

# Preparing Your Practice for Sale

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# Overview

- Motivations for Sale
- Process
- Preparation
- Deal Structure
- Regulatory Issues
- Business Issues
- Execution

# Motivations

- Recruitment challenges
- Overhead and decreasing reimbursement
- Health care reform
- Access to capital
- Perception of greater security
- Reluctance of new professionals to buy-in

# Pros

- Protect incomes
- Help with recruitment
- Avoid hassles of owning a practice
- Practice medicine

# Cons

- Lack of autonomy and independence
- Frustration with inefficiencies
- If the transaction doesn't work, it will be very difficult to “reverse” the deal
- Future financial pressures facing hospitals due to health care reforms and declining Medicaid/Medicare reimbursement; more consolidation likely
- Nonprofit / governmental hospital requirements (e.g., open meeting laws, fair market value compensation)

# Potential Buyers

- Hospitals
- Other practices
- Current employed professionals
- Other
  - Private equity
  - Other management companies

# Process

- Get your house in order – “GYHIO”
- Confidentiality Agreement
- Sign non-binding Letter of Intent (optional)
- Due Diligence (e.g., what contracts will be assigned vs. terminated)
- Negotiate and work on terms of legal agreements
- Approvals
- Execute transaction documents
- Satisfy closing conditions
- Closing of transaction

# Structure Options

- **Stock Purchase**
  - Purchase shares of clinic stock/ownership
  - Capital gain to physician owners
  - Rarely used; Buyer takes on liabilities of Seller (e.g. malpractice claims, bank debt)
- **Asset Purchase**
  - Parties select which assets are purchased/sold and what will be left behind (e.g., accounts receivable)
  - Ordinary income / some capital gain
  - Seller will need to pay obligations from proceeds of sale (e.g., bank debt)



# Asset Purchase

- Types of Assets that might be Purchased:
  - Tangible:
    - Accounts Receivable (if not purchased, then Buyer may collect for a collection fee)
    - Equipment
    - Supplies
    - Fixtures
  - Intangible:
    - Goodwill (e.g. going concern value, assembled workforce and trade name)
    - Covenants not to compete
    - Patient lists

# Stock Purchase

- Potential Benefits
  - Tax ID number
  - Licenses
  - Third party payer arrangements
- Downside
  - All liabilities remain part of acquired practice
    - known and unknown liabilities
    - indemnification provisions might be insufficient

# Regulatory Issues

- Antikickback
- Stark
- Antitrust
- Tax exemption (for nonprofit tax exempt organizations)
- Corporate practice
- Licensing
- HIPAA/Privacy laws

# Antikickback

- It is illegal to offer, solicit, make or receive any payment intended to influence referrals under a federal health care program.
- The government applies the “one purpose” test. If one purpose of the payment is to influence referrals, the payment is illegal.
- Prohibits the payment of anything of value to a referral source in return for the referral from/to a business reimbursable by a governmental program.
- “Sale of Practice” Safe Harbor
  - Applies to physicians retiring or leaving the practice area (no referrals to buyer post-closing)
- Not required to meet a safe harbor

# Antikickback - GYHIO

- Preparing for transaction
  - Review agreements with referral sources
  - Internal policies
- Structuring transaction
  - Earnouts
  - Compensation arrangements

# Stark

- Prohibits a physician from making a referral to a provider for “designated health services” if the physician has a financial relationship with the provider, unless an exception applies:
  - Isolated Transaction Exception
    - FMV
    - Not based on volume or value of referrals
    - Commercially reasonable agreement
    - No additional transactions between the parties for 6 months unless an exception applies (e.g. employment) and certain post-closing adjustments

# Stark - GYHIO

- Preparing for transaction
  - Review agreements with referral sources
  - Internal policies
- Structuring transaction
  - Earnouts
  - Compensation arrangements

# Antitrust

- Consider whether applicable (hospital v. competitor)
- HSR (if applicable)



# Tax Exemption

- No private benefit
- Fair market value
- Governance

# Health Information

- HIPAA
  - PHI may be disclosed in a “sale, transfer, merger, or consolidation of all or part of the covered entity with another covered entity, or an entity that following such activity will become a covered entity and due diligence related to such activity.”
- State Law

# Health Information - GYHIO

- HIPAA Policies and Procedures
- Employee Training
- Security Risk Assessment
- Breaches
- Business Associate Agreements

# Corporate Practice of Medicine (“CPM”) Prohibition

- CPM doctrine prohibits corporations from employing physicians or owning physician practices.
  - CPM doctrine was first introduced at the beginning of the twentieth century by the American Medical Association (AMA) in an effort for doctors to gain better control over the medical profession and to prevent the commercialization of the profession through the introduction of profit-making incentives.
  - Designed to prevent “quackery”

# CPM Prohibition (cont.)

- Most states subsequently adopted the doctrine, primarily through a judicial interpretation of licensing statutes that had its foundation in the public policy considerations originally articulated by the AMA.
- Medical practice acts generally do not explicitly prohibit the corporate practice of medicine.
  - Acts prohibit the practice of medicine by a "person" without a valid license.
- In subsequent decades, the corporate practice doctrine went unenforced in all but a handful of states.

# CPM Prohibition (cont.)

- Potential Ramifications for Violating the CPM Prohibition
  - injunction against continued operation of practice
  - criminal prosecution for engaging in the unauthorized practice of medicine
  - entire arrangement could be declared void

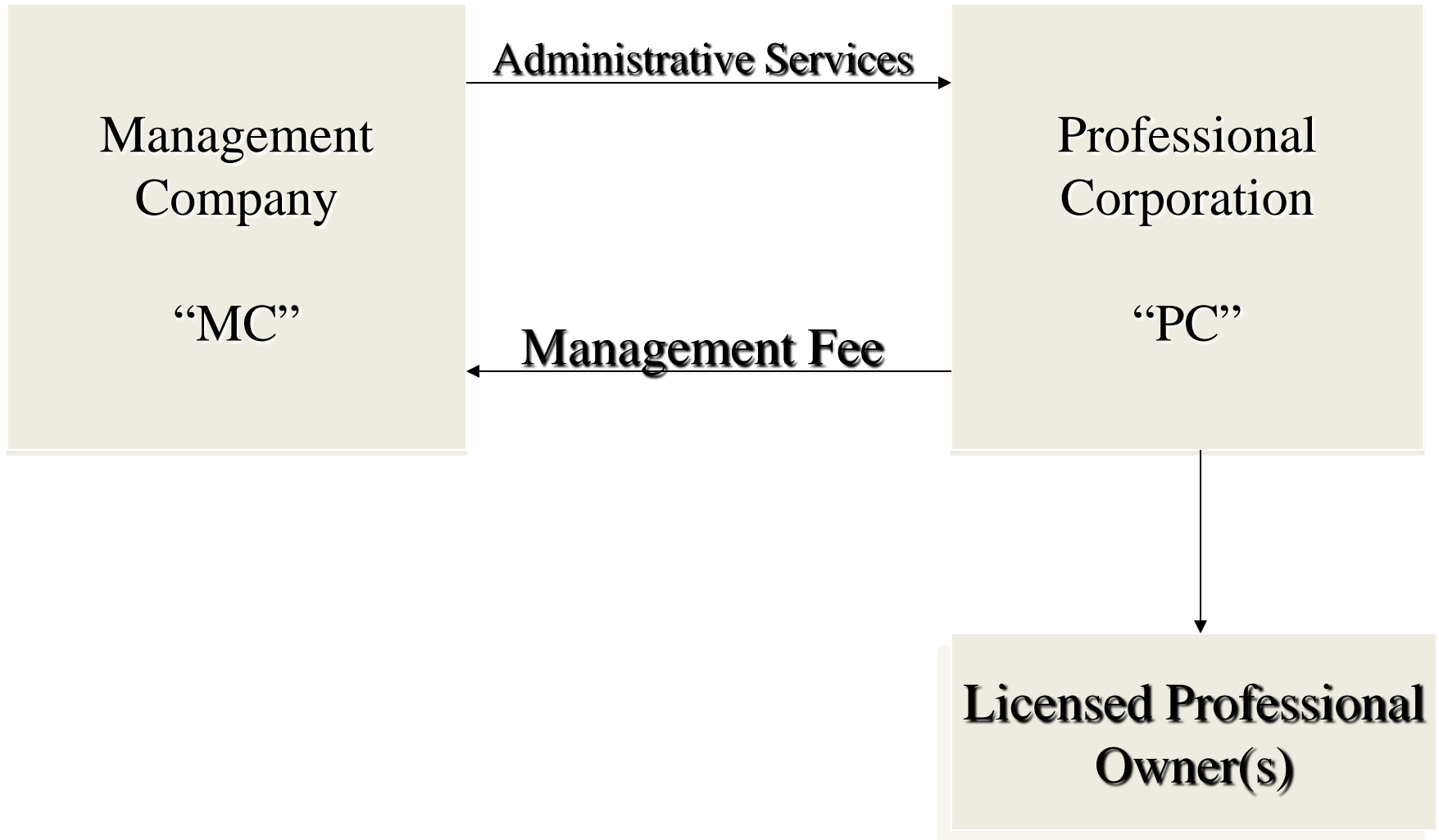
# CPM Prohibition (cont.)

- Potential Ramifications for Violating the CPM Prohibition (cont.)
  - refusal to pay claims
  - loss of “private practice”, “physician office” and similar exceptions from state licensing requirements (CON, lab license, etc.)

# CPM (cont.)

- If state CPM prohibition applies to structure, the management company model may be an option.





# CPM (cont.)

- Management agreement
  - long-term
  - restrictions on termination
  - restrictive covenant
  - management fee

# CPM (cont.)

- Risks with Management Company Structure
  - owners may seek to void the agreement
    - Flynn Brothers vs. First Medical Associates, 715 SW2d. 782 (Tex. App.—Dallas 1986)
    - Orthodontic Centers of Illinois, Inc. v. Christine Michaels, D.D.S., P.C. and Christine Michaels, D.D.S., 403 F. Supp.2d. 690 (N.D. IL 2005)
  - may be viewed as a sham

# Ownership and Governance - - GYHIO

- Stock Records
- Corporate Approvals
- Licenses
- Financials

# Employment

- Physicians and other providers are typically the key attraction
  - Do they fit the Buyer's criteria for employment (e.g. credentialing and privileges)?
  - What if one or more do not want to sell? Buyer will typically require nearly all physicians to sign
  - Key terms include term and termination events, compensation, duties, locations, hours, benefits, time-off (should all be set forth in writing and not subject to change without the professional's consent)
  - Other key terms include change of control provisions (i.e., can the Buyer assign to a new buyer in the future without consent?), governance, covenant not to compete
- Support Staff
  - Is employment of support staff important to Buyer or Seller?
  - Will support staff agree to employment with Buyer?
  - Union issues

# Restrictive Covenants

- Will the Buyer require a covenant not to compete?
- Typically required
- Important to consider if certain events should cause covenant not to compete to become unenforceable (e.g., Buyer decides to sell/merge with another organization)

# Covenants, Representations and Warranties

- Seller makes certain promises about its business in the purchase agreement (e.g., compliance with all laws, no amounts due others)
- If after closing, a representation is not true, Buyer may seek recovery against Seller
- Purchase Agreement may describe limits to liability of Seller and its owners

# Due Diligence – What is this Process About?

- UCC Search of any liens (e.g., bank loans secured by practice assets)
- Contracts that may require third party consents to transfer to Buyer (e.g., computer system, third party payor contracts)
- Leases
- Financial Statements
- Importance of considering Buyer's financial statements and future viability



# Approval Requirements to Sell

- Shareholder/Board approval
- Execution of new physician employment agreements

# Other Key Considerations

- If its not in writing, the promise doesn't exist from a legal perspective.
- People change
- The health care environment is changing rapidly; no one is sure of the future
- New players in the marketplace