

Annotated Model Physician Employment Agreement

2008 updated edition

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May 2008

Dear Colleague:

Physician employment is an integral part of the practice of medicine. Many physicians today are employed by small group practices, multispecialty group practices, medical faculty practice plans, hospitals or other institutions. With more medical students than ever entering the work force, this trend is likely to continue and accelerate. At some point in their careers, most physicians will likely be party to an employment agreement.

The American Medical Association (AMA) Office of the General Counsel has developed this Annotated Model Physician Employment Agreement as a resource for physicians who want to be prepared to negotiate an employment contract. While this manual is not a substitute for legal advice, it provides a description of basic contract terms typically found in employment agreements, as well as in-depth explanations, recommended language examples and alternative provisions. It also includes a detailed summary of the tax implications of compensation and employee benefit packages, a description of the distinctions between employee status and independent contractor status, and a compilation of selected state laws on several other relevant issues affecting employed physicians, such as corporate practice of medicine and restrictive covenants.

On behalf of the AMA, I hope you find this manual a useful resource at this important juncture in your career. Should you have any questions, please call the AMA Health Law Division of the Office of the General Counsel at (312) 464-4631.

Sincerely,

A handwritten signature in black ink that reads "Michael Maves". The signature is written in a cursive, flowing style.

Michael D. Maves, MD, MBA

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••• Introduction

The rise of physician employment

With the ongoing economic reorganization of health care, more newly graduated and established physicians are becoming employees in established medical groups, managed care organizations, health care institutions or group practices that they form with other physicians. As a result, physicians are increasingly covered by employment contracts. This manual is written to assist both physician-employees who are entering into employment contracts and physician groups that employ physicians.

The scope of this manual

A vast body of law governs employer and employee relations. This manual *does not* cover:

- State and federal statutes and regulations, Occupational Safety and Health Administration and workers' compensation, and/or the myriad collateral legal issues physicians face in their daily practice
- Employment agreements between a professional corporation and its sole shareholder, which are primarily tax-driven documents, rather than a contract negotiated at arm's length between two or more parties
- Independent contractor arrangements (the benefits and disadvantages of such arrangements are discussed in Appendix B, pages 37 and 38)
- Employment agreements between an employee-shareholder or employee-partner and an employing medical group (if the employee is a shareholder, the employment agreement would be significantly different and would interact with shareholder agreements and buy-sell agreements, as well as other corporate documents, while the corporate planning involved in such interactive agreements is usually individualized to the group and thus is beyond the scope of this manual)

Legal representation

It is strongly recommended that the employer and potential employee each retain an attorney specializing in physician business transactions to assist in evaluating and negotiating the employment contract. The issues in

such contracts not only involve complex legal relationships based on contract, employment and tax law, but also go to the pragmatic heart of working relationships affecting the day-to-day practice of medicine.

The employment contract not only establishes the expectations in the relationship, but governs the tone of the relationship as well. A lawyer's experience in working with physicians on these practical issues can be very important to the success of the overall arrangement. This manual does not constitute legal advice and cannot substitute for individual analysis by a legal advisor experienced in handling physicians' affairs consistent with the applicable state law.

Establishing goals

Physicians should review this manual and consult their counsel well before engaging in any interviews or starting negotiations for any particular employment opportunity. As in all relationships, both parties should identify the financial and professional goals that are important to them. Consider whether eventual partnership in the practice is an option and what value an ownership interest will have in the long term. Evaluate the growth potential for the practice, the payer mix, post-termination restrictions and other opportunities for professional growth. Due to the myriad individualized questions for the medical group and the potential employee, it is recommended that both the employer and employee evaluate their short- and long-term priorities.

Many physicians and medical groups fail to explore their goals, aspirations and objectives. The time to think about your future and to do something about it is *before* the contract is signed, preferably before negotiations begin. Know what you want and why you want it, then ask for it. You will have a more positive and open employment arrangement if both sides are candid with each other from the outset.

Intangibles

There are many considerations that factor in the decision to enter into an employment contract. The employer must consider whether the employee's credentials, personality and manner of practice are right for the position. The physician-employee must consider the geographical location of the practice, the personalities of the other physicians, the type of work he or she will be doing, the short- and long-term economic prospects for the overall practice, and the amount of time the position will leave for other professional and nonprofessional activities.

While this manual focuses mainly on the language of the contract, the intangible issues must be seriously considered by both parties before an employment relationship begins. The best-drafted contract cannot create and sustain the chemistry necessary to establish and maintain a long-term relationship. A good working relationship can only be built on a basis of trust, mutual respect and integrity. These and other intangibles should be carefully considered and evaluated when considering a long-term arrangement.

Employer due diligence

References: Employers should contact as many references as possible before hiring a physician. Subject to advance approval by the candidate and confidentiality considerations, references can include the prospective employee's current or former residency chiefs, colleagues and physicians. If a potential employee has not been recommended by someone whose judgment you trust, check and check again, even if the physician has letters of recommendation. Always verify the physician graduated from medical school, successfully completed training and presently has a valid, unrestricted license.

Interviews: All jobs are composed of several identifiable performance requirements. Physician performance issues may include diagnostic ability, technical clinical skills, interpersonal skills and teamwork. A good interviewing approach is to hypothetically put physician-employee candidates into a variety of realistic situations in which they can demonstrate their skills. For example, you can present applicants with several case descriptions containing symptoms, vital signs, and other diagnostic and personal information typical of cases encountered at your practice. The potential employees may be asked to discuss or write how they would proceed with the case, what questions they would ask and what tests they would order.

Joint patient care: You may also wish to do several joint consultations with the candidate while you retain ultimate responsibility. During the process you can observe the quality of the clinical decisions and the nature of the patient-colleague interaction. Or, you may ask to observe the candidate in his or her current work setting.

Employee due diligence

Complete due diligence should be reserved for finalists, perhaps only your top two or three choices. Remember to

never turn down your second- or third-choice applicant until your first choice has signed the employment agreement and is committed to coming to work.

Use advisors: Many physicians lack formal business training. Premedical courses and medical school curricula unfortunately do not always prepare physicians well for business issues they will confront in practice. Consequently, all physicians are urged to learn the "physician business," even if they are becoming employees in large groups and may not initially be involved in management. To that end, physicians and medical groups should engage knowledgeable advisors and consultants early and learn from them. Ask your advisors why they are giving you particular advice, and study how your advisors analyze and address practice-related problems.

Market research: Physicians should understand market conditions and market trends that affect them. As much as their employers, physician-employees need to know whether the group has a strong position in the marketplace as it exists—and as it evolves. Who are the employer group's current payers? What are the payer mix and demographics of the patient population? What is the strategic direction of the group? What are the intentions of the payers in the market? Will the employer be a major player in the future? The employer should be able to clearly share its plans for where it wants to be in one year, three years and five years. The employee should be confident the group's goals are realistic, achievable and in harmony with the employee's own objectives for that time frame.

Finance and business: A potential physician-employee should look into the long-term obligations of the group. Are any of the doctors in the group planning to retire? Will the rest of the physicians be obligated with a large buyout? Will capital be needed for other reasons, for example to upgrade facilities, reorganize, convert to managed care or pay for the demands of other market changes? Physicians considering executing an employment contract would be prudent to request background information about the employer, such as corporate documents and financial statements. The physician should also investigate the employer's history of hiring other physicians and talk to as many current and former physician-employees as possible in order to determine the employer's financial viability.

Management: Look into how the hiring group is managed. Does the group have a competent, full-time, professional administrator? Does that administrator have the support and cooperation of the doctors? Is the manager someone you find easy to work with? Good management is often a good

indicator of how profitable the group will be and whether the employee will be content with his or her new position. It is recommended that one inquire about the level of professional liability insurance and any pending legal matters including governmental agency investigations of the practice.

Written versus verbal agreement

A written contract is very important to both parties. It requires the parties to think clearly about their expectations and obligations in the employment relationship. Reviewing contractual language prompts physicians to think seriously about what they want out of the employment arrangement and encourages discussion of important practical issues. Real or potential misunderstandings, of which the parties were not even aware, may surface during discussion of the contract language and become clarified once the parties are required to put their understandings and expectations in writing.

Recruiting a physician is an expensive and time-consuming task for the employer. A written contract that enlists the employed physician for a set period enhances the likelihood that the recruiting investment will be amortized over time. The employee also is investing his or her time in the practice, and may have relocated or taken other important steps to work with the employer. A written contract can enhance the employee's protections, for example, by ensuring that the arrangement is not terminable at will. In a professional setting, it is generally not in the best interests of the patients or the smooth running of the medical practice to have abrupt changes. A written contract permits the employer to spell out the degree of control it plans to exercise over the relationship and allows the employee to react before actual situations arise. Both sides always benefit from a written contract.

Moreover, as the employment relationship progresses, memories tend to fade. The parties may forget precisely what was promised. A written contract serves as a clear reminder of precisely what the parties decided upon.

Finally, even the best of relationships may alter. In such cases, parties may change their minds as to the type of contract terms to which they wish to be bound. A written contract ensures that even during periods of disharmony, the parties will be required to abide by the contract terms they agreed upon. In short, no matter how perfect the deal seems or how much you trust the other party, do not rely on a handshake. It is prudent for the employee not to start work until the employment agreement is fully signed, and any and all exhibits or addenda are attached and initialed.

Negotiation

It is almost always appropriate to negotiate a contract. In fact, many contracts include provisions that are intended to be negotiable. There may be circumstances where a medical group or other type of employer uses standardized contracts that are never negotiated and physician-employees will have to decide whether that contract, as is, is right for them. The refusal to entertain or consider changes to a contract may be an indication of future working relationships or the personal style of the employer. The bottom line is that a physician should never hesitate to ask questions about—and seek to negotiate—the terms of an agreement.

No employer or employee should ever execute an employment contract that does not fully address (as terms and conditions) all the expectations and representations relating to the proposed employment. All too often physicians sign incomplete employment agreements thinking that omitted issues can be addressed as they come up. This is risky. If agreement on the unaddressed issue cannot be reached later, both parties could be in a position of risking the employment relationship over a detail that very likely could have been resolved with foresight. Listen to your intuition, practice common sense and work out all of the possible issues you can think of before you sign.

Drafting

There is always a distinct advantage in having your attorney draft the employment contract. As illustrated throughout this manual, there are pro-employer and pro-physician positions on many issues. By beginning with a draft that favors your interests, you are most likely to retain the overall language that benefits your position. It is, however, more common for the employer to control the contract format.

If an employer presents you with a contract, you should always consider treating it as a rough draft. Read every word contained in the contract carefully and mark everything that you do not understand or that you feel should be changed or added. Discuss these points with your attorney or advisor, who, in turn, can raise them with the other side. Physicians should not be afraid to bring up any and all points they consider unclear or confusing, despite the usually mistaken belief that they will be perceived as naive. Often, a lack of clarity in contract language reflects a lack of clarity about an issue. It is better to clarify all issues before the contract is signed.

••• Model employment agreement

How to use this model agreement

The purpose of this model employment agreement is to provide information concerning issues commonly presented in physician employment contracts. In this model employment agreement, the wording of possible clauses is laid out with explanatory comments given below each clause. Do not select contractual language without reading the comments and without consulting your attorney. Where applicable, this model presents pro-physician and pro-employer positions, and possible compromise language. It is designed to present the concerns of both parties.¹

This model is not intended to be used verbatim. The language in an actual contract will be the product of negotiations between the parties and will reflect the specific employment situation. Some of the model provisions may be inapplicable, inappropriate or not sufficiently detailed.

Brackets [] are used to indicate optional language or language indicating a subject of negotiation between the parties. For example:

“Remuneration from medical-related teaching, lecturing, writing, directorships, etc., shall belong to [Employer or Physician].”

The language in brackets means that either the word employer or physician could be chosen. Physicians deciding whether to enter into any particular employment contract are cautioned to make an independent decision based on their personal circumstances and on the advice of their counsel. This model is for general informational purposes only and is not intended as legal advice. Physicians should consult an attorney specifically experienced in handling physician business transactions for a personal legal opinion. Salary is typically just part of the financial package. Deferred compensation arrangements should be reviewed by a tax or legal expert familiar with Internal Revenue Code Section 409A and emerging Internal Revenue Service (IRS) regulations.

1. This model is also not intended to be used in collective bargaining situations. Given the increased interest in physician unionization, doctors should be aware that collective bargaining agreements are highly technical and subject to rigorous regulation under labor laws. At the other end of the spectrum, this contract is not intended to cover participation in loosely organized independent practice associations (IPAs). However, as IPAs become more integrated and more closely resemble medical groups, provisions of this model may become applicable.

••• Physician employment agreement

1. Preliminary considerations and basic agreements

1.1 Parties

This Physician Employment Agreement (“Agreement”) is made by and between _____ Medical Group, [Inc., PC, SC, MC, LLC, LLP], a [professional corporation, service corporation, medical corporation, limited liability company or limited liability partnership] organized under the laws of the state of _____ (“Employer”), and _____, [MD or DO], a physician licensed to practice medicine in the state of _____ (“Physician”).

The agreement should set forth the precise legal names of all the parties. Anyone who is required to perform obligations under the contract should be named. The party or entity that issues the paycheck should always be a party to this agreement.

If a medical service organization or hospital is operationally involved in the practice, it should also be a party to the agreement. Its role (e.g., providing facilities or practice management) should be carefully described, for the physician is relying on it in order to fulfill his or her duties under the agreement.

Likewise, the hospital should be a party to the agreement if it must perform, directly or indirectly, any obligations under a recruitment or other agreement affecting the terms of the physician’s employment or affecting the risks that the employer undertakes in hiring the physician. Even if the physician is not a direct party to the hospital recruitment contract, he or she may be relying on the hospital’s performance under the recruitment contract, e.g., to guarantee salary, so the hospital’s obligations should be spelled out clearly in the employment agreement and the hospital should be included as a party to the agreement.

Reminder: All persons or entities who are listed as parties should sign the agreement.

Verifying the name and organizational/ownership status of the employer is particularly important to ensure that the employer can legally employ the physician. Many states make

the corporate practice of medicine illegal. Under those state laws, physicians are prohibited from working for corporations or entities that are not controlled by physicians. Those laws are called the “corporate practice bar” and they are designed to protect the public from possible abuses stemming from the commercial exploitation of the practice of medicine. Accordingly, in other states, lay entities cannot legally hire physicians.

Some exceptions to the corporate practice bar may permit nonprofit, fraternal, religious, labor and educational organizations to contract with and to employ physicians to provide care under limited circumstances. In some states, certain nonprofit clinics and hospitals may also employ physicians, provided that the clinic does not interfere with, control or direct a physician’s independent medical judgment. In other states, there is no bar at all.

In Appendix C (pages 43 and 44), a chart shows the laws of 11 representative states.² To determine whether the corporate practice bar applies in your state, you should consult an attorney experienced in physician practice and business matters.

1.2 Employment

The Employer employs the Physician and the Physician accepts employment with the Employer under the terms and conditions set forth in this Agreement. The purpose of the Physician’s employment shall be to provide professional medical services on a [full or part]-time basis in the specialty of _____, which should also include _____. The Physician’s duties are set forth in paragraph three (3). The Physician is [board certified or board eligible] and will pass his or her boards no later than [date]. It is agreed that the Physician is an employee of Employer, not an independent contractor.

This paragraph establishes the employer-employee relationship. The general specialty that the physician will be practicing should be stated, as well as any particular requirements pertaining to the scope of the specialty practice. For example, it would be appropriate to specify if a family practitioner is expected to provide obstetric or gynecological services, or if a cardiologist is to perform invasive procedures.

Likewise, the agreement should specify any board eligibility or certification requirements for the job. The agreement may require that if the employee is not board certified, he or she must achieve board certification within a certain time frame.

2. California, Florida, Illinois, Maryland, Massachusetts, Michigan, New Jersey, New York, Oregon, Pennsylvania and Texas.

It is advisable to review the medical staff bylaws regarding board certification of the hospital where the physician will have privileges.

It is critical that the agreement specify the “employed” physician is being hired as an employee and not an independent contractor (see Appendix B, page 37).

A specific job description may be attached as an “exhibit.” This gives the parties latitude in changing the job description without rewriting the contract. If this is the case, sign and date the exhibit, and include a contract provision that allows revision of the job description only with consent of both parties.

2. Term

2.1 Initial term

The initial term of this Agreement shall commence on _____ (the “Effective Date”) and shall continue for ____ [months or years] thereafter subject to earlier termination (paragraph 10) or to extension (paragraph 2.2). The Physician’s first day of work shall be _____ (the “Starting Date.”)

Unless a term is otherwise specified, employment contracts are terminable at will, meaning that either party can terminate or end the employment relationship at any time. To provide stability in the relationship and comply with legal requirements, physician employment contracts normally specify a fixed term, subject to earlier termination (see section 10) or extension (see paragraph 2.2). The agreement, therefore, should state clearly its term, in other words the time period for which it is to last, e.g., one year, two years, etc.

An appropriate term from the physician’s perspective will depend on how long he or she plans to be with the group. From the employer’s perspective, it will depend on how sure they are that the physician will fit in with the existing physician group and other employees in the practice, and how easy or difficult it may be to find a replacement. From an organizational perspective, the decision may be influenced by budget or by strategic or patient care need considerations. Note that in some states the initial term of the agreement cannot exceed a specific number of years.

*The agreement’s beginning and ending dates also should be clear. In most situations, there are two dates at the beginning of the relationship that should be defined: the **effective date** and the **starting date** of the agreement. The effective date is the day that mutual obligations between the parties go into effect and become enforceable. This date may precede*

the physician’s starting date, which is the date he or she actually commences work, because the parties may need to rely on promises to each other (e.g., that the employer will stop recruiting to find a physician, or will pay the physician’s moving or other expenses before the starting date).

2.2 Extension of term

Pro-employer: The Employer shall have the right to extend this Agreement on the same terms and conditions for an additional period of _____ by giving the Physician written notice no later than _____. [If no notice of extension is given by the Employer, this Agreement shall expire at the end of the term or In the event no formal extension is signed, the Agreement shall remain in place from [month to month, quarter to quarter or year to year] subject to the termination provisions of paragraph _____, or, as alternate means of termination, subject to either party giving ____ [days’ or months’] notice of termination.

Pro-physician: This Agreement shall be renewed automatically for succeeding terms of _____ [years or months] unless either party gives notice to the other at least _____ [days or months] prior to the expiration of any term, stating in the notice the party’s intention not to renew. Any renewal of this Agreement shall be on the same terms and conditions as set forth herein, subject to any Amendment in writing and signed by both parties per paragraph _____ below.

Neutral: The term of the Agreement may be extended by a mutual written, signed agreement of the Employer and the Physician.

*The employer may wish to retain full control and discretion over the renewal or extension of the agreement. In fairness to the physician, however, notice of the employer’s decision should be given before the end of the term to allow the physician time to plan his or her career moves. At the end of the term the agreement may lapse, or the physician and the employer may agree to adopt the relatively easy position that upon expiration, the agreement shall rollover automatically for another contract period (or for some other period), unless terminated sooner by notice or by one of the termination provisions. Such a rollover includes compensation unless stated otherwise. Both employer and physician will want to mark their calendars well in advance (at least six months) of the expiration to be sure that meaningful renegotiations regarding an extension have time to take place. **Caution:** A rollover clause may commit the physician to another lengthy term and should not be used in place of negotiating a new contract.*

2.3 Probationary trial period

The first _____ months of employment shall be probationary, with periodic informal reviews of the Physician's performance by _____. During this probationary period [the Employer or either party] may terminate employment with _____ weeks' notice. During the probationary period, the Physician shall receive the compensation under paragraph _____ below, [and or but] shall [not] be entitled to other benefits specified in this Agreement.

Pro-physician: Within the first _____ months of this Agreement, the Physician may, without penalty at his or her discretion, notify the Employer that he or she does not wish to continue employment beyond the first _____ months.

Probationary periods—traditionally used as time to get to know each other—may be included in the initial term of the agreement. Often in making employment agreements, both parties have invested heavily in the hiring process and have made major commitments predicated on the stability of the employment relationship. It is recommended, therefore, that each party do its due diligence before the agreement is signed (see Introduction, pages iv and v). If sufficient investigation is performed in advance, the probationary provision will rarely be needed. Thus, a probationary clause should be considered optional and included only if the parties have real reservations.

If there are such reservations, it is possible for the physician to be hired on a temporary basis as a "locum tenens" until both parties are comfortable. Usually during a probationary period, termination is discretionary on the part of one or both parties, but a reasonable amount of notice is appropriate to ensure stability.

In institutional settings, the terms of the probationary period may be described in the bylaws or employee handbook. It is advisable to review these in employment situations with hospitals or other health care institutions.

2.4 Liquidated damages for physician's failure to report to work

Pro-employer: The Physician acknowledges that the Employer is relying on the Physician to commence employment on the Starting Date set forth above. In the event that the Physician breaches this Employment Agreement by failing to commence employment on the Starting Date, the Employer will suffer substantial damages as a result of the Physician failing to report for work. These damages include, but are not limited to, the costs of locating

a replacement, the loss of services during the search for a replacement and the costs of unused facilities. Both the Physician and the Employer agree that these damages are difficult to predict and to determine, and they have, therefore, agreed to the amount of \$ _____ as the amount of liquidated damages (not a penalty) to be paid by the Physician to the Employer in the event that the Physician fails to commence his or her employment as required by this Agreement.

3. Duties of physician

3.1 Scope of physician's duties

The Physician shall provide professional medical services in the Physician's specialty on a [full or part]-time basis to patients of the Employer. The Employer will assign patients and distribute payer mix [at the Employer's sole discretion or equitably]. The Physician shall also perform such other services relating to the practice of medicine as the Employer may assign from time to time.

The paragraph on physician's duties sets forth the physician's responsibilities—both medical and administrative. It is not uncommon for institutional employers to describe the duties of the physician in an exhibit, attachment or job description. Make sure that it is incorporated by reference to the agreement and that any revision to it requires the dated signatures of both parties to the agreement.

3.2 Hours

The Physician's required hours of practice shall be at least _____ days per week, _____ hours per day, and may include holiday, weekend and evening hours, as determined by the Employer, as may be necessary to provide patient care and assigned administrative services. The Physician shall also be expected to spend such time as necessary to remain on active staff at _____ Hospital(s). The Employer will make up call schedules for the practice on [a semimonthly or monthly basis, or an equitable and rotating basis with other physician-employees]. The Employer may, from time to time, exercise its right to extend or curtail the Physician's hours.

Hours include the general times during which the physician may be required to provide services and call coverage, such as nights, weekends and/or holidays. Note that the agreement should be drafted to specify how call will be assigned (e.g., on a seniority or equal basis). Required call rotation may also be attached as an exhibit or included in the position description.

3.3 Administrative and miscellaneous duties and responsibilities

The Physician will cooperate with the administration of the medical practice. Such cooperation shall include, but not be limited to, the following: maintaining medical records in a timely fashion, billing, peer review and the Employer's compliance programs. The Physician shall provide appropriate supervision and review of services rendered by physician assistants and other nonphysicians involved in the direct medical care of the Employer's patients.

In addition to treating patients, physicians in private practice must accept some administrative duties. At a minimum these duties include oversight of the physician assistants, nurses and other personnel with whom he or she works. If the employer wishes the physician to undertake other more complex administrative duties (e.g., overseeing the computer network or reviewing managed care contracts), the scope of these duties should be discussed, the anticipated time involved should be estimated and the parties should decide whether additional compensation is merited for the additional services. Those duties and any additional compensation should be specified in the agreement.

Institutional employers may require participation on committees, teaching and community service activities, which should be included in the job description with clarification regarding whether such activities are in addition to hours worked per week.

3.4 Billing and compliance

The Physician shall not directly submit a billing or statement of charges to any patient or other entity for services arising from the practice of medicine, nor shall the Physician make any surcharge or give any discount for care provided without the prior written authorization of the Employer. The Employer has complete authority to assign patients to various employees, set fees, determine write-offs and take any other action relating to billing and collection of fees for clinical services. All accounts receivable generated for services rendered by the Physician pursuant to this Agreement are the property of the Employer.

The Physician shall participate in all compliance programs adopted by the Employer. The Physician shall have the right to review any and all billings for his or her services bearing his or her name or provider number. The Physician is required to request the correction of any errors including providing a refund to payers if warranted.

With the increase in fraud and abuse enforcement, and the potential for financial, disciplinary and even criminal penalties, physicians and medical groups must work together to carefully ensure that billings are accurate. In fraud and abuse proceedings, errors by billing clerks or outside billing services are imputed to the billing physician. All physicians are responsible for the accuracy of their billings. Therefore, billings should be viewed regularly and any corrections made. Furthermore, to ensure adherence to the law, medical groups should consider adoption of compliance programs in which participation of all physicians is required.

3.5 Rules and regulations

The Physician agrees to abide by rules, regulations and guidelines provided by the Employer for all employees having comparable duties, which are attached hereto as Exhibit _____. The Employer may from time to time amend, add or delete rules, regulations or guidelines at the Employer's sole discretion, and such amendment will not affect the enforceability or terms of this Agreement.

The agreement should specify whether the physician is to abide by any of the employer's rules and regulations regarding the performance of his or her duties. If so, such rules and regulations should either be attached to the agreement, or be included in a document to which reference is made in the contract (e.g., an employee handbook) and provided to the physician for review by the physician and his or her attorney before the agreement is signed.

3.6 Professional standards

The Physician shall perform his or her duties under this Agreement in accordance with the rules of ethics of the medical profession. The Physician shall also perform his or her duties under this Agreement in accordance with the appropriate standard of care for his or her medical profession and specialty.

The agreement should be carefully worded so that nowhere does it oblige the physician to adhere to a standard of care that is higher than that required by law. Under the law the physician must provide the same quality of care as provided by a reasonable physician in his or her specialty, under similar circumstances. Agreeing to provide services "according to the highest standards of competence," "of optimum quality" or per some other superlative standard, while laudatory, may create liability by holding the physician to a standard of care that is higher than that normally imposed in a malpractice action. Plaintiffs' attorneys routinely subpoena employment agreements, so the standards in the agreement should be equal to the standards of reasonable care applied in malpractice actions.

3.7 Requirement of physician to notify employer of any detrimental professional information or violation of contract rules or policies

During the term of this Agreement, the Physician shall notify the Employer immediately, or as soon as is possible thereafter, in the event that:

1. The Physician's license to practice medicine in any jurisdiction is suspended, revoked or otherwise restricted
2. A complaint or report concerning the Physician's competence or conduct is made to any state medical or professional licensing agency, including without limitation, the Medical Board of _____ [state]
3. The Physician's privileges at any hospital, health care facility or under any health care plan are denied, suspended, restricted or terminated [or under investigation] [for medical disciplinary cause or reason]
4. The Physician's controlled substance registration certificate (issued by the U.S. Drug Enforcement Administration), if any, is being, or has been suspended or revoked
5. The Physician's participation as a Medicare or Medicaid provider is under investigation or has been terminated
6. There is a material change in any of the information the Physician has provided to the Employer concerning the Physician's professional qualifications or credentials
7. The Physician's conviction of a felony or crime of moral turpitude

The Physician must also notify the Employer within ___ days of any breach of this Agreement, violations of any of the Employer's rules or regulations, whether by others or by the Physician, or if the Physician is subject to or participant in any form of activity which could be characterized as discrimination or harassment.

The purpose of this paragraph is to ensure that the employer be put on notice of any detrimental information that could adversely affect the practice.

3.8 Managed care contracts

The Employer shall make all reasonable efforts to obtain membership for the Physician in all health

maintenance organizations (HMOs), preferred provider organizations (PPOs), independent practice associations (IPAs), and any other managed care organizations with whom the Employer contracts. The Employer shall make its best efforts to ensure that the Physician is eligible to participate in all managed care contracts in which the Employer participates. If, within six (6) months, the Employer is unsuccessful in obtaining eligibility for the Physician to participate in any contract covering more than ____% of the patients in the practice [**Pro-physician:** the Physician may at his or her option terminate this Agreement on sixty (60) days' notice. **Pro-employer:** the Employer may at its option terminate this Agreement on sixty (60) days' notice. **Neutral:** either party may terminate this Agreement on sixty (60) days' notice.]

The Physician shall, as directed by the Employer, observe the provisions of all managed care contracts which the Employer may enter into on behalf of the Physician for health care services with managed care organizations, e.g., HMOs, IPAs, PPOs, medical service organizations, integrated delivery systems and physician-hospital organizations.

[The Employer, under contracts with managed care organizations, may obligate the Physician to accept a certain number of patients; the Physician agrees to accept at least the required numbers of patients, whether capitated or not.] The Physician and the Employer agree that the Physician shall have the goal of conducting at least _____ patient office visits per day, when consistent with appropriate professional standards.

It is important for any physician accepting an employment offer from a medical group or sole practitioner to ascertain what managed care contracts the medical group or hiring physician has. Participation by the employed physician in the managed care contracts may be very important to the employer, as well as to the physician. It is recommended that the physician ascertain the percentage of patients of these various plans, and the terms of reimbursement for each plan as well.

Many HMOs, as well as some IPAs and PPOs, accept new physicians to their panels. However, an IPA may have "closed" the IPA panel to participation by new physicians. This is particularly prevalent in specialty IPAs.

Therefore, when evaluating an employment relationship, the employer and the physician should determine the plans—particularly IPAs—that the physician or medical group belongs to and whether they are accepting new panel members. The

agreement should obligate the employer to make reasonable efforts to obtain such membership on behalf of the physician.

In a capitated practice, it may be expected that the physician will see a relatively higher volume of patients. Therefore, the agreement may set a goal for patient visits per day. This should be discussed candidly and thoroughly by the parties prior to signing the agreement. Also, some capitation contracts specify a minimum number of enrollees to be assigned to each physician. Contractual requirements with payers, however, should never compromise quality patient care.

4. Employer's obligations

4.1 Equipment, facilities and personnel

The Employer shall provide or arrange to have provided an office and examination rooms on its premises at [address] for use by the Physician in treating and examining patients. The Employer, at its expense, shall engage the services of such administrative, nursing, scheduling and billing assistance as necessary for the Physician to fulfill his or her obligations under this Agreement.

The facilities provided shall contain such medical equipment and supplies, and shall be stocked with such medicines, drugs, dressings and other items necessary to practice the Physician's specialty. The Employer shall also furnish access to such [computer equipment,] instruments, gloves and items of wearing apparel required to perform the Physician's services under this Agreement. [All parties agree that the Physician is a third-party beneficiary of the Management Services Agreement dated _____ between _____ and _____ (exhibit ____), and has standing to enforce its terms and conditions to ensure that the facilities, equipment, supplies and services necessary to practice medicine are furnished as provided therein.]

Pro-physician: [The Physician shall have the right to interview any nurses or employees directly supervised by the Physician and to make recommendations regarding the hiring, firing or disciplining of those personnel. The Employer retains the final discretion to discipline, hire or fire any such administrative or nursing staff.]

Employment agreements generally provide that the employer will furnish all equipment and supplies required to provide the medical services called for by the agreement (medical

equipment and supplies, and possibly cell phones or pagers), with perhaps the exception of certain pieces of personal equipment (e.g., medical bag).

Increasingly, facilities and equipment services are being furnished by medical service organizations (MSOs), physician practice management companies, hospitals or others. The agreement should specify who is providing these. If it is a third party, the contract with that third party to provide the facilities and/or personnel should be attached to the employment agreement, and the employment agreement should specify that the physician has standing to enforce its terms. Such a clause ensures that the physician will have access to the means and services necessary to practice medicine.

The employer or the MSO is normally required to provide the physician with the office staff, technicians (if applicable) and nursing assistance needed by the physician in his or her practice with the employer. In the physician's interest, the agreement should specify whether the physician has any authority or input regarding hiring, firing or disciplining nonphysician personnel. Physicians who are required to supervise personnel usually want such input. By contrast, employers prefer not to be hindered in their personnel management oversight and normally retain discretion to hire, fire or discipline employees, although they may do so with the advice of the physician.

5. Physician compensation

Total physician compensation may be subject to tax, fraud and abuse, and anti-self-referral laws. Generally, pursuant to these laws, physician compensation must be fair market value demonstrating reasonable compensation. Fair market value is determined by comparing the entire compensation package, including benefits, insurance and signing bonuses, to industry standards for the relevant specialty and geographic market. In any compensation arrangement, the physician and the employer are protected from legal scrutiny when the compensation is determined to be fair market value.

Salary may be based on one of several compensation structures, such as a fixed, agreed upon sum, a percentage of the physician's production, a percentage of collections, or a salary formula that takes into consideration various managed care incentives. Examples of each of these arrangements can be found later in this manual. Likewise, bonuses may be paid as a fixed sum, a percentage of salary, a percentage of production, a percentage of collection or based on a formula.

The planning of physician compensation, particularly in the present environment of generally shrinking physician revenues, is complicated. Establishing incentives should be done with the help of professionals who are familiar with the applicable laws, the group, the market and the objectives of the parties.

Salary

5.1 Fixed base salary

The Physician shall receive a salary at the rate of \$_____ per year, payable in equal [semimonthly] installments, on the [first and 15th day or 15th and last day] of each month, subject to state and federal income tax withholding, employment taxes and such other deductions that may be required by law or may be agreed upon by the Employer and the Physician.

If the physician is being paid guaranteed payments of a fixed salary, the agreement should state the amount and frequency with which payment will be made (usually monthly, semi-monthly or biweekly). The agreement should also state the nature of any approved deductions.

Market surveys are available that list salaries by specialty and geographic market. It is unlawful to pay employees differently because of gender, color, race, national origin or religion.

If the parties cannot agree on the salary level, one area of potential compromise may be a higher level of benefits. Another is to write a provision requiring a review in six months with a predetermined means of fixing a raise. If the salary cannot be raised to a level sufficient to hire the physician full time, the agreement can be altered to part time, e.g., four days a week. A part-time arrangement may be attractive to some physicians.

To avoid misunderstanding, the parties should specify that the base salary is not subject to any deductions (such direct overhead elements as professional liability insurance, employer payroll taxes, benefits, etc.) other than ordinary payroll deductions. Unless otherwise specified in writing, those items of overhead are paid by the employer.

Many creative and common forms of alternative compensation are now subject to tax treatment as deferred compensation under Internal Revenue Code Section 409A.³ The rules and regulations for section 409A have been fluid

and uncertain, with “good faith” compliance provisions being issued several times since late 2004. The deadline for full technical compliance with final IRS regulations has been extended several times, and now is slated for Jan. 1, 2009.

Deferred compensation can include bonus, severance and delayed commission payments, stock options, certain sweat equity arrangements, and the buyout provisions of the sale of a practice. Paragraphs 5.2 through 5.12 cover payments that could be deemed deferred compensation subject to section 409A and its regulations. Clauses that accelerate when an employee can receive payments, allow the employee to choose the timing of receipt or protect the employee from forfeiture are triggers that prompt close scrutiny and hidden tax liability. The cost of tripping a section 409A trigger, such as incurring a current tax on income that may never be received, interest or a 20 percent excise tax, can be startling for the physician and the employer. When bargaining about alternative or deferred compensation, ask the employer and your attorney about the steps used to stay compliant with section 409A.

5.2 Alternative: Compensation based on percentage of productivity

On or before the 15th of each month, the Employer shall pay the Physician _____% of his or her prior month's "productivity." For the purposes of calculating compensation, the Physician's productivity shall include all charges in the preceding calendar month for services rendered by the Physician to patients as evidenced by the Physician's entries on the [super-bills or the charge slips] regularly used by the Employer, adjusted by any contractual allowances. Contractual allowances are those adjustments to charges made because contractual agreements to reduce fees, such as discounted-fee-for-service, Medicare allowances, managed care arrangements or any other differential between billed charges on the [super-bill or charge slip], and those charges actually charged to the patient or the patient's payer. Income [also or does not] include[s] writing, speaking and medicolegal activities. Teaching fees [are or are not] excluded from the Physician's production. [The Physician's productivity shall further reduce by _____% which is equal to the Employer's last 12 month's average bad debt or noncollection rate.]

Under the percentage-of-productivity compensation agreement, the physician is paid a set amount of his or her

3. Internal Revenue Code Section 409A, adopted in 2004, is the subject of many IRS regulations with delayed effective dates.

prior month's charges, minus adjustments. Most groups paying employed physicians based on gross charges will adjust those gross charges in accordance with the medical group's traditional discount percentage. For example, if a medical group expects to collect 70 percent of its charges, the group might credit the physician with his or her productivity adjusted by the amount of all contractual discounts.

This clause is designed to give the physician an incentive to work diligently and efficiently, and thus is useful primarily in a fee-for-service environment. Under this compensation arrangement, the employer assumes the risk of collecting the charges, although the physician's compensation may be adjusted downward to reflect an average of the practice's bad debt.

Physicians are not encouraged to compromise quality patient care through minimum patient contact requirements or any patient volume incentives used to calculate compensation or bonus. Rather, physicians must provide appropriate medical care to all patients. In many incentive compensation arrangements, quality indicators on outcomes will be incorporated as criteria in the formula to determine the physician payment. For example, obtaining a threshold score on a quality-assurance tool or patient-satisfaction survey may qualify the physician for the bonus. The physician should understand and agree with the general indicators and processes utilized in the quality assurance system of the employer.

5.3 Alternative: Compensation based on a percentage of collections

The Employer shall separately identify all services rendered by the Physician to the practice's patients, [as well as revenues received for the Physician's teaching, writing, lecturing and medicolegal activities]. The Employer shall use reasonable diligence and the same methods for collecting the Physician's billings as are used for the billings of other physicians in the group. When collected, the Employer shall pay the Physician as compensation ____% of the Physician's billings within ____ days of their receipt.

Paying employed physicians on a percentage of collections aligns the employer's and physician's incentives to generate revenue. This formula is relatively easy to administer, particularly using many of the commonly available software packages for practice management.

In a fee-for-service environment, medical groups will bill charges on a current basis and then await collection of those charges. Figures from the Medical Group Management Association show that the average wait for collection is 60 to 90 days.⁴ A physician on a percentage of collections arrangement, therefore, must understand that his or her collections will be delayed 60 to 90 days. This may have a significant impact on income and any bonus in the first year.

5.4 Alternative: Percentage of profit or net income attributable to physician's services

No clause is recommended.

Net income is that amount remaining after deduction or payment of all practice expenses. It is not recommended that an employed physician be paid on a percentage of the net income that physician brings to the group or a combination of salary and percentage of net income. If salary is based in any part on percentage of net income, the agreement can become complicated in defining what constitutes income and expenses, leading to the physician becoming entangled in the affairs of the employer and potential disputes as to the legitimacy of expenses, etc. Such net arrangements border on partnership and should be structured as such or as revenue-sharing agreements in a professional corporation or LLP.

Bonuses

Preliminary advice: Both parties should take the time to meet with their counsel and the group's chief executive officer and chief financial officer to realistically discuss examples of how the bonus formula would be applied in different circumstances. The physician can request a history of bonuses paid, or a sample calculation can be attached as an exhibit to the agreement, so that the definitions and methodology for calculating the bonus are clear to both parties. It is imperative for a physician to know what his or her chances are of achieving the bonus.

5.5 Bonus compensation based on percentage of salary

Within fifteen (15) days of the close of each [quarter or year], the Employer [shall or in its sole discretion may] pay the Physician bonus compensation of [up to] ____% of the Physician's salary in addition to the base salary paid to the Physician if the Physician has [produced or collected] \$_____ in the preceding [quarter or year]. If the Agreement is terminated or

4. See 1998 Medical Group Management Association report, Cost Survey.

expires between bonus payments, the Physician has no vested interest whatsoever in any bonus compensation that may have accrued in that bonus period. A sample bonus calculation using the foregoing formula is attached as Exhibit ____.

In this bonus structure, the physician is offered a bonus if revenue milestones are met. The bonus may be triggered by the physician meeting target gross production or gross collections (the agreement should specify which). If a medical group has ancillary services or an advanced nurse specialist, the production or collections from the ancillaries would generally not be credited to a physician when calculating the incentive bonus.

The amount of the bonus is based on a percentage of the physician's salary. The agreement should specify whether the physician is entitled to a bonus based on services rendered while physician was employed, but which are recovered after termination. Normally the post-termination collections remain the property of the medical group.

Whatever the salary or bonus arrangement, the physician should insist on a thorough explanation and a projection of several examples showing various scenarios, and the result of those scenarios when the bonus system is applied. Physicians should insist on not only a textual description of the bonus system, but also an exhibit showing by example the methodology of calculating it.

5.6 Alternative: Bonus based on collections

If the Physician's gross collections exceed \$ _____ [quarterly or annually], the Physician shall be paid as a bonus an additional [\$ _____ or ____% of the Physician's collections above \$ _____], [and an additional bonus ____% of his or her collections that exceed \$ (a higher number)]. If this Agreement terminates, the Physician has [a or no] vested interest whatsoever in any collection made after the date of termination. An example of bonus calculation is attached as Exhibit ____.

The most common method for calculating a bonus is to pay a percentage of the physician's collections over a targeted quarterly or annual goal. Sometimes the salary bonus or the percentage increases on an escalating basis—the more the physician exceeds the production goal, the more he or she earns.

In a hospital or other not-for-profit setting, the bonus or incentive may be capped at a specific dollar amount for legal reasons.

5.7 Alternative: Bonus based on percentage of productivity

On or before the 15th of each month, the Employer shall pay the Physician ____% of his or her prior months' "production" as a bonus, if the Physician's production exceeds \$ _____. For the purposes of calculating compensation, the Physician's production shall include all charges in a given month for services rendered by the Physician to patients as evidenced by the Physician's entries on the [super-bills or the charge slips] regularly used by the Employer, adjusted by any contractual allowances. Contractual allowances are those adjustments to charges made because of contractual agreements to reduce fees, such as discounted fee-for-service, Medicare allowances, managed care arrangements or any other differential between billed charges on the [super-bill or charge slip], and those charges actually charged to the patient or the patient's payer. Income [also or does not] include[s] writing, speaking and medicolegal activities. Teaching fees [are or are not] excluded from the Physician's production. [The Physician's production shall be further reduced by ____% which is equal to the Employer's last 12 months' average bad debt or noncollection rate.]

5.8 Alternative: Managed care bonus formula

In addition to the Physician's base salary, the Employer shall [in its sole discretion] pay bonus compensation to the Physician pursuant to the following formula that compares the Physician's capitated gross collections (as defined) with other physicians in the group, and if they are above average for the group when adjusted for overhead and the Physician's direct expense, then a bonus accrues. If they are below average a negative bonus accrues. Specifically:

1. The gross (i.e., capitated revenue, minus excess overcharge, minus 25%, minus fee-for-service revenue) fee-for-service equivalent cash collections received by the Employer during each subject period during the term of the Agreement shall be calculated ("gross collections").
2. During the initial one (1) year of this Agreement, the Physician's "percent of charges" shall be calculated by dividing the total [number of patient contacts, or relative value units (RVUs) or amount of charges for professional services rendered] by the Physician during the initial one (1) year term of this Agreement, by the total [number of patient contacts, or RVUs or amount of charges]

for professional services rendered by all of partners and employees of Employer during the same one (1) period. Thereafter, and during any renewal of subsequent term of this Agreement, the Employee's percent of [patient contacts, RVUs or charges] shall be calculated on a monthly basis, using a rolling twelve (12) month average.

3. The amount of the Employer's gross collections shall be multiplied by the Employee's percent of [patient contacts, RVUs or charges], with the result thereof equaling the collections which shall be attributed to the Physician during the subject term ("Physician's collections").

4. From the amount of the Physician's collections shall be deducted the following:

- a. An amount equal to 10% of the Physician's collections during the subject period
- b. An equal share of the fixed expenses of the Employer during the subject period
- c. An amount calculated by multiplying the total variable expenses of the Employer during the subject term, multiplied by the Physician's percent of charges during the subject period
- d. All direct expenses attributed to the Physician

5. The total amount paid to the Physician as base salary during the subject term shall be subtracted from the result of the above referenced calculation. If the difference thereof is a positive number, the Physician shall receive bonus compensation in such amount. If the difference thereof is a negative number, it will accumulate with any other negative monthly totals paid back to the Employer when the difference between the base salary and above calculation is consistently a positive number. When the accumulated negative total has been paid in full, all positive differences will be paid to the Physician as bonus compensation.

6. The calculation of amounts owed to the Physician as bonus compensation under this Agreement, if any, shall be undertaken once each month during the term of this Agreement. The payment of any bonus compensation from the Employer to the Physician shall be made promptly, and in no event later than within ____ days following the completion of the above referenced calculation. The payment of any amount owed by the Physician to the Employer shall be deducted promptly, and in no event later than within

_____ days following the completion of the above referenced calculation.

7. The definition of the specific expenses which shall be classified as the Employer's fixed expenses, variable expenses and direct expenses, shall be determined from time to time by the Employer, and the Employer shall have the right to amend and/or modify the specific expenses within each category of expense from time to time, provided that the application of any amendment and/or modification shall be equally binding upon all equity physicians and non-equity physician employees of the Employer.

While complicated to explain, this compensation formula compares the physician's production, collections, RVUs or patient encounters with others in the group, and pays the physician accordingly. In a capitated environment, the physician's collections may be equal to the monthly capitation payments for all patients who select the physician as their primary care physician, plus a percentage of capitated patients assigned to others but who were treated by the physician in that month. Likewise, in a capitated environment or heavily discounted setting, some medical groups will track production by the number of patient encounters (including phone contacts) or by RVUs.

This way of weighing the physician's production is essentially blind to traditional fee structures and counts physician efforts the same, regardless of the actual level of remuneration for the services from the payor. This system rewards efficiency by making incentives for the physician to deal with as many patients as possible in the shortest amount of time. In this system, physicians who see a significant amount of Medicaid or capitated patients can produce the "same" level of care as if they were treating full-paying insurance patients. For this reason, many groups in managed care are moving to patient encounter or RVU formulas.

In this compensation formula, the general expenses of the practice are deducted. The physician's direct overhead costs may also be deducted from the profit distribution, including the physician's personal salary, his or her professional liability premiums, dues and subscriptions, along with the payroll taxes and benefits attributable to the physician and his or her exclusive nurses (if the practice employs them).

The bonus is not paid if the physician is not consistently performing above average. Indeed, if a physician's performance lags, a negative number accrues and no bonus is paid until the negative number is eliminated.

5.9 Advances

Although the Physician is compensated based [in whole or in part] on a percentage of his or her [monthly production or monthly collections], the Employer agrees on the 15th of each month to advance the Physician \$ _____ against his or her percentage of [production or collections]. The amount the Employer pays in advances will be reconciled against the Physician's actual percentage of [production or collections] quarterly by April 10, July 10, Oct. 10, and Jan. 10 for the preceding quarter. If in any quarter the Physician has not been paid the full amount owed the Physician under paragraph _____ above, the Employer shall pay the Physician the difference by the 15th of the month in which the reconciliation is done. If the Physician has been overpaid in the preceding quarter, [the Physician will be obligated to pay the Employer back or the Employer will deduct] all overpayments in three (3) equal monthly [installments or deductions], with interest, commencing in the month the reconciliation was done. If the employment relationship ends during a payback period, the unpaid amount will be due immediately upon termination.

This provision is designed to even out the physician's compensation from month to month. Accordingly, if a physician's salary is based on a percentage of production or collections, this paragraph calls for payment of a specified advance each month for a certain number of months, with an accounting at the end of that period. If, under the compensation arrangement, the physician is entitled to more than the amount that has been advanced, the employer is obligated to pay the difference in a supplemental payment. However, if the amount due to the physician is less than the advances, the physician must pay back the employer from the next three months' earnings. Such agreements require employed physicians to budget their personal finances carefully and monitor their expected ultimate pay.

5.10 Review and compensation adjustments

The Employer agrees to provide the Physician with a performance review [in writing] at least once every [year or six (6) months], and if the Physician's performance overall is satisfactory the Employer agrees to immediately raise the Physician's base salary by ____%.

Pro-physician: If no review is provided before the end of the _____th month, the Physician's compensation shall be automatically increased to [\$ _____ per month or _____% of collections or production].

Pro-employer: If no review is provided by the end of the _____th month, the Physician may request arbitration of the issue pursuant to paragraph 12.1. The failure to provide a review or a raise shall not be grounds for terminating this Agreement.

The parties may wish the agreement to provide that salary provisions will be periodically reviewed and adjusted on an annual basis. The review should be memorialized in a written memorandum prepared by the employer and signed by the physician. Any promises regarding salary adjustments or other terms of the agreement should be stated within the memorandum and treated in the same fashion as an amendment under paragraph 13.1 (pages 29 and 30).

If no review is provided, an automatic remedy should be offered, such as an automatic salary increase or arbitration. In no event should the entire agreement be jeopardized by the failure to grant a timely review.

5.11 Accounting

Pro-physician: The Employer will maintain true and accurate financial records in accordance with generally accepted accounting procedures. The Physician shall have the right to inspect a copy of the financial records used in or pertaining to the calculation of his or her compensation at any reasonable time.

This type of provision may benefit employees who are not being paid in a timely manner or who feel payments based on production collections are not accurate. As a practical matter, employers who pay physicians on such a basis should provide regular detailed accountings showing exactly how the compensation was calculated. The issue, therefore, is whether the physician has a right to inspect and audit the records pertaining to his or her charges, receipts or overhead allocation formula in the event such accountings are not provided or the physician questions their accuracy.

5.12 Repayment of compensation held excessive

If any part of the salary or other compensation paid by the Employer to the Physician, or any amount paid by the Employer for travel or entertainment expenses incurred by the Physician, is finally determined not to be allowable as federal and state income tax deductions to the Employer, the amount disallowed shall be repaid by the Physician to the Employer.

Compensation or expenses paid to employee may be determined by the IRS to be unreasonable and treated as a nondeductible or as a disallowed business expense. To avoid

losing the deduction, the employer may require repayment. From the physician's point of view, a payback provision for nondeductible compensation or expenses may be seen as unfair, if there was a prior determination by the employer that the compensation expenses were a reasonable and necessary business expense. Furthermore, because IRS audits generally occur a number of years after the relevant tax year, liability for a significant amount of money could be incurred years later (see Appendix A).

5.13 Remuneration to physician

All remuneration the Physician receives due to the practice of medicine shall be promptly turned over to the Employer. Remuneration from medical-related teaching, lecturing, writing, directorship, shall belong to the [Employer or Physician]. Earnings from non-medical care activities will not be considered to be earnings from the Physician's professional activities and shall belong to the Physician.

If it is anticipated that the physician will engage in outside medical activities, such as teaching, lecturing, writing and directorships, the parties should agree whether compensation from such activities belongs to the employer or the physician.

6. Reimbursement of expenses

The Physician shall be entitled to reimbursement by the Employer for reasonable and necessary expenses incurred in the performance of the services hereunder, including travel expense for hospital visits during working hours, provided that, for all expense reimbursements, the Physician furnishes the Employer with records in compliance with Internal Revenue Code §274 [**Pro-employer:** and provided that the Physician has sought and obtained prior written approval of such business expenses in excess of \$_____].

Additionally, the Employer shall reimburse the Physician the following:

- a. Continuing medical education (CME) costs: [all] or [Employer-approved] costs of CME tuition/enrollment (including reasonable travel, food and lodging) [up to \$_____/year].
- b. Subscriptions to journals, costs of books [and cost of online services] [or a percentage of such costs] [up to \$_____/year].

- c. Up to \$_____ per month for all legitimately deductible professional entertainment and promotional expenses. Prior written approval is necessary for reimbursement of any costs in excess of \$_____.

Because expenses may be significant, this is an important issue. Documentation of expenses is required for IRS purposes. The employer's accountant should provide forms for the physician to fill out to obtain reimbursement and instructions on how to use them.

7. Employer-paid benefits and time off

The agreement should set forth all of the benefits and other expenses for which the employer is responsible. Larger employers or institutional employers may cover these issues in an employment manual, applicable to all employed physicians. In that case, a reference to the employment manual (or specific corporate policy) is usually included in the agreement, and the physician and his or her advisors should review the manual before signing the agreement.

7.1 Insurance

The Physician [and his or her dependents] shall be entitled to participate in the Employer's [health, dental, vision, life and disability] and other insurance benefits to the same level as other employees of the Employer. The Employer shall pay [all monthly premiums or up to \$_____ per month per employee toward the cost of the premiums]. [Participation in the insurance programs is subject to the Physician's meeting the eligibility requirements of the insurer.]

If the employer is paying health and/or dental insurance premiums, the agreement should state whether coverage will include family members. It is important to review the policies to determine the deductible amounts, and the type and extent of coverage to be provided by the employer.

Life and/or disability insurance may also be provided, and the specifics regarding these types of insurance should also be stated. If the employer is paying less than the full premium on any of the policies, the physician's share should be noted.

Caution: *The employer may wish the agreement to state that certain insurance benefits will be provided only if the physician meets the requirements set forth by the insurance company, and has no risk classifications or pre-existing conditions that would either deny the physician coverage or*

become so costly as to cause the employer to incur surcharges or increased fees. This may imply that physicians with illnesses or disabilities may be denied medical coverage, which may be a violation of the Americans with Disabilities Act. It may also violate state law prohibiting health insurers and employers from making insurability/employment decisions based on HIV seropositivity, and state and federal laws that generally require that there be no discrimination among employees with respect to benefits. Therefore, an attorney experienced in labor law should be consulted before finalizing the contract.

7.2 Qualified pension or profit sharing plan

During the term of this Agreement and for any extensions thereof, the Physician shall be entitled to participate in the Employer's qualified defined [benefits or contribution] plan. The Employer reserves the right to modify, suspend or discontinue any plan without recourse by the Physician so long as such action is done lawfully.

The agreement should specify whether the employer maintains any qualified pension or profit-sharing plans for eligible employees and the physician's entitlement to participate in them. The physician should carefully review the plans and have them analyzed by a benefits specialist (see Appendix A).

7.3 General and professional liability insurance

a) Patient care services performed within the scope of the Physician's employment by the Employer shall be covered by professional liability insurance with a policy limit of at least \$ _____ per claim, with an aggregate limit of at least \$ _____ at the expense of the Employer. The Physician shall be added as an additional named insured on the Employer's professional liability policies and the Employer shall furnish written proof of same within sixty (60) days of the Starting Date. The Physician may review a copy of the policy upon reasonable request. The [Employer or Physician] shall pay any deductibles before termination of this Agreement [and thereafter].

b) If professional liability insurance is on a "claims made" basis, the [Employer or Physician] shall purchase extended reporting endorsement coverage ("tail" coverage) for a period no less than _____ years after termination of the Physician's employment. The Physician shall have the right to review the policy on a periodic basis. The [Employer or Physician] shall pay deductibles, as necessary, before and after termination of this Agreement.

c) [In the event that either (i) the Physician terminates his employment without cause or (ii) the Employer terminates the Physician's employment for cause and the Employer's professional liability coverage is on a claims made basis, the Physician shall obtain professional liability tail coverage insurance for acts or omissions of the Employee during employment, for a period of no less than _____ years after termination of the Physician's employment, the Employer may obtain such tail insurance and deduct the cost of such coverage from any amount owed hereunder to the Physician. In the event that employment is terminated for any reason other than those stated herein, the Employer shall obtain the stated tail insurance at its expense.]

d) In the event that the Physician knows of a professional liability incident involving the Physician or receives notice of a claim or of an intended claim that alleges that the Physician or any other of the Employer's employees is or may be liable for a professional act or omission, the Physician shall immediately notify the Employer of such fact.

e) [**Pro-physician:** The Employer shall provide the maximum available coverage for the Physician for legal defense in administrative and disciplinary proceedings.]

f) The Physician shall also be named as an additional named insured on the Employer's general liability policy, including coverage of the Physician's business use of his or her automobile, and the Employer shall provide proof thereof within _____ days of the Effective Date of this Agreement. [**Pro-physician:** If permitted by the applicable state law, the Employer shall maintain in effect liability coverage for intentional torts, fraud, liability in the workplace (harassment, discrimination, wrongful termination, etc.) and punitive damages, and if necessary obtain riders to cover areas excluded by the general liability policy.]

The agreement should address whether the employer is responsible for maintaining general and/or professional liability insurance, and should set forth the policy limits for such insurance. The agreement should give the physician the right to review the policy on a periodic basis. The physician should take advantage of this right from time to time to be sure that the policy remains in effect and that its provisions have not changed. The agreement should specify which party is required to pay deductibles, if there are any, either before or after contract termination.

If the insurance is a claims made policy as opposed to an occurrence policy⁵, the agreement should specify whether tail coverage is required upon termination of the agreement.

While the employer almost always pays for professional liability insurance during the term of employment, the agreement should specify which party is obligated to pay for tail coverage. There are no set rules regarding which party pays tail coverage. Sometimes the employer pays, sometimes the physician pays, at other times the cost of the coverage is shared. Paragraph 7.3 presents two options in this regard. Physicians who are obligated to pay for tail coverage should inquire into the cost of such coverage before signing the agreement because it can be very expensive. Malpractice insurers, however, may waive the cost of tail coverage when the physician reaches a certain age, retires or becomes disabled. The physician should also find out if there will be any limitations on the ability to obtain tail coverage at a later date.

Malpractice insurers are increasingly offering coverage of legal expenses incurred by physicians in hospital medical staff or licensure proceedings, Medicaid or Medicare audits, or other administrative proceedings. Unfortunately, the risk of being involved in such proceedings is growing to the point where all physicians should carry such coverage, as legal defense fees can easily run into tens of thousands of dollars.

The employer's general liability policy should also expressly cover the physician as an additional named insured. The policy should cover business use of automobiles by employees. It should also cover as broad a spectrum of potential liability as possible.

Caution: *Many general liability policies exclude major potential sources of liability such as employment law (harassment, discrimination, wrongful termination and contractually assumed liability). Special riders can be written to cover these risks, but expense is an issue. Both parties should carefully check the coverage to see that all pertinent risks are covered if affordable insurance is available. Some states, by statute or case law, prohibit insurance coverage for intentional torts and punitive damages (see Appendix C). Check your state's law and investigate the coverage held by the employer. When feasible, obtain the maximum affordable coverage to provide both parties the maximum protection.*

7.4 Dues and license fees

The Physician shall maintain membership in the American Medical Association, the (state) Medical Association, the _____ County Medical Society [and the state and national specialty societies], and the [Employer or Physician] shall pay the dues and assessments to maintain such memberships. The Physician must also maintain active licenses and U.S. Drug Enforcement Administration (DEA) numbers in the following states: _____, _____ and _____. The [Employer or Physician] shall pay all licensing fees in those states. The Physician may maintain active or inactive licenses and DEA numbers in other states at [his or her or the Employer's] expense.

Regardless of the size of the medical group, the physician's membership in national, state and county medical societies, as well as specialty societies, is a very important benefit. Membership is commonly provided by employers. Even if the employer does not provide all of the membership dues, the employer may require such membership. Hospital medical staff dues are usually paid by the employer, but this is a negotiable item.

Likewise, hospital medical staff membership is important to most practices. Some contracts condition the commencement of employment on obtaining privileges at a particular hospital. Such a condition should be carefully evaluated as it may place control over the beginning of the employment relationship in the hands of third parties who may or may not process the medical staff application in a timely manner. Review hospital practice or bylaws to ensure temporary privileges are possible in the event the credentialing process is not complete when employment commences.

7.5 Moving and interim expenses

1. The Employer shall pay the Physician [an amount not to exceed \$_____] for the relocation expenses incurred by the Physician in moving from his or her present residence to a residence near the Employer's practice. The Employer will reimburse:

- a. The usual and customary expenses of selling the Physician's home (broker's commission, however, shall not exceed ___%)

5. Generally speaking, claims made policies cover the physician only if the claim is brought within the policy period. When the policy expires (usually when the physician leaves the employment), and if no claim has been brought, the insurance company has no obligation to provide coverage if a claim is made after expiration. Additional tail coverage is needed to cover claims made after the policy expires, for acts or omissions committed during the period of the policy. An occurrence policy, on the other hand, covers the physician for any alleged acts or omissions that occurred while the policy was in effect, even if the claim is brought well after the policy expires.

b. The reasonable costs of moving the Physician's belongings to his or her new residence (but the Physician shall select the carrier in coordination with the Employer having obtained three estimates)

c. Insurance at replacement value in the Physician's goods

d. Reasonable house-hunting expenses for the Physician [and spouse] up to \$ _____

e. Reasonable and customary closing costs on the Physician's new home up to \$ _____

f. Incidental expenses up to \$ _____

2. It is anticipated that the Physician may not move his or her residence right away, so the Employer shall reimburse the Physician for living expenses for the first _____ days of this Agreement, upon the Physician's periodic presentation of an itemized list of such expenses. Reimbursed expenses shall include:

a. Up to \$ _____ per month for lodging

b. \$ _____ per day for meals

c. Transportation costs for two round trips per month to the former place of residence, but costs of local transportation shall not be provided

3. [If the Agreement is terminated during the probationary period, living costs will not be provided beyond the date of termination.]

4. All relocation expenses shall be paid to the Physician within _____ days of the Physician's presentation of adequate documentation of the expenditure.

Pro-physician: If the Agreement is terminated by the Employer within one year after the Effective Date and after the Physician has relocated from his or her former residence, the Employer shall pay the reasonable expenses incurred by the Physician in connection with his or her moving back to his or her former location or to any location that is _____ or more miles from the location of the practice. Such payment shall in no event exceed \$ _____.

Pro-employer: Some or all of these payments may be taxable income to the Physician and are subject to the

condition that the Physician's move is accomplished by _____ and that the Physician does not voluntarily terminate employment for a period of _____ [months or years]. If voluntary termination occurs within that period, the Physician shall repay the Employer a prorated share of all moving expenses.

The agreement may specify that the employer is to reimburse the physician for relocation expenses. The agreement should state the maximum amount payable, if any. The agreement should also specify precisely what is covered, e.g., expense of moving household items, transporting of the physician and his or her family to the new location, packing and unpacking of household items, cost of insurance premium for full replacement value of household items, storage of household items, and disassembly or installation of household items. In addition, the agreement may specify that the employer will pay for living expenses up to a certain period of time while the physician finds suitable living arrangements.

A relocation expense provision will usually require the physician to submit appropriate receipts to the employer before the employer will reimburse the physician. The agreement should specify the number of days from receipt of written documentation of expenses that the employer will reimburse the physician. The employer may require a certain percentage of the reimbursed relocation expenses to be paid back to the employer if the physician terminates the agreement within a specified period of time, for example, six to 24 months.

7.6 Housing allowance/mortgage assistance

The Employer shall provide the Physician housing allowance of \$ _____ per month and a second mortgage loan of up to \$ _____ at _____% interest to purchase housing within _____ minutes of the [practice or _____ Hospital]. The terms of said mortgage shall be set forth in a separate deed of trust and mortgage to be signed by the parties when the Physician's purchase of residence is made.

While an argument could be made that housing within a specified distance of the practice or hospital is for the convenience of the employer, a housing allowance is most likely taxable compensation to the physician, so there is little advantage to separating out a housing allowance from salary. In expensive housing markets, however, there is a substantial benefit to the physician if the employer provides a second mortgage to help with the down payment. In some systems or hospital settings, housing allowances and mortgages may not be available. If they are available, restrictions or other requirements such as commercially reasonable interest rates

(prime plus 1 percent or 2 percent) and pay-back penalties may be required.

7.7 Student loans

The Physician has \$ _____ outstanding in student loans, which are identified as [provide specific description]. On the first anniversary of the Effective Date of this Agreement and on each anniversary date thereafter that this Agreement stays in effect, the Employer shall pay to the lender _____% of the outstanding balance on the student loans. Vesting of this benefit does not accrue *pro rata*. Payment is made annually only if the Physician is still employed by the Employer on the anniversary date.

Physicians are emerging from training with ever-larger student loan balances. Even though an employer's payment of student loan balances is taxable to the physician, it can be a tangible and disciplined way of addressing one of the physician's most serious financial concerns.

7.8 Vacation, CME and time off

The Physician shall be entitled on a [non]cumulative basis to [____ weeks or ____ working days] of time off per year which shall be used as vacation or CME time as the Physician may determine. [**Alternate:** So long as the Physician regularly collects at least \$ _____ per month in uninterrupted cash flow, the Physician may take up to ____ weeks of vacation per year.] The Physician must provide at least ____ days' notice prior to taking one week or more away from the practice. Time off shall accrue at the rate of ____ days per pay period. Vacation/CME time not taken in the calendar year can[not] be carried over to the following year [except in extraordinary circumstances with the prior written approval of the Employer]. All time off must be requested in writing in advance and approved by the Employer.

The agreement should specify the number of paid vacation days to which the physician is entitled, and whether such days—if not used—may be carried over to the next contract or calendar year. If they are treated separately, the same should be stated for the number of CME days to which the physician is entitled. In this agreement, the number of days permitted is stated in the aggregate, in other words, vacation and CME days are lumped together. The agreement may require the physician to remit a request in writing to the employer for approval in advance of the vacation or CME leave.

The physician may wish to inquire into the vacation habits of other physicians in the practice. A physician may be disappointed to learn that vacation terms exist on paper only

and that physicians are not really expected to take vacation. Generally speaking, the physician's legal entitlement to vacation is governed by the contract's written terms. However, contract renewal, termination and elevation to partnership or shareholder status may well be contingent on fitting in.

7.9 Sick leave

The Physician shall be entitled to paid time off for sick days of [____ weeks or ____ working days] per year. Sick leave shall accrue at the rate of ____ days per pay period and may accrue from year to year up to a total of ninety (90) working days. Unused sick leave is not compensable upon termination.

Unlike vacation, sick leave should be allowed to accrue up to the number of days in the waiting period before disability is paid (usually 90 days) in case the physician becomes disabled.

The agreement should state whether the physician is entitled to paid sick leave and how such sick leave is calculated (e.g., based on months or years worked, or based on calendar or employment year). The agreement should also specify whether sick days—if not used—may be carried over to the next year. Finally, the agreement should specify how sick leave days are treated when employment ends.

7.10 Holidays

[Subject to the call schedule,] the Physician shall be entitled to ____ paid holidays per year, specifically: New Year's Day, Martin Luther King Day, Memorial Day, Fourth of July, Labor Day, Thanksgiving and Christmas. [Other religious holidays may be traded for the paid holidays listed above.]

The agreement may set forth the holidays that the physician is entitled to take off or a mechanism for determining which physicians may take which holidays, e.g., per a call schedule. Some employers permit physicians to trade paid holidays for religious holidays, such as Easter, Yom Kippur or Ramadan.

Optional: 7.11 Midweek time off

In consideration of call and other professional demands on the Physician's time, the Physician shall not be scheduled to see patients one half-day per week [in order to take care of administrative duties and paper work within the office, or and shall have no other duties during that time].

The agreement may state that the physician is entitled to a certain amount of time each week (for instance one half-day) free from appointments and perhaps other practice responsibilities.

7.12 Family/medical leave

The Physician will be entitled to _____ [weeks or days] of leave within any twelve (12)-month period for illness or family matters.

Under the federal Family and Medical Leave Act of 1993 (FMLA), an employee is eligible for up to 12 weeks of unpaid leave during a 12-month period for the birth or adoption of a child, the care for a child, spouse or parent who is ill, or to recover from a personal illness or the effects of a medical treatment. FMLA applies to employers with 50 or more employees and to employees who have worked at least 12 months and 1,250 hours during the previous 12-month period.

In institutional settings, FMLA policies may be incorporated into the employment agreement by reference to a formal policy or an employee handbook. In other employment situations, the terms for leave should be stated in the agreement.

Some states have enacted similar medical leave laws, but federal law mandates compliance with whichever law provides greater employee benefits. Consult with legal counsel regarding the laws in your state.

7.13 Leave of absence

The Employer acknowledges and agrees that the Physician may request unpaid leaves of absence up to ____ days a year, which may be granted at the sole discretion of the Employer. Any unused vacation time will first be applied to any leave of absence; thereafter, whether the leave of absence is paid or unpaid shall be at the sole discretion of the Employer. If the leave of absence is requested for medical reasons, sick leave shall be applied first, then vacation, if any has accrued.

The agreement should specify the circumstances (if any) under which a leave of absence may be granted, such as whether the physician is entitled to allocate unused sick, vacation or CME time to leave of absence, whether and under what circumstances such leave will be paid or unpaid, and any time limitations. The procedure for requesting leave should also be addressed.

8. Equity status

8.1 [Shareholder or partner] status

No later than ____ days before the end of the term of this Agreement, the Employer and the Physician shall discuss in good faith whether the Physician shall become a [partner or shareholder] of the Employer and the precise terms thereof. [**Pro-physician:** The

parties agree that it is their current intent that upon the successful completion of ____ years of continuous employment pursuant to the terms of this Agreement, the Physician shall be given the opportunity to become a [shareholder or partner] of the Employer].

The Physician's progress toward equity status shall be reviewed in writing every [six (6) months or year]. The criteria for such evaluation shall be: _____. Failure by the Employer to provide timely written review shall be deemed a satisfactory review.

Optional: The Physician's equity interest, if offered, shall be ____% of the [corporation or partnership]. The Physician will pay a buy in based on [the book or fair market] value of the practice assets [including or excluding] goodwill [or a predetermined value of \$_____]. The Employer [will or will not] finance the buy in by extending a promissory note for ____% of the purchase price for ____ years at ____% interest. [This provision is not meant to be nor should be construed as a guarantee that the Physician will be offered an equity ownership interest. The Employer retains discretion as to whether or not to offer such equity ownership interest, as well as the terms of such offer.]

For hospitals, institutional or other non-physician employers, an ownership or equity interest is typically not an option for an employee. However, adjustment of salary or benefits may serve to compensate the employee for his or her professional investment.

Generally in the medical profession, employment arrangements with physician-owned practices are intended by both parties to lead to eventual partnership or ownership. From the employed physician's point of view, the investment of years of his or her professional career in a particular physician-owned practice normally leads to building a patient base, which is usually recognized by ownership.

The physician, therefore, will want the employment agreement to discuss whether he or she is likely to become an owner at the expiration of the agreement or at some other time. The physician should also investigate how many other doctors have rotated through the physician-owned practice without becoming a partner and why.

In negotiations, a physician should learn as much as possible about how to buy in or otherwise activate equity status in the employer group. The physician should also discuss, at least generally, the buy-in price and terms. (The employer should not postpone thinking about the price and terms of

equity status because salary and the buy-in price are usually linked to other considerations.) Balancing the buy-in price affects not only the terms of the physician's employment, but aspects of the whole practice. For example, if the employer pays a lower salary to the physician and makes money from the physician's period of employment, the employer can usually afford a lower buy in. However, if the employer's net return from the physician's employment is relatively low, the buy-in price may be higher. If a physician negotiates a lower buy-in price, buyout prices for retiring physicians may go down also, which may be unacceptable to senior physicians and cause some internal resentment. It could also affect the future capital obligations of the group by reducing the reserve necessary to buyout retiring partners. For the sake of both sides, these kinds of strategic issues should be thought through at the earliest possible time, preferably before the physician is initially hired.

There is no set formula to determine whether a particular buy-in price is fair. Both parties, therefore, should consult attorneys and financial advisors experienced in handling physicians' business matters. A tax consultant should be also contacted because a taxable gain could result to the buyer depending on how the deal is structured.

Caution: Market conditions may change expectations. As medical markets shift to capitation and other forms of managed care, patients choose their physicians based on participation in their managed care plans. As a result, the traditional goodwill of a medical practice (based on reputation and skill) diminishes in value. Yet goodwill is normally the biggest component of the buy-in price. In discussing the range of evaluation, therefore, both parties should carefully project the market conditions in the coming years.

Traditionally, employed physicians have invested their time at reduced compensation in return for the expectation of ownership. In fairness, the physician should be given some idea as to whether and under what circumstances an offer for equity status may be extended. The agreement should provide for interim review. The clearer the understanding about ownership, the more likely there will be a smooth transition.

A review of the physician's work should occur at least annually—preferably semiannually—so that both the employer and the physician know where they stand. The physician may wish the agreement to state the general criteria that will be considered in the performance evaluation, such as the quality of medical services provided,

the nature and frequency of patient complaints, the physician's productivity in terms of number of patients seen per day and the physician's contribution to the employer's operations, such as committee work, teaching duties or community activities.

It is imperative that time periods for evaluations be strictly followed. Performance evaluations should be presented in writing and should be accompanied by an oral discussion with the physician. They should contain a provision for signature and comment by the physician to make the process as fair as possible. The combination of the written review and the oral discussion should give the physician an understanding of exactly where he or she stands with the employer. Employers should be honest in employment evaluations, to ensure that the employees have an accurate assessment of their strengths, as well as areas in which they need to improve.

9. Loyalty and confidentiality covenants

9.1 Duty of loyalty

The Physician agrees to perform loyally and conscientiously his or her duties under this Agreement.

This paragraph means the physician cannot engage in activities that would harm the employer's practice. Employees generally owe a legal duty of loyalty to their employers.⁶

9.2 Covenant not to compete during the term of the agreement/anti-moonlighting clause

The Physician shall not, without the express prior written consent of the Employer, directly or indirectly during the term of this Agreement, render services of a professional nature to or for any person or firm for compensation, or engage in any activity competitive with or adverse to employer's business or practice, whether alone, as a partner, or as an officer, director, associate or shareholder of any other corporation, or as a trustee, fiduciary or other representative of any other entity, except as provided hereunder. This clause is limited to activities within a 25-mile radius and extends so long as this agreement is in force to provide medical services. This clause shall not be construed to limit the Physician's right to teach, lecture or research, but any remuneration for the Physician's professional activities shall be remitted to the Employer. The

6. Rest 2d, Agency §§387-398 (1958).

parties agree that damages for breach of this covenant would be difficult to calculate and, therefore, agree to the amount of \$_____ as the amount of liquidated damages (not as a penalty) to be paid by the Physician to the Employer in the event of breach on this covenant.

Pro-employer: In addition, the Physician, while employed, shall not take any action without the Employer's prior written consent to establish or become employed by a competing medical practice on termination of employment by the Employer. The Physician's failure to comply with the provisions of the preceding sentence shall give the Employer the right (in addition to all other remedies the Employer may have) to terminate any benefits or compensation to which the Physician may be otherwise entitled following termination of this agreement.

The agreement should state whether it is exclusive, i.e., whether the physician may moonlight or practice medicine other than for the employer. The issue of whether the physicians may engage in outside medical activities, like teaching, lecturing, writing and directorships, or medical-legal consulting, and whether compensation from such activities belongs to the employer or to the physician, should also be addressed.

Covenants not to compete during the term of the agreement are generally enforceable if the competition restriction is reasonable as to the geographic area, the time period and the activity covered by the restriction. Some states would require simple disgorgement to the employer of any benefits received by the physicians resulting from the competitive activity. Others would permit liquidated damages.

9.3 Covenant not to compete after termination of employment

Caution: *This clause may be unenforceable in your state. Please contact an attorney.*

Pro-employer: The Physician agrees that, for a period of ____ [months or years] after this Agreement has been terminated [voluntarily or involuntarily] by the [Employer or Physician] [for cause or for any reason] the Physician will not, directly or indirectly, solicit or accept employment with the same or similar duties than under this Agreement, with any person, medical group or any other entity that is a competitor of the Employer, or enter into competition with the Employer, either by himself or herself, or through

any entity owned or managed, in whole or in part by the Physician [within a ____-mile radius of the Employer's facility where the Physician worked or within the [county(ies) or city(ies) of _____]. The Physician further acknowledges that: in the event this provision is determined to be unenforceable by a court of competent jurisdiction, the parties agree that this provision shall be deemed to be amended to any lesser area or duration as determined by any court of competent jurisdiction and that the remaining provisions shall be valid and enforceable.

9.3.1 In the event the Physician's employment with the Employer terminates for any reason, regardless of whether the termination is initiated by the Employer or the Physician, the Physician will be able to earn a livelihood without violating the foregoing restrictions.

9.3.2 The Physician's ability to earn a livelihood without violating such restrictions is a material condition of his or her employment with the Employer.

This restriction on the physician's ability to practice in the same community or region for a certain period of time may be an important consideration for employers. This limitation is obviously undesirable for employed physicians. The AMA Council on Ethical and Judicial Affairs Opinion E-9.02 states: "The Council on Ethical and Judicial Affairs discourages any agreement between physicians which restricts the right of a physician to practice medicine for a specified period of time or in a specified area upon termination of employment or a partnership or a corporate agreement."

Caution: *Covenants not to compete that prevent an employee from competing with his or her former employer after leaving are unenforceable in many states (see Appendix C, pages 44–46). In those states, physicians will generally not be bound by such restrictive covenants in the employment contract after employment ceases. Note, however, that some state laws on covenants not to compete are different if the physician has an ownership interest in medical groups or partnerships.*

The employer may wish the physician to pay a certain amount of money as a penalty if the employee leaves employment and practices within the group's area of competition. The law will not enforce penalties. It will, however, enforce "liquidated damages" provisions, which are only enforceable if the underlying covenant not to compete is enforceable.

Covenants not to compete may also affect whether or how the terminating physician may notify his or her patients of termination of employment separate from the practice.

9.4 Prohibition against hiring personnel

Pro-employer: The Physician agrees that, for a period of [six (6)] months commencing on the last day of his or her employment with the Employer, the Physician will not employ or cause to be employed with him or her, either directly or indirectly, for either full- or part-time employment, any current employee (employed within thirty (30) days of the employee's termination) of the Employer without first securing the written permission of the Employer, which permission shall not be unreasonably withheld.

Employers may wish to prohibit physician-employees from "raiding the staff" when they leave. This clause is generally enforceable even in states that prohibit covenants not to compete.⁷

9.5 Confidentiality clause

For purposes of this Agreement, the term "confidential information" includes all such information that is by law so protected, as well as any and all information that is maintained and designated as such by the Employer, or any employee of the Employer, including but not limited to the following: (i) information regarding the identity, address, health plan or insurance status, medical history, diagnosis and treatment of the Employer's patients (whether or not treated by the Physician); (ii) the records and proceedings of quality assurance, peer review or utilization review evaluations; (iii) information about the financial operations, business plans, strategy of the Employer; (iv) information agreed to be held as confidential with entities with whom the Employer has contracted. Physicians shall treat such information as confidential by seeing that it is stored securely and kept under password, if stored on a computer.

The Physician shall not, during the term of this Agreement or at any time thereafter, directly or indirectly use, permit others to use or disclose any confidential information except as is necessary: (i) in the course of performing duties as an employee

of the Employer; (ii) as may be required by law or by professional ethics; or (iii) as provided under paragraph 10.2 with respect to patients who wish to continue to see the Physician upon employment termination.

The agreement may contain a provision that requires the physician to keep confidential certain information obtained as a result of his or her employment. The employer may use such provisions to protect confidential business information, as well as to ensure the confidentiality of patient information. If employers wish to maintain their claim of confidentiality, they must treat their confidential information as confidential. Thus, if it is kept in folders, they should be marked confidential and computerized information should be protected by passwords. Likewise, employers should hold staff meetings from time to time to reiterate the confidentiality of the material.

Some employers may prevent a departing physician from notifying patients he or she treated during the course of employment. Absent a covenant not to compete, the physician should have the right to notify all patients whom he or she has treated and who he or she will be working with elsewhere when the agreement terminates. This right arises from the ethical requirement that patients be given freedom of choice in selecting their physician (see paragraph 10.2, page 25, for the AMA Opinion 7.03 on Notice to Patients).

"Nondisclosure," "trade secrets" or "confidentiality" clauses are often vague as to the precise scope of confidential information and are therefore difficult to enforce. Allowing an ambiguous clause to remain in the agreement creates a risk of inadvertent disclosure that could be construed as a breach of the agreement and could spark needless conflict or even litigation. If the employer insists on including such a clause, it should state as precisely as possible what types of information are considered confidential and specify how to identify such information.

9.6 Intellectual property

The [Employer or Physician] is entitled to any remuneration generated from intellectual property of any kind created by the Physician during the term of this agreement, including but not limited to inventions, patents, copyrights and software. [While the Employer owns all intellectual property created

7. Restatement (Second) of Agency §393, Comment e (1958) "An employee is subject to liability if, before or after leaving the employment, he causes fellow employees to break their contracts with the employer." See also *Frederick Chusid & Co. v. Marshall Leeman & Co.*, 279 F Supp 913, 1968 US Dist. In appropriate circumstances, the solicitation of other employees of a former employer may constitute a breach of the employee's good faith duty even though it takes place after the former employee was no longer employed. See also, for an example of state law, *Martin-Parry Corp. v. New Orleans Fire Detection Service*, 221 La 677, 60 So 2nd 83, (1952) The Louisiana Supreme Court, while reiterating the invalidity of the noncompetition agreement, upheld the validity of an agreement not to solicit the employer's employees.

by the Physician in whole or in any part arising from the Physician's employment during the term of this Agreement, the Employer will share ___ % of any net profits therefrom.]

The parties may wish the agreement to discuss which party is entitled to any remuneration generated from intellectual property of any kind created by the physician during the term of the agreement, such as inventions, patents, copyrights, software and writings. The agreement should state whether income derived from the physician's intellectual property is to be considered income from the practice of medicine.

According to the federal works-made-for-hire doctrine,⁸ the employer owns the copyright on materials created by the physician-employee within the scope of his or her employment, unless they have an agreement to the contrary. As for patents, "unless otherwise agreed, a person employed by another to do noninventive work is entitled to patents which are the result of his invention although the invention is due to the work for which he is employed."⁹ The employment agreement, therefore, should state clearly whether the intellectual property rights arising out of the agreement belong to the employer or to the physician. Giving the physician some reimbursement for such creations would be an intermediate provision.

9.7 Peer review information

The Physician shall execute and deliver authorizations and releases to peer review committees of other entities that will enable the full and timely disclosure to the Employer's peer review committee, to the fullest extent permitted by law, of all medical professional information about the Physician.

Pro-employer: The Physician grants immunity to the following persons and releases them from civil liability, to the fullest extent provided by law, for any action or disclosure with respect to the Physician that is made (or omitted) in good faith, which is related to the achievement or maintenance of the quality of patient care: [Shareholders, officers, and directors or Partners] of the Employer; employees of the Employer; any person supplying information to the Employer; and any professional review organization approved or utilized by the Employer. The Physician shall, upon the request of the Employer, execute a written statement

of this release in favor of any of the foregoing individuals or organizations.

Increasingly, medical groups are engaging in formal peer review activities. This increase is due, in part, to state laws.¹⁰ In most states, statutes protect certain peer review discussions and documents from discovery and compelled testimony in actions brought by malpractice plaintiffs.

In addition to the confidentiality protections provided by such statutes, peer reviewers are generally protected by state statutory or case law, which frequently provides some form of immunity from peer review liability, where the peer review committee is composed chiefly of physicians and acts in good faith after investigation, in the belief that the action is warranted by the facts discovered. Finally, the federal Health Care Quality Improvement Act of 1986 provides peer review protection to health care entities that engage in formal peer review and otherwise adhere to the requirements of the act. Employers and physician-employees should understand, therefore, that they will generally be protected from liability for good faith peer review activity under the provisions of the Health Care Quality Improvement Act so long as the peer review procedures are formally adopted and fairly conducted.

When a physician (or a medical group) is asked to release others from liability for peer review activity, he or she may want to refrain from doing so unless absolutely required by the employer. Unfortunately, legal liability is the only check on improper peer review. If the physician must sign an agreement with a peer review release, he or she may want to do so only to the "extent provided by law" in order to avoid an unduly broad release.

9.8 Indemnification

Pro-employer: The Physician hereby indemnifies and holds harmless the Employer and its directors, officers, employees and agents from and against any claim, loss, damage, cost, expense (including reasonable attorneys' fees) or liability arising out of or related to the performance or nonperformance by the Physician of any services to be performed or provided by the Physician under this Agreement [to the extent covered by insurance].

Under the legal doctrine of respondent superior, employers generally are required to indemnify and hold harmless

8. 17 USC §§101, 201.

9. Rest 2d, Agency §397.

10. 42 USCA §12112: "No covered entity shall discriminate against a qualified individual with a disability because of the disability of such individual in regard to job application procedures, the hiring, advancement, or discharge of employees, employee compensation, job training, and other terms, conditions, and privileges of employment."

employees for acts of negligence occurring within the course and scope of work. Employed physicians, therefore, generally do not need a clause ensuring the employer's indemnification of them.

Employers, on the other hand, may want the agreement to contain a "hold harmless" clause. This type of clause requires the physician to hold the employer harmless from any liability that the employer may incur as a result of professional acts or omissions of the physician. That is, if a patient sues both the physician and employer because of an act or omission on the part of the physician, the employer wishes the physician to agree that the physician will pay any of the employer's damages for liability.

Such clauses are generally not advised for physician-employees because the execution of such a hold harmless clause may result in the physician assuming liabilities of the employer that may not be insured. Most professional liability policies specifically exclude from coverage contractually assumed liabilities. A hold harmless clause causes physicians to contractually assume liability. Consequently, the physician may be "going bare" or uninsured as to liability assumed under the contract. Physicians, therefore, would be prudent to consult their professional liability insurers and attorneys before agreeing to this type of contract term.

As a compromise, the physician may agree to hold the employer harmless only to the extent that the physician's malpractice coverage will pay the cost of the employer's liability. However, the employer and physicians are usually covered by the same policy, making such a clause unnecessary.

9.9 Disclosure of detrimental professional information or contract violation

During the term of this Agreement, the Physician shall notify the Employer immediately, or as soon as is possible, in the event that:

1. The Physician's license to practice medicine in any jurisdiction is suspended, revoked, or otherwise restricted
2. A complaint or report concerning the Physician's competence or conduct is made to any state medical or professional licensing agency, including without limitation, the Medical Board of California
3. The Physician's privileges at any hospital, health care facility or under any health care plan are denied, suspended, restricted or terminated [or

under investigation] for [medical disciplinary cause or reason]

4. The Physician's controlled substance registration certificate (issued by the U.S. Drug Enforcement Administration) if any, is being, or has been suspended, revoked or renewed
5. The Physician has been excluded as a Medicare or Medicaid provider
6. There is a material change in any of the information which the Physician has supplied to the Employer concerning the Physician's professional qualifications or credentials

The Physician must also notify the Employer within ___ days of any breach of this Agreement, violation of any of the Employer's rules or regulations whether by others or by the Physician himself or herself, or if the Physician is subject to or participant in any form of activity which could be characterized as discrimination or harassment.

The purpose of this paragraph is to assure that the employer be given notice of any detrimental information that could adversely affect the practice.

10. Termination

10.1 Voluntary termination (formerly titled automatic termination)

This Agreement, and the Physician's employment by the Employer, shall be terminated as follows:

1. Automatically, with cause:
 - a) Upon the Physician's loss, restriction or suspension of his or her professional license to practice medicine in the state of _____
 - b) Upon the Employer's inability to obtain malpractice insurance on behalf of the Physician, or if the cost of obtaining such insurance exceeds by [___% or \$_____] the cost of obtaining such insurance for other physician employees
 - c) If the Physician violates the state Medical Practice Act
 - d) If the Physician's professional practice jeopardizes imminently the safety of patients

Pro-employer:

2. Immediately, at the Employer's discretion, if:

- a) The Physician is arrested and charged with a felony under (state) or federal law
- b) The Physician violates ethical and professional codes of conduct of the workplace as specified under (state) and federal law
- c) The Physician is found during the probationary review process to fail to perform his or her duties as measured by criteria at the discretion of the Employer
- d) Inadequate performance in medical care, documentation, quality review, management style or personal relations are grounds for earlier termination at the Employer's discretion

Pro-physician:

3. With notice, at either party's discretion, if:

- a) Without cause, upon ____ days' prior written notice by either party
- b) In the event of a material breach of this Agreement by either party upon ____ days' prior written notice (i) if the breach is "cured" or corrected within the notice period, the Agreement remains in full effect; or (ii) if the breach continues, the Agreement terminates upon the expiration date of the notice period

4. Upon the termination of this Agreement for any reason, the Physician (or his or her estate) shall be entitled to receive such compensation as has accrued up to the effective date of termination. [The Physician is not entitled to a portion of any post-termination collections of accounts receivable attributable to the Physician's pre-termination services.]

The termination clause of the agreement is probably the single most important clause in the contract because it can dash the expectations of one or both of the parties. Close attention should be paid to its terms and conditions.

The termination clause pits two important interests against each other: predictability (job security/stability of the work force) versus flexibility (the freedom to end something that is not working out). Physician employees want job security, but do not necessarily want to be stuck in a bad

working environment if things do not go well. At the same time, employers generally do not want the disruption to the practice of a sudden termination or to be forced to reinvest in recruiting and hiring, nor do they want to risk that the employed physician will terminate and open an office down the street. When things are not going well, however, both parties may want the flexibility to terminate employment.

Legally, termination may be for cause (i.e., based upon a reason or justification related to job qualification or performance by either party) or it may be without cause (no reason needed). It may be immediate or with notice, and either party may or may not be given an opportunity to cure any problems. To maintain maximum flexibility, the employer may wish the agreement to contain a provision stating that it may be terminated without cause by either party upon a certain number of days prior written notice, e.g., 90 days. This type of term essentially leaves the physician with a contract which lasts only for the stated notice period, subject to potential renewal. The employed physician should consider whether he or she can afford to be subject to termination without cause upon short notice, and the employer should consider the possible disruption to the practice that might occur if the physician left on short notice.

By contrast, the agreement should specify that—with good cause or for material breach—it may be terminated by either party upon a certain number of days' prior written notice. Good cause or material breach means a substantial or legally sufficient reason for terminating the contract, depending on the particular case. Termination for good cause (or for cause) can follow a breach of an important term in the agreement. For example, the employer may be entitled to terminate the contract for cause in the event the physician becomes disqualified to practice medicine, while the physician would be justified in terminating for cause if the employer fails to pay the physician for work performed.

Under certain circumstances, the employer may wish to have the right to immediately terminate the agreement, for example, if the physician loses his or her license or medical staff privileges, or becomes uninsurable. Where the physician works for a solo or small employer, he or she may wish to have the right to terminate immediately for the same reasons vis-à-vis the employer physician(s).

If the agreement is terminated for reasons relating to professional competence or conduct, and the employer conducts a formal peer review, federal law states that for the employer to be protected from liability under antitrust laws, the employer must offer the physician a fair hearing. Generally, state law also requires that a fair hearing be

afforded when an employee is terminated for reasons relating to professional competence or conduct from any licensed health facility, group of physicians that conducts peer review or from a Medicare certified ambulatory surgery center.¹¹ The employer's medical staff bylaws (if any) should specify the hearing rights to which the physician is entitled. Otherwise, the hearing rights should be spelled out in a written policy or manual. The right to a fair hearing may not be waived by contract or bylaws provisions. Physicians terminated for alleged medical quality reasons who wish to contest the termination and ensure a fair hearing should immediately consult an attorney experienced in physician legal matters, because such determinations must be reported to the National Practitioner Data Bank and the state licensing board.

The agreement should state whether there is any guaranteed wage continuation if the agreement is terminated by the employer. Wage continuation or severance pay may constitute full salary and benefits for a certain number of weeks or months, a percentage of total salary (and sometimes benefits) paid to the employed physician in the past or an amount determined by some other formula. The employer may require that wage continuation is not triggered until the physician has worked for the employer for a specified period of time. The employer, in deciding whether to provide wage continuation, should consider that such pay may appease the terminated employee and avoid post-employment difficulties. The employer may also provide wage continuation upon the physician's death or retirement, but this is less common.

10.2 Patient records upon termination and notice to patients

All original patient records shall be property of the Employer. Upon termination of this Agreement, the Physician shall return any such records as may be in the Physician's possession to the Employer, subject to the Physician's right to copies of records, as follows: Upon termination, the Physician is entitled to copies of patient charts and records upon a specific request in writing from a patient. Moreover, upon and after termination, full access to copy patient records will be allowed to the Physician [at the Physician's expense] for any reasonable purpose, such as in the event of a malpractice action or administrative investigation proceeding against the Physician, for medical research, or to compare a new case with an old one.

Pro-employer: When the Physician requests copies of medical records, the Physician must pay \$0.25 per page and \$0.50 per page for records copied from microfilm, or the actual costs for reproduction of oversize documents or those which require special processing, as well as reasonable clerical costs incurred in making the records available.

Continuation of clause: The Physician shall have the right to inform his or her patients of the fact that he or she is leaving the Employer, and to give his or her patients the opportunity to choose whether to remain with the Employer or remain with the individual physician. The right to notify patients of a new practice extends only to patients who were treated by the Physician as evidenced by at least one patient encounter as shown by an entry in the patient chart signed or initialed by the Physician. The notification shall use the following language:

Pro-employer:

The _____ Medical Group announces that Dr. _____ is leaving our practice and will be practicing at _____ [address and telephone number]. The _____ Medical Group will retain your medical records and will make available another physician for you in our group unless you direct us to transfer your records to Dr. _____ at his or her new address. You may contact us at [address, telephone number, facsimile number].

Pro-physician:

Dear [patient name]:

This letter is to inform you that as of [date], I will no longer be a member of _____ Medical Group. This does not necessarily mean that you will lose me as your physician, as I am joining a new practice, the _____ Medical Group, at the following: [practice address and phone number].

I am happy to provide your care through my new group, should you so desire. My new group has contracted with the following plans: [list plans].

If your plan is not listed and you are interested in remaining my patient, please call my new office manager, [name], at [telephone number] to discuss

11. E.g., Illinois law: 210 ILCS 85/10.4 (the right to a fair hearing for hospital medical staff members) or Massachusetts law: ALMGL Ch. III §51E (the right to a fair hearing for certain staff members of hospitals, clinics and dispensaries).

your options. You may also continue your health care through [current group] and the group will see to it that you are transferred to another fully qualified physician. Please let [current medical group, telephone number and address] know at your earliest convenience which of the options outlined above is best for you. If you chose to remain my patient and have any problems in transferring your records, please contact [name of office manager].

Sincerely,

[Dr. _____]

Termination of the contractual employment relationship does not necessarily end the physician-patient relationship. Upon contract termination, the parties should be sure that physician's patients are notified that he or she will no longer be working with employer. Patients should be given the choice to continue to be seen by the physician at his or her new office or to be treated by another physician still working with the employer.

This position is supported by Opinion E-7.01 of the AMA Council on Ethical and Judicial Affairs, which states, in part, "The interest of the patient is paramount in the practice of medicine, and everything that can reasonably and lawfully be done to serve that interest must be done by all physicians who have served or are serving the patient. A physician who formerly treated a patient should not refuse for any reason to make his records of that patient promptly available on request to another physician presently treating the patient."

Opinion 7.03 of the AMA Council on Ethical and Judicial Affairs states, "The patients of a physician who leaves a group practice should be notified that the physician is leaving the group. Patients of the physician should also be notified of the physician's new address and offered the opportunity to have their medical records forwarded to the departing physician at his or her new practice. It is unethical to withhold such information upon request of a patient. If the responsibility for notifying patients falls to the departing party rather than to the group, the group should not interfere with the discharge of these duties by withholding patient lists or other necessary information." In addition to the issue of the patient notification, the physician's entitlement (if any) to patient lists and records upon termination of the agreement should also be addressed in the termination clause.

Because there are potentially competing interests, it is advisable for the parties to agree to the form of the notice

prior to signing the agreement to avoid future disputes. Samples of pro-employer and pro-physician notice have been offered. These can be customized by the parties as desired.

The employer may wish the agreement to specify that, upon termination, the physician will not be entitled to keep or copy charts, files, patient lists, etc. However, the agreement should acknowledge that the physician is entitled to copies of patient charts and records upon a specific request in writing from any patient. Moreover, the agreement should allow full access to patient records in the event of a malpractice action, administrative investigation or proceeding against the physician, as they would be necessary to the physician's defense.

10.3 Effect of merger, consolidation, dissolution

Pro-physician: In the event the Employer is acquired by or merges with another entity of the same or larger size, the Physician shall have the right to terminate the Agreement and upon such termination shall be entitled to full compensation through the date of termination. Additionally, upon such termination the Physician shall receive an amount equal [to ____% of the monthly base salary that the Physician would have received for the remainder of the term of the Agreement had the Physician continued employment for the full term of the Agreement or ____ times the last ____ months' compensation]. This additional sum will be paid to the Physician in a lump sum within thirty (30) days of his or her date of termination under this paragraph.

Pro-employer: In the event of a merger in which the Employer is not the surviving entity, or a sale of all or substantially all of the Employer's assets, the Employer may, at its selection (i) assign this Agreement and all rights and obligations under it to any entity that succeeds to all or substantially all of the Employer's practice through that merger or sale of asset; or (ii) on at least ____ months' prior written notice to the Physician, terminate this Agreement on the date of the merger or sale of assets.

Neutral: This Agreement shall not be terminated by the Employer's voluntary or involuntary dissolution or by any merger in which the Employer is not the surviving entity, or on any transfer of all or substantially all of the Employer's assets. This provision of this Agreement shall be binding on and inure to the benefit of the surviving entity or the entity to which such assets shall be transferred.

As markets consolidate, mergers and acquisitions in health care are virtually inevitable. As a result, the agreement should contemplate the position of each party in the event of such a merger or acquisition. The physician may want the agreement to remain in place, or he or she may want the right to terminate the contract. If the contract is terminated as a result of a change in ownership, the physician may want to negotiate for payment of a “golden parachute” for any transition period.

10.4 Market conditions

Caution: *Use of this clause may void the entire contract.*

Pro-employer: The health care system in this country is currently experiencing substantial and rapid changes affecting all health care providers. In order to respond and adjust to these changes quickly and effectively, the Employer reserves the exclusive right to reassign the Physician to a different department or facility, alter the Physician’s work schedule, and make any other changes in the conditions of the Physician’s employment according to the needs of the organization. Some of the conditions of the Physician’s employment are set forth in the Employer Policy Manual, which reflects the policies established by the Board of Directors of the Medical Group. The Policy Manual is amended from time to time by the Board of Directors of the Medical Group and all such amendments are binding upon the Physician, as applicable.

A clause such as this is designed to give the employer maximum flexibility. The problem is that the clause is so flexible that it may make the contract nonbinding under state law. Because this paragraph gives the employer the unilateral right to modify any conditions of the physician’s employment, a court could hold that there is no enforceable agreement between the parties and could invalidate the entire agreement.

Note also the reference to “some conditions” of physician’s employment being set forth in a policy manual. The precise provisions of the manual are not identified. This is vague and could be a possible point of contention. The specific provisions of the manual should be identified and incorporated by reference.

Because of the potential legal invalidity of this clause, both physicians and medical groups should avoid signing contracts containing such provisions.

11. Disability or death

11.1 Compensation for physician’s temporary or permanent disability

The Employer is responsible for contributing to the state Workers’ Compensation and disability funds on the Physician’s behalf. If the Physician becomes ill or injured on the job, he or she is entitled to Workers’ Compensation as defined by the Workers’ Compensation law of the state of _____. If the Physician becomes disabled for any reason, he or she will become eligible for state disability payments as specified by the state Disability Board.

Pro-physician: If the Physician shall become permanently and totally disabled, and retire on account of such disability, the Employer will continue the wages of the Physician for a period of ____ months commencing with the month following the month in which such permanent and total disability first occurs. Notwithstanding the proceeding, no disability payments shall be made after the death of the Physician. The term “permanent and total disability” shall mean that the Physician is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than twelve (12) months.

Pro-employer: If the Physician dies or is absent from practice for ____ weeks, or is, in the sole judgment of the Employer, unable to sustain the duties of working full time due to ill health or injury, the Employer may terminate the Physician’s employment by supplying the notice provided in paragraph 11.2 below. Employer shall pay the Physician compensation during any period of the Physician’s medical absence in accordance with the Employer’s sick pay policy at the time. The Physician’s rights under any disability insurance policy are strictly a matter between the Physician and the insurance company underwriting the disability policy. If the Physician’s employment terminates by reason of his or her death or medical absence, the Employer shall only be obligated to pay any unpaid and accrued salary and bonuses due at the Physician’s last date of employment.

11.2 Rights of physician upon his/her temporary total disability

“Temporary total disability” shall mean that the Physician is unable to perform his or her obligations

under this Agreement for a period of _____ weeks or less. If the Physician becomes temporarily and totally disabled, he or she shall be entitled to a [paid or unpaid] medical leave of _____ weeks, in addition to the sick leave provided for in paragraph 7.9.

11.3 Rights of physician upon his/her temporary partial disability

“Temporary disability” shall mean that the Physician has become disabled for a period of _____ weeks or less. Temporary disability is partial when the Physician is able to do some work. If the Physician becomes temporarily and partially disabled, the Employer shall allow him or her to work on a modified schedule for the duration of his or her disability or until this Agreement expires, whichever comes first. This scheduling accommodation is offered pursuant to the terms of paragraph 11.4 below, including but not limited to the condition that the Employer need not offer the accommodation if it would impose an undue hardship on the Employer.

11.4 Physician’s permanent partial disability/ accommodations for disability

1. If the Physician at any time during the term of this Agreement should become partially disabled as defined under the Americans With Disabilities Act (ADA), the Employer shall take affirmative steps to make reasonable accommodations so that the Physician can continue to work. Such accommodations may include, but are not limited to, making facilities readily accessible to and usable by the Physician, allowing the Physician to work on a part-time or modified work schedule, modifying equipment, and placing the Physician in an existing vacant position that he or she is qualified for and able to perform. This provision shall not be construed to require the Employer to make an accommodation that would impose an undue hardship on the operation of the Employer’s business.

2. If the Physician at any time during the term of this Agreement should become unable to perform the duties required by this Agreement because of any

condition or cause that does not render the Physician a qualified worker with a disability for purposes of ADA, the Employer may in its sole discretion assign the Physician to other duties, and the compensation to be paid thereafter to the Physician shall be determined by the Employer in its sole discretion. If the Physician is unwilling to accept the modification in duties and compensation made by the Employer, this contract shall terminate [immediately or within (specify time period) thereafter].

Subhead level B:

11.5 Termination for physician’s permanent total disability or death

If the Physician becomes permanently and totally disabled, the Employer or the Physician may terminate the Physician’s employment. Either the Physician or the Employer shall have given the other party _____ days’ written notice of his or her intention to terminate this Agreement because of such disability. “Permanent disability” shall mean that the Physician has become physically or mentally incapable (excluding infrequent and temporary absences due to ordinary illnesses) of properly performing the services required of him or her under this Agreement and that such incapacity shall exist or be reasonably expected to exist for more than _____ consecutive weeks in the aggregate during any one (1) year period. Total disability shall mean that the Physician’s disability has been rated 100% by the Employer’s group disability insurer. If the Physician’s employment terminates by reason of his or her death or disability, the Employer shall only be obligated to pay any unpaid and accrued salary and bonuses due at the Physician’s last date of employment.

In case of the physician’s temporary¹² or permanent¹³ disability, whether total or partial, the parties may wish the agreement to state that the employer will provide certain benefits. These benefits may be a portion of salary for a certain (specified) number of months after the disability occurs. The model does not provide salary redemption, but relies on the employer’s sick leave policy and group disability insurance policy (often provided by the employer). Sometimes the employer will self-insure the first few months of disability (often using the

12. E.g., in California, temporary partial disability exists when the employee is able to do some work. But if he is only able to do odd or specialized jobs, the burden is on the employer to show that such work is available to him (*Meyers v. Industrial Acc. Com* [1940] 39 C.A.2d 665). Temporary total disability exists when the employee is substantially incapacitated for gainful employment, with “consideration being given to the ability of the injured employee to compete in an open labor market” (Lab. Code §4653). Certain disabilities are presumed total, e.g., the loss of both eyes or of both hands, or an injury resulting in total paralysis or an incurable insanity (Lab. Code §4662).

13. E.g., in California, permanent disability exists when the condition becomes substantially stationary, even though further medical treatment may be required (*Postal Tel Cable Co. v. Industrial Acc. Com* [1931] 213 C.544.) Permanent disability may be total (rated 100 percent) or partial (any injury rate lower than 100 percent). (Lab. Code §4452.5.)

accounts receivable generated by the employee) and provide a disability insurance policy which kicks in after those first few (usually three to six) months. Total disability generally leads to contract termination after a specific period of time.

If the employer may terminate the agreement upon the disability of the physician, a definition of what constitutes disability¹⁴ should be stated.¹⁵ The type of disability, i.e., temporary or permanent, partial or total, should also be defined in the agreement. Each type of disability could have different consequences, which should also be spelled out.

The accommodations for disability paragraph is a provision that obligates the employer to make reasonable accommodations so that the physician can continue working if he or she becomes disabled under the ADA (42 U.S.C. §§12001 et seq.). This provision essentially restates the employer's obligations under the ADA (see 42 U.S.C. §§12112[b][5]). The second part of this paragraph provides that if the physician's inability to perform the job results from a condition or cause that is not covered by the ADA, any modification of the employee's duties and compensation is in the employer's sole discretion. However, the physician is given the right to reject any proposed modification and thus terminate the contract either immediately or after a specified period of time.

Caution: The law greatly restricts an employer's discretion to terminate a disabled employee.¹⁶ Before taking such action, a lawyer familiar with the pragmatic demands of the practice of medicine and employment law should be consulted. Indeed, many employers and labor lawyers shy away from using the word "disabled" in their employment agreements because of the implication of the ADA. This agreement takes a more straightforward approach. In a personal services profession like the practice of medicine, a doctor's disability is a significant risk to both the employer and the employee.

An absent doctor can significantly disrupt the operations of the office and such an absence can have a serious impact on earnings—and even the retention of the job. Accordingly, it is better to identify and allocate this risk in order to understand the definition of disability, whether there are disability benefits and the consequences of a prolonged absence due to injury or illness.

12. Remedies

12.1 Arbitration/mediation

Any controversy or claim arising out of or relating to this contract, or the breach thereof, shall be settled by arbitration administered by the American Arbitration Association under its commercial arbitration rules, and judgment on the award rendered by the arbitrator(s) may be entered in any court having jurisdiction thereof.

It is recommended that the parties to an employment agreement arbitrate their disputes as an alternative to litigation in the courts. While each process has its advantages and disadvantages, arbitration is generally faster and less expensive than litigation. It also avoids public exposure associated with court proceedings.

13. Miscellaneous

13.1 Amendment

This Agreement may be amended or modified only by a written document signed by both parties hereto.

Restriction on amendment to the employment agreement prevents either party from changing the contract without the

14. The ADA's first definition of disability hinges on the restrictions actually imposed by physical or mental impairments (42 U.S.C. §12101 et seq.). Physical impairments are defined as physiological disorders or conditions, cosmetic disfigurements or anatomical loss affecting a recognized body system. Mental impairments are any mental or psychological disorder. Generally, disability, for purposes of the ADA, does not include a temporary, nonchronic impairment that has little or no long-term effect, such as a sprained ankle, influenza or pregnancy (29 CFR §1630.2(j)(2)). A broken leg that takes eight weeks to heal is an impairment of relatively brief duration, and normally would not be considered substantially limiting. Thus, it is not a disability. If the broken leg heals imperfectly, however, the result of the impairment—a permanent limp—might be a disability. The above definition of disability follows the definition of handicap in other statutes, such as the Rehabilitation Act of 1973 (29 USC §706(8)(B)). Courts and regulators have interpreted disability very broadly to include such conditions as AIDS, asymptomatic HIV-positive status, chronic fatigue syndrome, depression, diabetes, emotional or mental illness, epilepsy, heart disease, high blood pressure, hypersensitivity to cigarette smoke, learning disorders, mental retardation, migraine headaches, multiple chemical sensitivity, schizophrenia, very short stature and vulnerability to stress.

15. E.g., the State of Oregon Workers' Compensation Act defines permanent total disability as "the loss, including preexisting disability, of use or function of any scheduled or unscheduled portion of the body which permanently incapacitates the worker from regularly performing work at a gainful and suitable occupation" (ORS §656.206). The same statute defines permanent partial disability as "the loss of either one arm, one hand, one leg, one foot, loss of hearing in one or both ears, loss of one eye, one or more fingers, or any other injury known in surgery to be permanent partial disability" (ORS §656.214). See also, Florida insurance law, which states "a person is totally disabled if the person is unable to perform the material and substantial duties of the person's regular occupation" (FSA §627.4233). See also, the New Jersey law applicable to hospital employees, which indicates that total disability exists only while the employee "(1) is not engaged in any gainful occupation, and (2) is completely unable, due to sickness or injury or both, to engage in any and every gainful occupation for which the person is reasonable fitted by education, training or experience."

16. 42 USCA §12112: "No covered entity shall discriminate against a qualified individual with a disability because of the disability of such individual in regard to job application procedures, the hiring, advancement, or discharge of employees, employee compensation, job training, and other terms, conditions, and privileges.

written consent of the other, either intentionally or through good faith misunderstanding. Contracts generally specify that no amendment or change to the terms of the agreement is valid unless made in writing, and signed by the physician and a duly authorized representative of the employer.

Changes made during the term of the contract, such as salary increases or changes in benefits or duties, should also be memorialized in writing by the parties.

13.2 Notices

All notices required by this Agreement shall be sufficient if delivered in writing either personally to the party to be notified or deposited in the United States mail, postage prepaid and return receipt requested, addressed to the party at the addresses set forth below:

Table with 2 columns: Employer, Physician. Each column has three blank lines for address entry.

Because many conditions of the contract depend on notice to the other party, the addresses and manner of delivery of notices should be specified.

13.3 Entire agreement

This Agreement constitutes the entire agreement between the Employer and the Physician with respect to matters relating to the Physician's employment, and it supersedes all previous oral or written communications, representations or agreements between the parties.

This "integration clause" requires all terms be addressed in the agreement or integrated into the agreement. Neither party can rely on any representations, verbal or written, if they are not incorporated into the agreement.

Any referenced attachments should be attached to the contract. Contracts may refer to documents or attachments that are "incorporated herein by reference." Such documents become fully binding on both parties and therefore must be carefully reviewed. The parties should verify that each has current copies of the same version of documents incorporated in the employment agreement by reference.

13.4 Assignment/merger or acquisition

Pro-employer: The rights and benefits of the Employer under this Agreement shall be fully assignable and transferable, and all provisions herein shall inure to the benefit of and be enforceable by or against

its successors and assigns. Neither the rights nor the benefits of this Agreement may be assigned or delegated by [the Physician or the Employer] without the written consent of the other party.

Pro-physician: If Employer assigns its rights under this Agreement, the Physician shall have sixty (60) days within which to elect to continue working under the terms and conditions of this Agreement or to terminate the Agreement.

Neutral: Nothing contained in this Agreement shall be construed to permit the assignment or delegation by the Employer or the Physician of any obligations or rights hereunder, without the prior written consent of the other party.

An assignment of a contract is a transfer of the agreement by one party to a third party. For example, an assignment by an employer medical group may be a transfer of the obligations under the agreement to another employer medical group, medical service organization, independent practice association or physician practice management company. In today's market it is important that the issue of assignment rights be considered by both parties. This paragraph presents three options with regard to assignment.

13.5 Partial invalidity

If any provision in this Agreement is held by a court of competent jurisdiction to be invalid, void or unenforceable, the remaining provisions will nevertheless continue in full force without being impaired or invalidated in any way.

This "savings" clause prevents the voiding of the entire agreement if one or more clauses are determined to be unenforceable by a court. This is standard language in virtually all contracts.

13.6 Attorney's fees and costs

In case of enforcement action arising under or related to this Agreement, the prevailing party shall be entitled to reasonable attorney's fees, costs and necessary disbursements in addition to any other relief to which he or she may be entitled. This provision shall be construed as applicable to the entire Agreement.

Unless the parties agree otherwise, each party to a lawsuit, mediation or arbitration ordinarily will pay his or her own attorney's fees and costs plus a pro rata share of the neutral arbitrator's fees and expenses. This clause clearly states the intention of the parties that the losing party is responsible

for legal fees. This clause may actually favor the employer because the employed physician may have a disincentive to bring action due to the risk of being responsible for all fees.

13.7 Governing law

This Agreement will be governed by and construed in accordance with the laws of the State of _____.

The state law that will apply to the enforcement of the agreement should be specified. Generally, the applicable state law will be obvious. However, if an employer does business in more than one state, the applicable law may not be so obvious. Contract law and laws governing the practice of medicine differ depending on the state. When seeking the assistance of an attorney, physicians should confirm that the attorney is experienced in the law of the relevant state.

13.8 Independent counsel/legal fees

The Physician acknowledges that he or she had the opportunity to consult an attorney regarding the terms of this Agreement.

Pro-physician: The Employer shall reimburse the Physician for all legal costs of up to \$_____ due by the Physician to his or her attorney for consultations regarding the terms of this Agreement.

Independent review by attorneys familiar with the practice of medicine and employment law is absolutely essential for both sides.

13.9 Counterparts

This Agreement may be executed in separate counterparts, each of which is deemed to be an original, and all of which taken together constitute one and the same Agreement.

This paragraph ensures that each party can sign separate copies and the agreement will still be binding. Nevertheless, it is recommended that all parties sign enough copies to give one to each party and to each lawyer. Providing a full set of completely signed copies to counsel ensures that each party will have a “safety copy” of an original agreement should they need it.

13.10 Authority of signatory to bind principal

Each signatory represents that [he or she] is fully authorized to enter into the terms and conditions of this Agreement and to legally bind the party on whose behalf the signature is proffered.

This clause ensures that the persons signing the agreement have the corporate or legal authority to do so.

13.11 Signatures

IN WITNESS HEREOF, the parties hereby execute this Agreement.

By: _____

Date: _____

Employer: _____

Address: _____

By: _____

Date: _____

Physician: _____, MD

Address: _____

The end of the agreement should contain lines for both parties’ dated signatures. The agreement may not be enforceable until it is signed by both parties. Therefore, the physician should not act in reliance on a contract (e.g., sell a house or quit a current job) until the contract is signed. Each party should insist on having a copy of the contract with all of the original signatures on it, and it is prudent for your lawyer to keep a signed original also.

All blank spaces within the agreement should be filled in before the agreement is signed, and all signed copies should have all blanks filled. Additions to the agreement, such as filling in blanks or making amendments, may be handwritten rather than typed in, but they must be initialed by all parties. It is also prudent to have all parties initial the bottom of each page.

Appendix A

••• Tax and ERISA considerations for compensation, benefits and expenses

Compensation

Creating an equitable compensation package is an extremely important strategic part of putting a medical group together and keeping it together. The incentives for all parties must be neatly aligned. This requires balancing the business objectives of the employer with the personal objectives of the employee. Compensation planning may involve the use of tax-favored methods of withdrawing funds from the practice for its equity owners and the use of tax-beneficial means for attracting and retaining employed physicians, while providing incentives to motivate their performance.

Because of the complex tax issues involved in negotiating and drafting an employment agreement, both parties should consult an attorney experienced in physician transactions.

Generally, employee compensation is tax deductible for the employer as an ordinary and necessary expense of the practice. Tax regulations permit a deduction for “a reasonable allowance for salaries and other compensation for personal services actually rendered.”¹

For the employee, taxable income includes all payments received for rendering services, unless they are in the form of a qualified tax exempt benefit under the Internal Revenue Code.

Compensation may be made in cash or in any other form that might benefit the employee. Both parties should be aware that payments, such as vacation pay, unemployment benefits, payment for the cancellation of an employment contract or payments for a covenant not to compete, are taxable income, as is forgone interest on below-market or no-interest loans.²

Compensation must be reasonable and in proportion to physician services. The issue of reasonableness of

compensation should not frequently arise in physician employment contracts, because the contracts are usually closely related to the professional services rendered by the physician. If, however, a substantial owner of a medical group disproportionately benefits from the services of other physicians, for example because of seniority, the distributions from the corporate entity or LLP could be re-characterized by the Internal Revenue Service (IRS) to be a dividend or distribution of profits (particularly if there are only a few shareholders in the group and the distributed amount corresponds or bears a close relationship to the ownership interest). Such dividends or profit distributions are not deductible to the employer, so they are taxed twice—at the corporate or medical group level and at the employee level.

If the excessive portion of compensation payments is disallowed as a nondeductible dividend, it is recommended that employers consider entering into payback agreements with employees that require them to repay the employer for the disallowed portion (*see paragraph 5.12, page 12*)

Nonqualified deferred compensation agreements

In some instances where medical practices are highly profitable, the corporation may wish to set up deferred compensation arrangements that defer receipt of salary, bonuses and other incentive compensation, and provide additional compensation at retirement. Such plans may be funded or unfunded. Nonqualified plans must comply with Internal Revenue Code Section 409A and emerging regulations to avoid tax surprises for employees and their employers. Overlooking or inadvertently violating section 409A can subject a payment you—and your employer—hoped would be deferred to current income tax interest and a 20 percent excise tax.

Funded deferred compensation arrangements involve earmarked funds that are set aside to meet the corporation’s deferred compensation obligations. Certain IRS-approved trusts can be used to provide deferred compensation to the employee and a current deduction to the corporation. However, the deferred compensation in a funded plan is taxable when the employee’s rights become “substantially vested,” even if they are not paid to him or her at that time.

Unfunded plans are paid from the employer’s general funds and remain subject to the claims of creditors. Income tax

1. Internal Revenue Code Section 162(a)(1)

2. Internal Revenue Code Section 7872

on compensation from unfunded plans may be deferred until payments are made to the employees if Internal Revenue Code Section 409A compliance is achieved. The employer deducts payments when they are taxed to employees. Physician-employees may be reluctant to take an unsecured promise to pay in the future while the employer may not wish to tie up its working capital for compensation if it is not to be immediately disbursed. Deferred compensation may be secured through a life insurance or annuity policy that ensures payment of the deferred compensation, while still qualifying the arrangement as unfunded. Such unfunded arrangements balance the competing concerns associated with deferred compensation plans. Unfunded deferred compensation plans also may be secured by a “rabbi trust.” Such an arrangement allows the employer to set aside funds to ensure that employees are paid the compensation deferred as long as the employer remains solvent. Such a trust, however, ties up substantial amounts of the employer’s assets without providing an immediate tax deduction or protecting them from the claims of creditors. The employer is also taxed on the trust’s income.

Qualified retirement plans

Retirement plans may be qualified, and therefore structured in compliance with certain Internal Revenue Code requirements, or they can be unqualified.

Contributions to qualified plans are tax deductible to the employer, contributions to unqualified plans are not. Among other restrictions, a qualified plan has limitations on the amount that can be contributed to an employee’s account and prohibitions against discrimination in the amounts contributed to high- and low-paid employees.

Qualified deferred compensation plans are subject to restrictions under both the Internal Revenue Code and the Employee Retirement Income Security Act (ERISA). These plans usually provide retirement benefits to all employees on a nondiscriminatory basis, and have tax benefits to the employers and the employees:

- The contribution to the qualified plan is tax deductible to the employer when made, even though the employee receives the benefits years later

- The tax on the benefits to the employee are deferred until distribution
- Tax on income earned by funds held in the plan is deferred until distribution
- Amounts may be rolled over to other eligible retirement plans
- Lump sum distributions may receive favorable tax treatment

A *qualified defined contribution plan* provides a retirement benefit that is dependent on the amount contributed over the years. The employer and the employee may contribute to an individual account for the employee, and the benefit accrued by the employee depends on the total amount contributed over the period of employment, plus any gains or losses on the investment of funds.

A *qualified defined benefit plan* provides a set amount of benefits for employees upon retirement, payable usually until the employee’s death. Such benefit plans are most often linked to the employee’s length of service and level of compensation. The annual contribution is fixed actuarially to fund the defined benefits. While these plans were once highly favored, they have now generally fallen into disuse because of their high administrative costs.

Golden parachute payments

Assuming a long-term employment arrangement is anticipated, a golden parachute agreement between the employer and the physician can provide special payments if the medical practice is sold, merged or makes other major changes in its structure. In the current climate of group mergers and job insecurity, golden parachutes may be something for both parties to consider in order to provide a sense of stability for both sides.³

Stock-based compensation

Not-for-profit health care providers generally do not have stock and cannot offer stock-based compensation. Using stock as compensation in medical groups is rare because, in most states, ownership of medical groups is limited to licensed professionals, so there is virtually no market for shares.⁴

3. A golden parachute payment by a tax-exempt employer, such as a not-for-profit hospital, could constitute unreasonable compensation, which would violate the anti-inurement rules of §501 (c) (3) or (4) and result in excise taxes under § 4958 of the Internal Revenue Code. See footnote 1.

4. Shares in a medical service organization (MSO) or physician practice management company (PPM), which are not professional corporations, often can be freely traded. Physicians taking such stock as compensation must be careful to ascertain the true market value of the stock. Many MSOs and PPMs have failed and the physicians involved did not receive the benefits anticipated. Such transactions may have complicated securities and tax issues, as well as health law questions. In such cases, physicians, the medical group and the MSO should each have experienced counsel.

In states without the corporate bar or in dynamic market conditions where appreciation in stock value of a medical group is anticipated, stock-based compensation can be considered in lieu of cash. Where growth of the group is anticipated, and real profits and long-term appreciation in the stock are expected, the employer may consider offering and the employee may consider asking for:

- Additional corporate stock for key employees, which may or may not be subject to certain restrictions, depending on the circumstances of the negotiations
- Nonqualified stock options that set a price for shares that can be acquired over time, but are restricted to the exercise and disposition of the stock option
- Stock and installment sales that allow certain physician-employees to purchase shares through installment payments (a device sometimes used to bring employed physicians into equity ownership)
- Stock appreciation rights that provide a long-term incentive based on the appreciation in value of the corporation's stock over a specified time
- Phantom stock arrangements that allocate hypothetical shares to employees, which can later be converted to stock, cash or a combination of the two
- Performance incentive compensation plans that set milestones and provide compensation in stock or cash based on an achievement of the stated goals

To the extent that the stock prices are below market value, the difference between the employee's stock price and the going market value of the stock is taxable income to the employee and deductible to the employer when the stock is actually acquired. Stock-based compensation programs are highly technical and may involve both tax and securities issues, so they should be constructed only with the help of experienced legal counsel.

Fringe benefits

Nontaxable fringe benefits include:

- Medical coverage (qualified plan)
- Premium for qualified long-term care insurance
- Employer contributions to medical savings accounts

- Qualified group life or group term life insurance up to \$50,000
- "Cafeteria" benefit plans
- Employee discounts
- Qualified transportation fringe benefits and dependent care assistance
- Qualified adoption assistance
- De minimus fringe benefits
- On-site athletic facilities
- Meals and lodging provided for the convenience of the employer as a condition of employment
- Christmas and other holiday gifts of nominal value

Taxable fringe benefits for employees include:

- Vacation payments
- Employer-paid educational expenses, unless they are job-related and the employer pays the educational organization directly or requires a full accounting before reimbursing the employee
- The cost of employer-paid life insurance premiums for coverage above \$50,000
- Housing payments or allowances, except when provided for the convenience of the employer or as a condition of employment
- Employer-provided child care unless provided under a qualified dependent/care assistance program
- Employer-paid or reimbursed moving expenses unless they meet the requirements of the Internal Revenue Code

Health insurance and reimbursement of medical expenses

Typically, employers—especially medical groups—provide health insurance or coverage by purchasing coverage from a health plan or insurer. Health benefits may be provided for the employee as well as to his or her dependents on a nontaxable basis. Corporate employers may also provide for reimbursement of medical deductible expenses. Employers may contribute to health plans in different ways. They may

pay the premium on a health policy, contribute to a separate trust or fund that provides accident or health benefits directly or through insurance to employees, or they may reimburse the employees who are not covered by group insurance for the expense of purchasing their own policies. The employer may pay the full cost of coverage or share the cost with the employee. Alternatively, the employer may provide health coverage through a flexible spending arrangement, under which the employee contributes pretax amounts to an account, then is reimbursed for his or her health expenses. Flexible spending accounts, however, must meet additional requirements to qualify as a health plan. Such medical reimbursement plans also must not discriminate in favor of well-paid employees. Employees are not taxed on their contributions to health insurance premiums or on qualified medical reimbursements.

Professional courtesy offered within an integrated medical group is nontaxable, but professional courtesy among physicians outside the same group may raise fraud and abuse concerns.

Dependent care assistance

Dependent care allowances under a qualified plan can be an excluded form of income up to \$5,000 per year for an employee filing jointly. This program, however, must be established in writing and meet strict Internal Revenue Code guidelines that ensure the dependent care is provided primarily to lower paid employees.

Life insurance and death benefits

Employers also may provide, tax-free to all employees, a group term life insurance with benefits up to \$50,000. Key-man insurance, however, covering only highly paid employees, is subject to income tax. Corporate employers may also provide up to a \$5,000 death benefit that is tax exempt. This, however, must be available to all employees of the corporation.

Accident and disability insurance

Employers may also provide group accident and disability policies. Due to the rise in disability claims from physicians, however, the cost of disability insurance has increased dramatically. Nonetheless, group disability insurance is less expensive than individual policies. Where income depends on personal services, as it does for physicians, a disability insurance policy is extremely important for both peace of mind and sound business planning. The AMA Insurance Agency Inc. offers this type of coverage.

Workers' compensation

Employers are required to provide workers' compensation benefits for all employees.

Cafeteria plans

A flexible benefit plan called a cafeteria plan can be offered to employees whereby the employees may choose their own "menu" of benefits in cash and qualified benefits. The cash under this benefit program is subject to taxation. The cost of providing a qualified cafeteria plan may be deducted by the employer. The plan must be established by a written document and may not discriminate in favor of highly paid employees. The plan is also subject to strict record-keeping requirements. These arrangements are usually limited to larger groups, and require specialized administration. Both employers and employees should consult the plan administrator if they have questions about cafeteria plans.

Expense reimbursement

Employment contracts should contain a provision outlining the procedures for expense reimbursement. Employers may reimburse or employees may deduct ordinary and necessary expenses paid or incurred in the practice of medicine. These include certain educational, transportation, uniform, moving and job hunting costs. Unless there is a written agreement between the employer and employee for reimbursement, or expense allowance arrangements on an employer reimbursement policy that meets IRS requirements, such reimbursements are considered income to the employee and the employee must report an offsetting deduction. The agreement or policy must establish reimbursement for expenses that have a business connection, and must require detailed documentation of the expenses and provide for the return of any amounts in excess of the expenses.

Moving expenses

The employment agreement may provide for reimbursement for moving expenses. Those expenses may include not only the cost of moving household goods, but lodging for the employee and family in transition. To qualify, the taxpayer's new principal place of work must be at least 50 miles farther from his or her former residence than was his or her former principal place of work. If he or she has no former principal place of work, his or her new place of work must be at least 50 miles from his or her former residence.⁵ If moving expenses are not reimbursed

by the employer they may be deducted by the employee. The employee may also deduct the costs of job hunting, including airfare, auto mileage expenses, employment agency fees, typing and printing, postage, toll calls, and advertising and legal fees, if the employee is looking for a job in the same trade or business in which he or she is currently employed.

Automobile allowances

Employers may provide employees with automobiles. However, the accounting requirements for employer-provided vehicles have become so complex that most advisors now recommend that the employee use his or her own vehicle and deduct the miles as an un-reimbursed business expense or reach an agreement with the employer to reimburse the employee for business miles. Any reimbursement of mileage above the IRS per-mile allowance is taxable income to the employee. In addition to mileage, the Internal Revenue Code also permits an untaxed \$110 value for transit passes and subsidizations of car pools or ride-sharing agreements, and up to \$215 for parking per month.

Travel and entertainment expenses

Travel expenses (transportation, lodging and meals) incurred while away from home on business can be reimbursed by employers. If not reimbursed, they are deductible by employees. This includes travel to conventions and scientific meetings. Foreign travel is deductible only to a limited extent and must be allocated between business and nonbusiness time. Entertainment expenses may also be reimbursed if they directly relate to the conduct of the practice and are conducted in a setting where reasonable discussions can be held. Only 50 percent of otherwise allowable meal and entertainment expenses can be deducted.

The employer should consider reimbursing employee expenses, because all of an employee's nonreimbursed expenses, including travel and entertainment, must be lumped together and can be deducted only as a itemized deduction—and then only if it exceeds 2 percent of the employee's adjusted gross income. If the expenses are reimbursed by the employer, there is no 2 percent minimum.

There are, however, strict record-keeping requirements for entertainment expenses. The employer must determine if the employee's entertainment/meal expenses are business related, whether they are subject to the 50 percent limitation and whether a business discussion occurred during or immediately preceding or following the meal.

Adequate records, therefore, must be maintained, usually in the form of a diary, expense statement or similar record detailing each of the items for the deduction. The record should set forth the amount, date, place and the essential character of the expenditure.

Dues, subscriptions and CME

Most medical groups provide dues to organizations such as the AMA and state and specialty societies. These are nontaxable to the employee and deductible by the employer. Subscriptions to trade journals and other publications are also a nontaxable benefit, and an allowance for such subscriptions is usually provided.

The employer may also offer time off and an allowance or travel and tuition for continuing medical education (CME) activities. Costs of CME may be reimbursed if they were incurred to maintain or improve skills required professionally, or if they meet the employer's requirements to maintain job competence or to qualify for compensation.

Additional ERISA consideration

ERISA controls the establishment and administration of employee benefit plans. Certain nonqualified deferred compensation plans are attractive for physician compensation because they are generally exempt from ERISA scrutiny. Nonqualified plans are generally not attractive for employees of tax-exempt employers due to the stringent limits on the amount of compensation that can be deferred. These include excess benefit plans, which are designed specifically to exceed the limitations on contributions and benefits under Internal Revenue Code Section 415 (nondiscrimination restrictions). Unfunded excess benefit plans are exempt from ERISA requirements, whereas funded plans are subject to ERISA rules for reporting and disclosure purposes, as well as the ERISA fiduciary responsibility standard for investments. Benefit plans that systematically defer compensation are also subject to ERISA. Because of the technicalities of ERISA, both parties should consult a specialized benefits counsel, accountant and/or plan administrator to assure strict compliance with the law. Failure to follow ERISA guidelines stringently can lead to very serious legal and financial consequences.

Appendix B

••• Employee versus independent contractor

Some groups hire physicians as independent contractors, as an alternative to hiring them as employees. **Great caution should be exercised when using independent contractor agreements.** Independent contractor arrangements can pose very serious legal and business issues. Most notably, fraud and abuse regulations and fee-splitting prohibitions apply to independent contractors, but federal regulations furnish greater latitude in bona fide employment relationships.¹ Therefore, physicians sharing fees in any way should consider only an employment relationship.² In addition, the Internal Revenue Service (IRS) and state agencies may recharacterize an independent contractor relationship as an employment arrangement and subject both parties to very substantial back taxes and penalties. Both parties in an independent contractor deal can face potential liability, so an attorney experienced in physician business matters should be consulted before such arrangements are finalized.

The importance of the distinction between “independent contractor” and “employee”

Whether an individual is an employee or an independent contractor can have important legal ramifications in a number of respects.

Benefits of independent contractor status for the employer

- Independent contractors are self-employed and responsible for their own income tax. Employers are required by law to withhold income tax from wages paid to employees.³
- The hiring party is not required to pay Social Security taxes.⁴

- The hiring party is not required to pay unemployment insurance taxes.⁵
- The hiring party need not withhold taxes from an independent contractor’s compensation.
- Independent contractors do not qualify for workers’ compensation benefits.⁶
- Independent contractors are excluded from participating in employer-sponsored benefit plans, and taking sick leave or paid vacation and holidays.
- The relationship with the independent contractor may be terminated for reasons specified in the agreement.
- The employer need not furnish tools, instrumentalities or a workplace for the independent contractor.

Disadvantages of using independent contractors for the employer

- Although a person engaging the services of an independent contractor may direct the work to be performed, he or she does not enjoy total control over the manner in which the work is performed.
- Because of the lack of control over the independent contractor’s work methods, it is difficult to monitor the progress of the work or to guarantee ahead of time that work will be completed on schedule.
- Independent contractor relationships are typically governed by very detailed contracts, while employment agreements tend to rely more on employee policies and procedures.
- The group’s malpractice carrier may require the contracting physician to be an additional insured on the group’s policy.
- Group pension plan issues may be affected when an independent contractor joins a practice. The

1. Care must be taken to ensure that an employment relationship would be considered bona fide under fraud and abuse standards.

2. 42 CFR §1001.952. See also Department of Health Services, Office of Inspector General Advisory Opinion No. 98.9.

3. 26 USCA §3402.

4. IRC §3111.

5. IRC §3306 (c), (l).

6. IRC §§3102, 3401(a).

independent contractor and the hiring medical group may be considered an “affiliated service group,” and employees may argue that they are entitled to benefits under the independent contractor’s plan. Retirement plans have even been disqualified based on the re-characterization of independent contractors as employees.

- Medicare billing regulations must be considered where the group wishes to bill for the independent contractor, as Medicare assignment rules generally prohibit a provider from billing Medicare for services performed by another provider.
- A hiring entity may be subject to significant taxes and penalties for unpaid employment taxes if the independent contractor is subsequently characterized as an employee by the IRS.
- An agreement on patient fees and charges made between independent contractors may pose significant fraud, abuse and antitrust risks because the parties are independent of one another and competitors. Employees are not considered to be competitors for antitrust purposes.

Who is an independent contractor?

The parties may designate the status of their relationship as employer/employee or independent contractor in their agreement, but governmental agencies and courts are not bound by the label the parties give to the relationship.⁷ In determining whether a person is an independent contractor or an employee, courts will look beyond the language of the contract or agreement to the substance of the relationship between the parties. In general, the key factor in this determination is whether the employer has the right of control over the worker’s methods and results. While the precise definition in any jurisdiction may be a function of state law, certain principles apply nationwide. In general, an independent contractor is a person who renders services, exercises independent judgment in his or her occupation, and is under the control of the person for whom the services are performed only with respect to the result of the work and not as to the means by which it is accomplished. The primary element, therefore, that establishes a worker as an independent contractor is the

degree of control the hiring person has over the manner and means of accomplishing the result or performing the work.

IRS factors to determine whether a physician is an independent contractor or an employee

The courts and the IRS have been active in determining whether persons in various employment relationships were in an employer-employee relationship for withholding tax purposes.⁸ No hard and fast rule can be stated for determining a worker’s status. Each case must be treated as unique and must be determined on its own facts. It is impossible to say categorically whether physicians would be deemed independent contractors or employees in various settings. Any employment agreement, therefore, must be drafted carefully to clarify the creation of one status or the other. Moreover, the relationship itself should be conducted in a way that avoids ambiguities.

The IRS has established 20 general factors to determine whether a worker is an employee or an independent contractor⁹:

1. **Instructions.** An individual required to comply with specific instructions is more likely to be considered an employee than an independent contractor. The more specific the instructions, the more likely the worker is an employee.
2. **Training.** If a worker is required to undergo training on the job, this is an indication of employee status.
3. **Integration.** If the services performed by the worker are an integral part of the business entity’s operations, the worker is more likely to be considered an employee.
4. **Services personally rendered.** If services must be personally rendered by the worker, as opposed to being rendered by an assistant, the worker is more likely to be considered an employee.
5. **Hiring, supervising and paying assistants.** Where the worker directly pays his or her assistants, the individual is more likely to be an independent contractor.
6. **Continuing relationship.** The longer and more continuous the relationship, the more likely employee status has been established.

7. Treas Reg §31.3121(d)-1(a)(3).

8. James L. Rigelhaupt Jr. “What Constitutes Employer-Employee Relationship for Purposes of Federal Income Tax Withholding,” 51 ALR Fed. 59(2000).

9. IRS Revenue Ruling 87-41, 1987-1 CUM BULL.

7. Set hours of work. An indication of an independent contractor is the individual's right to work when and for whom he or she chooses.

8. Full time required. If the business entity requires the worker's services on a full-time basis, this is an indication of employee status.

9. Work on employer's premises. Generally, working on the business entity's premises is an indication of an employee relationship, but it is not determinative. If the nature of the services rendered is such that they must be done on the business entity's premises (e.g., plumbing services) this factor should be neutral.

10. Order of sequence set. If the business entity determines the order or sequence of the services to be performed, this is an indication of an employment relationship.

11. Oral or written reports. Requiring reports of workers is an indication of control, and therefore an indication of employee status.

12. Payment by hour, week, month. Payment at regular intervals is an indication of an employee relationship, unless it is simply a convenient method of making periodic lump sum payments for the job.

13. Payment of business and/or travel expenses. Payment of expenses is considered an indication of an employee relationship.

14. Furnishing of tools and materials. An independent contractor is much more likely to furnish his or her own tools and materials.

15. Significant investment. If the worker has made a significant investment in facilities to be used in performing services, this is an indication of independent contractor status.

16. Realization of profit or loss. If the worker can realize a profit or suffer a loss for the job, this is an indication of independent contractor status. Generally, an employee is not likely to suffer a loss by virtue of his or her employment.

17. Working for more than one firm. If the worker performs services for many unrelated businesses, this is evidence of independent contractor status.

18. Making service available to general public. The IRS will look to see if the worker advertises or otherwise makes known to the public the availability of his or her services as an indication of independent contractor status.

19. Right to discharge. If the business entity has the right to discharge the worker, this indicates an employee/ employer relationship. (A prematurely discharged independent contractor could bring suit against the business entity for his or her lost profits.)

20. Right to terminate. If the worker has the right to end his or her relationship when he or she chooses, this is also an indication of an employer/employee relationship. (The independent contractor can be sued for damages for failure to fully perform a contract.)

The IRS historically established a rebuttable presumption of independent contractor status for physicians.¹⁰ In recent years, however, the IRS has been aggressively auditing medical groups and hospital employees, challenging the independent contractor status of physicians.¹¹

The IRS recognizes that due to the high degree of skill of professional employees, the control of an employer over the manner in which professional employees carry out the duties of their positions must necessarily be more general than the control over nonprofessional employees. Whether the requisite control and supervision exists to render a physician an employee is determined by the application of such factors as: (1) the degree to which such individual has become integrated into the operating organization of the person or firm for which the services are performed; (2) the substantiality, regularity and continuity of his work for such person or firm; (3) the authority vested in or reserved by such person or firm to require compliance with its general policies; and (4) the degree to which the individual under consideration has been accorded the rights and privileges which such person or firm has created or established for its employees generally.¹²

10. 26 CFR §31.3401(c)-1 (c): "Generally, physicians, lawyers, dentists, veterinarians, [...] and others who follow an independent trade, business or profession, in which they offer their services to the public are not employees."

11. See M. W. Peregrine, "Ascending Liability and Attribution: Corporate Concerns for the 1990s," American Hospital Association, Journal of Health Law Vol 26, No. 2, p 33, February 1993.

12. Rev Rule 66-274, CB 1966-2 at p 446.

The IRS has also recognized the fact that a physician hires and pays his or her own assistant or associate physicians is a strong indication of an independent contractor relationship. Other important factors are the restrictions, if any, that are placed on outside practice or whether employee-type benefits are granted to the physician.¹³ With respect to integration, the IRS stated that it does not mean simply that the services performed by the physician are those services provided by the organization, person or firm for which he or she renders his or her services. More important is the manner in which the services of the physician are integrated into the particular operation. Significant in this case are such factors as: (1) the manner in which the physician is paid for his or her services (whether on a percentage basis, salary or percentage with a guaranteed minimum); (2) whether he or she is permitted to employ associate physicians or to engage substitutes when he or she is absent from work and, if so, whether he or she is responsible for the remuneration paid to any associates or substitutes engaged by him or her; and (3) whether the physician is permitted to engage in the private practice of medicine or to perform professional services for others.

Employee status defined by social security laws

The Social Security Act¹⁴ defines the term employee as any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee. An identical definition is contained in the statute imposing the Social Security tax. If the physician is an employee, the employer must make contributions to Social Security and the physician is entitled to Social Security benefits.

Employee status defined by unemployment law

Every individual or entity who pays one or more employee's wages in excess of \$100 during any calendar quarter must contribute to their state unemployment fund. A principal, however, does not have to contribute to the fund for services rendered by an independent contractor. The Federal Unemployment Tax Act provides that the term employee does not include "(1) any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an

independent contractor, or (2) any individual (except an officer of a corporation) who is not an employee under such common law rules."¹⁵ If an employment insurance tax is assessed, the burden of proof is on the person engaging the services of another to prove that the person performing the work is an independent contractor.

Employee status defined by workers' compensation laws

Every individual or business entity (excluding the state) served by employees generally must either obtain workers' compensation insurance or secure a certificate of consent to self-insure from the appropriate state agency.¹⁶

Under state workers' compensation acts, an employer is ordinarily liable without regard to negligence for any injury proximately causing disability or death to an employee arising out of and in the course of employment, with limited exceptions. An independent contractor is usually not covered by workers' compensation laws.¹⁷ The person for whom the services are rendered typically has the burden of proving that the injured person was an independent contractor rather than an employee. In determining the employment status of the injured person, a key determination is whether the principal exercised control over the operation.¹⁸ A court may also consider the following: (1) the purpose of the workers' compensation statute and the intention of the legislature; (2) the persons sought to be protected; (3) whether the injured person is or is not of a class of persons generally intended to be protected; (4) whether there are any specific statutory exclusions; and (5) the relative bargaining positions of the parties.

Criminal and financial penalties can be imposed on an employer who knows of the obligation to secure the payment of worker's compensation and fails to secure that payment. Ordinarily, the right to recover workers' compensation is the exclusive remedy for an employee against an employer for injury or death on the job. However, an injured employee or his or her dependents may sue for damages against an employer who fails to secure payment of workers' compensation as if the workers' compensation laws did not apply. In addition, a "stop order" prohibiting the use of employee labor may be served

13. In Rev Rule 66-274, CB 1966-2 at p 446, the IRS stated that rights and privileges created and established for employees generally include such items as vacation and sick leave with pay, paid holidays, severance pay in case of discharge or layoff, increments for length of service, and life and accident insurance.

14. 26 USC §3101 imposes a tax on employees; 26 USC §3111 imposes a tax on employers; 42 USC §402 provides for old age and survivors benefit payments; 42 USC §423 relates to disability benefits.

15. 26 USC §3306(i)(1)(2).

16. See, e.g., Cal Lab Code §3200 et seq, Fla Stat §§440.01 et seq, Md Labor and Employment Code Ann §§9-101 et seq, NJ Stat 34:15-1 et seq, Tex Lab Code §§401.001 (1999).

17. See, e.g., Cal Lab Code §3353; Tex Lab Code §§406.121.

18. See, e.g., *Borello & Sons Inc. v. Department of Industrial Relations* 48 Cal 3d 341; (1989) See also *Williams Const Co v. Bohlen*, 189 Md 576, 56 A.2d 694 (1948).

on an employer who has failed to secure the payment of worker's compensation. Such a stop order will be effective until the employer secures the payment of workers' compensation. Thus, if a party is deemed an employee and there is no workers' compensation insurance in place for that employee, the employer can be subject to criminal and civil penalties, and the business can actually be shut down.

Fraud and abuse

The Anti-Kickback Statute makes it a criminal offense to *knowingly* and *willfully* offer, pay, solicit or receive any remuneration to induce or reward referrals of items or services reimbursable by a federal health care program. Where remuneration is paid purposefully to induce or reward referrals of items or services payable by a Federal health care program, the Anti-Kickback Statute is violated. By its terms, the statute ascribes criminal liability to parties on both sides of an impermissible kickback¹⁹ transaction. For purposes of the Anti-Kickback Statute, remuneration includes the transfer of anything of value, directly or indirectly, overtly or covertly, in cash or in kind. Penalties include criminal convictions and/or fines. Many states also have laws that prohibit payment for referrals.

Federal fraud and abuse laws include safe harbors,²⁰ which immunize certain payment and business practices implicated by the Anti-Kickback Statute from criminal and civil prosecution under the statute. Although meeting all the requirements of a regulatory safe harbor exempts a financial relationship from the reach of the Anti-Kickback Statute, failure to meet such requirements does not mean that the statute has been violated and prosecution will result. Failure to comply with a safe harbor also does not mean that an arrangement is per se unlawful, but it may increase the likelihood of a regulatory challenge, so the goal should always be to structure relationships to stay inside any applicable safe harbors. Two safe harbors are applicable when a physician considers establishing a professional relationship with a group or potential employer: the personal services safe harbor and the employment safe harbor. These safe harbors permit a physician to enter into a permitted arrangement with the group.

In the event that a physician decides to enter into an independent contractor agreement, the personal services safe harbor would apply. This safe harbor is met when the following elements are made part of the proposed relationship:

- 1) The agreement is set out in writing and signed by the parties.
- 2) The agency agreement specifies the services to be provided by the agent.
- 3) If the agreement provides for part-time or periodic services, the agreement must specify exactly the schedule of such intervals, their precise length and the exact charge for the intervals.
- 4) The term of the agreement is not less than one year.
- 5) The compensation to be paid is set in advance, is consistent with fair market value and does not take into account the volume or value of referrals.
- 6) Services performed under the agreement do not violate any state or federal law.²¹

Physicians who execute independent contractor agreements with groups should have qualified counsel evaluate any proposed agreement against these factors.

If the physician enters into an employment arrangement, the safe harbor for bona fide employment relationships would apply. As with independent contractor agreements, competent counsel should evaluate a proposed contract to ensure that it is structured to demonstrate the bona fide employment relationship.²²

Federal self-referral prohibitions

Federal anti-self-referral law, known as the Stark law, prohibits a physician from referring Medicare or Medicaid patients to an entity for the provision of "designated health services"²³ when the physician, or a member of the physician's immediate family, has a financial relationship

19. 42 USC §1320a-7(b).

20. 42 USC §1320a-7 and 42 CFR §1001.951 et seq (1991).

21. 42 CFR §1001.952(d) (1991).

22. 42 CFR §1001.952(l) (1991).

23. "Designated health services" are clinical laboratory services, physical therapy services, occupational therapy services, radiology services, including magnetic resonance imaging, computerized axial tomography scans, and ultrasound services, radiation therapy services and supplies, durable medical equipment and supplies, parenteral and enteral nutrients, equipment, and supplies, prosthetics, orthotics, and prosthetic devices and supplies, home health services, outpatient prescription drugs, inpatient and outpatient hospital services (42 USC §1395nn(h)(6)[1990]).

with that entity.²⁴ A financial relationship includes ownership or investment interest in the entity, as well as any compensation arrangement with the entity, unless an exception applies. For example, this law would apply to referrals made by a member of a medical group to a provider of radiology services (a designated health service) if the referring physician has an ownership interest in the radiology group. The physician would not be permitted to make the referral and the radiology group would not be permitted to bill for the services resulting from the referral unless all arrangements complied with applicable statutory exceptions or regulatory safe harbors.²⁵

Similar to the fraud and abuse law, the Stark law accommodates personal services arrangements and employment relationships. It provides detailed guidance on the requirements of both the personal service arrangement and employment exceptions. The personal service arrangement requirements that must be met are as follows:

- 1) The arrangement is set out in writing, signed by the parties and specifies the services covered by the arrangement.
- 2) The arrangement covers all of the services to be provided by the physician (or an immediate family member of such physician) to the entity.
- 3) The aggregate services contracted for do not exceed those that are reasonable and necessary for the legitimate business purposes of the arrangement.
- 4) The term of the arrangement is for at least one year.
- 5) The compensation to be paid over the term of the arrangement is set in advance, does not exceed fair market value and is not determined in a manner that takes into account the volume or value of any referrals or other business generated between the parties.
- 6) The services to be performed under the arrangement do not involve the counseling or promotion of a business arrangement or other activity that violates any state or federal law.

7) The arrangement meets such other requirements as the secretary may impose by regulation as needed to protect against program or patient abuse.²⁶

The bona fide employment relationship requirements that must be met are as follows:

- 1) The employment is for identifiable services.
- 2) The amount of the remuneration under the employment is consistent with the fair market value of the services and is not determined in a manner that takes into account (directly or indirectly) the volume or value of any referrals by the referring physician.
- 3) The remuneration is provided pursuant to an agreement that would be commercially reasonable even if no referrals were made to the employer.
- 4) The employment arrangement meets such other requirements as the secretary may impose by regulation as needed to protect against program or patient abuse.²⁷

It is worth noting that the Stark law specifically provides that the law will not operate to prohibit productivity bonuses based on professional services performed personally by the physician. There are other exceptions to the Stark law, for example services that meet the definition of “in-office ancillary services,”²⁸ certain ownership and investment arrangements,²⁹ and rental of office space and equipment.³⁰ Counsel may assist in navigating the complicated regulatory scheme of the Stark law in developing relationships that meet the applicable exceptions.

24. 42 USC §1395nn(a)(1)(A).

25. 42 CFR §411 et seq (1995), 63 Fed Reg 1659 (Jan. 9, 1998).

26. 42 USC §1395nn (e)(3) (1990).

27. 42 USC §1395nn (e)(2) (1990).

28. 42 USC §1395nn (b)(2)(1990).

29. 42 USC §1395nn (c)(1990).

30. 42 USC §1395nn (e)(1)(1990).

Appendix C

••• State law

Employment law is governed by both federal and state law. Often, federal law sets guidelines or broad principles that each state will adopt by passing relevant statutes. Other areas of employment law are exclusively governed by state case or statutory law. Therefore, employment law varies from state to state. It is extremely important to take this into account when drafting a physician employment agreement, in order to avoid illegal clauses or potential litigation.

The following charts cover very briefly the positions of 11 representative states' laws governing various employment law questions raised in this manual. These charts will help medical groups and physicians get an idea of what legal issues may be raised when drafting their agreements, but these charts do not replace local legal advice. Keep in mind that state laws, as well as their interpretation by courts,

may change over time. Moreover, state case law may not be consistent on certain legal issues. Therefore, the assistance of an attorney specializing in physicians' business transactions and who is familiar with the law of the state in which the physician will practice is necessary.

Issues covered by the following charts include:

- Corporate practice of medicine
- Covenants not to compete
- Customer lists and trade secrets

Representative state law on corporate practice of medicine

The following chart illustrates how 11 representative states have adopted the “corporate practice bar” rule that generally prohibits corporations and other organizations from practicing medicine. It also shows that all these states have some limited exceptions to the rule that bars the practice of medicine to corporations.

State	Corporate bar	Exceptions
California	Cal Bus & Prof Code §2400 (2000); <i>People v Pacific Health Corp</i> , 12 Cal 2d 156 (1958), <i>Alan J. Conrad et al v Medical Board of California</i> , 48 Cal App 4th 1038 (1996).	Public or private nonprofit university medical school clinics ¹ ; free nonprofit clinics ² ; regulated health care service plans ³ ; professional corporations ⁴
Florida	§458.327; § 641.01; § 641.17 et seq.	Hospitals ⁵ ; not-for-profit corporations ⁶
Illinois	225 ILCS 60/49 (2000); <i>Dr Allison, Inc v Allison</i> , 360 Ill 638, 196 NE 799 (1935); <i>Winberry v Hallihan</i> , 361 Ill 121, 197 NE 552 (1935).	Hospitals ⁷ ; professional corporations ⁸ ; limited liability companies ⁹
Maryland	Md HEALTH OCCUPATIONS Code Ann §14-601; <i>Backus v County Bd Of Appeals</i> , 224 Md 28, 166 A.2d 241 (1960).	Professional corporations ¹⁰
Massachusetts	Mass Ann Laws ch 112, §6 (2000).	Professional corporations ¹¹

1. Cal Bus & Prof Code §2401(a) (2000). See also, *California Medical Association et al, v The Regents of the University of California et al*, 79 Cal App 4th 542 (2000).

2. 16 CCR 1340.

3. Cal Health & Saf Code §1395(b) (2000) (Health care service plans regulated pursuant to Knox-Keene Health Care Service Plan Act may contract with or employ physicians.)

4. Cal Bus & Prof Code §2402 (2000) (Medical corporations may employ physicians as long as requirements of the Moscone-Knox Professional Corporation acts are met.)

5. *Rush v Petersburg* 205 So 2d 11 (1967) (City hospital employing physician to render radiology services was not engaged in illegal practice of medicine because doctor-patient relationship was not created.)

6. Fla Stat §617.2001 (1999).

7. *Richard B. Berlin, Jr, MD, v Sarah Bush Lincoln Health Center*, 179 Ill 2d 1; NE 2d 106 (1997) (Licensed hospitals are not prohibited from employing physicians.)

8. 805 ILCS 15/1 et seq (2000), 805 ILCS 305/1 et seq (2000), 805 ILCS 10/1 et seq (2000).

9. 805 ILCS 180-5/1 (2000).

10. Md CORPORATIONS AND ASSOCIATIONS §5-104 (Professional corporation may not perform any professional service other than the professional service authorized by its articles of incorporation.)

11. Mass Ann Laws ch 156A, §5 (2000) (Professional corporation may only render professional services through its officers, employees, and agents who are duly licensed to render such professional services.)

Michigan	MCL §333.17011 (1999).	Nonprofit cooperative clinic ¹² ; nonprofit hospitals and other corporations incorporated under the Nonprofit Corporation Act ¹³ ; Professional corporations ¹⁴ ; limited liability companies ¹⁵
New Jersey	NJ Stat §45:9-22 (2000).	Partnership/professional associations or limited liability company ¹⁶
New York	NY CLS Educ §6522 (1999); <i>The People of the State of New York v John H. Woodbury Dermatological Institute</i> , 192 NY 454, 85 NE 697 (1908).	Nonprofit medical or dental expense indemnity corporation or hospital service corporations, health maintenance organizations and professional corporations ¹⁷ ; medical colleges ¹⁸
Oregon	ORS §677.080 (1997).	Professional corporations ¹⁹
Pennsylvania	63 PS §422.10 (1999).	Professional corporations ²⁰
Texas	Tex Occ Code §155.001 (2000); <i>Genaro Garcia, et al v The Texas State Board of Medical Examiners and the Secretary of State of the State of Texas</i> , 421 US 3995; 95 S Ct 2391; reported at 384 F Supp 434 (1975).	Nonprofit organization and tax-exempt organization that is organized and operated as a migrant, community, or homeless health center or a federally qualified health center ²¹

Representative state law on covenants not to compete

Covenants not to compete are exclusively a matter of state contract and labor law. The following chart shows how some selected states regulate or even outlaw covenants not to compete in employment contracts. Most of the courts are more willing to accept covenants not to compete in a partnership/ownership setting than covenants not to compete contained in an employment relationship. It should help the employer who wishes to provide for some noncompete clause to check beforehand how his or her state regulates these covenants.

State	Reference	Content of the law
California	Cal Bus and Prof. Code §§16600 et seq (year).	California has a strong policy in favor of open competition; generally covenants not to compete are held to be void and unenforceable.
	<i>Haas v Hodge</i> 171 Cal App 2d (1959).	A covenant not to compete in a physician's employment agreement was held unenforceable because it was not incident to the sale of the goodwill of a business. Court upheld a covenant not to compete when, unlike in the Haas case, the departing physician was a partner in the practice.
	<i>South Bay Radiology v Asher</i> , 220 Cal. App 3d 1074 (1990).	

12. Op Atty Gen, January 13, 1961, No. 3550.

13. Op Atty Gen, September 17, 1993, No. 6770.

14. MCL §450.224 (1999)

15. MCL §450.4201 (Limited liability companies may provide services in a learned profession.)

16. NJ Ann. Code 13:35-6.16.

17. NY CLS Educ. §6527(1).

18. *Albany Medical College v McShane* 66 NY 2d 982 (1985) (Treatment of patients by a medical college with a corporate charter empowering it to promote medical science and instruction did not constitute the illegal corporate practice of medicine.)

19. ORS §58.375 (1997).

20. 15 Pa CS §2922 (1999).

21. Tex Occ Code §162.001 (2000).

Florida	Fla Stat §542.33.	Florida courts will not enjoin a covenant not to compete that is contrary to public health, safety or welfare, or where there is no showing of irreparable injury.
	<i>King v Jessup</i> 698 So 2d 339 (1997).	Restrictive covenant not enforced when a pulmonologist did not establish irreparable injury by the breach of the covenant.
Illinois	<i>Prairie Eye Ctr v Butler</i> , 305 Ill App 3d 442 (1999).	Employer sufficiently demonstrated that it had protectable interest in those patients of physician-employee with whom physician had preexisting professional relationship, and thus covenant not to compete clause contained in physician's employment agreement was enforceable with respect to such patients, and not just to those patients he acquired while working for employer.
	<i>Vascular & Gen. Surgical Assoc v Loiterman</i> , 234 Ill App. 3d 1 (1992).	Two-year restriction on surgeon's right to practice in certain named hospitals after leaving employment was a reasonable covenant not to compete in light of surgeon's right to resume practice elsewhere.
Maryland	<i>Intelus Corp v Barton</i> , 7 F Supp 2d 635 (1998).	Restrictive covenant (of a software account manager) is upheld if it is reasonably related to protection of goodwill and client base and does not impose undue hardship on the party restricted.
	<i>Holloway v Faw, Casson & Co</i> , 572 A.2d 510 (1990).	Five-year restrictive covenant of an accountant was modified to three years based on reasonableness.
Massachusetts	Mass Ann Laws ch 112, §§12X.	Any physician employment agreement provision that includes any restriction of the right of the physician to practice medicine in any geographic area for any period of time after the termination of such partnership, employment or professional relationship is void and unenforceable.
Michigan	Mich. Comp. Laws §445.774a.	A restrictive covenant which protects an employer's reasonable competitive business interests and expressly prohibits an employee from engaging in employment or a line of business after termination of employment will be upheld if reasonable as to its duration, geographical area, and the type of employment or line of business. A court may limit the agreement to render it reasonable in light of the circumstances in which it was made and specifically enforce the agreement as limited.
	<i>St. Clair Med., P.C. v Borgiel</i> , 270 Mich. App. 260.	Covenant prohibiting physician from practicing medicine within a seven-mile radius of two clinics was held to be enforceable because it was modest in geographical scope and was not unreasonable in relation to the employer's competitive business interests.

New Jersey	<i>Karlin v Weinberg</i> , (1978) 77 NJ 408.	Restrictive covenant in physician's employment contract restraining physician from practice within 10 miles of employer's office for five years after termination of employment was enforceable to the extent it protected interest of employer, imposed no undue hardship on employee and was not injurious to public.
		Factors to consider include: time in area employer needs to protect practice, whether covenant restricted employee from engaging in activities not in conflict with former employer, likelihood of employee finding work elsewhere, reason for termination, effect enforcement of covenant had on public interest, whether shortage of physicians would result, and whether existing patients would be unable to continue treatment. A restrictive covenant that substantially intrudes on the patient-physician relationship is contrary to public policy.
	<i>New Castle Orthopedics Assoc v Burns</i> , 392 A.2d 1383 (1978).	Covenant was not enforceable when considering its effect on society as a whole. A shortage of orthopedic specialists in the area created harm to the public.
New York	<i>Foster v White</i> , 290 NYS 394 (1936).	In physician employment contracts, the test to apply is whether the covenant is necessary and reasonable for the protection to the employer's property and goodwill, and whether it is reasonable, unjust or oppressive to the employee.
Oregon	Ore Rev Statutes §653.295 (1977).	Covenants not to compete are valid if entered into upon initial employment or subsequent bona fide advancement of employee with employer
	<i>Ladd v Hikes</i> , 55 Or App 801 (1982).	The Oregon court of appeal held a noncompetition provision included in a physician employment agreement enforceable and declared that the general Oregon statute permitting the use of restrictive covenants upon initial employment was applicable to the medical profession.
Pennsylvania	<i>Hayes v Altman</i> , 424 Pa 23 (1967).	The six-mile and three-year scope of a restrictive covenant clause in the contract of employment of a physician was reasonable and the covenant was held enforceable.
Texas	Tex Bus & Com Code §15.51 (2000).	Covenants not to compete that are unreasonable as to time, area or scope of activity can be reformed by a court to be reasonable.
	<i>Emergicare Systems Corp v Bourdon</i> , 942 SW 2d 201 (1997).	A covenant not to compete against an emergency department physician was not enforced because the "5 mile radius within any clinic operated by ECS" was too broad.

Representative state laws on customer lists and trade secrets

In all states, the theft of trade secrets by an ex-employee is prohibited. Civil or even criminal liability can ensue if the ex-employee uses that information for his or her gain.

From state to state, the definition of trade secrets may vary. In some states, for instance, the law prohibits ex-employees from using their former employers' customer list. Other states allow such use, under certain circumstances. The parties to the employment agreement must be careful when drafting the provisions relating to the notification to patients of the physician's departure, both under trade secrets law and under ethical obligations to patients.

State	Reference	Content of the law
California	Cal Civ Code §3426 et seq (2000).	Trade secret means information, including a formula, pattern, compilation, program, device, method, technique or process, that: (1) derives independent economic value, actual or potential, from not being generally known to the public or to other persons who can obtain economic value from its disclosure or use; and (2) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy. The person who misappropriates trade secrets may be enjoined.
	<i>Am. Credit Indem. Co. v Sacks</i> , 213 Cal. App. 3d 622 (1989).	The right to announce a new affiliation, even to trade secret clients of a former employer, is considered fair and legal, however, solicitation of those same clients is not and merits judicial intervention.
Florida	Fla Stat §812.081 (1999).	Trade secret means "any formula, pattern, device, combination of devices, or compilation of information which is for use, or is used, in the operation of a business and which provides the business an advantage, or an opportunity to obtain an advantage, over those who do not know or use it."
	Fla Stat §542.33 (1999).	It includes "any scientific, technical, or commercial information, including any design, process, procedure, list of suppliers, list of customers, business code, or improvement thereof." A trade secret is considered to be secret; of value; for use or in use by the business; and of advantage to the business when the employer "takes measures to prevent it from becoming available to persons other than those selected by the owner to have access thereto for limited purposes." "... [u]se of specific trade secrets, customer lists, or direct solicitation of existing customers shall be presumed to be irreparable injury and may be specifically enjoined."

Illinois	<i>Springfield Rare Coin Galleries v Mileham</i> , 250 Ill App 3d 922 (1993).	Confidential information and customer relationships can be protectable interest of the employer if they have been developed by employer over a number of years at great expense and kept under tight security, and the information is not generally available for the trade.
New Jersey	<i>AYR Composition, Inc v Rosenberg</i> , 261 NJ Super, 495, 619 A.2d 592 (1993).	Customer lists were found to be protected trade secrets, even after the employment was terminated.
New York	<i>Karpinski v Ingrasi</i> , 28 NY 2d 45 (1971).	The court severed an unreasonably restrictive covenant, thereby enjoining only the practice of oral surgery and not also dentistry within the proscribed area.
Maryland	Md. Com Law Code Ann, §11-1202.	Misappropriation of trade secrets may be enjoined.
	<i>Fulton Grand Laundry v Johnson</i> (1922), 140 Md 359.	An employer may be protected from the use by an employee of a customer list fraudulently obtained and where the names of the customers were so guarded as not to be easily obtainable by others than confidential employees.
Massachusetts	<i>New England Overall Co v Woltmann</i> , 343 Mass 69 (1961).	Customer lists and other information taken away upon termination of employment are confidential trade secrets.
	<i>Oregon Port Invest Co v Oregon Mut Fire Ins Co</i> , 163 Or 1 (1939).	An employee who, on the termination of the relationship, takes a list of the customers of his employer and uses it in soliciting the customers he had served during the employment is guilty of a breach of obligation that a court will enjoin.
Pennsylvania	18 Pa Cons Stat §3930.	Trade secrets are defined as the “whole or any portion or phase of any scientific or technical information, design, process, procedure, formula or improvement which is of value and has been specifically identified by the owner as of a confidential character, and which has not been published or otherwise become a matter of general public knowledge...”.
	<i>Id.</i>	Theft of trade secret may be a second- or third-degree felony.
	<i>Morgan’s Home Equipment Corp v Martucci</i> , 390 Pa 618 (1957).	Former employees who set up a rival business were liable to account to company for profits obtained from solicitation of those customers of company who had become known by reason of their former employment.

Texas

Tex Penal Code §§31.05.

Trade secret “means the whole or any part of any scientific or technical information, design, process, procedure, formula, or improvement that has value and that the owner has taken measures to prevent from becoming available to persons other than those selected by the owner to have access for limited purposes.” A person commits a felony of the third degree if, “without the owner’s effective consent, he knowingly: (1) steals a trade secret; (2) makes a copy of an article representing a trade secret; or (3) communicates or transmits a trade secret.”

Rugen v Interactive Business Systems Inc, 864 SW 2d 548 (1993).

Employer’s customer information, pricing information, identity of employer’s consultants and pricing of these consultants was confidential information that could be protected as trade secret, and thus, court properly granted temporary injunction prohibiting former employee from using information to solicit or transact business with former employer’s consultants and customers.

Appendix D

••• Relevant AMA policy

E-9.035 (formerly H-65-984) Gender Discrimination in the Medical Profession

Physician leaders in medical schools and other medical institutions should take immediate steps to increase the number of women in leadership positions as such positions become open. There is already a large enough pool of female physicians to provide strong candidates for such positions. Also, adjustments should be made to ensure that all physicians are equitably compensated for their work. Women and men in the same specialty with the same experience and doing the same work should be paid the same compensation.

Physicians in the workplace should actively develop the following: (1) retraining or other programs which facilitate the re-entry of physicians who take time away from their careers to have a family; (2) on-site child care services for dependent children; and (3) policies providing job security for physicians who are temporarily not in practice due to pregnancy or family obligations.

Physicians in the academic medical setting should strive to promote the following: (1) extension of tenure decisions through “stop the clock” programs, relaxation of the seven-year rule, or part-time appointments that would give faculty members longer to achieve standards for promotion and tenure; (2) more reasonable guidelines regarding the appropriate quantity and timing of published material needed for promotion or tenure that would emphasize quality over quantity and that would encourage the pursuit of careers based on individual talent rather than tenure standards that undervalue teaching ability and overvalue research; and (3) fair distribution of teaching, clinical, research, administrative responsibilities, and access to tenure tracks between men and women. Also, physicians in academic institutions should consider formally structuring the mentoring process, possibly matching students or faculty with advisors through a fair and visible system.

Where such policies do not exist or have not been followed, all medical workplaces and institutions should create strict policies to deal with sexual harassment. Grievance committees should have broad representation of both sexes and other groups. Such committees should have the power to enforce harassment policies and be accessible to those persons they are meant to serve.

Grantors of research funds and editors of scientific or medical journals should consider blind peer review of grant proposals and articles for publication to help prevent bias. However, grantors and editors will be able to consider the author’s identity and give it appropriate weight. (II, VII)

Issued June 1994 based on the report “Gender Discrimination in the Medical Profession,” adopted June 1993 (Women’s Health Issues. 1994; 4: 1-11)

E-7.03 Records of Physicians Upon Retirement or Departure from a Group

A patient’s records may be necessary to the patient in the future not only for medical care but also for employment, insurance, litigation, or other reasons. When a physician retires or dies, patients should be notified and urged to find a new physician and should be informed that upon authorization, records will be sent to the new physician. Records which may be of value to a patient and which are not forwarded to a new physician should be retained, either by the treating physician, another physician, or such other person lawfully permitted to act as a custodian of the records.

The patients of a physician who leaves a group practice should be notified that the physician is leaving the group. Patients of the physician should also be informed of the physician’s new address and offered the opportunity to have their medical records forwarded to the departing physician at his or her new practice location. It is unethical to withhold such information upon request of a patient. If the responsibility for notifying patients falls to the departing physician rather than to the group, the group should not interfere with the discharge of these duties by withholding patient lists or other necessary information. (IV)

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