VIRGINIA SUPREME COURT CONFIRMS RULES OF CONTRACT INTERPRETATION

Jackson & Campbell, P.C. won a significant victory before the Supreme Court of Virginia in a case involving the contentious termination of a medical partnership. A 50% shareholder of the medical practice had resigned from the practice and sued the practice for severance pay and other damages. Among other things, the departing physician claimed that he had not agreed to certain corporate expenses and that his Entitlement for the year prior to his resignation was understated substantially.

When medical practices dissolve, many conflicts can arise concerning a wide range of issues, including patient solicitation, payment of entitlement, distribution of profits to the physicians, and payment of expenses by the medical practice. The decision issued by the Supreme Court of Virginia underlined some important considerations in this area. In particular, contractual provisions involved must be scrutinized carefully, and the parties must be sure to comply in all material respects with those provisions, or else risk giving up rights they might otherwise enjoy.

The case was Countryside Orthopaedics, P.C. v. Peyton, decided on January 12, 2001 after three years of protracted litigation. The medical practice was comprised of two orthopedic surgeons. One physician had founded the practice in 1993 and the other had joined as an employee in 1995.

In 1997, the founder of the practice and the employee completed negotiations on an agreement for the employee to buy in to the practice as a 50% shareholder. The deal was finalized by the execution of four separate agreements: (1) an employment agreement between the founder and the medical practice; (2) an employment agreement between the employee and the medical practice; (3) a stock purchase agreement between the founder and the employee, under which the employee was to make buy in payments for the purchase the stock over 48 months, without interest; and (4) a stockholders' agreement establishing the new internal governing structure of the medical practice.

The four agreements were all signed on June 27, 1997, but were made retroactive to January 1, 1997. As of the date of closing, the employee was to make the buy in payments for January through June, and was required to make the additional monthly payments thereafter. The employee did not do so. In fact, he made only one payment, in August 1997, covering only the months of January through July. The payments were thus never current, and no additional payments were made after August.

On October 3, 1997, the employee resigned from the medical practice, effective December 31, 1997. He then sued the medical practice, claiming, among other things, severance pay under the employment agreement signed in June 1997.

Although the trial court had awarded severance pay, the Supreme Court reversed. In doing so, the Court underlined two important concepts.

First, the Court pointed out that, even though the transaction as consummated in June 1997 was comprised of four separate documents, those documents had to be viewed together as one single agreement. The Court made it clear that this is not new law: "This Court has repeatedly stated that 'where two papers are executed at the same time or contemporaneously between the same parties, in reference to the same subject matter, they must be regarded as parts of one transaction, and receive the same construction as if their several provisions were in one and the same instrument.'" The Court cited to Virginia law and cases from other jurisdictions that support this proposition, and the Court also noted that the departing physician had himself agreed with this proposition at various times during the case.

In this case, even though the parties to the four separate agreements were not exactly the same, the Court nonetheless found that the documents were intended to be "parts of one transaction." This was important, because the employee's breach of the buy in requirements of the stock purchase agreement thus affected his ability to seek severance pay under the separate employment agreement he signed with the medical practice.

The second important principle was also not new law. The Court found that by failing to make the buy in payments as required, the employee committed the first material breach of the overall transaction. Because he had done so, the employee could not enforce any provision of the transaction for his own benefit. Under Virginia law, a party committing a material breach of contract cannot pursue an action to enforce any provision of the contract.

In this manner, the employee's action for severance pay was barred, as a matter of law. By not making the required payments of approximately $1,900.00 per month, this employee was prevented from pursuing a substantial six-figure claim for severance pay.

This case contains important caveats for drafters of legal agreements, as well as for individuals planning to change jobs. In each case, the individuals involved and their counsel need to pay close attention to the legal principles reiterated by the Supreme Court in the Countryside lawsuit - to minimize the risk that rights will be lost or compromised.