Considerations for Private Equity Firms and Healthcare Companies in M&A Healthcare Deals

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Buyers are currently exercising patience and discipline to account for uncertainty in the global economy, but experts anticipate that healthcare companies and private equity firms will continue to see future M&A deal opportunities in the healthcare industry, given the availability of capital, competitive pressure imposed by larger players and new market entrants, and ongoing challenges related to reimbursement and regulatory issues.[1] This article summarizes some of the key considerations for private equity firms and other parties to consider in evaluating, negotiating and consummating their M&A healthcare deals.

Structuring Your M&A Healthcare Deal.

Parties considering a healthcare acquisition or sale must, first and foremost, take steps to ensure that the structure of the deal complies with applicable state and federal healthcare regulations. These laws can vary based on the type of healthcare entities and providers involved. For example, certain states, like Texas, have corporate practice of medicine laws that restrict the employment of physicians by business entities, although these states often permit the use of specific types of entities (such as nonprofit corporations) to employ such physicians. In the case of Texas, the state permits nonprofit health organizations certified by the Texas Medical Board (NPHOs) to employ physicians, but such entities must meet certain requirements (e.g., all directors must be physicians). While the NPHO may have a non-physician member that has certain control over certain financial decisions and may contract with a management company for certain services, the applicable corporate practice of medicine laws will limit the direction and control of the non-physician member/management company.

Other laws may also impact the transaction structure. For example, states may have fee splitting laws that limit how remuneration can be shared among healthcare providers and other parties. In addition, the parties will want to consider state and federal anti-kickback laws and physician self-referral laws when structuring the deal and related ancillary contracts. For example, ownership, contractual relationships, and bonus/compensation may need to be structured to comply with the in-office ancillary services exception under the Stark Law (and any state law equivalent) if designated health services payable by Medicare are involved. Lastly, there may be laws specific to the type of healthcare entity that may need to be considered and these laws can often change. For example, the “36-month rule” prohibits the transfer of a Medicare provider agreement and corresponding provider number to the new owner of a home health agency that acquires an existing home health agency (whether by asset purchase or stock transfer) if the change of ownership takes place within 36 months of the home health agency’s enrollment in Medicare or within 36 months of a change in majority ownership. Because of the delays associated with the Medicare enrollment process and accreditation and surveys, purchasers are motivated to structure transactions to avoid triggering the 36-month rule. Furthering the need to avoid triggering the 36-month rule, until January 30, 2019, there was a moratorium in place in certain states, including Texas, that prohibited new home health agencies from enrolling in Medicare; however, the moratorium has now been lifted in all states.

Restrictions on the Sharing of Certain Information.

To evaluate, negotiate and consummate a transaction, a buyer will require access to certain information of the target. In a healthcare deal, such information becomes particularly important, as it enables a buyer to assess the target's financial viability and compliance with healthcare regulations, and the potential liability it may incur post-closing.

The sharing of such information is not always seamless. A healthcare provider may not be able to freely share its agreements with third party payors or the rates payors pay for its services with a potential acquirer during the due diligence process. This is because federal antitrust laws require that the parties to a transaction continue to act as independent entities and refrain from exchanging competitive information. While the parties may exchange some information as part of the due diligence process, antitrust laws place limits on the type of information and how it can be shared. The consequences of an antitrust violation can be significant, ranging from investigations and enforcement actions by the Federal Trade Commission and Department of Justice to delays in closing the transaction. Often, parties will engage an independent third-party "clean team" to help manage and control the process of exchanging, reviewing, and formatting competitively sensitive materials and reduce the risk of any antitrust violations.

In addition, certain health information (such as patient medical records) is also subject to access restrictions under state and federal laws. The Health Insurance Portability and Accountability Act of 1996 (HIPAA) generally prohibits the disclosure of protected health information (PHI); however, it also provides an important exception for PHI exchanged for due diligence purposes in a healthcare deal.

Pursuant to such exception, parties to a healthcare deal may share pertinent information containing PHI during the due diligence process without obtaining patient consent, *so long as the entity receiving the information is or will be a covered entity (e.g., healthcare provider) upon completion of the transaction.*[2] Further, notwithstanding the exception, the parties making such disclosures will need to use their reasonable efforts to limit the PHI exchanged to only the minimum amount necessary to accomplish the transaction. Similarly, parties will need to consider whether other third parties, such as attorneys, advisors, investment bankers, and lenders, may need access to the PHI and whether a business associate agreement that meets HIPAA's requirements will be needed prior to the sharing of such information.

State laws regarding transfer of medical records should also be considered. Parties may wish to include provisions in the purchase agreement and other transaction documents specifying which party will own what records after closing and/or serve as the custodian of records in the event the buyer, seller, regulators, patients, or other parties require access to same post-closing. The timing and method of transfer of such medical records may also need to be addressed - depending on whether the records are electronic or kept as paper files, such timing or method of transfer may vary. Ultimately, federal and state laws governing the use and disclosure of health information require careful and proactive planning, and the assistance of experienced attorneys early in the deal process to ensure seamless compliance every step of the way may be of significant value.

Third Party Notices and Consents.

Healthcare M&A transactions may trigger notice and consent requirements arising from both regulatory and contractual requirements. A payor and other commercial contracts, for example, may contain notice or consent provisions that may be triggered depending on the type of transaction for which notice or consent is required, such as a sale of substantially all of the company's assets, a

change of control, or a transaction that will cause the provider or its physicians to cease providing services.

Also, when a healthcare entity changes hands, the parties may desire for licenses, provider agreements, accreditations, and registrations to transfer to the new owner, and certain information (such as the persons responsible for management of the entity) may change following closing. Typically, these changes require the parties to submit a filing to the relevant regulatory authority. For example, in transactions that qualify as either “changes of information” or “changes of ownership,” the parties may need to submit filings to the applicable state or federal regulatory bodies to enable the assignment of the seller’s licenses or health care program enrollments. The filing and notice requirements may not always be clear, especially under state law, which can vary from one state to another. While licensure filings often occur post-closing, there may be some (such as DEA registrations) that require pre-closing notification. In addition, the transaction structure (such as a stock or asset purchase) can impact the type and number of filings required. Thus, considering licensure-related requirements early in the transaction is critical for setting the transaction timeline.

Transactions involving nonprofit health systems may be subject to additional notice requirements. In many states, when a for-profit entity seeks to purchase a nonprofit healthcare system, the state attorney general (AG) must first approve the transaction. Some states go a step further and also require AG approval for acquisitions of nonprofits by other nonprofits. In each case, the parties would need to notify the AG far enough in advance to obtain the requisite approval before the transaction is allowed to close, which could cause delays depending on the timing of such notices. The consequences of failing to provide notice can be burdensome, ranging from liability for breach of contract to operational issues, termination of contracts or payor arrangements, investigations or penalties from regulators or payors, and delays in closing.

Managing and Addressing Potential Liabilities.

In a healthcare transaction, regulatory compliance diligence should be at the forefront of any buyer’s list of concerns. Certain types of healthcare arrangements—such as arrangements with referral sources—can be minefields for noncompliance with fraud and abuse laws (which can have long look-back periods and carry significant liability for the buyer). Buyers should be cognizant of these risks and should use diligence as an opportunity to thoroughly evaluate a seller’s compliance program and arrangements with referral sources that could expose the buyer to post-closing liability. Experienced healthcare counsel can help the parties evaluate and mitigate the risk, either in the purchase agreement (such as by using indemnities, escrows, etc.), through the deal structure, or by restructuring the arrangement and making any necessary disclosures or repayments. Other third-party experts (such as valuators and billing auditors) can also provide important insight into a target’s compliance and can be the first line of defense in identifying red flags that the buyer should investigate further.

Ultimately, there are unique challenges and considerations in M&A healthcare transactions that are not typically seen in other types of transactions. However, the same strategies that apply to deals in other industries are just as important in the healthcare context. By relying on careful diligence, proactive planning, and a sharp focus on regulatory compliance, parties to a healthcare deal can ensure a smooth and timely closing and significantly reduce any potential post-closing exposure.

[1] *See* PwC, *US Health Services Deals Insights: Q1 2019* (2019).

[2] Standards for Privacy of Individually Identifiable Health Information, Final Rule, 67 Fed. Reg. 157 (Aug. 14, 2002), at 53190 (codified at 45 C.F.R. § 164.501).