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Practice Divorces: Considerations in Practice Dissolutions or Separations

by Sharmila D. Jaipersaud

In the beginning of a medical business venture, those involved in the new company are naturally excited about working together. This is the case no matter how the partners join forces—whether all owners get together to set up the new practice or some partners are added when doctors working as employees of a practice are offered the opportunity to buy in.

However, things can change over time, and the once friendly group of doctors may begin to see differences in their business judgment and personalities. In this case, the physicians may want to go their separate ways. As counsel on these matters, practitioners need to consider a number of issues concerning physician-clients as they enter into negotiations for business separation. Some issues may have been well thought out and addressed in the respective shareholders agreement and employment agreements; however, often the separation is not as clear-cut as the agreements would dictate, or worse, the parties never entered into written agreements in the first place.

So the cleanup begins. At the time of separation, the situation has likely deteriorated. The parties are no longer able to communicate, and even day-to-day management matters become monumental issues. Naturally, the physicians turn to their attorneys to guide them through the process.

Fiduciary Duty

All parties involved should be reminded that while an owner or board member of the practice they owe a continued duty of loyalty and fiduciary duty to the practice. This continued duty shall last until the parties have formally separated. It is important to remind the client that actions that may be interpreted as going against their current practice can lead to a breach of fiduciary duty. Beyond the duty, in the event the parties' disputes escalate to litigation, neither side of the matter would want to defend actions that were against the best interest of the practice. Managing the existing entity until dissolution or separation should be handled in a manner that comports with a duty of loyalty, and general fiduciary duty is required throughout the process.

Decision making should also follow corporate formalities. Hiring and termination of physicians or staff members during the period of separation should be handled during special meetings. Departing physicians should not be steering patients to a new entity or billing outside of their current practice.

Patient Records

As a part of the negotiations, the parties will have to consider how to manage patient records.

Patient records belong to the patient; the practice is considered the custodian of the records. During a separation, the physicians will need to discuss how patient records will be distributed for custodial purposes. While the practice will be required to notify certain patients, in a perfect world all patients of the practice should be notified of the location of their records and provided contact information for the departing physicians. This global notice could prevent a dispute over who should maintain the records. Furthermore, it provides the patients with the opportunity to continue treatment with a physician of their choice.

Assets

Tangible assets of a practice generally have little value. This is likely one area where clients will be able to come to terms, barring a few pieces of expensive equipment. Regarding equipment that is leased, each lease will need to be reviewed to determine whether it is assignable and to what extent there are any personal guarantees on the equipment leases.

If the practice leases space, the agreement may require personal guarantees for default in payment.

The intangibles will present more of an issue. If one group wants to maintain the name, continue the busi-

ness and run the practice, the departing group will want compensation since there is value in the name. Furthermore, the continuing practice will not need to start fresh. It will not have to negotiate rates or new contracts with third-party payors. It will not have to invest in new space or negotiate lease terms or vendor agreements. Beyond goodwill, there is additional value in being able to continue with the name.

Restrictive Covenants

While there *may* be value in the intangible assets, there *is* value in a restrictive covenant. If the physician-client is departing and is bound to a mile and time restriction in his or her employment agreement, rest assured opposing counsel will see value in that covenant. In an easy negotiation, all the shareholders will have the same restrictions. However, there are plenty of instances where there will be physicians bound to a restrictive covenant, while the founding shareholders of the practice are not.

Employees

Leading up to and throughout the separation, employees of the practice will grow restless. Much like children during a divorce, the employees will need reassurances of their wellbeing and stability through the process. Practice owners will have to maintain a sense of decorum and do their best to keep employees out of the negotiation process. Early in the process, the parties should determine which employees, if any, will be offered continuing employment and with whom. This will alleviate some of the pressures felt by employees of the practice. However, nuances and details of the separation should not be a part of water cooler discussions between practice owners and employees.

Ownership in Real Estate

A business separation can be difficult enough when dealing with just the practice. However, often the owners have also purchased the real estate for the practice location. The parties will have to negotiate a buy-out for the real estate. This can be simple, provided there is no mortgage on the property and none of the physicians provided a personal guaranty for the mortgage. In other words, the buy-out is rarely ever simple.

With the real estate market still in repair, obtaining financing to fund a buy-out has become virtually impossible. The parties have options, such as: 1) obtain a new mortgage to cover the buy-out, if there is enough equity in the property; 2) sell the property to pay off the existing mortgage and divide the proceeds as applicable; or, 3) if one group remains on the property, they continue to make rental payments to the real estate entity. In the third option, the parties would have to maintain their ownership interest in the real estate but have a lease agreement in place. Rental payments will flow through the entity owning the real estate and be distributed accordingly.

Consequences of Dissolution

The majority ownership interest in the separation may seek to dissolve the practice as opposed to going through the rigmarole of negotiations. However, there are consequences to be considered in the event of dissolution. One issue to consider is the tax repercussions. There may be capital gain realized from the dissolution. This is also applicable if the parties decide to sell real estate associated with the practice, plus the realty transfer fee associated with the sale.

The parties must be wary of trying to push dissolution, especially when there is pending litigation against the practice. The state will likely reject a certificate of dissolution with a pending litigation, which will bring the parties back to the drawing board. ■

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