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STRATEGIES FOR EXCLUSIVE CONTRACTING

BY: MARK F. WEISS, J.D.

In these turbulent times for the business of radiology groups, in which the pace of -- to use Joseph Schumpeter's term -- creative destruction is quickening, it is more important than ever to strategically approach the way in which exclusive contracting and group structure and functions are intertwined. To simply keep on keeping on with a pure focus on patient care, thinking business success, or even business survival, will follow, is folly.

Consider this very instructive example:

In the late 1920s, Walt Disney had his first big commercial success with a cartoon character named Oswald the Lucky Rabbit.

Disney had an exclusive contract with Universal Pictures for the distribution of Oswald cartoons. It paid Disney a tidy cut, but not nearly enough. So Disney, based in Burbank, CA, set off on the train for Universal's headquarters in New York City to renegotiate the terms of the deal.

But Universal knew he was coming. And they knew what he wanted. They had signaled clearly that they were looking out for their own interests and that they controlled the power in the relationship -- in fact, they had made overtures, which had been rebuffed, to buy Disney out and employ him.

So while Disney was on his way to New York, Universal's agents hired away his staff of cartoonists. And when Walt arrived, he was surprised to learn that his company's original agreement with Universal had signed over to Universal all of his intellectual property rights to the Oswald character.

Walt's problems were that he thought he had a team, and he thought he had value in the underlying business assets: the rights to Oswald. But his team was loosely organized and not at all bound to his business, so they were free to leave. And, he didn't understand the intricacies of his exclusive contract with Universal, which gave the distributor ownership of the Oswald character.

Of course, although not exact, the analogy between the Disney-Universal situation and many radiology group-hospital relationships is tight.

Many radiology group leaders operate under the mistaken assumption that their group's business will simply continue on and on, even if they have not paid proper attention to protecting it, either in respect of the relationship with the hospital or the relationship between the group and its physicians.

Many radiology groups fail when disgruntled members or employed or subcontracted physicians break away, undercutting the group, its business operations, and sometimes its very existence.

Hospitals often have the same motivation as Universal did, but in respect of radiologists, not cartoonists. They want to gut the group of its leadership, directly employ the radiologists or put them into an accountable care organization (ACO) vehicle, and, voila, the business of the former group will be theirs. The analogy holds true in respect of the national and large regional groups as well, as they often seek to establish a foothold by luring away a group's providers.

Protecting your practice

In this article, we'll focus on a few of the many elements of a larger process that I call the Practice Protector Process, which serves as a series of guideposts for preserving and continuing your group's exclusive contract relationship with the hospital. More information on the process is available at www.advisorylawgroup.com/thepracticeprotector.html.

Many of the same elements apply in respect of obtaining an initial contract and, importantly, in expanding the business of your group to provide services at multiple facilities.

Additionally, and even though, for simplicity's sake, we will break preserving your exclusive contract relationship into three temporal categories, the reality of the situation is that nearly everything your group does and nearly every interaction your group and its physicians, other providers, and employees have, whether in regard to patients, referral sources, the hospital, or any other influencers, have a bearing on your group's ability to extend and renew its exclusive contract. Many of those elements are not themselves time specific.

The beginning stage

For purposes of this discussion, let's draw a distinction between the time before and the time after the commencement of *traditional* negotiation of an exclusive contract.

In other words, if you were to ask nearly everyone to explain when the negotiation over the renewal of an exclusive contract begins, they would say when we first have a discussion with the hospital concerning the renewal, whether that's an oral conversation or the exchange of something in writing.

And, of course, they would be 100% wrong.

As I mention above, because what you're doing many months, and even years, before you get to that point -- that point being what I call the "face-to-face" stage -- influences what happens during

the face-to-face stage, those actions and events must be considered negotiation if you are to stand any chance of achieving a transformational result.

So, let's refer to what happens before the face-to-face stage as the "beginning stage."

Among other things, during the beginning stage you want to make sure that you do not allow yourself to be put into the same situation that Disney found himself in when his entire team was poached by Universal. The relationship between the group and its owners, and between the group and its subcontractors/employees must be examined, strengthened, and documented.

Additionally, the governance structure within the group must be questioned and, if need be, revamped to permit it to quickly make the necessary strategic and tactical decisions that successful contracting entails.

Optimally, the group should engage in a publicity push strategy that includes -- but is in no way limited to -- a preemptive strike against competitors' claimed features and benefits.

Although these items give you the flavor of what should be occurring during the beginning stage, they're simply a few of the many elements of the larger process.

So, for example, if we take a typical group practicing at the fictitious Community Memorial St. Mark's Hospital, with a three-year contract that renews in a year and a half, if they're just beginning the process, they are already a year and a half late.

Let's assume they get moving fast, realizing that their 17-member, rule-by-consensus management committee has never been and never will be able to make quick strategic or even tactical determinations. They move to correct that.

They examine each of the group's organization-physician relationships and the way they are documented and take steps to preserve the ties that bind members to the group, even though covenants not to compete are not enforceable in their state.

Based on information developed through the Practice Protector Process, they create multiple initiatives to build support and engage in an active push for publicity and to create foreshadowing, both public and private.

The during stage

For purposes of our discussion, we'll use the term "during stage" to describe the goings on during the face-to-face stage of the negotiation -- the part of the negotiation that most groups mistakenly believe is the entire negotiation.

Of course, the during stage is far more complex than the actual across-the-table discussions.

Think of it as consisting of multiple subcategories, a few of which are discussed below.

Although it may appear as if the negotiation is being conducted between two parties -- your group and the hospital -- the reality is often very different. There are often significant influencers, for example, medical staff leadership, influential physicians, and, in some cases, the community at large, that can have a tremendous impact on the outcome, if used properly.

Thus, for example, in recent negotiations my clients and I have deployed various forms of recommendations and endorsements both from within and without the medical staff. In appropriate situations, we've also intertwined the process with the use of media relations.

You must develop a strategy and deploy tactics to exert control over the negotiation process itself. The group's negotiating team, led by experienced counsel and comprised of group members empowered to make decisions, must follow a negotiating strategy consistent with the group's overall business strategy.

At all costs, your group must avoid "negotiation by ambush," in which hospital administrators seek to pull group leaders -- often those most easily influenced -- into impromptu meetings, or even into a hallway chats, which *are* meetings to a hospital administrator, to "discuss" deal points.

As to the deal points themselves, and obviously there are deal points in common in almost every exclusive radiology contract negotiation, most groups and their advisors make the mistake of focusing simply on the issues as they affect the group's performance obligations in favor of the hospital and the hospital's obligations to the group.

But what's often missed is that exclusive contracts also generally contain provisions that have an impact, sometimes a severe impact, on the relationship between the group and group members -- both owners and employees.

An obvious example would be a provision permitting the hospital to remove a physician from the roster of providers pursuant to an exclusive contract. For a group that provides services at only one hospital, what's the effect of any particular physician no longer having the ability to provide services on behalf of the group? Obviously, and for purposes of this discussion I'm not addressing whether or not a provision like that is appropriate, if your group can no longer use the services of that doctor, then that relationship is going to end. But what does the agreement between the group and that physician, for example, the shareholders agreement or employment agreement, provide in that regard?

That's just a very simple circumstance -- the real impact is much more complex. How can actions permissible under an employment agreement trigger breaches pursuant to the exclusive contract? How can performance under the exclusive contract trigger breaches under the employment agreement? How can action permissible under an employment agreement result in the loss of your exclusive contract in favor of a new contract in the name of the former employee?

The after stage

Finally, we'll use the term "after stage" to describe the events following the execution of the agreement.

Ah, but wait! If you've been reading carefully, you know that there really is no after stage.

Just as August Kekulé said that his vision of a snake eating its own tail (an Ouroboros) inspired his discovery of the structure of the benzene ring, that image should inspire your realization that the after stage is the same as the start of the beginning stage: As soon as the ink is dry on this year's renewal agreement, your group's actions and interactions begin to influence the renewal -- or nonrenewal -- of the agreement two or three years hence.

Back to Oswald

As we come to a close, there is a second aspect to the Oswald story that's instructive for radiology group leaders.

Oswald the Lucky Rabbit didn't turn out to be so lucky for Universal after all. That's because it made a rather elementary error: It believed that the value in the Disney enterprise resided in its copyrights and its cartoonists -- after all, Walt wasn't the one who actually drew the cartoons -- which it, Universal, could capitalize on through its movie distribution system.

But under Universal, Oswald failed, because the real value was in the intellectual capital, the spark, residing in Disney himself. Soon after the Oswald debacle, Disney regrouped, Oswald the Lucky Rabbit morphed into Mickey Mouse and the rest became history.

If your group already has that spark, develop it and use it to your advantage in the full range of negotiation. If it doesn't have it, then you either have to develop it, which is possible with the right approach, or start practicing the words, "excuse me, when can I pick up my paycheck?"

Mark F. Weiss is an attorney who specializes in the business and legal issues affecting radiology and other physician groups. He holds an appointment as clinical assistant professor of anesthesiology at USC's Keck School of Medicine and practices with The Mark F. Weiss Law Firm, a firm with offices in Los Angeles, Santa Barbara and Dallas. He can be reached by email at markweiss@weisspc.com and by phone at 310-843-2800.

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