



The Physician's Guide to Selling a Medical Practice

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Introduction

Lawyers who frequently help physicians sell or merge their practices come to discover these transactions are almost always the most significant financial event in their clients' professional lives, and among the most significant events in their personal lives. This article and the accompanying checklist of steps to take will help physicians analyze and prepare for the sale or merger of their practice. The article and list are not comprehensive guidance, *nor are they legal advice to the reader*, and other professionals, such as accountants or brokers, would probably explain things somewhat differently. But we hope this is a useful start for physicians who are thinking about one of the most important things they will ever do.

The theme of this article is simply this: Put your house in order before you start to sell. A seller needs to be well organized and knowledgeable in order to avoid embarrassment, surprise, delay, mistake, and perhaps even the loss of a sale. In the physician's own terms, getting organized is rather like following protocols and meeting the standard of care. It is the best thing to do in its own right, and it puts the physician in the best position to succeed.

Why Sell Or Merge?

A physician practice is different from most small businesses. It is intensely personal, and its revenue comes from the physician's knowledge, skill, reputation, and personality, none of which is really transferrable to the next owner. Consequently, a physician who sells or merges a practice is often not selling in order to retire, but is, instead, selling in

mid-career, when his or her value is highest, in order to change the way he or she practices. The reasons for selling at this time include access to better professional resources and administrative support, greater power *vis a vis* payors, the prospect of internal referrals from within the new organization, greater stability in the face of health reform, and a better balance between professional life and personal life.

Whatever a physician's initial reasons might be for considering a sale, no physician should ever decide to sell unless he or she has identified the specific goals of the sale. You cannot assess the costs you have to pay, and you cannot negotiate a good deal, unless you know exactly what you want out of the sale. Also, you cannot know if your co-owners will join in a sale or thwart it, unless you understand what you want and decide if your goals and theirs are compatible.

This article is written primarily from the point of view of the seller who expects to go to work for the buyer. Of course, most of the considerations also apply to a physician who is selling in order to move or retire. Finally, although this is not its main purpose, much of this article may also help a physician-buyer think about how to acquire a practice.

Who Is Buying?

Here are some common buyers:

1. A new physician taking over the seller's practice.
2. A small group seeking to grow in the same medical specialty or a related specialty.
3. A mid-sized or large group seeking to acquire patients, spread overhead, or move into a new geographic area.
4. A large specialty group entering a new market, for example kidney dialysis, radiation oncology, or anesthesia.
5. A hospital or healthcare system.

Note that we have not mentioned one doctor selling to his or her existing co-owners. That particular transaction should be fully covered by the buy-sell agreement among all the physician-owners of the group.

Who Is Helping To Sell?

As soon as a physician decides to seriously consider selling, that is the time to begin to put together a team of advisors. There are at least two reasons to believe that a professional team will be necessary. One is that the physician may not have much experience in selling a business. A second is that the physician may not have the time or temperament to get involved in negotiating the details of a good deal.

A seller's team will probably come together over time, but eventually it may need to include an attorney, an accountant, a health care consultant, an appraiser, and/or a broker. Any one of these is probably qualified to guide the physician in the early stages of planning, but well before the sale closes, the seller will need at least two or three of them to handle all the parts of the transaction.

Selecting good advisors is not hard, but it requires careful attention. Education, experience and reputation are keys. So is your impression of your ability to work with each potential advisor. Beyond that, keep in mind that the broker may have the greatest self-interest in pushing a sale through. Also keep in mind that most business lawyers, accountants, and appraisers do not have much experience in health care, and that there is no threshold of education or experience to qualify someone as a health care consultant. In light of all this, the seller needs to investigate and interview all advisors carefully and put together a team suited to the seller's objectives.

Who Needs To Be On-Board With The Sale?

In a small practice with several physician owners, each one typically owns an equal share. At the same time, there are often special arrangements that have to be kept in mind. For example, the senior owner may have a veto over some decisions. Or some but not all the practice's owners may separately own the office the practice leases. Or, as yet another example, if one owner prefers to leave and work alone instead of selling and working for the buyer, a non-competition agreement might complicate the situation. With so many variables, it is important to reach consensus among all the owners before beginning the process of selling.

At some point, it will also be important to involve any key managers or employees, keeping in mind that they will be very concerned about how the sale will affect them.

Timing the decision to notify and involve key staff is important and difficult. It must take into account the personalities of the staff members and their personal situations.

Finally, third-party contractors such as a management company or landlord may sometimes need to be involved early in planning the possible sale of a practice.

What Is For Sale?

There are three ways to sell a practice. First, you can sell the entire practice by selling its stock, if it is a professional corporation, or by selling its membership interests, if it is a professional limited liability company. In either case, the buyer acquires the assets *and* the liabilities, and the company that is sold continues to exist and is operated by the buyers. Second, you can sell some or all of the practice's assets while you (the seller) continue to own the stripped-down version of your original company. In such an asset sale, the buyer acquires only the assets, and the liabilities stay with the seller, who will still have to pay them. This, of course, makes an asset sale especially attractive to buyers, but less so to sellers. Finally, the seller can merge his or her practice into the buyer's practice so that the seller's company disappears, while the buyer's company continues in business with the combined assets and liabilities of both original practices. If two small physician practices want to combine into one, which will employ all the physicians, the buyers and sellers alike, merger may be an option.

No matter the form of the sale, several kinds of assets typically go to the buyer: tangible assets such as land, buildings, and equipment; cash and equivalents such as money in the bank and accounts receivable; and intangibles, principally good will. In medical practices, tangible assets are often owned by a separate entity, such as a regular limited liability company, and leased to the practice. If a separate entity owns the real estate or expensive medical equipment, then it may be a second seller in the transaction. In any event, the seller needs to be clear with the buyer about exactly what can be and is being sold.

What Is The Price?

Early on, the sellers need to calculate the price for the practice. There are two reasons why this is important. The first is that selling physicians may decide it makes more financial sense to operate the existing practice than to sell it. The second is that the

sellers need to know what the practice is worth in order to negotiate with potential buyers.

In the sale of a practice, and especially if the selling physicians will continue to practice for the buyer, state and federal anti-kickback and anti-referral laws *require* that the sale price be for fair market value without regard to the value of future referrals. This is mandatory, so *it is essential to document fair market value*. However, even though the sale must be for fair market value, FMV is any price within a range of reasonable prices, and the seller is free to negotiate the highest possible price within this range. An appraiser or broker can help here, and one way for the appraiser or broker to help is to prove (not just assert, but prove) a high value for the goodwill of the practice.

Goodwill is a poorly understood concept among most physicians and lawyers, and even among some CPAs and MBAs. But one way to look at it is to say it is the value of the practice over and above its tangible assets (including cash, cash equivalents, and A/R). This, of course, is a bit vague, so let's be more specific about what gives this extra value to the practice, beyond the value of its tangible assets. A September 15, 2008, article in the AMA's American Medical News lists the following elements of goodwill: (i) location; (ii) payor mix, A/R, and collection rate, not as a pot of cash in hand, but as a predictor for the practice's financial future; (iii) competitors in the market; (iv) the practice's reputation; and (v) the effect of the anti-kickback and anti-trust laws. Looking specifically at item (iv), we should add that part of the practice's reputation is personal to the physician-owner, and while that value is real, it cannot be transferred to anyone else, so it is not going to be part of the goodwill value within the sale price unless the seller is going to work for the buyer.

How shall a seller use these elements of goodwill? The short answer is to get the best price within reason, without exceeding FMV. Obviously, reasonable people can disagree about the value of these factors, so there is room for negotiation between a willing seller and willing buyer. But equally obviously, some estimates of goodwill are too large or too small to be reasonable, and, therefore, are simply wrong. It is important for the seller to know early on where the reasonable price ceiling is, and the reasonable floor.

Like price, payment terms are also negotiable. They can take many forms, and they can have various tax consequences for both parties. A discussion of financing and taxes is beyond the scope of this article, but both should be considered early in the sale process.

What Needs To Be Done After A Prospective Buyer Appears?

Once there is a potential buyer in the picture, the first thing to consider is signing a non-disclosure agreement (“NDA”) between the prospective seller and buyer to insure confidentiality throughout the talks and afterwards, whether or not there actually is a sale. This NDA may or may not include a “stand still” clause requiring both parties to be true to each another and not court other possible partners while they are talking.

The NDA may be followed by a letter of intent (“LOI”), which will certainly include a stand still provision and should set out the basic terms of the deal and establish a time line to complete the parties’ investigation of one another (their “due diligence”) and either close the sale or walk away.

What Should The Seller Expect From The Buyer?

Once the seller has a serious potential buyer, the process proceeds in three stages. They are due diligence, negotiation, and formalizing (documenting) the decisions reached. In principle, these are consecutive steps, but in practice they overlap with a lot of back-and-forth between the parties.

During due diligence, the seller can expect the buyer to want to see the seller’s business entity’s documents, important deeds and contracts, loan documents and security interests, financial statements, billing and collection results, and tax returns. The seller may want to see some of this material from the buyer as well, especially if the seller is going to work for the buyer or if the buyer will pay the sale price over time out of operating income.

Negotiations can be short or long, simple or complicated. The seller may well want to leave them in an advisor’s hands, both as a way of getting the best deal and as a way to avoid lingering irritation after the sale is complete. In any case it is essential that the seller have all the key elements of the deal in mind when the negotiations begin. Raising new matters at the last minute can be a deal-breaker.

Documenting the sale is a key concern. Whatever may have been discussed and understood during due diligence and negotiation, the seller should assume that the final documents are the only binding explanation of the deal. If they are unclear or incomplete, some important part of the sale may be unenforceable and lost to the seller.

There is a second and equally important reason to document the sale carefully and completely. The sale of a physician practice and any subsequent relationship between the seller and the buyer must comply with the federal anti-kickback statute and Stark law and their state equivalents. The transaction documents are essential evidence that the parties complied.

Clearly, at this stage the seller and the buyer need to be represented by experienced business and health care lawyers. But really counsel ought to be involved much sooner in order to prevent missteps that would otherwise have to be corrected later.

What Must Be Done Because This Is A Physician Practice?

Because this is a physician practice, there will be other things to consider doing. It may be necessary to store or dispose of the seller's patient records. It may also be necessary to notify past and present patients by letters or public media. In some cases, it may be necessary for the seller to be credentialed by new payors, hospitals, or other provider entities. All this needs to be investigated early and done in a timely way.

Check List

Following this article is a checklist of items and topics that the parties will probably want to examine or discuss as part of a sale.

Conclusion

This article is, as we said, not comprehensive, and it is certainly not legal advice. But it should be helpful to physicians who want to sell or buy a practice. Anyway, we hope so.

This article was prepared by
the health care and business lawyers
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PHYSICIAN SELLER'S CHECKLIST

	Responsible Person	Due Date	Status & Notes
Items to Do			
I. Initial Matters			
A. Identify Reasons to Sell and Objectives			
1. Financial			
2. Personal			
B. Select Outside Advisors			
1. Attorney			
2. Accountant			
3. Others			
C. Identify Needed Collaborators			
1. Other physician-owners of seller			
2. Non-owner physicians of seller			
3. Key employees of seller			
4. Seller's key third-party contractors			
II. Consider Potential Buyers			
A. Physician group			
1. Similar to seller			
2. Larger than seller			
3. Specialty group			
4. Multi-specialty group			
B. Hospital or health system			
III. Compile Seller's Key Documents			
A. Articles of Incorporation or Organization			

	Responsible Person	Due Date	Status & Notes
B. Bylaws or Operating Agreement			
C. Shareholders' Agreement			
D. Minutes & Resolutions by Consent			
E. ACO, IPA, and Similar Agreements			
F. Leases: Realty and Equipment			
G. Management Agreements			
H. Payor Contracts			
I. Employment Agreements			
J. Corporate Compliance Plan			
K. Loan Documents			
L. Supplier & Service Contacts			
M. Financial Statements			
N. Tax Returns			
O. Insurance Policies			
P. Intellectual Property Licenses			
IV. Next Steps			
A. Get Appraisal: Assets & Liabilities			
B. Identify Possible Buyer			
C. Sign Non-Disclosure Agreement			
D. Sign Letter of Intent			
V. Key Issues to Resolve with Buyer			
A. Assess Buyer's Soundness			
1. Reputation			
2. Experience operating physician practices			
3. Business/professional culture			
4. Financial strength			
5. Buyer's management team			
6. Buyer's management agreements			
7. Leases & licenses			

	Responsible Person	Due Date	Status & Notes
8. Compensation formula			
9. Compliance plan (if any)			
10. Integrity agreement (if any)			
11. Actual regulatory compliance			
12. Litigation history			
B. Establish Seller's Relationship with Buyer			
1. Owner, employee, or independent contractor			
2. Compensation: FMV			
3. Benefits			
4. Work location			
5. Work schedule			
6. Professional liability insurance			
7. Termination of employment			
8. Non-competition terms			
9. Business/management role with buyer			
10. Ownership of related assets			
C. Choose Form of Sale: Stock, Asset, or Merger			
1. Identify assets excluded from sale			
2. Consider tax implications			
D. Price			
1. Determine fair market value			
2. Document FMV			
3. Method of payment: cash, note, other			
4. Security for payment			
5. Calculate tax consequences			
E. Resolve Seller's Outstanding Obligations			
1. Loans to retire			
2. Liens and security interests to terminate			
3. Leases & licenses to assign or terminate			

	Responsible Person	Due Date	Status & Notes
4. Contracts to assign or cancel			
5. Obligations to departing employees			
6. Collection of accounts receivable			
7. Maintain clinical and business records			
8. Settle tail coverage			
F. Seller's Health Care Issues			
1. Disposition of patient charts			
2. Notice to patients			
3. Credentialing with payors			
4. Credentialing with hospitals, etc.			
5. Others			
G. Seller's Employees			
1. Who will go to work for buyer			
2. On what terms			
3. Settle benefits for departing employees			
H. Other Negotiation Issues			
1. Seller's fees			
2. Seller's covenants, reps & warranties			
3. Buyer's covenants, reps & warranties			
4. Indemnification			
5. Limiting seller's liability			
VI. Poison Pills for Both Seller & Buyer			
A. Regulatory Matters			
1. Pending Audits			
2. Stark Problems			
3. Anti-Kickback Problems.			
4. Compliance Agreement Violations			
5. Licensing Board Matters			

	Responsible Person	Due Date	Status & Notes
6. Medical Staff Privileges Matters			
7. False Claims Issues			
B. Litigation			
1. Professional Liability Cases			
2. Business Litigation Cases			
3. Employment Cases			
VII. Prepare and Review Closing Documents			