



*Venture Capital and Private  
Equity Investment:*  
**How to Evaluate Contractual Agreements**



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## Introduction

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Following a wave of Venture Capital (VC) and Private Equity (PE) activity in the healthcare space, these firms have begun to aggressively seek deals with physician practices. VC and PE transactions often feature more attractive initial financial terms than partnerships with other potential investors, such as when a practice is acquired by a hospital. However, this kind of private capital investment usually involves unique deal terms that are important for physicians to understand. Building on the AMA's VC/PE investment [Model Checklist](#) and [Snapshot](#) documents, this resource outlines contractual terms and considerations that physician practices may utilize when evaluating a VC or PE investment involving Health Organizations.

## VC/PE Investment 101

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Physicians usually have options when contemplating external investment, including national VC/PE-backed entities, hospitals, collaboration with other practices, and others. While physicians should carefully review the specific terms of any investment opportunity, there are some high-level strategic considerations that usually apply with respect to VC/PE investment. VC and PE investors are usually non-healthcare entities in their own right, although they may be focused on acquiring or investing in a certain type of healthcare provider. In general, PE firms invest in mature companies with the goal of driving rapid increases in revenue and equity prices, and then negotiate a sale on favorable terms in a relatively short timeframe. VC firms may have a longer time horizon, investing in a wider portfolio of businesses with an eye to achieving growth and sustainability. In many cases the VC or PE investment will occur at the level of a "parent" or "holding company," which may then make further investments in one or more practices in a particular specialty or region.

In general, a VC/PE-backed entity will conduct an objective, market-based valuation of the practice, with an explicit or implicit intent to sell the practice again in the future. As a result, such entities will normally offer an attractive initial investment, such as a multiple of the practice's revenue (often measured as earnings before interest, taxes, debt, and amortization or

"EBITDA"). This equity investment represents a one-time payment representing the value of the practice at a single point in time. This large up-front payment may be coupled with relatively lower ongoing compensation (either because the rate paid is lower than competitors would pay, or because the physician takes on debt as part of the initial buyout that reduces his or her ongoing compensation). The financial terms of the transaction and associated tax, financial planning and other implications, should be considered in consultation with local financial and other advisors with experience with similar transactions.

Private investment in a physician practice may also take a variety of forms depending on the parties' strategic goals and legal requirements. Some states allow private companies such as these to directly purchase ownership interests in the practice. In other states, the parties may enter into a management or administrative relationship, with a separate VC or PE-backed entity assuming responsibility for many of the non-clinical business functions of the medical practice. Either way, entering into such a relationship often has significant implications for physicians' ownership interests in the practice, service compensation and their ability to practice independently. At the same time, a properly structured deal can relieve physicians of much of the burden of practice management, provide needed capital for investments, and allow physicians more time to focus on the clinical aspects of his or her medical practice.

The attractiveness of partnering with a VC/PE investor versus a more traditional healthcare entity investor, like a hospital, will also depend on the physician's preferred style of practice and specialty. For example, physicians who primarily perform office-based services, procedures in surgical centers, and other non-hospital services may see a benefit in a VC/PE investor's management capabilities, while other efficiencies afforded by a hospital may not be as applicable. Physicians should keep in mind that VC/PE deals are highly negotiated and unique to each practice and, as such, may be an opportunity for physicians to shape the deal in a meaningful way. Practice physicians should use their position and ability to negotiate acceptable terms, which may vary depending on the goals of both parties.

## Key Documents

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Contractual terms will have a significant impact on physician satisfaction following a VC/PE-backed deal. Physicians should understand the key documents that will shape the terms of their future practice under a VC/PE-backed deal. Of note, the relevant contractual terms and obligations may be spread across multiple legal documents. A general summary of the key documents is provided below.

Note that a VC/PE transaction will usually involve a practice entity ("Practice") owned by physicians and a manager entity ("Manager") that is directly or indirectly owned by the VC fund/PE firm. The exact term used may vary in different deals for business and legal reasons. For example, the Manager may be called an "Administrator," "Infrastructure Provider," or other term, depending on the nature of its services, legal considerations, and the parties' intent. In this document, we employ the terms "Practice" and "Manager" for purposes of clarity.

- **Letter of Intent/Memorandum of Understanding:** Most transactions will originate with a Letter of Intent ("LOI") or Memorandum of Understanding ("MOU"), which sets forth: major deal terms related to the transaction structure and associated compensation terms, practice governance, post-transaction physician relationship and compensation terms, and other deal-specific details. This document typically describes many business terms that are "non-binding" from a legal perspective, but will still define the key transaction terms and conditions. In other words, the LOI or MOU establishes the overall framework for the transaction. Given that the deal transaction is implemented and documented through numerous other documents and transaction steps, the LOI or MOU is often one of the primary documents through which physicians can begin to understand the overall "deal" from a big picture perspective. LOIs and MOUs will also define the transaction process, including imposing periods of exclusive dealing, timeframes for due diligence, confidentiality and other legally binding provisions.
- **Legal/Organizational Structure and Funds Flow Summaries:** The parties often develop informal documents that describe the legal entities and economics of the deal in simplified terms. These will help physicians understand their opportunities (or lack thereof) to benefit from different revenue streams such as those derived from successful performance in enhanced practice management, value-based payment systems, and at-risk contracting. VC and PE companies are typically well-focused on enhancing profitability, so understanding the flow of funds and compensation, as well as the associated triggers and incentives will be important to evaluating a proposal.
- **Purchase/Transfer of Ownership Interests:** The transaction will include one or more agreements transferring ownership to the legal entities involved. This could mean 1) selling ownership interests in the Practice to the Manager (or a related VC/PE-backed entity), 2) transferring ownership interests in the new Manager entity to the physicians, 3) buying back practice interests held by physicians, or 4) making other changes in ownership. This agreement(s) will usually identify financial terms for the sale of the interest, the individuals holding interests before and after the transaction, and any special agreements related to the sale or transfer of interests.
- **Management or Administrative Services Agreement:** There will usually be an agreement listing the responsibilities of the Manager. These should be non-clinical and administrative in nature. This agreement will usually include all key responsibilities of the Manager, including managing billing and coding functions, information technology investments, compliance functions, access to space and equipment used by the Practice, access to certain personnel, and similar business functions. This agreement will also specify a fee that the Practice will pay the Manager from any revenue the Practice earns.
- **Employment Agreement:** This will be the major financial document covering physician compensation. After the deal, most practicing physicians will remain employees of the Practice, but the terms of their compensation will likely

change to incentivize practice efficiency. The revised Employment Agreements may include other new terms that may be positive (such as additional bonus opportunities or more generous employee benefits) or negative (such as a revised non-compete requirement).

- **Financing Agreement:** The Manager may loan the Practice funds to help fund any initial practice investments and to ensure a consistent cash flow. If so, the terms of such a loan will be included in one of the agreements. In some cases (and if permitted by law), the Manager may require the Practice to put up certain assets as security against the loan, including any expensive capital equipment (e.g., diagnostic imaging equipment) or a right to the Practice's collections (if allowed under the federal reassignment rules found [here](#) and state law).
- **Operating Agreements or Bylaws:** The Practice and Manager legal entities will both have documents identifying how each entity will be operated, how profits and losses will be distributed, and who is responsible for making decisions for the entity. The Manager may require the Practice to modify or adopt new versions of these documents as a condition of investing in the Practice. Alternatively, the Manager may need to change aspects of its Operating Agreement/ Bylaws, particularly if the physicians will become part-owners of the Manager entity.
- **Equity Restriction Agreement:** The Manager may require the owners of the Practice to agree not to sell or transfer their ownership interests to others. In addition, especially when the Manager does not directly own the Practice, it may require any physician-owners to sign an agreement allowing Manager to replace them as owners of the Practice with another physician if certain events occur (e.g., failing to follow Manager recommendations, incurrence of additional debt, initiating bankruptcy proceedings, etc.). This requirement could be a freestanding agreement or part of another document (such as the Management Agreement, Financing Agreement, or Operating Agreement).

## Key Provisions

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Physicians interested in arrangements with a VC/ PE investor should carefully consider the following contractual considerations in one or several of the above key documents.

### 1. Retaining Practice Independence

Physicians have the ultimate authority and responsibility to engage in the professional practice of medicine, and contracts should expressly acknowledge that the other parties to the transaction (e.g. the VC/PE firm) will not interfere with the physicians' ongoing duty to exercise their own best medical judgment. Physicians may wish to further negotiate specific, additional detail regarding their exercise of that authority.

### Sample "Management Agreement" Language

- 1) *Practice authority over medical judgment*  
Notwithstanding anything to the contrary herein, at all times during the Term, Group is and will remain responsible for and have exclusive authority and control over the medical aspects of the Facilities, Group's health care practice, and direct patient care to the extent they constitute the practice of medicine, including all diagnosis, assessment, treatment and ethical determinations with respect to patients, prescription of drugs, therapy or other medical interventions to patients, and clinical protocols, which are required by regulations/law, or otherwise, to be decided by a physician (the "Medical Services").
- 2) *Lack of Manager control over patient referrals*  
Group acknowledges and agrees that Manager shall neither have nor exercise any control or direction over the number, type, or recipient of patient referrals made by physicians or the Group and nothing in this Agreement shall be construed as directing or influencing such referrals. None of Manager's activities contemplated under this agreement, or otherwise, shall constitute obligations of Manager to generate patient flow or business to Group. Rather, Group has engaged Manager to perform Management Services in order to enable the physicians employed by the Group to focus on delivering the highest quality of patient care by removing the increasingly burdensome task of operating the business aspects of

the Practice. No benefits to Group or Manager under this Agreement require or are in any way contingent upon the admission, recommendation, referral or any other arrangement for the provision of any item or service offered by Manager or Group or any of their affiliates.

While autonomy in clinical decision making should remain the same post-transaction, physicians should understand that investment by a VC/PE-backed firm may be accompanied by new limitations that may change the physician's latitude in managing the Practice. Further, a physician may face challenges in his or her ability to easily unwind the Practice and return to independent practice. The AMA has created a [snapshot](#), [model checklist](#) and [contractual guide](#) on Unwinding Existing Arrangements.

The Manager will often require that ownership in the Practice is consolidated into one (or a small number) of designated physician owners, many of whom will serve as "friendly physicians" to the Manager (such that they will effectively control the Practice entity on the Manager's behalf). In some cases, the Manager may designate a "friendly physician" owner with whom it has a prior relationship, who may be totally unknown to the Practice's current owner physicians.

Further, the Manager may have the right to replace the physician owners either at will, or based upon the occurrence of a variety of events (e.g., incurrence of additional debt, initiating bankruptcy proceedings, etc.). A sample contractual excerpt below illustrates the approach that some VC/PE firms take in defining events that would trigger such transfers of ownership.

### **Sample "Management Agreement" Language**

#### Automatic Transfer of Interest in Certain Events.

The Physician Owner agrees that immediately upon the occurrence of a Transfer Event (as defined in this Section), all of the Interests held by the Physician Owner (or any successor or assignee of the Physician Owner) shall be immediately deemed transferred to the Designated Transferee (as defined in this Section), without action by the Physician Owner.

"Transfer Event," as used herein, shall mean the occurrence of any of the following events:

- a. the death of the Physician Owner;
- b. the Physician Owner is determined by a court of competent jurisdiction to be incompetent or permanently disabled;
- c. the Physician Owner becomes disqualified under applicable law, the articles of organization of the Company, or the operating agreement of the Practice to hold membership interests of the Practice;
- d. an attempted Transfer of any of the Interests held by the Physician Owner;
- e. the Physician Owner withdraws or resigns as a member of the Practice;
- f. the Administrator Agreement between Manager and Physician Owner terminates or expires for any reason;
- g. the Physician Owner files for bankruptcy or similar protection or becomes insolvent;
- h. if Manager, in its sole discretion, determines that such event shall constitute a Transfer Event, the filing of any petition or other document causing or intended to cause a judicial, administrative, voluntary, or involuntary dissolution of the Practice; or
- i. if Manager, in its sole discretion, determines that such event shall constitute a Transfer Event, the filing of any petition or other document causing or intended to cause a judicial or administrative review or challenge to the enforceability of this Agreement, the articles of organization of the Company, the Operating Agreement of the Company, or any agreement or other instrument pertaining to the governance, management, or operation of the Practice.

"Designated Transferee," as used herein, shall mean a physician licensed to practice medicine in [STATE] who is designated by Manager.

#### Transfer of Interest.

Upon the occurrence of a Transfer Event, the Designated Transferee shall tender to the Physician Owner the purchase price for the Interests (the "Purchase Price") on the first business day following the date the Designated Transferee becomes aware of the occurrence of the Transfer Event by notice from Manager, the Practice or otherwise. The Purchase Price shall be Five Hundred Dollars (\$500.00).



The Designated Transferee shall tender payment of the Purchase Price in cash or by certified or cashier's check at the principal office of Manager.

Notwithstanding the Designated Transferee's obligation to make payment to the Physician Owner, upon the occurrence of a Transfer Event, the Interests will be immediately deemed transferred to the Designated Transferee.

In states where the Manager can directly own an interest in the Practice, it will normally acquire a majority interest that allows it to exert control over the Practice's governance. In this case, the physicians may be required to sell their interests in the Practice if they terminate their employment with the Practice. The Manager also may require the Practice to take on debt to fund the management fee and infrastructure investments. In the initial years of the relationship, that debt may exceed the fees produced by the Practice such that it must carry forward the balance and earn interest under a separate agreement (often called a "Deficit Funding Loan Agreement"). Should the parties seek to unwind the transaction, the Practice may remain responsible for the repayment of any such debt.

### Sample "Management Agreement" Language

Deficit Funding Loan Agreement. If the Practice does not have sufficient cash to pay for their liabilities or financial obligations (including any portion of the Management Fee or reimbursable expenses owed to the Manager hereunder), then the Manager may, in its sole discretion, loan to the Practice upon request funds to enable the Practice to pay its liabilities and meet its financial obligations ("Advances"). Funded Advances will be added to the amounts owed by the Practice to the Manager pursuant to that certain Deficit Funding Loan Agreement of even date herewith ("Deficit Funding Loan Agreement") and will bear interest as set forth in the Deficit Funding Loan Agreement. The Professional Company will repay funded Advances in accordance with the terms of the Deficit Funding Loan Agreement.

Finally, depending on applicable state and federal law, the Manager may require that funds are automatically moved out of accounts

accessible by the Practice and moved to accounts accessible by the Manager. This facilitates the efficient payment of fees, but it can also create impediments to the ability of the Practice to regain independence.

### Sample "Management Agreement" Language

Professional Company Accounts. To facilitate the billing and collection authority granted hereunder, the Parties shall establish and maintain, in the name of the Practice and for the Practice's benefit, certain bank accounts, including one or more designated the "Lockbox Account(s)" and one or more designated the "Operating Account(s)". Each Lockbox Account will be in the Practice's name, and the Practice will have sole ownership over each Lockbox Account. To facilitate the Manager's revenue cycle management functions under this Agreement, each Operating Account will be in the Manager's name and maintained for the Practice's benefit.

Lockbox Accounts. All payments due in respect of services rendered and products provided by or on behalf of the Practice, and any other amounts payable to the Professional Company, will be directed to the Lockbox Accounts. The Practice will enter into an agreement with a financial institution chosen by the Parties to (i) establish and service the Lockbox Accounts subject to the requirements of this Agreement, (ii) facilitate the collection and negotiation of payments from patients and the deposit of such payments into the Lockbox Accounts and (iii) sweep all funds, subject to a minimum balance as mutually agreed by the Parties, from the Lockbox Accounts into the Operating Accounts on a weekly basis. Except in connection with the termination or expiration of the Terms of this Agreement, any modification or revocation of such authorization and instructions by the Practice without the Manager's prior written consent will be in material breach of this Agreement.

Operating Accounts. The Manager will use the Operating Accounts to receive funds from the Lockbox Accounts and to make payments as specified in this Agreement (including, without limitation, all expenses, liabilities and financial obligations of the Practice) and as otherwise requested from time to time by the Practice consistent with the terms of this Agreement.

## 2. Compensation Modifications

In most cases, as part of a private capital-backed investment, the privately-backed investor will require physician-owners of the Practice to sell their individual ownership interests (either to the private entity or back to the Practice) and become employees of the Practice. The terms of any such sale and ongoing compensation are important factors for any physicians' evaluation of a VC/PE-backed proposal.

VC/PE-backed entities often have the ability to pay relatively high prices to purchase (or to cause the Practice to buy back) the physicians' ownership interests.

### Sample "LOI/MOU" Language

*Sample language related to the purchase of Practice ownership interests and impact on physician compensation:*

#### NON-BINDING SUMMARY OF TERMS

##### Potential Transaction:

Manager will acquire all of the equity interests of Practice from the Equity Owners for the Purchase Price (as defined below) through a [limited liability company/holding corporation] ("Holdings") (such investment transaction, the "Transaction").

##### Purchase Price:

[Dollar amount], or [A].0x EBITDA, subject to adjustment per the below ("Purchase Price") consisting of:

1. [x]% in cash at closing (the "Cash Consideration"); and
2. [y]% in equity in Holdings, (the "Reinvestment Equity").

##### Adjustments to Purchase Price:

The Purchase Price will be adjusted to the extent of any unpaid outstanding debt of Practice, any accrued but unpaid income taxes, earned but unpaid 401k and profit sharing, any pro rata portion of employee and/or shareholder bonuses, earned but unpaid compensation or deferred compensation, owed payer refunds, and other expenses incurred but unpaid by Practice in connection with the Transaction.

##### Pre-Closing Operation:

Practice shall manage its business (including working capital and fixed assets) and operations consistent with past practice and in the ordinary course.

##### Employment Agreements:

At the closing of the Transaction, Practice will enter into employment agreements with physicians and key management employees, with terms and conditions as mutually agreed upon by the parties thereto. Such agreements will also include a confidentiality, non-disclosure, non-competition and non-solicitation agreement covering mutually agreed upon territories, services, employees, customers and key-third party consultants for a period equal to two years for physicians and one year for key management employees.

##### Compensation Adjustment:

Physician compensation will be subject to a 20% decrease following the closing of the Transaction.

Similarly, the terms of the physician's compensation may also change. For example, as part of the Practice's new management, a physician might switch from a flat salary to a "draw" structure, in which the physician is paid on the basis of his or her expected productivity and subject to either bonuses or penalties based on his or her actual performance. Note that the actual structure of any physician compensation model is heavily dependent on applicable state and federal laws, and practices should work with legal and other advisors to develop any compensation model.

### Sample "Physician Employment Agreement" Language

*Revised compensation terms:*

In General. Physician will be compensated for his or her services as an employee of Practice in accordance with a "Compensation Plan" which is adopted by Practice, as amended from time to time, the terms of which will generally involve a uniform "Draw" (as described below and in the Compensation Plan) and opportunity for productivity or other incentives as determined by Practice's board of directors and Compensation Committee (as such term is defined in Practice's bylaws). In the event of any conflict between the terms of the Compensation Plan and this Agreement, the Compensation Plan shall prevail.

Advances and "Draws" on Compensation. The Compensation Plan will include appropriate methods involving "draws" on compensation otherwise earned in order to provide adequate cash flow to the Physician



for compensation due and payable hereunder. The compensation provided herein including draws and bonuses of compensation due and payable shall be paid in installments on Practice's normal paydays, and shall be subject to applicable federal, state and local income and employment taxes, withholding requirements and other deductions in effect from time to time. Any draw on compensation shall constitute an advance of compensation which is estimated to be earned under the Compensation Plan, and as such, is subject to adjustment and potential repayment in accordance with the Compensation Plan. Any compensation payable to Physician under this Agreement shall be paid to Physician no later than March 15 of the calendar year following the calendar year in which the compensation was earned, and otherwise to promote compliance with Internal Revenue Code Section 409A.

The attractiveness of these compensation changes will depend on the physician's current status and compensation arrangements. By agreeing to these terms, the physician often gives up the potential for capturing any future increases in the value of the Practice. However, the physician secures the benefit of a significant one-time payment and, potentially, a consistent revenue stream that is relatively insulated from changes in the market, modified payer policies, and other sources of volatility. Because the physician sacrifices growth opportunities (in the form of ownership) in exchange for a one-time payment and potential other benefits, this kind of transaction is often more attractive to physicians further along in their careers and nearing retirement, as opposed to physicians who are newer to the Practice, plan to practice for many more years, or have a smaller equity share of the Practice.

### 3. Infrastructure Investment

One of the major advantages of working with a private capital partner is that it can fund significant and costly improvements to the Practice's infrastructure. The Management Agreement will often include a variety of obligations for the Manager to either directly invest in, or to support the Practice's investments in technology and services.

## Sample "Management Agreement" Language

### 1) Budget development:

BUDGET FORMULATION AND APPROVAL. Manager, through the hired or contracted Executive Manager and Financial Manager, will present to the Group a proposed annual budget on or before thirty (30) days after the beginning of each fiscal year which contains Manager's recommendations for any changes to Group's operations. Group will communicate Group's decisions regarding budgetary items, and work with Manager regarding a final, approved budget ("Fiscal Year Budget"). Group has the sole discretion to accept some, all, or none of Manager's recommendations. The creation of a final Fiscal Year Budget will be a collaborative process between the Group and Manager, with Group maintaining the final approval rights of all budgetary items.

### 2) Sample definition of Management Services to be provided:

MANAGEMENT SERVICES. Manager will provide the Management Services listed in Section (a) through (k) below and strictly in accordance with the terms of this Agreement.

(a) Administrative and Operational. Providing administration and non-clinical management; maintaining current practice policies and procedures for the Group; managing inventory; procuring and managing transcription services; procuring and managing the Group's phone systems/services; assisting with establishing scheduling systems, protocols, and staffing; assisting with accreditation; negotiating, monitoring, and managing contracts; obtaining insurance/reinsurance; and risk management.

(b) Accounting and Financial. Establish/administer accounting procedures, controls and systems for the retention and management of administrative and financial books and records of account in accordance with GAAP; preparing budgets and monthly, quarterly, and annual financial statements and distribute the same to the physician owners of the Group; managing overhead and revenue; accounting and auditing; payroll and benefits; administration of physician income distribution model. At the Group's discretion, and expense, an independent audit or review of the financial statements will be completed using an outside firm, selected by the Group. In addition, Manager will provide its best efforts to timely provide the outside firm all of the necessary information for the filing of Group's applicable local, state, and federal tax returns.

(c) Human Resources and Non-Clinical Personnel. Screening and on-boarding employees; including office staff, billing and coding personnel, IT personnel, and technologists consistent with Group's policies and procedures; providing human resources policies and procedures and/or performing human resources functions; and staff training for general, non-clinical HR issues.

(d) Coding, Billing, Collections (Revenue Cycle). Oversee and make recommendations with respect to Group's policies and programs for proper billing and coding; coding personnel; monitoring and training Group Personnel on regulatory compliance, claims submission, and claims timeliness guidelines; monitoring claims status; managing accounts receivable; collections or collection agency coordination; monitoring and educating Group Personnel on reimbursement changes; monitoring and assistance with eligibility determinations and prior authorization, third party liability, coordination of benefits, and overpayments; providing billing support; reporting; assist with developing responses to claims audits; appealing denials; pursuing claims recoveries; maintaining payment logs; providing customized billing reports no less frequently than monthly.

(e) Assessing/Arranging for and Managing Facilities. Management of physical space, locating and negotiating leases for facility space, including arranging for all needed certificates and licenses.

(f) Assessing/Arranging for and Managing Equipment. Assessment and management of equipment needs, including timely arranging for any needed maintenance, inspection and licensure.

(g) Information Technology. Assessing and strategic planning regarding IT implementation and ongoing management; server maintenance; network management; providing, monitoring, and training on any EHR systems and practice management software; providing, implementing, integrating, and updating hardware, software; IT personnel and support; billing systems; helpdesk; data conversion; document management and scanning.

(h) Credentialing. Maintaining provider files; managing enrollment and credentialing with health plans and payors; reporting to payors; assisting with credentialing standards when required by vendors and outside agencies.

(i) Group Purchasing (GPO). Negotiating group purchasing arrangements and attempting to obtain group purchasing discounts and contracting for supplies and pharmaceuticals.

(j) Managed Care and Payor Contracts. Oversight and guidance with managed care and payor negotiations and contracting; assisting with compliance requirements, policies and procedures, referral authorizations, health plan audits, and regulatory changes.

(k) Strategic Planning. Analysis, implementation, development of integrated delivery systems; consulting services regarding the development of diagnostic and therapeutic services, including Ambulatory Surgery Centers, diagnostic imaging, and lab; project management; decision support; coordinating/developing shared risk arrangements.

A Manager that has invested in many practices may also achieve certain standardization techniques and economies of scale that can assist in the efficient and profitable management of the Practice. For example, a Manager may purchase or provide access to new technology for the office (e.g. online appointment scheduling or test results portals), enhanced patient engagement tools, and other IT systems enhancements. A Manager may also provide resources used in the Practice at a lower price per unit or on better financial terms than may be available to the physician-owned practice, for example on items like office-administered drugs or other supplies.

Although this may improve the efficiency of the Practice, some physicians may not respond well to standardization protocols or changes in purchasing patterns for technology, drugs, supplies, or equipment. As a result, physicians should be sure they understand the scope of the Manager's potential changes and are comfortable with modifications in these areas.

### **Sample "Management Agreement" Language**

Physicians agree to establish practice processes, systems and standards that emphasize providing high quality, cost effective health care leading to improvements in health status and patient outcomes. Without limiting the

foregoing, the Parties agree to work collaboratively to continuously improve the health status of the populations and communities served, continuously improve quality of care in the most cost-effective methodologies and work to develop and implement new methodologies, including through the use of jointly developed and/or adopted care pathways, and cooperate with each other to develop clinical benchmarks, standards and protocols that promote practice standardization and reduction of clinical practice variation.

If all goes well, these investments should grow the Practice's business and may result in economic benefits for the physicians. However, physicians should understand that the Practice may be responsible for paying for these services indirectly. Although the Manager will provide the initial investment, the Practice is usually required to reimburse Manager for these expenses as part of the Management Agreement fee or any Financing Agreement. Further, if physicians sell their ownership interests and become employees, the initial Employment Agreement may not allow these physicians to gain the benefit of any improved practice financial performance. Therefore, physicians negotiating an initial deal should understand how the Manager will invest in any infrastructure improvements, and whether the physician will have access to the "upside" based on growth or other financial improvements.

#### **4. Administrative and Management Services**

VC and PE firms are generally diligent about their investments, and physicians who partner with or sell to these entities should be prepared for a thorough evaluation of their accounting and administrative processes. Often VC and PE-backed entities assemble leadership teams with the intent of establishing standardized, high-performing administrative and management processes across the various practices the entity manages. Access to these types of professional management and other resources are typically not available to relatively small, independent practices, and this enhanced administrative capability is commonly one of several planned-for investments that physicians may find valuable in a VC or PE-backed deal. Physicians should also understand that the Manager may require the Practice to adopt industry-standard processes related to

a variety of "back office" business protocols, such as accounting, contracting, recordkeeping, compliance, and coding standards, as part of this more hands-on management process.

#### **Sample "Management Agreement" Language**

Practice expressly authorizes Manager to perform the Management Services in the manner that Manager deems reasonably appropriate to meet the day-to-day business needs of the Practice, including the performance of specific business office functions at locations other than those operated by Practice. Practice will not prevent Manager from providing, or causing to be provided, and the Manager will provide or cause to be provided, the Management Services in a business-like manner and in compliance with all applicable laws and the standards, rules and regulations of any federal, state or local government agency exercising authority with respect to accrediting or providing reimbursement for the Practice.

The hands-on management by an outside company can have its benefits for the Practice, including a better understanding of utilization and performance metrics. However, physicians who have enjoyed a high degree of independence may find the outside management of administrative processes to be intrusive. As part of the physician's initial evaluation and negotiation of the investment opportunity, the physician should understand the degree of management and administrative control the Practice will delegate to the Manager. Further, the physician should understand how the parties will effectuate this administrative responsibility.

#### **Sample "Management Agreement" Language**

The Parties acknowledge that mutual cooperation is critical to the performance of their respective duties and obligations under this Agreement. To ensure the communication necessary for mutual cooperation, Practice will permit a representative designated by the Manager (the "Manager Representative") to attend and participate (in a non-voting capacity) in all meetings of the Practice's board of directors or equivalent governing body and all meetings of the Practice's equity holders. To facilitate such attendance and participation, the Practice will give the Manager at least five calendar days' prior written notice of each such meeting, specifying the date, time and place of

the meeting and, if the meeting is a special meeting, the purposes for which the meeting is called. The Practice's failure to facilitate such attendance and participation will be a material breach of this Agreement.

Finally, the physician should understand the potential consequences of disagreements related to the administrative and operational changes implemented by the Manager. In most cases, physicians will become employees of the Practice, and they should understand any limitations on the Manager's ability to terminate their employment after the investment occurs. In many cases, the Manager can require any remaining physician owners to sell their interests for a nominal amount if they disagree with activities of the Manager. However, in some cases physicians can negotiate clear dispute resolution procedures into the deal, such as the following provision.

### **Sample "Management Agreement" Language**

Informal Dispute Resolution, Mediation and Arbitration. In the event of disputes between the parties arising out of or in connection with this agreement, the Parties agree to initially engage in a process of informal discussion and dispute resolution in an effort to resolve the dispute, and such informal process may, if deemed appropriate, use the services of an external third party or mediator to assist the Parties in resolving the dispute. Any dispute between the parties arising out of or in connection with this Agreement that cannot be settled amicably and informally between them will be finally resolved by confidential arbitration. Disputes subject to arbitration under this Agreement will be resolved by a sole arbitrator mutually agreed upon by the parties. If the parties fail to nominate a sole arbitrator within fifteen (15) days from the date the initiating party's demand has been communicated to the respondent, a board of three independent arbitrators will be appointed

with each party appointing one arbitrator and the American Arbitration Association appointing the third arbitrator. Arbitration proceedings will be conducted in \_\_\_\_\_ pursuant to the rules governing commercial arbitration of the American Arbitration Association, and the arbitrators will apply the substantive laws of the State of \_\_\_\_\_ (without giving effect to the choice of law principles thereof). The award rendered by the arbitrator or arbitrators will be in writing specifying the factual and legal bases for the award, and judgment may be entered in accordance with applicable law by any court having jurisdiction thereof. Notwithstanding the foregoing, any party to this Agreement may seek to obtain an injunction or other appropriate relief from a court to preserve or protect Confidential Information or to preserve the status quo with respect to any matter pending conclusion of the arbitration proceeding, but no such application to a court will in any way be permitted to stay or otherwise impede the progress of the arbitration proceeding.

## **Conclusion**

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VC and PE-backed investment can present an exciting opportunity for physicians looking to either grow or sell their existing practice. With an informed evaluation and negotiation of terms, this kind of investment can provide new resources to fund clinical and technological improvements, and provide financial stability. Moreover, by partnering with investors who may have specialized resources, physicians can gain the benefit of management services that reduce day-to-day burden and are uniquely tailored for their practice. However, physicians should fully understand the terms of any investment, the overall business goals of their partners, and the avenues to exit the relationship, if necessary.