

**Morgan Lewis**

# **M&A ACADEMY**

**Private Equity and Physician Practice  
Acquisitions: Key Legal Considerations**

**Speakers:**

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# PRESENTERS



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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



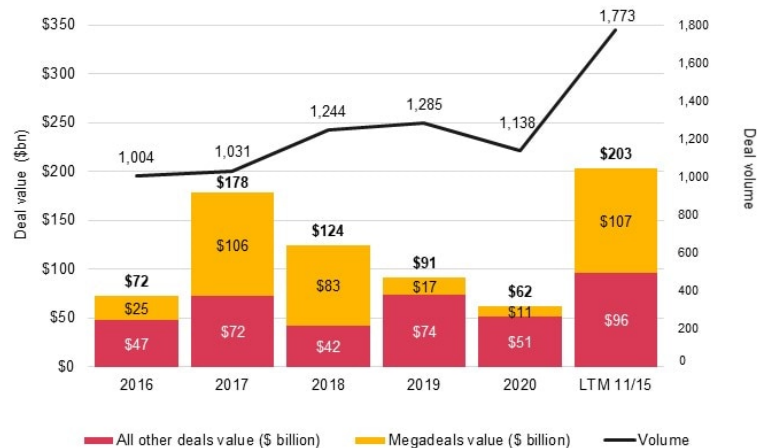
The background features a dynamic, abstract composition of light trails. On the left, numerous thin, parallel lines in shades of red and orange streak across the frame, creating a sense of rapid movement. These lines transition into a more structured, grid-like pattern of blue and white lines that converge towards the right side of the image. The overall effect is one of high-tech energy and forward momentum.

# **MARKET TRENDS IN PHYSICIAN PRACTICE ACQUISITIONS**



# HEALTH SERVICES TRANSACTIONS: RAPID GROWTH IN SIZE AND QUANTITY

Health services deal value (\$ billions) and volume, 2016—LTM 5/15/21



LTM 11/15/21 refers to the 12 months through November 15, 2021. Megadeals are those valued at \$5 billion or greater. Totals may appear not to sum due to rounding.

Source: LevinPro HC and LevinPro LTC, www.levinassociates.com

Health services deal volume, value and growth, by target subsector

Volume LTM 11/15/21	Value (\$ billion) LTM 11/15/21	Growth (LTM 11/15/21 versus 2020)		
		Volume	Value	
374	Other services*	\$114.2	53%	315%
102	Labs, MRI & dialysis	\$27.1	62%	374%
445	Long-term care	\$18.6	26%	132%
137	Home health & hospice	\$12.7	63%	252%
66	Hospitals	\$9.2	(16%)	181%
47	Managed care	\$7.2	114%	2%
114	Behavioral care	\$5.7	56%	103%
407	Physician medical groups	\$5.5	119%	55%
81	Rehabilitation	\$3.4	145%	408%
<b>1,773</b>	<b>\$203.5</b>		<b>56%</b>	<b>227%</b>

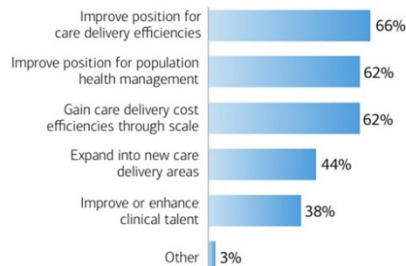
Source: LevinPro HC and LevinPro LTC, www.levinassociates.com

\*Other services includes a broad range of companies such as contract research organizations, ambulatory surgery centers, home infusion services companies, and medical office buildings.

# MARKET TRENDS FOR PHYSICIAN PRACTICES

- 2021 saw greater than 50% growth as compared to 2020, with particularly high growth in acquisitions of physician practices
- More than 400 reported physician medical group acquisitions in the 12 months ending November 15, 2021, as compared to approximately 200–250 transactions per year from 2017–2019
- Deal flow is down in February 2022 as compared to January by 53%, but this is not atypical
- 71% of survey respondents expect an increase in healthcare M&A activity over the next three years
  - When asked to indicate top M&A targets in the healthcare space, 54% of respondents indicated Physician Practice as a top focus, which surpassed the second-place answer (Ambulatory Surgery Centers) by 19%

What are the care delivery objectives of your M&A planning or activity?



Base = 119, Multi-response

Source: HealthLeaders Intelligence Report July/August 2021.

Sources of Information: PwC – Health Services: Deals 2022 Outlook; Bank of America – 2021 Healthcare M&A Report; LevinPro HC – The Dust Settles: Healthcare M&A Activity Simmers Down

# PROS AND CONS OF PE INVESTMENT IN PHYSICIAN PRACTICE GROUPS

## PROS

- Upfront Liquidity Event for Physicians
- 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 Get to Scale

## CONS

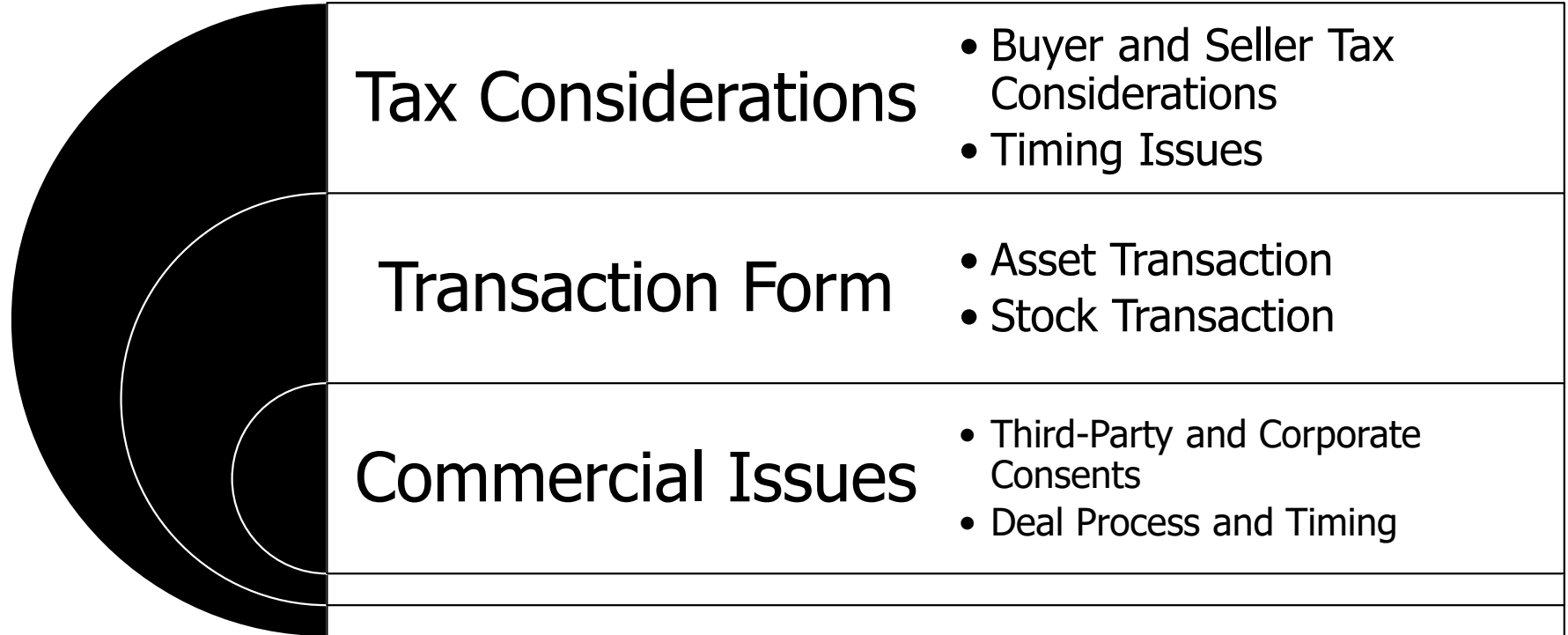
- Complexity of Typical PE Model in Corporate Practice of Medicine States
- Commercialization of Healthcare
- Pressure to Grow the Practice
- Loss of Ownership and Control of Business Aspects of Business
- Uncertainty Related to Long-Term Exit Event



The background features a dynamic, abstract composition of light trails. On the left, numerous thin, parallel lines in shades of red and orange streak across the frame, creating a sense of rapid movement. These lines transition into a more structured, blue-toned pattern on the right, consisting of multiple parallel lines that appear to form a perspective view of a road or a series of tracks receding into the distance. The overall color palette is dominated by deep blues and vibrant reds, with a dark, almost black, background that makes the light trails stand out prominently.

# **CONSIDERATIONS IN STRUCTURING PHYSICIAN PRACTICE TRANSACTIONS**

# CONSIDERATIONS IN STRUCTURING A TRANSACTION



# SPECIAL STRUCTURING CONSIDERATIONS IN HEALTHCARE TRANSACTIONS

## Corporate Practice of Medicine (CPOM)

- Friendly Physician Model
- Foundation Model

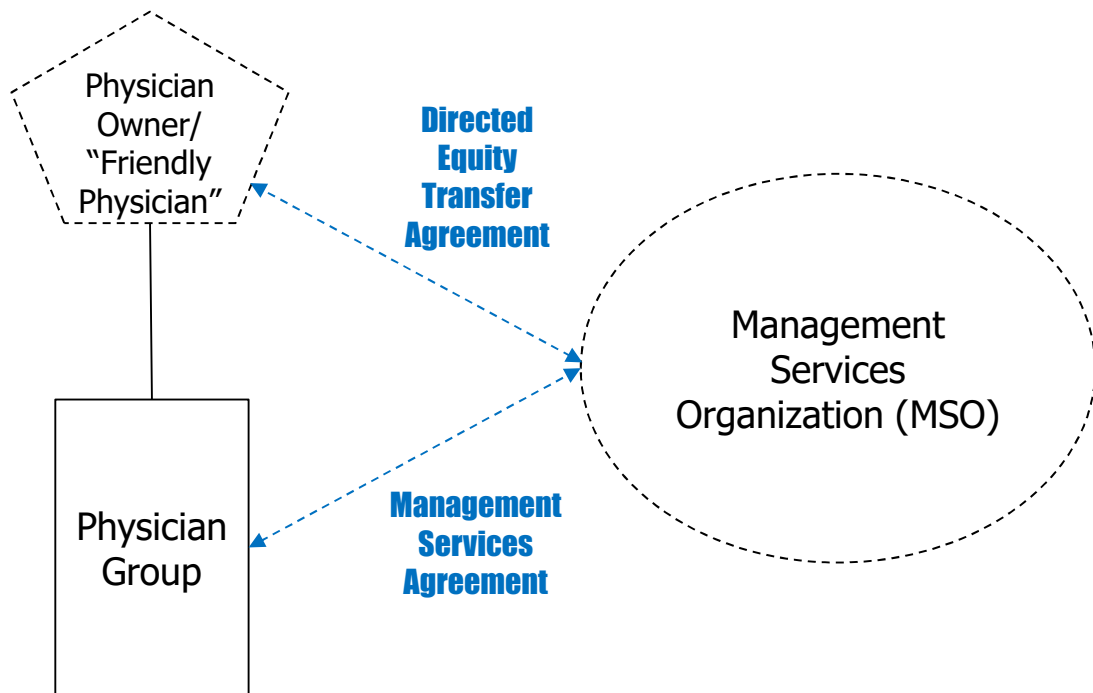
## Consents and Notices

- Change of Ownership (CHOW)
- Certificate of Need (CON)
- State AG Notification



# 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



# TRANSACTION DOCUMENTS: PRIMARY CONSIDERATIONS

- **Purchase price/form of consideration**

- Cash
- Equity Rollover
- Earnout/Deferred Compensation

- **Timing/closing**

- Simultaneous
- Bifurcated

- **Structure**

- Asset Acquisition
- Stock Acquisition
- Merger

- **Employment Agreements**

- Restrictive Covenants: many states require narrow geographic scopes when it comes to physician and healthcare practitioner noncompetes and nonsolicits

- **Diligence**

## Purposes of Healthcare Legal Diligence

Mitigate Risk

Obtain RWI Coverage

Obtain Financing

Confirm Compliance

# 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

# HEALTHCARE DUE DILIGENCE

- Healthcare regulatory due diligence typically consists of the following:
  - Written diligence requests for documents and information;
  - Engaging experts to conduct billing and coding review and fair market value evaluations; and
  - Management interview with physician owner or practice administrator.

# COMMON AREAS OF HEALTHCARE DILIGENCE





# NONHEALTHCARE 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**

# DEAL INTRICACIES FOR PHYSICIAN PRACTICE ACQUISITIONS

- Transaction timeline:
  - Diligence and negotiation efforts can take longer given corporate recordkeeping and physicians' patient hours during the week
- Physician groups with partner sellers of conflicting interests (often due to varied ages)
- The "family business" →→→
- PLCs and S corporations
  - Conversions to LLCs (f reorgs.)
  - State law
- Practice management Documents



# PURCHASE AGREEMENT: KEY FINANCIAL PROVISIONS

- Rollover Equity Component
  - Need to consider percentages, rollover participants, taxation
- 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 purchase price
  - Can be based on a number of factors; often ties to net working capital, indebtedness, cash

# 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 (RWI) FOR HEALTHCARE M&A

Historically, obtaining RWI 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 RWI coverage for healthcare transactions using a unique underwriting process involving primary healthcare diligence.

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

NOTE: Slides 25, 26, and 27 are provided with the permission of AON.

## 2022

Current market much deeper with more carriers 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

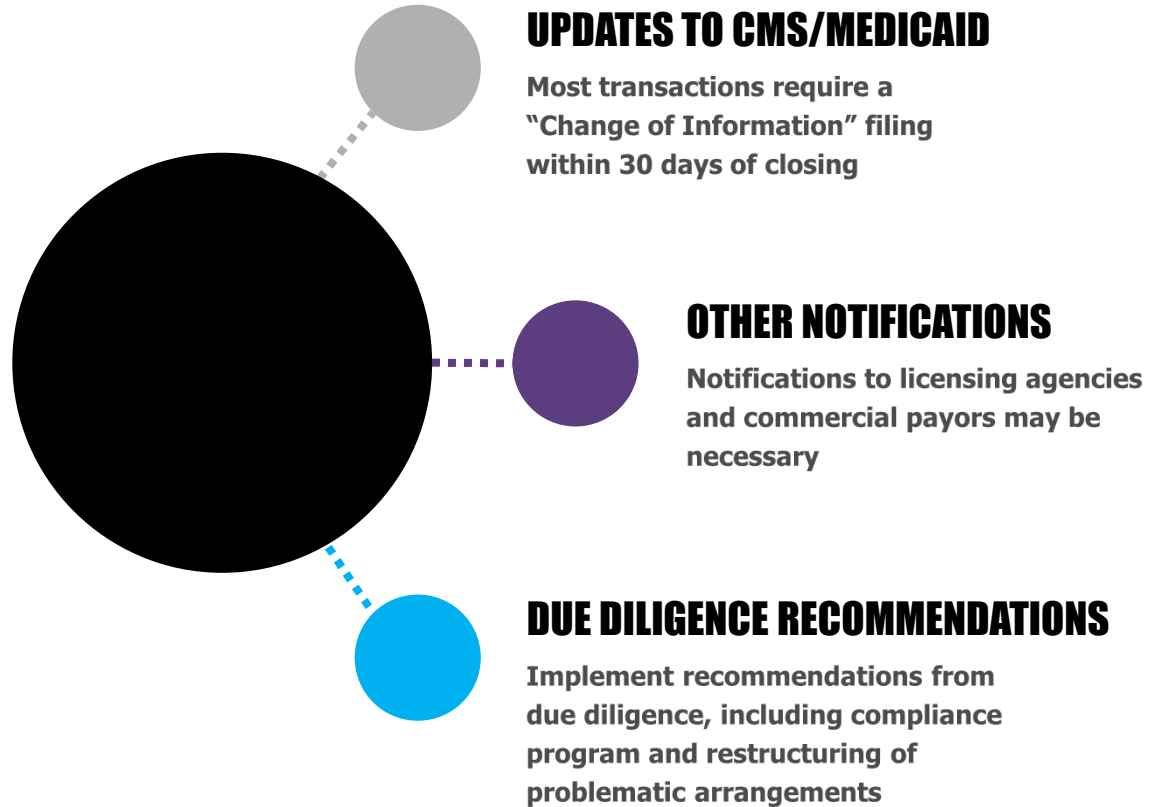
## Scope of Diligence

- Financial arrangements and referral sources
- Employment, physician and independent contractor arrangements
- Real estate leases
- Fair Market Value 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

Exposure	Availability of RWI coverage
<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-Closing 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

- Finding the right scope of diligence in a healthcare transaction is critical. More diligence helps mitigate risk for a buyer, and is necessary if the buyer wants to obtain RWI coverage.
- But too much can frustrate physicians and slow down or kill the deal.

3

- Physician practice acquisitions bring their own intricacies and challenges that are not as common in other areas of broader healthcare M&A; it is very important that the team understands the personality of the practice it is acquiring.

4

- Deal structures that may make sense for one transaction may not be right for another. Buyers should consider deal and tax structuring, rollover equity, and other purchase price mechanisms and adjustments to tailor the right deal for the transaction.

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Banee 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, as well as state and federal privacy laws. She assists healthcare clients with internal investigations, analyzing potential self-disclosures, responding to government subpoenas, and developing compliance programs.



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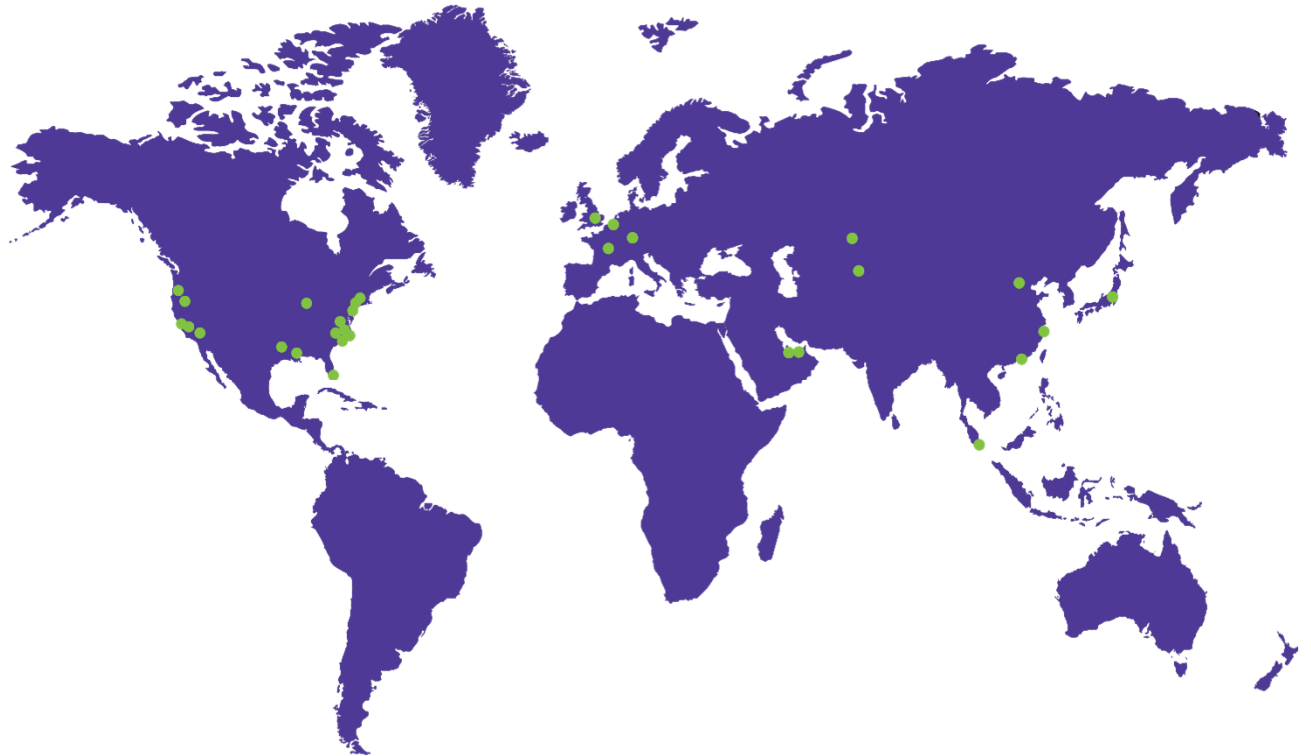
Adam advises clients on diverse business transactions, focusing on mergers and acquisitions and advising private equity funds and their portfolio companies. Adam also advises clients on venture capital and emerging growth company investments and transactional matters; finance and restructuring; and general corporate governance. Adam's clients represent diverse sectors including healthcare, media, technology, pharmaceuticals, retail, manufacturing, utilities, financial institutions, and energy. In law school, Adam served as an editor for the University of Pennsylvania Law Review. He holds a B.A. in philosophy, politics, and economics.

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