Practice Mergers: Traditional and “Clinic without Walls”

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Who We Are

- Business and legal advisors to physicians
- Publishers of the Goodwill Registry, used in valuation of ophthalmology and other medical practices
- Handle and advise re: practice buy-ins, buy-outs, sales, mergers and valuations

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Topics

• Why merge?
• The 2 primary merger models
• Merger process and challenges

What’s Happening Now

• The pressure of demographics: Baby boom doctors reaching retirement
• Uncertainty in the air
  • Obamacare/Trumpcare
  • Budget pressure/reimbursements
  • Watching other doctors get out

But there are positive factors to consider as well…..

• Ophthalmology is a well-positioned specialty
  • Lots of demand for services
  • Ancillary revenue sources: optical, ASC
  • Elective services: premium IOLs
  • New drugs, new technologies
Ophthalmology has been surprisingly resilient

- Per MGMA, median ophthalmologist compensation has increased 23% from 2010 to 2015, from $330,784 to $407,272

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What’s Happening Now

- When there is uncertainty, it is desirable to be big, so that you will have strength in the marketplace

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Time to plan is now…

- If you have more than 6-7 years of practice left, you should consider merger
- Bulk up to be bought out or just survive
- Bulk up to negotiate with payors
Common Reasons to Merge

- Merger enables the two groups to negotiate collectively with payors
- Without merger, such joint negotiation would be “price fixing” under federal antitrust law
- Gain clout in marketplace! (maybe)

Common Reasons to Merge

- Become more “full service”
- Pool resources to hire subspecialists

Common Reasons to Merge

- Geographic expansion (clout, branding)
- More attractive to recruits
Common Reasons to Merge

• Centralize billing, contract negotiation, legal and other administration costs
• Share costs of new equipment, new space, new personnel

Merger Concerns

• Merger entails costs and change
• More comfortable to do nothing
• So there must be good motivation by both parties, to overcome these obstacles

Why Are We Doing This?

• There needs to be a business plan
• A vision, that you are moving towards
• How will we make more money than we do now?
  • Or at least sustain current incomes
Types of Merged Entities

- Clinic without Walls or Group Practice without Walls ("GPWW")
  VERSUS
- Fully Integrated Merger

Fully Integrated Merger

- Very simple model
- Two corps become one corp
- Single tax ID, provider number
- Single pension plan

Fully Integrated Merger

- Single governance body: the new Board
- Full integration of finances
  - sharing of overhead
  - possibly, sharing of revenue
- “Everybody owns everything”
GPWW Corporate Structure

- Similar to full merger:
  - Two corps (or LLCs) become one corp (or LLC)
  - Single tax ID, provider number
  - Single pension plan

GPWW Finances

- But GPWW allows each site to retain its separate finances
  - The individual sites do not share revenue or overhead (with a few exceptions)

GPWW Governance

- GPWW also promises more autonomy
- Much less centralized than fully integrated model
3 Layers of GPWW Governance

- Site Level (individual practice location)
- Entity Level (Board of Directors)
- Shareholder level

Site Level

- Day to day decisions are made by the doctors at the individual sites
  - Hiring and firing
  - Selection/purchase of supplies, equipment, service vendors

Board of Directors Decisions

- Things that affect multiple sites due to:
  - Need for uniformity
  - Potential for harm caused by one site to another
Decisions Requiring Uniformity

- Selection of billing software and EMR
- Payor contracting
- Tax filings for entity
- Pension plan design and administration

Decisions Posing Threats to other Sites

- Business issues
  - Establishment of new office near an existing site (competition)
  - Move of provider from one site to another

- Legal threats/issues...
  - Audits
  - HR problems
  - Lawsuits (potential or actual)
  - Bank loans
  - Office leases
Shareholder Decisions

- Highest level of decision making
- For the biggest decisions
- Every doctor wants a say

Shareholder Decisions

- Merger
- Sale of practice
- Dissolution
- Admission of a new shareholder
- Capital contributions

Finances in GPWW

- Billing is centralized, under single group provider number
- EOBs from insurers are "unwound" so that revenues can be "drilled down" to generating site
Finances in GPWW

- Revenues allocable to a site are deposited in a site-specific checking account
- Site doctors write checks on site bank account
  - To pay site overhead (provider and staff payroll, supplies, rent, utilities, malpractice)

GPWW Classes of Stock

- Three (3) classes of equity
  - “A” shares
  - “B” shares
  - “C” shares

GPWW “A” Shares

- Voting shares, for shareholder decisions
- 1 share per shareholder
- $1 per share, for buy-sell valuation
GPWW “B” Shares

- Issued for each site
  - Site #1 shareholders hold “B1” shares
  - Site #2 shareholders hold “B2” shares

GPWW “B” Shares

- Have voting rights within a site
  - E.g., whether to hire a new associate for the site

GPWW “B” Shares

- Track ownership rights in site assets (equipment and goodwill)
  - For buy-in and buy-out

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GPWW “C” Shares

- Non-voting Shares
- Track ownership rights in shared assets (e.g., EMR investment, femtosecond laser)
  - For buy-in and buy-out purposes

So Which Model is Best?

- Both models
  - Allow the merging groups to (legally) band together to negotiate with insurance companies
  - May enable cost efficiencies, such as central billing

Full Merger

- Ideal in long run
  - Negotiations with payors
  - Recruiting
  - Cost efficiency
  - Strategic planning
Full Merger

• …but hard to achieve in short-run
• Higher transitional costs
• Lots of big issues to resolve (e.g. compensation funding buy-sell formula)
• Requires sharing overhead

GPWW Is Easier…

• Does not require sharing of overhead
• Sites can retain substantial autonomy
• And yet still achieve the objective of "grouping up" to negotiate with payors

…but Not Pain Free

• Stark requires sharing of some "DHS" ancillary revenue: A-scan, B-scan, pachymetry, OCT
• May need to use new entity-wide software systems, adopt EMR
• Hard to develop true strategic plan
More GPWW Compromises

- Single pension plan
- Other sites have a say about your practice, via Board or Shareholder votes
  - E.g., relocation or expansion of office

Rare in Ophthalmology

- Haven’t yet seen many GPWWS in ophthalmology
- Often, a GPWW is formed to share revenue from a new, expensive, centralized ancillary service
  - But there is no such service in ophthalmology (except maybe femtosecond, excimer)
- Compare: orthopedics (MRI); urology (radiation therapy)

Full Merger Considerations

- …With some application to GPWWs
Challenges

- Are the personalities compatible?
- Mutual respect?
- Any “problem partners” (in other group, of course)

Challenges

- Overhead rates and doctor compensation formula
- Amount of change contemplated

More Challenges

- Payor participation
  - Need to be together on this
  - Ensure compatibility of patient bases
  - Can everyone be credentialed?
Services and Style

- Interest in (and belief in) elective services (premium IOLs, Lasik, aesthetic services)
- Comfort with treatment styles – surgical aggressiveness, drugs used
- Co-management, relationship with ODs

Tastes and Plans

- Desire for latest and greatest technology, equipment
- Interest in growth
- Facilities used and/or owned
- Computer practice management software and EHR

Financial Compatibility

- How do “per doctor” incomes in the two groups compare?
- How do the compensation formulas compare:
  - Group A: equal splits
  - Group B: eat what you kill
  - Will the doctors accept a middle ground?
Financial Changes

- Will the business plan change the amount of $$ available for shareholder compensation? Consider:
  - New services offered
  - New specialists hired
  - New equipment and/or offices

Do a Financial Proforma

- No one is going to want to take a pay cut
  - Will there be efficiencies or extra revenue to cover transitional costs?
  - Need to have some idea of the business plan

Governance

- Do the groups have similar governance styles (e.g., everyone has equal vote versus benevolent dictatorship)?
- Can all current shareholders continue to be on the Board (of the new merged entity)?
**Buy-Sell Valuation Issues**

- Review each group’s buy-sell documentation
- Evaluate philosophy on goodwill
  - For buy-ins?
  - For buy-outs?
  - How much $$

**Termination Issues**

- What % Board vote is necessary to terminate a shareholder? 51%? 75% Unanimous?
- Is termination permitted without cause?
- Is the departing shareholder subject to a non-compete?
- How are charts handled?

**Liability Issues**

- Does either group have any substantial legal problems?
  - E.g., payor audits, government investigation, whistleblower claims, sex harassment suits, departed partner claims.
- There may be a show stopper, or no merger until issue is resolved.
Liability Issues, Cont.

- Consider indemnification clauses
  - Each group takes exclusive responsibility for its own contingent liabilities
- Also evaluate relative per partner bank debt load

Legal: Merger Mechanics

- Option A: Merger of one entity into another
- Option B: New “greenfield” entity

Option A: Merger of Entities

- Preserves at least one group’s provider numbers
  - But all contingent liabilities (payor recoupments, tax issues, legal claims) will follow the new, joint entity
Option B: “Greenfield”

- All doctors quit their old entity to join the newly formed one
- Medical charts and lists transferred to new entity
- Helps shield each group from the other’s prior liabilities
- But will need to re-credential all providers

Integration Issues

- Evaluate fringe benefit policies – need to transition to one framework for all staff
  - Health insurance
  - Vacation, sick, personal day benefits
  - Retirement plans – need to consolidate into single plan for everyone

Integration Issues, Cont.

- Review staffing
  - Any changes appropriate?
- Consolidation of offices?
- Other savings?
Integration Issues, Cont.

- Policy Manuals
  - Employee handbook
  - HIPAA Compliance Plan
  - OSHA plan

Other Entities

- Separate Optical Shop, ASC, Real Estate
- Try to give each doctor a stake in all entities
  - Differing doctor interests lead to differing doctor agendas and conflict

Concluding Thoughts?

- You will have to invest some time and money
  - This is a project to secure the future.
  - There will be some transitional costs and bumps
  - This is going to take some time: 12 to 36 months
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