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When Large Medical Groups Acquire Small Physician Practices – Legal and Economic Structure

A trend in the medical marketplace is for big group multi-specialty medical practices to buy up small practices, and integrate them into the big group as satellite offices and cost centers. In this article, I explain the basic structures of the deal.

Legal Structure

The deal can take various legal forms, but I'll focus on one legal structure that I'm seeing recently and that I find interesting. In this structure, the big group hires the small practice's physicians and ancillary staff as employees. The physicians and staff then continue to operate their old practice as a satellite office of the big group.

Hence the basic legal structure is an employment relationship: the big group is employer, and the small practice physicians and staff are employees. The small practice becomes a division of the big group, and the small practice physicians retain control over their satellite office, including hiring and firing. There is no visible change from the outside -- the physicians continue to practice in their original offices, they continue to use their old practice name (which becomes a fictitious name that is registered by the big group), and there is no change in staff or patients other than ordinary turnover.

Economic Exchange = Services For Money

Economically, the fundamental exchange is this: the big group provides administrative services to the small practice, and lets it participate in the big group's negotiated insurance rates. In return, the small practice pays a cut of its collections to the big group as compensation.

Services. The big group provides a full range of administrative, management and billing services for the small practice physicians. The big group handles the billing and collection for the small practice (said collections now belonging to the big group), and the big group manages the IT / electronic health records (EHR) system, payroll, benefit packages, accounting and more.

Most important, the relationship lets the small practice participate in the big group's insurance contracts and negotiated rates. This is the big payoff, and this separates the deal from just being a management services contract.

Money. In exchange for its range of services, the big group retains a percentage of the collections from the small practice. The small practice physicians keep the remaining percentage of collections, which they use to pay the costs of the satellite office, including staff salaries, office rent, insurance, supplies and nearly every other expense that existed for the small practice before the acquisition. The physicians pocket the net, net that is left over after payment of expenses and the big group. Now you see why the relationship is really a management services contract with a kicker, the kicker being the small practice's participation in the big group's insurance reimbursement contracts.

Exit

My clients know that I focus on the exit. Before integrating, both sides need a plan for separating. The contract they use for the deal must provide for their separation in clean and simple terms.

Both sides (big group and small practice physicians) should want a contract that permits either side to terminate at-will on reasonable notice. For example, the contract might have an initial term of one year, and thereafter be terminable at-will on 120 days notice. The big group might require a longer initial term (e.g. 2 years) if it needs more time to recover its upfront costs of integrating the small practice into the big group.

After termination, the small practice should take back its patients, its patient records (from the big group's EHR system), and its trade names / fictitious names. The office lease and equipment leases usually don't have to be returned to the small practice, because they will have remained in the small practice's name throughout (the big group doesn't want the lease liability hence it doesn't take assignment of the leases).

Pay attention to: (1) who pays for the tail insurance; and (2) what happens if the separation comes after a few years of integration. The longer the integration, the harder will be the separation. Unwinding the two sides back to their original positions becomes more difficult and costly the longer they have been together. This latter topic is too lengthy to cover here, though.

Thank you for reading my article. Our time together has been beautiful, but all beautiful things must come to an end.

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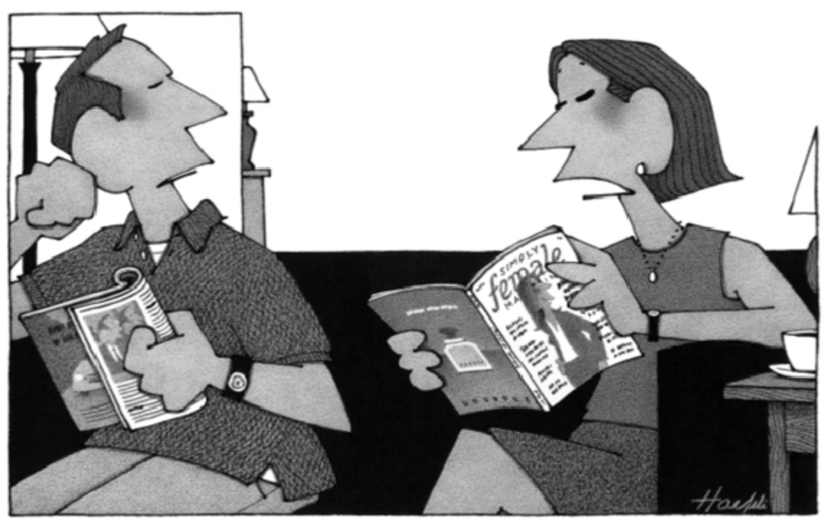

"There's an article in here that explains why you're such an idiot."