Are Non-Competition Agreements Enforceable or Not?

Non-competition agreements usually bar physicians both from encouraging patients to follow them to a new practice and from practicing for a certain period of time within a certain distance of the current employer's location. Most 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.

Enforceability

Enforcing non-compete agreements can be problematic, since courts construe the agreements narrowly and determine their enforceability on a case-by-case basis. Arizona courts generally disfavor non-competition agreements, especially among doctors. Thus, courts read the restrictions in a non-compete as narrowly as possible, with any ambiguities interpreted in favor of the employee rather than the employer.[1] To be enforceable, a non-compete agreement must protect "some legitimate interest beyond the employer's desire to protect itself from competition."[2] 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 were acquired because of the employer for a limited amount of time.

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."[3] 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 healthcare professionals. The court held that patients are entitled to be seen by the provider of their choosing, regardless of the contractual obligations between their provider and her former employer, because the harm to patients who could lose the option to see their chosen provider is greater than the employer's economic interest in enforcing a non-competition clause.

Because of the *Farber* decision, non-competition agreements between physicians 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.

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

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 grammatically severable, unreasonable provisions but keep the rest of the agreement intact.

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. 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."[4]

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. A sample step-down provision might be similar to the following:

> 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.[5]

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

Conclusion

Non-competition agreements can be useful 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 physician who is struggling to work around a non-compete agreement can rarely know for sure if it is truly enforceable or not, since courts consider each one individually, 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.

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1. BRENT A. OLSON AND LISA C. THOMPSON, BUSINESS LAW DESKBOOK § 12:12 (2009-2010 ed.).
2. Valley Med. Specialists v. Farber, 194 Ariz. 363, 367 (1999).

3. RESTATEMENT (SECOND) OF CONTRACTS § 188 cmt. a.
4. Varsity Gold, Inc. v. Porzio, 202 Ariz. 355, 45 P.3d 352.
5. Harris and Farhang, *supra* note 6.