Hospital Acquisition of Physician Practices
What is driving physician practice acquisitions?

- Reimbursement declines in certain specialties leading to decreased physician compensation
- Healthcare reform requiring physicians and hospitals to measure and report quality and efficiency
- Threat of bundled payments and integration of payments as well as ACOs
- Physician inability to expand net income
- Capital costs of installing EHR/EMR/other capital costs to expand
- Hospitals are the primary purchasers today, but many large practices are acquiring smaller practices for similar reasons
What is driving physician practice acquisitions?

PHYSICIAN ECONOMICS ARE GOING IN THE CRAPPER!!!!!!!
Possible Physician Benefits

- Money Issues:
  - Income guarantee
  - Signing bonus
  - Sale of assets
  - Assumptions of liabilities
- Insulated from business risks like HR, Stark Laws, etc.
- Possible lower insurance risks for Med Mal
- Ability to “cash out” as partner/physician transition
- No need to “buy in” as non-partner
- Better benefits?
- Increased ability to recruit
  - Use system’s pocketbook to fund new hires
  - Can generally afford to pay better to compete in marketplace
- Better ability to survive swings in economic and political changes
Physician Problem Areas

- Issues of Autonomy/Loss of Control
  - Strategy, direction, vision
  - My partners
  - Management/implementation
  - Compensation
  - Support staffing
  - Ancillaries
  - Technology
  - Quality of life

- Need to work from within the system
- Need to partner with other physicians – now as pseudo-partners
Physician Problem Areas

- Many times benefits are not as good
- Lose identity as a private practice
- Possible impact on referral sources
- Future loss of control over compensation
Physician Opportunities

- Potential for better contracts
- Ability to add new physicians with limited costs to existing partners
- Access to capital for expansion, capital purchases, EMR, technology
- Can participate in economy of scale areas: rent pools, lab, imaging...
- Potential to tie income to items other than revenue: RVUs, Industry Avg...
- Transition strategy
Possible Future Problems for the Physician

- What if this does not work, ability to opt out/ability to roll back to the original practice setting
- Changes in hospital/system administration
- Changes in government regulation
- Strategic plan changes for system to detriment of physicians
Benefits to the Hospital

• Increased coordination of care and quality oversight
• Additional negotiating leverage with insurance payors
• Opportunity to better manage and control physician productivity and utilization of hospital and system resources and facilities
• Ability to better market and brand major service lines (i.e., cardiology, oncology, etc.)
Benefits to the Hospital

• More efficient management of call and emergency coverage schedules
• Defense against competition from physician-owned ancillary services, surgery centers, and other facility provider services
• Relief from certain regulatory restrictions regarding hospital/physician relationships and prohibitions on managing physician referral practices.
  – This factor is an important one, as under both Stark and Anti-Kickback, hospitals and other designated health service providers are permitted to require referrals from their bona fide employees subject to certain limitations surrounding patient choice, insurance limitations, and appropriate care.
Typical Process

1. Sign Confidentiality Agreement
2. Valuation of the Practice
3. Due Diligence by all Parties
4. Sign Letter of Intent (Non-Binding)
5. Draft Documents and Negotiation
   1. Asset Purchase Agreement, Stock Purchase Agreement, or Merger Agreement
   2. Physician Employment Agreements
   3. Leases (with acquired group or third party parties)
6. Obtain Hospital Board Approval (if necessary) and Physician Shareholder
7. Approval
8. Sign Transaction Documents
9. Obtain third party assignments and consents
10. Physician medical staff and payor credentialing
11. Implementation
Key Issues

- Practice Valuation
- Physician Compensation
- Implementation/Governance
Practice Valuation

- What assets will the hospital acquire
  - Will goodwill be included?
- Regulatory issues to be aware of
  - Anti-Kickback
  - IRS private inurement
- Valuation Methods
  - Income approach
  - Market approach
  - Asset approach
Stark II regulations states, as follows:

- “Fair market value means the value in arm’s length transactions, consistent with the general market value. “General market value” means the price that an asset would bring as the result of bona fide bargaining between well-informed buyers and sellers who are not otherwise in a position to generate business for the other party, or the compensation that would be included in a service agreement as the result of bona fide bargaining between well-informed parties to the agreement who are not otherwise in a position to generate business for the other party, on the date of acquisition of the asset or at the time of the service agreement. Usually, the fair market price is the price at which bona fide sales have been consummated for assets of like type, quality, and quantity in a particular market at the time of acquisition, or the compensation that has been included in bona fide service agreements with comparable terms at the time of the agreement, where the price or compensation has not been determined in any manner that takes into account the volume or value of anticipated or actual referrals.” (Federal Register, Vol. 69, No. 59, March 26, 2004, page 16128)

Valuation Note: This may restrict and prevent the use of certain market comps
Defining Commercial Reasonableness

Stark I regulations state, as follows:

- “With respect to determining what is “commercially reasonable,” any reasonable method of valuation is acceptable, and the determination should be based upon the specific business in which the parties are involved, not business in general. In addition, we strongly suggest that the parties maintain good documentation supporting valuation.” (Federal Register, Vol. 66, No. 3, January 4, 2001, page 919)

Also, Stark II regulations state the following:

- “An arrangement will be considered “commercially reasonable” in the absence of referrals if the arrangement would make commercial sense if entered into by a reasonable entity of similar type and size and a reasonable physician (or family member or group practice) of similar scope and specialty, even if there were no potential DHS referrals.” (Federal Register, Vol. 69, No. 59, March 26, 2004, page 16093)
Practice Valuation

Sticky Areas – Asset Valuation

• Medical Records
• Workforce in Place
• **Must Meet Stark Fair Market Value Compensation Exception**
  - Applies to any physician or group of physicians (regardless of whether
  - the group meets the definition of a “group practice”
  - Must be in writing (signed by parties)
  - Must specify the timeframe (can be less than one year, but only one agreement for
    the same goods or services in the same year)
  - FMV, set in advance and not related to volume or value of referrals

• **Compensation Structure**
  - Base Salary/Income Guaranty
  - Productivity-Based Bonus
  - “Ancillary Services” Revenues – Often includes DHS. May not be able to divide these
    revenues as the physicians previously had.
  - EMERGING ISSUE – How to reward for “clinical quality”
Physician Compensation

- Employment Contract Issues to Address
  - Restrictive covenant
  - Malpractice tail premium
  - Termination
  - Physician duties
  - Employment benefits
Implementation

- What’s going to happen to the administrator?
- Everyone going to keep their jobs?
- What office procedure changes will the hospital make to the practice?
- How will the office be managed post-transaction?
- How much “say” will the physicians have in present and future integration strategies?
How does your practice philosophy fit with the hospital’s care philosophy? Nonprofit hospitals have a charitable mission to fulfill and that mission must, in many cases, take precedence over profitability. Many physicians used to running a lean private practice may find it difficult to adjust to a nonprofit way of thinking.

How does your practice fit into the hospital’s strategic plan? Before making the leap, find out what kind of marketing and development resources the hospital is willing to commit to your practice. Will they relocate your office(s)? Will you get a prime location in the new MOB or be in the basement? Support commitments should be spelled out clearly in the transaction documents so that promises are not forgotten if and when a new administration comes to town.
Factors to Consider Before Affiliating With a Hospital

**Will the hospital’s IT work for your practice?** An electronic medical record system that works well for a hospital may not be ideal for a physician practice. Before committing, get to know the hospital’s IT and make sure you can live with it.

**Are the financial expectations clear?** Many hospitals are avoiding large base salary guarantees in favor of productivity-bases compensation arrangements. Before signing on the dotted line, make sure you understand how your compensation will be determined and whether it is reasonable in light of your specific market and the past performance of your practice. If the hospital will allocate expenses to you, be sure expense categories are clearly defined and consider making a budget part of the transaction documents to avoid future surprises.
Where will you be in three years? Consider that most hospital employment arrangements have a term of not more than three years. Even if the initial deal you strike is too good to pass up, be prepared for changes when the contract is up for renewal.

Finally, what happens if things don’t work out? One of the most important things you can do is build an escape hatch into your arrangements which will allow you to return to private practice if one or the other party is unhappy with the deal. An unwind provision may be tied to specific financial or development milestones or can simply be exercisable by either party if they determine that the arrangement is undesirable.
WHAT CAN THE HOSPITAL DO FOR YOU THAT YOU CAN’T DO FOR YOURSELF?

This is why strategic planning is IMPORTANT for any medical practice of any size!
Questions

Reed Tinsley, CPA
www.rtacpa.com
reedt@rtacpa.com