



presents

Hospital Acquisitions of Physician Practices

Legal Issues in Valuing, Negotiating and Structuring the Transaction

A Live 90-Minute Teleconference/Webinar with Interactive Q&A

Today's panel features:

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Tuesday, February 9, 2010

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1 pm Eastern

12 pm Central

11 am Mountain

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Hospital Acquisitions of Physician Practices

February 9, 2010

Introduction

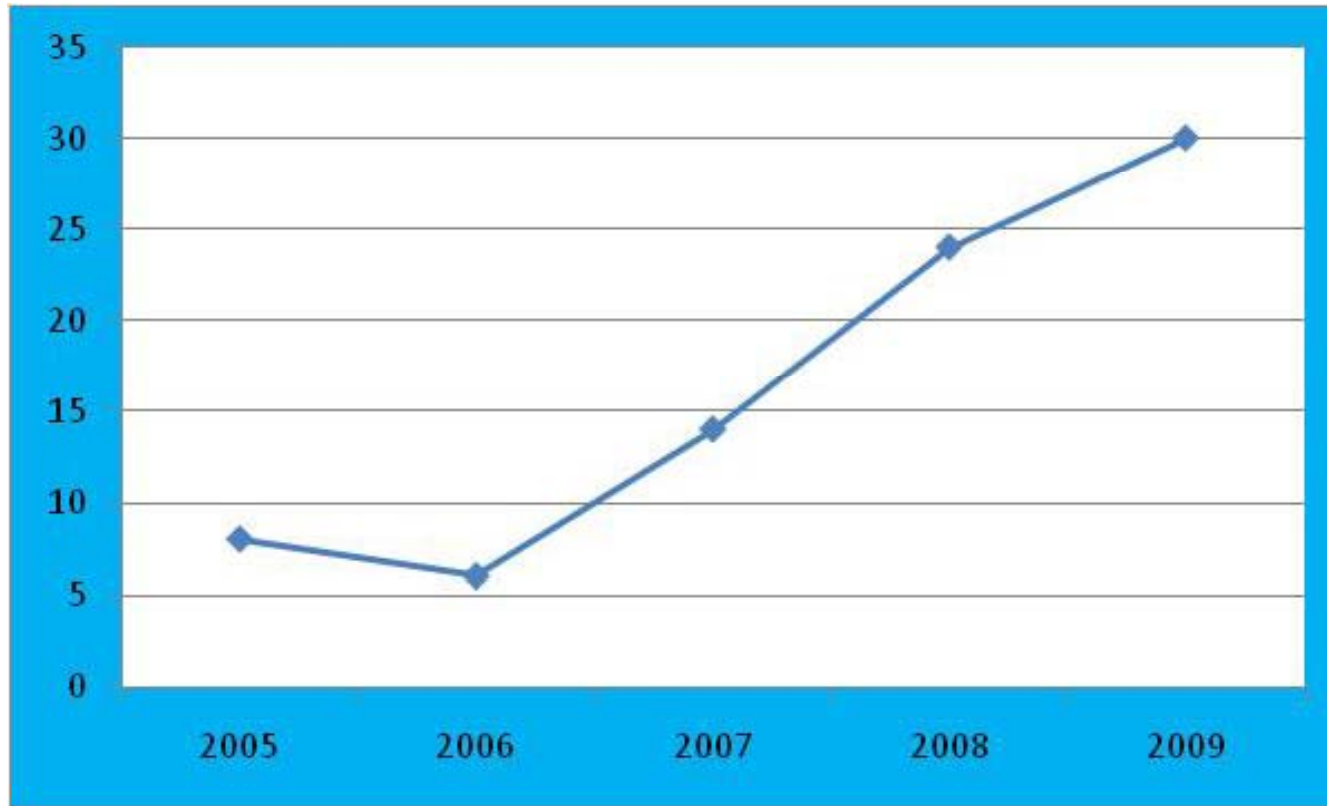
Introduction

- The most significant trend in investments by hospitals over the past few years has been investment and deployment of physician integration strategies
 - Direct employment
 - Acquisitions
 - Joint ventures
 - Contractual arrangements
 - Other arrangements

- A number of key external drivers are creating an impetus for physician acquisitions and other integration strategies
 - Legislative mandates for change
 - Managed care consolidation
 - Significant shortages of physicians in key specialties
 - Capital market changes

Hospital Acquisition Activity

Acquisition of Large* Medical Groups by Hospitals



Source: Irving Levin Associates and Cain Brothers

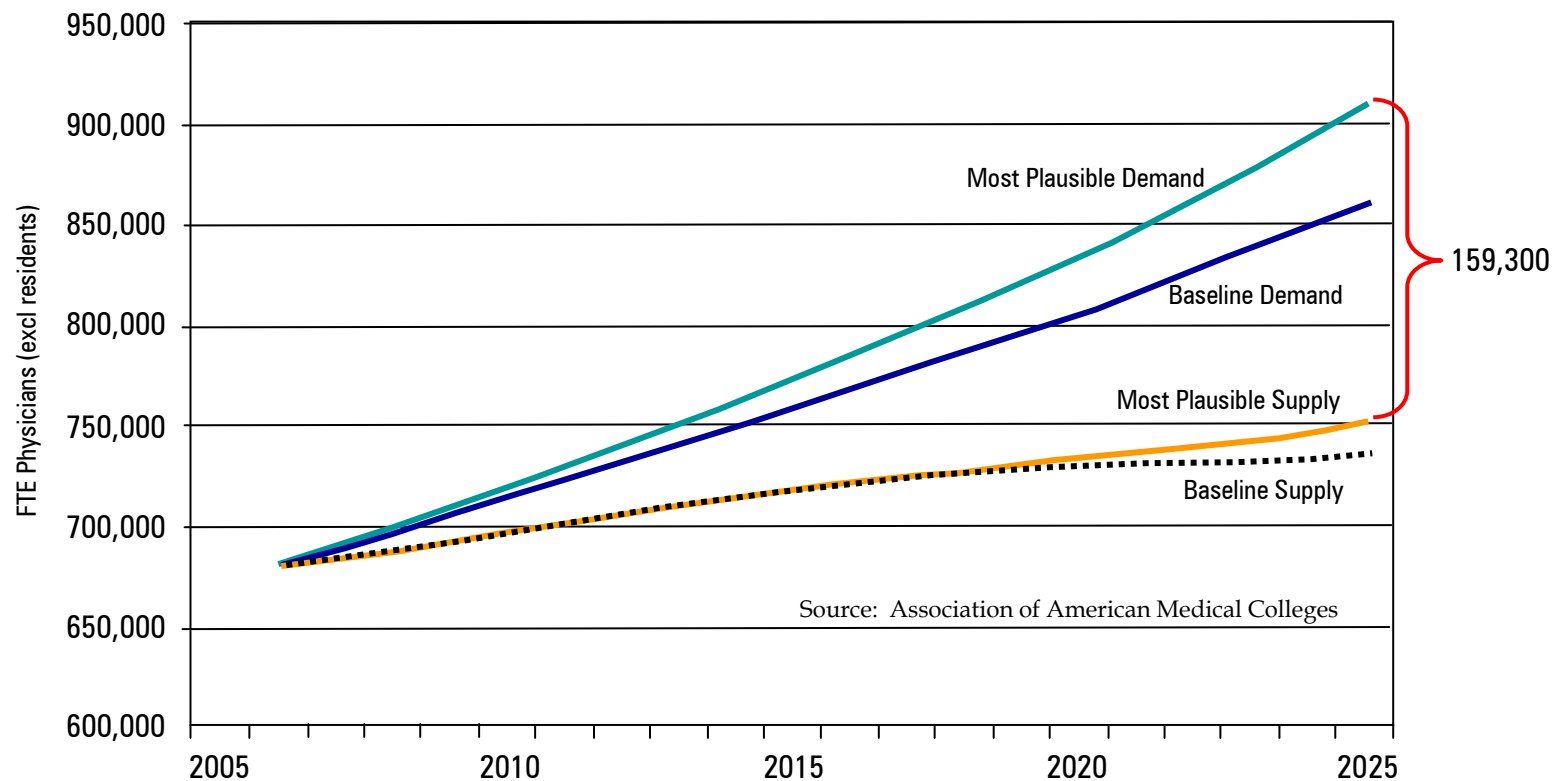
* Over 50 physicians in a group

Legislative Mandates for Change

- Legislation has created significant uncertainty for the industry
 - Health care reform and the failure's aftermath
 - New payment structures, whether "bundled" or "global" payments
 - Further reductions in opportunities for technical fees
 - Pressure on reimbursement

- Some changes are clear, with or without broad-based reform
 - Shift away from fragmented, volume-based payments
 - Unified payments based on episodes or populations
 - Pay for performance
 - Quality
 - Safety
 - Patient satisfaction

Physician Shortages

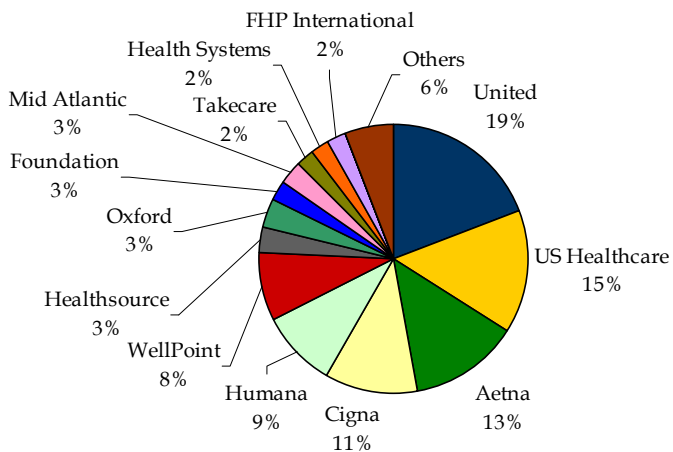


- Resources dedicated to retain and recruit medical staff will need to expand
- Cost and time to recruit will increase
- Payments to physicians to support hospital needs (call coverage, medical directors, performance improvement, etc.) will increase
- Stable practice models must be developed
- Physician integration strategies such as ASC joint ventures, employment models and market consolidation of existing practices into larger groups will be required to attract new physicians

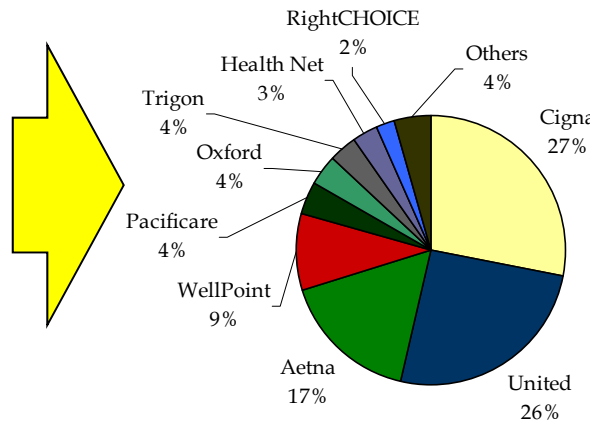
Managed Care Consolidation

- Since the mid 1990's, the managed care industry has seen significant consolidation
 - In many markets, providers are price takers with reduced clout to secure favorable contract terms
 - Providers in markets that consolidate either horizontal (hospital/hospital) or vertically (hospital/physicians) have been able to offset concentration of managed care payors

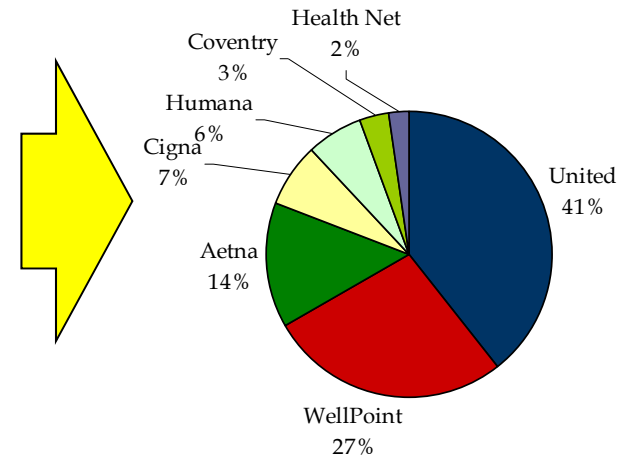
Managed Care Companies (as a Percentage of Total Market Capitalization)



1995 - Total \$40.6 billion
Top 5 = 67% of total



2000 - Total \$54.5 billion
Top 5 = 83% of total



2009 - Total \$83.7 billion
Top 5 = 95% of total

Capital Markets

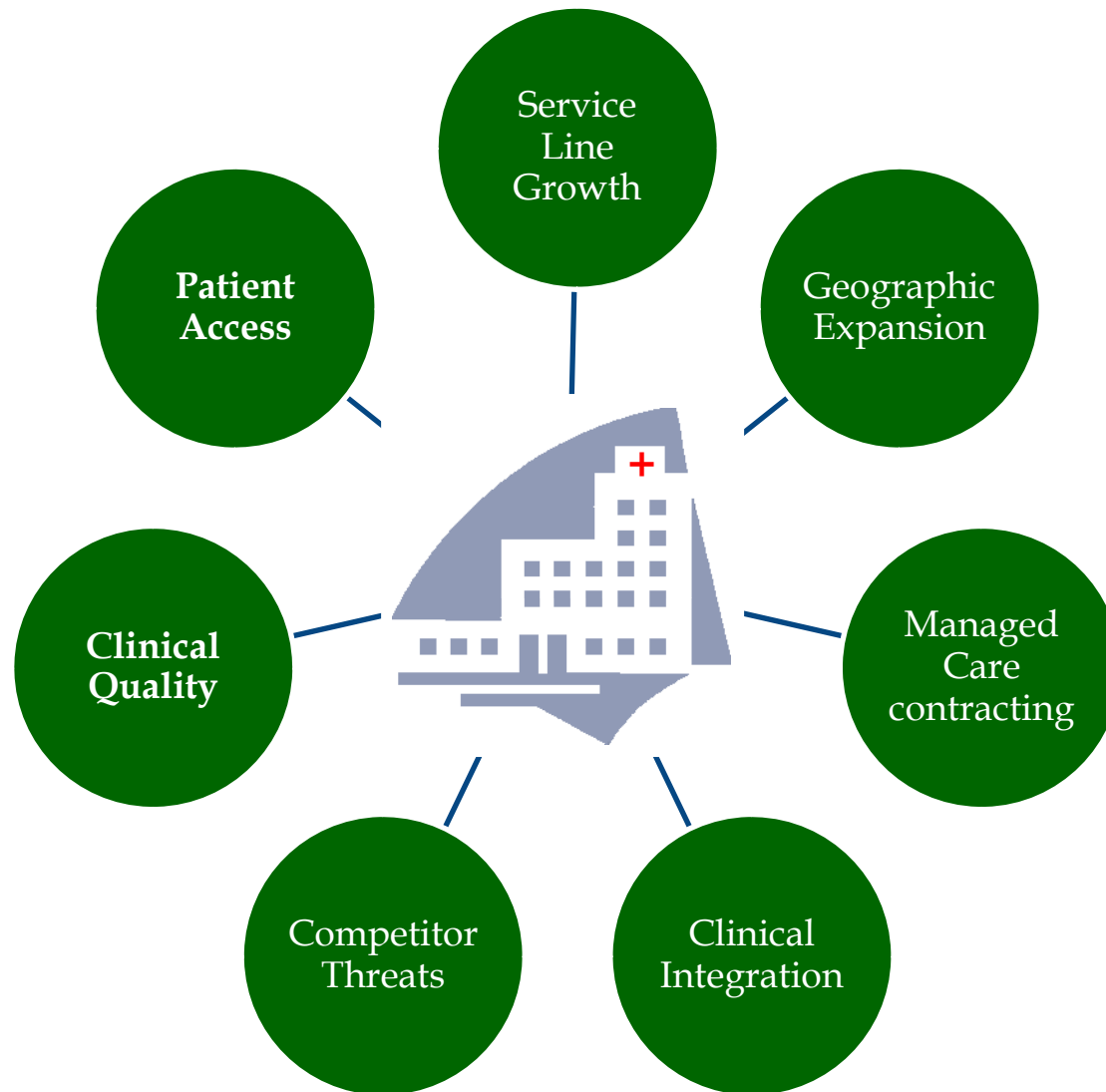
- Current capital market conditions makes access to tax-exempt debt capital difficult
 - Weaker balance sheets from investment losses and higher borrowing costs have changed the fundamentals of health care financing – challenging access to capital and re-prioritizing projects
 - Capital markets have “tightened” significantly, with lenders less willing to place extraordinary amounts of leverage on companies and have returned to more conservative lending practices
 - Although appetite for attractive investment opportunities have seen increased interest in recent months, investors are still cautious
 - Higher interest rate environment seems to be market expectation resulting in caution after brief optimism in last fall

- Constrained access to capital has lead a number of hospitals and health systems to alter strategies including:
 - Pursuing operational efficiencies and more focused attention to core businesses
 - Reprioritizing capital allocation including halting major projects
 - Divesting and realigning hospitals within their system that are not “core” assets
 - Attracting external capital through JV and/or affiliation agreements
 - Divesting of non-core assets and operations

- Despite market, rating agencies and bond investors are increasingly focused on how hospitals pursue physician strategies

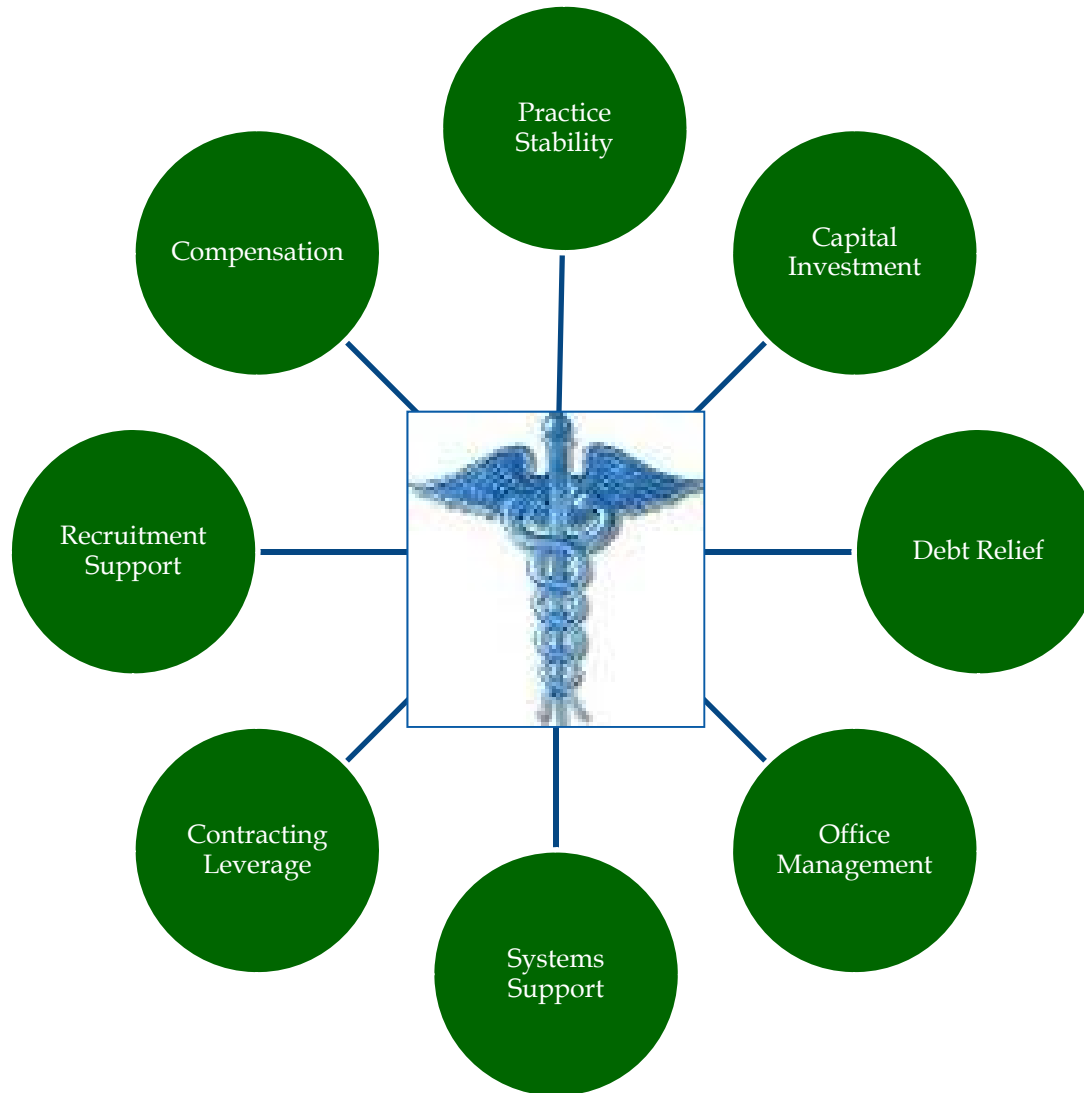
Hospital Strategic Rationale

Most hospital acquirers of physician practices focus on a number of key business, clinical and community-centric issues important to the decision.



Understanding Physician Objectives

Physician groups selling their practices have multiple motivations



Business Considerations

- In evaluating an acquisition there are a number of key issues that hospitals must consider
 - Financial Impact
 - Valuation
 - Funding sources
 - Pro forma financial impact
 - Impact on corporate allocations
 - How much allocated costs is shifted
 - Debt capacity and access to capital
 - Balance sheet
 - Income statement
 - Opportunity cost (capital allocation tradeoffs)
 - Impact on organization relationships and culture
 - Shared vision and mission
 - Corporate citizenship
 - Fit with larger enterprise

Business Considerations

- Resource Assessment
 - Management
 - Systems
 - Scalability
- Compensation Structure
 - Impact on value
 - Incentives for productivity
 - Collections
 - Alignment of other incentives
 - Core measures
 - Citizenship
 - Education and research
- Other Issues
 - Clinical care coordination and quality impact
 - Non-compete restrictions
 - Impact on core business third-party relationships and contracts (managed care, vendors, etc.)
 - Community impact and perception
 - Brand impact; especially if operations continue to be operated under same

Valuation Issues

Valuation Issues

- Traditionally, the question of valuation was determined by hospital buyers anxious to placate their physician partners.
 - Hospitals often overpaid for physician practices based on valuations not objectively validated.
 - Hospitals were not overly concerned with the impact of transactions on bond ratings
- Valuations have become a staple of physician/hospital relationships.
 - The concept of fair market value pervades almost every important legal principle applicable to these transactions.
 - Federal “Stark” law and “Anti-Kickback” statute mandate that the consideration paid for the physician practice be no more than, nor less than, the fair market value.
 - Physician compensation must be set at fair market value for the services provided
 - Fair market value is critical to retaining a hospital’s exempt status
- There is no single answer as what constitutes fair market value. The standard is a reasonably defensible opinion of value
 - Buyer
 - IRS
 - OIG

Valuation Issues

- “Value” is an opinion, not a “price”
 - Judgment applied to a set of circumstances
 - A practice can have a value without a price
 - Value is determined, price is negotiated between two specific parties, each with their own unique situations and needs.
 - Values are often a matter of differences in opinions
 - Are you the buyer or the seller
 - Underlying assumptions differ
 - Assessment of the future differ
 - Past may or may not be indicator of the future

- Using medical practice benchmarks
 - A medical practice valuation requires comparison to relevant benchmarks.
 - Financial statistics differ radically by specialty, geography, market characteristics, etc.

Valuation Issues

- Most physician practice leaders over-value their practices
 - Physician groups and their leadership are typically proud of their practices and what has been built
 - Entering into negotiations to sell their practices, physicians often have high (unrealistic) expectations of value
 - They have spent years of "blood, sweat & tears" building them and believe there value associated with that effort
 - Recognize and seek value for the referrals they will make to the acquiring hospital
 - See value created by increased reimbursement for physician services under hospital contracts
 - Leverage competition

- Gaps in expectations can create challenges for hospital acquirers
 - Economic rationale and discipline can be difficult to sustain
 - Prohibition from paying for strategic value
 - Referrals
 - Benefit from improved managed care contracting rates

Valuation Issues

- The answer to what practice should be valued at is: " it depends".
 - Generally, all but the largest physician practices generate minimal free cash flow beyond what is needed for working capital and servicing debt
 - The value of physician practice assets to be acquired will be constrained by the expected cash flow generated from these assets after physician compensation is paid
 - To the extent physician compensation remains the same or even increases after an acquisition, expected cash flow to the hospital from the practice may be limited
 - The value of the practice will then be limited as well

Valuation Issues

■ Determining reasonable medical practice valuation

- A valuation should be based on a notion of "reasonableness"
- A typical test of reasonableness is that the purchase of a practice should pay for itself, above the income available from simple employment, within 4 to 7 years or generate a return on investment of around 10-12% %
- Another is the "principle of substitution".
 - A hospital should not pay more for a practice or get a lesser return than available from purchase of a substitute
 - Limit to cost of starting a substitute competing practice
 - Net cost less than employment-without-purchase
- Strategic Value
 - Exceptions to the rule start changing the valuation to other standards of value other than fair market value
 - Hospitals must be careful to not pay a strategic premium to buy a practice above fair market value
 - Contracting rates
 - Referrals

Fairness Opinions

Fairness Opinions

- Board members have a number of duties including *duty of care* that requires them to be reasonably informed when making specific decisions on behalf of their stakeholders.
 - Transactions involving change in control
 - Purchase or sale of significant assets
- A formal opinion, most often referred to as a “fairness opinion,” rendered by an expert also serves as evidence that a board and its members have conducted a process that was sufficient and consistent with meeting its fiduciary obligations
- Overall attention to corporate responsibility and recent interest in the general topic of fairness opinions by nonprofit regulatory bodies are all signals that boards need to be careful in using and contracting for fairness opinions
- Boards should review their organization’s individual circumstances match specific recommendations to their needs.
- Fairness opinions are often obtained where:
 - Boards are likely to be second-guessed about its ability to act on behalf of all stakeholders
 - Regulatory review is more aggressive
 - Tax opinions and legal opinions are required to complete a transaction

Fairness Opinions

- Fairness opinions are appropriate for both investor owned companies, whether publicly owned or privately held, and nonprofit organizations.
- The fairness opinion itself is a short letter from a firm considered expert in the area of health care M&A and finance expressing the expert's opinion that the transaction is fair from a financial point of view.
 - The opinion should be supported by detailed analytic calculations using standard industry valuation methodologies
 - Discussed with the board prior to the board making a final decision on a transaction
- Some health care transactions may also benefit from obtaining a valuation opinion instead of/ or in addition to a fairness opinion
 - Anticipated regulatory review processes
- A valuation opinion specifically estimates the fair market value of what is being considered, which might be the equity of a company, a line or lines of business, or an asset or group of assets, with or without related liabilities

Fairness Opinions

- A fairness opinion can serve as an important contributor to a board’s decision making. It also shows evidence that a board followed a reasoned and deliberative process, and it can be used to defend board members against potential legal challenges
 - IRS
 - OIG
 - Stakeholders.
- A fairness opinion is a determination by an expert that a proposed business transaction is “fair from a financial point of view” as of a specific date.
- The opinion is usually issued to the stakeholders of an organization or those with governance responsibility and fiduciary duties owed to the stakeholders.
- Expert firms that deliver fairness opinions have experience in the relevant market and in related financial matters.

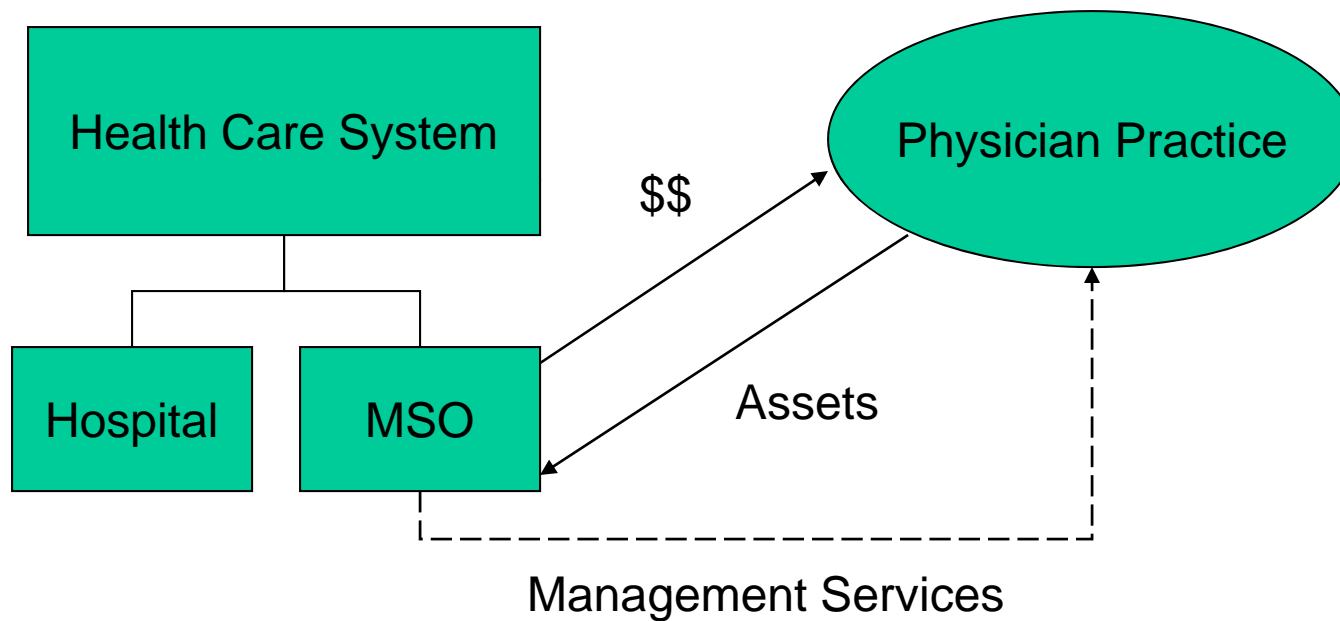
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Physician Practice Acquisition

Roger D. Strode, Jr.
McDermott Will & Emery
February 9, 2010

Typical Transaction Structures

MSO Model



Typical Transaction Structures

MSO Model

- MSO acquires tangible assets of the Physician Practice
- Physician Practice remains independent
- MSO provides turn-key management services to Physician Practice
 - Equipment
 - Physician extenders
 - Billing
 - Collections
 - Accounting

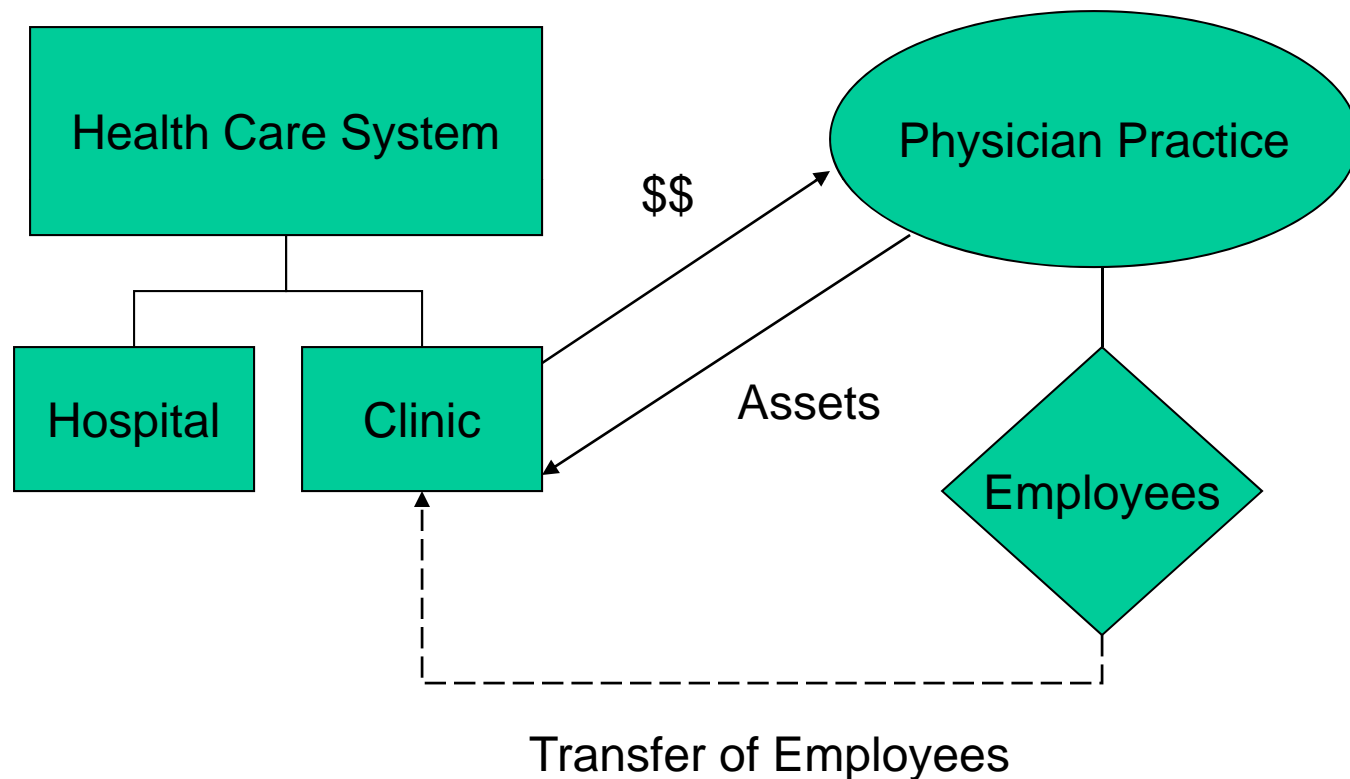
Typical Transaction Structures

MSO Model

- Purchase price limited to value of hard assets
- Physicians relieved of burdens of:
 - Capital investment
 - Administration of practice
- Physician Practice remains at risk for reimbursement and physician compensation
- MSO services must be provided at FMV

Typical Transaction Structures

Full Asset Purchase/Employment



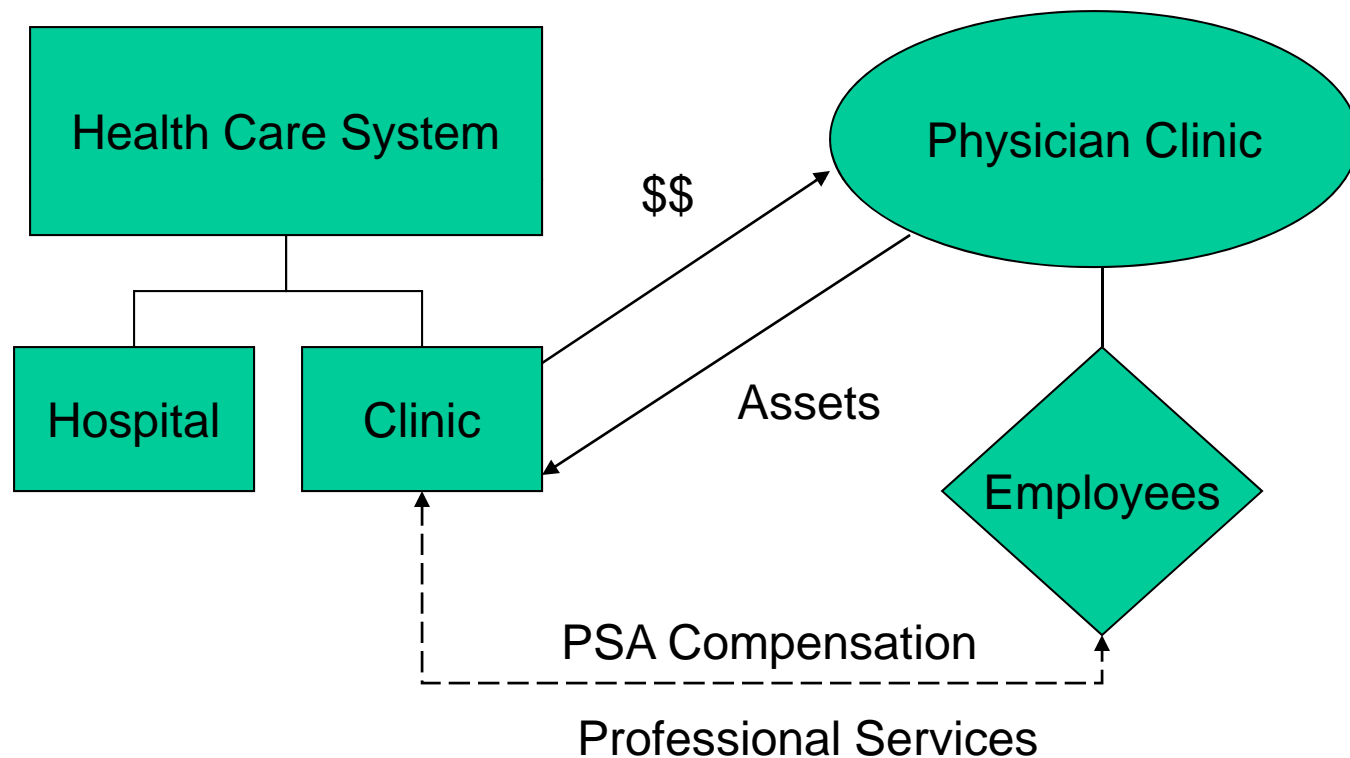
Typical Transaction Structures

Full Asset Purchase/Employment

- Assets of Physician Practice are purchased by Health System Clinic at fair market value
- Physician employees, along with clinical and non-clinical staff become employees of Health System Clinic
- Physician employees are compensated at fair market value in Stark Law compliant employment arrangements

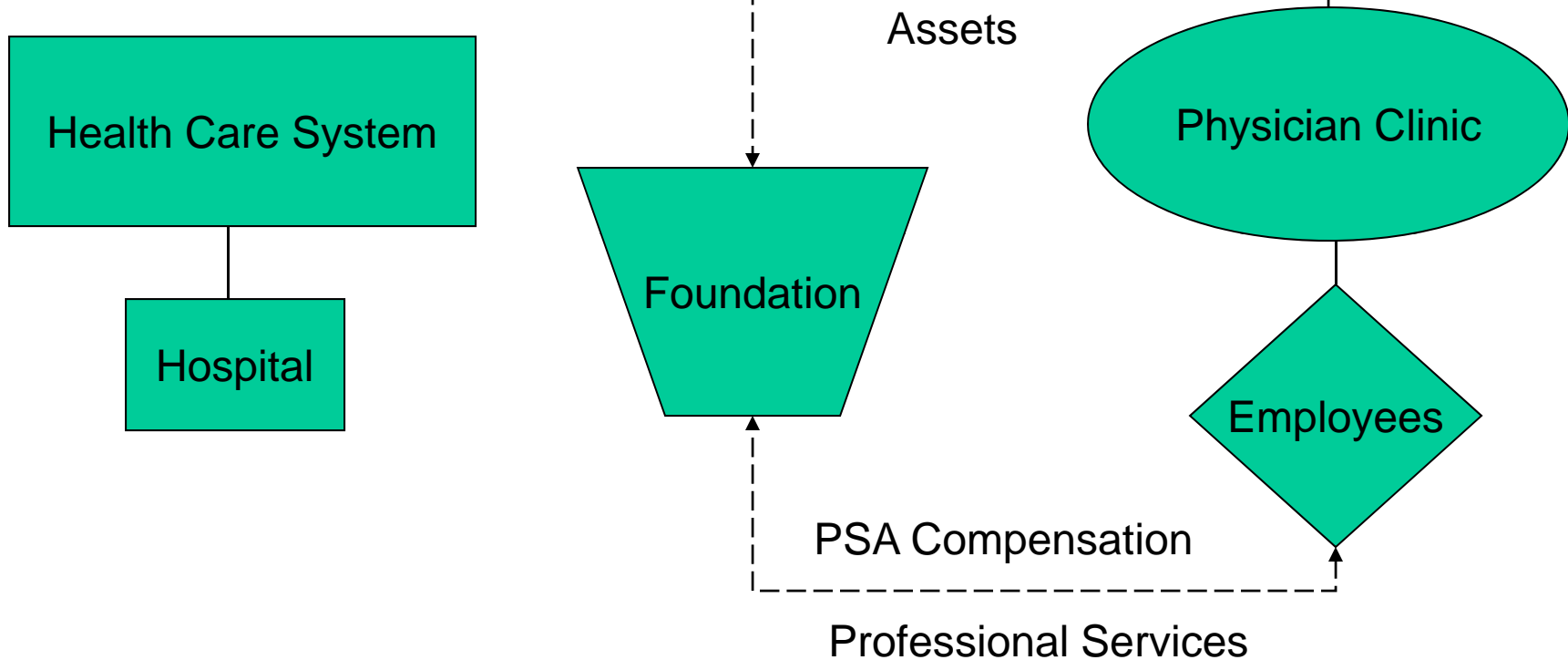
Typical Transaction Structures

Asset Purchase/PSA Arrangement



Typical Transaction Structures

Asset Purchase/Foundation



Typical Transaction Structures

Asset Purchase/PSA Arrangement

- Assets of Physician Practice are purchased by Health System Clinic or Foundation at fair market value
- Clinical and non-clinical staff become employees of Health System Clinic or Foundation
- Physicians remain employed by Physician Practice and enter into a long-term professional services arrangement to provide professional medical services to Health System Clinic or Foundation for fair market value compensation, which may include a medico-administrative fee
- Health System Clinic or Foundation retains right to bill for physician services
- Clinic or Foundation operated as 501(c)(3) organization

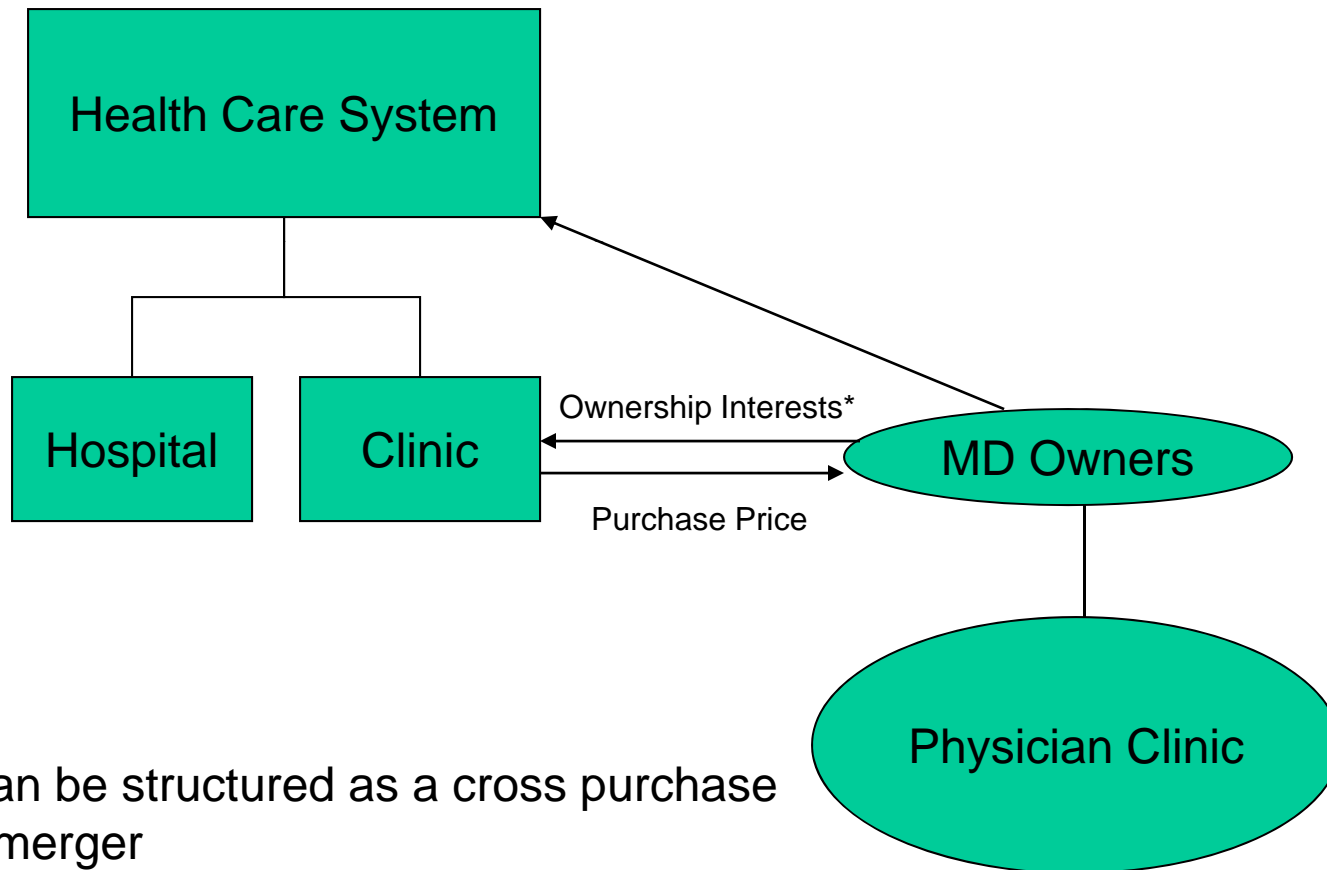
Typical Transaction Structures

Asset Purchase/PSA Arrangement

- Model works best in states where corporate practice of medicine is an issue
- Physician relieved of burden of capital investment and administration of Physician Practice
- Physicians remain responsible for their compensation utilizing PSA compensation
- PSA compensation can be structured utilizing various compensation methods

Typical Transaction Structures

Stock Purchase/Merger



*Can be structured as a cross purchase or merger

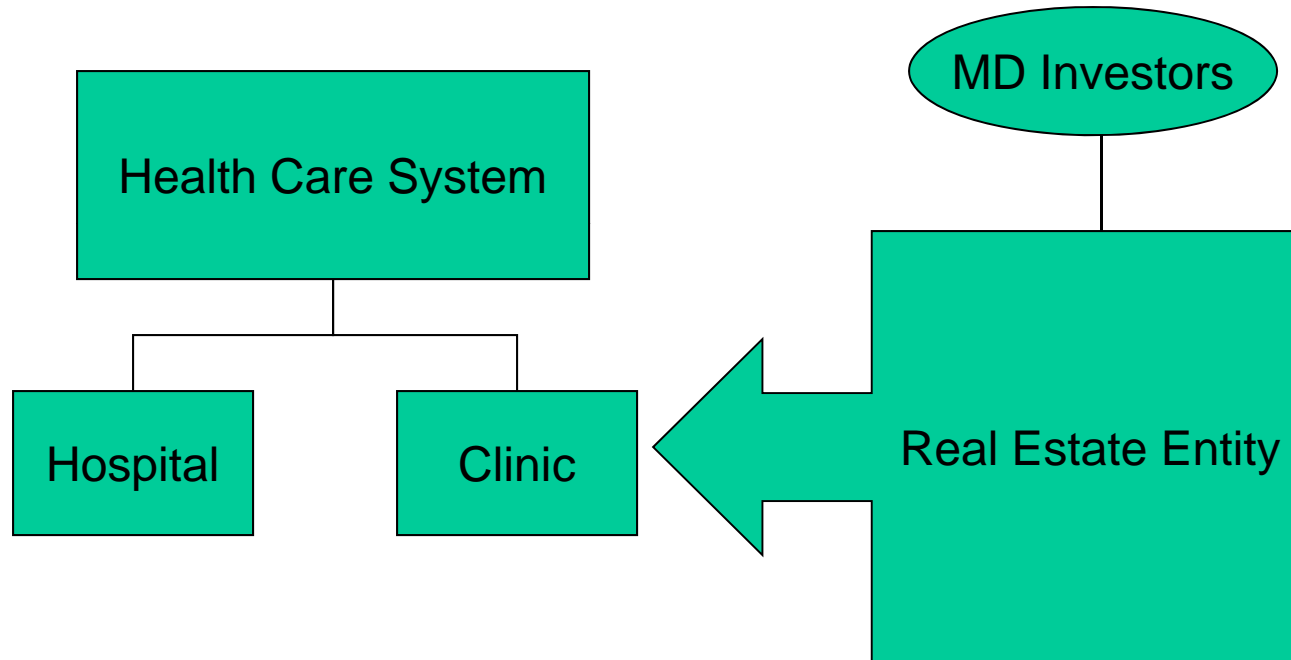
Typical Transaction Structures

Stock Purchase/Merger

- If possible, can be used to avoid double tax on physicians
- Also, can be used to avoid changes in licensure or assignment clauses
- Can be used in non-CPM states
- In certain states, physician practice can be converted to traditional stock corporation to allow for stock purchase by Health System or merger (including cross-species mergers)

Typical Transaction Structures

Real Estate Component



Typical Transaction Structures

Real Estate Component

- Often, physicians will hold practice real estate in a separate entity
- Transactions often structured to allow physicians to retain real estate and enter into leases with Health System
- Current leases can be renegotiated to longer term arrangements
- Lease valuations often are advisable

Physician Compensation Models

- Very few “guaranteed” salary models (mistakes of the 80s/90s transactions)
- Physicians generally compensated through production based models
 - Revenue *minus* expenses
 - Base compensation *plus* incentive compensation (incentive at risk)
 - Work relative value unit production (WRVUs allocated to CPTs)
 - Incentives for quality, good citizenship, etc.
- Physician participation in ancillaries
- Compensation must meet Stark Law exception
 - Fair market value a critical component
- Consider recent DOJ activity around physician compensation

Critical Business Issues

- Valuation Issues
 - All regulatory analyses turn on FMV
 - Formal valuations close the gap between perception and reality
 - Most tax exempt systems insist on third party valuations of physician practices
 - Physician professional component generally has relatively low valuation
 - Most value embedded in ancillary businesses that spin off cash flow (imaging, ASC, lab)
 - Certain intangible assets have value
 - Workforce in place
 - Medical records
 - Trademarks and trade names
 - Use of “stay bonuses”
 - Payments for covenants not to compete

Critical Business/Legal Issues

- Due Diligence
 - Like divorce, it is expensive...but worth it
 - Not uncommon to find physician practices with compliance issues
 - Avoids later problems
 - Possibility of self-disclosure
 - Indemnity escrows

Critical Business Issues

- Transaction Issues
 - Purchase price
 - Consider tax consequences to physicians
 - Installment payments v. lump sum payment
 - No more “covenant” light deals
 - Certain percentage of “inked” physicians contracts as a condition to closing
 - Regulatory approvals
 - Indemnity escrows

Critical Business Issues

- Physician Compensation
 - Physician compensation must meet Stark Law bona-fide employment exception
 - AKS compliance requires “only” that physicians are bona-fide employees
 - Tax exemption concerned about excess benefit transactions and private inurement/private benefit issues
 - Most compensation plans are production based
 - All plans must yield compensation that is FMV
 - Possible to structure compensation to include ancillaries (DHS)

Critical Business/Legal Issues

- Physician Compensation
 - Covenant Health System (Waterloo, IA)
 - \$4.5 Million to settle Stark Law/False Claims allegations
 - Whistle blower competitor
 - 5 highly paid physicians (also highly productive)



FOLEY & LARDNER LLP

Hospital Acquisitions of Physician Practices: Legal Issues in Valuing, Negotiating and Structuring the Transaction

February 9, 2010

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Regulatory Issues

- Federal Issues
 - Federal Anti-Kickback Statute
 - Stark Law
 - False Claims Act
 - Civil Monetary Penalty Law
 - Tax Exemption Issues
 - HIPAA

Regulatory Issues

- Select State Law Issues
 - State anti-kickback statutes
 - State Stark laws
 - Corporate practice of medicine
 - Fee splitting
 - Covenants not to compete
 - Clinic/facility licensure
 - Certificate of need
 - State privacy/security laws
 - Fiduciary issues
 - Physician licensure standards/professional ethics

Anti-Kickback Statute

- Prohibits knowing and willful offer or receipt of remuneration intended to induce or arrange for referrals of business paid for by Medicare/Medicaid programs
- Civil monetary and criminal penalties
 - CMP of \$50,000 per violation
 - Criminal penalties: \$25,000 per violation and/or up to 5 years in jail
 - Exclusion
- Any purpose test and problem of mixed motives
- Safe harbors
- Advisory opinions not available on FMV

Anti-Kickback Statute

- Is the purchase price a disguised kickback from the buyer (overpayment) or seller (underpayments) to induce post-deal referrals?

AKS and Practice Acquisitions

- Practice acquisition safe harbors
 - Practitioner-to-practitioner safe harbor
 - Practitioner-to-other entity (hospital) safe harbor
 - Practice acquired is ***located in a HPSA***
 - Sale completion with 3 years
 - Seller not in a position to refer after sale completion
 - Purchaser must use diligent and good faith efforts to recruit a successor within 1 year to take over the practice
 - Most practice acquisitions are ***not*** safe-harbored
- Bona fide employment exception and safe harbor

AKS Valuation Issues

- Valuation Importance – independent appraisal of fair market value in arms-length transaction may negate adverse inference of improper intent
- Fair market value means the value in arm’s-length transactions, consistent with the general market value.
- “General market value” means the price that an asset would bring as the result of bona fide bargaining between well-informed buyers and sellers who are *not otherwise in a position to generate business for the other party*, or the compensation that would be included in a service agreement as the result of bona fide bargaining between well-informed parties to the agreement who are not otherwise in a position to generate business for the other party, on the date of acquisition of the asset or at the time of the service agreement. Usually, the fair market price is the price at which bona fide sales have been consummated for assets of like type, quality, and quantity in a particular market at the time of acquisition, or the compensation that has been included in bona fide service agreements with comparable terms at the time of the agreement, where the price or compensation *has not been determined in any manner that takes into account the volume or value of anticipated or actual referrals*.

AKS Valuation Issues

- Legitimate business purpose and commercial reasonability
- Goodwill – payment for intangibles to physician who continues in a position to refer is suspect (OIG letter to IRS (Dec. 22, 1992); OIG letter to AHA (Nov. 2, 1993))
 - Professional level goodwill
 - Practice level goodwill
 - Larger vs. smaller/solo practices
- Discounted free cash flow/discounted earnings approach takes into account the value of future cash flows
 - See e.g., OIG Adv. Opinion 09-09 (footnote 5) – contribution of ASCs to hospital-physician joint venture should not include intangibles valued on cash flow/going concern basis

Anti-Kickback Statute Issues

- Challenge is to value without taking into account future referrals by seller
- PharMerica settlement
- Other matters affecting value under income approach
 - Salary to selling physicians post-sale
 - Overcoding
 - Payment for noncompete
 - Revenue growth assumptions
 - Deferred capital investments
 - Size of practice

Anti-Kickback Statute Issues

- Other Valuation Issues
 - Existence of true comparables under market approach
 - Same specialty and mix of services?
 - Same market?
 - Same time period?
 - Same context?
 - Private vs. public company transactions
 - See Sta-Home Health Agency vs. Commissioner, Case No. 02-60912 (5th Cir. July 11, 2006) (Inappropriate market approach to valuation based on public company comparables for home care company with no invested capital and no history of profitable operations/no goodwill)
 - Earnouts of sellers who remain in a position to refer
 - Use of attorney-client privilege

Stark Law

- Prohibits a physician who has a direct or indirect financial relationship with a DHS entity from referring patients to the DHS entity for "designated health services" for which payment may be made under the Medicare or Medicaid program; unless a specific exception applies
 - "Designated health services" includes all inpatient and outpatient hospital services, lab, imaging, pharmacy, DME, radiation therapy, PT, occupational and speech therapy, perenteral and enteral drugs, nutrients, and supplies, prosthetics, orthotics, and home health services
 - \$15,000 civil monetary penalty assessed against physician for each prohibited referral
 - DHS entity must refund DHS billed pursuant to a prohibited referral
 - \$15,000 civil monetary penalty assessed against DHS entity for billing for service rendered pursuant to a prohibited referral, unless it can show that it did not have actual knowledge and did not act in reckless disregard or deliberate ignorance of the prohibited referral
 - \$100,000 civil monetary penalty for circumvention schemes
 - Requirement to report to HHS financial relationships with physicians upon request; \$10,000 penalty for failure to report
 - Potential exclusion

Stark Law

- Stark law – purchase price transaction creates financial relationship that will prohibit referrals to hospital buyer (or other DHS entity) unless an exception applies
 - Zero tolerance law
 - Stark analysis has changed due to new “stand in shoes” rule
 - Stock transactions – payment to physician (direct)
 - Asset transactions – payment to medical group (indirect)
 - Direct compensation exception needed for physician owners
 - Direct or indirect compensation exception for titular owners and non-owners

Stark Law

- Principal direct compensation exception for practice acquisitions is isolated transaction exception
- Isolated transaction exception – compensation exception only (not applicable if stock, warrants, options or other investment interests are part of purchase consideration)
- Isolated transaction standards
 - Aggregate payments fixed in advance (no earn outs)

Stark Law

- Payable even if default by buyer (negotiable note or guaranteed by third party)
- FMV, not taking into account volume or value of referrals or other business generated between the parties
 - Similar to valuation issues under AKS if seller will continue to be in position to refer
 - Particularly acute if selling medical group provides ancillaries
 - Advisory opinions on fair market value not available
- No other transactions for 6 months except:
 - Other Stark Law excepted transactions
 - Commercially reasonable post-closing adjustments
- Burden of proof is on defendant
- Violations are not remedied until referring physician/DHS entity repays excess compensation or arrangement is terminated

Stark Law Issues

■ Other Stark Law Issues

- Installment sales – permitted if integral to transaction and payments guaranteed even if buyer defaults
 - Secured debt instrument treated as investment interest (isolated transaction exception does not apply)
- Sale of physician lab or DHS services – not permitted if price is based on anticipated post-transaction referrals by physician owners
- Investment interests in buyer (DHS entity)
 - Stock options and convertible securities issued as “compensation” are not investment interests
 - Investment interest exceptions for rural providers, and publicly traded securities
 - No small entity exception

Stark Law Issues

- Associated transactions (e.g., employment, consulting, lease agreements) and other Stark Law exceptions
 - Employment
 - Identifiable services
 - FMV and commercially reasonable
 - Not take into account v/v of DHS referrals
 - Personal services
 - Space rental or equipment rental
 - Fair market value
 - Indirect compensation

Tax Exemption Considerations

- 501(c)(3) Exemption Standards
 - No inurement
 - Not more than incidental private benefit
- CPE Guidance
 - Obtain appraisal of FMV
 - Agreement with selling physicians to retain goodwill
 - Pay market rate compensation (on the same scale as other employees) or justify higher comp
 - FMV lease of assets retained by practice

Tax Exemption Considerations

- Revocation authority and intermediate sanctions
 - Modern Health Care Services (d/b/a LAC Facilities) 94 TNT 216-38 (Nov. 3, 1994) – revocation
 - Carracci (Sta-Home) case – proposed revocation and intermediate sanctions overturned due to IRS valuation errors

Tax Exemption Considerations

- Lessons of Carracci Case
 - Select a qualified appraiser with particular expertise and experience
 - Properly take into account third party payor methodologies and rates
 - Use true market comparables
 - Follow process for rebuttable presumption of reasonableness (to shift the burden to the IRS to establish that appraised value is incorrect)

Tax Exemption Considerations

- Rebuttable presumption process
 - Approved by board or committee with no conflict of interest
 - Rely on appropriate data as to comparability
 - Determine that the property transfer is at FMV
 - Document basis of decision within 60 days after decision

Tax Exemption Considerations

- Charitable contribution of practice assets/valuation misstatement cases
 - Charitable deduction for donation of assets with value in excess of benefits received
 - Penalties for valuation misstatements (IRC § 6662)
 - 40% if overvalued by 400% or more and deduction exceeds \$5,000
 - 20% if overvalued by 400% or more and deduction does not exceed \$5,000
 - No penalty if taxpayer makes good faith investigation and relies on valuation by a qualified appraiser

Tax Exempt Considerations

- Derby case, T.C.M. 2008-45 (Feb. 28, 2008)
 - Disallowance of claimed charitable contribution to Sutter Medical Foundation (SMF) by physicians associated with Sutter West Medical Group (SWMG)
 - Part of practice consolidation transaction by which SMF purchased tangible assets, guaranteed compensation, and paid sign-on bonus of \$35,000/M.D.
 - SWMG physicians did not meet their burden of showing that value of intangibles donated exceeded value of benefits obtained from SMF, notwithstanding independent valuation using DFC method
 - Potentially above market compensation

Tax Exempt Considerations

- Derby case (con't)
 - Sign-on bonuses
 - No post-termination non-compete; personal goodwill not transferred
 - No valuation misstatement penalties
- Bergquist case, 131 T.C. 2 (July 22, 2008)
 - Tax court reduces charitable deduction of \$401.79/share to \$37/share for contribution of PC stock, and imposes valuation misstatement penalties

Tax Exempt Considerations

- Bergquist case (con't)
 - Tax court found that practice should not have been valued as going concern
 - Wind-down and payout of A/R at point of consolidation
 - No tangible assets
 - No non-competes
 - IRS valuator assessed value at \$37/voting share using market approach (assets net of liabilities, discounted for lack of control interest and marketability)
 - Penalties imposed because physicians unreasonably relied on assumption of going concern value when they knew (or should have known) otherwise

Regulatory Compliance

■ Advice

- Document proper purpose of acquisition: community benefit
- Disclaim improper purpose: induce referrals
- No evidence of improper purpose
- Independent appraisal of FMV
- If seller will continue in position to refer, determine and justify valuation on basis that does not take into account future referrals by seller
 - Do not value professional level goodwill?
 - Do not pay for unenforceable noncompetes
 - Do not pay for DHSs
 - Avoid earnouts
 - Avoid exclusive use agreements

Regulatory Compliance

■ Advice

– Independent appraisal of FMV

- Select knowledgeable appraiser who has experience with medical practice valuations and is sensitive to health regulatory issues
- Diligence appraisal for health regulatory compliance
- Make sure valuation takes into account all aspects benefits received by sellers in transaction documents
- Do not value personal goodwill in absence of non-compete
- Rely on true market comparables
- Do not use going concern value (income or market approach) for practice that is otherwise going out-of-business

Regulatory Compliance

- Follow steps for rebuttable presumption of reasonableness if buyer is a tax-exempt entity
- Properly value any assets contributed to exempt organization
 - Assure that charitable deduction is reduced by value of benefits received in connection with donation
- Acquiring entity must be authorized to engage in the practice of medicine
- Comply with clinic licensure/CON requirements, if applicable