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Physician Partnership Agreements: Structuring Key Provisions

Compensation, Organizational Decision Making, IRC 199A, Termination, Restrictive Covenants, Dispute Resolution

WEDNESDAY, AUGUST 21, 2019

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

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I. CONSIDERATIONS WHEN CONTEMPLATING PHYSICIAN PARTNERSHIPS

Purpose and Focus of a Physician Partnership Agreement

- Formation of a physician group practice.
- Joint Venture with other physicians or with non-physicians (i.e., management company).
- Consider potential ownership timeline, such as an agreement to operate a surgery center to generate income, or to operate and sell all or a portion in 2-3 years to an investor.
- Consider whether partnership operates a provider (i.e., physician practice or ASC), or merely holds an interest in another entity that owns and operates a healthcare provider.

- **Type of Corporate Entity**
  - Common are Limited Liability Companies and Corporations.
  - Will impact type of corporate documents (i.e., Operating Agreement, By-Laws, etc.).

I. CONSIDERATIONS WHEN CONTEMPLATING PHYSICIAN PARTNERSHIPS

Structural Options

- Structural Options to consider based on the purpose of the partnership and particular corporate entity.
- Purposes and focus will generally drive these decisions (i.e., types of owners, long term or short term focus).
- Group practice may consider having physician owners enter into employment or professional service agreements with the group practice entity.
- Group practice may use different entities for different business lines (e.g., optical shop, etc.), but need to keep regulatory compliance such as the Stark Law in mind.

II. PROVISIONS IN PHYSICIAN PARTNERSHIP AGREEMENTS

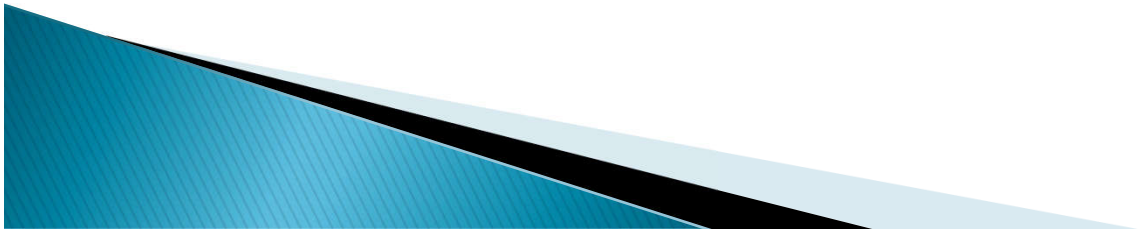
Organizational Decision Making

- Management structure will often be determined by type of corporate entity.
- Board of managers (LLC) or directors (Corporation).
- Decide whether to have officers (e.g., President).
- Delegations of day-to-day management (important to address in governing documents).

II. PROVISIONS IN PHYSICIAN PARTNERSHIP AGREEMENTS

Organizational Decision Making – Decision Making and Voting

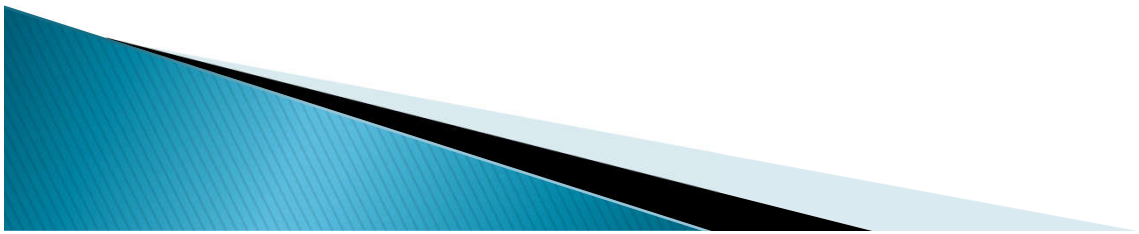
- May require a **Super Majority Vote** for certain key decisions such as:
  - Issuance of new interests in the corporate entity;
  - Admission of new physician owners;
  - Incurring debt above a certain threshold;
  - Requiring additional capital contributions;
  - Sale of a substantially all of the assets of the business; and
  - Dissolution of the corporate entity.



II. PROVISIONS IN PHYSICIAN PARTNERSHIP AGREEMENTS

Organizational Decision Making

- Decision Making and Voting
  - Majority Vote (i.e., greater than 50% of ownership interest or by heads).
  - Super Majority Vote (i.e., greater than 2/3 or 75% of the ownership interest or by heads).
- Decisions that must be made by the physician members/owners.
  - Generally key decisions are made by the members upon a Super Majority Vote.
  - All other votes by the Members are by Majority Vote.
- Decisions that may be made by the Board/Managers.
  - Distributions
  - Hiring/firing employees, other than as delegated to a day-to-day manager.



II. PROVISIONS IN PHYSICIAN PARTNERSHIP AGREEMENTS

Compliance With Healthcare Laws

- Need to consider certain statutory authorities:
  - Federal Anti-Kickback Statute;
  - Stark Law;
  - State anti-kickback laws;
- Impact on ownership structure and distribution of profits and losses (and compensation arrangements).
- Consider provisions in partnership agreement requiring compliance with certain laws and safeguards recognized by the OIG and other enforcement agencies.

II. PROVISIONS IN PHYSICIAN PARTNERSHIP AGREEMENTS

Compensation

"Blue Suits for White Coast" – Strategies for Maximizing Reimbursement

- Establish Fair Market Value (FMW);
- Determine Compensation Methodology;
  - Difference between draw and salary
  - How is compensation adjusted?
- Receipts and revenues attributed to physician less:
  - Direct Overhead (health insurance, CME, personal utilized by physician);
  - General Overhead; and
  - Draw.
- Regulatory Compliance – Stark Law and Anti-Kickback Statute
  - Addition of ancillary services: MRI, CT Scan, Physical Therapy, DME, and non-physician extenders
  - Exclusive Provider Agreements $\longrightarrow$ shift from set monthly/annual compensation to percentage of generated revenue
  - Medical Directorships
  - Participate in Clinical Trials

II. PROVISIONS IN PHYSICIAN PARTNERSHIP AGREEMENTS

Compensation *(cont'd)*

* Physicians are motivated not to leave money on the table. Strategies to increase physician revenues include:

- Joint Ventures and Collaborative Agreements with Hospitals and other physician Practice Groups
- Development of freestanding facilities/entities: specialty hospitals, ASTC, and Sleep Labs
- Concierge Medicine/Retainer Practice
- Medicare Opt-Out
- On-Call Coverage
- Hospital-Based Specialists

II. PROVISIONS IN PHYSICIAN PARTNERSHIP AGREEMENTS

Enhancing Compensation *(cont'd)*

- Tax-Exempt may not share net profits.
- How do you incentivize employed physicians?
- Incentives to maintain or reduce expenses.
- WRVU methodology.
- FMV/Reasonable Compensation.
- Recruitment Arrangements.

II. PROVISIONS IN PHYSICIAN PARTNERSHIP AGREEMENTS

IRC Section 199A (QBI): Pass-Through Business Deduction

- With the enactment of the Tax Cuts and Jobs Act on December 22, 2017, a new provision of the IRC was born ⟶ Sec. 199A.
- Sec. 199A permits owners of sole proprietorships, S-corporations, or partnerships to deduct up to 20% of the income earned by the business.
- A taxpayer (physician) other than a corporation, is entitled to a deduction equal to 20% of the taxpayer's (physician's) "qualified business income" earned in a "qualified trade or business."
- The deduction is limited to the greater of:
  - 50% of the W-2 wages with respect to the qualified trade or business; or
  - The sum of 25% of the W-2 wages with respect to the qualified trade of business; **plus** 2.5% of the unadjusted basis immediately after the acquisition of all qualified property.

II. PROVISIONS IN PHYSICIAN PARTNERSHIP AGREEMENTS

IRC Section 199A (QBI): Pass-Through Business Deduction *(cont'd)*

The deductible amount of the QBI for each of the taxpayer's (physician's) qualified trades or business is determined separately and added together.

The sum of these amount is then subject to a second limitation equal to the excess of:

- The taxable income for the year, over
- The sum of net capital gain (as defined by the IRC in Sec. 1(h)) plus the aggregate amount of the qualified cooperative dividends for the tax year.

* **The purpose of this overall limitation is to ensure that the 20% deduction is not taken against income that is taxed at preferential rates.**

METHOD FOR DISSOLUTION/TRIGGER EVENTS

- Identify Trigger Events for Dissolution of Entity and/or Withdrawal of physician as a Shareholder or Member of the entity.
- Develop a formula for redeeming physician's Stock or Units in the entity.
- Consider including a Put Option and a Right of First Purchase Option in conjunction with a Trigger Event.

Trigger Events may include:

- Physician Retirement or Relocation;
- Death;
- Disability;
- Loss of License/DEA number;
- Conviction of a Felony; or
- Dissolution of Practice.

II. PROVISIONS IN PHYSICIAN PARTNERSHIP AGREEMENTS

Addition of New Equity Partners

- Decide upon physician owner/membership qualifications.
- Buy in or purchase price.
- Approval by physician members or Board of managers or directors.
- Offer same terms to all potential physician owners to address regulatory issues.

II. PROVISIONS IN PHYSICIAN PARTNERSHIP AGREEMENTS

Valuation

- Approach is important for both business and regulatory issues.
- Purchase price must be at least fair market value to a physician and/or referral source investor.
- Discounted purchase price could be considered prohibited "remuneration" under the Anti-Kickback Statute and other regulatory authorities.

II. PROVISIONS IN PHYSICIAN PARTNERSHIP AGREEMENTS

Termination of a Physician's Ownership Interest

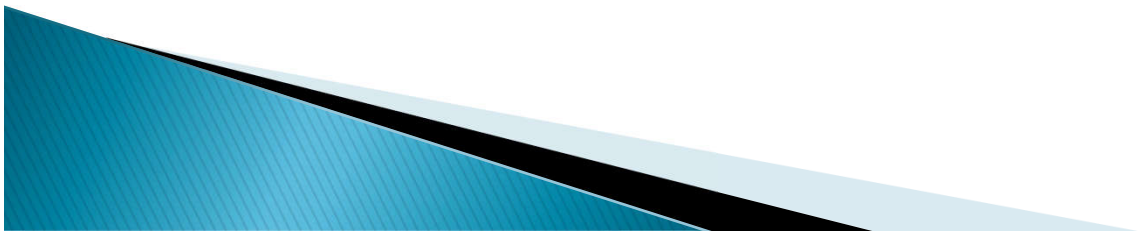
Important to address different types of triggering or redemption events:

- Events beyond a physician's control (death, disability, retirement, relocation, etc.).
- Events caused by the physician (loss of medical license, conviction of felony, breach of non-compete, etc.).
- Redemption without cause (e.g., expulsion).
- Voluntary withdrawal: generally prohibit ability to voluntary withdrawal without consent of physician members and specify the purchase price.

II. PROVISIONS IN PHYSICIAN PARTNERSHIP AGREEMENTS

Termination of a Physician's Ownership Interest - Buyout or Purchase Price (*cont'd*)

- Use of a pre-set formula such as a multiple of EBITDA, or specified amount agreed upon by the physician owners.
- Considerations include type of investors (may use a multiple of EBITDA with a management company owner, and may use a lower amount with only physician owners to address cash flow issues.
- Expulsion: Consistency with terminating physician owners is key.



III. PROVISIONS IN PHYSICIAN PARTNERSHIP AGREEMENTS

Malpractice/Tail Coverage/Insurance Coverage

- Identify Insurance Coverage and Responsible Party for Payment → physician and/or practice;
- Define who is responsible to pay for tail coverage upon a withdrawal from physician Partnership Agreement including: Operating Agreement, Shareholder Agreement, Partnership Agreement, or Physician Employment Agreement;
- Is payment of tail coverage dependent upon termination with cause or without cause?

* **Spell out the limitations and amounts of malpractice, tail coverage, and all insurance coverage, and which party is responsible to pay for such insurance coverage.**

II. PROVISIONS IN PHYSICIAN PARTNERSHIP AGREEMENTS

Restrictive (Noncompete, etc.) Covenants

- Check your jurisdiction regarding enforcement of Restrictive Covenants.
- Structure Restrictive Covenants to meet defined geographic and duration limitations → most jurisdictions require reasonable scope and duration for Restrictive Covenants.
- Utilize Restrictive Covenants to protect the physician Practice/Entity upon the departure of a physician.
- Restrictive Covenants may include:
  - Practice Non-Competes;
  - Non-Solicitation of Patients;
  - Non-Solicitation of Employees;
  - Non-Solicitation of Referral, Resources and Vendors.
- Identify penalties, remedies, and enforcement mechanisms if a Physician Shareholder/Member breaches the Restrictive Covenant(s).

DISPUTE RESOLUTION

Dispute Resolutions

- Identify mechanism for Dispute Resolution
  - Alternative Dispute Resolution:
    - Arbitration
    - Mediation
  - Litigation
- Who pays for Dispute Resolution?
- How are mediators or arbitrators chosen?
- Is the mediation or arbitration binding upon the parties?
- Is there a prevailing party provision in the Physician Partnership Agreement?

* **It is important to draft clear and concise dispute resolutions into a physician Partnership Agreement to protect the rights of all parties, including the practice.**

III. BEST PRACTICES FOR STRUCTURING THE AGREEMENT

Best Practices for Structuring the Physician Partnership Agreement

- Comply with all applicable State and Federal regulations;
- Consider the impact of referrals and any proposed compensation terms;
- Identify FMV and include in the agreement;
- Consider all tax implications to physicians and practice;
- Evaluate the impact of IRC Section 199A (QBI) on the agreement;
- Consider the impact on the agreement if there are changes to regulations and reimbursement. Include a regulatory modification provision to address any such regulatory and reimbursement changes;
- Address payment for relocation, bonuses, division of profits, CME, overhead, and other expenses;
- Establish policies for PTO, including vacation, maternity leave, short term and long term disability and extended time off;
- Determine how revenue from ancillary services will be divided among the physician owners; and
- Ensure that all agreements, amendments, resolutions, and all other corporate/organizational documents are signed.

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