Structuring and Negotiating a Health Care Transaction

Ryan Johnson and Katie Douglas

January 13, 2016

Fredrikson & Byron, P.A.

Overview

- Health Care Transactions
  - Joint Ventures
  - Acquisitions
  - Common Transactions
  - Services/License Agreements
  - New Players
- Anatomy of a Health Care Transaction (physician/hospital JV)
  - Key Issues
    - business (selection of investors/participants, valuation, governance, buy-sell)
    - regulatory (tax-exemption, antitrust, antikickback, Stark, etc.)
  - Structure

Joint Ventures

- Types:
  - Contractual
    - examples: leasing arrangements, management services
  - Equity
    - joint ownership of entity
  - Hybrid
    - joint ownership with various contractual arrangements between JV entity and owners
- Pros and Cons

Acquisitions

- Structure (asset v. stock v. merger)
- Consideration
  - Earn-outs
  - Equity

Other Common Transactions

- Shareholder Agreements
- Stock Redemption/Buy-Sell Agreements
- Compensation Agreements
  - deferred compensation

New Players

- Private equity/finance
- Affects structure/pricing

Services/License Agreements

- Management Services Agreements
- Professional Services
- Software Licensing Agreements

Anatomy of Health Care Transaction

- LOI and NDA
- Diligence
- Definitive Agreements
- Closing
- Role of Counsel

Key Business Issues

- Scope
- Ownership and Control
- Post-Closing Operations and Consideration
- Buy-Sell/Exit Provisions
- Termination/Unwind
- Valuation
- Restrictive Covenants

Key Regulatory Issues

- Antikickback/Self-Referral Prohibitions
- Antitrust
- Fee-Splitting
- Licensure/Corporate Practice of Medicine
- Tax-Exemption
- FDA

Antikickback Statute

- Illegal to offer, solicit, make or receive any remuneration intended to influence or reward referrals
- "One purpose" test
- Safe harbors may offer protection
  - ASC safe harbor
- Impact on earn-outs/post-closing consideration

Stark

- Prohibits a physician from making referrals of designated health services ("DHS") to an entity if the physician has a financial relationship with that entity, unless the relationship satisfies a Stark exception
- Unlike AKS, failure to meet an exception = automatic violation
- Might not always apply (e.g., ASC)

Antitrust

- Many antitrust issues associated with healthcare JVs
  - Sherman Act, Clayton Act, Federal Trade Commission Act, state laws, etc.
  - DOJ/FTC Guidance
- Today's Focus
  - Sherman Act, Section 1

Sherman Act, Section 1

- Section 1 prohibits contracts, combinations or conspiracies in restraint of trade
  - *per* se violations: price-fixing, allocation of territories or customers, customer or other nonprice restraints, group boycotts and concerted refusals to deal, tying agreements, and exclusive dealing arrangements
  - Rule of Reason
    - Does the challenged agreement promote or suppress competition?
    - Does the challenged agreement unreasonably restrain trade?

Sherman Act, Section 1

- Section 1 violation requires
  - agreement between <u>two or more</u> economic entities which has an anticompetitive purpose
    - parent/subsidiary relationships?
    - joint ventures?

Antitrust

- Can a member conspire with the joint venture in violation of the Sherman Act?
  - examples: payor contracting, territory allocation, etc.
  - *Copperweld Corp. vs. Independent Tube Corp. (U.S. 1984)*
    - involved a parent and wholly-owned subsidiary
    - one entity for antitrust purposes if
      - unity of economic interest
      - common, not disparate objectives
      - corporate actions guided by a single "corporate consciousness"

Antitrust

- If *Copperweld* satisfied, arrangement analyzed under Section 2 of the Sherman Act
  - prohibits conduct that creates, sustains, or threatens monopolization
    - more difficult to prove than Section 1 violations
- *Copperweld* requirements not clear
  - "legal control" test
    - could parent exert full control over subsidiary (JV) if failed to act in parent's best interest
  - "unity of interest" demonstrated by preponderance of multiple factors

Fee-Splitting

- Most states prohibit fee-splitting
  - perceived danger of allowing professionals and non-professionals to share in income from professional services
    - the temptation for the physician and nonprofessional to <u>maximize</u> profit through medically unnecessary services
    - temptation for the physician and the non-professional to <u>limit</u> medically necessary services in order to maximize income

Fee-Splitting

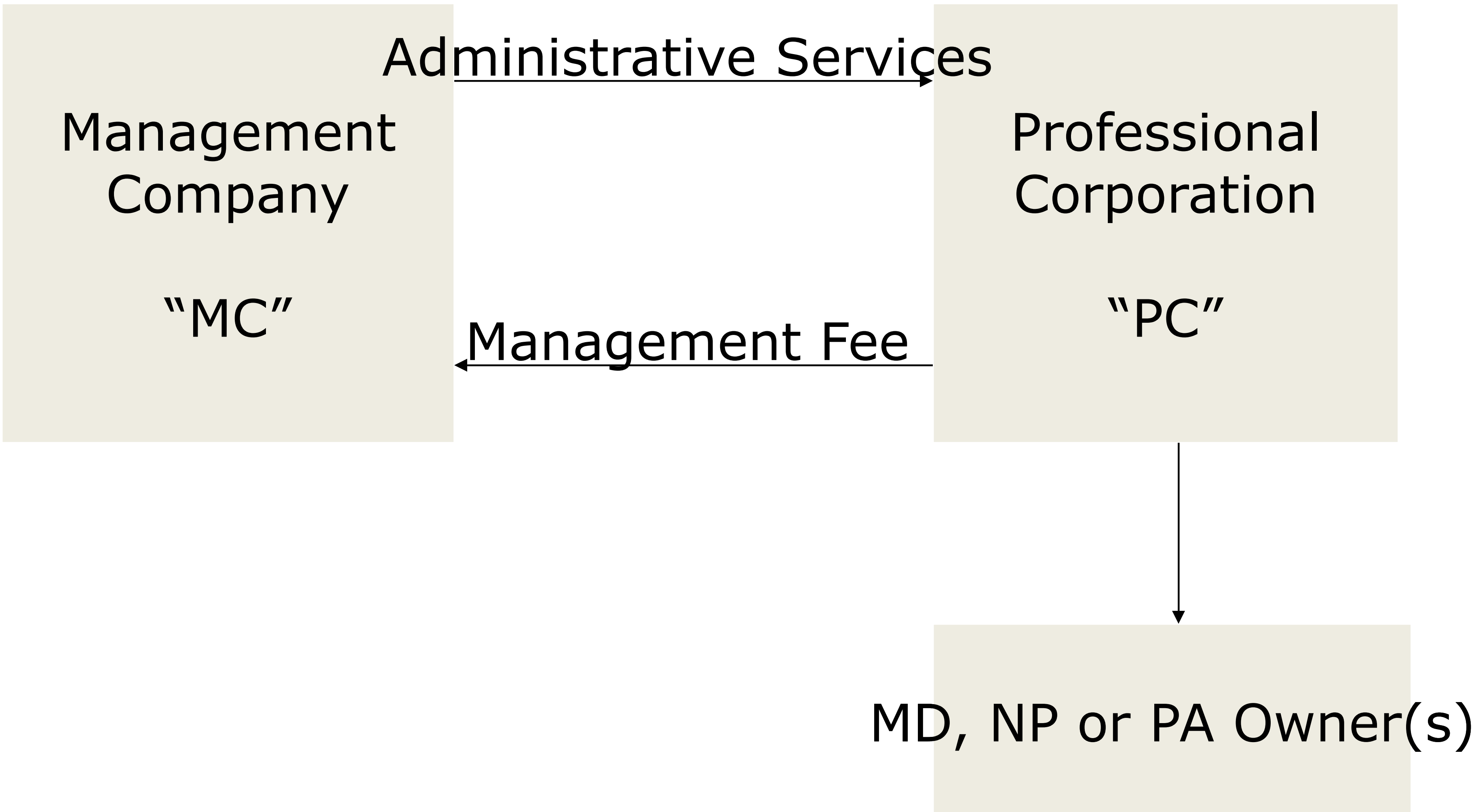
- Can impact structure of management fee
- Can impact structure/permissibility of earn-out

Corporate Practice of Medicine ("CPM") Prohibition

- CPM doctrine prohibits business corporations from employing or controlling medical professionals or owning medical practices
  - seeks to prevent lay control over medical judgment
- CPM prohibition has been criticized by many scholars
- May also apply to other professions (e.g., dental, physical therapy)

CPM (cont.)

- If state CPM prohibition applies to structure, the management company model may be an option.


Administrative Services
Management Company
"MC"
Management Fee
Professional Corporation
"PC"
MD, NP or PA Owner(s)

CPM (cont.)

- Management agreement
  - long-term
  - restrictions on termination
  - restrictive covenant
  - management fee
  - management company can handle all non-clinical matters

CPM (cont.)

- Typically includes other controls on PC ownership (e.g., Succession Agreements)
- Risks with management company structure
  - owners may seek to void the agreement
  - may be viewed as a sham

Tax-Exemption Issues

- Tax Issues
  - Section 501(c)(3) provides tax exemption for corporations organized and operated exclusively for charitable, scientific, or educational purposes, so long as no part of the organization's net earnings inure to the benefit of any private shareholder or individual.

Tax-Exemption Issues

- Tax Issues
  - No Private Benefit/Inurement
    - EO needs to ensure transactions are fair market value
      - contributed assets
        - » including value of any contributed existing business
      - valuation (consider having legal counsel engage valuation firm)

Tax-Exemption Issues

- Tax Issues
  - EO must have formal or informal control over JV sufficient to ensure furtherance of charitable purposes
    - *Redlands, St. David's, Rev. Rul. 98-15, Rev. Rule 2004-51, etc.*

Joint Venture Example

- Hospital/Physician ASC
- Hybrid JV
  - equal ownership of new JV entity
  - physician practice will provide management services to JV
  - hospital will provide payor contracting services

Investor Selection

- Which physicians can/should invest?
  - Some physician groups want all group members to be members of physician investment entity
  - Avoid “rewarding” good referral sources

Investor Selection

- ASC Safe Harbor - Key Requirements
  - 1/3 Test: Single-Specialty ASCs:
    - At least 1/3 of each physician investor's medical practice income from all sources for the previous fiscal year or previous 12 month period must be derived from the physician investor's performance of ASC procedures
  - 1/3 Test: Multi-Specialty ASCs
    - 1/3 income test, PLUS
    - At least 1/3 of the ASC procedures performed by each physician investor for the previous fiscal year or previous 12 month period must be performed at the ASC

Investor Selection

- ASC Safe Harbor (cont'd)
  - Terms cannot be conditioned on investor's past or anticipated volume of referrals
  - Distributions must be directly proportional to the amount of the capital investment of that investor

Investor Selection

- However, joint venture is not <u>required</u> to meet the safe harbor
- Advisory opinions offer insight
- Consider whether exceptions to safe harbor elements are appropriate

Valuation Issues

- Equity
  - Can physicians receive credit for their referrals?
  - Can distributions be based on volume or value of referrals?
- Management services
  - How can compensation be determined?
  - How often can it be evaluated?

Valuation Issues

- Regulatory Concerns
  - AKS: safe harbor prohibits basing investment opportunities on volume or value of referrals
  - Tax-exemption: needs to be FMV
- Consider obtaining an independent valuation
  - Credit for transferring revenue stream

Governance

- Regulatory Concerns
  - Tax-Exemption
    - JV must operate to further hospital's tax-exempt purpose
  - Antitrust
    - Payor contracting (*Copperweld*, etc.)
- Control Requirements
  - Hospital does not need control over all matters

Buy-Sell Provisions

- Triggers
  - failure to meet physician investor requirements (including safe harbor requirements)
- Valuation
- Regulatory Issues
  - Tax-Exemption
  - Anti-Kickback

Questions?

Presenters

Ryan S. Johnson
Fredrikson & Byron, P.A.
612.492.7160
rjohnson@fredlaw.com

Katherine J. Douglas
Fredrikson & Byron, P.A.
612.492.7283
kdouglas@fredlaw.com