Thoughts from a “Premarital Counselor” on How to Have a Successful Marriage (Merger)

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Disclosure:

NONE

Introduction

- “Should we get married, or just live together first?”
- Be familiar with the process for getting married.
- There are different types of marriages: know the alternatives.
- The legal hoops to jump through when getting married.
- Marriage-related questions to answer right away.
- And a preliminary note: This presentation addresses marriages among:
  - Radiology groups.
  - A radiology group and other specialties.

“Should we get married, or just live together first?”

- Do the groups want, and are they ready, to truly “merge” their practices?
- Would the groups prefer to come together in a way that is something less than a full merger?
- If so, how? What are the alternatives?
- What functionalities do they want to share, and what ones do they not want to share?
- What is the combination intended to achieve, in the short term and in the long term?

Process

- Before doing anything else, decide whether you even want to get involved in ANY discussions about a merger or other combination.
  - Once discussions start, it can sometimes be difficult to withdraw.
- For radiology groups (depending on what other specialties are involved):
  - It's important to candidly and honestly self-assess your relative strength and value proposition, *i.e.*, how attractive are you to your potential marriage partner?
  - Have some ideas on what changes you are willing to accept, and concessions you are willing to make, to deal with the inherent tension when groups of different specialties merge.

Process (cont'd)

- Combining tends to be more about the process and about developing creative solutions for addressing control and economics.
- Critical threshold question: Does a merger make sense economically?
- Next question: Can control be effectively allocated?

Process (cont'd)

- If the proposed merger or combination involves more than a radiology group and one other specialty, *i.e.*, it is a true multi-specialty deal, then consideration should be given to retaining a business consultant as facilitator.
- Have all groups sign a confidentiality agreement.
- Jointly identify a list of critical threshold questions that should be addressed and resolved as early as possible in the process.
  - These will largely revolve around control and economics.
  - TAXES: will tax considerations present a problem?

Process (cont'd)

- When groups merge, there is inherent tension:
  - Specialties accustomed to protecting their turf will need to subjugate their personal interests to the goals of the merged group.
  - Groups with technical component (“TC”) businesses will likely view the world differently than groups with no TC.
  - Each of the constituent groups will have to give up control to the merged group.
  - Each of the constituent groups will have to share economically (at least to some extent).

Process (cont'd)

- As discussions proceed, prepare a summary of the resolutions to the threshold questions, and obtain approval (albeit only orally) from all the groups.
- On a parallel path, any legal or regulatory issues that may be implicated by the merger should be analyzed, and a preliminary deal structure (with key compliance steps) should be approved (again, orally among the groups).
  - Big issue will likely be Stark Law compliance.
  - Another big issue will be reimbursement-related, *e.g.*, payor contracting, Medicare enrollment, *etc.*
  - Also exclusive contracting.
- Always stay cognizant of antitrust issues.
- Only then should the parties begin the documentation process.
- Negotiate and close the deal.

Structural Alternatives

Definitional Assumption

- For purposes of this presentation, the term "merger" is assumed to include:
  - A true merger (in the corporate law sense), as well as . . .
  - Asset purchases (that effectively achieve the same business objectives as a full merger), as well as . . .
  - "Consolidation transactions" that involve creation of a new entity as the vehicle to facilitate the combination of the disparate groups.

Typical Structures, and How They Differ

- Full merger.
- Merger “lite.”
- MSO.

Variations

- There are many variations and hybrids of these structures.
  - For example, a so-called “divisional merger” could be pursued, under which a true merger occurs, but professional component (“PC”) compensation and related expenses are segregated by “division,” and each division retains micro-level governance rights and responsibilities.
  - A divisional merger could also be effectuated, with the same results, through a consolidation model.
- Notably, subject to effectively addressing the Stark Law issues implicated by one or more of the groups consisting of specialists who refer, TC facilities and other ancillary services could either be included in the merger or kept separate.

Key Regulatory and Other Legal Issues

Antitrust

- THE STRUCTURAL ALTERNATIVE SELECTED WILL MATTER!
- Will need to perform at least a preliminary “market power” analysis of relevant product and geographic market.
  - If competitors are not involved, then this should not create an impediment.
  - Don’t overestimate the effects of teleradiology.
- Beware of restraints of trade.
- If the parties to the merger will be exchanging competitively sensitive information:
  - Determine whether such sharing creates antitrust risks.
  - If it may, use a process to assure that competitors don’t get access to such information in a way that would allow them to use it against their competitors.
  - Sharing prices (*i.e.*, fees) can be a real problem.

Payor contracting

- Again, always remain cognizant of the antitrust issues mentioned above.
- Consider whether the deal can be structured in a way that would preclude the need for the merged group to obtain new payor contracts.
  - This is an inherent problem with a consolidation model.
  - Note, however: because of liability concerns, even in a full merger the groups may opt to use asset purchases to bring the groups together, thereby requiring the “merged” group to obtain new payor contracts.

Payor contracting (cont'd)

- THIS IS A CRITICAL THRESHOLD ISSUE.
- If the merged group is going to have to obtain new payor contracts:
  - Will it be able to?
  - What will it cost, *i.e.*, will the payor take the opportunity to extract fee and other concessions?

Other Regulatory Issues

- Stark Law.
- Federal Anti-Kickback Statute.
- State analogues to the Stark Law and the Federal Anti-Kickback Statute and the Stark Law (including fee split prohibitions).
- Choice of legal entity.
  - This will be particularly important for mergers across state lines, or . . .
  - When radiology groups pursue interstate expansion.
- Licensure laws for TC facilities and other ancillary services.
- Tax considerations:
  - How are entities currently taxed, and will this pose an impediment?
  - Choice of tax treatment for any new entity.
- Consolidation and/or termination of pension and other employee benefits plans.

Marriage-Related Questions to Answer ASAP!

Which “merger” structure should be used?

- True merger?
- Asset purchase?
- Consolidation?
- AND why?
- What are the pros and cons of each?

How much governance will be shared and/or centralized?

- To what extent are the groups/specialties willing to share in governance, and how will governance rights be structured and allocated?
  - If there's going to be any amount of integration, then some shared governance and leadership is going to be required.
  - Also, the old paradigm of "one physician one vote on all matters" will need to give way to more delegation of governance and decision-making to a smaller board and potentially to an even smaller executive committee ("EC").

What kind of protection will each group/specialty be given?

- At least initially, and potentially on a quasi-permanent basis, the physicians in each existing group and/or from each specialty will need "protection" (possibly through specified, exclusive rights to select their own representatives at the board, EC and committee levels), at least with respect to certain matters.
  - Generally, such protection should not be permanent: at some point the physicians need to function as a fully-integrated group.

What kind of protection will each group/specialty be given? (cont'd)

- Decisions on specified items with significant potential implications for the physicians such as:
  - Hiring/termination of physicians, at least ones that are from their “previous” group or specialty.
  - Allocation of costs.
  - Capital calls.
  - Mergers with or acquisitions of other groups who have physicians of the same specialty.

What kind of protection will each group/specialty be given? (cont'd)

- Physician compensation/benefits decisions.
  - Will the current compensation methodologies used by the various existing groups/specialties be an impediment to merging or otherwise integrating the groups?
  - Could they be synthesized to a “best practices” approach over time?
  - Physician compensation methodologies could be locked in for an initial period of time, then gradually transitioned to an approach that puts more discretion in the hands of a compensation committee.

What kind of protection will each group/specialty be given? (cont'd)

- Scheduling decisions.
- Payor contracting decisions.

Top leadership roles, and who will initially fill them?

- The leadership roles (and the responsibility within each role) that a “multi-specialty” merged group will require may be different.
- Will there be leadership roles dedicated, temporarily or permanently, for each specialty?
- Are there key physicians who must initially have leadership roles to make the merger work.

Professional component revenue sharing across specialties

- Will each specialty's PC revenue be segregated and paid solely to it?
- Or will there be sharing of PC revenue across specialties?
- If so, how much of the PC revenue does each specialty want to share, and how do they want to share it?
- At a minimum, are the physicians willing to allocate some of their PC revenue for any shared leadership/management physicians or other persons?

How are ancillary services going to be handled?

- For any group that pre-merger has TC facilities or ancillary services, do they want to include those facilities in the merger or keep them separate?
  - Keeping them separate might be possible, but could be difficult in light of Stark Law considerations.
  - Radiologists may be able to hold separately, but referring physicians probably cannot.
- What about new ancillary services in the future: will the merged group develop them, or will they only be offered to one or more subsets of the physicians?
  - Again, doing everything within the merged group will be more feasible from a Stark Law perspective, but there may be limited ways to develop such services on a specialty-specific basis.

Do the groups want/need a transitional step before full merger?

- If so, components of the merger lite and/or MSO alternatives could be used in transition.
- On the other hand, if the groups start off using a merger lite or MSO, they should decide whether it will be permanent or merely transitory.
- For any transitory components, the existing groups may want to prospectively agree upon a mechanism that either:
  - Facilitates, though doesn't force, potential evolution to a true merger, or
  - Leads automatically to a true merger (perhaps if certain benchmarks are met).

Thank you!

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