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Mergers and Acquisitions

Physician Practice Deals Should Define Dissenting Doctors' Rights

A group of New York physicians is challenging their partnership's merger with a hospital practice group that, they claim, would reduce them to indentured servants.

The dispute highlights the need to clearly spell out the rights of physician partners, as well as those of the acquiring entity, before closing a deal involving a physician practice. Physician practice deals made up about one-third of all health-care industry transactions in 2017, according to information compiled by Bloomberg Law.

Attorneys who represent physicians and health-care systems told Bloomberg Law the dispute is an anomaly, because the partnership agreement and the deal documents usually contain terms defining the rights of dissenting partners. Careful drafting of both agreements could have avoided the situation, in which nine partner physicians claim they didn't consent to the merger and are seeking modification of terms outlining competition, termination rights, and compensation.

Employment Dispute Middletown, N.Y.'s Crystal Run Healthcare entered into a merger agreement with Bronx-based Montefiore Medical Center. Nine of the practice's 133 physician partners, however, balked at the deal.

According to a complaint filed in the New York Supreme Court, Westchester County, these doctors didn't agree to the deal. They alleged the merger wasn't in their best interests, as it required them to sign employment agreements with Montefiore that transformed them from partners into employees.

The employment terms, moreover, were highly unfavorable, they said. The terms included a provision mandating patient referrals to Montefiore and ''draconian'' noncompetition clauses. ''Essentially, Plaintiffs would become indentured servants to Crystal Run's New Entities,'' the complaint said.

The new entity will be known as Crystal Run Healthcare Physicians LLP, the complaint said.

'Highly Unusual' Ericka Adler, a partner at Roetzel & Andress in Chicago, counsels physicians and physician groups. In the hundreds of physician practice deals she's overseen, Adler hasn't ever encountered a fact situation like this one, she told Bloomberg Law. This is a ''highly unusual'' case, she said.

Most partnership agreements anticipate this type of problem, she said. They normally require the partners' unanimous consent for major events, such as a sale or merger. That's standard, she said.

Even if the partnership agreement authorized a committee to decide whether to merge with the hospital group, the committee would have had a fiduciary duty to make that decision in the best interests of the partners and to tell them about the decision, Adler said. Here, ''it looks like the partners were blind-sided,'' she said. Adler noted the complaint doesn't include a breach of fiduciary duty claim against the partnership committee.

Adler's advice for physician partnerships seems self-evident: Make sure the partnership agreement includes a requirement that any major decision must be authorized by a unanimous or super-majority vote.

Walk-Away Agreement Adler added that a partnership agreement could include a ''walk-away'' clause, giving partners an option to leave if they don't like a deal approved by the majority. She would prefer one that allows the physician to retain his or her full severance rights, but acknowledged the doctor may have to give up something for the right to leave the practice.

It can be very difficult to get unanimous consent to a merger, so including provisions that cover the terms for deal approval, and effective communication, are key.

MICHAEL F. SCHAFF, WILENTZ, GOLDMAN & SPITZER PA, WOODBRIDGE, N.J.

Partners also may be able to include in the partnership agreement a release from a noncompetition clause, which would kick in if they want to opt out of a major partnership event. Adler also would like to have a provision requiring the partnership to continue paying tail costs—that is, payments for malpractice insurance that covers the doctor for claims made while a member of the partnership. A release from claims made against the partnership also could be included in the severance provision, she said.

Partnership agreements often have ''drag-along'' clauses, which allow the majority partners to drag others along with them if there is a merger or acquisition. These clauses, however, don't completely divest dis-

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senting partners of their right to opt out, Adler said. Another common term is a ‘‘tag-along’’ clause. This allows partners who aren't part of the initial deal to tag along. For example, a hospital that wants to grow its cardiology practice may target the cardiologists in a multispecialty group. Partners in other specialties may have the right to tag along.

Communication Is Key Michael F. Schaff, chairman of Wilentz, Goldman & Spitzer PA's corporate and health care departments, told Bloomberg Law it is hard to predict how this dispute can be resolved without knowing all the facts and circumstances. Future dealmakers, however, can avoid a similar situation through communication, the Woodbridge, N.J., attorney said.

Schaff advises hospitals and health systems on forming and structuring new ventures and group practices. He said the letter-of-intent (LOI)—the first document outlining the physician practice-hospital alignment—should include terms for dealing with dissenting partners.

Schaff said it can be very difficult to get unanimous consent to a merger, so a deal may be made contingent on the approval of a certain percentage of the group. For example, the deal documents may require 80 percent of the partners to vote in the transaction's favor, he said.

An ‘‘unwind’’ provision should be included in the LOI, giving the acquiring entity an out if the number of approving partners doesn't meet the threshold needed for the deal to go forward, Schaff said. The provision should include a ‘‘break-up fee,’’ which the practice would be required to pay if it isn't able to close the transaction, he said.

Balancing Interests Assuming that the threshold is met, but fewer than all the physicians agree, the LOI should set out terms for the dissenters, Schaff said. The acquirer could, for example, offer to buy out their interests in the practice and waive or modify noncompetition or nonsolicitation clauses by which they were bound. The buyout would be lower than the amount offered to the approving physicians, because the acquirer isn't getting the value of the dissenters' services, he said.

Adler agreed, saying she would expect the dissenting physicians to receive less money for selling their partnership interests. She would want other concessions, however, such as narrowing the duration or geographic coverage of the noncompetition clause. The clause, for example, could be limited to locations in which the dissenting doctors actually practiced, instead of applying broadly to any area in which the partnership had an office.

Acquiring entities—whether they are hospitals, private equity investors, or corporate practices—want these arrangements to succeed, Schaff said. They don't want to employ doctors who don't want to work for them. If a disgruntled doctor wants out, there should be a mechanism to allow that to happen, he said. At the same time, the acquiring entity should receive some concession to balance the scales.

The case is *Sodha v. Crystal Run Healthcare LLP*, N.Y. Sup. Ct., *filed* 12/19/17

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