Considering Selling Your Practice? Here's What You'll Need to Share

There can be no secrets in negotiations to sell a practice. Even if the other side is inadequate in their due diligence, you have to be cognizant of lawsuits for fraud if misrepresentation ever comes to light. Here's what to think about before initiating a dialogue.

BY RON LEBOW, ESQ.

Any dermatologist considering selling a practice, whether to another dermatologist, a hospital group, or a private equity investor, should be aware that she or he will not necessarily be able to hide any issues. Once the initial confidentiality and non-disclosure agreement is reached, the buyer will have the right to access to all the records associated with the practice. Therefore, when practice owners ask if there is anything they should hold close to the vest when they begin conversations with a potential buyer, I tell them to be forthcoming with records and answers to questions. However, there are a few caveats.

Relative to other medical specialties, dermatology is a low-risk area. But practices may run afoul of the law when it comes to use of laboratories, improper independent contractor relationships, or inflating profits with aggressive tax deductions. The important thing to do is to assess your actions before you initiate a conversation and open the books and to identify and correct any issues so you can be prepared to respond to them. If "clean up" is possible before review begins, then that's even better.

LABORATORIES

Although most practices abide by the law, some practices do not use their labs properly or may be engaged in fee sharing arrangements that are inappropriate. A few specific scenarios seem to recur and warrant scrutiny. While it is permissible and, in fact, somewhat common for physician-owned or practice labs to exist, in some instances the labs are shared amongst multiple legally separate practitioner entities sharing the same space. This could run afoul of laws governing the use of physician-office laboratories (which are supposed to be used for a single Tax ID only) or potentially even the so-called Stark Law (a Federal law for Medicare and Medicaid governing when labs can be used by a single practice, which has State equivalents for private pay and insurance). Very commonly, Mohs practitioners utilizing the lab (and others) are also treated as independent contractors, and the percentage (%) splits with them can be interpreted as kickbacks, both for Medicare/Medicaid and at the licensure level governing paying commissions for referrals.

First Thing First: The NDA

No private or confidential information should be discussed until a non-disclosure agreement (NDA) is in place. This NDA serves to protect the practice from having certain sensitive information shared publicly. This includes financial details that the practice would not want to potentially reach competitors and information that owners may simply prefer to keep private.

As with any legally binding document, do not sign an NDA without having your lawyers review it first. Do not sign an NDA supplied to you by the other party without review.

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In some cases, the lab may be out-of-network. Practices have to be cognizant that many states and insurance companies are cracking down on out-of-network billing. This is particularly true if the practice is waiving co-insurance obligations, which are designed to cause the patient more financial "pain" by forcing them to pay more if they go out of network. In essence, if the co-insurance obligation is never balance billed or chased, then the dollar amount on the claim form that the practice says they want from the insurance company is overinflated, because they incorporated the co-insurance dollar amount into that claim form. That makes the claim form a lie, and, accordingly, fraud. The laws and case law, among other requirements, have specific requirements for notice to patients before agreeing to use their out-of-network benefits for lab services operated by the practice. Transparency and patient choice are paramount.

Recent Federal enforcement raids have focused on practices that were in particular serving heavy Medicaid populations. Don't let a buyer bring up any of these issues as a way to undercut the price for your practice—or worse, as a reason to back out of the deal. Clean up your business practices well in advance of any anticipated sale.

Every practice should conduct regular due diligence to assure compliance with all facets of lab operation and use, as well as relationships with outside physicians and practices.

INDEPENDENT CONTRACTOR CLASSIFICATION

There are a few tax scenarios that range from illegal to suspect, and potential buyers are sure to find them out. One scenario involves personnel sharing space or really working under your direction taking payment as a "consultant," with earnings reported via form 1099, rather than as an employee, reported on form W2. This is often done in efforts to affect a tax benefit for the individual receiving compensation, and achieve costs savings for the practice.

It is certainly permissible to compensate an individual as a consultant—if that individual functions as a consultant. However, the taxing authorities and the State labor departments have been whittling down the definition of an employee to cover practically anyone you provide patients to, or even if you simply have their name under your letterhead or on your business card. Misclassification carries heavy fines, particularly from Labor departments that need you to fill their coffers for workers' compensation and unemployment insurance. The prospect of an action even years later can result in penalties or bad "ratings" by the Labor Department carrying real financial consequences even to a successor purchaser of your practice.

TAXES

Some practice owners will run certain expenses through the business that are actually personal expenses. A competent tax advisor and/or attorney can help guide a practice owner on the appropriate reporting of expenses. It is not wise to rely on the advice of an office manager only, especially if the manager is not a tax expert.

A potential buyer needs to know the bottom line profit in order to establish a valuation for the practice. And in order to find that number, they will review expenses and payments. Improper reporting will be found and drive down your purchase price value.

THE FALLOUT

Even in the absence of a sale, inappropriate activity leaves you vulnerable to legal action from payors and potential financial and other penalties, including licensure suspension or revocation. It's also clearly unwise to open your books to the eyes of a potential buyer with these black marks on your record.

With a proper NDA, it is unlikely that a prospective buyer will be able to report you to the relevant authorities. If there were honest mistakes, these can likely be corrected with little to no significant impact on a future deal.

A NOTE ON REAL ESTATE

One area where practice owners may wish to retain a level of secrecy is in dealing with real estate ownership. In many cases, the practice owner also owns the space where the practice is housed. The owner may see the potential sale of the property to the practice buyer as an opportunity to augment proceeds from the sale of the practice. Alternatively, the property owner may wish to retain ownership and rent the property to the new buyer for a persistent income stream.

It is wrong to hide ownership of a property if asked, but you don't necessarily need to say anything if you are not.

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Sometimes owners will form a limited liability company (LLC) as the ownership entity and lease it to their own practice entity. Owners of LLCs are not readily discoverable in public records. Certainly, the lease agreement will need to be reviewed by the buyer, but not all buyers want the real estate ownership.

ALL CARDS ON THE TABLE

Any practice owner considering a sale must understand that there may ultimately be no secrets in this process. All cards may end up on the table—and they will be laid out early in the process. As long as confidentiality is ensured, there is nothing to be lost by sharing information candidly with the potential buyer and potentially nothing to be gained by trying to withhold or hide information.This is not the same as telling them your legal risks—they still have the onus on identifying any issues that may give them leverage in negotiating the price. You definitely do not want to do the job of "analysis" for them!

In any event, it is wise to work with an experienced consultant and lawyer to make an assessment of your practice before you initiate conversations with a potential buyer and open your books. Appropriate guidance will be critical to identifying and correcting any problems before scrutiny begins. ■

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