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Why Buyers of Medical Practices Need Professional, Independent Representation

By Ike Devji, J.D. | May 10, 2011

A recurring liability I address in asset-protection planning for doctors surrounds the sale or purchase of a medical practice.

Most conflict and losses that arise from the purchase of a medical practice result from a combination of mismatched expectations between buyer and seller, a lapse in due diligence by either party, or the failure of one of the parties to understand or honor the terms of the sale. These issues often expose sellers to costly litigation that consumes their newfound liquidity and buyers to the loss of their investment and income stream.

Most sales seek to maximize the sale price of the practice for the seller and his agents and brokers. This puts buyers into an environment where he is often left shopping blind, and without the due diligence and fiduciary representation that they might commonly employ in buying a home, as one example. In this analogy the realtor would help you identify a geographically desirable area, help you pre-qualify as a buyer, find a home with your desired features, and help provide comps that will illustrate exactly what the price of the home should be based on the market. Surprisingly, many medical practices of all types are purchased without this same level of due diligence by the buyer.

Fortunately a new emerging specialty in the medical practice sales space involves specialized representation for buyers outside the traditional, seller-oriented business broker channels. I turned to attorney Trisha Lotzer and Ross Landreth of Physis, Inc., a specialty Phoenix-based consulting firm that works in this area, for more insight.

“Mergers and acquisitions in the context of medical and dental practice sales and formations have unique issues and hurdles,” says Lotzer. “What most buyers are presented with is a set of numbers and claims that are often unsubstantiated and either intentionally or unintentionally misstated. Part of the issue is the lack of a clear formula in the marketplace that can adequately account for intangibles like goodwill, a part of most practice sales. Another issue is that determining the validity of claims of revenue is difficult given varying accounting and record-keeping practices.”

Physis provided some startling specific examples of issues experienced in its representation of buyers. In one case, a practice that claimed to have 3,000 case files turned out to have only 1,500 that were active. In another, a doctor’s office that was up for sale stopped marking files as “active” a year before the sale of the practice, drastically reducing the ability of the buyer to understand what they were buying and what its real revenue potential actually was.

“Part of the problem is that buyers often cut a deal to buy a practice largely on their own, involving legal counsel and other professionals only after the deal has been negotiated,” says Landreth.

And Lotzer adds, “That’s true, the buyer’s lawyer typically gets the contract only after it’s been written, largely by the seller and their broker who has a mandate to maximize the sale price of the practice for their client, regardless of actual value. We feel it’s important to both be a part of the negotiation process and help write an agreement that fully supports the intention of both parties and the real numbers.”

It’s important that the numbers and accounting are verified independently, and use real math and commonly accepted accounting and valuation standards including details like the number of active patients a practice claims to have as a source of recurring revenue. This not only makes financing easier to justify and obtain and more realistic, it avoids costly mistakes that inevitably lead to litigation and more expenses for all involved.

It’s important to view this separate representation in the right context, which is not an adversarial but rather a cooperative one. Sellers and their brokers should understand that separate buyer representation, required by law in many forms of legal transactions, will lead to greater surety for all parties. It can reduce seller and broker liability, help brokers find real, pre-qualified buyers more easily, and help ensure that a seller receives all the proceeds of the sale as intended for any sale that’s not an all-cash deal or that involves an earn-out in some form.

Learn more about Ike Devji, JD, and our other contributing bloggers here.