

Morgan Lewis

**HEALTHCARE**  
Mergers & Acquisitions

# PRIVATE EQUITY AND PHYSICIAN PRACTICE ACQUISITIONS: KEY LEGAL CONSIDERATIONS

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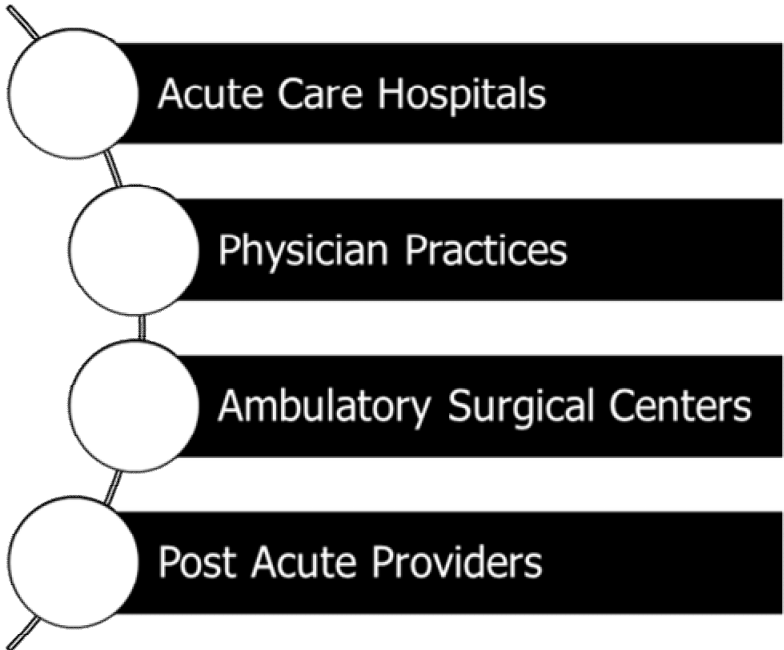


# Agenda

1. Market Trends in Physician Practice Acquisitions
2. Considerations in Structuring Physician Practice Transactions
3. Transaction Stages:
  - Letter of Intent
  - Due Diligence
  - Transaction Documents
  - RWI Coverage
  - Post-closing Obligations

# **MARKET TRENDS IN PHYSICIAN PRACTICE ACQUISITIONS**

# SECTORS INVOLVED IN HEALTHCARE M&A INDUSTRY



Transaction Distribution - YTD



Total: 1936  
Source: Bloomberg Law Health-Care Advisory Panel

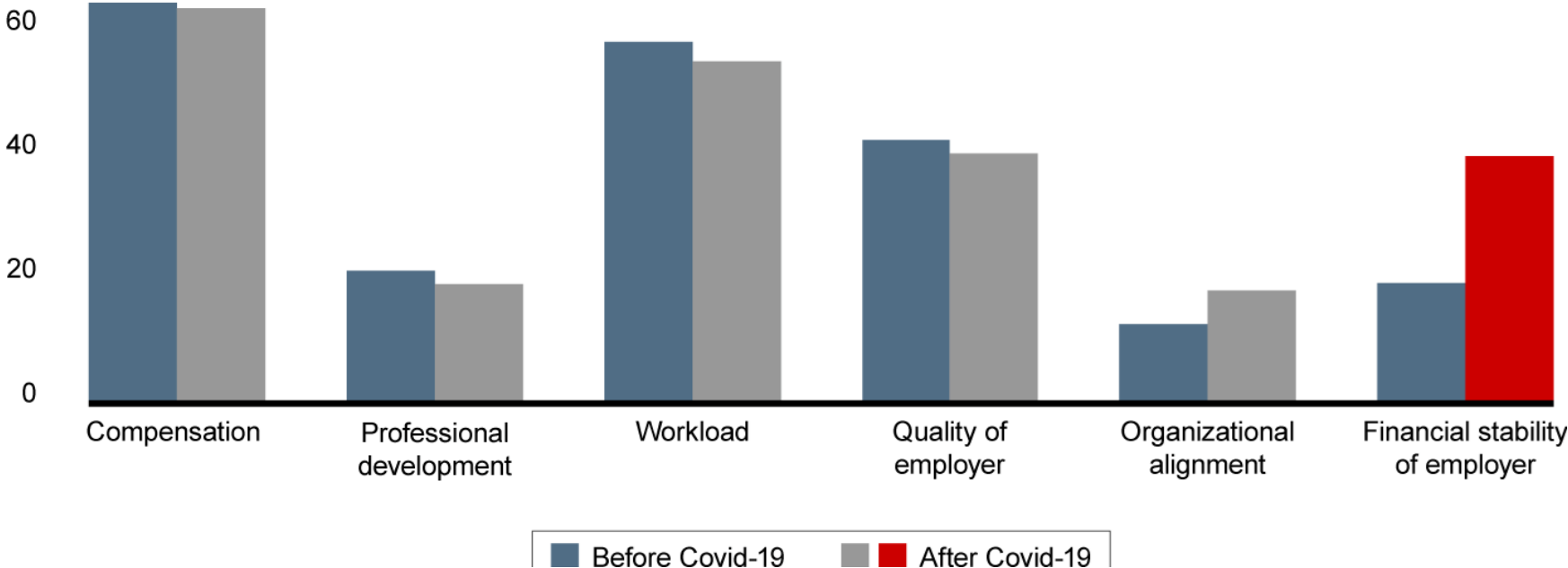
Bloomberg Law

# MARKET TRENDS FOR PHYSICIAN PRACTICES

- The fourth quarter of 2020 had the most physician medical group M&A activity for the year, increasing 15% from the previous quarter, according to data from HealthCareMandA.com.
- Compared to the 52 acquisitions recorded in the third quarter of 2019, the physician group M&A market accelerated in the last quarter of 2020 with 60 publicly announced transactions.
- “The M&A momentum from the fourth quarter has carried over into 2021 and we could see a record year for physician practice deals,” said Lisa Phillips, the editorial director at Irving Levin Associates.
- Nearly three-quarters of the deals announced in the fourth quarter involved private equity firms and their portfolio companies.
- The data shows that the physician medical group sector is attracting investors from outside the healthcare market, according to Lisa Phillips at Irving Levin Associates, which collected the data.
- The coronavirus pandemic has placed a renewed focus on the healthcare market in general. In fact, the Kaufman Hall analysts say the pandemic acted as a catalyst for future strategic partnerships and transactions, and they predicted an uptick moving forward.

Source of Information: Healthcare Finance: “Physician Medical Group M&A Peaked in fourth quarter of 2020.”

# EFFECTS OF COVID-19: STABILITY IS MORE IMPORTANT THAN EVER, PER BAIN & CO. STUDY



# PROS AND CONS OF PE INVESTMENT IN PHYSICIAN PRACTICE GROUPS

## PROS

- Fragmented Sector for Investment
- Upfront Liquidity Event in the Form of Tax-Advantaged Purchase Price
- Employed Physician Model with Consistency of Compensation Structures
- Capitalize on Brand Recognition
- Consolidation Opportunity
- Efficiencies of Scale by Consolidating the Back Office
- PE Firm Provides Capital Needed to Update Antiquated Systems and to Get to Scale

## CONS

- Complexity of Typical PE Model in Corporate Practice of Medicine States
- Commercialization of Healthcare
- Pressure to Grow the Practice
- Loss of Ownership and Control of Business Aspects of Business
- Uncertainty Related to Long-Term Exit Event

# **CONSIDERATIONS IN STRUCTURING PHYSICIAN PRACTICE TRANSACTIONS**

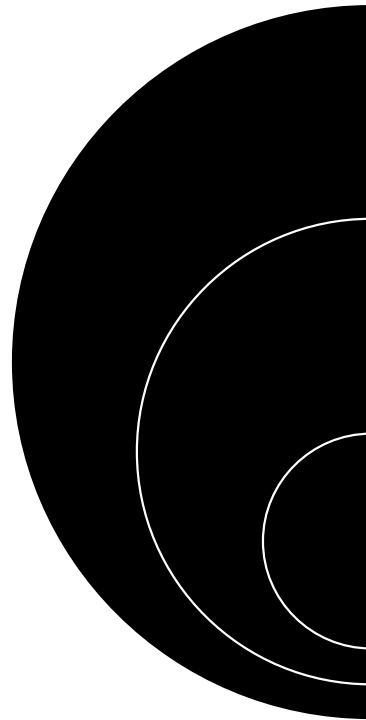


# TYPICAL STRUCTURE FOR ACQUISITION OF PHYSICIAN PRACTICE

The typical private equity transaction involving a physician practice contains four participants:

- the physician practice selling its assets
- the private equity firm funding the transaction
- the management company that acquires the physician practice's assets and employs its administrative and non-licensed medical personnel
- the physician practice that will employ the physicians and other licensed medical providers and owns the clinic assets if the private equity firm offers not to utilize the target physician practice as the medical practice going forward

# CONSIDERATIONS IN STRUCTURING A TRANSACTION



Tax Considerations	<ul style="list-style-type: none"><li>• Buyer and Seller Tax Considerations</li><li>• Timing Issues</li></ul>
Transaction Form	<ul style="list-style-type: none"><li>• Asset Transaction</li><li>• Stock Transaction</li></ul>
Commercial Issues	<ul style="list-style-type: none"><li>• Third-Party and Corporate Consents</li><li>• Deal Process and Timing</li><li>• Antitrust</li></ul>

# SPECIAL CONSIDERATIONS IN HEALTHCARE TRANSACTIONS

## Corporate Practice of Medicine (CPOM)

- Friendly Physician Model
- Foundation Model

## Fraud and Abuse

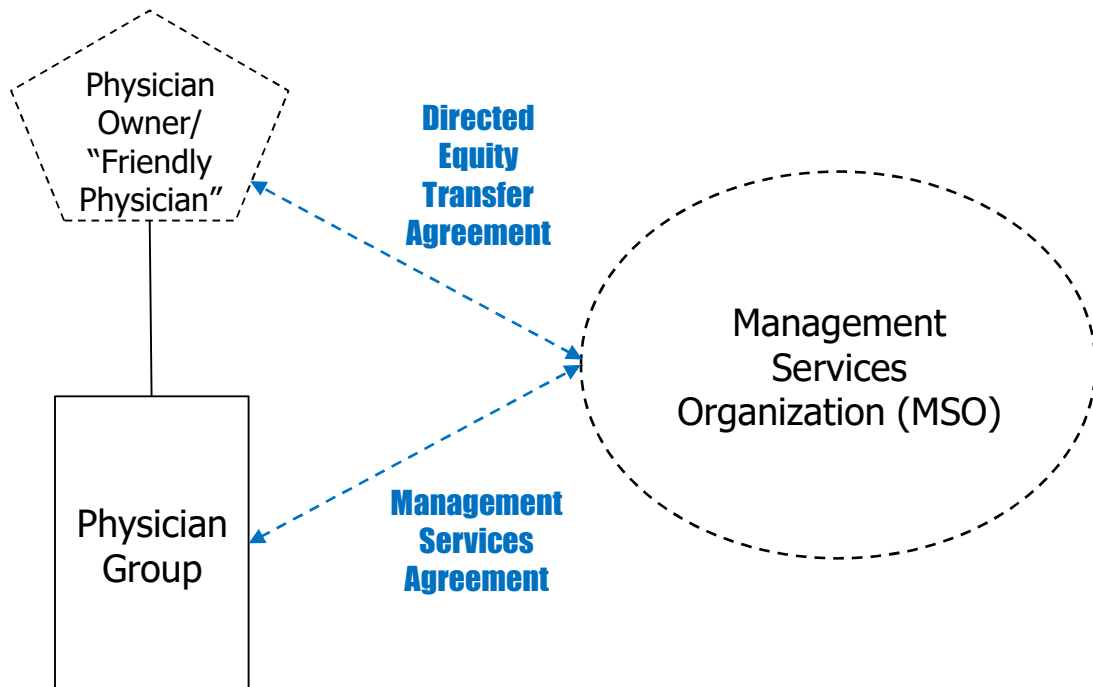
- Earnouts
- Stark Law/AKS

## Licensing and Enrollment

- Change of Ownership (CHOW)
- Certificate of Need (CON)

# CORPORATE PRACTICE OF MEDICINE

- CPOM prohibits certain relationships between physicians and non-physician-owned entities
- CPOM is a state law licensure issue



# TRANSACTION STAGES

# KEY STAGES OF AN M&A TRANSACTION



Letter of  
Intent



Due Diligence



Transaction  
Documents

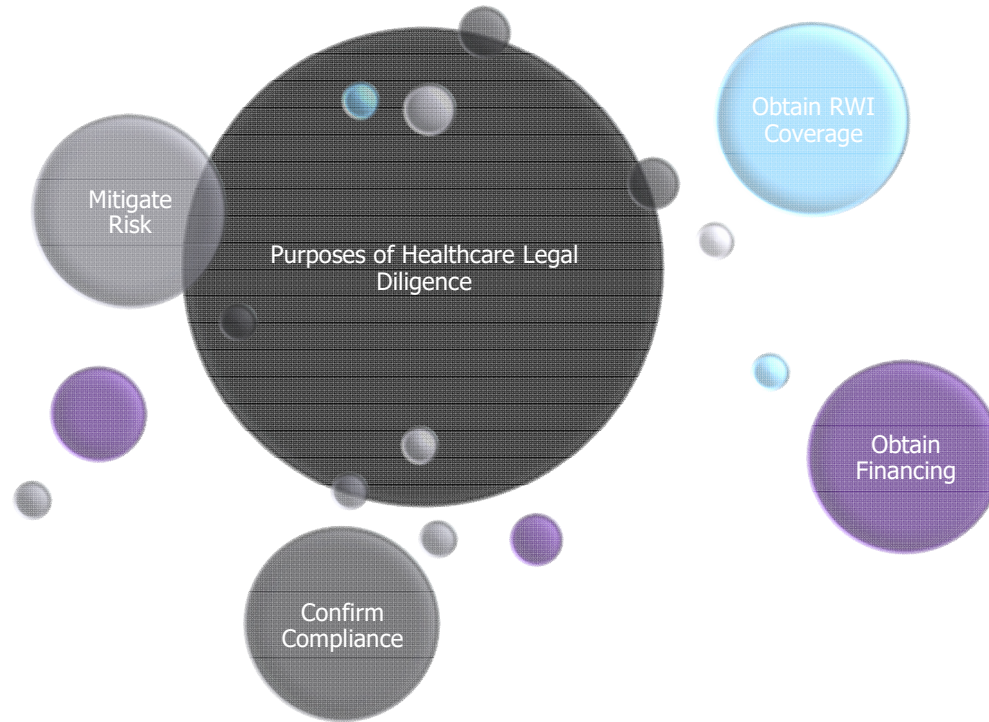


Post-Closing  
Obligations

# Letter of Intent

- Non-Binding
- Structure
- Purchase Price
- Form of Payment
- Tax-Free Rollover Aspects
- Communication Control
- Costs and Expenses
- Exclusivity

# HEALTHCARE DILIGENCE





# HEALTHCARE DUE DILIGENCE

- Customize the diligence based on the specialty of the physician practice
- Key regulatory issues vary based on physician practice specialty:
  - Ortho
  - GI
  - Ophthalmology
  - Dermatology
  - Women's Health
  - Substance Abuse
  - Hospital-Based Specialties

# COMMON AREAS OF HEALTHCARE DILIGENCE



# COMPLIANCE PROGRAM

- Seven elements of an effective compliance program:
  1. Written policies and procedures
  2. Compliance professionals
  3. Effective training
  4. Effective communication
  5. Enforcement of standards
  6. Internal monitoring
  7. Prompt response



# FRAUD AND ABUSE: STARK LAW/ANTI-KICKBACK STATUTE

- Stark Law:
  - Physician may not refer Medicare/Medicaid patients to a DHS entity if the physician or immediate family member of the physician has a financial relationship with the entity
  - DHS entity cannot bill for the services unless the financial relationship qualifies for an exception
  - Strict liability statute; intent is irrelevant
- Anti-Kickback Statute:
  - Prohibits the willful and knowing offer, solicitation, payment, or receipt of any remuneration, directly or indirectly for:
    - Referring an individual covered by a government health program or arranging for such a referral; or
    - Purchasing, leasing, ordering, arranging for, or recommending the purchase, lease, or order of any good, facility, service, or item covered by a government health program
  - Criminal statute; intent is a key element of liability

# PAYOR AGREEMENTS/BILLING & CODING

- Notice/consents required by commercial payors
- Confirmation of historical audits
- Review of a sample of claims for compliance with Medicare billing rules



# LICENSES / CPOM



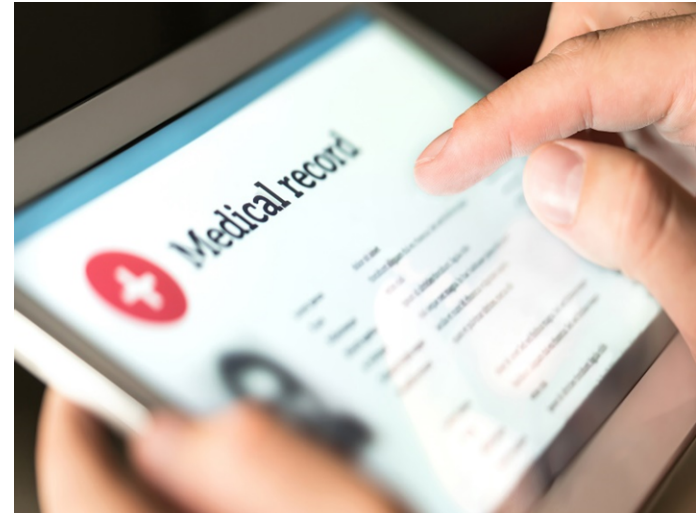
Confirm that the target physician practice has all necessary licenses, permits, and enrollments.



Identify any existing structuring issues that may create CPOM risk

# PRIVACY COMPLIANCE

- Health Insurance Portability and Accountability Act of 1996 (HIPAA) and its implementing regulations
- Part 2 Regulations
- State privacy laws



# NON-HEALTHCARE DUE DILIGENCE



**Tangible and  
Intangible  
Property**



**Corporate  
Documents**

Focus on governance,  
distributions, buy-sell  
arrangements, and  
structure for providing  
ancillary services



**Material Contracts**



**Debt and  
Financing  
Arrangements**



**Litigation Matters**



# TRANSACTION DOCUMENTS: PRELIMINARY CONSIDERATIONS

- Purchase price/Form of consideration
- Timing/Closing
- Depending on the structure of the deal, this section will describe what is being purchased, transferred, etc., and the mechanics/instruments of transfer
  - **Asset Acquisition** - lists purchased assets, excluded assets, assumed liabilities, excluded liabilities, mechanics/instruments of transfer (bill of sale, assignment and assumption agreement, IP filings)
  - **Stock Acquisition** - describes the capital stock being purchased, mechanics/instruments of transfer (stock certificates, stock powers, lost securities/affidavits), and treatment of outstanding stock options, warrants, and other equity-linked arrangements
  - **Merger** - mechanics of the merger, describing the effect of the merger, what entity survives the merger and assumes assets/liabilities, mechanics/instruments of transfer (merger certificate, letters of transmittal/role of transfer/payment agent), and treatment of outstanding stock options, warrants, and other equity-linked arrangements

# ANTITRUST CONSIDERATIONS

- The FTC and DOJ have placed increased scrutiny on healthcare transactions that involve consolidations or affiliations.
- Early analysis of whether the transaction may adversely affect competition.
- State laws that require pre-transaction notification.
- The healthcare sector will face increased antitrust scrutiny from the Biden administration, with the FTC and DOJ (together, the “Agencies”) as the Agencies ramp up their reviews not just of “horizontal” transactions (i.e., deals between competitors), but also of “vertical” transactions (i.e., deals that combine market participants at different levels of the healthcare industry, such as payors, hospitals, and physician practices).

# PURCHASE AGREEMENT: KEY FINANCIAL PROVISIONS

- Escrows
  - Portion of the purchase price is placed in escrow to secure post-closing obligations of the Sellers
  - A separate agreement sets up separate escrow account(s) to be held by the escrow agent
  - Depending on the type of consideration, think about a different form of escrow (i.e., holdback of stock to be issued as consideration)
- Purchase Price Adjustments
  - Mechanisms used to ensure that enterprise value is fairly reflected in the ultimate purchase price
  - Can be based on a number of factors – net worth, net working capital, revenue, value of specific assets
  - Parties need to ensure an agreed-upon financial accounting methodology to properly measure the specific adjustment metric
- Rollover Equity Component

# EARN-OUTS AND CONTINGENT PAYMENTS

- Common in non-healthcare transactions
- Portion of the purchase price is contingent on the future financial performance of the target business
  - Payment is contingent on a future event, such as exceeding a specified gross revenue, net income, or EBITDA
- Incentives to increase revenues or earnings can present risk under fraud and abuse laws
  - Prohibited in some circumstances
  - May create material risk if not prohibited
- Must ensure that earn-out structure is permissible under applicable fraud and abuse laws.

# PURCHASE AGREEMENT: HEALTHCARE CONSIDERATIONS

- Representations and Warranties:
  - Statements of fact and assurances made by the parties
    - Seller and/or the target are providing a description of the property being sold, the underlying business, and the company's financial condition; also serves as additional diligence/comfort for Buyer
    - Buyer is basically providing comfort that it can consummate the transaction
  - Allocates risk related to the condition of the target business
- Indemnification
  - Breach of representation/warranty
  - Special indemnification

# PRACTICE MANAGEMENT DOCUMENTS

- Management Services Agreement
  - Management Fee
- Directed Equity Transfer Agreement
  - Ability to replace friendly physician without cause
- Other Attachments to Management Services Agreement
  - Employee Lease
  - Lockbox Agreement
  - Power of Attorney
  - Security Agreement

# REPRESENTATIONS AND WARRANTIES INSURANCE FOR HEALTHCARE M&A

Historically, obtaining R&W coverage for transactions involving healthcare providers was challenging.

*Carriers did not want to assume risks for violations of US and state healthcare regulatory laws, primarily risk associated with Medicare and Medicaid billing and reimbursement practices (False Claims Act violations), Anti-Kickback, and Stark laws.*

## 2014

In 2014, Aon introduced R&W coverage for healthcare transactions using a unique underwriting process involving primary healthcare diligence.

- Market largely limited to one carrier providing a side-car R&W policy for healthcare coverage (underwritten via a primary diligence process) to a standard R&W policy (i.e., two RWI policies)
- Other carriers more selective on healthcare
- Only two carriers (Concord Specialty and Ironshore)

NOTE: Slides 30, 31, and 32 are provided with the permission of AON.

## 2020

Current market much deeper with more carriers (more than 13) providing RWI for healthcare transactions.

Carrier interest influenced by:

- Provider type
- Government payor exposure
- Availability of audited financials
- Size of provider and scope of operations
- Compliance history and operation

# HEALTHCARE REGULATORY DILIGENCE FOR RWI

Carriers expect fulsome diligence on healthcare regulatory matters

- Federal False Claims Act, Stark Law, Anti-Kickback Statute, HIPAA
- Billing/coding compliance and medical necessity – claims sample review (75-100 records)
  - Focused on government payor reimbursement (Medicare, Medicaid, etc.)
  - Understand error rate compared to industry
- Determining overall effectiveness of compliance infrastructure and program (compliance culture)
  - OIG's Compliance Program Guideline for the seven essential elements of an effective compliance program

## Scope of Diligence

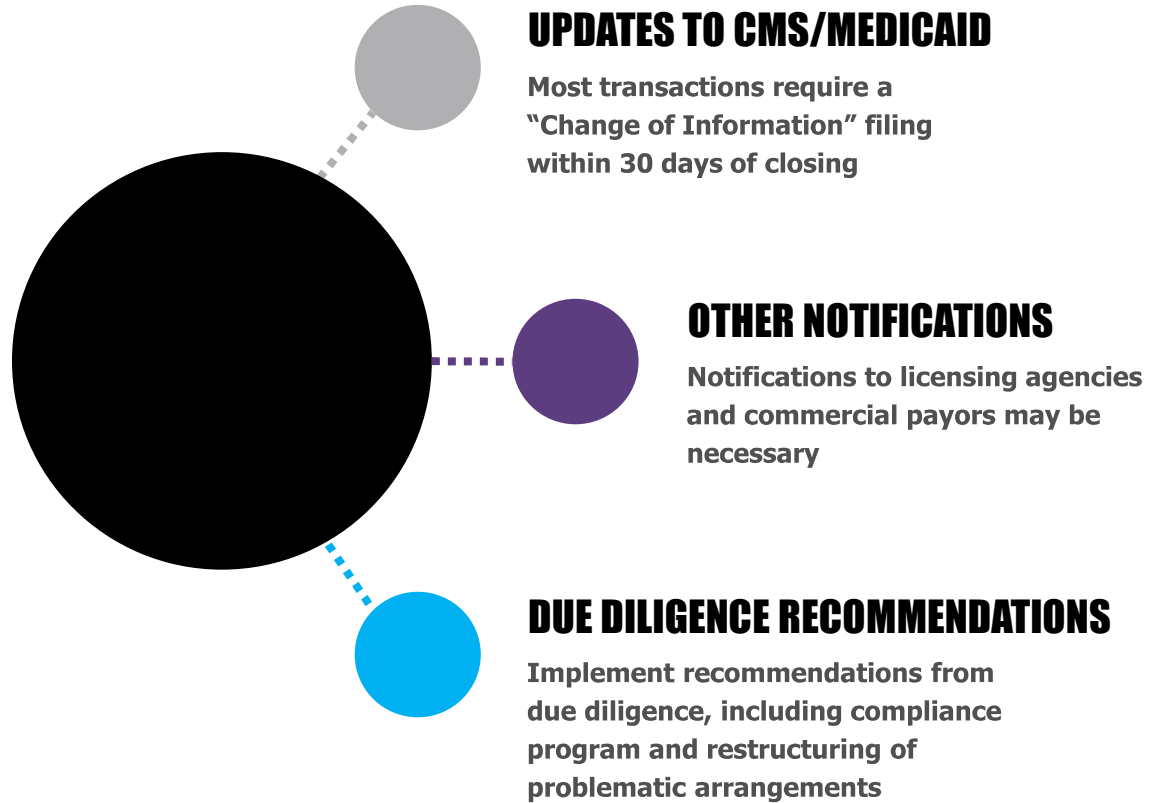
- Financial arrangements and referral sources
- Employment, physician and independent contractor arrangements
- Real estate leases
- FMV analysis, as applicable
- Sales and marketing activities
- Internal/external compliance audits
- Compliance program – policies, procedures, Chief Compliance Officer
- HIPAA – policies, security assessment, prior breaches, BAAs, training
- Licenses, permits, and excluded provider testing
- Payor contracts – commercial,
  - governmental, fee-for-service, capitated rate



# COMMON RISKS IN HEALTHCARE SERVICE/PROVIDER TRANSACTIONS AND AVAILABILITY OF RWI COVERAGE

<b>Exposure</b>	<b>Availability of RWI coverage</b>
<b>Government-payor reimbursement</b>	Yes, from certain markets, and subject to diligence, including a clean third-party billing/coding audit of claims sample
<b>Private-payor reimbursement risk</b>	Yes, subject to standard diligence
<b>Regulatory risk (e.g., Stark, AKS)</b>	Yes, subject to standard diligence
<b>Data privacy/Cyber/HIPAA</b>	Yes, subject to standard diligence; may attach excess of (and no broader than) underlying cyber coverage depending on carrier
<b>Corporate practice of medicine</b>	Yes, subject to standard diligence
<b>Medical malpractice/bodily injury</b>	Typically excluded, with limited exceptions (presumed to be covered by other insurance); if covered, will attach excess of (and no broader than) underlying medical malpractice coverage

# Post-Close Obligations



# Key Takeaways

1

- Businesses in the healthcare industry are regulated by a wide array of federal and state laws enforced by various specialized regulatory agencies.
- Violation of these laws can subject parties to these healthcare transactions to onerous sanctions, including criminal penalties.

2

- Not all physician practices are the same. It is very important that the team understands the business of the target.

3

- Diligence in a healthcare transaction is very important. It helps mitigate risk for a buyer, and it will be necessary for a buyer to obtain financing or RWI coverage.

4

- Certain healthcare transactions result in successor liability, regardless of how the transaction is structured.

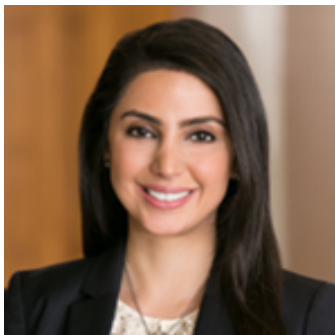
# JANICE DAVIS



Janice Davis has a broad-based corporate practice with an emphasis on M&A, corporate and securities law, and private equity and venture capital transactions. In the healthcare area, Janice represents hospitals and health systems, academic medical centers, managed care companies, and other healthcare and life science companies in implementing innovative integration and alignment strategies. She has extensive background in leading significant transactions, including mergers, acquisitions, distressed acquisitions and dispositions, joint ventures, affiliations, private placements, and asset and stock purchases and sales for clients throughout the healthcare industry.

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Banee Pachuca focuses her practice on healthcare law, including transactional, regulatory, and compliance matters. She represents hospitals, health systems, academic medical centers, large physician groups, and private equity and financial investor clients in mergers, acquisitions, divestitures, joint ventures, and other collaborative and alignment strategies. Additionally, Banee frequently advises clients with respect to fraud and abuse laws, including the Stark Law and state and federal anti-kickback laws, billing compliance, and state and federal privacy laws. She assists healthcare clients with internal investigations, analyzing potential self-disclosures, responding to government subpoenas, and developing compliance programs.