

## PHYSICIAN EMPLOYMENT CONTRACTS

---

The once dominant form of health care delivery, the sole practitioner, has given way to delivery by group practices, managed care organizations, hospital affiliated medical practices and other integrated organizations. As a result, physicians have a number of employment options, ranging from independent practice to staff model HMOs. Each of these relationships should be accompanied by a written employment contract, which clearly outlines the parties' expectations and obligations. While the complexity of the contract may vary with the size of the practice organization, certain topics must be addressed in all relationships. This article will discuss issues for physicians to consider as they engage in employment contract negotiations.

### I. PRE-CONTRACT CONSIDERATIONS

Before a written contract is developed, a significant amount of time is spent getting acquainted. Physicians evaluating a practice opportunity must first consider non-contract issues such as geographic location, practice philosophy, patient mix, and compatibility. During this assessment process, issues that will ultimately be reflected in the employment contract will be discussed. The employment contract is typically presented after agreement has been reached on many of these items. It is critical, therefore, that the contract be carefully reviewed to be sure that it accurately reflects the discussions and contains no surprises.

### II. PARTIES

The agreement should clearly identify the parties. In the case of the employer, the legal status (i.e., sole proprietorship, professional corporation, nonprofit corporation, limited liability company or partnership) should be set forth. Physicians should ascertain who provides management and oversight of the physician and the practice.

When the employer is a private practice, the physician should determine whether one or more physicians own the practice and, if more than one, whether it is owned equally or unequally. Further, if the physician expects to buy into the practice, it is important to determine what assets (i.e., medical equipment and furnishings) or lines of business (i.e., ancillaries) are part of the practice. Real estate is typically owned outside the practice; if some or all of the practice's owners also own the office in which the practice is located, physicians should discuss expectations regarding buy in to the real estate.

When the employer is a hospital affiliate, HMO or other large organization, the physician should understand the organizational structure and the department or group to which the physician is assigned. The physician should also determine whether there are administrative obligations, such as supervision, training, committees, and the like. In academic institutions, an academic appointment may be required.

### III. EMPLOYEE'S DUTIES AND RESPONSIBILITIES

**A. Representations and Warranties.** Employment agreements generally contain a number of physician representations and warranties, such as a valid and unlimited license, federal and state narcotics registrations, medical staff privileges, board certification/eligibility, health plan participation and eligibility for liability insurance coverage at ordinary rates. Representations and warranties should be reviewed carefully to be sure the physician is compliant. In addition, if compliance with practice rules, regulations, policies or standards of behavior is required, these should be provided in writing, both at the contract review stage and on an ongoing basis.

**B. Duties.** The agreement should state whether it is for full-time or part-time services and should define those terms. They are sometimes defined in terms of the number of patient appointment hours or office sessions; other times there is a list of required

tasks. Keep in mind that time spent on meetings, record keeping, rounding, etc. often is not included in the specified number of hours or duties, and must be considered in determining the total time commitment. If the practice has more than one location, the agreement should specify the physician's designated location and address and how the location can be changed (i.e., at direction of practice, or by mutual agreement). Finally, if the office maintains extended hours, it may be advisable to have the physician's specific work schedule set forth.

Employment agreements often impose responsibility for call and coverage, and these obligations should be clearly delineated. If it appears that the practice has insufficient coverage, physicians often request a specific call schedule so that the practice must pay outside covering physicians or other employed physicians who take additional call. It is important to determine whether there are physicians in the group who are not required to take call or whether physicians new to the group receive a higher share of the call.

**C. Outside Activities.** The agreement should address outside professional activities of the physician. Most employment agreements require the physician to devote his or her efforts to the practice on an exclusive basis, except when explicit written permission is granted by the employer for a particular activity. When exceptions are granted, physicians are generally required to conduct activities on their own time, without using practice resources, and which are not contrary to or do not compete with the business of the practice. Customary exemptions include teaching, writing, and investment activities. Less customary exemptions include expert witness activities, school/town physician activities, peer review activities and independent medical examinations. Moonlighting is unusual and should be carefully negotiated, particularly with respect to malpractice coverage for activities conducted outside the practice. In large non-profit and academic institutions, there are likely to be provisions on research, inventions, consulting and arrangements with pharmaceutical and biotechnology companies. If the physician expects to retain income from any outside professional activities, the agreement should so specify.

#### **IV. SERVICES AND SUPPLIES TO BE FURNISHED BY THE EMPLOYER**

Employment agreements generally provide that the practice furnish space, supplies, secretarial and administrative services, as well as billing and collection. Negotiated items often include paging, cellular phone service, computer equipment and specialized medical equipment required for a particular specialty.

#### **V. FEES**

If employment is full-time, the employer is usually entitled to all revenue generated by the employee's services, except for income related to outside activities as negotiated by the parties. Return of managed care withholds, surpluses and quality incentive payments are generally assigned to the practice; if the physician has a productivity based compensation arrangement, the agreement should specify whether and how these payments affect compensation.

The practice is generally responsible for determining charges, doing the billing and maintaining billing records. However, the physician is generally responsible for coding and documentation. The agreement should address responsibility if inadequate coding and documentation results in denial of payment or payor audits.

#### **VI. COMPENSATION**

Compensation provisions range from fixed salary to specific formulaic calculations. Physicians new to a practice are typically paid a base salary, which must be assessed in light of the physician's specialty and experience, the practice's geographical area and the time commitment. An agreement providing for base salary should indicate both the amount and frequency of payment; i.e., weekly, monthly. If the agreement covers more than a one-year period, it should address how base salary will be adjusted in future years. Typical adjustment factors include cost of living, patient satisfaction, physician productivity or overall profitability of the practice.

The agreement may provide an opportunity for bonus compensation. In most cases, there is a productivity target, such as receipts, charges or offset of expenses. There may also be non-financial components. If the target is achieved, the bonus may be a percentage of any excess revenue or a stipulated amount. An agreement may also include a penalty provision, such as a payback obligation or base salary reduction, if productivity targets are not met. The agreement should set forth when bonus will be calculated and paid (i.e., quarterly or annually) and whether it will be prorated if a physician leaves during the contract period. The agreement should also address review of the books and verification of bonus determinations.

## VII. FRINGE BENEFITS

An employment agreement should state which benefits are to be provided; it may either describe benefits in detail or refer to other corporate documents that describe the benefits. The variety and flexibility in fringe benefits will depend on the type of practice. A smaller practice may be able to negotiate a specific individualized package with a physician, while a larger practice will be more likely to have a uniform program covering all employees. Part-time physicians should determine whether benefits are limited or prorated to reflect part-time status.

Fringe benefits that are commonly addressed include:

**A. Insurance.** Does the practice offer health and dental insurance? Is it individual or family coverage? What is the physician's contribution? Is there a life and disability insurance benefit? Note that group life insurance that exceeds \$50,000 is taxable to the employee, and when disability insurance premiums are paid by an employer, the benefits are taxable to the employee. Therefore, physicians often purchase these coverages personally, either to supplement a nominal group policy or in the absence of employer policies.

**B. Time Off.** What is the vacation policy? Is unused time paid or carried over? What are the limits on carry over? How is vacation time assigned? Is there a sick leave policy? What are the holidays observed by the practice? Is Continuing Medical Education (CME) time included in or in addition to vacation time?

**C. Expense Reimbursement.** What is the practice's contribution to CME expenses, subscriptions, dues (medical staff, IPA/PHO, medical society) and license fees? Is there an auto allowance? How are cell phone expenses covered? Is there a moving expense allowance?

**D. Malpractice Insurance.** Malpractice insurance coverage is generally an employer paid fringe benefit; exceptions may occur with part-time employment. The agreement should specify the minimum limits of coverage; \$1M per claim and \$3M annual aggregate is most common but high-risk areas of practice may warrant higher coverage limits.

Coverage will be either on an occurrence or claims made basis.

1. Occurrence. With an occurrence policy, the physician is covered for malpractice that occurred during the period that the policy was in force, regardless of when the claim is filed. While an occurrence policy is generally more desirable because of the broader coverage, occurrence policy premiums are generally higher.

2. Claims Made. With claims made coverage, the physician is covered for claims filed during the coverage period regardless of when the malpractice occurred. Therefore, claims made policies require the purchase of a "tail" policy, which covers claims which may be filed after the coverage period ends.

3. Who Pays? If the practice has claims made coverage, the agreement should address who is responsible for payment of the tail. Some practices will assume responsibility, others will impose responsibility on the physicians and others will pay these expenses only

if employment continues for a specified period of time. The agreement should also address who pays for any retroactive premiums that may be assessed by the carrier as well as responsibility for excess premiums if insurance cannot be purchased at usual rates.

**E. Retirement Benefits.** What are the eligibility requirements? Is there a vesting schedule that will result in forfeiture if employment is terminated? Are there employer or employee contributions?

## **VIII. PURCHASE OF OWNERSHIP INTEREST**

**A. Discussion Points.** It is very unusual for a physician's initial employment agreement to contain a binding commitment from the practice that the physician will be eligible to buy into the practice. However, the negotiation process should include a discussion of long-term expectations of both parties if it is anticipated that the physician will have the opportunity to purchase an interest in the practice. There should be a discussion of the following:

- When will the physician be considered for ownership?
- What are the criteria? Productivity, patient satisfaction, specialized training, collegiality?
- Will the physician be an equal owner with an equal vote? How will the physician participate in the management and operational decision-making?
- What is the buy-in price and over what period is it to be paid? Pre-tax or post-tax? What liabilities of the practice will the physician have to assume?
- What are the buy-out provisions? What other physicians' buy-outs must the new physician participate in, and what are the terms?
- What is the compensation system for senior physicians?

**B. Stock Price.** Discussions concerning buy-in terms generally focus on three areas: hard assets, accounts receivable and goodwill. In many cases, the practice's stock value excludes accounts receivable and goodwill in order to keep the new physician's stock purchase as low as possible, as this purchase must be made with after-tax dollars. The practice must consider whether to value the hard assets at their depreciated book value, fair market value or replacement value, and must also consider the valuation of any leasehold improvements. This valuation methodology also serves as the basis for the amount physicians receive for stock upon their departure from the practice.

**C. Accounts Receivable.** Even though they may not be included in the value of the stock, accounts receivable are generally considered to belong to the practice. A practice owner would expect to receive a share of the receivables collected by the practice after departure, and many practices pay this to departing physicians in the form of "severance compensation" or "termination pay" rather than in the form of a stock redemption payment. This is tax advantageous to a corporation, because payment of compensation is deductible while payment of stock redemption is not. However, it is not as advantageous to the departing physician, who must pay ordinary income tax on the severance compensation rather than capital gains tax on the stock redemption payment.

In most cases, if an employed physician were to leave a practice, he or she would leave the receivables generated by his or her services behind. When new physicians purchase an interest in a practice, they may acquire the right to receive the severance compensation by taking reduced compensation in the first several years after becoming a shareholder. Other practices do not reduce compensation, but impose a vesting schedule, so that physicians earn the right to the severance compensation over a period of years. Still others do not pay any compensation to the new physician until his or her services generate income to the practice.

**D. Goodwill.** It is important to determine a practice's expectations with respect to goodwill. Many practices do not include goodwill in the value of a practice, taking a long-standing position that, as a personal service business, there is no goodwill. Further, few practices build up equity to fund a goodwill payment to a terminating owner. Some practices, however, seek a goodwill payment from a new physician. This sometimes takes the form of an obligation to pay the "founding" members of the group additional compensation on their departure; some practices include a goodwill component on the front end as well. These negotiations will often turn on the amount the new physician is expected to pay as compared to how much it would cost to leave the practice and either set up a new practice or join another. Practices who wish to obtain goodwill from new physicians must be prepared to justify their position.

## IX. TERM AND TERMINATION

**A. Contract Term.** An employment contract will either provide for a stated term, or will automatically renew. Most contracts for physicians joining a practice are for a term of one to three years. In such cases, it is important to have a clear understanding of expectations upon expiration of the term so that the physician does not become an at-will employee. In the case of automatically renewing contracts, it is important to address the process for making changes, particularly with respect to compensation.

**B. Termination.** Termination is an area which is rarely discussed until the physician is presented with a contract, yet it is the most important provision in the agreement, as it affects both the physician's job security and the practice's ability to treat its patients. Termination provisions usually list the "termination triggers," or events causing termination, along with the required notice for each trigger. The following is a common structure:

1. With or Without Cause. Most agreements permit either party to terminate with or without cause on 30 to 180 days notice (depending on difficulty of obtaining a replacement). Since this provision essentially reduces the contract term to the notice period, physicians joining a practice often object to the lack of job security. Practices, on the other hand strongly prefer to remove a physician without documenting cause, and often reserve the right to pay the physician in lieu of notice. In some cases, compromise is appropriate, so that the physician cannot be terminated without cause for a specified period, generally no longer than one year.
2. With Cause. An agreement may be terminable for cause by either party after written notice of the alleged cause and a reasonable cure period. It is important to establish the definition of the term "cause". Many agreements define cause as breach of the agreement, in which case, the agreement must be comprehensive in establishing duties and responsibilities of the parties. Others use an exhaustive definition, listing numerous circumstances as well as a "catch-all" provision. Examples of cause include:
  - Failure to comply with the practice's policies and procedures
  - Fraud or material dishonesty with respect to the practice or its patients
  - Conduct which reflects adversely upon the practice
  - Abusive behavior to staff, patients and colleagues

In cases where the existence of cause is determined subjectively by the employer, it is important that the physician be provide with detailed written notice and a sufficient cure period which gives the physician sufficient time to address and, if possible, correct the problem.

**C. Immediate Termination.** Most contracts provide for immediate termination by the practice upon certain circumstances. Immediate termination triggers should be objective and independently determined. Examples include:

- Loss of license to practice medicine in this state or anywhere
- If license to practice medicine is restricted (a) at all or (b) such that the physician can no longer render the full range of services specified without hardship to employer
- Loss of federal and state registrations to prescribe controlled substances
- Physician's death
- Physician's disability for a period of time (consecutive or non-consecutive within a set period) if physician cannot perform the essential functions of the job with such reasonable accommodation as is required under the Americans with Disabilities Act
- Loss of board certification or failure to obtain the same within a specified period
- Loss of hospital medical staff privileges
- Loss of participation status with payors
- Criminal charges/convictions

**D. Effect of Termination.** Termination provisions also include statements as to the effect of termination. For example, in hospital-based groups, the physician may be required to resign hospital privileges upon termination of employment, and to sign a waiver of all

medical staff hearing and appeal rights. If the agreement provides for severance compensation, consider whether the amount can be affected by the method of termination. Some groups reduce severance compensation if the physician fails to give adequate notice or is terminated for cause.

## **X. POST TERMINATION RESTRICTIONS**

**A. Covenants not to Compete.** Employment agreements often prohibit a physician from establishing a practice or accepting other employment within a certain area for a certain period of time following termination of employment. Restrictions also include prohibitions against recruiting staff members of the practice. In general, a covenant will be enforced only insofar as enforcement is necessary to afford reasonable protection to an employer's legitimate interests, usually trade secrets, confidential information or goodwill. A covenant must be reasonable in time and in geographic area. Note also that geographic restrictive covenants are illegal in some states.

**B. Notification to Patients.** The parties may wish to have the agreement address the issue of responsibility for patient notification following termination. Note that the AMA Code of Medical Ethics §7.03 states that:

"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 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."

Some agreements include a patient notification letter that is prospectively agreed to in the event the physician leaves the practice. Others stipulate that the physician shall bear the financial responsibility for patient notification and transfer of medical records if he or she continues to practice in the area.

**C. Confidential Information.** Most agreements restrict the employed physician's use or disclosure of confidential information following termination. Confidential information might include any patient related information (including names and addresses) or any and all information of the practice that is not generally known by others with whom the practice does, or plans to, compete or do business. Patient records belong to the practice, subject to the patient's right to request transfer. However, physicians should continue to have access in the event of malpractice claims, audit or other legal process.

Good agreements establish good relationships. Discussion about these points enables all parties to get a sense of the other's priorities and concerns and provides an opportunity to assess the ability to work together. Even if the relationship subsequently fails, the agreement provides a blueprint for separation.