

Veterinary Hospital Managers Association
Legal Symposium
April 3-5, 2009 • Atlanta, GA

“Veterinary Non-Competition and Non-Solicitation Covenants”

Duane Flemming, DVM, DACVO, JD

DISCLAMIER

This material is presented for educational purposes only and is not offered as nor intended to be legal advice. Each reader is encouraged to seek qualified legal counsel in his or her own jurisdiction before acting upon any of the concepts contained in this material.

COPYRIGHT NOTICE

Copyright Notice: ©2009 *Veterinary Hospital Managers Association, Inc.*

All rights reserved. No part of this work covered by the publisher's copyright may be reproduced or copied in any form or by any means (graphic, electronic or mechanical, including photocopying, recording, recording taping, or information and retrieval systems) without the written permission of the publisher.

Veterinary Hospital Managers Association
Legal Symposium
April 3-5, 2009 • Atlanta, GA

“Veterinary Non-Competition and Non-Solicitation Covenants”

Duane Flemming, DVM, DACVO, JD
American Veterinary Medical Law Association

INTRODUCTION

NON-COMPETITION COVENANTS

For the purposes of this discussion, a non-competition agreement is a promise by an employee that during, or upon the termination of, the employment relationship, the employee will not engage in specific activities competitive with the employer's business for a given time period and within a specified geographic area. Non-competition agreements are also widely known as non-compete clauses, restrictive covenants, or covenants not to compete. Non-competition agreements can be simply a clause in an employment contract or can be a completely separate, stand-alone agreement. Non-competition agreements should always be in writing and signed by all parties.

The goodwill developed by a veterinary hospital, in terms of customer relations, is an asset, so a hospital may use a non-competition agreement to prevent a former employee from capitalizing on that asset. Non-competition agreements are intended to protect the employer by limiting employees and former employees from working for a competitor or from setting up a competing practice within too close a proximity.

Non-competition clauses do not apply to all employees. Generally they are applied to the most skilled employees that play a significant part in generating income or good will for the business, or those that have access to trade secrets or specific proprietary knowledge like client or price lists. In veterinary practices that will often be the veterinarians, licensed veterinary technicians, and office or practice managers. Non-competition agreements will not often apply to casual workers, kennel workers, non-licensed assistants, or cleaning personnel.

Non-competition agreements have been around since the 1400's when an English cloth dyer tried to enjoin a former assistant of his from setting up shop in the same town. These clauses were largely disfavored because of labor shortages and because non-competes were seen as a barrier to craftsmanship and open trade. The greater opportunities offered by the industrial revolution altered the employment landscape with many courts finding non-compete clauses now necessary to protect trade secrets and client lists from unscrupulous ex-employees.

California, Alabama, California, Colorado, Delaware, Massachusetts, and North Dakota will not uphold non-compete clauses in employment contracts. Other states have varying rules on their

use. Before inserting a non-compete clause in an employment contract, each hospital administrator should check with a qualified employment law attorney in their state.

In this country, people are bound by their agreements and courts, unless there are state laws prohibiting them, will generally uphold well-written non-competition clauses that clearly specify the geographic scope of the restriction, the specific scope of services to be restricted, and the exact duration of time the restriction will cover. Courts will balance the employer's interest in protecting its business with the employee's right to pursue a career in his or her chosen profession.

In evaluating the validity of the non-competition agreement the courts will consider several factors including:

The Rule of Reasonableness: In order to be valid, a non-compete agreement must be reasonable. Courts recognize that employers have a legitimate interest in protecting the time, investment, and other resources they have invested in employees, but that interest must be balanced against an employees' job mobility in a free enterprise system. Courts generally will scrutinize non-compete agreements carefully to make sure that they are geared to protect the reasonable business interests of an employer without unduly limiting an employee's other work opportunities. Therefore, these arrangements must usually be tailored narrowly to restrict truly competitive activities without forbidding an employee from working in the same industry or profession in a way that is not competitive.

Whether there was independent consideration or not: Consideration is the quid pro quo (this for that) of contracts. Non-competition agreements are usually entered to at the time of employment when employees have little knowledge, incentive, or bargaining power to resist unfair terms. Moreover, most employees do not seriously contemplate the possibility of leaving employment at the outset of the relationship and, therefore, are not overly concerned about specific terms that might restrict their future employment prospects. Despite the inherent imbalance of these agreements they will often be allowed and, when entered into at the time of employment, the employment contract itself is often sufficient enough consideration.

There are also many employers who will try to insert a non-competition agreement after the employee has been hired. In many states, such an agreement can be valid. Because, in these late entry agreements it may be harder for the employee to walk away, management often has much more leverage than the employee in setting the terms. Therefore, the courts will often bring additional scrutiny to the terms of the late entry non-competition agreement.

In some states, the courts will not enforce late entry non-competition agreements unless the employee gets what is termed "independent consideration." In other words, they get something in exchange for signing the agreement. If this principle applies in your state, a non-competition agreement will be valid only if it is signed at the time employment commences, or at a later date if the employer gives the employee something of additional value such as increase in salary, promotion, or benefits. **Caution:** In some states, it is

considered to be an illegal termination if an existing employee is fired for refusing to sign a non-competition agreement.

Some states will allow what are called “clawback” provisions which require that, in the event the employee violates the agreement, he/she must return the compensation. This might occur, for example, where the employer gives money in exchange for the agreement. Provisions requiring the return of the consideration are enforceable if the court finds that the employer would not have given the consideration "but for" the employee's promise not to compete.

Scope: As a matter of public policy, non-competition agreements shouldn't bar an employee from any reasonable opportunity to use his or her skills. Clauses that effectively prevent an employee from engaging in any trade or practice for which the employee is suited may be too harsh and, hence, unenforceable. The practice of veterinary medicine is very broad with a multitude of disciplines. Licensees are generally allowed, by state law, to practice any discipline they wish. Restrictive covenants should narrowly specify what aspect of veterinary medicine is being restricted. For example, it would be reasonable to restrict an ophthalmologist employee from practicing ophthalmology but not to restrict him/her from practicing equine medicine. It would not be reasonable to restrict a general veterinarian from practicing exotic medicine or lab animal medicine if the restricting practice offers neither of these services.

Duration: In order to assure that these non-competition agreements are not too stifling on the employee, courts will generally require that they only last for a limited amount of time. In many jurisdictions one or two years is considered a reasonable length of time. Longer terms are often looked upon with suspicion. Since the main reason behind a veterinary non-competition agreement is to protect the client base and the good will of the practice, the benchmark is often determined by how long an average client will stay with that practice (attrition rate). Most practices can at least estimate the average time a client stays with the practice. If the particular practice has an average client life of 18 months than that would be a reasonable restriction time. Because a longer time does nothing to protect the practice it could be viewed as punishing the employee for leaving. Because many disputes arise from disagreement over when the restriction ends, the beginning and ending date of the agreement should be specified using the month, day and year format.

Distance: Non-competition agreements must have reasonable geographic limits. What is a reasonable distance is largely dependent on the services provided by the employee and the importance of those services to the employer's business. In general, courts will only enforce a non-competition agreement in a geographical area where the employer does business. For example, most veterinary clients will travel only so far to see their veterinarian. Most practices, especially the computerized ones, can determine what this distance is for their clients. For example, a given veterinary hospital may get the majority of its business within a radius of 20 miles or from the surrounding four zip codes. The courts will likely uphold an agreement that restricts an ex-employee from working within that distance.

In drafting a distance limitation, the veterinary hospital should be as specific as possible. The distance clause should include:

1) The starting point: This should be a specific and unchanging geographic point such as the hospital's physical address. It should be clearly stated that all measurements will begin at that point. Court's will generally not allow multiple measurement points such as might happen if a hospital has several satellite clinics and wants to specify a radius from each one. Also the courts may not uphold a restriction where it is based on a satellite clinic set up in a distant location just to enlarge the restricted area.

2) The method of measurement: The agreement should state clearly how the distance is to be measured so as to give firm guidance to the ex-employee. The most common method is a simple radius measured by a compass on a map. Be careful that the radius does not fall outside the jurisdiction of the court enforcing the contract. This is especially true where the practice radius may involve more than one jurisdiction, especially more than one state.

3) The unit of measurement: This should be stated in miles and should reflect the distance that encompasses the majority of the hospital's clients. The percentage of clients taken into consideration varies with circumstances but some courts have allowed a distance that includes up to 90% of the business' clients. The court will not uphold a 100 mile restriction just because the practice has one client there. Your local attorney should be able to help you determine what your local courts will uphold. To minimize conflicts keep within that limit.

Blue Pencil Rule: Many courts follow the "blue pencil" rule, which means if an agreement is too restrictive, the courts can modify it so that it is, in their eyes, reasonable and then enforce it. For example, a court could rewrite a five year restriction to two years or a 50 mile radius to 10 miles. In some states (Missouri and Georgia), the "blue pencil" rule is prohibited, and courts must harshly uphold the entire non-competition agreement as drafted or completely invalidate it. Clearly, it is important to determine the rules in your state before drafting such an agreement.

New Employer Liability: In many states, employers who lose an employee to a competitor in violation of a non-competition agreement can sue the new employer, as well as the old employee. In these states, employers are reluctant to hire away employees who have non-compete agreements. The best approach for employees in these states is to let their prospective new employer know about the non-compete so that the employer is not later "surprised" with a lawsuit by the old employer. The new employer may decide that the non-compete agreement is invalid, or may be willing to assist the employee, including payment of legal expenses, in the event of a lawsuit by the former employer.

Employers also can be held liable if they hire someone who violates an agreement with a previous employer. In some cases, employers can recover damages from both the former employees and their new employers. To protect your hospital from these kinds of claims,

hospital administrators should ask all potential employees to disclose if they are subject to any non-competition agreements.

REMEDIES: Before a hospital considers an action for breach of the agreement there are couple of things for the employer to consider.

The first is do you have clean hands. Before proceeding be very, very sure that you are not in “material” breach of the agreement yourself, especially when the non-competition agreement is found within an employment contract. Breach of the agreement by the employer can invalidate the non-competition clause and perhaps even the entire employment agreement leaving the employer so called, “holding the bag.”

These kinds of employment disputes frequently generate anger and hard feelings on both sides. Employers who get embroiled in these disputes should anticipate countersuits. These often come in the form of counterclaims for discrimination, harassment, unpaid wages, or any of a variety of other perceived wrongs.

Employers often want to use these agreements as hammers to punish miscreant employees. They should do so with caution as the employer may be liable for the employee’s attorney’s fees and costs if he/she can prove that: the scope of the covenant is unreasonable, the employer knew at the time the agreement was signed that it was unreasonable, or that the employer has attempted to enforce the covenant to a greater extent than necessary to protect its goodwill or other business interests.

If you proceed, there are basically two remedies for employers who show that an ex-employee has violated or breached the non-competition agreement.

The first is injunction. An injunction is a court order prohibiting someone from doing a specified act. Here, it would be an order prohibiting the employee from working in violation of the agreement. To obtain injunctive relief to stop violation of a non-competition agreement, one must generally prove irreparable harm. Irreparable harm may exist when there is a continued breach of a non-compete agreement by a highly-trained employee especially where the damages resulting from the breach are hard to quantify or cannot be compensated in money. In determining whether to grant temporary injunctive relief, the court must balance probable harm to the employer if the injunction is not issued with probable harm to the employee if it is.

In addition to injunctive relief, a court may award monetary damages. Monetary damages, in these cases, are often hard to quantify. To cover that eventuality, non-compete agreements should contain a reasonable liquidated damages provision.

NON-SOLICITATION

A non-competition agreement restricts an employee from working in competition with his/her employer. A non-solicitation agreement allows him to work in competition with the employer but restricts his actions while doing so.

Solicitation, for this purpose, can be considered as an invitation to do business. There are two forms of solicitation affected by employee non-solicitation agreements:

Customer Non-solicitation: The first form of non-solicitation agreement occurs when an employee agrees not to solicit or do business with the employer's customers. As a general rule, a common law duty of loyalty should prevent an employee from soliciting his/her employer's customers while still employed by the company.

Unfortunately, as with a lot of things legal, what actually constitutes "solicitation" is subject to interpretation. The employee may legitimately notify customers that he/she is leaving the employ of his company before the actual time of the termination. Casual conversation with a customer is not usually considered solicitation unless the casual conversation actually leads to an invitation to do business.

When employees solicit business away from their former employer, they commonly use knowledge of their former employer's customers and/or pricing schedule. Both, may, under the Uniform Trade Secrets Act, be protected as "trade secrets."

The definition of what constitutes "trade secrets" is also somewhat uncertain. Generally, a trade secret is information that is closely guarded by the practice, it likely cost the company at least some effort and expense to develop, and is not generally available to the public. As "trade secrets" an employer might be able to enforce a non-solicitation agreement that prevents former employees from using the company's customer and/or price lists to solicit their business.

To effectively do so, the practice must show that the information has value to the practice and that they have made reasonable efforts to safe guard the information. For example, where the customer/price lists are kept, access must be limited to those employees with a demonstrated need to access it. If anyone in the practice or, for that matter, any member of the public can get to the list, it will probably not be considered a trade secret. Computerized practices can limit access by password. Non-computerized practices should keep the list in a locked safe or file cabinet with only certain people having keys.

Having a confidentiality clause in the employee's contract along with a strong confidentiality policy statement in the practice manual can go a long way to show the importance of the material to the practice and that the practice has made efforts to keep the material secret.

Often, non-solicitation agreements will cover only those clients who the employee met and worked with directly during the employment relationship. Generally, the restriction will only apply to active clients in existence on the date of termination and not to inactive or prospective clients. The duration of inactivity is determined on a case by case basis. Look to the medical record retention time mandated by your state veterinary practice act for guidance. An informed local attorney can also find guidance in the business records sections of your state codes.

Employee Non-solicitation: The second form of non-solicitation agreement occurs when the employee agrees not to solicit the other employees with job offers before or after his or her employment terminates. This kind of agreement is particularly important where the employee is

popular and may take others with him/her when they leave. We are not a slave holding society so nothing, absent a contract, can prevent an employee from leaving if they wish. A non-solicitation agreement simply prohibits the departing or departed employee from making job offers to the existing employees.

As with the non-competition agreements discussed above, the enforceability of non-solicitation agreements often depends on their reasonableness. For example, agreements that aim to prohibit all manner of contact, even social contact, between a departing employee and his colleagues, will not be upheld. Reasonableness is also often determined by the duration of the restriction. One or two years is generally considered reasonable.

Examples of Non-Solicitation Agreements:

Another Disclaimer: These are educational examples only and are not offered or intended as specific legal advice.

Customer Non-Solicitation: In order to protect (Insert practice name)'s Confidential Information, during the term of my employment at (insert practice name) and for XX (XX) consecutive calendar months following the termination of my employment for any reason, I agree that I will not, either on my own behalf or on behalf of any other person or entity, directly or indirectly, solicit, or assist anyone else to solicit as a veterinary customer any person, or entity who is or was a customer of (insert practice name) and with whom I, or those employees reporting to me, had Material Contact. For the purpose of this Non-Solicitation Agreement, Material Contact shall be defined as personal contact or the supervision of those who have direct personal contact with a customer or potential customer.

Employee Non-Solicitation Agreement: During the term of my employment at (insert practice name) and for XX (XX) months following the termination of my employment for any reason, I agree that I will not, either on my own behalf or on behalf of any other person or entity, directly or indirectly, hire, solicit, retain, or encourage to leave the employ of (insert practice name) or assist any other person or entity in hiring, soliciting, retaining or encouraging any person who is an employee of (insert practice name).