

Congress of Physician-Owned MEDICAL PROPERTIES

2022



This copy of the CPOMP 2022 session slides are presented as they were during the conference. Over the next few weeks, annotated versions of the slides will be uploaded that highlight some of the outcomes from each presentation and panel discussion.

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Essential Elements That Should Be in Every Operating Agreement

Michael Okaty, Partner, Foley & Lardner

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A photograph of a modern building's interior, featuring a large glass wall and a wooden floor. The image is used as a background for the title text.

Physician-Owned Real Estate Operating Agreements

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- *Chambers USA: America's Leading Lawyers for Business* in the practice area of Corporate/M&A & Private Equity (2021-2022)
- Selected by his peers for inclusion in *The Best Lawyers in America*® in the fields of:
 - Business Organizations (including LLCs and Partnerships) (2015 - 2022)
 - Corporate Law (2010 - 2022)
- *Florida Super Lawyers–Rising Stars*® (2009, 2011 - 2014)
- *Orlando Business Journal's* "40 under 40" (2008 and 2011)
- "Florida Trend Legal Elite Up & Comer" by *Florida Trend* magazine where only 42 attorneys in Florida and six in Orlando were selected for this honor (July 2004)
- Mike focuses on a wide variety of corporate transactions, governance, and counseling.
- Mike has experience in a wide variety of corporate law matters, including: corporate formation, corporate operations and governance, contract drafting, review and negotiation, mergers and acquisitions, and capital raising and finance transactions for both public and private companies and lenders.
- Mike is founder and former chair of the firm's Senior Living Industry Team, former vice chair of the firm's Industry Teams Department and formerly the managing partner for the Orlando office.
- Mike is presently co-chair of the firm's Transactions Practice and a member of the firm's Management Committee.

Rene M. Larkin



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- Rene counsels health care clients on a wide variety of transactional and governance matters and understands the aspects of health care that can make these matters unique from other industries
- Rene has in-depth experience in all real property issues, including health care lease arrangements, purchase and sale of real property and acquisitions and dispositions of health care and medical facilities
- Rene advises on clients on health care transactions, assisting with acquisitions and mergers, physician alignment and physician contracting as well as governance, which includes advising boards on health care and governance issues.
- Rene typically works with clients from large-sized health systems to single-hospital medical centers and small, rural county hospitals
- Rene is an active member of the American Health Law Association and a recently completed a term as vice chair of the association's Real Estate Affinity Group
- Rene serves as a board member for a non-profit that serves women and men who find themselves in unplanned and difficult situations and serves on the steering committee for the women's initiative with Denver Institute for Faith and Work

Services

- Facilities Management
- Fraud and Abuse Counsel
- General Business Transactions & Services
- Mergers & Acquisitions
- Real Estate & Construction

Memberships

- American Health Law Association
- Association for Corporate Growth
- Colorado Bar
- Florida Bar
- American Bar Association

Top Ten Reasons You DON'T Need an Operating Agreement





Reason No. 10

The other person is going to die first.

- Perfect! So what is the plan when the other person dies? Oh, and since you can predict that, can you also tell me the right Powerball® numbers to play?





Reason No. 9

My colleagues and I are best friends.

- This is great news! Do you want to remain friends?
- And are you best friends with you colleague's spouse? Ex-spouse? Children? Executor? Because, remember, the other person is going to die first





Reason No. 8

I know the “value” of our business.

- Great. Now do the other Physicians agree with this?
- Will the IRS agree?
- How about all of your “new members” that are created by the death of the other owner? Remember, you will be the last to die.

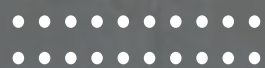


Reason No. 7

Value is a simple concept everybody understands.

- Exactly! So are we talking about "fair market value" ...
- Value is a simple concept, but it isn't a precise term.





Reason No. 6

We get along great. Why would we need an operating agreement to govern how we conduct business?

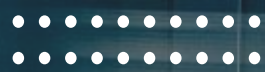
- I see -- and do all physicians adhere to the exact same medical opinion as well?



Reason No. 5

An operating agreement costs too much money to draft.

- Agreed! It is far cheaper to litigate every issue in a back-logged court.



Reason No. 4

We've already agreed how to split the profits!

- Perfect! What if there are losses? What if someone retires?
- Has the IRS agreed on how you will split the profits?
- What if there are significant unexpected capital improvements required in a year?
- What if there are uninsured losses or expenses to property?





Reason No. 3

Everyone knows what their obligations are!

- Yes. This works in every scenario! That is exactly why we do not need loan agreements to document repayment of student loans. Everyone knows their obligations and everyone always meets them!





Reason No. 2

We always agree, so why bother addressing things like voting rights.

- That's right -- everyone always agrees. I forgot. So everyone in here voted for the same presidential candidate in 2020?



Reason No. 1

We are professionals and know how to handle a disagreement.

- Right! We and our colleagues too! Until we don't.
- And whatever that disagreement happens to be at the time is the number one reason why you "don't need an operating agreement."





- Now that we know all the reasons you don't need an operating agreement...
- Let's talk about the top three reasons you do!

Top Three Areas for Consideration in a Physician- Owned LLC Operating Agreement



1. Transferability



2. Valuation



3. Major Decisions



I. Transferability of Interest



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Voluntary versus Involuntary

- **Voluntary Transfers**
- Can occur when a member wants to:
 - Perform estate planning
 - Sell or assign his/her interest to another
 - Retire
- **Involuntary Transfers**
- Can occur upon a member's:
 - Death
 - Disability
 - Divorce
 - Bankruptcy of a business owner



Transfers

- Many LLC Agreements govern the transferability of interests whether transfer is voluntary or involuntary





Voluntary Transfers





Permitted & Prohibited Transfers

An LLC's Operating Agreement may contain "Transfer Provisions"

- permitting certain transfers (e.g., to a revocable living trust for estate planning purposes); and,
- restricting the ability of a member to sell or otherwise transfer all or any portion of its LLC interest without:
 - Company Consent;
 - Member Consent;
 - Right of First Refusal
 - Right of First Offer
- Transfer Agreements may also include:
 - Drag-Along Rights;
 - Tag-Along Rights.





Right of First Refusal (ROFR) and Right of First Offer (ROFO)

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- An LLC's Operating Agreement may include a 'Right of First Refusal' (ROFR) or a "Right of First Offer" (ROFO) clause.
- A **right of first refusal** requires a member receiving an offer from a third party to first offer its membership interests to the other members.
- Like the right of first refusal, a **right of first offer** requires a member wishing to sell its membership interests to offer the interests to the other members first.



“Drag Along” Rights

- A drag-along provision enables a majority shareholder to force a minority shareholder to join in the sale of a company.
- The majority shareholder must give the minority shareholder the same price, terms, and conditions as any other seller.

“Tag Along” Rights

- Tag-along rights allow shareholders to “tag-along” with the majority sale and sell their stock when another shareholder receives a sale offer.
- Tag-along rights generally must be negotiated for by the minority shareholders.

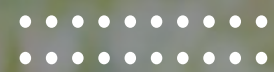


Involuntary Transfers

- 1) A deceased member's membership interest transferring to their estate.
- 2) Bankruptcy or involuntary transfer of their membership interest to creditors.
- 3) A member's separation or divorce resulting in the transfer of their interest.
- 4) A valid court order, levy, or other transfer.
- 5) Breach of confidentiality.
- 6) Violation of a mandatory provision of the Operating Agreement.
- 7) Lack of license or other qualification.



Who, What, When, Where, and How?



II. Valuation



Valuation

Asset Valuation

Book Value
Income
Capitalization
Bank Appraised
Value
Investment
Appraised Value
Some
combination of
the above?

Liability Valuation

Accrue for all debt
Inclusive of swap
unwind & break
funding
prepayment
penalty

Equity Valuation

Assets minus
Liabilities =
Owner's Equity,
but discount due
to lack of
marketability?





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Initial Investment Valuation

Can the
investment be
made in something
other than cash?

If non-cash
investments, how
will the contribution
be valued?



III. Major Decision Rights

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Voting Rights Options

Providing

Providing for each member to have one vote.

Limiting

Limiting voting to those with active roles with company operations.

Designating

Designating a specific group of members to handle the voting process.

Basing

Basing voting rights on percentage of ownership interests.



Voting Considerations

- If unanimous voting is required, one member can negate the majority's decision-making power.

In contrast....

- If a simple majority vote is required for major decisions, a simple majority can bind everyone to unpopular decisions (e.g., a capital call).





Voting Logistics

- Will meetings be allowed to be held virtually?
- Will proxy voting be allowed?

An overhead photograph of four people (three women and one man) sitting around a white rectangular table in a meeting. They are engaged in discussion, with some pointing at documents. The table is cluttered with various items: papers, a spiral-bound notebook, a small potted plant, pens, pencils, a pen holder, a yellow notepad, a black folder, a smartphone, and two coffee cups. The background is a plain, light-colored wall.

Types of Major Voting Items

- Admitting or dismissing members from the LLC
- Authority to transfer membership interests
- Authority of Manager
- Roles and responsibilities of the members
- Financial:
 - Capital call
 - Distributions
- Sale/Dissolution/Liquidation

Admitting Members

The process for adding a new member to an LLC should be addressed in the LLC's Operating Agreement.



If the Operating Agreement does not address how to add a new member, state statutes typically govern the default method.



Dismissing Members

Voluntary- An LLC buyout agreement can provide direction when a member decides to leave an LLC.

Expulsion by Operating Agreement- Most LLC operating agreements contain provisions that allow for the expulsion of LLC members as a remedy for the member's misconduct.

Expulsion by Unanimous Consent of LLC members- Under the Revised Act, LLC members may expel a member by unanimous vote (in limited circumstances).

Expulsion by Court Order- LLC members can request that a court expel an LLC member (in limited circumstances).



Transferring Membership Interest

Most LLC agreements have a rule that members cannot sell or otherwise transfer their LLC interests unless approved in advance or allowed under another provision (such as a “Right of First Refusal” provision).

Usually, the Operating Agreement will specify how many votes are required to transfer membership, or whether it is up to the Manager to decide when a transfer is approved.



Manager Responsibilities

- What will be delegated to the manager?
- What are the procedures for management decision-making?
- What limits will be placed on a manager's authority.
- How will the manager's compensation be determined?





Roles and Responsibilities of Members

Members own the LLC and provide the capital with which the LLC commences its business. Members are responsible for voting to elect managers and other matters outlined in the Operating Agreement.

Managers are elected by the members, and typically manage the business and affairs of the LLC. Managers may either perform these responsibilities themselves or these responsibilities can be performed by officers and employees under the direction of the managers.



Capital Calls

- Should the manager be able to make a capital call any time it deems it necessary?
- Should a capital call require member approval? If yes, will that require a majority vote, a supermajority vote, a unanimous vote?
- What are the consequences for failure to contribute as called?



Distributions

Tax

- Who determines whether there will be distributions for tax purposes?

Excess Cash Flow

- Who determines if there is excess cash flow and whether it should be distributed?

Other distributions?

- Who determines?
- Timing?
- How much?

Capital Event or Liquidating distributions.

- Liquidation preferences?



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Sale of Assets, Dissolution, Liquidation

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- Who decides when the LLC or the assets of the LLC will be sold and for what amount?
- Who will decide when the LLC should be dissolved?
- How will the assets be liquidated upon dissolution?



We've only covered the Top 3
most important considerations for
creating an Operating Agreement



The most important issue is...





The issue at hand!

Questions?



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