

## M&A and Joint Venture Compliance Due Diligence

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## 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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- Energy
- Regulatory
- 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
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- Cannabis
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- Hotels, Hospitality & Food Service
- Manufacturing
- Technology
- Real Estate & Land Use

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