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When is an Agreement Not an Agreement?

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You hired an employee and made a deal. Everyone understood the terms, which were clear and concise and everyone agreed to them. You wrote it down, signed it, and filed it away. You went forward with this employee, trained her, and introduced her to your practice and your patients. You lost money on her for awhile, but believed you were investing in the future of your practice.

Fast forward a few years. Having had the benefit of stepping into a thriving practice in a good location with an up to date facility, the employee has become busy and built up a patient base. But in discussions about a possible buy in, several sources of disagreement arise. At what pace should we target our growth? Should we open another office? How do we see the role of physician extenders in our environment? What is the fair price/time line for the employee to buy into the practice? Different philosophies on these business issues cause tension in the relationship, and you agree that perhaps you should go your separate ways. You are disappointed that it did not work out, but feel confident that the agreement you tucked away a few years ago will protect you from unfair competition and the erosion of your practice.

Two weeks after the effective date of the employee's resignation, you see an announcement in the local paper. The smiling face of your former employee appears beneath the logo of a large practice just down the street. "Meet Our Newest Doctor," the headline reads. "Call for an Appointment." Feeling angry and betrayed, you go into your drawer, pull out the agreement, and bring it to your lawyer's office, only to be told that there may be challenges to enforcing the agreement, and that it may cost a significant amount of money to get a judge to prevent your former employee from breaching the agreement.

Why is it, you wonder, that a perfectly clear contract, agreed to by reasonable, intelligent professional people, will not be swiftly and effectively enforced?

The short answer to the question can be found in one of the briefest state statutes on the books, enacted in 1913. Your contract is sliced down by one sentence: "Every contract . . . in restraint of trade or commerce in the State of North Carolina is hereby declared to be illegal." N.C. Gen. Stat. Sec. 75-1. An agreement inhibiting a party from doing business is a restraint of trade. Therefore, the starting premise under North Carolina law is that a non-compete agreement is illegal.

That is not the end of the story, however. North Carolina courts have recognized that a business or professional practice has a legitimate interest in protecting itself from unfair competition. A purchaser of a business can require the seller not to set up a competing business. An employer can prohibit a former employee from joining a competitor and taking its customers. However, the party seeking to enforce a non-competition agreement has to be prepared to prove that the non-compete meets the requirements to merit exception from the general rule: "An individual's voluntary contractual restraint on his right to carry on his trade or calling is *prima facie* illegal and must be shown to be reasonable by the party seeking to enforce it." *Rose v. Vulcan Materials Co.*, 282 N.C. 643, 194 S.E. 2d 521 (1973).

What then are the keys to crafting a non-compete agreement that you can promote as an exception to the general rule?

1. The contract must be in writing. A straightforward requirement, but one that requires careful, consistent record keeping. It is not uncommon for a client to recall having entered into a non-competition agreement years ago with a former employee, but have difficulty producing a written contract that the client knows to be the final version of the agreement with original signatures of all parties.

2. The employee must have been given consideration for the agreement not to compete in the future. The offer of employment is adequate consideration if the non-compete is executed at the time the employment begins. To enter a non-compete with an existing employee, or to alter the terms of the non-compete, additional consideration must be given to the employee. Often a bonus payment, increase in salary, or extension of the contract term is given in exchange for the non-compete agreement entered into later in the employment relationship.

3. The non-competition agreement must be no broader than is necessary to meet the reasonable business interests of the enforcing party. This is really three requirements:

   The period during which competition is prohibited must not exceed that required to protect the practice. This requirement is scrutinized particularly closely in the employment context, where an individual is being foreclosed or limited in the practice of his trade or profession.

   The territory covered by the non-competition agreement must be reasonable. Practically speaking, a medical practice should be prepared to show that it draws patients from the entire area covered by the non-compete agreement, and that the departing employee had the opportunity to interact with patients from throughout the non-compete area. If a practice has three locations, and the non-compete covers a ten mile area around each of the three locations, it will be difficult to enforce against an employee who has only worked at one of the locations.

   In addition, time and territory restrictions are considered in tandem. A non-compete with a broad territory is more likely to be enforced if the time restricted period is briefer, and vice versa.

   Further, the scope of restricted activities must be tailored narrowly. A non-compete contained in the employment agreement of a physician who specializes in orthopaedic surgery, whose practice with the employer has been limited to orthopaedic surgery, will not be enforced if it is written broadly to prohibit the practice of medicine.

   Finally, in evaluating reasonableness parameters, it is important to remember that it is the scope of the agreement itself that is being evaluated, not the intended conduct of the former employee. An agreement that prohibits an orthopaedic surgeon from practicing medicine east of the Mississippi River for a period of ten years will not be enforced, even if the employee is actually opening an orthopaedic surgery practice across the street on the day after he leaves your employment.

4. The agreement must not violate public policy. This has a particular application in the healthcare context. Even if all of the other requirements are clearly met, a non-competition agreement that deprives the public of access to healthcare will not be enforced. If enforcement of a non-competition agreement may mean that patients will be required to travel an unreasonable distance to obtain an appointment in a reasonable time or to have access to a particular specialty, the non-compete agreement may be struck down. A practice operating in a medically underserved area, or employing physicians having narrow subspecialties can meet this defense to non-compete enforceability if it can show the court that it will be replacing the departing physician.

Thus, every non-competition agreement in North Carolina is subject to a judicial determination that it fails to meet one of these requirements, and therefore, is not an enforceable agreement.

There is, however, a way to construct an agreement which discourages a departing employee from competing with a former employer and yet avoid scrutiny for reasonableness of time, territory and scope. North Carolina Appellate Courts have held that contracts that require a departing employee to forfeit an amount otherwise owing to him, or to make a “cost sharing” payment to the practice, if they compete with the practice after they leave are not actually non-compete agreements, and therefore not subject to the strict scrutiny as to reasonableness required with a non-compete. The trade off is that the employee may decide that the price is right and write the check or forfeit the payment, so you cannot rely on these agreements to prevent post-termination competition. And raising the cost to elevate the disincentive risks having the payment be determined an unreasonable penalty and therefore unenforceable.

In short, there are ways to protect a practice from unfair competition by a departing employee, but it is important to avoid naivety in this area, understand the potential landmines, and be aware of the options available. And the viability of any agreement in this area is only as good as the most recent appellate court decision, so there is no substitute for obtaining legal counsel when confronted with the need to draft, evaluate or enforce a non-compete agreement.

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