

The Lifecycle of a Deal: *Applying Knowledge to a Hypothetical Transaction*

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Introductions



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Setting the Stage

- Why is this session important?
 - Transactions, collaborations, and strategic partnerships are a significant and essential component of our health care industry
 - Having a foundational understanding of health care business transactions is important for corporate/transactional attorneys, litigators, and regulatory/compliance team members alike
- Session is intended as a primer
 - Will build upon other plenary sessions
- Our objective:
 - To demonstrate the full lifecycle of a deal, from initial stages of interest through post-closing integration
 - Provide practical guidance for addressing critical path items common in negotiations and due diligence

Case Study: The Sale of a Physician Practice



Case Study: Part 1



Healthy Hearts is a large, multi-specialty physician practice located in a bustling suburban community. It has 20 office locations and has been expanding in recent years.



Docs for Sale is a multi-specialty physician practice with 2 office locations in the same community as Healthy Hearts.



With operational costs rising and reimbursement decreasing, Docs for Sale has struggled to keep a healthy profit margin.



The founder (and one of the owners) of Docs for Sale, Dr. Amelia Harris, has discussed operational challenges with the other physician owners in great depth and the group has decided they need to make a change.



Dr. Harris learned that Healthy Hearts is looking to expand. She reached out to the management team at Healthy Hearts to discuss potential partnership opportunities.



Healthy Hearts is very interested in pursuing a partnership with Docs for Sale and has approached us to discuss next steps for doing so.

Importance of Pre-Deal Planning

- All parties should understand the “why” and goals of a deal
- Identify strategic vision and rationale for each party
- Ensure parties’ cultures and organizational missions align
- Evaluate impact on current business and referral relationships
- Consider implications for other business & contractual relationships
- Identify potential obstacles
- Identify potential deal structure and process

Pre-Deal Legal Review

- Parties must evaluate the legal implications of any desired transaction
 - Will ultimately affect the transaction structure and can at times kill a deal before it starts
- Depending on potential structure and parties, the following may apply:
 - Corporate Practice of Medicine
 - Anti-kickback Statute (42 USC 1320a-7b)
 - Physician Self-Referral Law (Stark Law) (42 USC 1395m)
 - Civil Monetary Penalty (42 USC 1320a-7a(b)) against payments to reduce or limit services
 - Antitrust
 - Tax-Exemption
 - Debt Covenants
 - Religious Directives or other restrictions
 - Medicare Change of Ownership

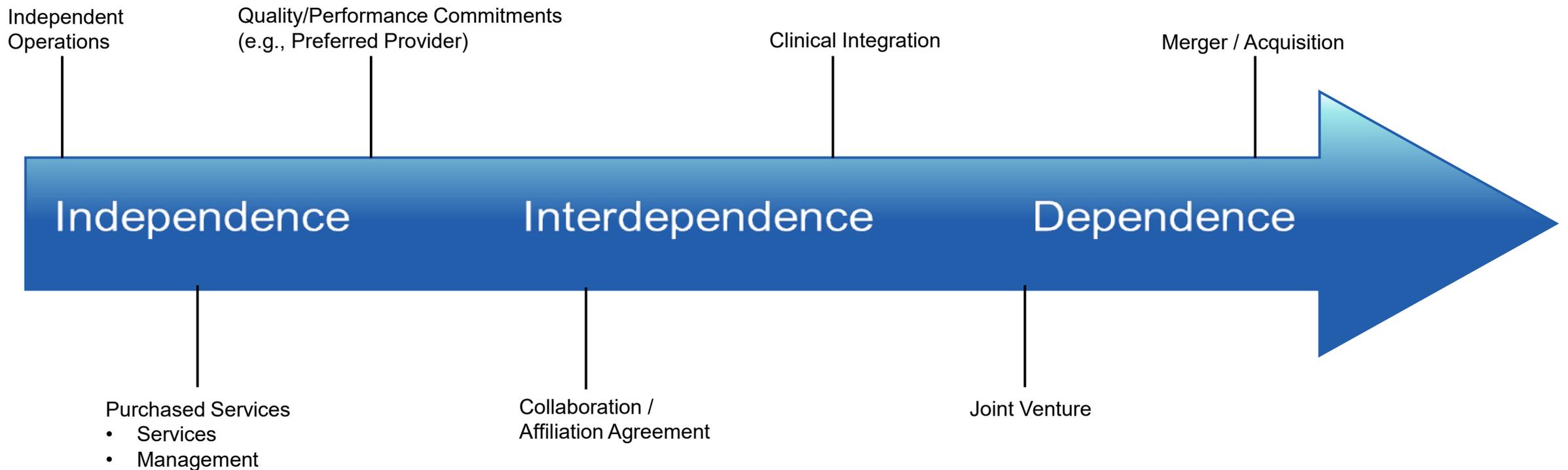
Overview: Deal Structures



Choosing a Transaction Structure

- Transaction structures are selected for a variety of reasons
 - Business considerations
 - Financial / tax considerations
 - Regulatory constraints
 - Liabilities
- Healthy Hearts and Docs for Sale could achieve their goals using a variety of different structures:
 - Professional Services Arrangement
 - Management Services Arrangement
 - Collaboration or Joint Venture (e.g., development and co-ownership of ambulatory surgery center)
 - Asset Transaction
 - Stock Transaction

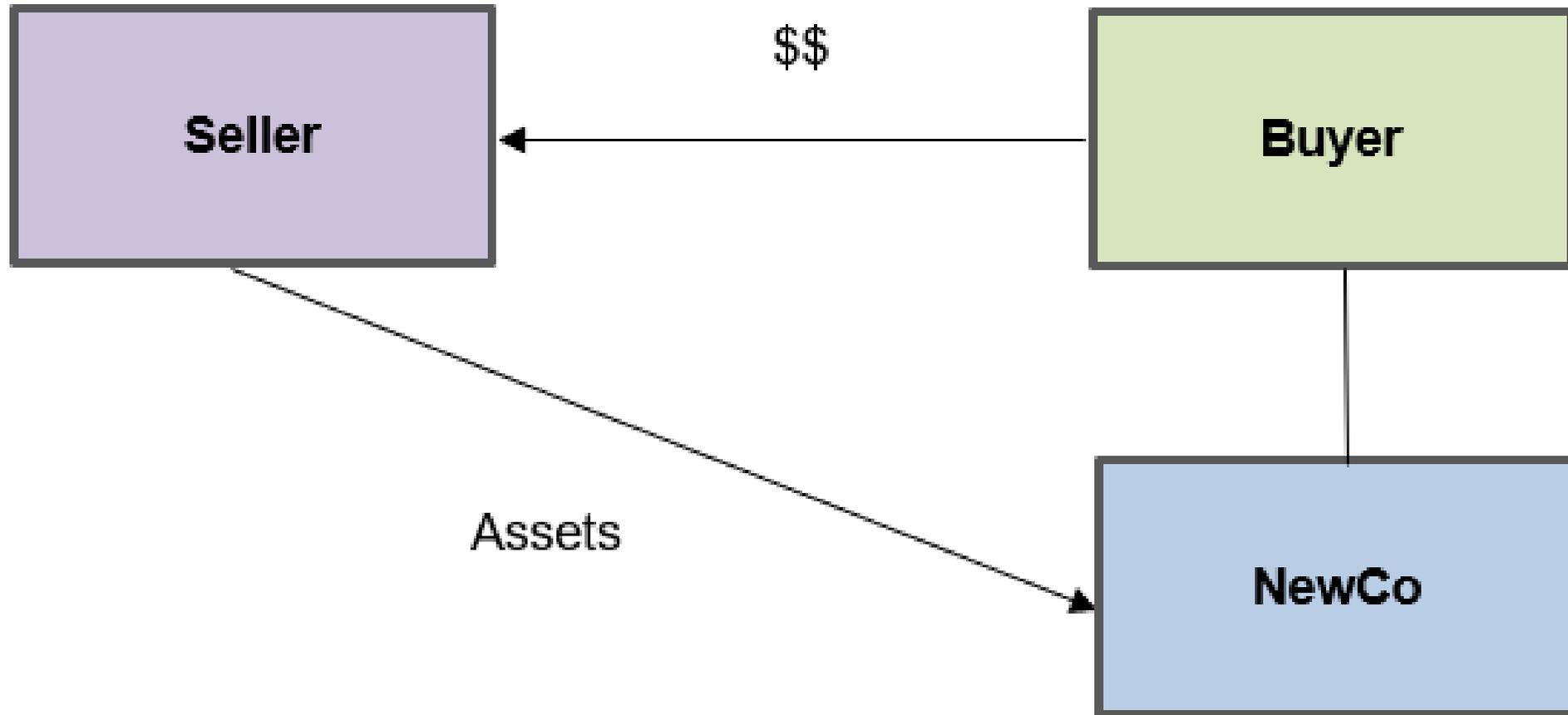
A Range of Available Relationships



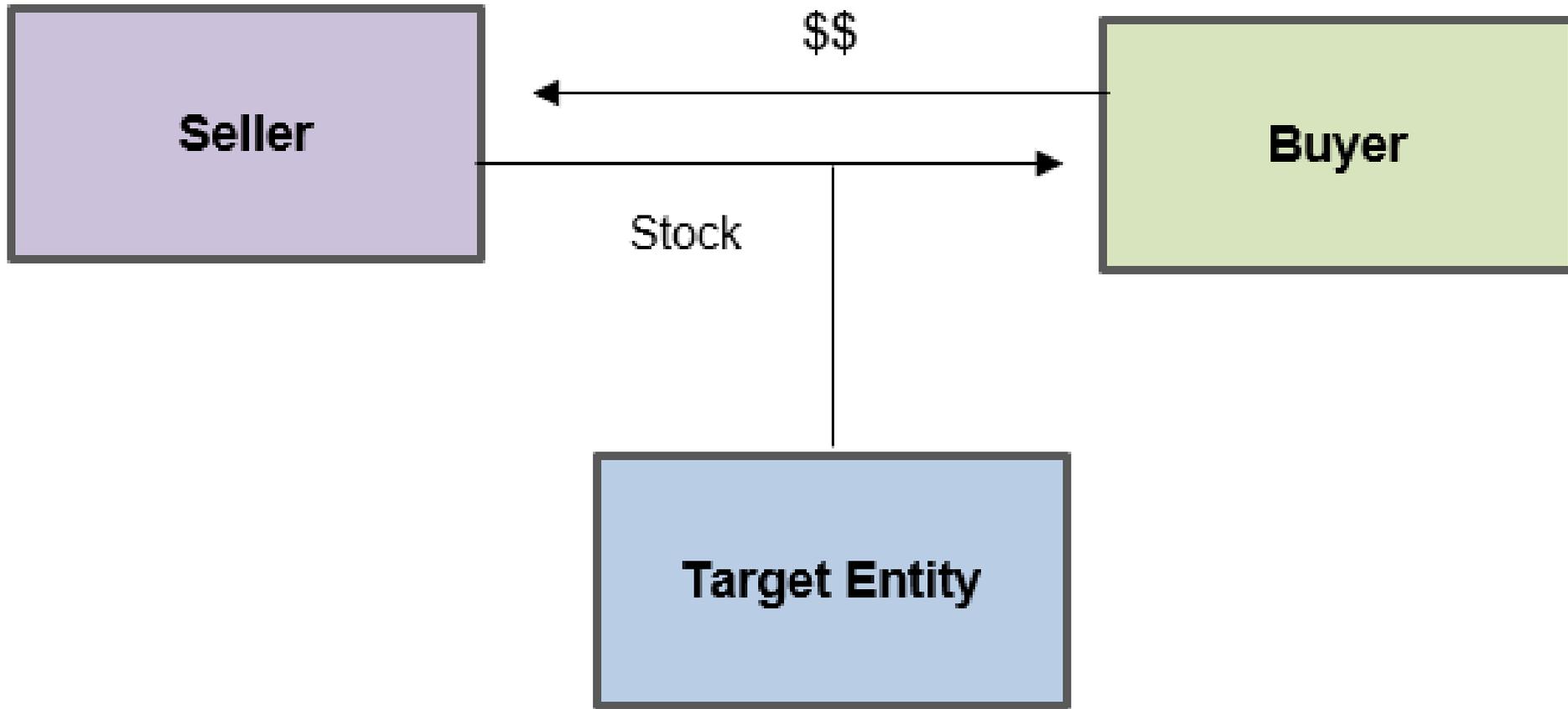
Deal Structures

- Asset Purchase
- Stock Purchase
- Mergers
- Joint Ventures and Affiliations
- Standard Contractual Arrangements
 - E.g., Employment Agreements, Leases, and Professional Services Agreements
- Complex Contractual Arrangements
 - E.g., Long-Term Professional Services or Management Arrangements
- Practice Management Model

Asset Deal



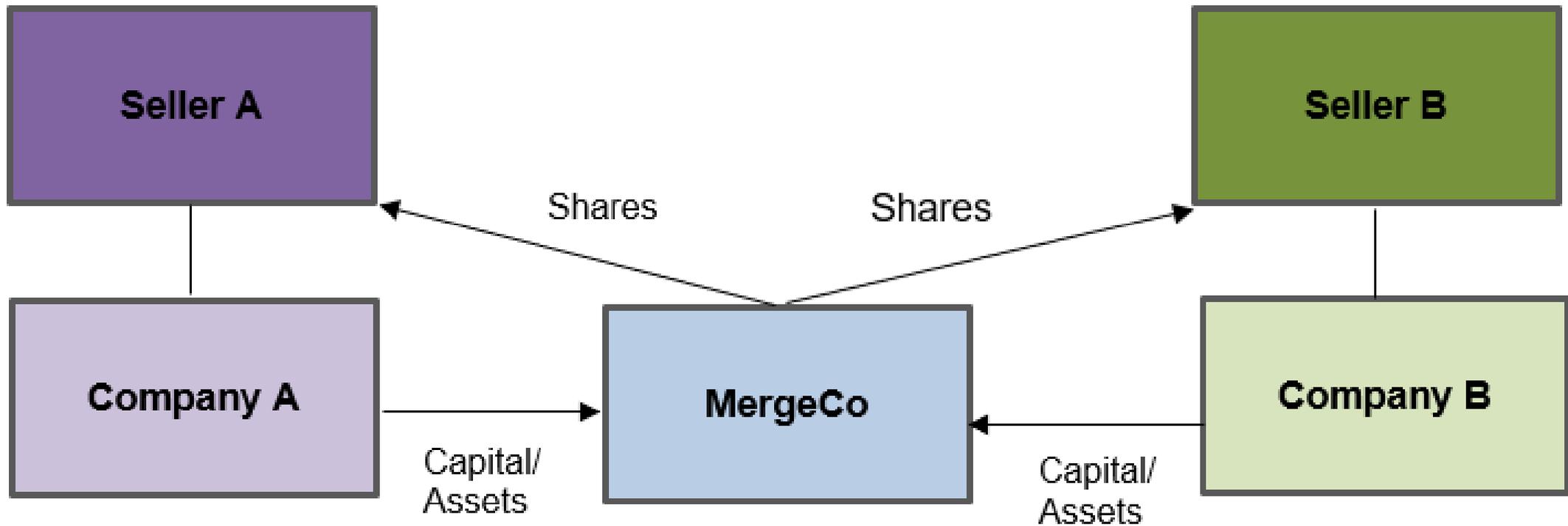
Stock Deal



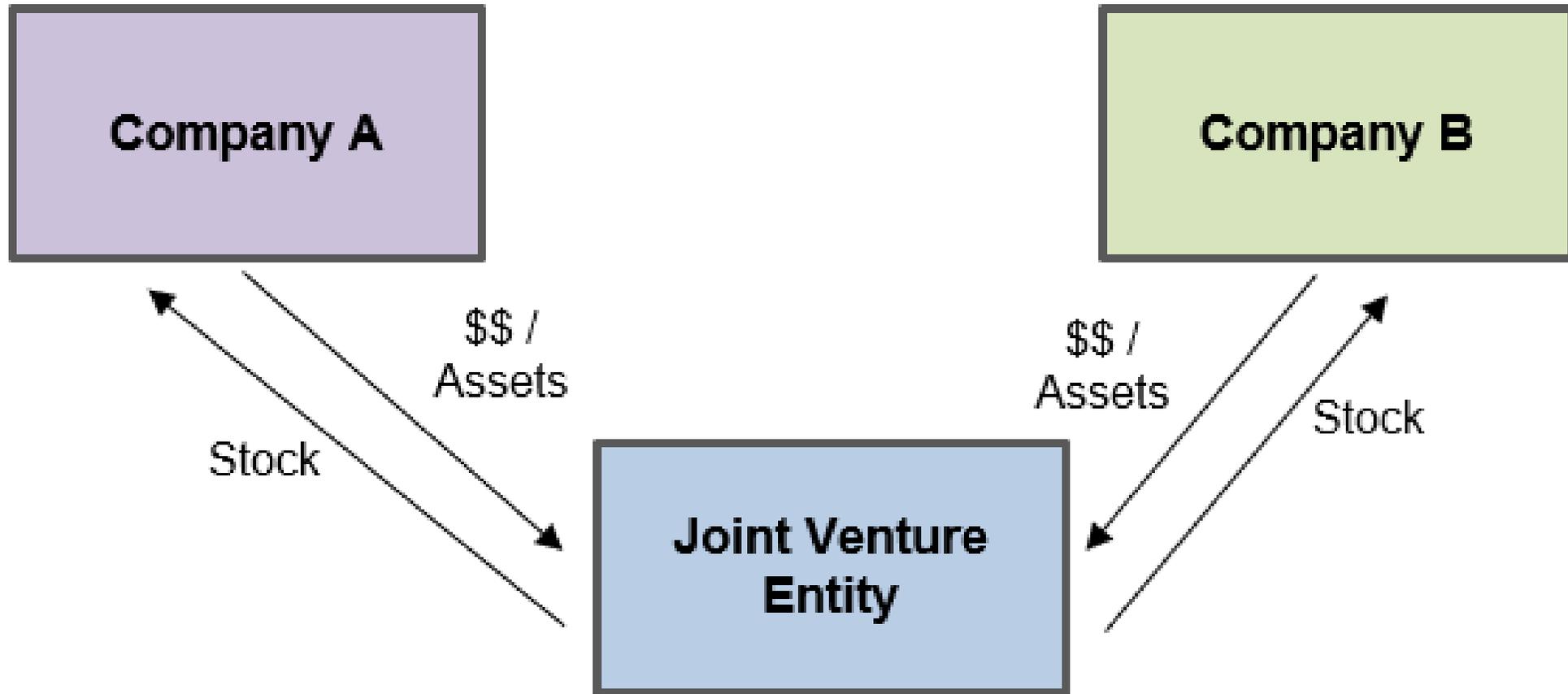
Asset v. Stock Deal

	Asset Deal	Stock Deal
Assets	Buyer purchases only identified assets	Buyer assumes all assets
Liabilities	Buyer assumes only identified liabilities	Known and unknown liabilities are transferred
Due Diligence	Due diligence is used primarily to identify assets and liabilities and assess whether they should be included or excluded	Due diligence is used primarily to evaluate risk and inform other key deal terms (purchase price, reps/warranties, indemnification, insurance, etc.)
Licenses / Permits	Very few, if any, healthcare licenses are transferable or assignable from the Seller to the Buyer. Each license requires review for transferability	Licenses are not technically transferred or assigned; may avoid a CHOW (e.g., Medicare considers this a “change of information” instead of a “change of ownership”)
Third party consents	Often triggers “assignment” provisions, which may require third party consent or approval to be assigned	Typically triggers fewer “assignment” provisions; but may still need approval re: change of control

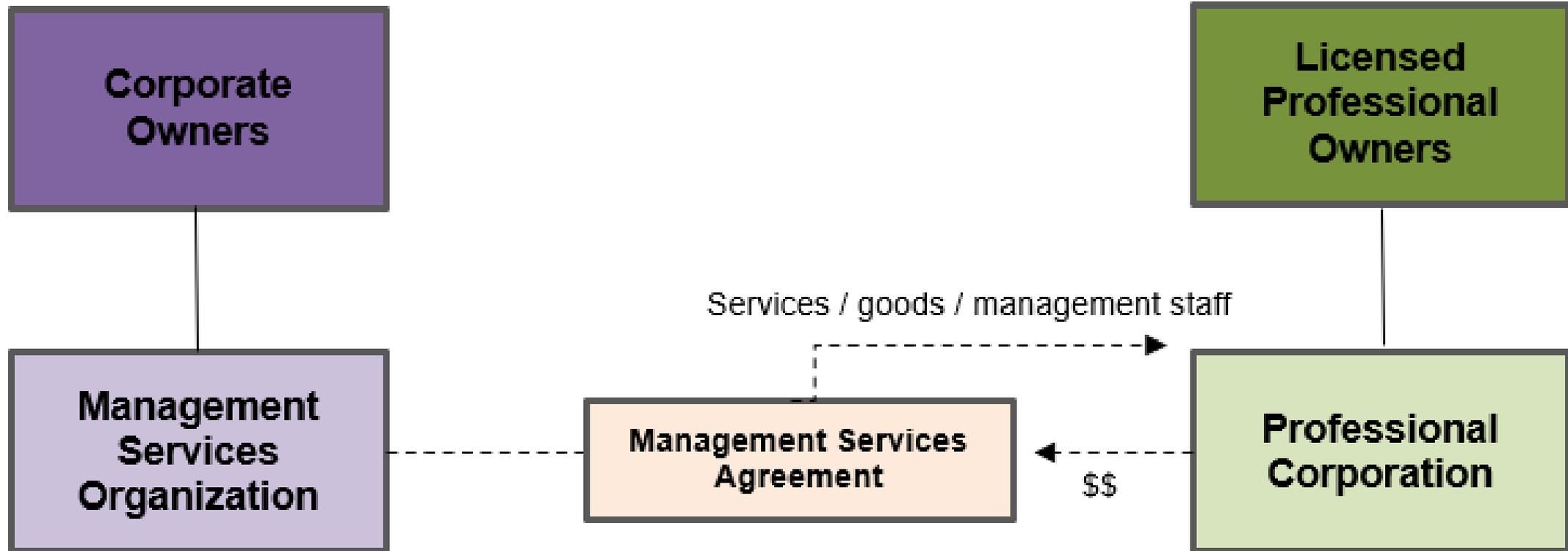
Merger



Joint Venture



Practice Management Model



Case Study: Part 2



After considering a variety of transaction structures, Docs for Sale has decided it would like to sell the practice and have its professional and non-professional employees join the Health Hearts practice.



Healthy Hearts is very interested in this structure. Specifically, it would like to purchase all or substantially all of the assets of Docs for Sale.



Both parties are eager to begin discussing and negotiating the terms of this transaction.



What's next?

Letter of Intent

- **What Is It?**
 - A “brief” document indicating the parties’ intention to proceed with the negotiation of a definitive agreement
 - Contains the basic terms of the proposed deal
 - Typically nonbinding (although often containing binding provisions)
 - Sometimes referred to as (and perhaps formatted as) a “term sheet,” a “memorandum of understanding” and sometimes, the seemingly oxymoronic “preliminary agreement”

Letter of Intent—Advantages

- Isolates and memorializes key deal points or identifies deal breakers
 - Confirms there is a “meeting of the minds”
- Provides a map and timeline for the transaction
- Governs the parties’ relationship to the signing of definitive documents
- Provides a vehicle for binding obligations (e.g., exclusivity, expense allocation, confidentiality)
- Can be used with regulators (e.g., HSR filing), financing sources and other constituencies
- Demonstrates the seriousness of the parties
- Creates “moral commitment”

Letter of Intent—Disadvantages

- Certain provisions can lead to loss of leverage
 - For Seller, exclusivity provision
 - For Buyer, too much detail on deal terms
- May inadvertently create a binding agreement as to certain deal points along with potential liability
- May create a duty to negotiate in good faith
- Nonbinding nature of letters of intent does not always justify the expenditure of time and money

Case Study: Part 3



Healthy Hearts and Docs for Sale have signed the letter of intent (“LOI”) for Healthy Hearts to purchase all or substantially all of the assets of Docs for Sale.



The due diligence phase has now begun. Healthy Hearts provided Docs for Sale with a due diligence request, and Docs for Sale is compiling and producing documents.



Meanwhile, counsel for Healthy Hearts is preparing a preliminary draft of the Asset Purchase Agreement, which will be reviewed and revised by counsel for Docs for Sale.

Due Diligence—Why Do We Care?

- Know your client...
- Learn about the other party:
 - Learn about their business
 - Identify liabilities and compliance risks
 - Identify assets
 - Identify consents/notices that may be needed
- Operational and regulatory due diligence
 - Understand the difference
 - Appropriate staffing is key
- As you review documents, start building your post-closing checklist
- Client should be prepared to revise the deal structure or walk away, depending on results of due diligence

Snapshot of Sample Due Diligence Request

1. Corporate Structure, Governance, and Operations

- a. Governing documents (articles or certificate of organization, operating agreement, etc.) and any amendments for the applicable ambulatory surgery center (the “ASC”) and any entities in which the ASC has an ownership interest or the right to appoint a member of such entity’s governing body
- b. The ASC’s equity record books, equity holder list, and minutes of member, officer, and/or manager meetings for the last three years
- c. A list of all current managers, members, and officers and expiration dates of their terms, if applicable
- d. An organizational and management chart showing relationships within, between, and among entities with whom the ASC has an ownership interest

2. Material Contracts

- a. All active and ongoing letters of intent, memoranda of understanding, and similar documents; all partnership, acquisition, sale, and joint venture agreements
- b. Agreements with payors (commercial insurers, Medicare, Medicaid, other government payors), vendors, suppliers, employees, managers, and members
- c. Medical equipment contracts, including service or maintenance agreements, leases and purchase agreements

Due Diligence—Process

- Signing Confidentiality / Non-Disclosure Agreement before due diligence is critical
- Process
 - Buyer delivers due diligence request
 - Seller compiles documents and delivers to Buyer
 - Usually through electronic platform
 - Law firm often provides this software or otherwise facilitates
 - Both parties track process and assess what items are outstanding
 - Operational and regulatory analysis of the produced documents
 - Buyer analyzes to assess risk and evaluate deal terms
 - Do certain liabilities warrant a reduced purchase price or special handling in deal documents?
 - Seller analyzes to maintain position during negotiations and enable completion of disclosure schedules
 - Compliance is never perfect—what items actually warrant revised deal terms, and what is just the cost of doing business?
 - Legal team delivers due diligence report to the client with recommendations

Sample Due Diligence Report

INDICATOR	RECOMMENDATION
Red 	Address Pre-Close. The issue is significant enough that we recommend it be addressed—as part of the deal structure, through provisions in the deal documents, or otherwise—before the Integration Effective Date.
Yellow 	Post-Close System Improvement. We recommend that the issue be addressed in the short term after the Effective Date as part of operational improvements and/or risk mitigation efforts.
Green 	Inform New Board. The combined Board of ___ after the integration should know about the issue to go in “eyes wide open” as to our concerns, but the issue need not be addressed prior to the Effective Date, nor does it necessitate immediate post-Integration operational changes.

Due Diligence Practice Pointers

- Communicate with your client / organization early on about the goals, cost, and process of due diligence
 - Some organizations may want to lead to keep cost down
 - Understand your role and create clear boundaries
 - Other organizations may want the lawyers to handle this process exclusively and provide a thorough due diligence report
 - Costs can escalate really quickly
 - Process is scalable
 - Will vary depending on the size of the transaction and the sophistication of the parties
- Good due diligence is project management combined with substantive legal review
- Cooperation and engagement on both sides is critical
 - Failing to do so can raise red flags and impact the deal
- Be prepared to explain the importance of due diligence and why doing a deal without going through this process creates significant exposure

Developing a Work Plan and Closing Checklist

- Purpose of a Work Plan and Closing Checklist
- Consider action items for each stage of the transaction, including post-closing
- Know your audience
 - Some work plans are used internally by deal lawyers to manage the legal deal process
 - Others work plans are used by the operational team to manage business tasks
 - A good work plan meets in the middle
 - Deal lawyers can add value by understanding and helping to track key operational milestones

Snapshot of Sample Closing Checklist

	Document/Action	Responsible Party	DOC ID	Status	Signatures
A.	<u>Due Diligence</u>				
1.	Due Diligence Memo				
2.	Supplemental Due Diligence Request List				
3.	Lien Searches				
B.	<u>Pre-Closing Actions and Deliveries</u>				
1.	Funds Flow				
2.	Closing Statement				
3.	Statement of Sellers Debt and Sellers Transaction Expenses				
4.	Resolution of [XYZ] Loans				
C.	<u>Primary Transaction Documents and Closing Deliveries</u>				
1.	Asset Purchase Agreement				<input type="checkbox"/> Buyer <input type="checkbox"/> Owners <input type="checkbox"/> Sellers
2.	Schedules to Purchase Agreement				
3.	Transition Services Agreement				<input type="checkbox"/> Buyer <input type="checkbox"/> Owners <input type="checkbox"/> Seller
4.	Bill of Sale, Assignment and Assumption Agreement				<input type="checkbox"/> Buyer <input type="checkbox"/> Seller
5.	Escrow Agreement				<input type="checkbox"/> Buyer <input type="checkbox"/> Escrow Agent <input type="checkbox"/> Seller

Definitive Agreements

- Primary Deal Document
 - Asset Purchase Agreement
 - Stock Purchase Agreement
 - Merger Agreement
 - Affiliation or Collaboration Agreement
- Common Ancillary Documents
 - Professional Services Agreement
 - Management Services Agreement
 - Bill of Sale and Assignment and Assumption Agreement
 - Intellectual Property Assignment Agreement
 - Trademark License Agreement
 - Clinic Lease Amendment
 - Business Associate Agreement

Snapshot of an Asset Purchase Agreement

- Introduction and Recitals
- Purchase and Sale of Assets
 - Acquired Assets; Excluded Assets; Assumed Liabilities; Excluded Liabilities
- Purchase Price
 - Amount, structure, and manner of payment
- Closing
 - Closing date; seller deliverables; buyer deliverables
- Representations and Warranties
- Covenants
 - Pre-close; post-closing
- Closing Conditions
- Employee Matters
- Limitation of Liabilities and Indemnification
- Termination
- Definitions
- Miscellaneous

Representations and Warranties

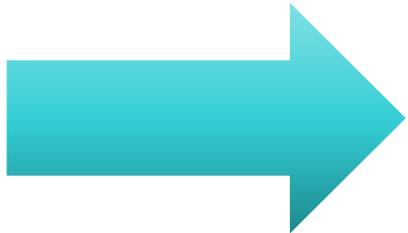
In representations, party is stating that certain things are true as of a particular date

Accuracy of representations and warranties is condition to closing (via a “bring down certificate”)

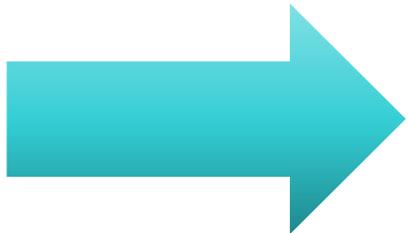
- Seller (and sometimes Seller’s shareholders) will make comprehensive representations and warranties to Buyer in the purchase agreement regarding Seller’s business
- Buyer also makes certain limited representations
- Form basis for indemnification claims
- Health care reps address things like:
 - Stark Law; Anti-Kickback Statute; False Claims Act; HIPAA; EMTALA; conditions of participation; unlawful retention of overpayments; cost-report liability; civil monetary penalties; licensure issues; corporate practice of medicine; etc.
 - Healthcare specific liabilities, including: repayment or breach of contract obligations to payors; malpractice liability; general contractual liability for equipment, service contracts, supplies; medical staff disputes.

Representations and Warranties

When reviewing and drafting representation and warranty provisions, consider the following:



As a Seller how confident are you that you can make certain representations (including compliance with health care regulations and other laws)? Are there any exceptions that need to be disclosed?



As a Buyer, how much liability and risk are you willing to take on?

Representations and Warranties Practice Pointers

- Parties need to understand what they are representing
 - Importance of conducting due diligence on your own client
 - Often includes lengthy calls with your client to review each provision in close detail (particularly when representing the Seller)
- Often heavily negotiated
 - Buyer will try to get broad provisions to reduce liability and form basis for future indemnification rights
 - Seller will try to limit the scope, often through “knowledge” and “materiality” qualifiers
- The extent of negotiations often depends on scope of indemnification rights available

Disclosure Schedules

- What are Disclosure Schedules?
 - Used by Seller to disclose exceptions to the representation and warranties made in the Purchase Agreements
 - Supplements the due diligence process
 - Attached to the Purchase Agreement and incorporated by reference
- Understand your role in the transaction
 - If you represent the Seller, you should keep track of potential disclosures (and begin building the schedules) throughout due diligence and the transaction process
 - If you represent the Buyer, you should be sure the purchase agreement requires the Seller to make the disclosures needed to mitigate risk

Case Study: Part 4



Due diligence has revealed that Docs for Sale was billing claims to Medicare under the wrong CPT code, which caused Docs for Sale to get paid for services at a higher billing rate than it should have.



The investigation is ongoing, but preliminary figures indicate that Docs for Sale will need to refund around \$2 million to Medicare due to the overpayment.



The Parties still want to proceed with the transaction but are grappling with how to respond to and address this issue.

Issues are Discovered...Now What?

- Regulatory issues that are identified can significantly impact the deal
 - Require resolution prior to closing (expensive and time consuming)
 - Impact critical deal terms (including purchase price and representation and warranty provisions)
 - Stop a deal from closing
- Give special consideration to the following during due diligence:
 - Compliance
 - E.g., maintaining permits, licenses, and certifications necessary for operation
 - Regulatory and fraud and abuse issues, such as:
 - Contracts with referral sources (think “kickback” payments)
 - Agreements documenting relationships between physicians and other providers
 - Shifts in referral patterns
 - Unexplained expenses
 - Sales and Marketing activities/budgets, etc.
 - Debt, liens, and other financial matters
 - Requirements associated with key contracts
 - E.g., consents for real estate leases

Liability and Risk Mitigation Strategies

- Require complete resolution prior to the Closing Date
- Revisions to representation and warranty provisions
 - Buyer may add representations and warranty provisions to address areas of concern
 - Seller may add the following to limit the provision:
 - Knowledge qualifier
 - Materiality qualifier
 - Lookback range
 - Reference to disclosure schedule
- Conditions to Close
 - Contractual provision relieving party from duty to close if certain events occur or do not occur
 - Deal-specific
 - Often includes finalizing ancillary documents, obtaining consents and approvals, and providing certain deliverables

Liability and Risk Mitigation Strategies

- Indemnification
 - Provisions in purchase agreement providing a party with post-closing claim against another party
 - Typically covers:
 - Breaches of representations and warranties
 - Breaches of covenants
 - Assumed and excluded liabilities
 - Specifically identified liabilities
 - “Threshold”
 - Minimum amount before which a party may not bring a claim for indemnification
 - Upon reaching threshold, party can make a claim for amounts above that threshold (a “deductible”) or for whole amount, including amounts up to threshold (a “tipping basket”).
 - “Mini basket”
 - Provision that any single claim or group of related claims not exceeding a certain amount will be disregarded

Liability and Risk Mitigation Strategies

- Purchase Price / Financial Strategies
 - Earnout
 - Agreement by which a portion of the acquisition purchase price is paid only upon the Target business achieving certain milestones post-closing
 - Typically based on post-closing earnings of Target business
 - Be careful when using earnouts
 - Area of potential future dispute
 - Regulatory implications
 - Purchase Price Adjustment
 - Used to adjust purchase price for changes in Target's financial condition between a pre-closing date and closing date
 - Typically based on difference between net working capital of Target on closing date and a specified net working capital target amount
 - Escrows and Holdbacks
 - Buyers typically prefer a holdback; Sellers typically prefer escrow
 - Certain portion of purchase price held in escrow with a third party or “held back” by Buyer for payment of indemnification claims and purchase price adjustments
 - Held for specified period, often between one to three years

Case Study: Part 5



The transaction between Healthy Hearts and Docs for Sale is progressing nicely.



Healthy Hearts has completed due diligence and the Parties have finalized the terms of the Asset Purchase Agreement.



Operationally, the Parties have a plan in place to onboard Docs for Sale employees and practice locations.



The Board of Directors of both Parties have analyzed the risks and benefits of the transactions and have given formal approval to proceed.



Closing is set to take place in one week.

Closing

- Understand and track the closing timeline
 - Is there a single Closing Date or is the transaction structured as a “Sign and Close”?
- Ensure conditions to closing are satisfied
- Buyer and Seller exchange closing deliverables
- In-person closings have largely turned virtual
 - Attorneys prepare signature packets in advance
 - Often hold signed copies and exchange on day of closing following successful wire of the purchase price



Post-Closing Practice Pointers

- Prepare a closing book
- Ensure client understands and continues to comply with post-closing covenants
 - Regulatory filings, notices, non-compete restrictions, employee benefits (for buyer), etc.
 - Track indemnification periods
 - Develop post-closing checklist and work plan
- Integration does not magically happen ...
 - In collaborations/affiliations, parties should consider forming integration teams
 - Post-signing, pre-closing
 - Identify all promises and commitments and operationalize to ensure both sides get what they bargained for
 - Operation under new entity requires education (new policies, procedures, etc.)
- Address escrow and/or reconciliation payments
 - Create calendar reminders



Questions?



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