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## *Mergers and Acquisitions*

### **Attorneys Say Health-Care Transactions Present Significant Due Diligence Challenges**

**H**igh risk issues facing health-care providers make due diligence challenging in most health-care transactions, attorneys told Bloomberg BNA.

The increase in health-care merger activity—with hospitals acquiring non-acute care facilities, physician practices acquiring ambulatory surgical centers, and health information technology firms being bought up by health systems—exposes the reality that due diligence in health-care deals presents unique challenges, they said.

Effective due diligence can help parties consummate good deals and avoid bad ones, they added.

Problem areas for health-care due diligence stem from the risk posed by fraud and abuse laws, such as those addressing physician self-referral of Medicare and Medicaid patients (Stark law) and kick-backs (Anti-kickback law). Though less risky, regulatory compliance, reimbursement and competition issues are important areas of concern as well. Other hot button issues include HIPAA compliance and cybersecurity preparation.

When conducting due diligence, there are a variety of checklists, guidance and other sources of information. There also are common sense things a health-care attorney can do to make the deal go as smoothly as possible and obtain the best result for the client.

**Areas of Concern.** “The biggest areas of concern in due diligence are potential fraud and abuse violations,” John R. Washlick, with Buchanan Ingersoll & Rooney PC, in Philadelphia, told Bloomberg BNA. If uncovered during due diligence, a decision sometimes has to be made whether to self-disclose the violation to the government, Washlick said. This decision may be dictated by the acquiring party in the transaction if they believe the risk is too great to simply ignore or account for it through indemnification, he added.

Howard T. Wall III, executive vice president and chief administrative officer at RegionalCare Hospital Partners Inc., in Brentwood, Tenn., echoed similar concerns, saying, “for an institutional deal such as one involving a hospital, a major focus of due diligence is to look at referral source arrangements.” Referral source arrangement due diligence is not just about looking at specific physician contracts for Stark and anti-kickback statute issues, he said. Rather, an attorney must look at the overall big picture, which is a systemic issue, Wall added.

Attorneys said it is advisable to look at the systems the health-care entity has in place—the way referral sources are managed, not just individual contracts. Health-care attorneys need to look at forms of agreements, the system for verifying commercial reasonableness and fair market value, the contract management system, how the contracts are monitored, where the contracts are stored and if board approval is required for certain levels of contracts, Wall said.

He explained that, “major issues include a quality of earnings analysis, and this is usually performed by an accounting firm.” Second is revenue integrity analysis to verify the cash part of the deal followed by a high level due diligence about any regulatory systemic problems. These include whether there are False Claims Act cases brought by whistle-blowers, pending fines or investigations, or lawsuits of a material nature, Wall said. “Front loading these activities is mission critical for proceeding with the deal.”

**Type of Deal Matters.** The regulatory issues that will arise in due diligence will depend on the type of entities involved in the deal, said Jeffrey W. Mittleman, a partner with Holland & Knight’s Boston office. While Stark and anti-kickback laws are always relevant to deals involving health-care and life sciences entities, other laws and regulations may apply depending on the type of entity. For example, FDA regulations would apply to pharmaceutical and medical device manufacturers, he noted.

One of the main areas of concern in due diligence is evaluating government program billing issues, Mittleman continued. “Many deals have been sunk by issues such as incorrect or fraudulent billing and coding by health-care providers for Medicare and Medicaid,” said Mittleman, adding that these issues can draw unwanted government attention.

Another area of concern is licensing issues, because a change of ownership presents Medicare and Medicaid reimbursement issues, Mittleman said. However, a deal can be structured so that regulatory approval can be obtained quickly. It is up to the attorney to advise the client on weighing the value of the target company against the regulatory risks that could potentially involve costly penalties for noncompliance. Clients are savvier these days in understanding the regulatory issues and realizing that the regulatory issues in health-care deals are often more important than corporate governance issues.

Wall cited the current focus on health information privacy and cybersecurity as other areas that are subject of scrutiny. “I am hopeful that, as lawyers learn how to deal with these emerging issues and as clients

improve their internal compliance efforts, the level of complexity of the issues will go down,” he said.

**First Steps.** How the due diligence process starts can have a beneficial effect on how it proceeds, the attorneys said.

“Talk to the other side in the deal,” Mittleman said, adding “sometimes it is better to have a discussion with the lawyers on the other side about the actual process of the deal.”

“Organization is key,” Washlick counseled, noting that “careful consideration should be given to the document request *before* it is sent out to the other party, and any request received should be carefully reviewed and negotiated.” Washlick said that, other than the negotiations leading to a definitive understanding and, ultimately, the receipt of documents, due diligence is most often the most costly part of a transaction.

Effective due diligence is not only the key to determining whether the deal will move forward and eventually be consummated, but it also impacts disclosure schedules, indemnifications and identifies key consents and approvals from regulatory bodies and contacts that may be necessary to close the transaction, Wall said.

“One thing that is important is to stage due diligence in a reasonable way,” noted Wall. There should be an initial focus on certain big issues that will determine whether there is going to be a deal or not, he said.

Mittleman agreed, noting that it is always advisable early on in a health-care deal to look at the entire risk spectrum and how much risk a buyer will decide to take on.

**Deal Process.** Washlick said that, “there are many business issues that can adversely impact a deal or sink it, most notably, unfunded or underfunded pension obligations and satisfaction of outstanding debt obligations.” Those issues get fleshed out during due diligence. However, from a legal perspective, regulatory matters can either halt a transaction or add considerably to the cost of a transaction, he said. In particular, in many health-care acquisitions the development and formation of clinically integrated networks potentially implicate the antitrust laws and must be structured to withstand heightened scrutiny from state attorneys gen-

eral, the Federal Trade Commission, the Department of Justice and even competitors.

Washlick said M&A transactions involving nonprofit health-care organizations present other challenges. Most of these deals must be approved by state attorneys general who must determine whether the transaction reflects fair market value and that no charitable assets were misused. The level of review increases when there is a sale of a nonprofit to a for-profit buyer, he said. These issues can be navigated if the parties to the transaction communicate frequently on their status and resolution. “I always advise weekly calls with the client, as well as frequent calls with both parties and their respective counsel,” Washlick said.

Wall explained that another important area for health-care transaction attorneys is contact with members of the board and the people who actually are working for the target health-care organization, because attorneys can’t just rely on the documents for information. They should talk to department heads, such as compliance officers and risk managers, physicians and other leaders, he advised. “If the health-care organization is not letting you talk to people there might be a problem,” Wall said, “but more importantly, being unable to talk to these people will unnecessarily disrupt and delay the due diligence process.”

Some health-care organizations are concerned that the due diligence process associated with the transaction will disrupt the organization’s work. However, if the people who can explain certain contracts or due diligence issues are not available, then the due diligence process will be delayed, Wall said. It is helpful to propose to the client a two-week period of wide open access to the people who can answer the due diligence questions rather than spreading it out over a longer period, he said.

“The biggest enemy of any transaction is time,” Wall said. While clients tend to understand that, lawyers often think that turning over every last rock is important, knowing to turn over the important rocks and get the deal done quickly is a valuable skill,” Wall explained.

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