

M&A and Joint Venture Compliance Due Diligence

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Philip Glorieux, Senior Underwriting Counsel,
Ambridge Partners LLC

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Christopher Greene, Partner, Barclay Damon LLP

Due Diligence: General Purposes and Goals

- Purpose
 - Setting the stage for the deal after a letter of intent
 - Determining risk, value, price, structure and terms
- Goals
 - Identify key legal and compliance concerns to guide whether the deal can/should happen and the terms thereof
- Buyer vs. Seller
 - Buyer: Identify risks for liability, purchase price and structure for the deal
 - Seller: Identify risks to determine representations and warranties, and purchase price

Investing in the Healthcare Sector

- 2018 saw continued robust activity in healthcare transactions, with \$108 billion in private equity investments and overall deal volume surpassing that of 2017
- Sectors continuing to garner interest from private equity and strategic investors alike:
 - Healthcare Information Technology
 - Behavioral Health
 - PPM and Urgent Care
 - Hospitals / Health Systems
 - Home Health & Hospice
 - Ambulatory Surgery Centers
- Why the focus?
 - Economic resilience in downturns (see 2000, 2008)
 - Aging populations and an expanding middle class
 - Opportunities to leverage balance sheets
 - Ability to remove costs and utilize M&A to drive returns

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Common Transactions

- Hospital mergers, acquisitions and affiliations
- Sale of upstate for profit and not for profit nursing homes, including county homes, to larger, for profit nursing home chains
- Sale of physician practices to hospital captives; physician group affiliations
- Mergers and asset purchases by physician groups to other physician groups
- Physician group/hospital affiliations to provide specialty services
- Mergers/combination/affiliations of not-for-profit behavioral health and disability agencies
- Asset acquisitions of non- medical practices (e.g., chiropractic, podiatry, physical therapy) and employment of non-medical professions

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Unique Risks in Healthcare Transactions and Red Flags

- Key drivers of risk
 - Professional liability
 - Data privacy and security
 - Billing and reimbursement
 - Fraud, waste, and abuse
 - CPOM and permitting/licensing
 - Government audits
 - Reporting requirements
 - Contractual arrangements
 - Compliance plans
 - Litigation
- Why is private equity different when it comes to M&A?
 - Highly transactional
 - Five to ten year fund structure
 - Desire for certainty and full exit
 - Small deal teams – high reliance on (robust) third party advice

Industry Specific Risk Areas: Examples

- Hospitals
 - Staffing contractual arrangements
 - Physician contracts/financial relationships
 - Lease agreements for space and equipment
- Physician Groups
 - Corporate practice of medicine
 - Non-compete and non-solicitation provisions
 - Disciplinary actions
- Nursing Homes/Home Care
 - Quality of care
 - Eligibility of residents and services
 - Abuse and neglect claims
- Managed Care Organization
 - Provider credentialing and exclusions
 - Member eligibility
 - Medical Loss Ratio (80/20 rule)
- Behavioral Health
 - Referral sources
 - 42 CFR Part 2 compliance (SUD providers)
 - Arrangements with laboratories

Materialization of Risk: Examples

- Behavioral health providers waiving co-pays based on financial hardship without requesting or retaining supporting documentation
- Revenue cycle management companies applying code modifiers (e.g., the 59 modifier) or maintaining percentage-based compensation arrangements with customers
- Providers failing to run ongoing exclusion checks on employees and relevant contractors
- Related party space lease arrangements not being made at arm's length
- Health IT service providers aggregating PHI data without express authorization

Overview of the Due Diligence Process

- General purposes and goals of the compliance due diligence initiative
 - Differing perspectives for buyer versus seller, private equity versus strategic investor
- How does the due diligence initiative fit into the overall context of the M&A transaction?
- The process and timing of the due diligence process and the personnel involved
- What is the most efficient way to accomplish the due diligence process?
- Risks to a buyer in connection with historic compliance issues – successor liability?
- Issues of confidentiality as to sensitive litigation, enforcement actions, consent orders and materials to be disclosed by a seller

Due Diligence: Request Lists and Practical Considerations

- Assembling the due diligence request list
 - There are many *standard* due diligence request lists available that cover common areas, including: Corporate/Governance, Investigations and Audits, Litigation, Licensing/Credentialing, Privacy and Security, Coding/Billing, Relationships with Payors, Employment Contracts, Compliance Plans
- **But every deal is different...consider the following**
 - Industry?
 - Regulations
 - Oversight agencies
 - Structures? NFP vs. FP?
 - Artificial Intelligence
 - Use and establishment of data room?
 - User friendly and navigable
 - Useful for disclosure schedules
 - Location: State?
 - Corporate practice of medicine
 - Strict regulations
 - Nature of the transaction
 - Asset purchase
 - Merger
 - Stock purchase
 - Reorganization

Managing Risk: The Traditional Approach

- The identification of material risk during the due diligence process complicates negotiations
- Historically, a buyer or JV partner with any leverage would seek fulsome special indemnity coverage from the seller in the transaction agreement
- In the worst cases, a buyer or JV partner might simply walk away from the deal
- Even where the seller has the upper hand in negotiations, generally, a reduction in purchase price or other consideration will almost certainly result

Managing Risk through Transactional Insurance Products

- Transactional Insurance includes three principal products:
 - Representations & Warranties (“R&W”) Insurance
 - Tax Opinion/Tax Liability Insurance
 - Contingent Liability Insurance

- Types of risks covered include:
 - Disclosure risk
 - Legal/judicial interpretation risk
 - One-off contingency risks (other than financial or performance guarantee)

R&W Insurance: Basics and Process

- R&W Basics
 - Limit
 - Premium
 - Retention
 - Policy Period
 - Market appetite

- Underwriting Process
 - Market selected
 - Underwriting fee
 - High level review of diligence process (if buy-side) or disclosure process (if sell-side)
 - Access to legal, financial, tax and other diligence reports (if buy-side)
 - Conference call(s) with deal team

- Policy Negotiations
 - Run concurrent with underwriting process
 - Most regional and national firms have pre-negotiated policy forms

R&W Insurance for Healthcare Deals

- Little to no appetite in the marketplace prior to 2016
- Subset of carriers and underwriters now willing to insure transactions involving service providers, manufacturers, and beyond
- Scope of coverage evolving in the policyholder's favor, but remains challenging to insure certain risks (e.g., medical malpractice, heavy government payor reimbursement)
- Ambridge healthcare team has deployed total limits of liability in excess of \$1.5 billion on healthcare R&W deals
- Fulsome diligence is paramount to fulsome coverage
 - Billing/coding sample audit
 - Licensing and CPOM
 - Policies and procedures
 - HIPAA/HITECH
 - Compensation arrangements
 - Sales and marketing practices

Ambridge Overview

- Established in 2000
- Managing general underwriter for a consortium of Lloyd's syndicates and other insurers
- 50+ legal, financial and tax professionals focused on transactional insurance products
- Offers the largest per-risk capacity in the marketplace (up to \$175M per policy)
- Offices in New York, San Francisco, London, and Frankfurt

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KEY PRACTICE AREAS & INDUSTRIES

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- Intellectual Property
- Labor & Employment
- Health Care & Human Services
- Health Care Controversies
- Corporate & Transactional
- Restructuring, Bankruptcy & Creditor's Rights
- Project Development & Construction
- Public Finance
- Litigation
- International & Cross-Border
- Tax Credits
- Cannabis
- Higher Education
- Insurance & Reinsurance
- Financial Services
- Hotels, Hospitality & Food Service
- Manufacturing
- Technology
- Real Estate & Land Use

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