

# Buying or Selling a Medical Practice

## A Legal Perspective

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**By Alexander Levy**

This article is intended to help physicians identify and consider various factors when buying or selling a medical practice.

We understand that medical practices are businesses. This does not diminish the societal significance of medical professionals. Rather, it simply recognizes the fact that when negotiating a purchase or sale of a professional practice, it is the business side of the practice that we are taking into consideration. It is through this lens, that we ask you to consider the concepts in this article.

This article will analyze elements of a practice's revenues and expenses, which are important from a legal perspective to consider. It will also highlight how a deal may be structured. Please note, the issues highlighted in this article may also be helpful for current practitioners to better organize their practice.

Before continuing, we recommend keeping these key questions in mind to help orient your analysis of your business:

- (1) What are the revenues of the practice? How are they generated, are they stable and how will those revenues be transitioned to a purchaser?
- (2) What are the expenses of the practice? Will the purchaser be assigned all contracts, is the seller allowed to assign contracts, and are there any contracts that need to be put in place prior to a sale?
- (3) What is being purchased and what efforts will the seller be obligated to make, if any, to transition the practice over to the purchaser?
- (4) Should the purchase price be paid all at once? Should the purchase price be partly dependent on the success of the transition of the practice to the purchaser?

- (5) How can the deal be structured to protect each party, when the seller is obligated to provide notice to patients that he or she is leaving the practice (i.e. placing the seller in a vulnerable position)?

Not all sales of medical practices need be complicated or consider every item discussed in this article. We have experience representing both buyers and sellers of many professional practices and routinely tailor our services to the scale and nature of the transaction.

### **Practice Elements: A Deeper Look**

Regardless of the type of business being purchased or sold, there are two primary factors to analyze in determining price: Revenues and Expenses.

- (i) Revenues: Revenue streams for medical practices differ from other types of businesses. Physicians are not in a traditional business relationship with their patients and cannot unilaterally assign care to another physician. A prospective purchaser of a practice needs to ascertain that revenues are and have been stable and they can maintain the same (or greater) degree of success after a transition.
- a. *Sources*: For certain medical professionals such as family doctors, revenues will be determined by patient roster sizes. For a dental practice, a prospective purchaser may want to understand the proportionate share of revenue from each kind of service offered. Generally, clients anticipate the source of revenues, but it is important to understand how revenues are generated.
  - b. *Stability*: A practice that has a history of stable (or growing) revenues is generally more valuable. A purchaser should ask to see revenues for prior years as part of due diligence. Please bear in mind, that a retiring physician may have been gradually winding down his or her practice prior to sale. It is important not to just analyze hard numbers, but also to inquire as to the reasons for any significant increase or decrease in income.
  - c. *Transition*: Physicians do not have the authority to sell patient files or transfer patients to another physician unilaterally. Accordingly, it is sometimes confusing to determine what exactly is being sold. A purchase agreement should clearly set out the steps the seller will take to help transition patients to the purchaser. In certain cases, this may require the seller to keep working for a period of time post-sale. In others, the seller will write a letter to patients notifying them of the transition and the contact information for the purchaser. In a later section, we will discuss how to address this issue in a purchase agreement.
- (ii) Expenses: In our experience, buyers need to focus on the expenses of running a medical practice. After all, physicians train for many years in their field, gaining knowledge of the services they will provide and how they will be compensated.

Conversely, physicians can overlook the back-office functions even though those functions can have a big impact on the bottom line.

- a. *Employees:* Physicians operating a practice rarely do so without help. Ideally, all employees will have signed employment agreements containing enforceable termination clauses. Long-serving employees can be a great benefit, but also a potential liability. Well trained employees can make the transition period after a sale far smoother because they have innate knowledge of the business. Conversely, if a purchaser's relationship with employees deteriorates after the sale and there are no valid employment agreements, liability for potential terminations costs can often exceed the purchase price of the practice. As a seller, you may be surprised to learn that if you sell your practice and your prior employees are not hired by the new purchaser, these employees' employment may have effectively been terminated and you could be personally responsible for termination entitlements. Please see our article [FAQ's Employee Terminations](#) for more details.
  
- b. *Real Estate:* A commercial lease is typically one of the most significant expenses of operating your practice. We recommend, if possible, that physicians do not sign the lease personally, but rather incorporate a company and have that company sign the lease. However, that may not be possible at the time of buying or selling a business. The benefits of a corporate entity signing the lease is that the physician will not be personally liable for obligations under the lease. This can relieve a lot of stress and you will sleep better at night (guaranteed). Other factors of the lease to consider are:
  - i. What is the length of term left remaining? If you are selling your practice, a purchaser will want a degree of certainty that they will not have to relocate offices or enter into lease negotiations soon after their purchase.
  - ii. Is there an option to extend the term of the lease?
  - iii. What are the liabilities beyond basic rent payments?
  - iv. Is the lease assignable? If the lease cannot be assigned to a new physician under substantially the same terms, this is a red flag. Parties should never enter into an agreement without obtaining the landlord's prior consent, if required.

Purchasers of a practice should ask for a full description of lease costs for the current year as well as a few prior years to get a better sense of their potential obligations.

- c. *Equipment:* It may seem obvious, but it is important to clarify which equipment a purchaser will be buying, or what equipment the seller wants to keep. Further, the purchaser should ascertain whether the equipment is owned or leased. If the

latter, review a copy of the lease terms. A seller of a practice should be careful to exclude specifically any equipment which is not subject to the sale.

- d. *Other Commercial Agreements*: To the extent possible, a purchaser should be informed of and have reviewed any other commercial contracts which are important in operating the practice. If a seller is organized and can easily identify all material commercial agreements, that will demonstrate an efficiently run business, which is more attractive to buyers. This can save time and money.
- e. *Group Practices*: Certain physicians, such as family doctors or dentists, are more likely to operate as a group or to share office space. If you are purchasing an individual's practice and that person operates as part of a group, you need to understand how liabilities are apportioned amongst the group and how decisions are made. If you are selling your practice while operating as part of a group, you will want to ensure that you are released from any liabilities under any commercial agreements the group may have signed.

### **The Purchase Agreement: How to Structure the Deal**

Having analyzed key factors to consider when buying or selling a practice, we turn now to what the transaction looks like.

Not every practice will sell for a large sum, due in part to the nature of the market and the fact that the revenue stream is linked to patient files, which are not a commodity.

Regardless of the size of the deal, liabilities for employees and/or under lease agreements or other commercial contracts, should be weighed by both the buyer (as you may inherit these liabilities) and the seller (as you want to ensure you are released from these liabilities).

#### **(i) Determine what is being purchased**

In the sale of a practice, these three types of assets are purchased:

- a. *Physical Assets*: the purchaser is purchasing the assets (i.e. equipment) used by the seller in operating the practice, subject to specific exclusions. The agreement should clearly identify what items are being purchased.
- b. *Effort to Transition Patients*: The purchaser is often expecting that the seller help transition patients to the purchaser. Usually, the selling physician sends a letter to patients (in compliance with regulatory guidelines), notifying patients that he or she is leaving the practice and that a new physician (i.e. the purchaser), will be starting on a certain date. Sellers should be careful not to exaggerate their ability to transfer patient files, as these files are *personal medical information* and are not theirs to transfer freely, let alone "sell". If a purchaser requires the seller to stay on for a period of time after the sale to help introduce the purchaser to patients or become familiar with the practice, this should be clearly set out in an agreement. Both

parties need to exercise caution in complying with all regulatory and statutory guidelines for patient files.

- c. *Contractual Arrangements:* A purchase agreement should list the contracts that the purchaser will be expected to assume. Often, this may be limited to employment contracts, a lease for the premises and perhaps any leased equipment. However, there are often contracts regarding IT support, bookkeeping and other administrative functions. The more complex the practice, the more contracts the purchaser should expect to assume. A prudent seller will require that these contracts be terminated on closing or assigned to the purchaser.

Purchase agreements do not have to be complicated. A clear and precise contract can eliminate ambiguity between the parties and give both the seller and the purchaser peace of mind after the deal has closed.

(ii) Purchase Price

As stated previously, patient files are **not assets** and may not be sold or transferred freely.

A purchaser should be acutely aware of this fact if he or she signs a deal with a firm price. One option to address this issue, is to tie the price to the number of patients that actually transfer to the purchaser when the sale is concluded. This may be more common for medical professionals such as family physicians.

For certain practices such as dentistry, where revenues are not tied to patient roster sizes (at least not directly) but rather are more heavily service based, the parties may feel more comfortable that historical performance serves as an accurate guideline for future performance, particularly if the seller stays for a 'transition period'.

The same issues are also concerns for the seller. A seller is taking a risk when it helps transition his or her patients over to another physician. Once the seller notifies patients that he or she is leaving the practice or retiring, the practice instantly becomes less valuable if the deal fails because patients are likely considering other means of obtaining care. Accordingly, if the full purchase price is not paid immediately, a seller should ask for a substantial deposit.

(iii) Timing

The unique nature of the sale of a practice often means an agreement will be signed but will not close until a later date. Think of this as similar to a house purchase – you do not purchase the home and move in on the same day. While this happens all the time for all sorts of businesses, the reasoning in this case is somewhat unique.

Physicians (like lawyers) are almost always obligated to provide notice to patients that he or she is leaving the practice. A seller will be reluctant to make this announcement

prior to signing an agreement, while a purchaser will be reluctant to pay the purchase price in full, until the notice period to patients given by the seller is over and the purchaser begins to work full-time.

How and when the deal will be signed and closed will be negotiated on a case-by-case basis, but both sides may have legitimate concerns regarding when the deal is signed, and funds are paid.

(iv) Unique Considerations

- a. *License Requirements:* Physicians are often required to maintain memberships and keep licenses in good standing. Depending on the circumstances, it may be prudent on the seller to make these requirements part of the conditions for closing the deal. Failure of the purchaser to have his/her license in good standing (among other things) on the date of closing could be grounds to terminate the deal.
- b. *Group Practices:* If the seller operates his or her practice as part of a group, the purchaser may reasonably inquire as to how costs are apportioned among group members. Ideally, this would have been addressed in an agreement. If the group uses a wholly owned management company to manage its common affairs (lease, employment agreements etc.), the purchaser may be expected to participate in this management company and pay his or her proportionate share of expenses.
- c. *Liabilities After Closing:* The purchase agreement should list what liabilities, if any, the seller may be responsible for post-closing. It is also the seller's opportunity to make clear all the liabilities the purchaser is assuming. For example, the seller may have 'promised' that it is up-to-date on all payroll taxes and is in compliance with the terms of the lease, but after-closing, the purchaser finds out taxes are owing and the seller is not in good standing under the lease. Similarly, the seller may have expected the purchaser to extend employment offers to all employees, but after the deal closes, finds no such offers have been made. These situations can be avoided with clear, simple and precise drafting.

### **This is not the Death of the Handshake**

In any business transaction, trust is paramount. If you do not trust the person with whom you are dealing, paperwork alone will not save you from unscrupulous conduct. Although it will help mitigate the damages. Handshake deals remain pervasive and, in many circumstances, can work well. However, when agreements are not in writing and issues arise, it is usually more challenging to reach a resolution – hence, the value of an agreement.

Undoubtedly, on certain points a buyer or seller will simply choose to trust the other party to act reasonably. Without this trust, every agreement would be a cumbersome project.

At Houser Henry & Syron LLP, we regularly advise clients on drafting and entering agreements that capture the core elements of the deal, without obstructing a desirable outcome. Our aim is to draft agreements that protect our clients and yield an efficient and cost-effective result.

If you have any questions regarding this article, the purchase or sale of a practice or implementing any of these items in your current practice, please contact Alexander Levy at [alevy@houserhenry.com](mailto:alevy@houserhenry.com) or 416-860-8016.

This publication is designed to help physicians identify and consider various factors when buying or selling a medical practice only. The content should not be taken as legal advice. We encourage you to speak to one of our lawyers for information or advice specific to your situation.

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