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Breaking up is hard to do -- especially for physician practices

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Multi-faceted and complex changes in the nation's healthcare delivery system are increasing the number of physician group practices currently experiencing realignment, reconfiguration, and in some cases, dissolution of the practice altogether.

Although some of the major drivers of these transitions may be directly related to the impact of the Affordable Care Act, many causes for group practice disruption are evolutionary, reflecting an aging physician population and the rapid growth of technology. They may also be related to marketplace economics, including provider consolidation and payer reimbursement.

For whatever reasons, the group practice landscape is experiencing unprecedented change, as physicians in greater numbers transition out of their established groups into friendly professional corporations controlled by health systems; as specialists create and integrate into super groups; as primary care practices acquire and merge to gain critical mass; and as practitioners structure accountable care organizations both for government and commercial payers, or join horizontally integrated payer/provider systems such as Multiple Employer Welfare Arrangements.

These external factors, individually or in some combination, can often serve as catalysts for internal discord that may result in breakup of physician practices. The most common reasons for practice group disruption include unfair, or the perception of unfair practices involving:

- distribution of practice management and administrative responsibilities;
- patient workload and coverage;
- control over practice decision-making, such as expenditure of practice surpluses on infrastructure;
- salary draws and distribution of profits; and
- differences of opinion on the future direction of the practice group in terms of structure, size or affiliation.

With lesser frequency, sources of discord can also include domestic pressures, theft or misappropriation of practice revenues, and impaired practitioner issues.

Whatever the cause, when physician group practices hit the rocks, emotions can run high, internal communication often shuts down, and either individually or collectively, partners frequently resort to legal remedies to end the relationship and protect their personal interests.

Although the legal standards for involuntary dissolution of a physician group practice vary from state to state, the common legal standards require a partner or shareholder to demonstrate a breach of fiduciary trust, misconduct, gross mismanagement or the inability to carry out business functions either because of mistrust or decisional deadlock.

If legal disputes are addressed, under involuntary dissolution statues in many states, the court may appoint a custodian, provisional director or fiscal administrator; determine the fair value of shares, order a sale of stock to the company or to other shareholders; award counsel fees and expenses where appropriate under the statute; and enter a judgment dissolving the corporation.

In all physician practice group break-ups, regardless of whether the courts are involved in resolving the conflict, valuation of the practice is typically the prevailing concern for all parties. Whether governed by the interpretation of an established buy/sell agreement formula, determined through competing expert opinions in litigation, or arrived at through settlement negotiations, group practice valuation can be a complex, expensive and often painful ordeal largely because of the difficulty in determining the value of "goodwill."

The major challenge related to the concept of goodwill involves the allocation of value that's assigned to the practice as a whole, versus its individual practitioners. The practice group has tangible assets that are transferrable. The practitioners have personal relationships and technical skills that are not transferrable. The practice group and its members have professional reputations that are integral to the value of the enterprise, but which have no tangible market value.

The U.S. Tax Court on valuation holds that there is no enterprise goodwill with tangible commercial value where the business depends on key employees' skills unless they have entered into enforceable covenants not to compete. But there is less than a bright line test from the courts on whether or how, in a service business, clients might be considered assets of the company.

Given the complexity, cost and potential reputational damage related to the breakup of a practice group, physicians are best served by taking steps at the outset of a business relationship — whether that venture involves one partner or 50 partners — to execute a formal buy/sell agreement with a clear methodology for determining purchase price, and that anticipates shareholder death and retirement as well as a breakup. Further, physician employment agreements should include restrictive covenants that protect the commercial interests of the practice as well as the rights of individual practitioners to continue with their careers.

Established, harmonious practice groups without formal agreements in place should explore the advantages of "retrofitting" these legal agreements, as an insurance policy to avoid or minimize problems that may arise. For practice groups without formal agreements that are currently involved in, or headed toward serious conflict, the most beneficial approach for all parties is to litigate only as a last resort. Given the financial complexities and reputational risks involved, mediation in the first instance is likely to be the most reasonable and cost-effective solution for physician practice groups, regardless of how long that process may take.

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