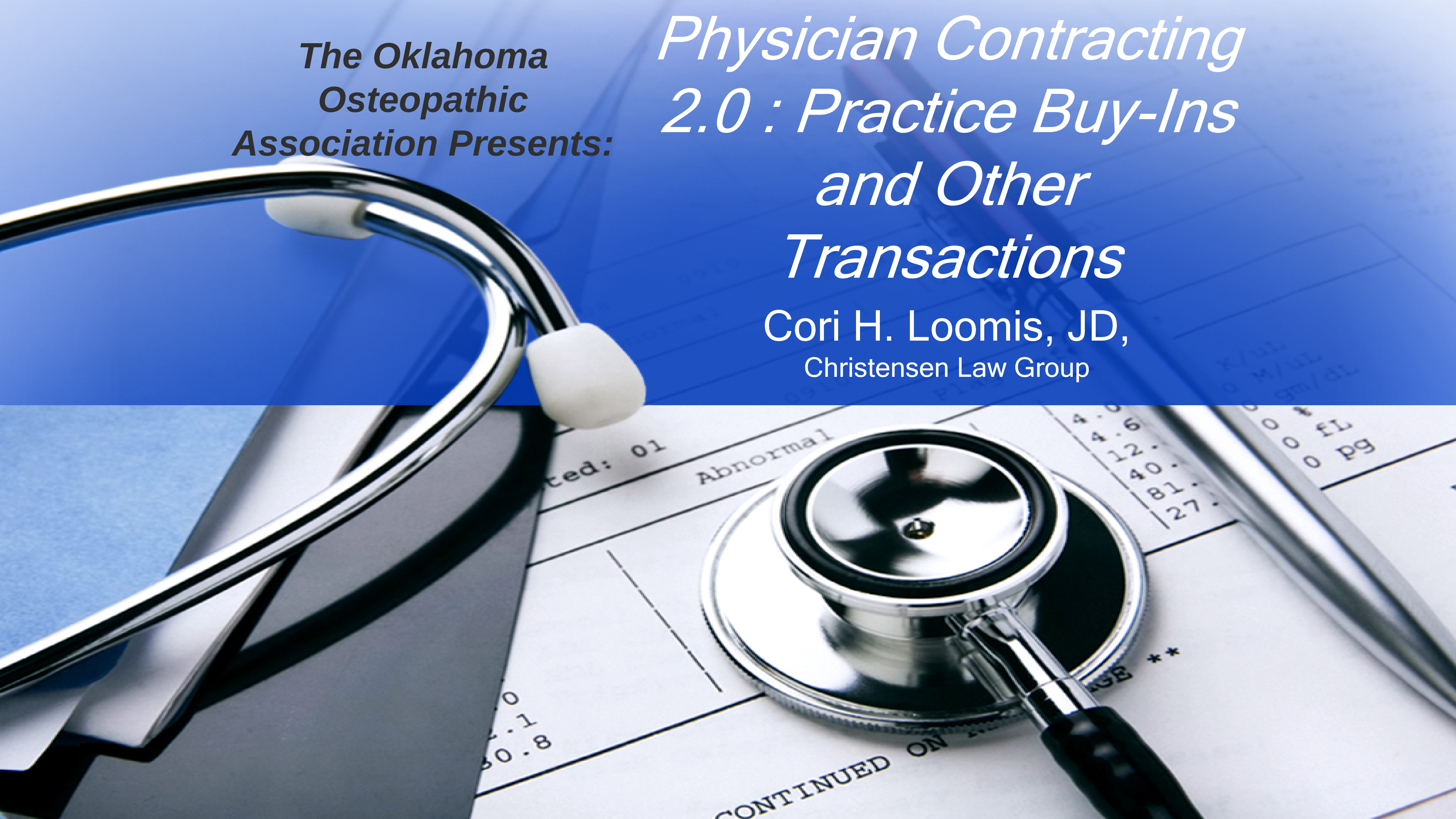

The Oklahoma Osteopathic Association Presents:

Physician Contracting 2.0 : Practice Buy-Ins and Other Transactions

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Objectives

- **Employment Agreements**: Recognize the biggest mistakes physicians make in negotiating employment agreements;

- **Medical Practice Ownership/Buy-Ins:** Identify key issues and terms that need to be considered and negotiated;

- **Physician-Hospital Integration Models:** Understand the complicated legal issues that must be considered when determine the level of integration.

- **Private Equity:** Identify the pros and cons of participating in a private equity transaction.

Employment Agreements

Employment Agreements – Common Mistakes

- Not consulting an attorney, consulting them too late or not telling the attorney verbal commitments.

Employment Agreements – Common Mistakes

- Failure to conduct adequate due diligence or research on employer and employer culture.

Employment Agreements – Common Mistakes

- Failure to ensure understanding of terms.
  - Defined terms
  - Vague provisions
  - Obligations incorporated by reference
  - What's there and what's not

Employment Agreements – Common Mistakes

- Failing to understand compensation formulas and benefits.
  - What circumstances may negatively impact comp.
  - Supplementing benefits if needed.

Employment Agreements – Common Mistakes

- Failing to recognize one-sided nature of most agree-ments and considering impact of termination.
  - Tail insurance
  - Repayment of any loans/advances.
  - Restrictive covenants.

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Practice Buy-In

Negotiating Practice Buy-In

- What does your initial employment agreement say?
  - Hopefully, it said something. . . .
  - Prospective nonbinding buy-in terms

Know what you are buying

- **Type of entity**
  - PLLC (LLC)
  - Professional Corporation (Corporation)
- **Other related entities**
  - Do the owners of the practice own other entities that generate revenue?
  - Are there other entities that diminish the revenue generated by the practice?

Know what you are buying

- **Liabilities**
  - Has the practice been subject to payer audits or recoupments?
  - Compliance issues?
  - Debt?   Personal guarantees?
  - Lawsuits?
  - Is it as profitable as you think it is?

Documentation of Transfer

- **Subscription Agreement**
  - Governs when a physician buys and the Practice sells an ownership interest in the Practice.
- **Purchase Agreement**
  - Governs when an existing owner of the Practice sells an ownership interest to a physician (as opposed to the physician buying the interest from the Practice).

Documentation of Transfer

- **Corporation**
  - Shares
  - Stock

- **Limited Liability Company**
  - Membership interests
  - Units

Governance Documents

- **Corporation**
  - Stockholder Agreement (a/k/a Buy-Sell Agreement)
  - Bylaws
  - Employment Agreement
  - Deferred Compensation Agreement

Governance Documents

- **Limited Liability Company**
  - Operating Agreement (which may include provisions of Buy-Sell Agreement, Bylaws, Deferred Comp and Employment Agreement)

  - Employment Agreement (if applicable)

Major Issues

- Buy-In terms
- Control/decision making
- Transferability of ownership
- Compensation/allocation of expenses
- Restrictive covenants
- Tax Issues (Consult CPA, LLM)

Another way to approach this.

- **Avoid these top 10 sources of conflict between physician and practice**
  - Compensation/expense allocation
  - Departing physician – income continuation payment – A/R collection efforts by practice
  - Departing physician – tail coverage/other benefit payment
  - Departing physician – non-compete
  - Departing physician – medical records

Another way to approach this.

- **Avoid these top 10 sources of conflicts between physician and practice**
  - Departing physician owner – buy-out calculations
  - On-call responsibilities
  - Productivity – bonus calculations
  - Outside income/activities
  - Support staff – personality conflicts

Buy-In Terms

- Formula
- Flat Amount
- Valuation (What is it based on?)
- Sweat equity
- Lump-sum
- Pay-out

Control

- **How are decisions made?**
  - A senior physician manager (founding owner)
  - Management or executive committee
  - All owners

- **Minority owner protections**

Transferability of Ownership

- Sale/assignment/transfer of an ownership interest: permitted or prohibited?
- Right of first refusal on sale
- Triggering events for repurchase
  - Death
  - Disability
  - Voluntary?

Transferability of Ownership

- **Valuation of ownership interests**
  - Certificate of agreed value
  - Valuation formula
    - Book value
    - Multiple of earnings
    - Multiple of compensation
    - Other
  - Appraisal method

Transferability of Ownership

- **Payment method and terms**
  - Insurance funding of death/disability
  - Payment terms and security
    - Lump sum
    - Installments
      - Promissory note
      - Interest rate
      - Events of default
    - Security

Compensation a/k/a Income Distribution

- Equally
- Production
- Combination

Expense Allocation

- Equal assessment

- Direct cost allocation
  - Each owner calculated separately.

- Indirect cost allocation
  - Fixed costs such as rent and utilities are charged to each physician.

- Allocation based on time worked/productivity.

Restrictive Covenants

- Under current Oklahoma law, a non-compete in an employment agreement is not enforceable, but in the ownership context, it is enforceable.
  - Geographic restrictions
  - Time
  - Services/Scope of restriction

Restrictive Covenants

- Covenant Not to Compete
  - Prevents departing physician from competing with employer in specific geographic area for defined period of time.
  - Not enforceable under current Oklahoma law.
- Confidentiality Provisions
  - Trade secrets
  - Proprietary information
  - HIPAA - patient identifiable information
  - Enforceable
- Non-solicitation Clause
  - Cannot solicit patients
  - Cannot solicit other employees or contractors of the practice
  - Enforceable

Common Mistakes

- Starting negotiating the buy-in too late.
  - New physician employees want to know from the outset when and under what terms they will become an owner, but they often fail to negotiate terms in their employment agreement that will put them in a good position to negotiate the buy-in later.

Common Mistakes

- Failing to retain an experienced attorney and accountant.
  - New physicians assume they have no leverage.
  - Don’t want to spend the money.
  - Retain friends/family members with no health care experience.

Common Mistakes

- Failing to negotiate or review all the documents.
  - Not understanding the terms.
  - Avoidance of delicate or sensitive issues.

Common Mistakes

- Failing to thoroughly evaluate the deal.
  - Related party issues
  - Liabilities
  - Management
  - Culture

Get what you bargain for!

Common Mistakes

- Not addressing the tax issues.
  - Get assistance from qualified accountant.
- Failure to consider buy-out terms.

Physician-Hospital Integration

Integration Models

- Accountable Care Organizations
- Physician Hospital Organizations
- Clinically Integrated Networks
- Professional Services Agreements
- Co-Management Arrangements
- Joint Ventures
- Independent Practice Associations

Laws Affecting Integration

- Antitrust Laws
- Federal Anti-Kickback Statute
- Stark Law
- Tax-Exemption Laws
- State AKS and ‘mini-Stark’ Laws
- State Fee-Splitting
- State Corporate Practice of Medicine Issues
- Medicare Reassignment Rules
- Medicare Anti-Markup Rules

Contracting Issues

- THEN, after addressing all the legal issues, you have to negotiate the contracts, which are also lengthy and complicated.

Private Equity

Recapitalization

- In the context of physician practice, “recapitalization” is a fancy term for a transaction in which a private equity investor purchases an interest in a physician practice.

Overview

- Recapitalizations yield a lump sum of cash for the selling practice up front in exchange for reduced future income. The lump sum is taxed as capital gains, based on current practice profits–earnings before interest, taxes, depreciation and amortization (EBITDA). Additionally, the selling doctor(s) may receive stock in the new entity.

Pros

- Private equity transactions may occur more quickly than a traditional sale.

- Private equity groups seem to be offering more for practices than traditional practice valuation models would suggest, resulting in larger up-front cash payouts.

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Pros

- Seller is relieved of the day-to-day administrative and regulatory challenges of running a practice.
- Possible expense savings by leveraging buying power and other management efficiencies.

Cons

- Seller is often required to stay on as an employee of the new entity for a specified time period.
- Seller loses decision-making control and authority.
- Culture of practice may change.

Thank you.

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