

# The Role of Risk Management in Health Care Provider Mergers and Acquisitions

Beecher Carlson - Risk Roundtable

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DEFINING SUCCESS TOGETHER

# MERGERS AND ACQUISITIONS – OVERVIEW AND TRENDS

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- Healthcare Reform
- Strategic initiatives: proliferation of integrated delivery systems and other ventures
- Profitability of outpatient services
- Medicare and other payors' reimbursement methodologies
- Emphasis on quality and consumerism
- Explosion of IT and technology requirements
- Consolidation and growth of physician organizations
- Growing access to capital; private equity
- More than 25 Southern California hospitals sold in the last 7 years
- More than 30 Southern California hospitals closed in the last 10 years

# M & A

## FINANCIALLY DISTRESSED HOSPITALS

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- Recurring Issues:
  - Market share and revenue problem (rather than expense)
  - Insufficient or misalignment of physicians
  - Bad debt and/or charity too high
  - Medicare LOS too long
  - Insufficient commercial insurance or commercial insurance with bad rates

# M & A ACTIVITY PHYSICIANS

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- More than 3,000 physicians involved in mergers in 2011
  - Capital
    - Track quality
    - Electronic medical records
    - Changes in practices
  - Seeking stability
  - Specialty driven
    - 60% of cardiology practices planned layoffs
    - 40% looking to “merge” with hospitals

# OVERVIEW OF M & A TRANSACTIONS

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- Types of Transactions
- Structure of Agreements
- Fiduciary Duties
- Due Diligence – Mechanics
- Due Diligence – What/Why?
- Material Risks
- Deal Protection
- Past Role of Risk Manager
- Future Role of Risk Manager

# TYPES OF TRANSACTIONS

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- Asset Purchase
- Stock Purchase
- Merger
- Affiliation of Nonprofits
- Joint Venture
- Management Agreement

# STRUCTURE OF AGREEMENTS

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- Mechanics of transaction/structure
- Consideration
- Representations and Warranties
- Covenants
- Conditions to the deal
- Investigation/Due Diligence
- Indemnification
- Related agreements
- Time frames to close

# ROLE OF THE RISK MANAGER





# TRADITIONAL ROLE OF RISK MANAGER

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- Organize response to request for documents
- Oversee antitrust guidelines
- Review insurance policies
- Provide information on litigation and claims
- Oversee nondisclosure agreement
- Respond to specific questions

# FUTURE ROLE OF RISK MANAGER?

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- Step up to the Big Table
- Manage due diligence process
- Prepare due diligence report to management
- Be the due diligence resource

# FIDUCIARY DUTIES

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- Duty of Care
  - Where due diligence emanates from:
    - What would a reasonable person do in a like position in the conduct of his/her own affairs
  - Reliance Right (within area of competence, professional expertise)
- Duty of Loyalty
  - Absence of a conflict of interest
- Business Judgment Rule
  - If meet fiduciary duties, no liability to the corporation or its shareholders

# DUE DILIGENCE

## KEY ROLE OF RISK MANAGER

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- Risk Manager needs to know overall strategic objectives of transaction
- Identify sooner than later
  - Unknown liabilities
  - Unfunded/underfunded Liabilities
  - Inadequate insurance
- Importance of Due Diligence Report - - Materiality impact on:
  - Price
  - Post-transaction cash flow/revenue
  - Protection against unanticipated costs
  - Efficacy of risk management
  - Change terms?
  - No deal?

# DUE DILIGENCE - MECHANICS

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- Request List/Disclosure List
  - Access source data when possible
- Antitrust guidelines
- Data gathering
- Data and virtual data rooms
- Access risk management policies; loss prevention, and risk financing programs
- Importance of inventory of documents  
Produced

# DUE DILIGENCE: EXPOSURE TO LOSS

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- Contract liability
- Worker's compensation risk
- D & O liability
- Employment liability
- Professional liability risk
- Property
- Environmental
- Stop loss/capitation/claims
- Health insurance; pension plans
- Historical claims analysis

# DUE DILIGENCE – WHAT/WHY

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- Buy Side:
- Materiality thresholds need to be set
- What are we buying? What are we getting?
- What are the prospects for the business?
- Are there material liabilities/concerns?
- Anticipated losses or down-turns in business
- Cataloging information about the business

# DUE DILIGENCE – WHAT/WHY (cont.)

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- Sale Side:
- Disclosure
- Appropriate steps to effect transfer:
  - Consents
  - Notices
  - Approvals
- Both Sides:
- Constraints
  - Legal
  - Contractual
- Antitrust Concerns
- Cultural Issues



# MATERIAL RISKS

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- Regulatory Compliance: Stark, Antikickback, Civil Money Penalties
  - Material Investigation
  - Integrity Agreement
- Material Litigation
  - Class action/wage and hour
  - Environmental matters
  - Antitrust
- Criminal Investigation or Inquiry
- Loss of Tax Exempt Status or Right to Participate in Medicare
- Certain Union Activity

# DEAL PROTECTION

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- Break up or termination fees
- No shop
- Confidentiality provisions
- Representations and Warranties
- Indemnification
  - Representations and Warranties
  - Breach of definitive agreement
  - Pre-closing activities
- Indemnification Escrow (e.g., 5-20% of the purchase price 2-4 years)
- Medicare Provider Number

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## Davis Wright Tremaine LLP

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Dennis Diaz, a partner with Davis Wright Tremaine LLP in Los Angeles, is a health care transactional and regulatory lawyer. For over 25 years, he has represented health care providers in (1) transactional matters, including the purchase and sale of providers, and the structuring and negotiation of provider joint ventures, medical foundations, accountable care organizations, integrated health care organizations, and other contracts, and (2) regulatory and compliance matters, including Stark, fraud and abuse, and billing and payment issues and disputes. He regularly advises and defends providers against government investigation and enforcement actions, and in internal investigations involving health care regulatory issues.

Dennis has been recognized as one of the best health care lawyers in America by Chambers and by Woodward/White, was named by Nightingale Healthcare News as one of the country's 12 best hospital lawyers in 2007, and has served as an Adjunct Professor of Law, Health Law, at the University of Southern California Gould School of Law and at Loyola Law School. He received his J.D. from the UCLA School of Law

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