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Mile High Non-Compete Law: Colorado Court of Appeals Determines Enforceability of Liquidated Damages Clause in Physician Non-Compete Agreement

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The Colorado Court of Appeals, in ***Crocker v. Greater Colorado Anesthesia, P.C.,*** recently examined several unique enforceability considerations with respect to a physician non-

compete agreement. Of particular interest was the Court's treatment of a liquidated damages provision in the agreement. Pursuant to a Colorado statute (8-2-113(3), C.R.S. 2017), the Court held that the provision was unenforceable because the liquidated damages were not reasonably related to the injury actually suffered.

Michael Crocker, a former physician-shareholder at Greater Colorado Anesthesia (Old GCA), signed an employment agreement with Old GCA that contained a non-compete provision that prohibited Crocker from practicing anesthesiology within 15 miles of a hospital serviced by Old GCA, for two years following termination of the agreement. The employment agreement also included a liquidated damages clause that required a former employee who violated the non-compete agreement to pay "(1) the three-year annual average of the gross revenues produced by the doctor's practice; (2) minus the three-year annual average of the direct cost of [Old GCA] employee; (3) multiplied by two, to reflect two years of competition; and (4) plus $30,000 to cover the estimated internal and external administrative costs to terminate and replace the competing doctor."

In January of 2015, Old GCA's shareholders voted to approve a merger. Crocker dissented. Crocker severed his employment relationship with Old GCA and later began working for another anesthesiology group within the non-compete area outlined in his employment agreement. After the merger, New GCA sought damages for Crocker's breach of his non-compete. The district court determined that the non-compete was unenforceable. The Court of Appeals affirmed the district court's decision on several grounds, including hardship on Crocker and Crocker's rights as a dissenting shareholder with respect to the merger.

The court also independently rejected New GCA's request for liquidated damages, determining that the company suffered no damages, and that the liquidated damages clause was unenforceable because it was not reasonably related to "any injury [New GCA] *actually suffered* due to Crocker's departure." Citing the Colorado statute governing liquidated damages clauses in physician non-compete agreements, the court explained that "a damages term in a non-compete provision such as here is enforceable only if the amount . . . is reasonably related to 'the injury suffered' in the past tense. Under this plain language, the reasonableness of the relationship between the two amounts must be demonstrated, and it cannot be analyzed prospectively; by definition, it can only be determined upon the termination of employment."

This case underscores the need for employers seeking to enter into restrictive covenants with their employees to consult with counsel when drafting such covenants. In the circumstances of this case, there was a state statute specifically bearing upon the liquidated damages provision in the physician non-compete agreement, which effectively prevented that provision from being enforced against the employee. The world of restrictive covenants can be tricky and compliance with state laws (statutes and case law) is crucial when the time comes to enforce them.

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