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Howdy Partner! - Creating a Veterinary Practice Partnership Correctly.

Teaming up in business - is a handshake sufficient?

Working together, in a business partnership, should be considered a team effort, a pooling of resources if you will, and can serve as a good exit strategy for a senior DVM, or a way to strengthen retention of talented associates. Like all relationships, the structure of the agreement is important, and the most important components are usually not the what and how of working together, such as splitting of profits, scheduling duties, and delegating management authority, but rather how and by what rules are we going to play by when we split this arrangement up. The mark of a truly good “partnership” agreement is the ability for the entity to be disbanded, fairly, efficiently, equitably and without unnecessary hardship or hatred amongst the parties. Therefore, careful planning at the beginning, for an elective or forced breakup, will allow an unemotional flowchart-like approach to the process of dissolving the partnership, or the exiting of an individual owner. The object of the game should be having a good agreement that is useful during the period when everyone is excited about the project and likes each other, and then be equally useful if that perspective changes. More importantly the document should serve as a resource for all future reference regarding management, ownership, compensation and other issues that will guide the owners down a preplanned protocol, while minimizing emotion as an influencing factor.

One of the most important steps in the set up process is choosing the entity structure. You should ensure that all owners share a similar philosophy of practice, management style and commonality of opinion regarding voting vs. non-voting rights, responsibility, ability to indebt without consent, tax ramifications, and other daily duties. It’s important to consult with an attorney for a legal perspective of the good and bad characteristics of each “partnering” entity. Each entity has positive and negative attributes, and all should be examined carefully. General Partnerships have fallen out of favor, but numerous other structures like limited liability partnerships, limited liability companies, C and S corporations, as well layered structures that utilize one or more of these entities in combination may be appropriate. Discuss each with your attorney and accountant, choosing the one that best fits all “partners”. Pay attention to the tax implications both during *and after* the end of the partnering arrangement and discuss those in advance with your respective accountants. As with most issues we tend to focus intently on the “now”, but we must not lose sight of the “later” and the “end” since you will eventually travel the entire road. Assuming you have now chosen the legal structure or entity for the “partnering” arrangement and are happy with its pre, during and post “partnering” management and tax issues, we suggest you ensure your agreement contains the components necessary to handle issues that can and will arise during this “partnership”. The list below, although not all encompassing, contains many of the components that should be addressed in a well-constructed agreement.

Agreement Drafting Components

1. Ensure all business names, DBA's, trade names, trademarks, logos, and other identifying or defining titles are protected or included, especially as they apply to a later buyout.
2. Define who will own what or what %, and how much capital will be invested at the beginning.
3. If there is a 51/49% ownership, its critical to define "who and how will we make decisions or rule on conflicts". Consider segregating ruling power, or voting powers into medical, financial, ownership and management. In other words, a single 51% owner should not be able to override the four 49% owners regarding medical philosophy. Consider establishing a medical practice philosophy board, which all owners (and future minority DVM owners) participate on, that considers a medical issue, and the deciding vote is majority based. Example: 4 of 5 DVM's want to go with "Sevo" as the anesthetic of choice, but the 51% owner wants to stay with Halothane. In contrast, the decision to change all pricing and marketing strategies or sell the practice may be less appropriately done by "vote", especially by minority owners, when a direct conflict exists.
4. Define or limit a partner's ability to indebt the practice or its assets. This is especially important in a General Partnership entity where new indebtness doesn't require approval from all partners.
5. Define how additional capital contributions will be made.
6. If there is cash on deposit, such as long-term working capital reserves, define if the contributors have limitations on withdraw and interest generation entitlement.
7. Define the parameters of partnership loans. This has been a big cause of partnership break ups in veterinary medicine. The resulting conflict is often fueled by the non-borrowing owner's family.
8. A huge area of concern is compensation and profit disbursement. In general, we see the best setup as one where each owner DVM is compensated as a clinical DVM, commensurate with industry standards, and commensurate with the hours worked or services performed. We highly support compensation based on a percentage of professional services rendered. This allows a hard working partner who may only have minority ownership (10%) and very little end of year "earnings", to be well compensated as a clinical producer, in contrast to a senior owner that may get 40% of the earnings, but works only 1 day a week. Too often we have seen problems where a senior partner works very little, but splits everything, or writes off a lot of expenses, using up profits disproportionately.
9. Define how earnings will be dispersed. When? In what form? Can you elect to obtain shares, rather than cash?
10. Consider when it's necessary to allow guaranteed %'s or shares to be purchased. Will a majority owner hold the right to that 51% forever? Or is there a 5 year master plan that spells out a guarantee that no less than X% will be purchasable on a certain date.
11. Define how net losses will be distributed, and how the responsibility for additional capital injections will be handled.
12. Define and limit owner draws, or personal expensing.
13. Death, Expulsion, Withdrawal or Retirement needs special attention. Will the whole entity dissolve? How do we handle the cost of purchasing the "exiting" partner's shares or interest? If the exiting partner has residual cash capital, loans, or tax issues, define how those will be cleared first, before the purchase of the remaining value of the exiting partner by the remaining partner(s).

14. Include part-year formulas, and any premium or discount applied whether it's a death, or a withdrawal.
15. Include wording for forced dissolution or voluntary retirement. In a forced out sale, consider a premium added to the value owned. (10-30%). If it's an unexpected demand for buyout by a partner who wishes to electively exit, consider a discount (10-30%) on the value of the exiting partner's interest that must be bought by the remaining owners unexpectedly. In the event of a pre-planned exit, death or severe disability, generally no premium or discount is applied.
16. Who will determine value? The tax preparing CPA's? Professional veterinary practice appraisers? Use of only one firm or more? Ensure there is a description of how a conflict of valuation will be resolved.
17. Avoid the use of any cookbook, % of gross, or other rules -of-thumb to assess value.
18. How quick must the remaining partners comply with a demand for payment and buyout?
19. How is the buyout paid? How long? Who will set the allocations? Stock vs. Asset sale? Who will pay the financing costs?
20. What about un-collected cash, such as accounts receivables and rebates not yet received?
21. What about medical disability of a partner?
22. Define the operating structure parameters including fiscal year, accounting method to be used, capital accounts, "the books", annual report structure and when it will be completed, bank accounts, and choose if there will be an overseeing CPA vs. individual partner's CPAs.
23. Define management control, daily/period duties, roles and authority. Minimum time requirements, and a plan to refute or reapportion the duties. Is there separate compensation for these duties? Consider Majority vs. Minority owner(s) duties and rights.
24. Define the voting rights of partners and restrictions on Managing partner(s), such as hiring, termination of partnership, sale, purchase of assets/facility, other practice acquisitions, equipment (consider a $ amount that needs approval so no one schedules a meeting to get approval for a
$300.00 monitor), operation of other entities such as satellite offices, expansion of services, borrowing and indebting the business(s), transferring, hypothecating, compromising, or releasing any partnership claim except on payment in full, selling/leasing/refinancing, knowingly suffering
or causing anything that allows the business to be seized or subject to loss, loans, admission of new partners, bonuses, write offs.
25. Establish retirement funding and pension regulations.
26. Funds handling, and inter-account transfers.
27. Payment of partner personal expenses such as benefits.
28. Insurance coverage often called "key person" coverage.
29. Temporary replacement of an owner DVM due to illness or disability, and long-term replacement.
30. Vacations, absences – elective/non-elective.
31. DIVORCES! What are you going to do if this happens?
32. Accruing benefits and expirations.
33. Outside activities, reputation, law violations, convictions.
34. Loss of professional licensing.
35. COVENANT NOT TO COMPETE, exceptions for other business entities owned.
36. Guidelines for new partner admissions and removal.
37. Bankruptcy and Insolvency.
38. Privileged information, trade secrets, client lists, goodwill transfer protection.

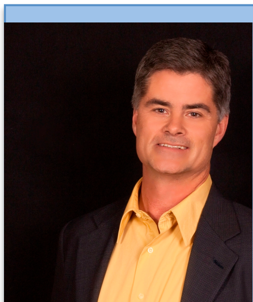
39. Ownership Interest Transfer. Define what is and is not a permitted transfer. With what rules does an internal, external, and merging sale need to comply.
40. Indemnification.
41. Notices/Waivers/Severability/Governing Law/Etc.
42. Arbitration? Lawsuit limitations? Injunctive relief?
43. SPOUSAL CONSENT Clauses.
44. Amendment processes or rules.
45. Death, Disability, Long Term Absences, what is your plan? Insurances?
46. Rules for dealing with an unexpected buyer (corporate offer).

In general, these make up most of the topics that need to be discussed, and there are always those that need to be removed or added. Ultimately, if the reader can envision its use as a document of perpetual reference, and can sit down and clearly follow what needs to happen when a partner leaves voluntarily or otherwise, all the while remaining clearheaded without confusion, with minimal opportunity for emotion, then you have a good agreement. The highpoints of contention that fuels many practice sales resulting from partnership break-ups are:

a) Disagreement on Compensation (clinical compensation vs. management vs. profit distribution)
b) Spousal conflicts originating from divorce of a partner.
c) Not clearly separating duties, voting rights and authority for both majority and minority owners.
d) Confusion between majority ownership rights vs. a dictatorship.
e) Undue hardship to remaining owner(s) upon the exit of a partner (planned or unplanned).
f) Destroyed practices due to prolonged probates or the "new partnering" of existing owners with the deceased partner's (previously non-involved) spouse or family.

As with all these agreements, they must be structured by a competent attorney, familiar with specific state and local laws governing the arrangement. It should receive the review and blessing of the accountant(s), and should be commensurate with standards currently used in the veterinary profession.

Remember, "Having a well planned exit in advance of a battle (as in a partnership breakup), can quickly become your most important strategy, and when not needed, does nothing to diminish its importance to your success." – Farquer



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