MATT DICKSTEIN

Practice Attorney

Making legal matters easy and economical for your practice

39488 Stevenson Place, Suite 100, Fremont, CA 94539
510-796-9144. mattdickstein@hotmail.com mattdickstein.com

Newsletter, April 2015
How to Bring a New Partner into a Group Practice

This is a brief summary of how to bring a new partner into a group medical, dental, veterinary or CPA practice.

Culture & Compensation. When bringing a new partner into your practice, first think whether the new partner will fit in with the culture. Culture includes things like required coverage hours, the handling of employees, and the division of money. As always, let's talk about the money.

An incoming partner must fit in with your practice's compensation structure. Some people prefer a fixed but lower income, while others prefer a variable but potentially higher income. The tension is between (1) salary, and (2) productivity payments / shares in collections. Both have their pluses and minuses.

Salary-- A compensation structure that is heavy on salary fosters team spirit, but can lead to freeloading. Why work so hard if either way you'll get paid the same and everyone else is slacking off too?

Productivity Payments-- A compensation formula heavy on productivity & collections gives incentive to work, but leads to complexity and griping, to wit: (i) malcontented partners who are unhappy to make less than others in the group; (ii) administrative staff devoting their time to tracking individual production and allocating overhead; (iii) complexity because you must find some other way to compensate partners for necessary work that doesn't produce revenue, for example, practice governance, management, staff development, hospital committee work.

In sum, make sure that the incoming partner fits in with your compensation structure, whether it's eat-what-you-kill, or the team approach.

Buying into the Practice. After culture / compensation, think ownership. Frequently the practice asks the partner to wait a period of time (e.g. one year) before they discuss the buy-in. This ensures that the new partner fits-in before buying-in. Employment agreements sometimes have clauses for the partner's purchase of ownership in the practice. Usually the clauses are vague and non-binding, and only express the parties' expectations on the subject. If the buy-in is a material part of the deal, however, specify these deal terms:

- The ownership percentage that the partner will obtain
- The purchase price
- The period over which the partner will pay the purchase price
- The extent of the partner's participation in control decisions for the practice, e.g. is the partner on the board of directors?

Ownership percentage is a matter of control. It's dangerous to give control to a new person, and even a minority owner can get control if she aligns with other shareholders. Existing owners must think carefully about the effect of admitting the new owner on existing and future voting bloqs among the shareholders and on the board of directors.

Group Liabilities. If the existing partners are liable for group debts, state clearly the liabilities for which the new partner will become responsible. Will the new partner guarantee existing loans or leases? Will the new partner step into a capital call?

Exit Strategy. Now that you've structured the entry of the new partner, structure the exit. The existing partners and the incoming partner all need an exit strategy. The most common exit is the termination of the partner's employment plus the buy-back of his or her equity.

This is where a buy/sell agreement comes in. A buy/sell agreement is essentially an agreement for exiting a practice. A buy/sell agreement works like this –

First, the agreement names certain trigger events for buy-back (e.g. termination of employment, loss of license, death, disability, bankruptcy);
Second, the agreement permits the buy-back of the partner's equity on the occurrence of a trigger event;
Third, the agreement sets a price for the buy-back.

Termination of employment is the most important of the trigger events, because that's how the existing owners get rid of the new (soon to be ex-) partner. The control group on the board of directors can fire the problem partner as a doctor within the practice; and the control group among the shareholders can remove the problem partner as a director. If the buy/sell agreement permits the buy-back of shares on termination of employment, the control group can take this final step to completely remove the partner from the practice.

Buy-Back Price. The buy-back price is all-important, clearly, because a low price may cause the ex-partner to sue the practice, while a high price gives the ex-partner an undeserved windfall. Various methods exist for setting a buy-back price, including appraisal procedures and earnings-based formulas. The payment terms are important too, because payment up-front is a lot different than payment over 3, 4 or more years. I talk about these topics a lot on my website.

No-Competes. The last item to keep in mind is whether the practice will lock up the departing partner with a non-competition covenant. A practice that buys back shares can prohibit the departing partner's competition in a limited geographic area for a limited time.

Call me if you want to talk more.

Dogs

- Outside of a dog, a book is man's best friend. Inside of a dog it's too dark to read. — *Groucho Marx*
- If you pick up a starving dog and make him prosperous he will not bite you. This is the principal difference between a dog and man. — *Mark Twain*
- If there are no dogs in Heaven, then when I die I want to go where they went. — *Will Rogers*