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## Physician Planning Series

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### PURCHASING A MEDICAL PRACTICE

The process of purchasing a medical practice is similar to that of the purchase of any other business. This typically involves negotiation of the terms of the purchase and completing the purchase pursuant to definitive agreements, such as a purchase agreement, employment agreement and other transaction documents. There are, however, nuances unique to the purchase of a medical practice that need to be considered.

#### Corporate Practice of Medicine

In New Jersey, all purchasers of a medical practice must be duly licensed physicians. New Jersey, as well as other states prohibit what is generally referred to as the “corporate practice of medicine.” The doctrine specifies that medical services must be provided through individuals licensed to practice medicine, whether directly or indirectly through a professional corporation in which all owners are so licensed. In other words, non-licensed individuals generally cannot own medical practices. The rationale for the doctrine is that the public is best-served when physicians are in control.

#### Asset and Stock Purchases

Transactions that are structured as acquisition of assets, rather than stock, generally provide the purchaser with two benefits. **First**, the acquisition of assets reduces the risks that liabilities will be assumed by the purchasing entity. By contrast, all liabilities are effectively assumed if the transaction is structured as a stock purchase. **Second**, the purchaser is able to allocate the purchase price among the purchased assets, which in turn will be depreciated and provide an income-tax deduction for the purchaser. In a purchase of assets, the acquired assets, including the purchase of physician medical records, practice trade name and telephone numbers, must be clearly identified.

#### The Physicians

One of the most significant “assets” are the physicians themselves. Often, patients will follow a particular physician without regard to location, especially with certain specialties. Thus, it is imperative that a purchaser obtain an employment agreement from each employed physician at the practice to ensure that transition of the practice to the purchaser and to maintain continuity of patient care. The employment agreement also must contain a restrictive covenant that prohibits the physician from practicing medicine during the term of employment other than through the purchaser, and for a specified period after the termination of employment within a certain geographic area, as well as prohibits the employed physician from

soliciting patients, referral sources and employees. Upon termination of a physician's employment with the practice, the physician should also be required to resign his or her privileges at all hospitals within the restricted geographic area.

Without such restrictions, physicians may leave the practice, open a new practice in the vicinity of the purchaser's location, and solicit patients, employees, thus reducing the value of a practice and in some cases even rendering the practices worthless.

### **Office Location**

Just as a patient may identify only with a physician, and "follow the physician" a patient is often only concerned that the location of the practice be in close proximity to his or her office or home. Thus, it is imperative that the purchaser assume the seller's office lease or enter into a new office lease that adequately governs the use and occupancy of the office location for a substantial time in the future. It is recommended that the purchaser obtain from the landlord an exclusivity for the physician's specialty.

### **Pre and Post Purchase Notices**

As with all acquisitions, a good marketing campaign is just before or immediately after consummation of the transaction. In the context of medical practices, notices sent to current and former patients are at the core of any such marketing campaign. The notice should include reassuring descriptions of the purchaser's medical ability and similar medical philosophies and reaffirmation of medical care. New Jersey does not require formal notification in the context of the sale of a practice (although there are regulations relating to the continuity of patient care). A purchaser will want the seller to be involved with the notification and marketing process. In addition, in-person introductions to patients leading up to and possibly after the closing should be part of the transition process.

### **Conditions to Closing**

It is not unusual for the closing of a sale transaction to be subject to the satisfaction of certain pre-closing conditions. Conditions, such as employment agreements and leases have already been identified above. Unique to the medical industry is the ability to bill government payors (Medicare and Medicaid) and private third-party payors for medical services performed. Before being paid for medical services performed, a practice and its physicians must obtain the approval of each third-party payor in which they are a participating provider – i.e. credentialing. The credentialing process can take a matter of days in the case of some private payors, two weeks or months in the case of government payors. These approvals should therefore be considered as pre-closing conditions. The speed at which the credentialing is obtained and the payor changes its records to reflect the new owner will have a significant effect on cash flow.

### **Cash Flow**

In the context of the acquisition of a medical practice, the cash-flow issue often is addressed in two ways by the purchaser – by the borrowing or the outright purchase of the seller's accounts receivable and/or obtaining third-party financing. Each scenario raises several concerns. In the case of a purchase of accounts receivable, representations must be given regarding collectability and a post-closing adjustment to the purchase price will need to be

included for deficient collections. It may also be appropriate that the purchaser charge the seller a billing-and-collection fee. As a patient may owe the seller for pre-closing services as well as the purchaser for post-closing services, a method of allocation of collected amounts will also usually be needed.

### **Malpractice Insurance**

Malpractice insurance has become a significant issue in New Jersey due to the rise of premiums. This has affected almost every medical specialty. It is imperative that the purchaser carefully scrutinize the seller's malpractice premiums, especially if the purchaser is acquiring the ownership interest of the selling physicians (rather than the assets). Malpractice insurance can be characterized as occurrence-based, which will cover a claim against a physician if the underlying action to the claim occurred during the policy period (even if the claim was asserted after the policy expired), or claims-made, which will cover a claim against a physician only if the policy is in effect at the time the claim is asserted (which can be effectively converted into an occurrence policy by the acquisition of a "tail/prior acts" liability insurance policy). Regardless, all policies must be reviewed for existing and former employees to ensure the purchaser is not assuming (directly or indirectly) and malpractice claims.

### **Conclusion**

It is essential that a purchaser of a medical practice consult with experienced attorneys, accountants and other professional consultants - as the engagement of skilled professionals will help you ensure a smoother transition and eliminate unexpected consequences.



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