Joining a Practice As a Shareholder

So, you're expecting an offer of partnership after 2 years working at an oncology practice. How will you evaluate the offer, and what should you look for in the shareholder agreement?

First, let's clarify some terms. Technically, "partner" applies only to legal partnerships, which are few and far between in medical practices these days. Most medical practices are structured as professional corporations or limited liability corporations (LLCs), where owners are shareholders, not partners. However, it is common in colloquial speech to refer to "becoming a partner" and "being offered a partnership," even when speaking of entities that are not legal partnerships. In this article, we also will use "partner," "owner," and "shareholder" to refer to an equity owner of a medical practice.

Start Early and Use Advisors

*Jeffrey B. Sansweet,
JD, LLM*

To oncologists anticipating signing a shareholder contract, Jeffrey B. Sansweet, JD, LLM, a partner in a health care law firm in Wayne, Pennsylvania, offers this tip: "Start early, and bug the senior people to get you all of the documents and all of the financials as early as possible—*months* in advance of when it's supposed to take effect. These things tend to get complicated and a lot of times end up being put into place retroactively."

Alice G. Gosfield, JD

Retain advisors who can help you. "It's worth having a lawyer who is familiar with the laws of that state," says Philadelphia health care attorney Alice G. Gosfield, JD. "In addition, it's worthwhile having an accountant. The personal tax implications to a physician can be significant."

Sansweet adds, "Make sure you don't use your brother-in-law who's a divorce lawyer or a

criminal lawyer to look at the agreement; use someone who has experience in health care. [The lawyer] doesn't have to [specialize] in oncology agreements specifically (that can be tough to find), but [look for] someone who has experience in health care and medical buy-in transactions. It's not just the

legal issues; it's knowing the type of business and knowing what is important."

In addition to attorneys and accountants, another excellent resource for young oncologists is a business mentor—a senior physician or business person in the community who can provide informal advice and serve as the "voice of experience" on financial issues as well as career matters. Ideally, a mentor should be from another practice and be able to provide objective advice.

Practice Valuation

The practice is a business and has value. Each oncologist is part owner of the practice, so in a shareholder agreement the value of the entire practice will be stated and can be calculated using many different formulas. Make sure the valuation of assets is reasonable and explicit, and be sure you understand how it was determined. For example, was the value calculated by book value (the total value of all assets minus the practice debt), appraised value (if so, appraised by whom?), market value, or replacement value?

The value of the accounts receivable may be another component of the valuation. Is the value of the accounts receivable set at full value, or is it discounted for collectability? Some practices carry millions of dollars of bad debt or "uncollectibles" on their books as receivables, and a newcomer shouldn't be expected to have to buy in to these inflated "assets." The value of accounts receivable is especially important in oncology because of the large invoices for expensive drugs processed through the practice's cash flow. Finally, if the amount of accounts receivable is used as part of the total valuation, be sure your own contributions to the receivables (while you have been an employee) are not included. A good accountant will understand these issues, but not all attorneys do, so you should have an accountant and attorney who work together, or an attorney with experience in this area.

Sansweet advises, "As a junior doctor, you should engage a health care lawyer, an accountant, or a medical practice appraiser—somebody who is very knowledgeable and experienced in that area—to examine the proposed buy-in price to see if it's reasonable and makes sense." However, he adds, paying for a *separate* appraisal of the practice is usually not worth the effort or money. If the practice's appraisal and buy-in amount has been set for several new partners before you, it's unlikely that the practice will change it. "But doctors considering partnership should look at the proposal and see if it makes financial sense, doing projections about how much income they will earn compared to how much the buy-in costs."

Be Sure to Check These Documents

In addition to the shareholder agreement itself, be sure you examine the following documents with your attorney and accountant:

- Appraisal of practice (ie, practice valuation)
- Practice tax returns for previous two years
- Employment agreements for the other physicians in the group
- Bylaws of the corporation
- Operating agreement (for an LLC)
- Real estate agreements, including property belonging to the owners of the practice, and all lease agreements
- Documents related to debt or lines of credit
- Practice financial statements
- Documents explaining income division and expense allocation

Gosfield puts it this way: “The real issue is how viable the business is. Is it a good investment? This *is* an investment, like buying stock, except riskier, because the amount you are going to own far exceeds anything you will ever own on a publicly traded exchange.”

Structure Your Buy-In

Your buy-in price will be a percentage of the total value, usually divided equally among all of the partners. Thus, if there are already four partners, you would be the fifth partner, and the total practice value would be divided by 5 to determine your buy-in amount. Sansweet says, “I would say in probably 90% of the medical practices I see, the ownership shares are equal.”

Still, as Gosfield points out, group practices have different cultures that influence how the ownership is divided. “Some are very egalitarian, where everyone owns equal shares,” she says. “But characteristics of practice cultures are quite variable.”

The group might structure your buy-in over several years. For example, if the buy-in is structured over 3 years, in the first year you pay one third of your total buy-in price. The next year, you would pay another third, and in the third year you would pay the final third and become an equal partner with the others in the group. Generally, buy-ins spanning several years are structured as deductions from your annual salary. Thus, if the buy-in payment is \$100,000 for each year, instead of paying cash, your salary would be reduced by \$100,000 that year.

“Most of the time, the physician buying in gets a full, equal vote right away, even if paying the buy-in amount over time,” Sansweet explains. “But when the junior doctor is buying shares in increments, such as one tenth of the full ownership

amount, his or her vote is usually proportionate to his or her ownership percentage.”

Some groups accommodate a new partner without any buy-in per se. “They might have the doctor work for four years at a relatively low salary with no bonus, and then he or she becomes a partner with no buy-in,” Sansweet says.

This is considered a buy-in using “sweat equity.” “They’ve basically worked their tail off for four years and have built a kind of equity through sweat as opposed to paying money,” Sansweet explains.

The structure of the buy-in is a critical part of the partnership arrangement. These are key points to clarify about the buy-in:

- Will your percentage of ownership be the same as that of the other partners?
- Will your ownership include a percentage of the facility, equipment, supplies, and accounts receivable?
- If accounts receivable are used as part of the buy-in calculation, do they reflect the normal and expected pattern of income?

If you are paying the amount of the buy-in during a period of time, the agreement should specify the interest rate, frequency, and duration of your payments. Consult your accountant about the tax implications of your payback arrangement.

Decision-Making Authority

Be sure you understand what kind of say-so you will have in practice decisions. The governance structure and decision-making authority is usually spelled out in the shareholders’ agreement, but specifics could be covered in the corporation bylaws or the operating agreement of an LLC. Make sure you read and understand *each* of these documents.

“Control and decision making can be a big issue,” Sansweet comments. “It could involve big decisions, such as opening up a new office, merging with another practice, or hiring a new associate, or smaller decisions about office policies. Some decisions might require a unanimous vote of the shareholders or some sort of super majority, such as 75%, while others may require a simple majority.”

Be sure you are comfortable with your role in how decisions affecting the practice will be made. A large practice may have an established governance structure, with officers or committees with authority over matters such as office policies and fees, staffing, hiring and firing physicians, and participation in managed care contracts. In smaller groups, such decisions may be voted on by all partners.

Examine the Management of the Practice

Most likely, you have been working as an employee with this group for one or two years, and you’ve had the chance to see

how things run. Now is the time to scrutinize such issues as an owner, not as an employee.

Ownership of real estate can become a divisive issue. For example, sometimes the senior partners own the building being used by the practice and lease space to the practice. Be sure you obtain copies of relevant lease agreements. If the senior partners are charging excessive rent, the junior partners are likely to feel they are being treated unfairly. Now is the time to put such issues on the table for discussion.

Another issue that troubles numerous attorneys, practice management consultants, and oncologists is the use of family members as practice employees. As one experienced oncologist noted, nepotism can create issues that can far surpass money concerns. If the spouse is on the payroll, be sure the spouse's salary is reasonable and that the patients are not being inappropriately directed to the spouse's mate. One attorney reported a case in which the wife of a senior physician "came in one day a week and was paid a salary of \$50,000 a year."

Income Distribution

Groups use different methods for distributing income among partners. Some do so equally, others use productivity measurements, and some use a formula that combines productivity and other factors. "The income distribution formula is another cultural difference between groups," Gosfield notes.

Productivity can be calculated using numerous measures, such as how much revenue you generate, how many hours you work, or how many patients you see.

Sometimes the group gives weight to other factors in determining remuneration, assigning value to such variables as seniority, special training, research or teaching activities, and administrative duties. A potential pitfall is inequality of ownership, Sansweet cautions. "Be concerned about any sort of special rights that a senior doctor may have that last a long period of time or never end," he says. "One example is a management fee that the senior partner gets for running the practice—over and above the regular income division." Such extra income should be reasonable and correlated with additional effort and responsibilities.

Expense Allocation

How the practice allocates expenses to each partner is another important element of income that should be addressed at the time you sign a shareholder agreement. "The profit-sharing formula will turn to some degree on expenses," Gosfield points out.

Listed below are accounting methods that might be used for allocation of expenses. Sometimes combinations of these methods are used.

- **Equal assessment.** The net income (gross revenue minus expenses) is distributed equally to all shareholders. This works best when all physicians have approximately equal schedules and responsibilities—that is, when everyone makes about the same contribution to the practice.
- **Direct cost allocation.** The expenses incurred by each partner are calculated separately and deducted from his or her share of the gross revenue. This approach can be helpful when certain equipment or staff are not used by all of the oncologists.
- **Indirect cost allocation.** Fixed overhead costs, such as those for rent and utilities, are charged to each physician, usually as a per-square-foot charge.
- **Allocation based on time worked.** This method can be used to accommodate physicians who work part time.
- **Allocation as a percentage of productivity.** The percentage of expenses charged to each physician equals the percentage of revenue generated. Thus, an oncologist who generates 30% of the income will be charged 30% of the expenses.

Sansweet explains that the details of the income distribution formula and allocation of expenses may not be in the shareholder agreement itself. "Those issues need to be dealt with, but it varies as to what form it is in," he says. "It could be an attachment to the employment agreement or a separate compensation agreement. Sometimes it's just a printout from the office manager or practice accountant, and not even formally incorporated into an agreement."

Partnership Termination and Buy-Out

Although your focus now is joining the group as an owner, you don't know what the future holds. Voluntary or involuntary termination, death, disability, retirement, and bankruptcy are all circumstances that would end your partnership interest.

The agreement should make clear how the amount of your buy-out (your equity) would be calculated on termination, how long it would be before you are paid in full, and how much interest you would receive on the balance due until it is completely paid off. In addition, the contract should address how shared assets, including equipment and real estate, would be handled.

Remember, as an equity shareholder you will also be responsible for buying out the share of any partner leaving the group. "The buy-out is a huge issue," Sansweet remarks, "especially if somebody is joining a practice or buying in to a practice where some of the other physicians are close to retirement. The buy-out structure is very important. Typically, there is what's called a force buy-sell. If someone leaves for whatever reason—retirement, death, moving to another state—the remaining shareholders have the obligation to buy that doctor out. The buy-out is typically paid over time and, for tax purposes, usually part of it is structured as

payment of stock, and part is structured as deferred compensation.”

Most of the time a contractual restrictive covenant, or noncompete clause, is part of the employment agreement.¹ But aspects of the restrictive covenant are likely to apply to the shareholder agreement. For example, the restrictive covenant prohibiting a competing practice may no longer apply to full shareholders (those who have completed their buy-in), but the buy-out may be reduced or eliminated altogether if the partner leaves and competes.

Use Your Judgment

“It’s like a marriage.” Both Sansweet and Gosfield chose these words to describe becoming an equity shareholder in an oncology practice.

“Doctors shouldn’t be buying in if they think it’s a bad investment,” Sansweet concludes. “If it’s not the right feel, don’t do it. Go somewhere else, even if you feel like you may be starting over.”

Gosfield emphasizes that the people are more important than the legal contract. “The most important thing, really, is how comfortable you feel with the people you’re working with. Many bad contracts actually don’t ever present problems, because the people you’re working with are decent human beings. In other instances, you can have a brilliantly drafted contract that the parties you’re dealing with will ignore anyway, and always have. All this folderol about contracts is important, but in the last analysis, a contract is only as good as the will of the parties involved to follow it.”

In the final analysis, Gosfield stresses, “This is about people; this is about people you are casting your fate with.”

Reference

1. Employment contracts: what to look for. J Oncol Pract 2:308-311, 2006

DOI: 10.1200/JOP.0716501

RESOURCE FOR FELLOWS

Oncology fellows can interact with colleagues and peers by subscribing to ASCO’s fellows listserve. The fellows listserve is an unmoderated online discussion, which means that all replies to an e-mail are posted immediately to the entire group of subscribers. There is no better way to keep up with your peers and ask those tough questions than ASCO’s fellows listserve. To subscribe, visit ASCO.org and click the Education & Training tab, Faculty & Training Program Directors, Listserve Information.