigation to enforce or breach the restrictive covenant are time consuming, costly, and uncertain because courts are reluctant to enforce such restriction.

### Extending the Period of Restriction of Practice

If a terminated physician goes to court to have the covenant not to compete declared unenforceable, a problem can occur because the court may not decide the issue for 2 or 3 years. If the terminated physician is successful in being allowed to practice during the litigation, the restricted period may thus be ineffective because the employee may be allowed to continue to practice during the litigation and patients will go to the employee. To alleviate this problem, a provision may be included in the employment agreement.

If the employee terminates employment, the period that the employee cannot practice within the restricted area can be automatically extended by the length of any period during which the employee is in breach of the noncompetition agreement and for any period that the medical practice institutes litigation to enforce the restrictive covenants. Therefore, the covenant will continue in full force and effect throughout the duration of such an extended period. For example, if the restricted period is for 2 years after employment and the litigation extends for 3 years after employment, and if the court rules in favor of the medical practice, the employee would be restricted from providing medical services within the restricted area for the 4th and 5th year after termination of employment.

### Termination of Medical Staff Privileges

Upon termination of employment, the employee can also be required to terminate privileges at the hospitals that are in the restricted area and not reapply for privileges at such hospitals for the restricted period after the date of termination of employment. The employee can irrevocably appoint the president of the medical group, or his designee, as the employee's attorney-in-fact to submit such resignations on the employee's behalf if the employee fails to do so after the effective date of the termination of employment. In connection with the relinquishment of such privileges, the employee waives any and all rights that the employee may have by virtue of such medical staff membership, including but not limited to, any rights to a fair procedure or due process under any medical staff bylaws, or rules and regulations thereof, or any part of or supplement thereto governing hearing and appeals.

**TABLE 3. TYPES OF MALPRACTICE POLICY COVERAGE**

- *Occurrence Policies:* Cover acts of malpractice that occurred during the policy year, regardless of when the patient or physician is first notified of the alleged malpractice.
- *Claims-Made Policies:* Cover acts of malpractice when the claim is reported during that policy year, even if the malpractice occurred years before.

## MALPRACTICE INSURANCE

Deciding who pays the cost of professional liability insurance for the employee upon the employee's termination is probably the most critical and controversial provision in current employment agreements. The rising cost of malpractice insurance and the grim possibility of exposing your personal assets to a judgment makes this both a costly and essential area of negotiation.

Before analyzing the contractual issues, it is essential to understand a few basic concepts regarding medical malpractice insurance policies. Coverage of a physician under a malpractice insurance policy is triggered by events described in your insurance policy. There are two types of policies that have two very different triggers (Table 3).

### Occurrence Policies

These policies cover acts of malpractice that occurred during the policy year, regardless of when the patient or physician is first notified of the alleged malpractice.

### Claims-Made Policies

These policies cover acts of malpractice when the claim is reported during that policy year, even if the malpractice occurred years before. This is an important distinction. If the physician is covered by an occurrence policy, he or she is covered for malpractice that occurred during the policy year, even if the malpractice does not manifest itself for years after the policy expires. Under the more prevalent claims-made policy, if the malpractice occurs in 2006 but no claim is made until 2008, the policy that was in effect in 2006 would not provide coverage. A physician under a claims-made policy who terminated employment at the end of 2006 would need to carry insurance to cover those claims that may arise from malpractice that occurred during 2006 but does not result in a claim until years later.

**Tail Policy Coverage**

The most common situation I encounter in negotiating employment agreements is whether the employer or the employee is responsible for purchasing the tail coverage for the professional liability coverage after termination of employment. A tail policy covers any lawsuit filed after termination of employment that relates to activities performed by the physician while an employee of the medical practice. Many years ago, most professional liability policies were occurrence policies. As a result, there was no need to buy tail coverage because the typical policy provided insurance protection for any claim made for acts that occurred while the physician was an employee, even if the claim did not arise until after termination of employment. Thus, if you are fortunate enough to be covered by an occurrence policy, the cost of professional liability insurance after employment is a nonissue. Unfortunately, most insurance policies today are claims-made policies, and it is that type of policy that most of my clients must deal with on a day-to-day basis.

The general rule has been that medical groups will pay for the professional liability coverage during the period the physician is employed. Once the physician terminates employment, however, most medical groups place the burden of purchasing the tail coverage policy on the terminating employee. One exception to this rule may occur if the particular medical specialty has a reasonable professional tail coverage cost.

When I represent medical groups, I always recommend that the medical group not pay for the tail coverage. When I represent the individual physician, I attempt to carve out situations in which the medical group would pay (ie, the employment agreement is terminated because the medical group has materially breached the agreement or the medical group terminates the employment of the physician without cause). Medical groups are hesitant to pay for tail coverage if they terminate the agreement for cause because it creates a litigious environment, which questions the meaning of "for cause" and "material breach."

An occasional compromise is that the medical group and the physician may agree that they will split the cost of tail coverage if the physician leaves for whatever reason in the short term. For example, if the physician's employment is terminated within 1 to 2 years of employment, the medical group may pay a portion of the cost (say 50%) and the physician pays the remaining 50%, so long as the physician leaves the area and does not compete with the medical group.

Many factors will determine which posture can be used in negotiating an employment agreement. If the physician is highly trained in a subspecialty, an existing medical group may be willing to make an exception and provide tail coverage as an enticement to the physician to join the group. On the other hand, if the medical group has had disappointing experiences with physicians voluntarily leaving the group, and not as a result of the group not fulfilling its obligations, then it is more likely they will not make this accommodation.

**Employment With Hospital Systems**

Because of the economic climate, a number of physicians and physician groups have or are considering becoming employees of hospital systems. The major advantage of joining a hospital system is that the physician will be insured under the hospital system's professional liability policy as an employee. Thus, if there is a liability claim, the hospital will defend and pay for any claim because the physician is an employee, not an independent contractor. If you are entering into an arrangement with a hospital system, it is important to clearly identify the following factors: (1) whether you are an employee or independent contractor; (2) whether the hospital system's coverage is self-insured, or insured through a third party carrier; and (3) the terms and conditions of the hospital system's insurance policy. If it is an occurrence policy, there is no need for the physician to have to buy a tail policy when he or she terminates employment. On the other hand, if the hospital policy is a claims-made policy, it is extremely important that the physician's employment agreement with the hospital specify whether the hospital or the physician is responsible for paying for the tail coverage, if any.

**Changes to Coverage**

You should also be aware that when physicians join a hospital system or any other health care provider, the type of insurance coverage can change. Even if they have an occurrence policy on the date of employment, that may not be the situation at the time of termination of employment. Medical groups and hospitals change insurance coverage and policies from time to time, depending on the cost and other circumstances. Therefore, to fully protect yourself, you should clearly spell out in the employment agreement that upon termination of employment, the hospital system will pay all costs and expenses relating to professional liability coverage for the period of employment, including any required tail coverage, regardless of whether the hospital system has a claims-made or occurrence policy at the date of employment termination.

**Self-Insurance Programs**

Because of the dramatic increase in the cost of professional liability insurance policies from traditional insurance carri-

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ers, some medical groups have established their own self-insured insurance programs. When I negotiate an employment agreement for a physician who joins a medical group that has a self-insurance program, I first advise the physician of the major issues unique to such a program. The establishment of a self-insured program should only be considered if conventional insurance policies cannot be obtained, or the cost of conventional policies is economically prohibitive for the group. Extreme caution and care should be taken when establishing such a self-insured program.

A major detriment is the maintenance of sufficient reserves to cover several significant claims that may occur within a short period of time. Although self-insured programs generally have a supplemental insurance policy to cover a portion of the excess claims, any group seriously considering such a program should do an in-depth analysis of the self-insured program. The group should also analyze how to position the entity's assets and the physicians' individual assets in an asset protection program, in the event that the self-insured program does not have sufficient funds to pay significant claims.

## CONCLUSION

Your ability to negotiate your employment agreement will be determined in large part by your economic reality and your own needs. If you do not plan to stay at a position long, you may prefer a verbal agreement and a handshake, with the parties filling in the details as you go along, leaving you free to join a competing practice at your leisure. On the other hand, a physician seeking employment at a sought-after practice with an ample supply of resumes may also find that there is no room to negotiate, even the most basic provisions. Regardless of your position, it remains important for all fellows to be aware of the terms of their employment agreement and to seek a legal opinion regarding any provision with which you are uncomfortable before you sign. ■

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