Key Issues in Physician Partnerships

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If you have partners in your medical practice it's a good idea to decide now, how the value of the practice will be divided if a partner leaves for any reason. There are a host of circumstances which can disrupt a partnership, including death, retirement, business disputes, disability and divorce. And each event can have a powerful financial impact on the business of the partnership. How should the business be split up or paid out in these situations? Similar issues arise outside of your medical practice for business ventures or real estate investments with any co-owners. Planning in advance, with a written and detailed Buy-Sell Agreement which addresses each possible scenario, can help avoid costly litigation and financial loss in the future.

Events Triggering Buy-Out

The first issue to consider is what events should be covered by the terms of the Buy-Sell Agreement. Under what circumstances should a partner, have the right to be bought out? Certainly, death and long-term disability would be included, as well as planned retirement. Equity in the practice may be a big part of your savings nest egg and you, or your family, are likely to need it under these circumstances.

What happens if a partner quits, is "fired" or wants to sell his interest to a third party? What rules should govern each of these instances? We often consider whether the buy-out amount can be reduced in these situations. Although everyone may agree that it's fair to pay a "full" share on death, disability or retirement, a partner who leaves voluntarily might face some type of penalty, such as valuing his share less generously, if the withdrawal creates a financial burden on the remaining partners.

Valuing a Partner's Share

In addition to defining the specific events which are covered, the Buy-Sell Agreement provides a method for valuing each share in the practice and how much will be paid under each circumstance. Sometimes valuation is pretty straightforward. In many medical practices accounts receivable and equipment represent a significant portion of the assets and the amount of these assets is easily determined. More difficulty is faced in a practice with substantial goodwill - an earning power apart from the services of a particular physician. This intangible asset is often difficult to value and there are a variety of techniques and formulas which can be used (See "Valuing Your Medical Practice" MDNetGuide Article, July 2006 http://www.rjmintz.com/wp-content/uploads/2011/01/medicalpractice.pdf).

A partner’s share of accounts receivable is usually discounted for collection losses and an amount of the liabilities of the practice directly associated with these assets. For example, Dr. A owns a 25% interest in a medical partnership which has $1 million in receivables. When he retires, his $250,000 share of the accounts receivable might be discounted by 20% (based on collection experience). Then, consider what share of other liabilities of the practice should reduce the payout. Is there an outstanding line of credit which Dr. A should pay back? Should overhead costs of labor and rent associated with the collection of the receivables be considered? Also, if there are possible charge-backs from Medicare or other insurers, who will be responsible for those payments? There are no right or wrong answers to these questions. Everyone involved should simply consider the economic impact of each decision and an appropriate “formula” should be devised. We’ve seen Buy-Sell Agreements which did not factor in liabilities and the costs of collection and the remaining partners were stuck with much higher costs than they anticipated.

Payment Terms

Once the amount of the buyout has been determined, how should that amount be paid? Will it be all cash or payment over a period of time? That issue often turns on the timing of the partnership’s cash flow and whether the buyout event has been funded. A buyout due to the death of a partner can be funded with insurance so that a cash payout is feasible. If the buyout is based on a partner’s voluntary withdrawal, unless the partnership has accumulated a reserve for the payments, immediate cash may not be available. Often, a payout schedule over a period of months can be tied to the collection of the accounts receivable so that the impact on cash flow is minimized. If goodwill is included in the buyout amount, the payout may be deferred for a number of years unless adequate insurance or a reserve fund has been maintained.

Conclusion

Buy-Sell Agreements are an important legal component of every medical partnership. You should understand your rights and obligations so that you can properly plan this aspect of your financial future. Discuss all of the key issues with your attorney so that each possible buyout event is clearly defined and appropriately funded and that partnership liabilities are properly accounted for in determining each partner’s share.