I. Introduction

• A. Purposes of Shareholder Agreement
  – Mechanism for transferring, selling and valuing the shares
  – Process for decision making and managing the practice
  – Financial relationship among the physicians

• B. “Close” or “closely held” Corporation
II. Legal Background

- No ‘prescription’ for Shareholder Agreements
- C. The New Jersey Board of Medical Examiners Regulations, N.J.A.C. 13:35-1.1 et seq.
III. General Principles

- A. Representation of the Client
  - Who is the Client?

- B. Due Diligence
  Obtain Documents
  Engage Accountant
IV. Drafting Tips

- Ascertain the expectations of the parties.
- Agreement is consistent with all other corporate documents.
- Consider all of the triggering events for a buy/sell event
  Ensure terms are defined, e.g., “doctor’s minimum production.”
- View becoming a shareholder from two perspectives – that of the individual physician and that of the member of the practice.
V. Anatomy of the Shareholder Agreement

• A. Introduction
  – Recitals - Naming partie Agreement
  – Whereas Clauses

• B. Purpose of Agreement: Restriction of Shares

• C. Endorsement on Stock Certificate
V. Anatomy of the Shareholder Agreement

D. Events Triggering the Obligation to Transfer Shares
   - Death
   - Disability
   - Retirement of the Shareholder
   - Voluntary Withdrawal by the Shareholder
   - Termination of Shareholder by the Corporation
V. Anatomy of the Shareholder Agreement

• E. Determining the Price for the Shares
  – Specified Price
  – Book Value Formula
  – Appraisal at Time of Sale
  – Multiple of Earnings

• F. Determining the Purchaser of the Shares
  – Redemption Agreement
  – Cross-Purchase Agreement
  – Hybrid Agreement
V. Anatomy of the Shareholder Agreement

• G. Financing the Purchase and the Closing
  – Life Insurance
  – Disability Buy-Out Insurance Policy
  – Pay-Out over time

• H. Decision-Making, Control and Voting Rights
  – All decision by simple majority
  – Selected decisions by supermajority or unanimously
V. Anatomy of the Shareholder Agreement

• I. Financial Relationships Among the Shareholders
  – Equal Compensation
  – Senior physician paid for administrative duties
  – Physician paid net collected billings after expenses
  – Physicians paid the same base salaries; incentive compensation based on percentage of collections
V. Anatomy of the Shareholder Agreement

- J. Other Provisions
  - Resolution of Disputes - Arbitration and Mediation
  - List events causing termination of Shareholder Agreement
  - Elect Subchapter S Status
CASE STUDIES
#1 A. Junior MD Joins Solo Senior MD - Facts

Dr. Fellow is to join Dr. Senior, a solo practitioner - Senior, P.A. After being employed for 4 years in Dr. Senior’s office, Dr. Fellow is offered an equity interest after six years, if Dr. Fellow is still employed by the practice. The buy in is $25,000.00 cash.

Dr. Senior wants to be the manager and make all decisions, including whether to admit a new MD as a shareholder, and be paid $15,000.00 as manager.

Compensation will be equal, but when Dr. Senior leaves the practice, he wants the corporation to pay him $500,000.00 even if there is an insurance policy to pay for the shares.
#1 A. Junior MD Joins Solo Senior MD - Facts

Dr. Senior can terminate Dr. Fellow without cause, or cause the corporation to dissolve and Dr. Senior will remain at the practice and keep the telephone number.

If Dr. Fellow leaves the practice, Dr. Fellow will be paid $175,000.00 unless he leaves or is terminated for cause and then he will be paid $25,000.00.

All payments are over 5 years.

There is a restrictive covenant for Dr. Fellow; for 2 years he cannot establish an office within 5 miles of the practice.
#1 A. Junior MD Joins Solo Senior MD - Issues:

- Length of time as employee until buy-in; percentage ownership of shares
- Amend Certificate of Incorporation to reflect that Board has been abolished or give one director more than one vote. See, N.J.S.A. 14A: 5-21, 6.2 and 6-7.1.
- Increase decision-making for the junior MD
- Reduce or eliminate restrictive covenant for junior MD under certain circumstances and require restrictive covenant for senior MD under certain circumstances.
#1 A. Junior MD Joins Solo Senior MD - Issues:

- Termination of senior MD for cause
- Fixing price of shares, restructuring buy-out amounts as deferred compensation and lump sum payout for Dr. Fellow
- Changing name of practice to name of specialty: Towne Pediatrics, P.A. or Kidz Medicine, P.A.
#1 B. Junior MD Joins two Senior MDs - Facts:

- Dr. Sun, an oncologist, has been employed by the P.A. for 8 years. He finally asks about becoming a shareholder.
- The two senior MDs offer to sell him a 20% interest in the practice and they will each keep a 40% interest.
- Each shareholder will elect himself to the Board of Directors and each director will have one vote. All decision will be by majority vote.
- Compensation will be equal, but bonuses will be based on % of ownership interest.
- There is a restrictive covenant if a shareholder leaves the practice.
#1 B. Junior MD Joins two Senior MDs - Facts:

- If a senior MD leaves the practice, the remaining senior MD may permit Dr. Sun to purchase the number of shares to make him an equal shareholder with the remaining senior MD.

- If a shareholder wishes to leave the group, the shares must be offered to the corporation, then to the shareholders and if the offer is declined, the selling shareholder may elect to dissolve the corporation.

- The purchase price for the shares of a selling shareholder is 40% of gross receipts for the preceding 12 months minus the cost of drugs, divided by the # of shares, x the number of shares owned by the selling shareholder or the proceeds of any life insurance policy.
#1 B. Junior MD Joins two Senior MDs - Issues:

- The classic state of affairs for the junior partner
- Increase decision making for junior MD
- Set salary high to increase total compensation to junior MD
- Alternative pricing of shares
A family practice doctor joins a multi-specialty group P.A. The physicians practice in multiple offices, some in the offices they had before they originally joined the group. Family practice doctor joins for $25,000.00, the book value of the shares for the practice. 75% of the shareholders have to approve him joining. If he leaves voluntarily, he receives 75% of book value if he leaves within 3 years payable over 3 months. Upon leaving the group, each shareholder will get a percentage of Net Collected Billings, depending on the length of time with the group.
#2 A. MD Joins Group Practice: Joining Multi-Specialty Group - Facts:

Upon dissolution, the leases and phone numbers where each physician practices will be auctioned to the highest bidder.

The restrictive covenant prohibits practice of medicine within ten miles of every office of the corporation for 2 years and applies no matter why the physician leaves.

Each shareholder is paid his Net Collected Billings from which are subtracted overhead expenses, charges and capital acquisitions in a complex formula.

F P doctor’s practice is a start-up practice in space leased for 2 yrs.

He is promised he will be on the group’s executive committee, but there is no mention of the executive committee in the shareholder agreement or the by-laws.
#2 A. MD Joins Group Practice: Joining Multi-Specialty Group - Issues:

- Have by-laws redrafted to cover the current management scheme of the group
- Group practices are more rigid and have less opportunity for physician to have provisions in the documents changed
- Have accountant review compensation formula
  - Confirm group’s plan to renew the lease for the office
- Carve out of the restrictive covenant teaching or working in a clinic
#2 B. MD Joins Group Practice: Joining Single Specialty Group - Facts:

- The doctor is joining a two person plastic surgery P.A. after one year of employment.
- The office is to purchase 1/3 of the shares over 5 years.
- The doctor is required to generate collections of $600,000.00 each year as the buy-in purchase price.
- He will have no voting rights until the end of the fifth year.
- If he fails to generate the collections in two consecutive years, he will be off the shareholder track and the two senior doctors can buy back his shares at a discount.
#2 B. MD Joins Group Practice:
Joining Single Specialty Group -
Facts:

- The senior doctors are also considering inviting a second doctor to become a shareholder in another year so that each doctor would ultimately have a 25% interest in the corporation.
- The P.A. takes x-rays in the office and also has a massage therapy group.
- He will share, based on his stock ownership, in the profits generated by these ancillary services.
- The doctors perform surgery in the suite next door and the senior doctors have formed an LLC for the surgery suite.
#2 B. MD Joins Group Practice: Joining Single Specialty Group - Issues:

- Buy in of shares over several years and no voting rights until purchase is completed vs. purchase of shares over several years with stock certificate held in escrow and voting rights, unless there is a default in payment of purchase price
- Price of buy-in based on sweat equity and generation of a set amount of collections each year – what is price per share?
- Review option to purchase an interest in the surgery suite
- Review opinions by group’s attorney re: possible violation of Stark II and New Jersey self-referral laws
Hospital administration wants the anesthesiologists to form a group so that there is more central management and control and less bickering about cases.

The group forms a corporation and sets up an executive committee with the power to run the day-to-day operations of the group.

The shareholders have reserved certain decisions that require the vote of two-thirds of the shareholders.

Compensation is based on productivity of the physician, minus expenses.
#3. Hospital Based MDs Form an Anesthesia Group Practice - Facts:

The work schedule is prepared by the management committee. There is no termination by the group without cause. Two-thirds of the group must terminate a shareholder for cause. There is a restrictive covenant for two years within a 5 mile radius of wherever the group gives anesthesia. Upon termination of employment, the anesthesiologist must resign medical staff privileges. Buy-in and buy-out are nominal.
#3. Hospital Based MDs Form an Anesthesia Group Practice - Issues:

- Getting along with colleagues
- Assignment of cases
- Compensation and expenses
Two psychologists who have been in solo practice want to form a P.A. with everything equal.

They plan to hire independent contractors to assist in providing services and to cover the overhead of the practice.
#4. Two Psychologists Form a Group - Issues:

- Who is the attorney going to represent?
- Are the practices of equal size? How will be compensation be structured—based on individual collections or divide all collections equally after expenses; compensation for administrative work of the practice, including supervising the other therapists?
- How will disputes be resolved and in the case of deadlock, who will keep the office and telephone number?
- Can there be a restrictive covenant? See N.J.A.C. 13:42-10.16.
#5. A Dentist with no Shareholder Agreement Leaves the Practice -

Facts:

- Dentist, a 50% shareholder in the dental P.A., becomes disabled with a terminal illness and must stop practicing after 20 years in a “less than state of the art” office.
- There is no shareholder agreement with the other dentist.
- The P.A. was audited two years before and required to pay back money for questionable work done.
- The Department of Insurance and Board of Dentistry may have been notified.
#5. A Dentist with no Shareholder Agreement Leaves the Practice - Issues:

- Requirement to buy disabled shareholder out if there is no shareholder agreement?
- Minority shareholder entitled to relief, See N.J.S.A. 14A:12-7 (c) and Bonavita v. Corbo, 300 N.J. Super. 179 (Ch. Div. 1977) and the Professional Corporation Act, N.J.S.A. 14A:17-13 (c)
- Disability buy-out insurance
- Appraising the practice
- Structuring the buy-out over time and withholding payments if further money must be repaid on account of disabled dentist’s practice, continuing liability insurance coverage after stopping practice - tail coverage, notify Board of Dentistry of departure from practice
Selected Issues:  A. Termination Without Cause Provision in the Shareholder Agreement

- The pros and cons of having this provision
- Determination of buy out amount
- Waiving the restrictive covenant

- No Par Value/Par Value. Shares of stock will have no par value unless otherwise stated in the certificate of incorporation and the shares are to be issued in accordance with a formula or at not less than a minimum price fixed by the Board of Directors.

- Treasury Shares. Treasury Shares (stock issued by a company but later reacquired) are treated the same as other authorized but not issued stock.

- Stated Capital. Stated Capital is capital contributed by the stockholders, a concept that has been eliminated along with par value and treasury shares.
- Capital Surplus
Selected Issues: C. Required Retirement Provision

• Provision requiring physician shareholder to retire at age 70.

• Review: New Jersey Law Against Discrimination prohibits mandatory retirement, unless the person is employed in a bona-fide executive or high policy making position for 2 years immediately preceding retirement and entitled to an immediate, non-forfeitable annual retirement benefit of at least $27,000. N.J.S.A.10:5-12(a). Under ADEA, the retirement allowance threshold is $44,000. 29 U.S.C.A. 631(c)(1). Case law - none. Alternatives: offer physician incentive to retire, or offer option of reduced service and corresponding reduced compensation.
Selected Issues: D. Drafting the Disability Clause

- Define disability and sick leave
- What will trigger buy out and termination of employment?
  - Permanent and total disability as defined in the agreement or in the insurance disability policy –
  - Sample provision: inability to perform all duties required by the corporation for a period of time, e.g., a period of twelve months or any period of continuous or intermittent disability for 12 months in any 18 month period.
  - For a cardiologist, this could include performing invasive procedures, such as angioplasty. Total and permanent disability is deemed an offer to sell all of the shares owned by the disabled shareholder.
Selected Issues: D. Drafting the Disability Clause

- Provide for a mechanism to resolve a dispute over the question of whether the shareholder is disabled.
- Option to include a partial disability clause with provision for part time work and reduced compensation.
- Buy-out may be more generous than if shareholder employee is terminated with cause.
- Provide for staggered buy-out, if two shareholders are disabled at the same time.
- Provide salary for several months at outset of disability, reduced by disability insurance income or benefits received.
Selected Issues: E. Handling Accounts Receivable: Buy-In

- Accounts receivable not included for purposes of valuing the stock of the corporation.
- Existing receivables may continue to be allocated for compensation purposes to the current owners, thus allowing a lower buy-in cost by the new physician.
- New physician receives a lower salary during first several years so A/R can be paid to the current shareholders.
Selected Issues: E. Handling Accounts Receivable: Buy-Out

- In valuing receivables, consider bad debts, cost of collection and estimated collection period
- Allocation of receivables: specific allocation, percentage of charges during a prescribed period, prorata with stock ownership
- Treat A/R for tax purposes as deferred compensation and ordinary income
CONCLUSIONS