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Unscrambling the Egg Hospital-physician deals are unwinding everywhere.

If your hospital-owned practice is about to be unloaded, make sure you come out clean.

BY JOHN ALLEVATO



Remember how good it all sounded? The hospital would buy your practice, paying you not an insubstantial sum. You would enter into a contract with their medical entity, who guaranteed you a salary close to what you had been receiving. You agreed not to compete against the hospital. You would continue to have input on medical decisions, while the hospital corporation would take over the billing, personnel, and other administrative hassles. Those were the days, right?

Flash forward a couple of

years. The hospital lost tons of money on its investment in physician practices, physicians' productivity dropped, insurance companies negotiated lower reimbursements, all of which left the hospital holding the bag on its significant investment in physician offices. The hospital Board has recently mandated to the hospital administrator to get out of the business of owning and managing physician practices, and the administrator is now in

your office discussing your disentanglement options.

What happened? How could the nirvana of the first paragraph have turned into the nightmare of the second? Is your practice alone in this mess? How could you have been so duped by the siren song of the hospital purchasing your practice?

You're not alone. While hard evidence is hard to come by showing how many hospitals are now getting out of the

physician practice business, anecdotal information suggests that significant numbers of physician practices have been, or are now in the process of dis-engaging from their hospital purchasers.

You remember the good old times when practice valuations went through the roof, especially for so-called "gatekeeper" type practices such as family practice, internal medicine, ob/gyn, and the like. Hospitals were outbidding each other to acquire their businesses. I recall one particular gatekeeper practice where three separate hospital entities were involved, at one time or another, in the bidding process.

"Experts" at valuing medical

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practices were coming out of the woodwork. Expert valuations were necessary, especially when tax-exempt hospitals were bidding on the physician practice (which was most likely the case), to assure that “fair market value” was being paid for the physician assets. The most difficult part of the appraisal process was determining the value of the “goodwill” of the practice—that amount that a buyer would pay for the intangible assets of the practice, such as its reputation, years of service in the marketplace, combined with elements of its profitability.

Fanning the flames of these purchases were fears of virtually every hospital that it could find itself “shut out” of its stable of gatekeeper physician practices—those practices which it hoped would result in patient admissions to its hospitals—if it didn’t act. Without a good network of such gatekeepers, the reasoning went, the instances where patients may be admitted to its competitor hospitals would increase, thereby depriving the hospital of its piece of the ever-shrinking patient population. This was also done to assist the hospital in the shift from traditional fee-for-service payment plans to the managed-care environment.

As the realization has sunk in for hospitals that being in the physician practice business is not a productive use of their funds, and that managed care is struggling everywhere, physicians are now being increasingly confronted with the prospect of having to work for a new “boss,” (or for themselves once again), as hospitals try to shed themselves of these previously acquired practices.

I’ll examine some of the impediments to “unwinding” hospital purchases of physician practices from the perspective of the physician. In the process, I will also discuss issues that hospitals face (mostly tax-exempt hospitals), since those issues play a pivotal role in the process.

What went wrong?

With the ballyhoo surrounding the acquisition of physician practices by hospitals, why have so many have failed? First and foremost, financial expectations were not met. Perhaps with the payments for their practices and the “guaranteed” nature of many of the contracts, physicians had little incentive to produce at the same levels they had prior to the sale.

Other reasons why these arrangements didn’t work include:

- Cultural differences—the perspectives of physicians and hospitals running physician practices were not always aligned
- Lack of trust between physicians and hospitals
- The failure to integrate operations
- The lack of vision of the parties to wring out the perceived efficiencies which both sides thought would arise from their combination.

There were other reasons as well, but this list points out how many of the expectations initially present in hospital-owned practices were unmet in the reality.

The unwinding process

Dis-entangling physicians and hospitals is now becoming the topic of many conversations among attorneys for hospitals and physicians. Unscrambling the egg presents many hurdles. Yet a number of options exist for achieving the separation.

- Selling back to the physician(s). This option is the most logical and probably the most common model for unwinding these deals. But a closer examination reveals many warts.

Most of these deals included a non-compete provision, whereby the doctor agreed not to compete with the hospital. A physician thereafter opening her own practice is a technical violation of this provision. The hospital should be willing to waive the requirement if the physician locates near the hospital. One key question is whether the non-compete agreement has value to the hospital. If so, should the

physician pay this value to the hospital in consideration for its waiver?

After paying taxes on the proceeds from the original sale, the physician probably does not have enough money left to purchase the practice back. However, if the practice has turned unprofitable (which is most commonly the case), its value has probably diminished, perhaps significantly, thereby reducing the price. Nevertheless, many physicians may still not be able to afford to repurchase their practices.

- Not all the assets need be sold. For example, goodwill, which was probably the largest component of the price when the practice was sold to the hospital, may not have to be sold to the physician. Perhaps the physician can purchase only the hard assets and patient files to successfully accomplish the objective. Nevertheless, the practice sold by the hospital (tax-exempt hospitals must follow this rule) should be reappraised. In that process, goodwill may have to be resold to the physician. This issue and could be a major hurdle.

If the physicians cannot afford to buy back the practice, can the hospital assist in the sale with financial incentives? The answer to this question is complex, and will vary from practice to practice. In addition to tax issues raised, Stark and fraud-and-abuse concerns will have to be negotiated. One thing that tax-exempt hospitals should not do is negotiate a bargain purchase price—one that is below fair market value—to sell the practice back to the physicians.

- Selling to an unrelated for-profit group. This solution may result in the most advantages to all parties involved, though it is unlikely the physicians would be any happier in this arrangement than they were working for the hospital. Though nice in theory, this solution will not present itself very often. The best solution may be a sale to another physician group in the community.
- Selling to another tax-exempt entity. Many of the same problems the hospitals have already encountered would continue in this approach, plus the new entity would undergo the same close scrutiny the selling hospital had to

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contend with, which may have been the basis of many of the problems. This is probably the most unlikely possibility of all.

So, if faced with this scenario, what should you do? First, determine the hospital's strategy in the disposition of its physician practices. Is your practice being singled out, or is the hospital getting out of the physician-practice-ownership business? Next, find out if other physicians (perhaps your former partners) face the same dilemma to determine if some "synergy" may develop. You may be able to form another group practice. Also determine if the hospital is willing to assist you or your group in repurchasing the practice's assets.

Find out if there is another group or physician in the community that is a good candidate for you to "partner" with to assist in the process and perhaps make it go more smoothly.

Whatever course you take, don't sign on for anything until you have had a chance to consult with your professional advisers and develop your own strategy.

Try to be in control of your destiny. ■

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