Do You Know What's In Your Physician Agreement?

by Andrea I. Schwab, JD, CPA[1]
October 28, 2016

Notice: The information provided in this article is commentary of a general nature. It is not intended to provide specific legal advice, and should not be used as a substitute for the advice of an attorney.

Physicians are faced with numerous agreements throughout their careers, and those impacting their financial relationship with a practice are important not only to their livelihood, but also to their ability to provide quality care to their patients. Whether faced with an employment agreement or an opportunity to purchase an ownership interest in a practice, a physician should be vigilant in scrutinizing the fine print of those agreements. Contracts are generally written by attorneys for other attorneys (and ultimately for courts), so it is essential that physicians have an attorney review the agreement on their behalf. The potential ramifications of failing to perform due diligence in the analysis and negotiations of such agreements, can outweigh any short term financial gain, and the duration of the agreements' impact can potentially far exceed the immediate term of the agreement.

Employment Agreement

The receipt of a proposed employment agreement after a pleasant recruiting process is an exciting time for any physician. This momentum is often carried forward with a short deadline to accept the agreement. Hiring an attorney at this point could seem counterintuitive and unfriendly to some, and may even appear as though it would be "putting the brakes" on the progress. But physicians should keep in mind that the potential employer has already had the benefit of drafting all of the provisions in the proposed agreement, and those provisions may be unfairly skewed in the employer's favor. It is only fair and reasonable to give that agreement at least as much scrutiny from the physician's perspective. People usually enter into contracts while they anticipate their relationship will be long and happy one; ironically, however, contracts are usually written in part to determine how the relationship will end, and what will happen when it does. Carefully reviewing the contents of a proposed employment agreement is a critically important step in the employment arrangement, and in the trajectory of a physician's career.

An employment contract can effectively restrict where and when a physician can practice in the future, what other services or business ventures the physician can be involved in during the

[1] Andrea I. Schwab currently practices law with the Law Office of Andrea I. Schwab, PLLC in Austin, Texas. She has over 21 years of legal experience, primarily focused on business law, health law, and professional liability litigation. She can be reached at andrea@aschwablaw.com.

employment, the hours and details of the physician's work, the types of patient conditions that will be seen, and added requirements that the employer can unilaterally impose on the physician, such participating in peer review or providing training to nonphysician providers. Although the beginning of a business relationship is usually a positive experience, and agreements are entered into while everyone is getting along, relationships can deteriorate and contracts are often breached. This is why it is important to not only know how your employment arrangement will practically look, but also what effect it may have on your ability to practice medicine if things deteriorate.

It is important to understand all of the details of the employment agreement, because what appears fair on the surface may really be unacceptable upon closer review. Additionally, it is important to note that the provisions that appear in the actual employment agreement are what prevails--not the promises that were made during oral discussions or even most offer letters/ letters of intent. Offer letters are usually agreements by which both parties agree to negotiate and to try to enter into a formal employment agreement. The provisions in the employment agreement usually prevail over any offer letter or letter of intent.

Although the entire agreement is important, some of the provisions that cause physicians the most trouble involve restrictive covenants (noncompete and nonsolicitation), compensation, restricting outside activities such as research or moonlighting, and unilaterally expanding the scope of responsibilities.

Noncompete/Nonsolicitation
A covenant not to compete can significantly restrict a physician's ability to practice medicine after an employment relationship is terminated, often regardless of the reason for termination. In some circumstances, physicians have been left with no choice but to pack up and leave the town in which they live, because the geographical and time restrictions of their noncompete prevented them from being able to find reasonable employment elsewhere. If a physician violates a noncompete, the employer can seek an injunction against the physician, and in many cases against the physician's new employer. This results in a legal battle to determine whether the noncompete is enforceable. Physicians often don't want to face that cost and uncertainty, even if the noncompete is unreasonable or unenforceable, and rather opt to move away, uprooting their families and leaving their patients behind.

Although noncompete agreements are not unique to physician contracts, Texas law requires a physician noncompete to contain certain provisions, because it is against public policy to restrict a physician's ability to practice his or her profession and to prevent patient access to physicians. In general, a physician's noncompete must contain a buyout provision at a reasonable price, must provide access to medical records upon patient authorization, and cannot deny the physician access to a list of the physician's patients. Additionally, a noncompete must be reasonable as to its scope, time, and geographic limitations.

Courts have held some physician noncompetes to be unenforceable when they fail to contain statutorily required language. Other courts have revised unreasonable noncompetes, to make them enforceable, such as shortening the time restriction, or moving the mileage radius closer to the primary practice location.

In general, courts will tend to find a way to enforce an agreement made between two parties. Therefore, if a physician agrees to a noncompete, the court will attempt to honor that agreement, even if the physician later regrets agreeing to its terms. Physicians need to focus carefully on what the covenant is restricting. Sometimes the geographic limitation is a radius from the primary practice location, other times it can be a radius of *any* of the employer's practice locations, even if the physician never worked there. Likewise the scope of restricted services can be extremely broad, preventing for example a physician who is in clinical practice from even taking a job in an inpatient facility or teaching institution. It is extremely important to understand any agreement that is being signed.

Finally, it is important to note that some very restrictive provisions are not even found in the noncompete provision, but are hidden elsewhere in the agreement. For example, some contracts will require a physician to terminate all facility medical staff membership upon the termination or expiration of the agreement, and even ask the physician to waive due process. These requirements have been buried in a seemingly innocuous paragraph, such as a provision wherein a physician agrees to return keys and computers upon the end of the relationship.

Scope of Employment and Compensation

Employers can often modify a physician's required duties at the employer's sole discretion. These provisions can appear benign, usually stating that the physician will provide services within the physician's specialty, but will add "as directed by the employer"; or the practice location will be stated clearly, then will add "as well as other sites as directed by employer." The call schedule can be vague, sometimes not being addressed at all, or other times written in such a way that allows the employer to change the call schedule at its sole discretion. This can result in an unfair allocation of call to one physician, or hours of employment that far exceed what the physician may have agreed to.

Agreements can require the physician to perform "additional professional and administrative services" without limit, such as engaging in educational programs, serving on committees, or supervising and training staff. Such requirements could be an unwelcome and unanticipated additional demand on a physician's time. A physician may be willing to engage in these activities, but if these activities are not clearly defined, or if the compensation does not reflect the additional hours expended (or if these hours are not calculated into full time clinical work requirements), they can be overly burdensome and lead to burnout. Limits or expectations of hours should be considered, as well as the scope of duties.

Compensation provisions can also be misleading. A physician may agree to a salary that is satisfactory upon signing the agreement, but not understand that the salary could change the next year, or that calculations and expectations can be revised at the employer's discretion. Common language in an employment agreement can be "Upon completion of the Initial Term of the Agreement, Physician's compensation shall be calculated in accordance with the methodology approved by Employer." This kind of language gives the employer the power to modify compensation terms, and a change in compensation is a rude awakening for a physician who is working unexpectedly long hours, for the same or less money, and who is bound by a noncompete. Understanding and negotiating an agreement before it is signed can prevent most surprises.

Furthermore, physicians are often enticed with opportunities for bonuses, but may not understand that the employer often controls the calculations, and can change them. For example, the employer can allocate percentages of overhead expenses to the physician, making profitability too low for a valuable bonus. Indeed, upon close analysis, a physician may be surprised to learn that the bonus is often purely discretionary, or that the physician has no right to review the books in order to challenge a calculation or to evaluate his or her own profitability.

Compensation and quality metrics can also be affected when the employer has the sole right to schedule patients and assign new patients to physicians. Employers are not required to assign patients in an equitable manner (unless the contract requires them to do so), and therefore some physicians end up with patients who have low reimbursement insurers while others receive the high reimbursement patients. This of course will skew profitability numbers. Additionally, schedules can be made requiring some physicians to have the high morbidity patients, while others have the healthier ones. This can skew quality measures for some physicians.

Compensation, patient mix, and scope of professional services should all be clearly understood and negotiated in a contract. These provisions go to the heart of an agreement, but unfortunately can often be a surprise after the ink is dry.

Billing and Assignment

An employment agreement will usually contain a provision assigning all billing to the physician's employer, and may also add that the physician cannot retain any professional fees or nonclinical fees. Particular attention should be given to ensure that the physician can retain fees or activities that are not related to the employment.

Agreements have been known to outright prohibit activities such as having an ownership interest in medical facilities, engaging in expert witness activities, conducting research, giving speeches, or moonlighting, while other agreements require the physician to turn over to the employer all funds received from those activities. Many agreements require the employer's prior written approval to engage in outside income generating activities.

The agreement can include a provision of "permitted activities" to carve out and clarify the types of activities that are permitted. Physicians should advocate for their ability to engage in and get paid for activities that are of interest to them, such as research or ownership in an ambulatory surgical center, and retain their ability to receive financial and professional credit for those activities.

Professional Liability Insurance

The threat of professional liability is always present in the practice of medicine. Employers will provide malpractice insurance coverage during the term of employment, but sometimes those requirements are discretionary. Insurance should be clearly required in the terms of the agreement, and the type of insurance and limits should also be understood. Whether the coverage is claims-made or occurrence, and the limits of coverage, will be important to consider, as well as the insurer.

In that regard, there can be a significant difference between professional liability insurance provided under an insurance company's indemnity contract and self-insurance administered by the employer. In a self-insured arrangement, the employer may manage its liability risk up to a defined amount, and will purchase excess loss insurance beyond that defined amount. The employer's risk manager may be the individual selecting the defense attorney, potentially without the physician's approval or consultation rights. Importantly, in a traditional indemnity liability insurance policy, the physician can usually refuse to settle (as a settlement can negatively impact the physician), but with a self-insured policy, the employer may be able to settle on behalf of the physician without the physician's consent. The risk manager will be motivated to limit costs as much as possible, and the cost of defense versus settlement will be taken into account.

Also, tail insurance is important to consider in the agreement, because it may be required to protect the physician after employment for alleged negligence that occurred during employment. Often an agreement will require the physician to purchase the tail, but this can often be negotiated to require the employer to purchase the tail, because liability coverage is beneficial to the employer as well.

Finally, the benefits of cyber liability insurance should not be underestimated. Cyber liability is a very real concern to all physicians, whether it be in the form of a privacy breach or a hacking incident. A physician should be aware of any shifting of risk from the employer to the physician, and whether there is any insurance coverage available to protect from that risk. Physicians should inquire whether the professional liability insurance contains coverage for cyber liability, and if not, whether additional cyber liability coverage can be obtained on behalf of the physician.

Benefits

Physicians often leave the issue of benefits to the discretion of the employer, assuming that benefits will be provided fairly. This is not always the case, however, and if an issue is important to the physician, it should be addressed in the agreement. For example, common language in an agreement can be vague, such as "Practice agrees to provide Physician the same various fringe and other benefits as other similarly situated physicians employed by Practice." Other provisions will refer to an attachment to the agreement, but state that the benefits can be changed from time to time at the discretion of the employer. If a physician wants to have health insurance, disability insurance, vacation days and days off for CME, payment of CME and association dues, retirement plans and contribution, etc., then those requirements should be addressed in the agreement. If a physician is relocating to take the position, then moving expenses can be negotiated (but note that employers will often contractually require that these moving expenses be returned to the employer after termination of the agreement). The value of benefits should not be underestimated, and can contribute greatly to a physician's job satisfaction.

Partnership/Membership Agreements

At times an successful physician employment arrangement may evolve into an opportunity to purchase an interest in the organization, whether it is a professional association, partnership, or professional limited liability company. Buying into an organization usually involves multiple agreements. These agreements will usually include an agreement regarding the actual transfer of ownership interest, and a company/partnership agreement that is an agreement among the owners pertaining to how the organization will be governed.

Agreement for Purchase and Sale

Once a purchase price and percentage of ownership is agreed to, an agreement for the purchase and sale of that ownership interest will be entered into. This agreement will set forth the closing date, the number of units or shares that will be transferred, the purchase price, and the form of consideration—i.e., cash, promissory note, or both. This agreement will also contain provisions regarding warranties, representations, and indemnification, and may require the execution of additional agreements, such as an employment agreement (where even owners are hired as employees of the entity), an income distribution plan (defining how compensation will be paid), and a company/membership agreement (which will govern the entity).

This agreement is an excellent opportunity to set forth how additional transfers of ownership will take place. For example, a provision allowing an option to purchase additional ownership could be included, allowing the buying physician to purchase additional increments of ownership, for example when that physician's collections hit certain thresholds. A young physician purchasing into an existing company may otherwise be disheartened when he finds himself owning 25% of a company in which he is generating 50%, 60%, or more of the collections. Provisions can be included allowing that physician to purchase incremental ownership as certain thresholds are met. There are numerous ways to incentivize a physician with ownership, and this is simply one such example.

Additionally, a right of first refusal could be considered. For example, a physician purchasing a small percentage may be concerned that the existing partner or partners may be able to bring in new physicians, thereby circumventing an existing owner-physician's opportunity for growth, or even diluting each physicians' membership interests. Allowing the physician the first option to purchase a selling member's interest would preserve the physician's right to continue to grow his share of ownership and remain incentivized and vested in the company's growth and wellbeing.

Another item to consider in the purchase and sale agreement, is whether the purchasing physician is willing to assume debts and liabilities that may have arisen prior to his or her ownership. If not, exclusions from such risk should be drafted in the agreement; otherwise, the physician could be assuming the debt or other liability risks for which the purchasing physician was not responsible for, or often not even aware of. Consider, for example, a premises liability claim that arose prior to the purchase of ownership interest, but which is filed after the physician becomes an owner. Unless an exclusion or indemnification for such claims is written into the agreement, the new physician owner may find himself liable for a percentage of that loss.

Numerous opportunities and risks arise in the purchase of an ownership interest, and these should be understood. With ownership comes a great opportunity of financial gain, but also a corresponding risk of loss. These risks should be identified and contained as much as possible.

Member Agreement

The Member Agreement (or Partnership Agreement, or Company Agreement) is the agreement by which the organization is governed. It is akin to a contract among all of the owners, agreeing how the organization will be run, i.e., who will manage the affairs, who can conduct the banking, how new members will be admitted, how current members can be removed, what will happen to ownership when a member dies or is disabled, who the officers of the organization will be, how ownership interest/shares will be valued, etc. Often the spouses of the members will also be required to sign the agreement, because their rights will be affected in the event of, for example, death of a member or divorce. There are numerous scenarios and variations to a Member/ Partnership Agreement, the scope of which cannot be covered in an article. However, some general considerations include transfer on death, admission of new members, restrictions on transfers, and management.

When a physician member of an organization dies, the physician's heirs may inherit that physician's ownership interest, along with other assets the physician had owned. The organization, however, along with its remaining physician members, may not want to be in a partnership with that physician's heirs. (Indeed, Texas law limits who can be an owner of a physician organization, and the heirs may not be legally able to be such owner.) Considerations should be made to deal with a scenario such as this. One such option, for example, is a buy-sell agreement which could provide that the heirs are paid by the organization, or the remaining owners, through the proceeds of an insurance policy on the decedent's life which was owned by the organization or the other physicians. Another option is to pay the heirs with a promissory note that is paid off over time. Sometimes the value of that interest can be agreed to at the time the membership agreement is entered into, and other times the value is calculated using a set formula agreed to in the membership agreement. These are just a few important considerations to make when entering into a membership agreement.

Additionally, the management of the organization is important to your investment. Consideration should be made regarding who will be the manager, and what decisions need other members' approval. Sometimes a dollar amount can be set beyond which the manager cannot purchase assets or enter into debt without other parters'/members' consent. Some other limitations to consider placing on the manager can include prohibiting the manager from (without the approval of the other partners/members) selling, mortgaging, or otherwise transferring the assets of the company, merging the company with another person or entity, amending the company agreement, or assuming any liability that requires the personal guarantee of another member without the member's consent. Requiring the manager to act in good faith and in the best interest of the company, and requiring a fiduciary duty to the members and duty of loyalty to the company, are additional requirements that can protect the members' investment, and enforce such protection by allowing a future cause of action against the manager if needed.

Furthermore, a physician should consider prohibiting the association from allowing any new members to the association without the prior approval of all existing members. Additionally, disallowing the issuance of new shares (thereby diluting existing shares), without the approval of all other members, could also be a consideration. Finally, some agreements prohibit a member from disposing of all membership interest, i.e. "walking away", without other members' approval.

In summary, there are numerous provisions and scenarios that could be created to address an association's—and its members'—needs and preferences. Although the offer of partnership may be a milestone in a physicians' career, it should not be taken lightly. These agreements should be custom made to reflect an understanding and agreement among all the members/partners involved.

Conclusion

You have committed yourself to becoming a physician, and have spent a significant amount of time and money in that pursuit. You should not disregard your hard work and investment on an unfavorable physician contract. Do your due diligence and carefully review your agreements. This is your livelihood and what you have worked for. Ask questions and negotiate for better terms. Hire an attorney and understand what you are signing. Sometimes you can negotiate better terms. But if you can't, at least you know what you are getting into, and you can walk away from a deal if it's not a good one.