IN THE COURT OF COMMON PLEAS OF LYCOMING COUNTY, PA

WILLIAMSPORT ORTHOPEDIC ASSOCIATES, LTD., Plaintiff	:	
v.	:	No. 00-01,390
JOHN H. BAILEY, JR., M.D., Defendant	:	

Issued on October 27, 2000

OPINION and ORDER

In this case the Williamsport Orthopedic Associates, Ltd. (WOA), has asked the court to enforce two restrictive covenants and issue an injunction prohibiting John H. Bailey, Jr., M.D., from practicing orthopedic medicine within a 50-mile radius of Williamsport for two years. Dr. Bailey, an orthopedic physician who was formerly affiliated with WOA, recently left that company to start his own practice.

Restrictive covenants are not favored by the law or by this court. Fierce marketplace competition keeps this country's economy vital and healthy and is one of our most important and valued economic principles. It inspires hard work, ingenuity, and bold entrepreneurship, and thus creates better products, lower prices, and a wide variety of product and service choices.

Although medical services are not generally thought to be part of the competitive marketplace, the above principles are every bit as applicable to physicians. When the practice of medicine is stripped of its romantic mantle, it is clear to see that doctors are health care vendors and patients are consumers. Competition in the medical industry is even more important than in other industries because it brings about important health benefits, expands health care access to a greater number of people, and helps hold down soaring medical costs.

For these reasons, covenants restricting physicians from opening competing practices must be examined as harshly as other types of restrictive covenants. The covenants at issue in this case fail to survive such scrutiny.

Findings of Fact

The factual background in this case is clear and virtually uncontested.[1] WOA is a professional corporation which provides support services to affiliated physicians for a fee. These services consist primarily of the following: (1) leasing space at 1705 Warren Avenue, where WOA operates the Costello Center, a facility that offers patients treatment by orthopedic surgeons, x-ray examinations, physical therapy, and related services; (2) training and maintaining a support staff in connection with these activities; (3) planning and executing marketing programs to attract patients; (4) performing billing and bill collection; (5) depositing income from billings into a checking accounts for WOA physicians and paying their related expenses; and (6) taking care of patient scheduling.

Dr. Bailey is a board certified orthopedic surgeon who was hired by WOA on 17 January 1994, soon after he finished his residency. WOA paid Dr. Bailey a salary, and Dr. Bailey assigned his physician fees to WOA. Pursuant to that employment Dr. Bailey and WOA executed an Employment Agreement which contains the following language in paragraph 9:

> EMPLOYEE shall not engage in a business or practice competing with the physicians and professional corporations who have contracted with WOA (except as authorized by the terms of this agreement) during the term of this agreement and during any period he is a party to any practice management agreement with WOA and for a period of two (2) years from the date of this agreement or any practice management arrangement, whichever is later, and as to the years following such later termination date, in the geographic area of the United States which is within a fifty (50) mile radius of Williamsport, Pennsylvania.

When a patient calls the WOA office with an orthopedic problem, the patient is scheduled with the physician who formerly treated the patient. If that physician is not available and the patient's condition is deemed an emergency, the patient is referred to another physician on a rotating basis. The next time that patient calls, the patient is asked which physician he or she desires to receive treatment from. If a new patient calls the WOA office, the patient is assigned to a physician on a rotating basis.

By receiving rotating patient assignments in this manner, Dr. Bailey slowly built up a body of patients who treated primarily with him. After four years of working as an employee, Dr. Bailey had accumulated a sufficient

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[1] The court cannot help but wonder why so much testimony was taken when the primary dispute is over the legal issue of whether the restrictive covenants are enforceable.

number of patients to make it feasible for him to move into the position of the other WOA physicians: generating his own income from his patients and paying WOA for its services.

On 30 June 1998, Dr. Bailey ceased his employment with WOA and became a WOA-affiliated physician. Rather than receiving a salary, his income was derived from the patients he treated. Dr. Bailey's physician fees were no longer assigned to WOA. Instead, he paid WOA a monthy "practice management fee" in return for the services WOA provided to him. The fee varied throughout his affiliation with WOA, but most recently was $27,400 per month.

On 1 September 1999, WOA and Dr. Bailey entered into a Practice Management Agreement (made retroactive to 1 July 1998) which reduced to writing the manner in which the parties had been operating. In addition to stating that Dr. Bailey will pay WOA a monthly fee in return for WOA's services and setting forth various details of this relationship, the Agreement states in paragraph 20:

> Customer and/or Customer's professional employee, if Customer is a professional corporation, shall not engage in any business or practice competing with the physicians and professional corporations who have contracted with Company (except as authorized by the terms of this Agreement) during the term of this Agreement and for a period of two (2) years from the date of termination of this Agreement for any reason whatsoever, and as to the years following the termination of this Agreement, within the geographical area of the United States which is within the City of Williamsport and/or within fifty (50) miles of the city limits of the City of Williamsport, Pennsylvania.

Dr. Bailey properly terminated the Practice Management Agreement in the manner specified in the agreement, effective on 31 August 2000. Immediately thereafter, he opened an office at 699 Rural Avenue, Williamsport and began practicing orthopedic medicine on his own. Before he left WOA, he rifled through over twenty thousand patient files, selected those patients for whom he considered himself the primary physician, and made off with their names and addresses. He then sent these three thousand individuals a letter stating that he was leaving WOA, along with a postage-paid return post card addressed to WOA which provided two boxes to check: one if they wanted WOA to release their chart to Dr. Bailey, and another if they wanted WOA to release their chart to themselves. WOA has received about one thousand of these post cards in the mail.

WOA was not amused by Dr. Bailey's conduct, and filed a complaint requesting an injunction to stop him from practicing at his current office, claiming he was violating the Employment Agreement and the Practice

Management Agreement, which promptly landed both parties in court.

DISCUSSION

Dr. Bailey has argued that neither of the restrictive covenants are enforceable,[2] and we are inclined to agree. As discussed earlier, restrictive covenants are not favored in our free enterprise system because they tend to stifle competition and prevent freedom of labor. However, our society has recognized that in certain limited circumstances restrictive covenants can actually benefit the economy by providing a certain amount of protection to those individuals who have excelled or invested in a particular area, so that they may reap the full rewards of their labor.

In order to balance these competing interests, courts have developed four requirements before a covenant not to compete can be enforced: (1) they must be ancillary to an employment agreement, a sale of a business or stock agreement, or a franchise agreement; (2) they must be reasonably necessary to protect the employer's interests; and (3) they must be supported by consideration. If the covenant meets these threshold requirements, the court must then determine whether it is reasonably limited in both time and territory.

1. Restrictive Covenant in the Practice Management Agreement

The Practice Management Agreement is clearly unenforceable for several reasons, as has been discussed fully and competently by the Hon. Kenneth D. Brown in Williamsport Orthopaedic Asssociates, Ltd., v. Liddell, Lycoming County Court of Common Pleas, Docket No. 95-02,203. The Liddell case is precisely on point, as it not only addresses the same legal issue, but also involves essentially the same practice management agreement, the same plaintiff, and the same factual scenario: a WOA-affiliated physician leaving and setting up his own practice.[3]

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[2] Although the merits of the case underlying a preliminary injunction are not ordinarily decided until a full trial has been held, Fischer v. Dept. of Public Welfare, 497 Pa. 267, 439 A.2d 1172 (1982), both parties have asked the court to make a determination on the merits at this time.

[3] We are totally perplexed as to why counsel for WOA, although aware of Liddell, did not see fit to even mention that case in his brief and when questioned,

Although this court does not shy away from thorough analysis of legal issues, we also see no reason to re-invent the wheel, especially when the initial innovator has done a good job. We therefore adopt Judge Brown's reasoning as to his holding that the Practice Management Agreement is not ancillary to a contract for employment or the sale of goodwill, franchise, or stock. In fact, it was an agreement to purchase services from WOA. The beauty of a free enterprise system is that buyers are free to purchase from whomever they like, and this court certainly will not shackle that system by enforcing what is nothing more than a blatantly illegal restraint on free trade and labor, gussied up as a legitimate restrictive covenant.

WOA has argued that the restrictive covenant in the Practice Management Agreement was executed in connection with Dr. Bailey's employment, and compares it to Wainwright's Travel Service Incorporated v. Schmolk, 347 Pa. Super. 199, 500 A.2d 476, 478 (1985). In that case, however, a current employee signed a restrictive covenant in conjunction with a stock purchase agreement, which was held to be binding. Here, however, Dr. Bailey's status clearly changed on 1 July 1998. At the time the Practice Management Agreement was in effect, he was no longer WOA's employee; he was WOA's customer.

Nor can WOA slip this through by piggy-backing it onto the Employment Agreement. If the restrictive covenant is not enforceable in the Practice Management Agreement, it cannot be magically transformed into an enforceable covenant merely because the Employment Agreement states that the covenant will extend to any practice management agreement the parties happen to sign some time in the future. The two agreements are separate and distinct, and must be analyzed and scrutinized in that manner. Each must stand or fall on its own merits.

We also agree with Judge Brown's reasoning in regard to his holding that the restrictive covenant in the Practice Management Agreement was not supported by adequate consideration. Rather, Dr. Bailey, like Dr. Liddell, was receiving from WOA nothing more than the services he was paying for.

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responded that Liddell is no more pertinent than Marbury v. Madison. While we certainly agree that Marbury v. Madison is totally irrelevant, we cannot help but conclude that Liddell is entirely on point in nearly every way.

WOA has argued that new consideration exists in several respects,[4] all of which amount to the purported "benefit" of extending to Dr. Bailey the privilege of buying services from WOA. That argument does not fly. There was no evidence that part of the practice management fee covered the services Dr. Bailey was buying, and part covered the privilege of buying them. Moreover, there was no evidence that WOA was so exclusive in its selection of physicians that merely being offered the opportunity to sign a practice management agreement was in itself worth any value whatsoever. Indeed, Dr. Bailey evidently did not think so, for he left as soon as two years had expired from the termination of his status as a WOA employee.[5]

When pressed to address Liddell in his closing, counsel made a weak attempt to distinguish it, namely that there was no consideration in Dr. Liddell's case because he had been a founder of WOA, rather than an employee whom WOA hired fresh out of residence, like Dr. Bailey. Such consideration might support a restrictive covenant in the Employment Agreement, but not the one in the Practice Management Agreement. Apparently, WOA took in Dr. Bailey when he had no patients of his own, and paid him a salary while he built up a body of patients who considered him their primary treating physician. That benefit to Dr. Bailey could certainly constitute adequate consideration for the restrictive covenant in the employment agreement. Therefore, Dr. Bailey was restrained from starting his own local practice for two years after his termination as an employee, and he has duly honored that provision of the Employment Contract.

However, when the Practice Management Agreement was in effect Dr. Bailey had reached the stage where he was able to stand on his own two feet and support himself through his patient fees. He then became a purchaser of WOA services, rather than its employee. At that point, new consideration was needed to sustain another restrictive covenant, and there was none.

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[4] The supposed benefits are: (1) Dr. Bailey was permitted to continue his medical practice as a physician at WOA, (2) he was permitted to keep the net proceeds of his medical practice, (3) he was permitted to practice medicine supported by WOA services, and (4) he continued to receive patients through WOA's referral system.

[5] Dr. Bailey or the attorney he consulted obviously considered the restrictive covenant in the employment agreement valid, but not the one in the practice management agreement.

We also find that the restrictive covenant in the Practice Management Agreement is not reasonably necessary for the protection of WOA, nor is it designed to protect that company's legitimate business interest–at least insofar as it prohibits the practice of medicine. As discussed earlier, WOA provides certain management services to physicians. It does not provide medical care to patients. Therefore, WOA has no interest which is threatened by Dr. Bailey practicing medicine on his own.

Of course, the physicians associated with WOA practice medicine, but they are not parties to the Practice Management Agreement and there is no reason why we should apply a third party beneficiary theory to restrictive covenants, given the begrudging manner in which these restrictive agreements are treated under current law. Therefore, even though the Practice Management Agreement refers to the WOA-affiliated physicians, that provision is merely gratuitous.

Judge Brown made no finding as to the element that the restrictive covenant must be reasonably necessary, and in a footnote he indicated why: there is "at least a tenable argument that the covenant is reasonably related to WOA's legitimate business interests" because WOA employed one physician and therefore was in the business of providing medical care to patients and did not solely provide management services. Liddell, p. 9 fn. 3. That argument, however, is not applicable here because WOA does not currently employ any physicians.

Since the restrictive covenant in the Practice Management Agreement fails to satisfy the three prerequisites to enforcement, we need not address whether it is reasonably limited in time and distance. However, the court notes that the burden falls on the plaintiff to establish the reasonableness of the covenant, and the plaintiff has offered little evidence in that regard.

2. Restrictive Covenant in the Employment Agreement

WOA has also asked the court to enforce the restrictive covenant in the Employment Agreement, which prevents Dr. Bailey from opening his own local practice for two years after the expiration of the Employment

Agreement or any practice management agreement he might happen to sign in the future.[6] The restrictive covenant thus purports to extend itself beyond the contract at hand, and impose itself on any practice management agreement that Dr. Bailey might ever sign with WOA.

This provision is nothing more than a sneaky attempt to hide an illegal restraint upon purchasing services within an employment contract. As already discussed, the restrictive covenant in regard to the Practice Management Agreement is unenforceable because it is not ancillary to an employment agreement. WOA cannot transform it into an enforceable provision by simply transplanting it into an employment agreement.

Moreover, even if we were to turn a blind eye to this smuggling attempt, we would refuse to enforce the provision referring to a future practice management agreement because it creates a restrictive covenant that is not reasonably limited in time. In fact, it is *unlimited* in time, for it prevents Dr. Bailey from practicing locally for an unspecified period after his employment ends.[7] The time limit depends upon how long he purchases services from WOA under a practice management agreement, which was completely unknown at the time the employment contract was executed. In short, WOA is entitled to restrict Dr. Bailey from practicing locally on his own for two years after his employment ended–not for two years after his agreement to purchase WOA services ended.

WOA took Dr. Bailey under its wing when he was fresh out of his internship, without a patient to his name. Within a few years, however, Dr. Bailey was ready to be pushed out of the nest and fly on his own, which he did in August 1996, when he became a WOA-affiliated physician rather than its employee. But even though Dr. Bailey generated his own income for the next two years through patient fees and although he paid WOA about $328,800 each year for its services, WOA still insists on characterizing Dr. Bailey as remaining under its tutelage during that time.

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[6] The Employment Agreement states: "EMPLOYEE shall not engage in a business or practice competing with the physicians and professional corporations who have contracted with WOA (except as authorized by the terms of this agreement) during the term of this agreement *and during any period he is a party to any practice management agreement with WOA* and for a period of two (2) years from the date of this agreement *or any practice management arrangement*, whichever is later . . . ."

[7] In this case, Dr. Bailey would be under the restriction for four years beyond the time his employment was terminated.

WOA cannot have it both ways. Either physicians are employees, in which case they can be subject to restrictive covenants, or they are affiliates, in which case they are not. WOA cannot function as a feudal lord, creating a fiefdom in which all workers are treated as serfs, even when they own their own land. Like any other vendor, WOA can bargain for a contract in which the physicians agree to purchase services only from it while the contract is in effect, but WOA cannot restrict them from practicing locally once the contract is terminated.

3. Elements of a Preliminary Injunction

Having found that the restrictive covenant relating to the Practice Management Agreement is unenforceable, and that the restrictive covenant in the Employment Agreement is unenforceable in regard to its reference to future practice management agreements, we must deny the injunction. However, we will briefly discuss the other elements necessary for a preliminary injunction.

To obtain a preliminary injunction, a party must show that: (1) the relief is necessary to prevent immediate and irreparable harm which could not be remedied by damages; (2) greater injury will result from refusing to grant the injunction than by granting it; (3) the injunction will restore the parties to their status as it existed prior to the alleged wrongful conduct; (4) the injunction is reasonably suited to abate the allegedly wrongful activity; and (5) the moving party must demonstrate a clear right to relief. Fischer v. Dept. of Public Welfare, 497 Pa. 267, 271, 439 A.2d 1172, 1174 (1982).

As our previous discussion on the merits shows, WOA has failed to prove element (5). Elements (3) and (4) are clearly met. Therefore, it only remains to discuss elements (1) and (2).

WOA has alleged that it will suffer immediate and irreparable harm if Dr. Bailey is not prohibited from practicing locally for several reasons. First, it claims he is in a position to disclose and utilize information regarding the methods by which WOA and the WOA-affiliated physicians conduct the practice of medicine. There was no evidence to support this proposition; WOA offered no testimony of any special or secret orthopedic techniques developed by WOA or its physicians. Second, WOA claims as trade secrets its sophisticated computer system, its marketing techniques, the design of its facility, and its specially trained support staff. None of these arguments are

convincing because: (1) Dr. Bailey has no knowledge of or access to the WOA computer programs or marketing program; (2) anyone who enters the building can observe the design of the Costello Center; and (3) WOA has lost no staff members to Dr. Bailey, nor does it appear likely any of its employees will jump ship in the future. Moreover, loss of staff members could hardly be viewed as irreparable harm, as there is no evidence any of these individuals are irreplaceable.

Lastly, WOA argues it will lose numerous patients if Dr. Bailey is permitted to practice locally. This is inaccurate because WOA has no patients; the patients are referred to the WOA physicians, who treat them and charge them. WOA makes no money from these patients. Its income is derived from the practice management fees paid by the physicians. Nor does it appear that any of the WOA physicians will be unable to pay their fees if Dr. Bailey leaves and takes his patients with him. The only thing WOA will lose is Dr. Bailey's practice management fee, which it loses whenever a physician leaves WOA–whether or not the physician practices locally. Because Dr. Bailey has properly terminated the Practice Management Agreement, WOA will lose Dr. Bailey's fee whether or not the restrictive covenant is enforced. Clearly, the loss of the practice management fee is not caused by a breach of the restrictive covenant. Moreover, the mere loss of funds cannot constitute irreparable harm, because it is compensable by money damages. And finally, there was no evidence WOA will not be able to find another physician to take Dr. Bailey's place within a matter of months.

It is true that if Dr. Bailey practices locally, the other WOA physicians will likely lose the *opportunity* to pick up his old patients. However, those physicians were not parties to any of the contracts Dr. Bailey signed, and therefore their interests need not be taken into account. The court is aware that some of the WOA physicians own a financial interest in the corporation, but so long as our law allows the corporate mantle to shield owners from lawsuits, that mantle will also keep them from benefits they might otherwise realize.

Regarding element (2), a comparison of harm caused by granting the injunction, the answer to this is obvious. As discussed above, WOA will suffer little if any harm if Dr. Bailey is permitted to practice locally. Dr. Bailey, however, will suffer a great deal: he will be prevented from practicing in the location of his choice, in close proximity to the patients he has treated and whom are likely to want to continue being treated by him.

Dr. Bailey has requested the court to consider the harm that would result to the individuals he has treated if an injunction is issued. Specifically, he argues that these former patients will be deprived of their right to choose a physician if Dr. Bailey cannot practice locally. During the hearing, Dr. Bailey attempted to introduce evidence that five of his patients want to continue treating with him and would be burdened if he is not able to practice locally. Counsel for WOA objected on the basis of relevancy, and we reserved our decision. After researching the issue, we conclude that although adverse impact on the public is certainly a consideration when evaluating a request for injunctive relief, the Pennsylvania appellate courts have held that patient choice is not a proper consideration in this regard. New Castle Orthopedic Associates v. Burns, 481 Pa. 460, 392 A.2d 1383 (1978); West Penn Specialty MSO, Inc. v. Nolan, 737 A.2d 295 (Pa. Super. 1999). Rather, the public interest analysis in physician restrictive covenant cases is limited to determining whether there will be enough physicians to serve the community if the injunction is granted. Id. Therefore, the court denies Dr. Bailey's motion to admit Defendant's Exhibit #1.

4. The Purloined Patients

As is clear from this opinion, the court finds the restrictive covenants at issue to be repugnant because they attempt to prevent physicians from striking out on their own more than two years after their employment with WOA ends. By including a restrictive covenant in the Practice Management Agreement, WOA is trying to stop doctors who are WOA's customers from establishing a local practice for two years after they stop purchasing services from WOA. While restrictive covenants are reasonable in employment agreements because they protect certain valid interests of the employer, they have no place in contracts to purchase services or products.

WOA's attempt to keep physicians in its clutches long after they cease being employees discourages entrepreneurship, which is highly prized in our country and which has made America great. By striking out on his own, a physician leaves the sheltered environment of WOA, where all administrative matters are provided for him, where there is a comprehensive orthopedic care facility, and where there is a specially trained support staff to help him treat patients–albeit at a high price. The departing physician faces many challenges and risks in establishing his own practice. Most of all, he risks failing to attract enough patients to pay his overhead, cover his bills, and turn a

profit. Such a move requires courage and initiative.

Unfortunately, we must stop short of recognizing these qualitites in Dr. Bailey, for he has demonstrated that he is not willing to fully face the risks of private practice. Instead of shouldering the responsibility of attracting old and new patients through marketing, like all entrepreneurs, Dr. Bailey performed a secret "examination" of the WOA files and made off with all names and address of patients he considered his own. But while the patients might have been his, the files were not, and Dr. Bailey had no right to take information from the WOA files in order to increase his chances of succeeding in his new business. He should have had the courage to take on the task of attracting these patients to him through advertising, telephone directory listings, and other means, as WOA had done. He should have had enough confidence in his professional relationship with those individuals to believe that when they called WOA for an appointment with him and learned he had left, they would follow him.[8] Dr. Bailey is rather like a young man who declares his financial independence and leaves his parents' home for his own apartment–after secretly using their credit cards to purchase furniture and make advance payments on his rent.

In this action for injunctive relief the court sits in equity and we therefore have broad discretion to fashion an appropriate remedy. In our opinion, Dr. Bailey acted unconscionably in secretly copying 3000 patient names and addresses and sending those individuals a letter announcing his new office and enclosing a postage-paid postcard addressed to WOA asking for the release of their records to Dr. Bailey or themselves. What Dr. Bailey neglected to explain, of course, was that there was a third option: remaining with WOA, in which case one of the other highly qualified orthopedic physicians would treat them. We are certain that if given the opportunity, WOA could point out many advantages to patients who choose this alternative, such as continuing to benefit from the WOA support staff and facilities.

Because the solicited patients were not provided with this third alternative, nor given all the information necessary to permit them to make an intelligent and informed choice, we find that the post cards received by WOA

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[8] We sincerely hope that WOA would have given Dr. Bailey's phone number and address to any patient who asked for them. Even if it did not, however, such patients could certainly find him if they truly wanted to.

are not knowing and voluntary requests, and that WOA need not honor them.[9] WOA is certainly free to respond to these requests in a manner that is fair and appropriate, or to ignore them altogether. Moreover, in the order attached to this opinion we will direct Dr. Bailey to immediately return all names, addresses, and phone numbers of individuals he obtained from WOA files, and to refrain from using the list again.

If Dr. Bailey wanted to go out into the world to seek his fortune he was free to do so, but he should not have stacked the deck in his favor first. He must muster the courage to build his practice through his own effort and initiative, like all entrepreneurs. We will not permit him to get a free ride on the back of WOA, who has already done the hard work.

[9] Of course, any legitimate patient requests for records should be honored.

O R D E R

AND NOW, this _____ day of October, 2000, for the reasons stated in the foregoing opinion, the court finds that the restrictive covenants signed by Williamsport Orthopedic Associates, Ltd. (WOA) and John H. Bailey, Jr., M.D. are unenforceable. Therefore, the plaintiff's request for a preliminary injunction is denied but the following relief is granted:

1. The court finds that the postage-paid post cards addressed to WOA which Dr. Bailey sent out are not knowing and voluntary requests for transfer of patient records, and need not be honored;
2. Dr. Bailey is ordered and directed to refrain from using–in any manner whatsoever–the patient list that he surreptitiously purloined from the WOA files; and
3. Dr. Bailey is ordered and directed to return to WOA all copies of this list and to retain no patient names, addresses, and phone numbers he obtained from WOA files. Any computer databases including this information are to be destroyed immediately. Dr. Bailey may, however, retain any names, addresses, and phone numbers he has derived independently, such as patients who have contacted him or whom he has treated after leaving WOA.

BY THE COURT,

Clinton W. Smith, P.J.

cc: Dana Stuchell Jacques, Esq., Law Clerk
Hon. Clinton W. Smith
J. David Smith, Esq.
William Carlucci, Esq.
Gary Weber, Esq., Lycoming Reporter