



Hospital/Physician Integration - LHA Rural Hospital Leadership Forum

Conrad Meyer, JD/MHA
Health Law Section Chair
Chaffe McCall – New Orleans

Introduction

- I. Introduction of speakers and topic

Conrad Meyer, MHA, Attorney

Chaffe McCall, L.L.P.

New Orleans, Louisiana

Current Trends

- Nationwide, there is a resurgence of hospital/physician integration activity.
- **“The acquisition of physician practices by hospitals and health systems—once thought to be a thing of the past—has returned with gusto.”** *Healthcare Financial Management Association magazine*, July 2009
- According to this article (and other informed sources) “ [t]oday’s physician practice acquisition deals are bigger, more complex, and riskier than the transactions that took place during the 1990s. It’s important for healthcare organizations to understand this trend: what is occurring, why, and how buyers and sellers can structure, plan for, and execute these deals successfully.”
- Numerous valuation and consulting firms have presented data that indicates that the rate of these transactions is increasing and not likely to subside anytime soon.



Current Trends:

Are we going back to the future?

Avoiding Past Mistakes (what have we learned?)

- Lack of experience with professionals; treated physicians like line-level employees
- No incentives for continuing long hours (flawed compensation models)
- The physicians' loss of control of practices created frustration and dissatisfaction
- Poor management; poor collections

Drivers for Hospitals

- Physician shortages, including call coverage obligations (EMTLA)
- Focus on quality continues to gain strength
- Reimbursement and payment concerns
- Dealing with regulatory concerns
- Market Share and reducing threat of competition

Drivers for Physicians

- Perception of falling reimbursement for professional services
- Limitations on ancillary services
- Desire to reduce stress and pressure of private practice
- Strength in being part of larger team

Incentive Based Compensation

- Key difference in 90's deals and current deals is incentive based compensation
- Usually based upon RVU model
- Base salary plus bonus
- Salary must be at fair market value and must be structured/calculated to comply with the Stark Law and Anti-Kickback Statute
- Separate valuation necessary, apart from asset valuation
- May be helpful to process for parties to identify make or break elements and obtain preliminary valuations prior to proceeding

Deal Breakers?

- Any initial hurdles (restriction on corporate practice of medicine not an issue in Louisiana)
- Not-for-profit restrictions on employment of physicians or compensation limitations
- Disagreements over valuations
- Governance and control
- CIA limitations

Ready to proceed?

- If the business interests align, the price is right, and the parties appear to be willing to proceed, what are the next steps?

Corporate Practice of Medicine

- In many states physicians cannot be employed directly by hospital
- Typically the hospital will acquire the practice through a non-profit health organization to satisfy prohibitions
- Physicians are employed by or structure a Group practice through the non-profit health organization

Key Initial Legal Considerations to Consider

- a. Employment exceptions (Stark/AKS)
- b. Isolated transaction exception for
asset purchase
- c. Organization of Group Practice under
Stark exception?

Stark Employment Exception

- *Bona Fide* Employment Relationships –
 - Amount of payment is consistent with fair market value and does not take into account value or value of referrals
 - Compensation is commercially reasonable even if no referrals are made
 - Productivity bonuses permissible for personally provided services
- 42 C.F.R. § 411.357(c)

Anti-Kickback Protection for Employment

- Statutory Exception: any amount paid by an employer to an employee with a *bona fide* employment relationship for employment in provision of covered items or services
- IRS definition of “bona fide employee”
- No explicit requirement of fair market value

42 U.S.C. § 1320a-7b(b)(3)(B); 42 C.F.R. § 1001.952(i)

“Isolated Transaction” Exception

- A one-time sale of a medical practice will not violate the Stark Law if
- (1) the purchase price is consistent with fair market value and is not determined in a manner that takes into account (directly or indirectly) the volume or value of any referrals by the target physician or other business generated between the parties,
- (2) the transaction would be commercially reasonable even if the physician whose practice was acquired made no referrals, and
- (3) there are no additional financial relationships between the parties for six months either before or after the sale unless the other relationships meet another Stark exception.

42 CFR . § 411.357(f)

Qualify as a Group Practice?

- Hospital cannot form a “group practice” of its employed physicians without organizing a separate entity
- Upside – greater flexibility in how physicians are compensated than using employment exception
- Downsides – possibly no longer qualify for the direct compensation exceptions under Stark; Group Practice exception is complex

Basic structures generally used

- a. Asset purchase
- b. Co-management of service lines
- c. Others

Key Business Decisions

- Valuation of assets -- multiple methodologies; concerns over "goodwill" and going concern valuations; assets used in ancillaries and hospital based services; keeping focus on present value, not on future values or expected revenues
- Compensation expectations -- RVUs; medical directorships; service line management; medical staff expectations
- Control of day-to-day management -- setting realistic achievable budgets, who has control; can Hospital live with Physician control; can Physicians live with some Hospital controls and bureaucracy; hiring of former Practice administrator, chief accounting personnel, billing personnel

Asset Purchase Model

- Letter of Intent -- focus on key issues
- Preliminary Valuations/Final Valuations -- need to focus on how to stage getting preliminary valuation prior to getting too far down the line; if the money is not right, either for the assets and particularly for the compensation, the deal is dead in the water
- Asset Purchase Agreement – this is the road map to accomplishing a deal
- Employment Agreements – this may be the only document that the physician actually reads
- NewCo Organizational matters -- who controls; how to have reserve powers; annual budgets and other matters that arise after the initial year of closing; who hires and fires

Valuations

- Get them started early; helpful to have preliminary valuations to temper expectations
- They take time and are not cheap, but they will be valuable
- It is critical that the hospital purchasing pays a price that does not exceed fair market value.

Fair Market Value: How is it Determined -- assets

- Usually, the practice retains cash and A/R
- Hard assets and “goodwill” are acquired
- “Goodwill” includes the name of the practice, the medical records, patient data, value of non-competes and other protective provisions
- OIG guidance can be found; OIG has been very skeptical of amounts in excess of hard values as payments for referrals
- Most reputable valuation firms are very well acquainted with the legal restrictions
- FMV analysis usually involves a blend of methods: income (discounted cash flow), market, and cost

Examples -- LOI

- A good LOI helps avoid future shock!
- Deal with expected governance post-closing
- Practice employees; administrator
- Key terms of employment agreements

Examples – Asset Purchase Agreement

- Threshold issues; purchase price; hold out doctors; assets purchased and retained; liabilities retained or assumed
- Representations and warranties of Seller and selling shareholder/physicians
 - Joint and several?
 - Limitations on knowledge; whose knowledge?

Examples – Asset Purchase Agreement (continued)

- Ability of Purchaser to consummate
- Guaranty if shell subsidiary
- Key conditions to closing – receipt of FMV appraisal; receipt of any governmental approvals
- Post closing covenants; employment of staff; maintenance of support to enable practice to continue uninhibited
- Tail insurance; non-compete and other protective provisions; unwind provision
- Indemnification issues – basket; limitations to amount each Shareholder receives

Examples – Employment Agreements

- No-cut by hospital without cause (5 year)
- Call coverage
- Outside activities
- Conflict of interest policies
- Compensation plan
- Non-compete and other restrictive covenants
- Guarantee of NewCo obligations by hospital

Examples – NewCo Organizational and Operational Matters

- Bylaws limit ability of hospital member to change terms post closing
- Have a board controlled by physicians except for certain matters, such as termination of the administrator, etc.
- If the hospital has any “reserve power” or override power, this is where to document
- Perhaps consider a contract between NewCo and hospital where hospital commits to fund the approved budget to NewCo in return for NewCo’s provision of certain services

Post-Closing Issues (how long will the honeymoon last?)

- billing issues;
- registration process;
- co-payments, etc.

Questions?

Conrad Meyer JD/MHA

Health Law Section

Chaffe McCall

(504) 585-7067

cmeyer@chaffe.com