



## Tips for Navigating Physician Practice and ASC Transactions During COVID-19

CAREFUL SCRUTINY, REALITY-BASED ASSESSMENTS, AND FRANK COMMUNICATION BETWEEN PARTIES ARE KEY

By Lori Beam, JD

Just as the positivity rate in COVID-19 cases continues to go up, the positivity rate for physicians considering selling their private practices has also been trending upward. In a national survey of general and specialty physicians conducted in 2019 and repeated six weeks into the pandemic, McKinsey & Company found that:

- 53% of all independent physicians expressed worry that their practice would not survive the pandemic.
- One-third said they were considering partnering with a larger entity, selling their practice or becoming employed.<sup>1</sup>

The upshot is that many physician practices are considering new opportunities. At the same time, health systems are evaluating whether—and how—to respond. Some opportunities might also involve businesses that physician practices directly or indirectly own or operate: ambulatory surgery centers (ASCs), diagnostic imaging centers, outpatient laboratories or other related businesses.

Despite concerns about an uncertain economic landscape, there's no need to panic. Avoiding buyer's or seller's remorse requires calm, cool analysis and communication.

As negotiations progress, each party should communicate areas of flexibility for meeting the other party's needs. Health systems should define and effectively communicate the value their platform offers as well as the expectations of physician employment. Physicians should also be thoughtful and candid about their expectations.

### TIPS FOR EFFECTIVE NEGOTIATIONS

*Following are tips for approaching deals and negotiations:*

**Appraisals.** Get an independent valuation expert's appraisal of the value of the physician compensation, the physician practice and related ASCs and businesses. Then establish a purchase price and physician employee compensation in the range of fair market value specified by the appraiser.

- Consistent with pre-pandemic times, obtain an appraisal and use it to establish the purchase price and physician employee compensation. This would ensure that, if ever challenged, the parties would have proof that they based the purchase price and physician employee compensation on fair market value—not on the volume or value of referrals, which are prohibited by the Anti-Kickback Statute and the Stark Law.

In most cases, health systems will pay only a tangible asset value for a physician practice. But they will accept an earnings-based methodology for determining the purchase price of an ASC or other associated business.

- Each party should also consider getting a new appraisal, an update or a confirmation opinion from the same appraiser in cases where a valuation was done pre-coronavirus. However, if patient volumes and revenue have returned since restrictions limiting operations to only essential visits and procedures were lifted, the parties may not need a new

appraisal. But getting a confirmation opinion is worth considering.

The valuation expert may adjust the proforma to better reflect 2020 financials under normal operations, finding that the months directly affected by the coronavirus are not representative of future results.

**Due diligence.** It's essential to take an even more thorough approach to due diligence review of the physician practice. Since historical business information may be less useful, health system buyers and appraisers should carefully scrutinize it as a predictor of future performance and valuation. Near-term impacts, though, should be distinguished from long term.

**Working capital.** For ASCs and other businesses related to physician practices, closely evaluate the working capital needs and targets tied to the purchase price.

A common approach for ensuring adequate working capital on the transaction closing date is to use the average level of working capital—current assets minus current liabilities—for the most recent months excluding certain adjustments.

But it may be appropriate to make adjustments to address the financial impact of the coronavirus. For instance, a buying health system might ask these questions:

- Does it make sense to exclude a portion of the accounts receivable considered uncollectible or slow to collect?
- Should a portion of the accounts payable now be treated as indebtedness because the physician practice and vendor have extended payment deadlines or terms due to the coronavirus? Or should the

- amount of payables be adjusted to reflect the impact of any non-recurring penalties paid or expected to be owed?
- Where inventory is a key component, is a larger than normal part of the inventory aged and unusable or closer to expiration because the coronavirus reduced demand during shutdowns and restrictions?
- Should buyers withhold a portion of the purchase price from amounts paid on the transaction closing date to provide security while they determine the actual working capital existing on the closing date?

#### TIPS FOR NEGOTIATING CORONAVIRUS RELIEF FUNDS

**Transparency.** Be transparent about any and all federal, state and local coronavirus relief funds that the physician practice applied for and/or received. As part of due diligence process, each party should:

- attempt to confirm that the physician practice met all of the eligibility requirements for receiving the relief funds.
- understand the potential obligations to repay the relief funds and, where applicable, the conditions for earning forgiveness of any payback obligation.
- investigate whether the contemplated acquisition transaction would trigger any undesired consequences (e.g., a duty of repayment rather than loan forgiveness).
- negotiate special terms for allocating risks associated with the relief funds.

The terms governing the coronavirus relief funds depend on the specific type of funds received and could change if the relevant administration changes and as the applicable legislative or government body continues to respond to the coronavirus. For instance, terms governing eligibility, permitted uses of funds, repayment, forgiveness, transferability, etc., are all different for:

- CMS Medicare advance funds
- Provider relief funds issued by the U.S. Department of Health and Human Services
- Loans made under the Paycheck Protection Program

**Transferability of relief funds.** Each program's terms through which the seller received funds should be assessed at the time of the transaction as to the issue of transfers and changes of ownership, but as a general rule:

- A transaction structured as a sale of assets likely is subject to restrictions on the transfer of unused funds to a buyer.
- A transaction structured as a purchase of stock or equity interest in the recipient of the funds, where the recipient's tax identification number remains the same after the transaction closing, likely will not trigger any negative consequences (e.g., required repayment of relief funds not otherwise subject to return).

**Relief fund warranties and indemnities.** The health system should require the selling physician practice to represent and warrant to the health system that the physician practice met all of the eligibility requirements for receiving the funds. The practice should also represent it complied with all relief fund program requirements on and prior to closing of the acquisition transaction—including specifically those governing application, attestation, certification, receipt, use, disposition, expenditure, transfer, reimbursement, return and forgiveness.

Breach of any of these seller representations and warranties would then trigger a physician practice obligation to indemnify the health system for losses resulting from the breach.

If the health system asks the physician practice to represent there has been no change since the date of the last finan-

cial statements that materially affects the business, the physician practice may want to include a general coronavirus exception. The practice should not be liable to the health system for the impact the coronavirus has on the practice or business. However, the health system should avoid overly broad coronavirus exceptions that drive a big hole into the physician practice's other representations and related indemnity.

**Special terms for relief funds.** Other special terms desired might include:

- **CMS Medicare advance funds.** CMS currently plans to recoup all CMS advance funds through offset against Medicare claims submitted on and after April 10, 2021. That means it may make sense to treat CMS advance funds received by the physician practice as indebtedness that is offset against the purchase price. Treating relief funds as indebtedness might also be appropriate for other relief funds where repayment is expected or likely.
- **Escrow.** If the relief program rules are not clear about the recipient's ability to transfer funds in connection with a purchase transaction or about repayment obligations, the parties could put the unused relief funds in escrow with a bank or other third party until the rules are finalized. If the dollar amount at stake is large enough to merit the escrow procedures and costs, escrow might also make sense in situations where the selling physician or practice wants to ensure the buying health system complies with expected repayment obligations.

As always, physicians and hospital systems should evaluate these opportunities to achieve desired outcomes and avoid unexpected downsides. For instance, many might think joining a health system will enable it greater access to digital assets (*continued on pg. 20*)