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IN PRACTICE

HEALTH CARE LAW

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Patients For Sale

Selling or acquiring a medical practice raises unique legal issues

Selling a medical practice is similar in many ways to selling other businesses. The process begins with rudimentary discussions about the proposed transaction; moves through the due diligence process; proceeds to the negotiation and execution of an acquisition agreement and concludes with the closing and closing-related actions. However, selling or acquiring a medical practice raises certain unique issues.

In New Jersey, the "Corporate Practice of Medicine Doctrine" governs ownership of a medical practice. This doctrine prohibits unlicensed individuals or entities from practicing medicine. Put another way, the owners of a practice must all be licensed physicians. Historically, the doctrine arose out of fear that general corporations, driven to increase the "bottom line," would unduly influence physicians and their medical decisions with the provision of unnecessary health care (or too little care) as a result. Before beginning the negotiation process, it is useful to ascertain whether the purchaser is legally permitted to acquire and operate the medical practice.

The "goodwill" of a practice helps determine its value. This is a nebulous term that reflects the value of the practice as a going concern and takes into account many items that are not quantifiable. Often, the goodwill component is derived principally or solely from the reputation of the physicians and the practice's patient list and comprises most of the "value" of the practice.

As with most potential transactions, the first step in the sale of a medical practice is usually the elementary discussions regarding the practice's operations. During these discussions, the patient list is disclosed, the seller is given access to the physicians and other employees, and the physicians' compensation packages are disclosed. A purchaser often interviews the physicians and may develop a relationship with them prior to entering into the acquisition agreement.

These disclosures, however, expose the seller to the risk that the purchaser may solicit the patients and hire the physicians, effectively acquiring the practice for free. Accordingly, the seller should insist that a confidentiality agreement be entered into before any information is disclosed, prohibiting the purchaser from using the information (specifically the patient list) or soliciting any employee of the practice (specifically the physicians). A confidentiality agreement that adequately protects the confidentiality of patient health information will satisfy the requirements of the privacy regulations adopted pursuant to the Health Insurance Portability and Accountability Act of 1996.

It is important that the parties recognize the regulatory landscape governing the practice, the medical services provided by the practice and the equipment the practice will use when providing such services. The medical profession is highly regulated and there are numerous federal and state regulations that must be reviewed, including fraud and abuse laws, anti-kickback laws and self-referral laws (the Stark law on the federal level and the Codey law on the state level). Accordingly, a thorough regulatory analysis of the proposed transaction must be conducted.

The parties should also make sure that the purchaser has obtained, prior to closing, the necessary approvals, known as credentialing, from all (or at least the significant) third-party payor programs (insurance companies and other reimbursement programs) in which it intends to participate. Prior to receiving remuneration for medical services performed, a practice and its physicians must be approved by each payor. This process can take weeks or even months. If the seller is receiving payments from the purchaser after the closing, it must make sure the purchaser has obtained such approvals so

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the purchaser is in a position to bill and collect for its services. Similarly, a purchaser will want to make sure it can bill and collect for its services before acquiring the practice.

One of the most significant provisions to a purchaser relates to the post-closing restrictive covenants which bind the physicians — both the selling-physicians and the employed-physicians. Often, the real worth of the practice is derived from the physicians themselves. A restrictive covenant may prohibit the physicians from engaging in the practice of medicine within a certain geographic radius of the office and/or hospitals at which they have privileges, and prevent them from soliciting patients which they previously treated or physicians which previously referred them patients.

Some or all of the selling-physicians may continue performing services for the purchaser after the closing. This may be for a variety of reasons. The purchaser may not have enough physicians to treat all of the patients without the selling-physicians. The purchaser may need the selling-physicians to introduce the patients to the new owners, to assist in the collection of accounts receivable or to assist in the transition of the practice. In this context, all issues which arise in an employer-employee relationship must be discussed and agreed upon. Significantly, the relationship must be examined to ensure that it complies with all regulatory requirements.

New Jersey generally does not require that written notice of the sale of the practice be sent to the patients. However, the seller must ensure that the Board of Medical Examiner's requirements set forth at N.J.A.C. 13:35-6.22 concerning the termination of a physician-patient relationship are not violated in any manner. In addition to such concerns, the purchaser often wants some type of formal introduction to the patients of the practice to preserve the continuity of the business. This can be done by the selling-physicians if they are employed by the practice after the closing.

Alternatively, or in addition to such introduction, the purchaser may want a written notice sent to some or all patients notifying them of the sale of the practice and assuring them of their continued treatment. The parties should decide whether notification is made before or after closing and whether the seller or the purchaser pays for the notification, and incorporate the terms into the acquisition agreement.

Will the accounts receivable be retained by the seller or sold to the purchaser? If it is to be sold, common accounts receivable-related provisions, such as a representation of their collectability and a post-closing adjustment of the purchase price for deficient collections, may be appropriate. The parties must ensure that the Medicare reassignment restrictions are not violated.

On the other hand, numerous issues arise if the seller is to retain the accounts receivable. Initially, who is collecting the accounts receivable that relate to pre-closing services, the seller or the purchaser? If it is the purchaser — who may be in a better position to perform the collection services — the seller may pay the purchaser a collection fee. If it is the seller, the seller may need access to the premises post-closing to use the computers and/or the billing staff, and again, a fee may be appropriate. The parties must determine the method of allocating money that is paid after the closing from a patient or his insurance company in the event both the seller, during the pre-closing period, and the purchaser, during the post-closing period, perform services on behalf of such patient. It can be applied to the seller or purchaser as directed by the patient or the explanation of benefit from the payor or as otherwise agreed to by the parties.

The purchaser typically analyzes the malpractice insurance policies that are maintained on behalf of the physicians of the practice. Malpractice insurance generally is characterized as either an occurrence insurance policy or a claims-made insurance policy (which can be effectively converted into an occurrence policy by the acquisition of a "tail/prior acts" liability insurance policy). If the purchaser is acquiring the ownership interest of the selling-physicians and continuing to practice through the selling-physician's former entity and/or continuing to employ the seller's physician(s), she will want to make sure that all current physicians are adequately insured and all former physicians were covered by an adequate occurrence insurance policy or a claims-made policy with a "tail/prior acts" liability insurance policy.

Selling a medical practice is similar to selling a business outside of the medical field in many respects. However, as with other industries and professions, the sale of a medical practice has its own unique features. Understanding them will assist you when representing your physician client. ■