



Business divorce/separating medical practices

By **Terrell J. Isselhard**

The emotional and economic issues that surround the separation of medical professionals from a medical practice can be identical to a dissolution of a marriage. This article is designed to present a brief overview of the various legal issues that must be considered in order to effectuate the separation, while causing the least amount of financial distress and disruption to patient care as possible.

It is my experience that all parties in a medical practice separation, including the patients, are better served if the separation can be amicable. Unfortunately, because of the perceived actions of the parties and their individual concerns for their financial well being, amicable separations are very difficult to accomplish. There is no question, however, that if the parties go to war with a "scorched earth" approach, the only accomplishment will be the disruption of medical care and general dissatisfaction to patients. The patients will go elsewhere for medical assistance, and the physicians' time, money and emotional efforts will have been wasted in legal fees, possible litigation and economic disaster.

So what can be done by physicians when they no longer wish to work together? Hopefully, when the medical partnership or corporation (LLC) was organized, documents were prepared that set forth a framework for departures from the medical practice. These documents, if properly prepared, may be all that is necessary if one physician terminates employment, retires, or dies. However, when multiple physicians decide to leave the medical practice, or when two groups or two equal partners decide to separate, organizational documents may not have contemplated such actions, and thus do not address all the issues that must be considered.

One physician termination

When one physician terminates employment, his employment agreement should address what

severance payments he is to receive, generally a portion of the outstanding accounts receivable, and what value is paid for his ownership in the medical practice. The valuation of the practice is generally contained in a Shareholders Agreement or in the Bylaws of the entity. You may wish to prepare a Separation Agreement if (a) circumstances have changed, (b) both parties agree that adjustments need to be made, and/or (c) additional issues have arisen that need to be addressed. The major goal in this scenario is finality and clarity between the parties, so that each party can provide medical services to each respective patient base, retain a high professional relationship among themselves and a well-respected image in the public community as well as the medical community.

Separation of medical practices or multiple physician termination

It has been my experience that when a multiple physician medical practice separates into two or more practices, the original documents prepared do not contemplate all of the issues that must be considered and resolved. First, if multiple physicians are leaving a group or the group is being separated into two or more groups, a major tax planning issue is how the proposed separation is structured from a legal and tax planning point of view. Several options available are: (a) a separation of multiple physicians into a new entity from the existing organization; (b) a dissolution of the organization and each group setting up new entities; or (c) a recapitalization for tax purposes, wherein the one entity is divided into two separate legal entities with little or no income tax since the two entities are considered a continuation of the original practice, only in two separate forms.

Patient records, continuity of care and professional reputation

After deciding the form of the legal transaction, all parties to the separation must recognize that patient care and patient perception of the way the

physicians treat one another, as well as the concern for the ongoing care of the patients, is paramount to the successful conclusion of the transition process. This will require all parties involved in the separation sending a joint letter informing the entire patient base why the separation is in everyone's best interest. The patients should be informed of how they may select which physician will continue to provide their medical care.

All parties must recognize that the patient medical records and charts are those of the existing entity. Care must be taken to ensure that the medical records are properly transferred in a timely manner when authorized by the patients. Decisions must be made as to where the original records are to be kept and who receives copies and who pays the costs of copying records. Under Illinois law, an existing practice may charge patients a reasonable cost for copying records if transfers are requested. Many of my clients, when separating from existing organizations, will pay the transferring costs to avoid the patients being asked to pay.

Other issues that need to be considered:

- **Phone service after separation.** Will the existing medical practice continue to answer the phone and refer patients to the physicians who have separated, or will there be a standardized electronic phone answering system that will direct patient calls to each office? The physicians separating may feel vulnerable that patients wishing to relocate their medical needs may be persuaded to stay with the existing practice if an employee of the existing practice is the contact person.

- **Waiver of restrictive covenants.** Most employment agreements will have a restrictive covenant not to compete. Depending upon facts and circumstances, it may be in the best interests of all parties to allow the departing physicians to continue to practice, even though it would violate an existing restrictive covenant. On the other hand, if there is a restrictive covenant, the parties need to recognize its existence, and discuss whether or not the restrictive covenant will be enforced. It is possible to negotiate a liquidated damage provision at the time of separation. For example, the separating physicians would pay the existing medical practice \$100,000.00 for the restrictive covenant to be terminated.

Termination payments. The parties must review what terms the existing documents provide

upon termination of employment. There are a myriad of methodologies of how termination (separation) payments are computed and paid. The parties may wish to attempt to renegotiate the amount and/or method in which the amount is computed and the period of time over which payments will be made. The separating physicians will generally be incurring significant start-up costs to open a new office and may request that separation payments be accelerated in order to assist them in meeting their initial cash outflow (new office, leasehold improvements, new furniture, medical equipment, etc.).

- **Billing and collection of accounts receivable.** In most instances the severance payments due a physician upon termination of employment are computed based upon the collection of outstanding accounts receivable of the individual physician's medical practice, or the accounts receivable of the group as a whole. It is important, therefore, especially when a separating physician is a shareholder, that all parties cooperate in maximizing billing and collection of the accounts receivable; otherwise, a significant amount of otherwise collectible accounts receivable for services previously rendered may be lost.

- **Reallocation of existing staff.** When a medical practice separates, each group may wish to retain certain staff members, correspondingly, certain staff members may prefer to go or stay with one of the groups as opposed to the other. The parties need to discuss a methodology that will communicate to the entire staff a positive picture of why the separation is occurring, allow each staff member to make his or her preference for whom they prefer to work, and attempt to facilitate those requests. It would be foolish for a group to attempt to take a staff member hostage if the employee prefers to go or to stay with one of the other practices. All this will create is ill will, animosity and eventual financial loss. It also needs to be recognized that there may be certain employees who may not be needed by either group.

Certain employees will align more with one group as opposed to the other. This creates the issue of whether certain staff members' compensation is a "group" expense of the existing entity's, or whether it should be a direct allocation to one or the other group. This must be considered since the staff members are devoting most of their time to either rearranging the office to continue to provide

medical care after the group leaves, or they are providing significant time and/or energy assisting the departing group to transition their practice to the new office. Finally, you need to recognize that there may be severance pay, workers compensation or other costs associated with the transition and separation of practices, and the corresponding staff relocations.

- **Legal representation.** The current law firm representing the entity may not be able to represent the two separation groups because of a conflict of interest. They represent the corporation, not the individual owners. Therefore, the physicians who are separating will need to hire their own lawyers, and the physicians who are staying need to hire their own lawyers. To avoid the cost of three law firms, I generally recommend that the corporate counsel does not get involved if at all possible in the negotiations of the separation. There are many issues here that need to be considered and discussed.

- **Professional liability insurance coverage.** All parties need to exercise care that the existing professional liability insurance policies continue in effect for the physicians who remain with the original entity and that the separating physicians' pro-

fessional liability insurance coverage continues for the individual physicians as well as their new legal entity. It would be a financial disaster if there was a lapse of coverage and a claim would occur during the transition period.

Summary

The above article highlights some, but not all, of the sensitive issues that will occur and must be addressed during a legal separation of physicians from an existing medical practice. There is no doubt that if the parties can maintain a rational, professional attitude during this process, they will benefit. If they do not seek legal representation with experienced lawyers who know what to expect and have the foresight to be prepared to deal with issues, chaos will ensue, the physicians will incur significant financial losses, patients will be dissatisfied and many patients may seek alternative medical care outside of the parties in dispute. It is therefore incumbent upon all the parties to make every effort and take every planning opportunity to avoid such a disaster. ■

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