Protecting the value of your practice: non-compete & trade secret agreements

By Stuart Oberman, Esq.

Dentists are often concerned about how to best protect their patient base when an associate dentist leaves the practice. The owner of a dental practice must make sure that associates cannot take the practices’ patient base or employees with them when they leave.

There are two methods of preventing this type of devastation to a dental practice, which are: (1) non-compete agreements and (2) trade secret agreements. Both of these types of agreements should be incorporated into an associate’s employment contract. In order to ensure that an employment agreement is properly drafted, you should consult with an attorney before entering into the contract.

Non-compete agreements

Dentists may have been exposed to a wide variety of terms when contemplating the issue of protecting their patient base, such as non-compete agreements, non-competition clauses, covenants not to compete and restrictive covenants. These are all different terms used to essentially describe a non-compete agreement.

A non-compete provision is typically a section of an employment agreement, however, a non-compete agreement may also be a separate document that an associate may be required to sign as part of his/her employment.

A non-compete agreement allows the owner of a dental practice to limit a former associate from starting his/her own dental practice that competes with his/her former employer, and a non-compete agreement may prohibit an associate from working for a competitor. Generally, non-compete agreements are enforceable, however, state laws may vary. The owner of a dental practice should always consult with his/her attorney before entering into any type of non-compete agreement.

In order to ensure that a non-compete is enforceable, there are some general requirements that must be complied with. The non-compete must be reasonable in that it protects the legitimate interests of a dental practice. The dentist’s interest in protecting the time he/she put into training a new associate must be balanced by the associate’s freedom to work where he/she chooses and the public’s interest in obtaining the services of a particular dentist.

Time limit. The second requirement for an enforceable non-compete agreement is that the agreement must have a specific time limit. The shorter the period of time, the more likely the agreement will be upheld. Typically, a non-compete agreement with a time period less than three years will be enforceable.

Geographic restriction. The third requirement for an enforceable non-compete agreement is that the agreement must contain a reasonable geographic limitation. If a former associate moves to a dental practice within a 10-mile radius of his/her previous employer, and the former associate has a 10-mile non-compete agreement (depending on state laws), the court would likely uphold the agreement as valid and issue an injunction against the former employer.

However, if a non-compete agreement attempts to restrict an associate from practicing within a 50-mile radius of the associate’s former practice, the non-compete may be considered too broad as to the geographic restriction and, as a result, the agreement may be considered unenforceable.

If a court determines that certain provisions of a non-compete agreement violate state law, the court may utilize the Blue Pencil Rule. This rule allows a judge to modify the terms of the non-compete agreement that may be too burdensome on one party and yet enforce the remainder of the agreement to make the agreement more reasonable.

For example, if the non-compete agreement reasonably protects the employer’s legitimate interests and has a reasonable geographic limitation but the agreement states that the non-compete is to be enforced for a period of five years, the court may strike the five year time period and replace it with a two year time period and enforce the remainder of the contract.

However, some states prohibit the use of the Blue Pencil Rule and, as a result, the agreement will be either upheld or invalidated in its entirety. For this reason, it is extremely important that a non-compete agreement comply with state law.

Non-compete agreements are widely used in the purchase of a dental practice. If a dentist purchases a dental practice, the purchase price by way of special allocation typically includes the personal and corporate “goodwill” of the seller and patient accounts.

However, without an effective non-compete, the seller of a dental practice may open another dental practice across the street. A non-compete agreement would prevent the seller from competing with the buyer in a specified geographic location once he/she sells the practice, for a specified period of time, which would in turn permit the purchaser of a practice to establish his/her new practice.

Additionally, when hiring a new employee, a dentist should always ensure that the new employee is not subject to a non-compete agreement with his or her previous employer. In some states, a new employer may be held liable for hiring an employee who violates a non-compete agreement with a former employer.

Trade secrets

Trade secret provisions in an employment contract will also help protect the patient base of a practice. A trade secret provision should provide that all patients and their confidential information are trade secrets of the practice, and sanctions will be enforced against any associate or employee who attempts to use this confidential information for his/her own personal gain.

Generally, trade secret laws have three components, which are:
• any information that is not generally known to the public,
• that confers some type of economic advantage, and
• that the employer has taken steps to keep confidential.

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