

ACQUIRING A MEDICAL PRACTICE

Practicing physicians live in a dynamic time, where the professional is confronted with a wide range of choices for providing medical services. Very often the pursuit of those choices involves a sale of an existing medical practice, which is sometimes related to the age of the medical staff; the willingness of the physicians to bear the risk associated with practicing in an uncertain environment; practice costs, such as implementing an electronic health record system; increased competition for talent as well as increasing competition between physicians and hospitals; eroding income; pressures associated with extensive regulatory compliance; and difficult insurance reimbursement issues. Both primary care and specialty practices are often acquired by:

- Larger single specialty or multiple specialty groups practices seeking to grow to attain critical mass;
- Public companies or private equity firms engaged in the healthcare industry (an acquisition by this type of purchaser can create corporate practice of medicine issues unless the transaction is properly structured); or
- An affiliate of a non-profit hospital.

As the practice pursues any of those various alternatives, it is important for the participants in the transaction to understand (i) the practice that is being acquired by conducting a comprehensive due diligence examination of that practice; (ii) that the regulated industry in which they operate imposes certain restrictions on the sale/acquisition process that do not apply in an unregulated setting; and (iii) that the failure to comply with applicable regulations in the context of an acquisition and otherwise carries with it significant adverse effects, including fines and penalties.

This article will not treat this complex subject of selling and acquiring a medical practice in detail, but instead is intended to highlight certain issues relating to due diligence, deal structure and other miscellaneous matters.

Due Diligence Examination of the Practice Being Acquired

The purchase of a medical practice is, in many respects, not unlike the purchase of any business. Purchasers in either setting normally want to examine, among other things, general corporate matters, financial information, agreements and arrangements to which the target practice is a party, relationships with employees and contractors, tax matters, environmental matters and overall compliance with the laws governing the organization that is being sold. Even though the seller's compliance with laws is a due diligence concern for the purchaser of any business, it is of heightened importance to the purchaser of a medical practice. Such heightened importance comes as no surprise given the extensive regulatory scheme within which a medical practice must operate.

Whether or not the failure of the seller to comply with applicable laws will result in potential liability to the purchaser is, in part, a function of the deal structure. However, regardless of whether or not the purchaser will succeed to liability, it is important to know whether the seller has complied with the laws applicable to its business. Among other things, it will be an indicator of whether the financial statements of the practice truly reflect its earnings history and the potential of the practice. Certainly, profits obtained by a seller that has not complied with the law are less likely to be achieved on an ongoing basis, particularly where laws are strictly enforced by various governmental bodies having jurisdiction over a medical practice.

With that said, due diligence issues of importance to the purchaser of a medical practice include, among others:

- Will the purchaser be able to get properly credentialed into the third party payor system?
- Are there complaints against physician members of the selling practice pending with the New Jersey Board of Medical Examiners or comparable body in another state?
- Has the seller engaged in fraudulent conduct either as it relates to claims for payment or applications for insurance?
- Is the seller in compliance with the privacy, security and related requirements of the Health Insurance Portability and Accountability Act (HIPAA)?
- Are the seller's accounts receivable being purchased and, if so, are the accounts receivable collectable? The seller should make representations in the purchase agreement as to the collectability of accounts receivable and if it turns out that the accounts receivable are not collectable, provision should be included for an adjustment to the purchase price to be paid for the practice.
- Are the seller's claims for payment for medical services rendered currently being audited by Medicare, Medicaid or another third party payor?
- Have the billing practices to all third party payors been true, accurate and complete and in compliance with all applicable laws?
- Does the seller have any liability for any refund, overpayment, discount or adjustment under any governmental program?

- Is the seller under investigation by any State or Federal governmental agency?
- Has the seller entered into any consent decree, supervisory agreement, settlement agreement or other agreement with any governmental agency or third party restricting or otherwise affecting the operations of the Company (including any entered into since inception which may have lapsed or terminated or which are pending, proposed or under negotiation)?
- Does the seller use medical equipment, operate a licensed health care facility, or provide any services for which licensure, registration, accreditation or prior approval of a transfer of ownership is required?

Deal Structure Affected by Healthcare Regulations

The impact of the vast network of healthcare regulations is initially encountered in valuing the medical practice for sale. The practice cannot sell its patients nor can the purchaser pay for patient referrals. In addition, if the purchaser is tax-exempt or has an existing referral relationship with the selling practice physician, a fair market value analysis of the sale must be obtained. Value cannot be attributed to the patient base and instead the going concern value of a medical practice is premised upon such factors as the practice's staff and relationships in the community. Consistent with this prohibition, payment for the practice must be fixed at the time of sale and paid to the sellers no more than 12 months after the closing of the sale. So called learn out provisions which adjust the purchase price of a selling entity to account for post-closing operating results are prohibited. Any rental of space or equipment or personal service and management contracts entered into between the seller and the purchaser of the practice cannot include payment provisions that are adjusted based upon post-closing patient volume. These prohibitions are derived from a complex set of rules set forth in the Federal anti-kickback laws and regulations, the Federal Stark law and regulations, and the laws and regulations of the New Jersey Board of Medical Examiners. The purchaser will also need to evaluate whether the purchaser's acquisition of the practice will create any issues for the purchaser under New Jersey's Codey law, which deals with physician self-referrals.

Other Issues Requiring Attention

A threshold issue to consider in the purchase/sale of a medical practice is whether or not there is a cessation of the practice by virtue of the sale. If a medical practice ceases to operate, the law requires that each patient of the practice be given notice that the practice will no longer operate. An argument can be made that if the practice is being acquired by a third party, the practice continues and there has been no cessation of the medical practice. Because the question of whether or not the medical practice has ceased to operate is somewhat murky, involving subjective factors, the better course of action is to provide patients with notice of the sale transaction. The Board of Medical Examiners has the authority to impose fines on the selling practice and suspend the license of the physicians that own the practice if proper notice is not given to the patients in connection with a sale that is considered a cessation of the practice.

Another very significant aspect of the sale of a medical practice is how the parties treat patient medical records. It is absolutely essential that the purchaser of the practice be obliged to fulfill the seller's obligation to make medical records available to the patient. The purchaser should be contractually obligated to make the medical records available to patients for seven (7) years following the date of the most recent medical record entry, and, in the case of the records of a minor, for a two year period after the minor has reached age 18. The seller should maintain a right of access to the patient records being transferred for the same number of years so as to be in a position to address payment disputes and/or malpractice claims.

There are many other issues to be addressed in connection with the sale or acquisition of a medical practice, some of which are complex. The information presented in this article is just a snapshot. With the advice of experienced professionals, the difficult issues can be resolved and a transaction successfully completed.

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