OPHTHALMOLOGY PRACTICE
PARTNERSHIPS AND BUY-INS

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* Financial Interest

Financial Interest Disclosure

I have the following financial interests or relationships to disclose:

- Shareholder of and Consultant with The Health Care Group, Inc. and Health Care Consulting, Inc.
- Shareholder of and Attorney with Health Care Law Associates, P.C.

Who I Am

- Business and legal advisor to physicians
- Publisher of the Goodwill Registry, used in valuation of ophthalmology and other medical practices
- Handle and advise re: practice buy-ins, buy-outs, sales, mergers and valuations
Partnership/Co-Ownership

Critical evaluation
- What does it mean to be a "partner" anyway?
- Better to resolve problems earlier than later

What Does it Mean to be a "Partner" Anyway?
- More than just being employed "long enough"
  - Not just passage of time
  - Not just that associate did not do anything bad enough to get fired
  - Not automatic or everyone would qualify
- Proving commitment to the overall health and success of the practice
Partnership/Co-Ownership

- Partnership/Co-Ownership planning ideally begins prior to associate's first employment agreement
- Set expectations, outline terms
- But, no promises
- Critical evaluation, feedback, notice of problems
- Firing an associate vs. divorcing a "partner"

Partnership/Co-Ownership

- Health care reform and changing health care environment
  - Effect on who becomes a "partner"/co-owner
  - Effect on when an associate becomes a "partner"/co-owner

Partnership/Co-Ownership

- Don't overpay associate
  - Associate may make more than "partners"/co-owners
  - So associate may not want to buy-in
Buy-ins

Formal Valuation of Practice?

- Not strictly necessary
- Review financials
- Ball park values usually involved
- Evaluate financial feasibility

Method and Structure for the Buy-in

- For the ease of understanding and illustration, assume the practice entity is a professional corporation
- But, the same basic principles apply to other types of practice entities
Method and Structure for the Buy-in

- Two-part process
  - Stock purchase ("hard assets")
  - Income discounting (accounts receivable, goodwill)
- Tax considerations
  - Capital Gains vs. Ordinary Income
- Financial affordability

Values Involved in a Buy-in

- "Hard assets"
  - Equipment, inventories, supplies, leasehold interests and improvements, other tangible assets
- Accounts receivable
- Goodwill
  - Includes going concern value, charts, phone number, staff, contractual arrangements, practice's endorsement of the associate, etc.

"Hard Assets"

- Modified net book value
  - Eliminate assets no longer in use
  - Section 179 assets
  - Recalculate depreciation
    - Straight-line depreciation over 8 - 12 years
    - 20% floor
  - Capitalized leases
  - Exclude personal items
  - Possible appraisal of "major" ophthalmic equipment
"Hard Assets"

- Modified net book value
- Less debt and other liabilities
- Equals stock (net equity) value

Accounts Receivable

- Include associate’s accounts receivable?
- As of when?
- How to value accounts receivable?

Goodwill

- What is it? Does it exist?
- Is there really any goodwill value in ophthalmology practices today?
  - Effect of health care reform and changing health care environment
  - Market comparables - The Health Care Group’s Goodwill Registry
  - Effect of location and profitability
Pay-outs

Pay-out Planning

• Pay-out planning ideally begins prior to the time of the first owner's departure
• Pay-out agreements should be entered into prior to the first owner's departure
• Pay-out arrangements should be determined and completed in conjunction with an associate's buy-in

Formal Valuation of Practice?

• Not strictly necessary
• Review financials
• Ball park values usually involved
• Evaluate financial feasibility
Method and Structure for the Pay-out

- Two-part process
  - Stock repurchase/redemption ("hard assets")
  - "Separation Pay"/Deferred Compensation (accounts receivable, goodwill)
- Tax considerations
  - Capital Gains vs. Ordinary Income
  - Tax deductible or not
- Financial affordability

Practice Valuation Upon Departure

- Same assets and valuation as for a buy-in
  - "Hard assets"
  - Accounts receivable
  - Goodwill

Stock Repurchase/Redemption

- Valuation formula based principally on "hard assets"
- Same valuation as for a buy-in
"Separation Pay"/
Deferred Compensation

- Deciding on the pay-out amount for:
  - Accounts receivable
  - Goodwill value of the ongoing practice
  - Same valuation as for a buy-in

Goodwill

- Same valuation as for a buy-in
- Date of valuation
- What/whose gross income to include?
- Reluctance of "partners" to recognize goodwill value for a departing "partner"/co-owner
- Logic of goodwill payment to a departing "partner"/co-owner

"Separation Pay"/
Deferred Compensation

- Deciding on the total pay-out amount
  - Exact or inexact methodology
  - Year's "net income" principle
Limitations to Protect Ongoing Group

- Reduction if compete or solicit patients or referrers
  - Logical necessity
  - How broadly to define the restricted area?
  - Reduce all, or only the goodwill portion?
  - Recoup amounts previously paid?

Limitations to Protect Ongoing Group

- Reduction if group’s income decreases
  - Philosophical question if proper
  - Reduction of gross income vs. net income?
  - Should reduction eliminate the payments?
  - Should reduction extend the payments?
    - If so, how long of an extension?
    - Indefinitely, until paid?
  - Multiple pay-outs at the same time

Limitations to Protect Ongoing Group

- Reduction for short notice given for voluntary termination of employment
- Reduction for sick pay previously received
- Reduction for "bad partner" actions
Limitations to Protect Ongoing Group

- Reduction for post-separation benefits
  - Malpractice insurance
  - Health, disability, and life insurance
  - Other
- Reduction for post-separation liabilities
  - Malpractice, tax, third party obligations
- Eliminate remaining "separation pay"/deferred compensation or attempt to recoup all amounts owed?