

Announcing Exciting New Additions to our Business of Medicine Newsletter



In an effort to inform you, the physician or healthcare professional, of financial trends in the current marketplace, we have made some exciting new changes to our bi-monthly newsletter. In addition to our "Let's Talk Money" newsletter, we will be bringing you articles of interest from various professionals specifically targeted to physician's needs and interests. This week we are proud to highlight an article from attorney Justin Daniels of the law firm Lamberth, Cifelli, Stokes & Stout, P.A. Justin has many years of experience in helping physicians protect their interests when negotiating employment contracts in the healthcare field. Future mailings will include articles of interest penned by various practice management consultants, accountants, and other area professionals whom we work closely with.

We hope you are as pleased with these articles as we are. If you would like to discuss any of the items mentioned in further detail, please do not hesitate to call our office.

We will continue to offer such services to keep you informed. If you have any suggestions for future articles, please let us know and we will attempt to grant your request. The better educated you are on today's physician marketplace, the better we are doing our job.

What Physicians need to know about Shareholder Agreements Financial Relationships among the Shareholder Physicians

Physicians often overlook the importance of a shareholder agreement until a problem arises and belatedly discover that an ounce of prevention is worth more than a pound of cure. A shareholder agreement addresses three main areas that otherwise usually result in divisive problems that undermine the well being of a medical practice. These three areas are (i) the financial relationship among the shareholders; (ii) the transfer or sale of shares; and (iii) the medical practice's operation and decision making process.¹ This article will discuss issues physicians should consider when discussing a shareholder agreement relating to the financial relationship among the shareholders and the transfer or sale of shares. A separate article will consider issues related to the medical practice's operation and decision-making process.

Shareholder agreements should address important aspects of the financial relationship among the shareholders. Addressing these issues initially in the shareholder agreement will help avoid disagreement and potential litigation over compensation related issues. The following is a list of the important issues to consider when discussing a shareholder agreement.

New Shareholders. Extending an offer to a physician to become a shareholder can have enormous financial and operational implications for the medical practice. The new shareholder will share in the profits and want influence in the operation of the medical practice. It is important to decide, therefore, whether the approval of all shareholders, a super-majority, a simple majority or some other basis is used to determine whether or not to admit a new shareholder. Shareholders must also decide if the new shareholder will have the same ownership rights as the other shareholders. Medical practices typically address this issue by maintaining different classes of shares with different rights. For example, founding shareholders may maintain Class A shares that have special financial, operational and voting rights while other shareholders have Class B shares that have no such rights.

Initial Contribution. New shareholders usually pay a purchase price and receive shares representing his or her ownership interest in the medical practice.² Thought should be given to determining the purchase price for shares sold to a new shareholder and how many shares he or she should receive in return for such an investment.

Additional Contribution. Certain shareholders may acquire more shares and take a greater ownership interest in the medical practice.³ Shareholders should decide the terms and conditions under which a shareholder can purchase additional shares. Additional purchases also create the issue that other shareholder's ownership interests will be reduced unless those shareholders have the right to purchase additional shares to maintain their ownership interests if they so choose.

¹ Master, Mark A. and Joshua Zissman. "What Should Go Into a Shareholder Agreement". *Physician's News Digest*, December 1999. < <http://physiciansnews.com/business/1299.html>>.

² *Id.*

³ *Id.*

Tag Along Rights. When the shareholders of a medical practice are bought out, the acquirer typically wants to purchase all the outstanding stock. Shareholder agreements, therefore, may contain provisions stating that if a majority of the shareholders vote to sell their shares to the acquirer the minority who dissented can be required to sell their shares to the acquirer as well.

Pledging Shares. Shareholders should decide if individual shareholders may pledge their shares in order to secure personal debts. Typically shareholder agreements prohibit this practice because it potentially allows third party creditors to acquire the shares if the shareholder defaults on his personal debt.

Termination/Death/Disability/Retirement. Shareholders should consider what will happen upon termination, death, disability or retirement of a shareholder. Three major issues arise in these contexts: (i) who will purchase the shareholder's shares who is no longer with the medical practice; (ii) what is the process for placing a value on those shares; and (iii) what is the process for ensuring funds are available for purchasing the shares. Typically, a shareholder agreement provides that upon termination, death, disability or retirement that the medical practice or the other shareholders shall purchase the shares. Fair market value determinations can take the form of an agreed upon price that the shareholders or Board of Directors sets each year, a fair market value formula agreed upon by all the shareholders or the engagement of an appraiser who will determine the fair market value of the shares. Lastly, the shareholder agreement may provide that the medical practice purchase life insurance on each shareholder whose proceeds shall be used to purchase the shares upon the shareholder's death from his estate. In the event of termination, death, disability or retirement, the shareholder agreement may provide that a portion of the buyout purchase price be payable in the form a promissory note to ease the financial burden on the medical practice and shareholders if cash is not available to pay the purchase price immediately.

The shareholder agreement is a valuable tool for addressing divisive financial issues that could otherwise divert a physician's valuable time and resources and disrupt a successful medical practice. This article outlines major financial issues among the shareholders. However, you should consult with a knowledgeable attorney to fully understand the implication of these issues and how they relate to each other as well as the medical practice's operation and decision-making process.

Justin S. Daniels is a corporate and commercial real estate attorney who practices with the law firm Lamberth, Cifelli, Stokes & Stout, P.A. Mr. Daniels represents privately held businesses in all aspects of their operations from structuring new ventures, advising on acquisitions and divestitures and reviewing and negotiating key vendor, employment and customer contracts. His varied experience includes representing medical practices, individual physicians veterinary practices, telecommunications companies as well as manufacturing and professional services firms. He graduated with an MBA/JD from Duquesne University in 1998 and is licensed to practice law in Pennsylvania and Georgia. He can be contacted at 404-495-4463 or jdaniels@lcsslaw.com.