Look Before You Leap: Understanding The Ins and Outs of Medical Practice Mergers

By Seth I. Rubin, Esq.

There are many factors involved in a physician's decision to sell his medical practice. The physician may be looking for a glide path into retirement, or a way to expand his practice by joining a larger group of doctors, or to take advantage of synergistic opportunities presented by effectively merging his practice with another. Whatever the reasons for the sale, there are certain things that both sides need to consider before consummating a deal.

Major Deal Terms

Before getting too far down the road in terms of time, energy and expense spent trying to make a deal happen, the parties need to make sure they are on the same page regarding the terms of the deal they expect to make. This is also the time to consult your legal and accounting advisors, so you don't lock yourself into terms that are less than advantageous.

The most basic deal term is the purchase price. It may also be the hardest point on which to obtain agreement, especially before due diligence is completed. At a minimum, the parties need to make sure they are in the same neighborhood regarding purchase price, if not on the same block, before proceeding further.

Once you have an idea of the purchase price, you'll want to determine whether the transaction will take the form of an asset sale or a stock sale. Generally, a seller of a medical practice will seek to sell stock, while a buyer will want to purchase assets. For the seller, a stock sale will result in more favorable capital gains treatment which would allow the seller to effectively achieve a higher sale price. Another significant benefit of a stock sale by the selling party is that all liabilities of the medical practice would attach to the stock being sold, thus freeing the seller from liability (excluding any personal guarantees that may have been given). Naturally, given the potential liabilities, the buyer will need to be convinced that a stock sale is a beneficial way for him to acquire the practice. One argument a seller could make is that a stock sale will permit uninterrupted cash flow, as the buyer can continue using the seller's provider numbers. Another potential advantage for the buyer in a stock deal is that it may permit the buyer to continue a long-term favorable lease for pre-existing office space.

Despite the seller's best arguments, a buyer will, in most cases, insist on an asset deal. In arguing against a stock sale, the buyer will point out the dangers of taking on an existing practice's provider numbers – e.g.., if there are overpayments due to Medicare, the overpayments will be deducted from any new claims submitted by the buyer. In addition, many office leases will deem a change in ownership of stock as an assignment requiring landlord consent; thus, any perceived advantage of a stock sale in connection with the continuation of a favorable lease will be lost. Finally, the most important detriment to getting a stock deal done is that there may be liabilities that only the seller knows about, which even the most comprehensive due diligence will not uncover.

In an asset sale, a buyer will likely seek to purchase all of the seller's assets, including accounts receivables. A seller must take care to exclude any assets that he wants to keep (e.g. items of personal or nostalgic value) and should insist that if a buyer is getting accounts receivables, the buyer must also become responsible for seller's accounts payable. Even in an asset sale, a seller can realize certain tax advantages through an allocation of assets that permits at least partial capital gains treatment for goodwill and restrictive covenants. In the right circumstances, a beneficial purchase price allocation can be achieved as long as such allocation is grounded in reality and can satisfy the IRS.

Due Diligence and Other Protections

Before entering into any transaction, the buyer must conduct appropriate due diligence regarding the seller's medical practice. This will allow the buyer to obtain information about the practice and make an informed decision about whether to proceed with the transaction. Proper due diligence will include searches of public records, examination of material contracts, analysis of financial records, review of insurance records, etc. Due diligence will also let a buyer know what third party consents may be required before a deal can be completed – e.g., landlord consent or consent of a bank or major equipment leasing company. In order to avoid potentially costly mistakes, buyers should conduct due diligence in conjunction with their attorney and accountant.

For additional protection, regardless of whether the transaction is a stock or asset deal, the buyer will receive from the seller certain representations and warranties regarding the seller's practice. These are promises that the seller makes to the buyer regarding the business and will cover everything from seller's due authorization of the transaction, title to assets, tax issues, license issues and a host of other items. In addition, the buyer should insist upon receiving indemnification from the seller to protect against breaches of these representations and warranties, as well as for any unknown liabilities which may arise post-closing.

Post-Closing Employment of Seller

As noted at the beginning of this article, there are a variety of factors which may lead to the sale of a medical practice. Whatever the reason, employment of the selling physician after the closing will almost always be a required part of the transaction. After all, the buyer will want to demonstrate to the seller's patients a continuity of care and service that will keep these patients part of the practice for years to come. Also, the acquiring practice may expect to benefit from additional referrals of patients for its other practice areas now that the selling physician is "part of the family." Additional factors which are all subject to further negotiation are the length of employment, compensation levels, severance and a restrictive covenant limiting the seller's ability to practice in a specified geographic area following termination of employment.

Unwinding the Deal

In any deal, in spite of the parties' best intentions and best efforts to complete the deal in a way that is beneficial to all, there is always the possibility that things simply won't work out. To protect against this, the parties should consider including in their definitive agreements a mechanism which will allow them to unwind (or "un-do") the agreement upon the occurrence of specified events. Of course, it will be easiest to unwind a deal if such a decision is made early on – i.e. within the first 6 or 12 months following the closing. After such period of time, unwinding a transaction can be exceedingly difficult and will necessarily involve landlords, third party payors and other complicating factors.

Taking the Right Steps

In any transaction, whether you are a buyer or a seller, it is important to get your professional advisors involved early in the process. Many times, parties think they will save a few dollars by waiting until the deal terms are agreed to before calling the attorneys and accountants, only to realize that this decision cost them a lot of money in the long run because they lacked professional advice to assist in structuring a more favorable deal. When considering a transaction as important as the purchase or sale of a medical practice, it is best for the physician and his professional team to work together to analyze the specific situation and determine the best course of action.

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