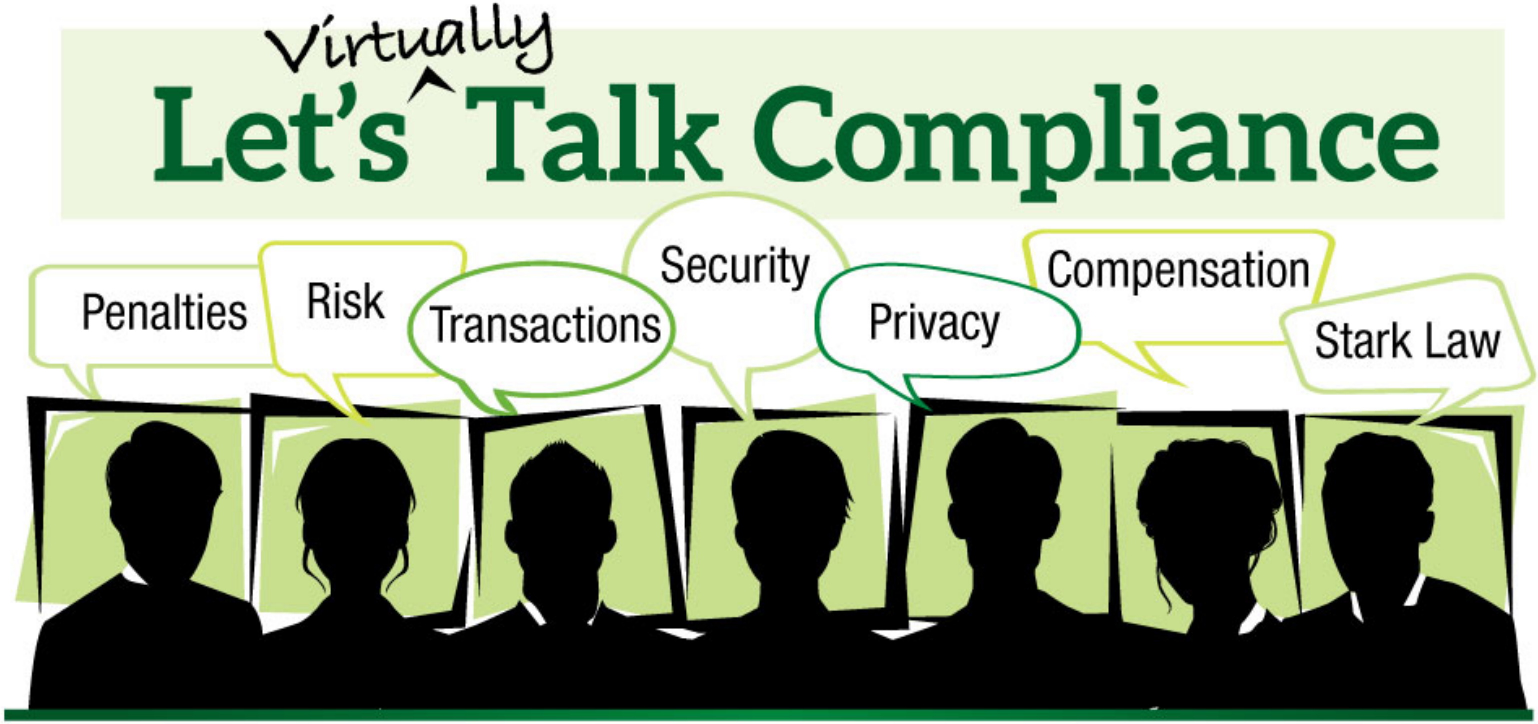
Let’s Talk Compliance

One-Day Compliance Master Class



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SESSION #2

The Unintended Consequences of Due Diligence

Lori Foley & Roger Strode

Agenda

- Why Diligence is Important to Sellers and Buyers
- Most Common Issues Found in Diligence—Impact to Seller
- How to Prepare for Future Transaction and Deal with Issues Found in Diligence

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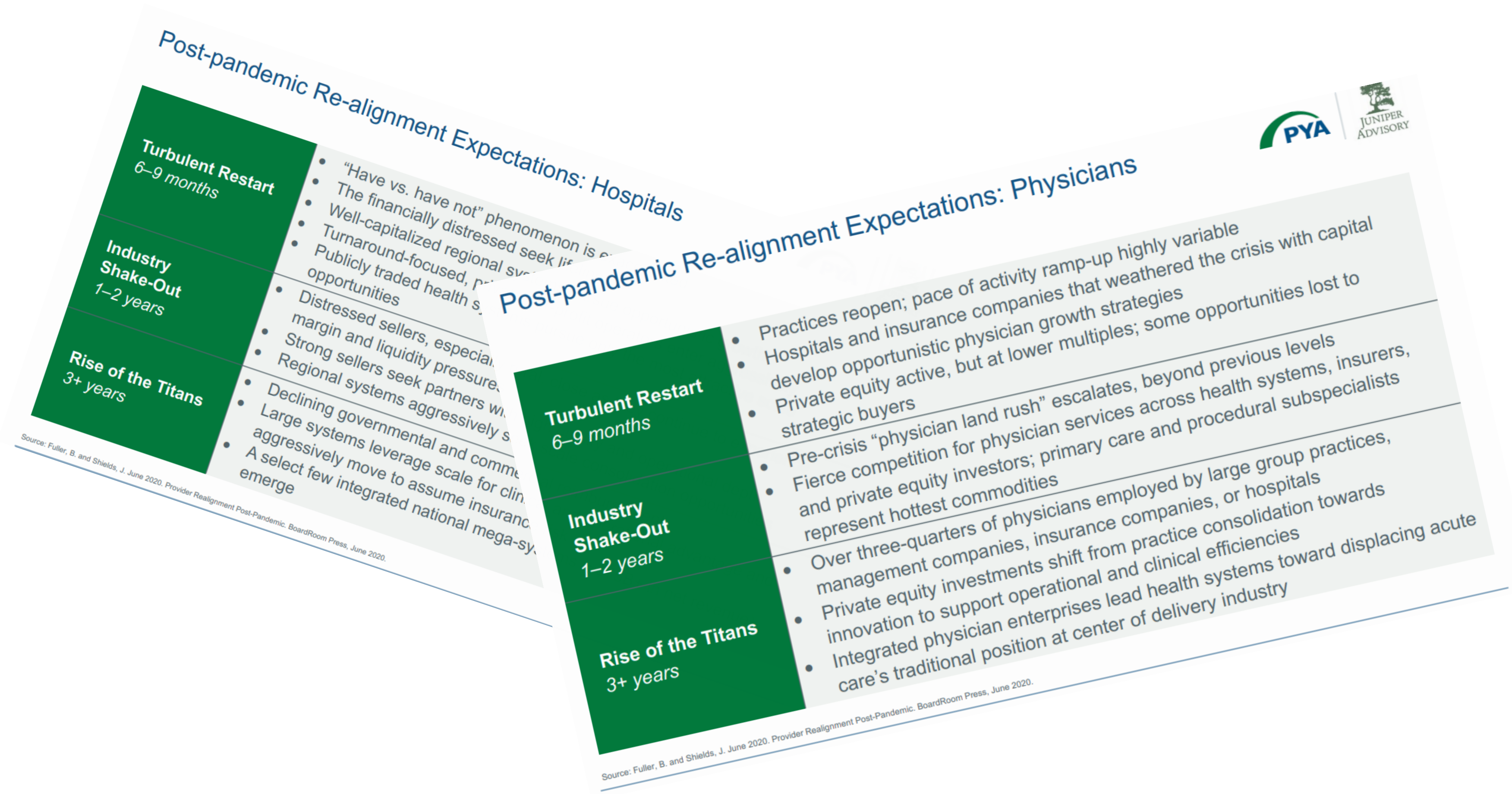
Transaction Trends



Post-pandemic Re-alignment Expectations: Hospitals

Turbulent Restart *6–9 months*	• "Have vs. have not" phenomenon is e… • The financially distressed seek lif… • Well-capitalized regional sys… • Turnaround-focused, p… • Publicly traded health s… opportunities
Industry Shake-Out *1–2 years*	• Distressed sellers, especia… margin and liquidity pressure… • Strong sellers seek partners w… • Regional systems aggressively s…
Rise of the Titans *3+ years*	• Declining governmental and comm… • Large systems leverage scale for clin… aggressively move to assume insuranc… • A select few integrated national mega-sy… emerge

Source: Fuller, B. and Shields, J. June 2020. Provider Realignment Post-Pandemic. BoardRoom Press, June 2020.

Post-pandemic Re-alignment Expectations: Physicians

Turbulent Restart *6–9 months*	• Practices reopen; pace of activity ramp-up highly variable • Hospitals and insurance companies that weathered the crisis with capital develop opportunistic physician growth strategies • Private equity active, but at lower multiples; some opportunities lost to strategic buyers
Industry Shake-Out *1–2 years*	• Pre-crisis "physician land rush" escalates, beyond previous levels • Fierce competition for physician services across health systems, insurers, and private equity investors; primary care and procedural subspecialists represent hottest commodities
Rise of the Titans *3+ years*	• Over three-quarters of physicians employed by large group practices, management companies, insurance companies, or hospitals • Private equity investments shift from practice consolidation towards innovation to support operational and clinical efficiencies • Integrated physician enterprises lead health systems toward displacing acute care's traditional position at center of delivery industry

Source: Fuller, B. and Shields, J. June 2020. Provider Realignment Post-Pandemic. BoardRoom Press, June 2020.

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Transaction Structure Primer

- Hospital Affiliations
  - Often done as “member substitutions”
  - Cash usually doesn’t change hands
  - Often the “acquirer” may provide promises of capital, new facilities, etc.
  - Exception to the above: Purchases by for profit acquirers
- Physician and Facility Deals
  - Generally done as cash or cash/equity (rollover) deals
  - Often priced/quoted as a multiple of EBITDA
  - Acquirers range from hospitals to private equity to owner/managers
  - Can be done as sales of assets or sales of equity/stock

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Why Diligence is Important

- Hospital Affiliations
  - When no real cash changes hands, the “acquirer” has little recourse for problems that are discovered post-closing
    - May allow for re-pricing of planned capital commitments or expenditures
  - Allows for problem areas, such as billing and coding violations, Stark Law violations to be self-reported (if appropriate) and remedied prior to closing
    - Common to require self disclosures prior to or immediately following closing
  - Allows parties to put in place appropriate compliance programs and controls (should they be lacking)

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Why Diligence is Important

- Physician and Facility Deals
  - Critical to pricing and problem areas can, and often do, reduce purchase price
    - Assume a physician practice or facility, such as an ASC, is priced at 8x TTM EBITDA
    - A business practice, such as up-coding a particular procedure that has a \$500,000 impact on annual EBITDA, has a \$4,000,000 impact on value (\$500,000 x 8 = \$4,000,000)
  - Issues can result in self-disclosures to the CMS, OIG, or MAC
  - Issues often will result in escrowed purchase price and/or so-called "specific" indemnification items

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Why Diligence is Important

- Buy side due diligence is customary, but sell side diligence is just as important - helps vet the relationship
- Both sides gain insight into
  - Organizational culture
  - Other party’s willingness to share information/transparency
  - Business acumen and operational/regulatory sophistication
  - Post-transaction expectations and goals
  - Items that will need to be a primary focus post-transaction
    - Including the “lift” needed to address (time, dollars, resources)

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Common Issues Found in Diligence

- Billing and Coding Issues
  - Up-coding
  - Unbundling
  - Modifier usage
  - Failure to supervise certain services properly
    - “Incident-to” billing
    - General v. direct supervision
  - Failure to properly chart

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Common Issues Found in Diligence

- Improper management of over payments
  - Failure to research/refund governmental overpayments
  - No reporting of unclaimed patient refunds/state escheat
- Non-compliance with other regulatory requirements
  - OSHA
  - CLIA
  - HIPAA Privacy
  - HIPAA Security

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Common Issues Found in Diligence

- Stark Law Issues
  - Excessive physician compensation
  - Other non-FMV arrangements
  - Failure to meeting “in-office ancillary services” exception
  - Technical failures to comply with exceptions
- Corporate Practice of Medicine Issues
- ASC Compliance Issues
  - Failure to comply with 1/3 tests

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Common Issues Found in Diligence

- Failure to perform exclusions checks
- Failure to monitor open payments/Sunshine Act
- Lack of formal compliance knowledge/program
  - Leads to additional probes
  - Jeopardizes attractiveness to become a “foundational” practice (PE acquisition)

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How to Deal with Transactions and Issues Found in Diligence

- Sellers should consider preemptive billing and coding audits and desk compliance audits of “big picture” issues as early as selling is contemplated
  - Helps avoid surprises, minimizes likelihood of events that negatively impact sales price and cause closing delays
  - Provides ability to address weaknesses and manage messaging
  - Demonstrates knowledge of laws and regulations and good-faith efforts to comply
  - If done before the LOI Sellers can build issues into negotiation
  - If found after critical terms are negotiated can lead to re-pricing or worse

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How to Deal with Transactions and Issues Found in Diligence

- Issues found in diligence can be handled through escrows and special indemnities if not remedied prior to closing
- Issues found following closing
  - Indemnity provisions
  - Representations and warranties insurance
  - Financial withholds
    - Often used with medical practices where selling physicians are key to go-forward revenue stream

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Resources

- https://www.pyapc.com/insights/cms-open-payment-registry-review-checklist/
- https://www.pyapc.com/insights/compliance-officer-role-in-covid-19-checklist/

Thank you.

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Lori leads PYA's Compliance and Business Support & Improvement services and is a member of PYA's Value Transformation Team. She combines industry experience in managing multiple hospital-owned practices with nearly two decades of consulting experience advising physicians, and organizations affiliating with physicians, in the areas of compensation, strategic planning, operational and financial improvement, and affiliation structures. Recently, Lori has been immersed in assisting physicians with understanding the volume-to-value transition, population health management, and deployment of chronic care and transitional care management structures so providers can use existing CMS-funded mechanisms to learn survival skills for value-based reimbursement.

Lori earned a Bachelor of Science in Elementary Education from the University of Alabama and a Master of Accounting from the University of Alabama at Birmingham. She is a Certified Management Accountant (CMA), Professional in Human Resources (PHR), Society for Human Resource Management Certified Professional (SHRM-CP), and Change Diagnostic Index (CDI) Certified. Lori is a member of the Institute of Managerial Accountants, the Society of Human Resource Managers, the Professional Association of Health Care Managers and the Healthcare Financial Management Association. Lori is a frequent speaker at local, regional, and national organizations on operational, financial and human resource topics impacting today's medical practices.

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Roger Strode is a partner and health care business lawyer with Foley & Lardner LLP where his practice focuses on health care business transactions, including mergers, acquisitions, corporate restructurings and joint ventures, general corporate matters and health care regulation. His experience includes the representation of institutional health care providers (hospitals, health systems and integrated delivery systems), large physician groups, specialty providers (ASC development organizations), health care private equity firms and industry consultants. Roger is a member of the firm's Health Care Industry Team.

Roger has participated as lead counsel in numerous health care and corporate transactions, including the purchase and sale, or transfer of sponsorship of hospitals, health systems, physician practices and health maintenance organizations; the formation of specialty hospitals; and the formation of ancillary services joint ventures.

Roger lectures frequently on health law and corporate issues and he co-authored, "How to Manage Personal Finances," a chapter published in *The Academic Medicine Handbook* (2013 and 2018).

Roger is a graduate of Marquette Law School and earned his bachelor at Illinois State University.

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