

Navigating Health Care Transactions: Beyond the Basics

Health Law Webinar

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Fredrikson

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Agenda

- **Aligning Incentives**

- Deferred Payment Structures
 - Earn-Outs
- Regulatory Issues
 - Anti-kickback
 - Fee-Splitting
 - Stark and State Self-Referral Prohibitions

- **Compliance Issues**

- Due Diligence Surprises
- Post-Closing Issues

- **Government Notifications**

- CHOWs
- Healthcare Transactions Law

- **Avoiding “deal-killers” and messy post-closing “divorces”**

Earn-Outs

- What is an earn-out?
 - Portion of purchase price that is contingent on future performance or achieving certain targets
- Have become increasingly popular in provider transactions over the last several years

Earn-Outs: Pros and Cons

- **Pros:**

- Gives buyer protection from overpaying for a business that doesn't perform as anticipated
- Allows seller the opportunity to prove its worth and potentially get more purchase price
- More favorable tax treatment than employment-based bonuses

- **Cons:**

- Puts a portion of the purchase price at risk; no guarantee seller will receive it
- Depending on circumstances, could create regulatory risk

Earn-Outs: Structure

- Focuses on a specific post-closing period (e.g., 1-2 years)
- Payment typically made at the end of the period (could also have multiple earnout periods with multiple payments)
- Portion of purchase price that is subject to the earn-out varies
- Examples of Targets:
 - Revenues/collections
 - EBITDA
 - Recruiting/hiring additional providers

Earn-Outs: Structure

- Definitions matter: “Revenues,” “Collections,” “EBITDA”
- Conduct of business post-closing
 - Seller will want to try to impose restrictions on buyer’s operation of the business to maximize chance of achieving earn-out.
 - Buyer will want freedom to run the business.
- Dispute Resolution
 - Independent Accounting Firm

Deferred Payment: Regulatory Issues

- Anti-Kickback
- Fee-Splitting
- Stark Law

Deferred Payment: Regulatory Issues

- Anti-Kickback Statute
 - Illegal to offer, pay, solicit, or receive remuneration to reward or induce referrals
 - Criminal statute: intent matters
 - The government applies the “one purpose” test:
 - If one purpose of the payment is to influence referrals, the payment is illegal
 - Federal statute: Medicare, Medicaid, Government Programs
 - Many states have “mini” anti-kickback statutes

Deferred Payment: Regulatory Issues

- Anti-Kickback Statute – Sale of Practice Safe Harbor
 - Practitioner to Practitioner
 - i. The period from the date of the first agreement pertaining to the sale to the completion of the sale is not more than one year.
 - ii. The practitioner who is selling his or her practice will not be in a professional position to make referrals to, or otherwise generate business for, the purchasing practitioner for which payment may be made in whole or in part under Medicare, Medicaid or other Federal health care programs after 1 year from the date of the first agreement pertaining to the sale.

Deferred Payment: Regulatory Issues

- Anti-Kickback Statute – Sale of Practice Safe Harbor
 - Practitioner to Hospital or Other Entity
 - i. The period from the date of the first agreement pertaining to the sale to the completion date of the sale is not more than three years.
 - ii. The practitioner who is selling his or her practice will not be in a professional position after completion of the sale to make or influence referrals to, or otherwise generate business for, the purchasing hospital or entity for which payment may be made under Medicare, Medicaid or other Federal health care programs.
 - iii. The practice being acquired must be located in a Health Professional Shortage Area (HPSA), as defined in Departmental regulations, for the practitioner's specialty area.
 - iv. Commencing at the time of the first agreement pertaining to the sale, the purchasing hospital or entity must diligently and in good faith engage in commercially reasonable recruitment activities that:
 - A. May reasonably be expected to result in the recruitment of a new practitioner to take over the acquired practice within a one-year period and
 - B. Will satisfy the conditions of the practitioner recruitment safe harbor.

Deferred Payment: Regulatory Issues

- Fee-Splitting
 - Most states prohibit fee-splitting
 - Perceived danger of allowing professionals and non-professionals to share in income from professional services – 2 concerns:
 - Gives incentive to maximize profit through medically unnecessary services
 - Gives incentive to limit medically necessary services to maximize income
 - Varies by state law and by discipline

Earn-Outs and Stark Law

- Stark prohibits physicians from referring patients to receive "designated health services" payable by Medicare or Medicaid from entities with which the physician or an immediate family member has a financial relationship, unless an exception applies
- Earn-outs can implicate Stark law

Does Stark Apply to Transaction?

- Yes
 - Physician seller who is in a position to make or influence DHS referrals or generate business post-closing
- No
 - No physician owners, no Medicare or Medicaid, certain post-closing milestones not involving DHS
- Don't forget state self-referral prohibitions

Stark Law Exceptions?

- Isolated Transaction?
 - Fixed before payment is made
 - Not determined in any manner that takes into account the volume or value of referrals
- Indirect Compensation?
- Fair Market Value?
- In-Office Ancillary?
- Other?

Stark Law Exceptions?

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- Other?

Earnouts and Stark: Example 1

- Physician Practice; Solo Owner
 - Earnout period 1 year
 - Earnout achieved if TTM revenues achieve pre-closing revenues
 - No government payers
 - Owner is retiring

Earnouts and Stark: Example 2

- Physician Practice
- Earnout period 1 year
 - Earnout achieved if practice reduces costs by 5%
 - Owners will be employed by buyer post-closing
 - Payer mix includes 10% government payers

Earn-Out Alternatives

- Quality Targets
- Cost-Savings
- Hiring or Retention of Physicians or Other Employees
- Opening of New Clinic Locations
- Launching of New Service Lines
- Maintaining or Winning a New Contract
- Completing Pipeline Acquisitions
- Employment
- Other

Due Diligence Surprises

- Billing and Coding
- Licensure
- Structure
- Health Privacy and Security
 - HIPAA, Part 2, State Laws
- Stark and Anti-kickback Issues
 - Incentive Programs
 - Physician Compensation Arrangements
 - Ancillaries and ASC Investments
 - Referral Source Financial Relationships
 - Failure to meet the “Group Practice” definition

Addressing Compliance Issues

- Identify and quantify potential exposure on compliance issues
 - Deal structure matters for successor liability
 - Is it an indemnifiable risk?
- Consider pros and cons of disclosure and settlements pre- or post-closing
- Mitigate risks on a go-forward by implementing changes at closing
- Negotiate purchase documents to address risk and potential exposure (e.g., reduce purchase price, escrow, specific indemnity, etc.)
- Assess disclosed vs. undisclosed/unknown issues
- Some risks may be deal-killers

Examples of Compliance Issues

- Deficiencies in the provider's authority to operate business
 - Wide range in severity and ability to clean up – i.e., from administrative errors to fundamental structure deficiencies
- Change of ownership issues
- Failure to properly document arrangements with referral sources
- Lease arrangements with physicians
- Compliance plan/head in the sand deficiencies
- Background studies or exclusion list issues

Post-Closing Discoveries

- Common to discover additional issues when rolling out your own compliance plan and policies
- Assess and mitigate
- Analyze applicability of indemnification, unwind provisions and R&W Insurance
- Options are much the same as pre-Closing (i.e., payback, self-disclosure, assume risk, etc.), but incentives are different

Navigating Change of Ownership Requirements

- Understand the full scope of requirements:
 - Certificate of Need
 - Medicaid and State Waiver Programs
 - Medicare
 - Licensure
 - CLIA and other permits
- Notification vs. Approval vs. De-facto Approval
- Service-line specific approvals (e.g., service authorizations)
- Assess appetite for delay in receivables as CHOW is processed
- Permissibility of Transition or Bridge Agreements

Healthcare Transactions Laws

- These fifteen states have laws on the books: California, Colorado, Connecticut, Hawaii, Illinois, Indiana (as of 7/1/24), Massachusetts, Minnesota, Nevada, New Mexico, New York, Oregon, Rhode Island, Vermont and Washington
- Legislation is pending in Pennsylvania, plus California, Connecticut, Minnesota and Washington
- Laws failed to pass in Florida, Maine and North Carolina

Who is Subject to the Transactions Law?

- Most often, hospitals and physician practices
- Scope varies a lot after that. Could include ambulatory surgery centers, dental groups, licensed facilities like nursing homes or assisted living facilities, mental health professionals, nurses, imaging centers, clinical lab, insurers, and pharmacy benefit managers
- Some laws specifically target private equity sponsors

What Transactions are Covered?

- Not just mergers and stock or asset acquisitions
- Could include a PSA or revenue sharing arrangement or even the creation of a new entity
- Look out for a lookback period, too

What Do I Need to Disclose? And to Whom?

- Disclosures can be onerous and include very sensitive information
- Is the state agency obligated to publish any information?
- Could the disclosed info be subject to an open records request?

When Do I Need to Make the Disclosure?

- Typically, 60 to 90 days pre-closing, but some are up to 180 days
- Minimum of 30 days
- State may be able to extend the notice period while it reviews the transaction

Notice Only? Or is Consent Required?

- Most jurisdictions are notice only...
- But a few states have a consent requirement
- Can the state seek an injunction to prevent or delay the transaction?

What are Potential Penalties or Remedies?

- Daily monetary penalties
- May be subject to increased delays or risk of the state seeking injunctive relief
- Can the state unwind a transaction?

Tips and Tricks to Mitigate the Effect of the Law

- Modify the transaction structure?
- Do any exceptions apply?
- Understand the legislative intent
- Contact the state agency early
- Be proactive

Avoiding “Deal-killers” and Messy Post-Closing “Divorces”

- Engage legal counsel as soon as possible
- Conduct thorough due diligence
- Set Expectations
- Include strong protective language in transaction documents
 - reps and warranties, covenants, indemnification, dispute resolution
- Strategic communications with third parties, including government agencies
- Reps and warranties insurance

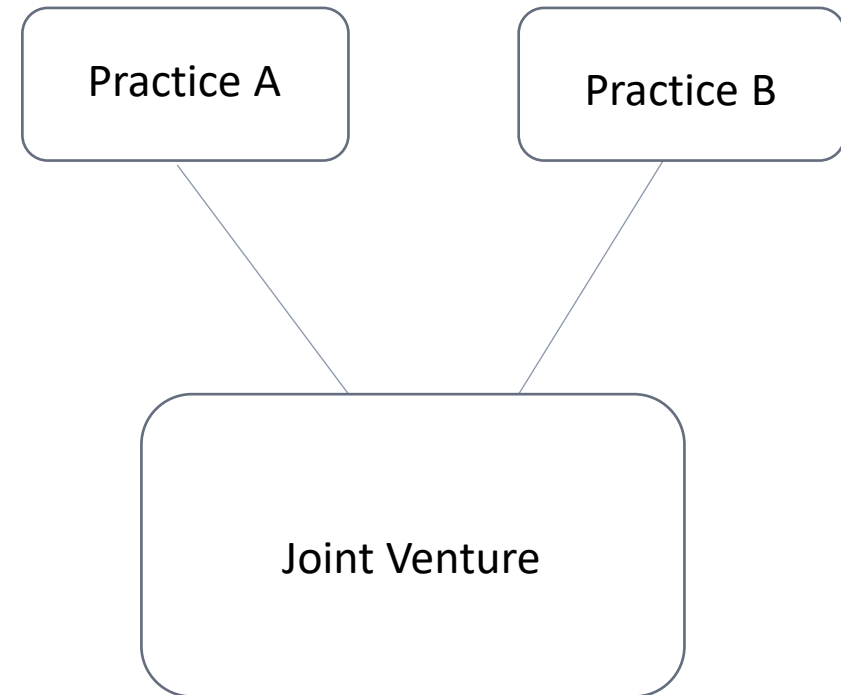
Lessons Learned and Q&A

More Partners, More Problems

- Two practices created a joint venture and shared assets such as office space, support staff, some equipment and a trade name
- Practices employed professionals and continued billing separately

Joint Venture Structure

- What happens if Practice A wants to sell but Practice B does not?
- Would the practices or the joint venture qualify as a group practice?



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