Structuring Physician Group Practices: Key Legal Considerations
Evaluating Compensation Models, Forming Practice Management Arrangements, and Navigating Corporate Practice of Medicine Issues

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Structuring Physician Group Practices: Key Legal Considerations

- Navigating Corporate Practice of Medicine Issues
- Structuring Practice Management Arrangements
- Evaluating Compensation Models

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Overview

- Group Formation
  - Selecting appropriate legal entity
  - Tax issues

- Physician Compensation In Group Practices
  - Professional compensation
  - Compensation for ancillary services

- Mergers and Acquisitions
  - Determining purchase price
  - Key deal terms
  - Physician employment contract issues

- Hospital, Private Equity and Other Non-Physician Participation
  - Corporate practice of medicine and fee splitting
  - Management agreements
  - Impact of health reform

- Q&A
Group Formation
Group Formation Considerations

- Reasons For Forming or Joining a Physician Group Practice
  - Ancillary Services
  - Economies of Scale
  - Ensure patient coverage, sharing call responsibilities
  - Increased leverage in negotiating contracts
  - Lower risk for new physicians
Group Formation Considerations

- Preliminary Considerations
  - Partners, Specialties, Level of Integration
- Choice of Entity
- Tax Issues
  - Initial Election
  - Transaction Considerations
- Governing Documents
- Benefits Issues
- EHR
Group Formation Considerations

- Professional Compensation Structuring
  - Personally performed services
  - Ancillary Services

- Challenges of Non-Physician Ownership
  - Corporate Practice of Medicine
  - Fee Splitting
  - Others
Physician Compensation In Group Practices
Physician Compensation in Group Practices

- **Personally Performed**
  - “eat what you kill” – revenue from personally performed services less overhead
    - Methodologies for allocating overhead are key:
      - Pro rata
      - Direct expenses plus share of fixed costs
  - Base salary or draw with productivity bonuses (or downward adjustments for low productivity)
  - Guaranteed salaries (typically only found in recruitment arrangements or hospital affiliated groups)

- **Ancillary**
  - Stark Law State “baby Stark” laws Fee Splitting (*e.g.* Florida’s *Crow* decision)
Determination of Compensation

- Percentage of collections (minus overhead) (i.e. “eat what you kill” or some portion thereof)
- Based on survey or market information for physician’s specialty in the locality and anticipated productivity (wRVU’s)
  - Base compensation is often set by the physician’s historic production and supplemented by bonus for meeting personal productivity targets.
  - Group should also retain right to adjust compensation for productivity that falls significantly below expectations
- Other factors:
  - “Incident to” services and supervision of MLPs
  - Quality measures
  - Patient satisfaction
Physician Compensation and the Stark Law

- **Stark Law General Prohibition** – Physician may not make a referral to an entity for the furnishing of *designated health services* (“DHS”) that may be covered by Medicare if the physician (or an immediate family member of the physician) has a *direct or indirect financial relationship* with the entity (such entity is the “DHS Entity”)

- Strict liability – if financial relationship exists, then must meet an exception

- Exceptions most relevant to group practices:
  - In-Office Ancillary Services Exception
  - Bona Fide Employment Relationships
  - Personal Services Arrangements

- Potential sanctions: Recoupment, Civil monetary fines, federal program exclusion, False Claims Act Liability
Stark Law’s In-Office Ancillary Services Exception – Elements

- Performance/Supervision
- Location
  - Same Building
  - Centralized Building
- Billing
Stark Law’s In-Office Ancillary Services Exception – Group Practice Defined

- Meeting Stark’s “Group Practice” definition critical for group practices to qualify for the In-Office Ancillary Services exception and to be able to pay physicians productivity bonuses that include DHS profits

- A group of physicians practicing together does not necessarily qualify as a “Group Practice” under Stark
  - Single legal entity operating a unified business
  - 2 or more “members”
  - “Members” furnish substantially all services through group (HPSA exceptions)
  - Income and Expense allocation determined prospectively
  - Others (range of services, patient encounters, volume/value)

- Productivity Bonuses and Profit Shares paid in accordance with 42 CFR § 411.352(i)
Group Practice Productivity Bonuses and Profit Shares

- A physician may be paid:
  - a share of the practice’s *overall profits*; and
  - a *productivity bonus* for services personally performed or for services incident to personally performed services

- neither profit share nor productivity bonus can be determined in any manner that is directly related to the volume or value of the physician’s referrals for DHS (other than DHS referrals “incident to” a physician’s personally performed services)
Productivity Bonuses

- Personal services or services incident to the physician’s services
- Calculated using a reasonable and verifiable methodology unrelated to the volume or value of the physician’s DHS referrals
- 3 enumerated methodologies for productivity bonuses
  - Based on patient encounters or wRVUs
  - Based on allocation of physician’s compensation attributable to non-DHS services
  - Revenues from DHS are less than 5% of Group’s total revenues and each physician’s allocation is less than 5% of total compensation
- Be prepared to show your math (to the Secretary)
Profit Shares

- The Group’s entire profits derived from DHS payable by Medicare or Medicaid; or
- The profits from DHS from any component of the group that consists of at least 5 physicians
- Must be a verifiable and reasonable methodology for the division that is not related to the volume or value of DHS referrals
- 3 enumerated methodologies for profit shares
  - per capita
  - Based on allocation of physician’s compensation attributable to non-DHS services
  - 5% tests
Stark Law’s Personal Services Arrangements and Employment Relationships Exceptions

- **Employment Exception:**
  - bona fide employment for identifiable services compensated at FMV
  - does not take into account (directly or indirectly) the volume/value of any referrals by the employed physician (productivity bonus excepted)
  - compensation provided pursuant to agreement that would be commercially reasonable in the absence of referrals

- **Personal Services Arrangements:**
  - signed writing specifying the services (and all services between parties) required
  - term of at least 1 year
  - compensation set in advance at FMV, not taking into account the volume/value of referrals by the contracted physician or other business generated between the parties
  - aggregate services contracted for do not exceed what is reasonable and necessary for the legitimate business purposes of the arrangement and do not involve the promotion of a business that violates any law
  - holdovers okay (up to 6 months)
Group preferences for methodologies and structure of compensation vary

Business objectives and legal compliance often at odds

As reimbursement and regulation continues to change and evolve, compensation should be reviewed frequently
Mergers & Acquisitions
Determining Purchase Price

- Roll-Up
  - Typically, no consideration paid to physicians/practices that join the group
  - Might be reimbursed at book value
  - Goodwill payment (or sign-on bonus)
- True M&A (private equity, strategic, or hospital buyer)
  - EBITDA multiple or other market valuation
- Physician buy-out events & unwinding
  - “For Cause” vs. “without cause” vs. disability/retirement
  - Importance of clarity in governing document
  - Terms (staggered payout, life insurance, price)
Determining Purchase Price

- Valuation Methodologies:
  - Discounted Cash Flow (usually for ancillaries only or if physicians are seeking to monetize future earnings will take a multiple along with a reduction in salary)
  - Net Book value (more common for roll-ups or in physician-to-physician deals)
  - Appraised value
  - Physician compensation package can be a significant factor
Key Deal Terms & Issues

- Confidentiality Agreement
  - Exclusivity/“No shop” clause
  - Termination
- Letter of Intent/Term Sheet
- Representations and Warranties
  - Condition of practice
  - Corporate and regulatory housekeeping
- Restrictive Covenants
  - Non-compete
  - Non-solicit
  - Non-disparagement
Key Deal Terms & Issues

- Structure considerations
  - What will the new group look like?
  - Financial arrangements
  - Ancillary services – sharing of revenue/expenses

- Personnel
  - Reducing/compensating staff
  - Single administrator
  - Employee benefits/policies
Key Deal Terms & Issues

- Plan for post-closing issues
  - Regulatory consents & approvals
  - Medicare/Medicaid provider numbers
  - Notice to third party payors
  - Retain insurance coverage
  - Integration of practice management & EMR systems
Deal Structure Particulars

- Asset Purchase
  - Physician Employee Model
  - Foundation Model
- Stock Purchase
- Merger
Direct Practice Acquisition (Asset Deal)

Health Care System

Hospital

HAPG

Multispecialty Physician Practice

Physicians Become Employees of Hospital Affiliated Physician Group

Employees

FMV Purchase Price

Assets
Foundation Model Schematic

Affiliated Hospital

100% Membership

Medical Foundation

PSA

Multispecialty Group Practice

Group Practice

Group Practice

Managed Care Contracts

Third Party Payors
Pros:
- Retention of provider billing numbers & key relationships
- Foundation handles billing for the Professional Services
- Foundation pays the Physician Practice pursuant to an agreed compensation formula

Cons:
- May be difficult to return practice to its status quo
- Less complete integration (compared to other JV structures or the employment model)
Physician Employment Contracts

Key Terms:

- Term and renewal period
- Duties: On-call terms, supervision or admin tasks
- Compensation package (is there a path to ownership, where applicable)
- Vacation/sick/CME time
- Professional liability insurance
- Patient records (maintenance and access)
- Termination events and effect of termination
- Restrictive covenants
Hospital, Private Equity and Other Non-Physician Participation
Hospital, Private Equity and Other Non-Physician Participation

- Confluence of Events Have Led to a Surge in Healthcare Investments and M&A Generally
- Multispecialty Group Practices Can Position Themselves Well as the Landscape of Healthcare Changes

State of the (U.S. Healthcare) Union:
- In 2013 U.S. health care spending increased 3.6 percent to reach $2.9 trillion; the share of the economy devoted to health spending has remained at 17.4 percent since 2009 as health spending and the Gross Domestic Product increased at similar rates for 2010 - 2013*
- According to a June 2014 Commonwealth Fund Report, Americans still spend significantly more than other developed countries on Healthcare, but getting lower quality and less efficiency**

- Providers Being Asked to “Do More With Less”
- Multispecialty Physician Practices and Their Investors Can Benefit from Shift Toward Greater Clinical Integration

**http://www.commonwealthfund.org/publications/fund-reports/2014/jun/mirror-mirror
Hospital, Private Equity and Other Non-Physician Participation

- **Hospitals**
  - Currently, the Most Active Player in Multispecialty Physician Practice Mergers, Acquisitions and Affiliations/Investments
  - Not Limited to For Profit Hospitals/Systems
  - Potential Antitrust Issues

- **Private Equity**
  - Physician Practice Investments Have Generally Been Focused on Hospital (or Facility)-Based Physicians (e.g., Anesthesia, Radiology, Hospitalists)
  - Focus on Healthcare Increasing and Uptick in Hospital Investment Will Expose Investors to More Practice Acquisitions and Opportunities

- **Other Investors**
Corporate Practice of Medicine

Most States Still Have Laws Prohibiting, to Varying Degrees, the “Corporate Practice of Medicine” ("CPOM")

CPOM States Generally Prevent Unlicensed Lay Entities from Employing Physicians or Otherwise Contracting with Physicians to Furnish Medical Care

CPOM Laws May Limit the Flexibility of Physicians and Non-Physicians to Structure Ownership and Employment Arrangements

Some States with Strong CPOM Laws (e.g., California, Nevada, and Texas) Even Prohibit Hospitals from Employing Physicians, but Have Laws Permitting Nonprofit “medical foundations” to Engage Physicians (e.g., Through Their Existing Medical Group) Indirectly to Provide Medical Care
Regulatory Barriers to Non-Physician Participation

- Fee-Splitting
  - Typically Defined to Include Unearned Division of Professional Medical Fee with Layperson/Lay Entity and/or Payment for Referrals
  - Some States Without CPOM Prohibition Still Have Fee-Splitting Limitations that Can be Triggered by Certain Non-Physician Participation Models (e.g. Florida)
  - Documentation of Fair Market Value of Services is Key

- Others

  - Investments and Business Models in States with These Barriers Will Require Careful Regulatory Analysis to Minimize Regulatory Risk
Physician licensed in applicable state, generally will enter into a stock transfer restriction agreement (or have same incorporated into MSC), but stock transfer restrictions are prohibited in some jurisdictions (e.g., New York).

Management Company is typically either the former practice entity (and medical assets are spun out into new practice entity), which is acquired by the non-physician investor(s) or is a NEWCO that acquires the non-medical assets. It then provides the Multispecialty Physician Practice with use of those assets (typically including real estate – whether owner or leased) and turnkey management and administrative services.

Has provider number(s), payor contracts, employs and/or contracts with physicians.
Management Model (Cont.)

- Management Agreement Terms are Key to Success of Arrangement

- Pros
  - In CPOM States, Allows for Non-Physician “Ownership” of Practice
  - Subsequent Transactions at Management Company Level Have Minimal Impact on Practice

- Cons
  - Risks of Friendly Physician
  - Can Be Limitations On Management Fees