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## GENERAL COUNSEL NOTE

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2008

Effective January 1, 2008, Tennessee law now permits employers of physicians to impose covenants not to compete as a condition of employment. The new statute, T.C.A. § 63-1-148, was passed in reaction to a decision of the Tennessee Supreme Court issued on June 29, 2005 in which the Court ruled that physician non-competition agreements were unenforceable and void in Tennessee unless specifically authorized by statute. *Murfreesboro Medical Clinic P.A. v. David Udom*, 166 S.W.3d 674 (Tenn. 2005). The effect of this decision was broadly to invalidate non-competition agreements between physicians and independent group practices because, at the time it was rendered, there was no specific statutory authorization for such agreements. By contrast, the *Udom* Court left undisturbed the rights of hospitals and hospital-affiliated employers to impose restrictive covenants on physicians, as such employment restrictions had been specifically authorized by statute. The new statute levels the playing field by permitting all employing and contracting entities to enter into non-competition agreements with health care providers. Independent group practices, as well as hospital and hospital-affiliated employers, are therefore now free to enter into reasonable non-competition agreements.

### Restrictive Covenants and the *Udom* Decision

As a general matter, covenants not to compete are disfavored in Tennessee as a restraint on trade. *See Hasty v. Rent-A-Driver, Inc.*, 671 S.W.2d 471 (Tenn. 1984). Such covenants are enforceable only when an employer can show a legitimate business interest in need of protection and that the covenant is limited to the time period and geographic area reasonably necessary to protect the business interest. Non-competition agreements that raise public policy considerations are even more strictly construed.<sup>1</sup> Prior to the *Udom* decision, Tennessee courts had generally applied the “reasonableness” standard when analyzing physician non-compete agreements, and public policy considerations had not been relied upon to strike down otherwise valid agreements. *See Med. Educ. Assistance Corp. v. State*, 19 S.W. 3d 803 (Tenn. Ct. App. 1999). The *Udom* court, however, found that non-competition agreements with physicians that were not specifically authorized by statute were contrary to the public good and, therefore, unenforceable.

The case involved a non-competition covenant in an employment agreement entered into by an internal medicine physician, David Udom, and a private medical practice, Murfreesboro Medical Clinic (MMC). The covenant required that, upon termination of Dr. Udom’s employment agreement, he would not engage in the practice of medicine within a twenty-five (25) mile radius of the public square of Murfreesboro, Tennessee for a period of eighteen (18) months. The agreement contained a “buy-out” clause under which the covenant not-to-compete would be waived if Dr. Udom paid an amount equal to one year’s salary and reimbursed moving expenses paid by MMC on Dr. Udom’s behalf. One month prior to the expiration of Dr. Udom’s

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<sup>1</sup> Citing its decision in *Spiegel v. Thomas, Mann & Smith, P.C.*, 811 S.W.2d 528 (Tenn. 1991) (law firm’s deferred compensation plan contained restrictive covenant that was void as against public policy), the Court compared the practice of medicine to the practice of law and noted the American Bar Association’s position that restrictions on legal practice are unethical as they limit the public’s access to lawyers.

employment contract, MMC gave him notice that it did not intend to renew his contract. Following inquiries from Dr. Udom, MMC informed him that the non-compete agreement precluded him from accepting a position as a hospitalist at Middle Tennessee Medical Center (MTMC), from retaining clinical privileges at that facility, and from accepting a position at the Veterans Administration hospital in Murfreesboro, despite the fact that neither MTMC nor the VA hospital directly competed for patients with MMC.

Dr. Udom then notified MMC of his intention to open a medical practice in Smyrna, Tennessee within the non-compete area specified in his contract, and that he did not intend to seek a waiver as provided in the non-compete agreement. MMC sought to enjoin the opening of the practice, and the trial court granted a temporary injunction. After the Court of Appeals sustained the lower court's holding that the non-compete clause was enforceable, Dr. Udom appealed to the Supreme Court.

The Court held that, absent specific statutory authorization, non-competition agreements involving physicians are unenforceable as against public policy. In declaring non-competes between group practices and their employed physicians unenforceable, the *Udom* Court concluded that such agreements are inimical to the public interest because they inhibit access to services and disrupt physician-patient relationships that, in contrast to general business relationships, require a unique level of trust and confidence in the protection of personal information.<sup>2</sup> Patients' rights to freedom of choice and the benefits to Tennessee communities of having access to an increased number of practicing physicians outweighed the business interests of employers in restricting competitive practice, according to the *Udom* Court. Importantly, the decision preserved the right of a hospital or hospital-affiliated employer, as well as a faculty practice plan associated with a medical school, to enter into non-competition agreements with physician-employees under certain limited circumstances because such agreements, unlike those between independent group practices and their employees, were explicitly authorized by statute.

### **Legal Landscape for Hospital and Hospital-Affiliated Employers**

Throughout the period prior to and following the *Udom* case, Tennessee statutory law has permitted an employer to impose a limited restrictive covenant on a physician-employee if the employer is a hospital or affiliate of a hospital, or a faculty practice plan affiliated with a medical school. T.C.A. § 63-6-204. A hospital or hospital-affiliated employer that has made a bona fide purchase of a physician's practice assets may restrict the physician from practicing medicine upon termination of employment, but only if the restriction is for not more than two (2) years and within a geographic area that does not exceed the greater of the county in which the primary practice site is located or a ten (10) mile radius around such site. Employment agreements and medical practice sale agreements that contain these restrictions must permit the physician to elect to remove the restrictions and to continue medical practice by re-purchasing the medical practice

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<sup>2</sup> "The right of a person to choose the physician that he or she believes is best able to provide treatment is so fundamental that we can not allow it to be denied because of an employer's restrictive covenant." *Udom*, at 683.

that was sold to the employer for its original purchase price or, if the parties so agree, a price not to exceed the fair market value of the practice at the time of the buy back. Upon a physician's re-purchase of his or her medical practice in accordance with the statute, the restrictive covenant is voided.

In instances in which a hospital or affiliate of a hospital employs a physician independently of a bona fide practice purchase, the employer may only restrict physicians who have practiced for five (5) or more years in the county where the hospital or primary practice site is located from soliciting or treating patients seen during the course of the employment, and then only for one (1) year or less following termination of the employment agreement. For a physician who has practiced in the county for less than five (5) years, the employer may only restrict the physician's right to directly solicit patients seen during the course of the employment, but the physician is free to *treat* any patient. In the event that the hospital or hospital-affiliated employer terminates an employment contract with a physician employed independently of a bona fide practice purchase for reasons other than a breach by the physician (i.e. a "without cause" termination by the employer), the restrictive covenant is void and no longer effective.

The *Udom* decision did not affect the rights of hospital and hospital-affiliated employers to impose such restrictions because its ruling explicitly does not apply to non-compete agreements rendered enforceable by statute. Group practices did not fare so well, however, as statutory protection for physician non-competes in agreements with non-hospital employers did not exist at the time of the *Udom* decision.

### **Recent Statutory Authorization of Restrictive Covenants**

In the aftermath of the *Udom* case, the Tennessee General Assembly, at the urging of many physician groups and practices, enacted new legislation in an attempt both to restore the ability of practices to enter into reasonable non-competition agreements with their physician employees and to define the limits of such agreements. Of note, the new law applies to all employers, including group practices, and permits reasonable non-competition restrictions to be imposed not only on most physicians, but also on podiatrists, chiropractors, dentists, optometrists, psychologists and certain other licensed health care providers. T.C.A. § 63-1-148. As a result of the new statute, hospital and hospital-affiliated employers and faculty practice plans now apparently have two statutes under which they might proceed, and it will be important for attorneys representing such organizations to review with their clients the application of each of these statutes to particular facts in order to determine how best to craft and interpret agreements.<sup>3</sup>

The new statute permits agreements within employment agreements and other written contracts (such as shareholder agreements, partnership agreements, and independent professional services

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<sup>3</sup>In a case involving allegations of a physician's anticipatory breach of a non-compete agreement with the faculty practice plan that employed her, the Tennessee Supreme Court suggested in a footnote that both T.C.A. § 63-6-204 and the newly adopted T.C.A. 63-1-148 would have authorized the non-compete at issue. *UT Medical Group v. Vogt*, 235 S.W.3d 110, 113 (Tenn. 2007).

agreements) which restrict the health care provider from practice upon termination of the employment or contractual relationship so long as the restriction is:

- in a written employment agreement or contract signed by the parties;
- for a duration of two (2) years or less; and
- limited to either:
  - a geographic area not to exceed the greater of a ten (10) mile radius from the health care provider's primary practice site or the county in which the primary practice site is located; or
  - where no geographic restriction is specified, any facility at which the employing or contracting entity provided services during the contract or employment term.

Such a restriction is not binding on a physician who has been employed by, or under contract with, a group for at least six (6) years. This six-year "burn off" provision indicates a legislative intent to permit more senior physicians within a group to leave the group, take group patients with them, and establish a practice within the same community.

The statute provides more flexibility for noncompetition agreements in the context of an employment agreement or contract entered into in conjunction with the purchase or sale of a health care providers' practice or substantially all of the assets of the practice. In this circumstance, there is no six (6) year "burn-off" provision, so non-competes that are part of an agreement to sell or purchase the provider's practice are enforceable even if the provider has practiced more than six (6) years with the practice. In this respect, the law provides additional comfort to purchasers of medical practices who wish to prevent selling physicians, regardless of seniority, from establishing a competitive practice that might undermine the benefit of the bargain contained in the purchase agreement. In addition, in the case of a sale or purchase of a practice, the statute does not define the parameters of what constitutes a reasonable restriction on the duration and scope of a non-competition agreement, but instead provides for a rebuttable presumption that the parameters agreed upon by the parties in such an agreement are reasonable. It remains to be seen what additional restrictions Tennessee courts would consider to be "unreasonable" even if agreed upon by parties in this context. While the law provides for deference to parties to a purchase and sale agreement who wish to negotiate for slightly longer durations or broader geographic areas than are permitted outside the purchase and sale context, buyers and sellers of medical practices should be mindful of the general hostility of the courts to restrictive covenants in Tennessee when crafting such agreements.

## **Conclusion**

The *Udom* decision did not affect the rights of hospitals and hospital-affiliated employers and faculty practice plans to enter into non-competition agreements that were already permitted by statute at the time of the decision. The new non-competition statute that went into effect at the

beginning of 2008 makes clear the Tennessee General Assembly's intent that reasonable restrictive covenants should be enforceable notwithstanding the public policy analysis presented by the *Udom* Court. The new statute further defines the ability of health care providers and those with whom they contract to enter into restrictive covenants. Permitted restrictions under both statutes are limited in scope, however, and Vanderbilt clients are advised to consult with the Office of the General Counsel when questions arise regarding non-competition agreements in physician offer letters or other contracts.

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