MERGE HEALTHCARE INC
Form 10-K/A
August 26, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K/A

Amendment No. 3

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2009

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission file number 0-29486

MERGE HEALTHCARE INCORPORATED
(Exact name of Registrant as specified in its charter)

Delaware	39-1600938
(State or other jurisdiction of incorporation or organization)	(I. R. S. Employer Identification No.)

900 Walnut Ridge Drive, Hartland, Wisconsin 53029
(Address of principal executive offices, including zip code)

(Registrant's telephone number, including area code) (262) 367-0700

Securities registered under Section 12(b) of the Exchange Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, $0.01 par value per share	NASDAQ Global Market

Securities registered under Section 12(g) of the Exchange Act: NONE

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes o No x

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes o No x

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.o

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer, or a smaller reporting company. See the definitions of "accelerated filers", "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer x	Non-accelerated filer o	Smaller reporting company o

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes o No x

The aggregate market value for the Registrant's voting and non-voting common equity held by non-affiliates of the Registrant as of June 30, 2009, based upon the closing sale price of the Common Stock on June 30, 2009, as reported on the NASDAQ Global Market, was approximately $116,910,210. Shares of Common Stock held by each officer and director and by each person who owns ten percent or more of the outstanding Common Stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

The number of shares outstanding of the Registrant's common stock, par value $0.01 per share, as of August 5, 2010: 83,268,608

EXPLANATORY NOTE

This Amendment No. 3 on Form 10-K/A ("Amendment No. 3") to our Annual Report on Form 10-K for the year ended December 31, 2009, filed with the United States Securities and Exchange Commission ("SEC") on March 12, 2010 (the "Form 10-K"), as amended by Amendment No. 1 on Form 10-K/A filed with the SEC on March 17, 2010 ("Amendment No. 1") and Amendment No. 2 on Form 10-K/A filed with the SEC on April 30, 2010 ("Amendment No. 2"), is being filed by Merge Healthcare Incorporated ("Merge Healthcare," "we," "us," or "our") for the sole purposes of (i) amending the Item 11 information in Amendment No. 2 to include the table on quantified termination and change in control benefits under the section captioned "Potential Payments upon Termination or Change in Control" that was also included in our subsequently filed definitive proxy statement filed with the SEC on August 12, 2010 and (ii) amending Item 15(a) of the Form 10-K to include or incorporate by reference, as the case may be, new Exhibits 10.15, 10.16 and 10.17.

Exhibit 10.15 is a Value Added Reseller Agreement dated March 31, 2009 pursuant to which Merrick Healthcare Solutions, LLC d/b/a Olivia Greets ("Merrick Healthcare") purchased software licenses from a subsidiary of Merge Healthcare for $400,000. Exhibit 10.16 is the Olivia Greets Standard Reseller Agreement dated March 12, 2010, pursuant to which Merge Healthcare received the right to market, resell and supply certain of Merrick Healthcare's products and services. Both Exhibit 10.15 and Exhibit 10.16 were terminated on July 30, 2010, in connection with Merge Healthcare's acquisition from Merrick Healthcare on July 30, 2010, of substantially all of the assets related to the development and distribution of the Olivia Greets system. Exhibit 10.17 is a Senior Secured Term Note between Merge Healthcare and Merrick RIC, LLC, pursuant to which Merge Healthcare borrowed $15,000,000 on June 4, 2008. This Senior Secured Term Note was repaid in full by Merge Healthcare on November 18, 2009.

No other changes have been made to the Form 10–K, Amendment No. 1 or Amendment No. 2. This Amendment No. 3 does not reflect events occurring after the filing of the Form 10-K, nor does it modify or update the disclosures and information contained in the Form 10–K, Amendment No. 1 or Amendment No. 2 in any way other than as described in this Explanatory Note.

Updated certifications of our principal executive and financial officer are included as exhibits to this Amendment No. 3.

PART III

Item 11. EXHIBITS, FINANCIAL STATEMENT SCHEDULES.

COMPENSATION DISCUSSION AND ANALYSIS

INTRODUCTION

This Compensation Discussion describes our executive compensation program for 2009 and certain elements of the 2010 program. We use this program to attract, motivate, and retain colleagues whom the Board has selected to lead our business.

This section of the Proxy Statement explains how the Compensation Committee made its compensation decisions for our officers who also comprise our named executive officers. Those Named Executive Officers are our Chief Executive Officer, Justin C. Dearborn; our Executive Vice President — North American Direct Sales, Nancy J. Koenig; our Vice President, General Counsel and Corporate Secretary, Ann Mayberry—French; our Chief Financial Officer, Steven M. Oreskovich; and our Executive Vice President — Research and Development, Antonia A. Wells.

MARKET AND BUSINESS CONDITIONS

Although the global economy rebounded somewhat toward the end of 2009, our business remained affected by the downturn that started in 2008. Healthcare in particular showed country-by-country challenges and opportunities as a direct result of the local government investment. In 2009 our major market, the U.S., passed dramatic healthcare legislation intended to spark new investment in health IT. While it originally served to freeze the market as elements of the legislation were further defined, market conditions improved toward the end of 2009 and major market segments are forecasted for growth in 2010 and onward. At the same time, legislation aimed at reducing reimbursement to our customers hindered their ability to invest in our solutions. Merge Healthcare improved its financial position during the second half of 2008 and continued to grow top line revenue throughout 2009. Management successfully limited overhead while growing revenue in order to improve our financial strength and sustain future performance.

PHILOSOPHY AND GOALS OF OUR EXECUTIVE COMPENSATION PROGRAM

Compensation Philosophy

The primary objectives of our executive compensation policies are as follows:

- to attract and retain talented executives by providing compensation that is in alignment with the compensation provided to executives at companies of comparable size and growth trajectory in the health care information technology industry, while maintaining compensation within levels that are consistent with our annual budget, financial objectives and operating performance; and

- to provide appropriate incentives for executives to work toward the achievement of our annual financial performance and business goals, based primarily on diluted earnings per share.

Our incentive compensation programs are designed to reward executive and other employee contributions based on the success of our organization. Specifically, they are designed to reward achievement of our annual financial performance and business goals and creation of stockholder value.

Compensation Mix

Historically, we have used a mix of short—term compensation (base salaries and annual cash incentive bonuses) and long—term compensation (stock option grants and restricted stock awards) to meet the objectives of our compensation programs. We do not have a fixed policy for allocating between long—term and short—term compensation or between cash and non—cash compensation. Because we believe that it is important to align the interests of our executives with those of our stockholders, equity incentive compensation has made up a portion of each current executive's overall compensation package. In the near term, we plan to continue to use primarily short—term compensation (base salaries and annual cash incentive bonuses) as well as long—term compensation, as appropriate.

The compensation that we pay our Named Executive Officers consists of base salary, cash incentive compensation and stock option awards. The following discussion explains the reason we pay each element of compensation, how the amount of each element is determined, and how each element fits into our overall compensation philosophy and affects decisions regarding other elements.

We seek to pay executives a base salary in alignment with salaries of executives at companies of comparable position in the healthcare information technology industry and at a rate that fits within our annual budget, financial objectives and operating performance. However, we do not make use of any formal survey information or benchmark against any specific compensation percentiles. We have not historically attempted to make base salary a certain percentage of total compensation.

In light of the Company’s 2009 annual performance and the public sentiment regarding corporate bonus payouts for substandard, annual corporate performance, the Compensation Committee determined that Merge Healthcare’s performance did not warrant cash incentive payments for 2009.

In early 2010, the Compensation Committee established targets for bonuses for Merge Healthcare’s Named Executive Officers, as well as the rest of the employees. However, due to the Company’s acquisition of AMICAS, Inc., such targets are no longer in effect.

Role of the Compensation Committee

The Compensation Committee of our Board is responsible for administering our compensation practices and ensuring they are designed to drive corporate performance. Our Compensation Committee reviews compensation policies affecting our executive officers annually, taking into consideration our financial performance, our position within the health care information technology industry, the executive compensation policies of similar companies in similar industries and, when reviewing individual compensation levels, certain individual factors, including the executive’s level of experience and responsibility and the personal contribution that the individual has made to our success. Further, our Compensation Committee also considers the global economic trends and the macroeconomic environment.

Annually, our Compensation Committee reviews the base salaries of all executive officers and based on these reviews, may adjust these salaries to ensure external competitiveness and to reflect the executive’s individual position and performance, as well as the performance of our Company. In addition to these factors, our Compensation Committee considers the recommendations of our Chief Executive Officer when adjusting base salaries of our Named Executive Officers other than himself. Our Chief Executive Officer can and does call and attend Compensation Committee meetings. We may also make base salary adjustments during the year if the scope of an executive officer’s responsibility changes relative to the other executives.

Modifications To Our Executive Compensation Program

The Committee continues to focus its efforts to refine the executive compensation structure and process consistent with evolving good governance practices.

Beginning in June 2008, in connection with the investment by Merrick RIS, LLC (“Merrick”) in our Company, several changes occurred in the makeup of our senior management team. Specifically, effective on the closing of the Merrick investment, Mr. Dearborn became our Chief Executive Officer, Mr. Oreskovich became our Chief Financial Officer, Ms. Koenig became our President of Merge Fusion and Ms. Wells became our President of Merge OEM. In connection with these changes, the Compensation Committee proposed and the Board accepted several modifications to our executive officer and director compensation programs to ensure that we offer competitive compensation that will help us to retain our executive officers and to reflect the views of the current members of our Board and the Compensation Committee on appropriate compensation structures. In April 2010, several additional changes occurred in the makeup of our senior management team, namely Nancy J. Koenig was appointed Executive Vice President — North American Direct Sales and Antonia A. Wells was appointed Executive Vice President — Research and Development.

We have entered into letter agreements with four (4) Named Executive Officers: Mr. Dearborn, Ms. Koenig, Mr. Oreskovich and Ms. Wells. The agreements formalize and confirm the base compensation, target annual bonus amounts and the stock option grants that we agreed to in connection with the hiring of Mr. Dearborn and Ms. Koenig, and Mr. Oreskovich's and Ms. Wells' promotions. The agreements provide for twelve (12) months' base salary as severance upon a termination other than for cause or other than due to the executive officer's death or disability, conditioned on the executive officer's execution of a release agreement. The agreements do not include a definition of "cause." In addition, upon a change in control of Merge Healthcare, all of the executive officers' stock options will vest. We proposed the amounts of these severance benefits and the triggering events based on the subjective judgments and experiences of the members of the Compensation Committee indicating that these amounts are consistent with market practice and that the triggering events are likely to involve circumstances in which it is customary and appropriate to offer the protections embodied in the letter agreements.

We established the terms of the compensation arrangements with four (4) of our Named Executive Officers at the time of the closing of the Merrick investment, as noted above. The compensation arrangements for our Named Executive Officers as of December 31, 2009 were as follows: Mr. Dearborn received an annual base salary of $250,000 and has a target annual bonus equal to his base salary. Ms. Koenig received an annual base salary of $200,000 and has a target annual bonus equal to her base salary. Ms. Wells received an annual base salary of CAD$200,000 and has a target annual bonus equal to her annual base salary. Mr. Oreskovich received an annual base salary of $200,000 and has a target annual bonus equal to 50% of his annual base salary. The compensation arrangement for Ms.

Mayberry—French was determined upon her date of hire. As of December 31, 2009, those arrangements were as follows: Ms. Mayberry—French was hired at an annual salary of $150,000 and received a salary increase effective on January 1, 2009, due to additional responsibility for the Human Resources function of Merge Healthcare. Because of the salary increase Ms. Mayberry—French received an annual salary of $160,000 and had a target annual bonus of thirty five percent (35%) of her base salary. No bonuses were paid to the named executive officers under the 2009 annual bonus program because the factors defined by the Compensation Committee were not achieved.

COMPENSATION COMMITTEE REPORT

The Compensation Committee has reviewed and discussed the Compensation Discussion and Analysis required by Item 402(b) of Regulation S—K set forth above with management and, based on such review and discussions, the Compensation Committee recommended to our Board that the Compensation Discussion and Analysis be included in this Proxy Statement.

The Compensation Committee

Dennis Brown, Chairperson
Gregg G. Hartemayer
Richard A. Reck

COMPENSATION OF EXECUTIVE OFFICERS AND DIRECTORS

Summary Compensation Tables

The following table relates to the compensation earned by our current Named Executive Officers for the fiscal years ended December 31, 2007, 2008 and 2009.

Name and Principal Position	Year	Salary ($)	Bonus(1) ($)	Stock Awards(2)($)	Option Awards(2)($)	Non Equity Incentive Plan Compensation(3) ($)	All Other Compensation ($)		Total ($)
Justin C.	2009	250,000	50,000	—	—	—	17,453	(5)	317,453
Dearborn(4)	2008	143,109	—	—	340,000	—	7,018	(5)	490,127
Chief Executive Officer									
Steven M.	2009	200,000	—	—	—	—	14,475	(5)	214,475
Oreskovich(6)	2008	189,583	—	—	82,000	—	10,222	(5)	281,805
Chief Financial Officer	2007	175,000	130,000	80,000	150,000	5,469	9,514	(5)	549,983
and Treasurer									
Nancy J. Koenig(4)	2009	200,000	—	—	—	—	4,687	(5)	204,687
Executive Vice	2008	114,487	—	—	82,000	—	2,236	(5)	198,723

President — North American Direct Sales									
Antonia A. Wells(7)	2009	199,123	—	—	—	—	11,223	(8)	210,346
Executive Vice President — Research and Development	2008	160,474	—	—	82,000	—	5,975	(8)	248,449