

# 10 Trends in Physician Practice Transactions to Track in 2020

By all accounts, 2019 proved to be another year of significant investment by private equity firms in the physician practice space. Below we discuss 10 trends we observed as counsel on a number of these transactions during 2019 that bear tracking in 2020.

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## 1. Managing Physician Buy-In Has Proven to Be Key.

The ability of investment bankers and private equity firms to manage physician buy-in on the front end of a transaction is key to completing the deal, particularly in transactions involving a large physician shareholder base. Transactions that did not go to market or that have been put on hold were often the result of a lack of clarity by the physicians regarding post-closing operations and earnings over the life of the investment and eventual exit. It is crucial to identify the right champions and leaders in the practice to help drive consensus and ensure a more efficient process - ideally before you commit substantial time, money and resources.

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## 2. R&W Insurance Is Not Just for Large Deals Anymore.

Over the last several years, representation and warranty (R&W) insurance has become accepted in the healthcare industry, including insuring compliance and billing and coding risk, provided that the transaction is of significant size and the practice has audited financial statements. However, over the last 12 months, we have seen products come to market that are available for smaller transactions, such as add-on acquisitions. This could allow for a competitive go-to-market strategy for your roll-up, as well as limiting the need to make indemnification claims against your number one asset - the physician owners. This move down market is an exciting trend to monitor in 2020.

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## 3. The Audit After the Audit.

Billing and coding audits have been a core diligence practice from private equity investors for some time now, but does a general billing and coding audit go far enough? Even following a general billing and coding audit, we have seen specialized audits in areas of particular risk reveal errors that otherwise would have gone undetected. Time will tell whether this is a trend that will accelerate in 2020.

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## 4. Protecting Against Physician Departure Is a Must.

If you complete the transaction and get each physician to sign a five-year employment agreement, do you get liquidated damages if they leave? That may be hard to do for several reasons. But if you don't or can't, then you have a duty to mitigate damages and search for a replacement physician. Including representations and warranties in the purchase agreement regarding the known plans of physicians following the transaction can help protect your purchase price (we have seen it at work) should a physician decide to leave after the transaction. And, holding back a portion of the purchase price can further safeguard against the mass exodus.

## 5. The Resurgence of the “Partnership Model”?

In 2019, we saw more thought and structure around implementing true or “quasi” physician partnership models. This plays an obvious role in retention and market differentiation. Although there are numerous considerations and structural alternatives, a consistent theme is to allow existing or new physicians an opportunity to “earn” partnership-like status. New physician buy-in and other equity-based programs are also avenues that private equity firms continue to utilize, including using equity as a way to enforce noncompetes that otherwise might be invalid in an employment context. With the competitive marketplace, it is more critical than ever to find ways to ensure a desirable culture that fosters the ongoing commitment of the physicians.

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## 6. There Is Diligence, and Then There Is Diligence.

The lawyers prepare the request list, follow up, have diligence calls, and prepare a memo. That, however, is no substitute for walking the halls. A long-standing business practice that could result in a self-disclosure or repayment (and subsequent indemnification claim) will not be revealed if it is not reflected in any documentation or if you don’t have the right people on the diligence call. If possible, interview clinical personnel on the front end to get insight into potential compliance issues that may not surface through formal requests or calls. If a founding physician group will not let you speak to the broader non-owner provider group prior to closing, that should be a warning sign. Further, closing the deal despite employee dissension or uncertainty hoping it will naturally resolve itself is not a prudent strategy. If several providers leave after learning about the deal and the owners promise they can replace them in short order or pick up the slack, consider pressing the pause button. Discovering the true root issues and whether they are manageable before you make your investment is key.

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## 7. 12 Is Still the New 18.

It used to be that a buyer proposed a 24-month survival period for representations and warranties, the seller came back proposing 12 months, and the parties settled at 18 months. For a while now, survival periods have been trending down in physician practice deals, and 12 months is now the baseline survival period for standard representations and warranties, particularly in larger deals that involve an auction process and R&W insurance policy. That said, we are still seeing longer survival periods in smaller add-on transactions. We expect these trends to continue into 2020.

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## 8. Healthcare Is Still Special, but Not Fundamental.

Historically, compliance with healthcare laws has been a fundamental representation in physician practice transactions, subject only to a statute of limitations survival period and purchase price cap. These caps have trended down, with survival periods typically at three years and caps at 25-50% of the purchase price. As 2020 continues to be a sellers’ market, we see this trend continuing. And in large transactions and platform exits, we have observed true walk-aways and recourse limited to the R&W insurance policy and any retention.

## 9. Importance of Customer Relationships.

Particularly for a hospital-based practice - such as orthopedics, radiology and anesthesiology - being familiar with the terms of the practice's customer agreements should be of primary focus during the diligence process to assess the potential implications of a transaction on the customer relationship.

Determining whether an agreement complies with the following criteria are just some of the issues of buyer focus when reviewing the practice's customer agreements:

1. Requires consent to the transaction.
2. Contains restrictions on competition that may be implicated by the impending affiliation with the buyer.
3. Allows the facility to directly hire practice physicians if the facility agreement terminates.

Also, many practices have long-standing relationships with their facility partners, which can prove to be both beneficial and challenging in the context of a deal, especially if the facility agreement requires consent. Knowing how the customer views the transaction generally (good or bad) is crucial in understanding how these key relationships will work post-closing.

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## 10. Managing Moonlighting.

Many physicians are monetizing their specialty (possibly in more ways than one) by moonlighting as inventors, spokespersons, salespeople and researchers. Depending on the particular activity and source of income, buyers are not typically opposed to physicians having a secondary source of income as long as the activity does not interfere with the moonlighting physician's responsibilities to the practice. However, it is important to be clear in the deal documents what is permitted, when it is permitted, and whether the revenue generated from the activity should belong to the practice or the individual physician. We often see pre-approval of any outside activity required so that the activity and the physician can be appropriately monitored from a risk management perspective. As more and more physicians become entrepreneurial in an effort to replace lost income following a post-transaction pay cut, we see this as a trend to watch.

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And here's a ***bonus tip for 2020 transactions:***

## 11. Beware the Ides of March - C Corp Considerations.

If any physician practice you are targeting is structured as a C Corporation, you are likely aware of the headaches this can cause from a structuring or tax efficiency standpoint - particularly if your goal is to do an asset sale. However, you can alert these targets of the potential to convert to an S Corporation to avoid one of the tax inefficiencies of paying the 3.8% net investment income tax on the sale of the practice. The catch is the practice must convert to an S Corporation no later than March 15. Although this conversion does not solve the double taxation issue if you, as the buyer, prefer an asset sale (there is still a five-year waiting period post-conversion to avoid that), there may be other potential solutions to lighten the physicians' tax burden on the sale of their practice while still allowing you a tax basis step-up for the bulk of the purchase price. For example, depending on the facts and circumstances, you may be able to purchase the personal goodwill directly from the physicians, outside of the sale of assets. Often, the valuation is allocated based on a professional valuation, and the absence of a pre-existing non-compete is a helpful fact.

## About Our Healthcare Private Equity Practice

The [Healthcare Private Equity Team](#) at Bass, Berry & Sims has advised in over 150 private equity transactions in the healthcare industry over the past two years, including The M&A Advisor's Healthcare & Life Sciences Deal of the Year in 2018 and 2019 for transactions valued between \$100 million and \$1 billion. In addition, two separate deals were named as a finalist for The M&A Advisor Awards in 2019 in the "Healthcare and Life Sciences Deal of the Year (\$100MM-\$1B)" category. As the fourth largest healthcare law firm in the U.S. (as ranked by American Health Lawyers Association in 2019), Bass, Berry & Sims has long been recognized as a staple law firm for private equity funds investing in healthcare.

To learn more about our team, industry experience and value-add, [click here](#).

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