Colorado Court of Appeals Issues Needed Guidance on Physician Non-Compete Agreements

The inclusion of a non-compete agreement, or covenant not to compete, is frequently one of the most anxiety-producing issues in physician employment contracting on the part of both the physician and the employer. This has been particularly true in Colorado, given the lack of case law interpreting its physician non-compete agreement statute. On March 8, 2018, however, the Colorado Court of Appeals issued much needed guidance on that statute in ***Crocker v. Greater Colorado Anesthesia, P.C.*, 2018 COA 33**.

Enacted in 1982, Colorado's physician non-compete statute provides:

> Any covenant not to compete provision of an employment, partnership, or corporate agreement between physicians which restricts the right of a physician to practice medicine . . . upon termination of such agreement, shall be void; except that all other provisions of such an agreement enforceable at law, including provisions which require the payment of damages in an amount that is reasonably related to the injury suffered by reason of termination of the agreement, shall be enforceable. Provisions which require the payment of damages upon termination of the agreement may include, but not be limited to, damages related to competition.

C.R.S. § 8-2-113(3). Despite its year-of-enactment and rather inscrutable language, prior to *Crocker*, C.R.S. § 8-2-113(3) had been the subject of only a single published Colorado appellate decision—*Wojtowicz v. Greeley Anesthesia Servs., P.C.*, 961 P.2d 520 (Colo. App. 1997). In *Wojtowicz*, the Colorado Court of Appeals held unenforceable a liquidated damages clause calling for a physician to pay 50 percent of his fees generated from practicing medicine in competition with his former employer for two years following the termination of his employment. *Id.* at 523. The *Wojtowicz* division reasoned that the record indicated that "net profits to [the former employer] remained essentially the same as they were prior to the termination of [the physician's] employment contract," and thus the damages in the amount of 50 percent of the physician's fees were "not reasonably related to the injury suffered" by the former employer and were unenforceable under C.R.S. § 8-2-113(3). *Id.*

The *Crocker* division greatly expanded upon this analysis. The plaintiff in *Crocker* was an employed physician and shareholder in Greater Colorado Anesthesia, P.C. ("GCA"). He was subject to an employment agreement requiring him to pay liquidated damages if he competed with GCA within 15 miles of a hospital served by GCA in the two years following the termination of his GCA employment agreement. 2018 COA 33 ¶¶ 2, 14. The non-compete agreement also included acknowledgements by the physician that GCA had invested substantial sums on him, that GCA would suffer damages if he were to compete with GCA during the two years following termination of his employment agreement, and that "a court may change unreasonable terms to the extent necessary to make the provision enforceable." *Id.* ¶ 14. The agreement went on to provide a liquidated damages formula that essentially called for the physician to pay an amount equal to the profits GCA had earned on his work, averaged over the three years prior to termination of the agreements, multiplied by two to reflect two years of competition, "plus $30,000 to cover the estimated internal and external administrative costs to terminate and replace the competing doctor." *Id.* ¶ 25.

The *Crocker* division concluded that the non-compete was unenforceable because the physician was forced out of his employment by reason of his dissenting to a merger between GCA and another company. Importantly, however, it also concluded that, to be enforceable, the liquidated damages sought "must be reasonably related to the injury actually suffered and not simply related to an injury prospectively estimated at the time of contract formation." ¶ 12. The court noted that the trial court had properly determined that "the amount of injury . . . GCA suffered because of [the physician's] departure was zero" because there was no evidence of any work diverted to him, any lost revenue or profit caused by his departure, or "anything other than conjecture to support the administrative costs portion of the formula." *Id.* ¶ 24.

Critically, the court went on to reject GCA's argument that validity of a liquidated damages provision should be measured as of the time the contract was executed. *Id.* ¶ 26. Rather, the court held that the plain language of C.R.S. § 8-2-113(3) permits only damages "reasonably related to 'the injury suffered,' *in the past tense*." *Id.* ¶ 30 (emphasis added). That is—the reasonableness of the damages "can only be determined upon termination of employment." *Id.* And, the court apparently declined the invitation in the physician's contract to reform, or "blue pencil," any "unreasonable terms to the extent necessary to make the provision enforceable."

As a result of this case, Colorado employers using non-compete clauses in their physician employment agreements will need to evaluate whether their current contracts comply with *Crocker*'s interpretation of Colorado's physician non-compete statute. Contract clauses purporting to establish liquidated damages through either a sum certain or a formula tied to a prospective damage calculation are no longer enforceable. Instead, restrictive covenants must now be structured to reflect that the remedy for breach is damages in the amount of the employer's actual injury suffered to be determined post-termination.

It remains to be seen whether GCA will try to appeal this case to the Colorado Supreme Court. In the meantime, parties seeking to enforce a non-compete clause containing now outdated language will be out of luck as the court in *Crocker* not only refused to do so, but also refused to reform the non-compliant portion of the restrictive covenant.

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This memorandum is intended to provide you with general information regarding the Colorado Court of Appeals' interpretation of C.R.S. § 8-2-113(3). This memorandum is not intended to provide specific legal or tax advice. If you have any questions or if you need legal advice as to a specific benefit plan or employment law issue, please contact one of the following members of the Brownstein Hyatt Farber Schreck Employee Benefits Executive Compensation Group or Employment Law Group: