



WHITE PAPER

Due Diligence of Contracts

When you are considering a merger of your practice or when you are considering acquiring another practice, you will eventually have to undertake the due diligence process. Due diligence allows you to feel more comfortable that your expectations regarding the transaction are correct. In mergers and acquisitions, purchasing a medical practice without doing due diligence substantially increases the risk to you. As I have written about before, there are many facets of this process and while some are relatively standard, your particular transaction will certainly require customization. One area that is of particular importance is the review of contracts. In this article, I will give an overview of what due diligence of contracts entails. To be clear, note that we look at all contracts during due diligence; this includes provider contracts, employee contracts, hospital-related contracts (e.g. medical directorship, joint ventures, etc.), commercial payor contracts and vendor contracts. This is a not a task that can be done quickly as there can be many nuances to look into and depending on the medical practice, the review can be quite daunting.

Why care about contracts?

Due diligence gives you access to important and confidential information about a medical practice. For many medical practices, these existing contracts not only constitute intrinsic value, but they are also a source of significant operating obligations and even potential liability. Consequently, it is imperative that you have a proper understanding of the other practice's contractual rights and obligations. By gathering this information, you are better equipped to make an informed decision and close the deal with a sense of certainty. When soliciting the help of a transactional consultant and/or attorney, make sure you advise them of any particular areas that you want to address. As previously mentioned, this process should be tailored to determine what unique information you may be seeking to discover from the various contracts provided for review and whether any additional documents should be requested from the other practice.

Getting organized

Once the focus is properly tailored, a common approach to managing the information gathered from contracts is to create a table to summarize the contracts reviewed. We recommend the contracts are annotated when digitized to allow for cross-referencing within this master table.

We have found this to be an ideal setup as the process moves forward and various professionals need to refer back to a particular document. Having said all that, it is important to note that not all due diligence investigations are the same, and surprises are to be expected. This can greatly impact the length of the due diligence process as well as the time invested by all parties. And, if due diligence drags on for too long, one or both parties can lose interest in the potential transaction at stake.

Provisions and clauses and restrictions, oh my!

One of the items to initially look for is a signature. If the document isn't fully executed, then it isn't a valid contract, and that becomes a follow-on exercise to obtain correct documentation. Next we look to see if the contract contains any provisions that would render the contract void or would require consent as a result of the proposed transaction. These provisions can take the form of change of control termination or acceleration rights, anti-assignment clauses, or other transfer restrictions. As a buyer in an asset acquisition, you are acquiring the assets of the other practice and therefore the seller will have to assign contracts to you so that you can take them over upon closing. In a merger or stock acquisition, the entity being acquired frequently survives the transaction, and therefore no change to the parties to the contract will be required. Again, there may be certain particulars to your transaction that you will want to discuss with your transactional consultant and attorney. For example, we may find that a contract defines a change in ownership as constituting a transfer, a restriction which is potentially applicable to a merger or stock acquisition, and thus consent may be required.

The kitchen sink

Due diligence before a transaction involves a rigorous examination and evaluation of a medical practice's critical documentation. It must be conducted before a binding agreement is signed between parties. This ensures that all risks have been disclosed and all opportunities are on the table before the transaction proceeds. Depending on the context of the transaction, you may also be interested in duration, pricing, indemnification obligations, warranties, or any number of other provisions. In keeping with this, we often look into ongoing liabilities arising from the contracts that will survive the consummation of the transaction. Additionally, we want to red flag any non-compete provisions in contracts as they may result in unintended restrictions being place on you after the transaction is completed. Contracts on physicians and any other employees may need to be redone and thus the buyer will often have sensitive discussions with the seller during due diligence as it relates to those. If you have any questions regarding the documents, now is the time for the other practice to address your concerns.

Final thoughts

Disclosure of critical business information is fundamental when conducting due diligence. The whole point of the exercise is to be thorough and your transactional consultant should be assisting you with building a comprehensive list of questions for the components of the due diligence process.

Contract due diligence is just one part of the due diligence process, a process that is conducted to confirm and verify information that was brought up during transaction discussions, and to identify potential flaws in the opportunity and thus avoid a bad business transaction. Due diligence helps you understand the nature of a transaction, the risks involved, and whether the deal fits with your current practice and strategic plans. Essentially, undergoing due diligence is like doing homework on another medical practice and it is critical process in order for you to make informed decisions. When you are able to gather important on a medical practice, there is a lower risk of unexpected legal and financial problems as part of the transaction.

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P.O. Box 1465

Valrico, FL 33595

www.abisallc.com

info@abisallc.com