



# MATT DICKSTEIN

## Business Attorney

Making legal matters easy and economical for your business

39488 Stevenson Place, Suite 100, Fremont, CA 94539  
510-796-9144. matt dickstein@hotmail.com matt dickstein.com

## Newsletter, September 2012 Merging Medical Practices

In this article I discuss the merger of medical practices, from a legal perspective. Without further adieu:

**Legal Structure of the Merger.** There are a number of possible legal structures for a merger, but usually the choice is either the classic merger or the newco merger. You choose based on the facts of your merger.

*Classic Merger.* Here you merge PC 1 into PC 2. PC 2 is the surviving corporation. PC 2 takes the assets of both PCs 1 and 2, and it carries on their combined practice. PC 1 dissolves not long after the merger. The shareholders of PCs 1 and 2 divide up ownership of PC 2. [PC = professional corporation]

PC 2 inherits all contracts and liabilities of PC 1 and keeps its own old contracts and liabilities. This creates risk for each merger side that it takes on the unknown liabilities of the other. The parties mitigate the risk through pre-merger due diligence on PCs 1 and 2. The shareholders of PC 1 also indemnify the shareholders of PC 2 for pre-merger liabilities, and vice-versa.

The IRS treats a classic merger as a tax-free reorganization. Regarding provider numbers, PC 2 (as the surviving corporation) uses its old provider numbers to bill the post-merger services of all physicians. The provider numbers for PC 1's shareholders are reassigned from PC 1's old corporate number to PC 2's corporate number.

*Newco Merger.* The alternative to a classic merger is to start a new company, called PC 3 (aka Newco). PCs 1 and 2 transfer their assets (but not their receivables or liabilities) to PC 3. This transfer can be direct to PC 3 or via an intermediary distribution to the shareholders, who then contribute the assets to PC 3. The shareholders contribute cash to PC 3 to cover its startup period until post-merger receipts come in. The shareholders divide up ownership in PC 3.

The primary benefit of the Newco is limited liability. PCs 1 and 2 dissolve, giving PC 3 and the shareholders an argument that old liabilities died with the old PCs. These liabilities might include, for example, Medicare audits, tax audits, past malpractice, employment law claims, etc. If this argument holds, the shareholders of PCs 1 and 2 can feel safe that the new venture doesn't take on old liabilities,

including the liabilities of the other PC to the merger. This limited liability benefit is not full-proof, however, and the creditors have a counter-argument. The creditors can sue PC 3 for liabilities of PCs 1 and 2 on grounds that PC 3 is the successor to PCs 1 and 2. The facts of the merger will tell you the strength of the creditors' argument.

As for taxes, the IRS can characterize as a taxable sale the transfer to PC 3 of assets out of old PCs 1 and 2. This can be painful. PC 3 must get new provider numbers, too, which can be painful depending on the number of carriers. Delays in getting the new numbers affect cash flow at startup.

**Contributions to Ownership.** The hardest part of a merger is figuring out how the shareholders of PCs 1 and 2 divide up ownership of the new practice. In any merger, expect to spend a majority of the negotiation on this problem.

The problem is accounting for differences in value between PC 1 and 2 so that you divide ownership of the new practice in a fair way. It's rare that PCs 1 and 2 are so equal in value that shareholdings translate directly across from the old to the new. One way to solve this dilemma is to put a dollar value on all assets to be contributed to the new practice, and base new shareholder percentages directly on the dollar values. The parties can use cash to equal out the asset values / shareholder percentages.

**Exit Clause.** Sometimes a party to a merger wants an exit clause in case the merger isn't working out, usually within the first year. With the exit, the party receives the return of its assets, plus patient lists, charts, phone numbers, office leases, staff, equipment, and corporate name and entity. Note that items acquired jointly (post-merger) need a special mechanism to ensure a buy-out at fair value.

**Miscellaneous Issues.** Some additional issues to consider in the merger:

- How to divide corporate control, including membership on the board of directors, veto rights and super-majority votes.
- How to set the formula for compensation of the practicing shareholders.
- Drafting a Buy-Sell Agreement for the shareholders.
- Dealing with insurance companies, including getting the physicians accepted by the applicable insurance companies that reimburse medical services.
- Buying malpractice insurance for the new practice that covers all physicians.

I hope this article helps you. Call me if you want to talk more.

## PJ O'Rourke:

- Children must be considered in a divorce valuable pawns in the nasty legal and financial contest that is about to ensue.
- If you spend 72 hours in a place you've never been, talking to people whose language you don't speak about social, political, and economic complexities you don't understand, and you come back as the world's biggest know-it-all, you're a reporter.

## Freeman Dyson:

We gain knowledge of our place in the universe not only from science but also from history, art, and literature. Science is a creative interaction of observation with imagination. Hermann Weyl, who was one of the main architects of the relativity and quantum revolutions, said to me once, "I always try to combine the true with the beautiful, but when I have to choose one or the other, I usually choose the beautiful."