Compliance Corner

Private Equity Investment In Michigan Healthcare Entities

By REESA N. BENKOFF AND DUSTIN T. WACHLER

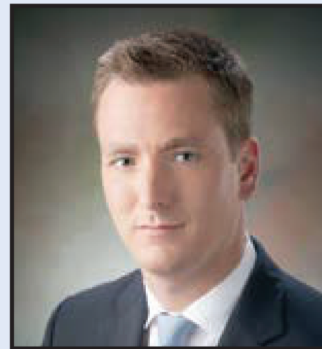
Michigan healthcare providers contemplating a relationship with private equity investors must be aware of various legal considerations relative to such arrangements. Increasingly, private equity investors are becoming more interested in investing in healthcare entities. Such investments often present lucrative opportunities for healthcare providers, yet these arrangements implicate a myriad of legal issues. This article will focus on health law issues, however other legal issues including, without limitation, corporate, tax and real estate matters, must be considered when evaluating private equity investment in healthcare entities.

Michigan laws include a legal doctrine commonly referred to as the corporate practice of medicine (CPOM) doctrine. CPOM laws restrict who can own and control certain healthcare entities and employ certain healthcare providers. Specifically, Michigan law requires entities that provide professional medical services to be organized as professional corporations (PCs) or professional limited liability companies (PLLCs). Michigan PCs and PLLCs engaged in the practice of medicine may only be owned by individuals licensed to provide the professional medical services rendered by the entity, or by entities directly or indirectly solely owned by such licensed individuals.[1] Further, all officers of PCs and managers of PLLCs must be licensed to provide the professional medical services rendered by the entity.[2] Accordingly, a medical practice through which physicians perform professional medical services cannot be owned or controlled by non-physicians (with the exception of ownership by a non-profit hospital). Thus, Michigan's CPOM laws do not generally permit a physician practice to be owned or controlled by non-physician private equity investors. Accordingly, relationships with private equity investors must be structured so that the providers retain ownership of the professional entity when required by the Michigan CPOM laws. The result is usually a complex organizational structure that involves holding companies and management companies, some of which may include joint-ownership opportunities for the providers. Such structural considerations must also address any entities that are related to the professional practice but that are not governed or restricted by Michigan's CPOM laws, as ownership of these entities may be transferred to private equity investors in certain cases, subject to federal and state fraud and abuse laws.

Federal fraud and abuse laws include, without limitation, the Anti-Kickback Statute ("AKS") and the physician self-referral prohibition commonly referred to as the "Stark law."[3] The AKS prohibits a person or entity from knowingly and willfully offering, paying, soliciting or receiving remuneration, directly or indirectly, overtly or covertly, in cash or in kind, to induce or reward the: (a) referral of an individual for the furnishing of any item or service that may be reimbursed under a federal health care program, or (b) purchase, lease, ordering or arranging for or recommending the purchasing, leasing or ordering of any item, facility or service that may be reimbursed under a Federal Healthcare Program.[4] Protection of an arrangement under an AKS exception or safe harbor avoids treatment as a criminal offense under the AKS. Stark contains a ban on physician self-referral which generally makes it unlawful for a physician to refer Medicare or Medicaid patients (or present claims for payment to Medicare or Medicaid) for designated health services (DHS) to an entity with which the physician (or an immediate family member) has a financial relationship.[5] If Stark is implicated, the arrangement must satisfy all elements of a Stark exception in order to comply with Stark. These laws must be evaluated by the parties to ensure previous and future compliance, particularly since the relationship between the healthcare entity and private equity investors often results in organizational restructuring involving multiple entities. For example, if the resulting organizational structure involves a management company and private equity ownership of related entities, the relationship between these entities and the professional healthcare entity must be evaluated for compliance under the AKS and Stark.

Similarly, Michigan fraud and abuse laws must be considered and include, without limitation, state self-referral laws, anti-kickback laws, and fee-splitting laws.[6] Michigan's fraud and abuse laws differ from Stark and the AKS in various ways and as applied to various healthcare providers. Whereas Stark and the AKS only apply to governmental healthcare programs, Michigan fraud and abuse laws also apply to services reimbursed by commercial payors such as Blue Cross Blue Shield of Michigan (BCBSM). Michigan fraud and abuse laws, in conjunction with the CPOM doctrine, may also be implicated in arrangements whereby physicians retain ownership of the professional entity but the private equity firm earns fees generated by professional medical services. In addition to state fraud and abuse

Continued on page 11



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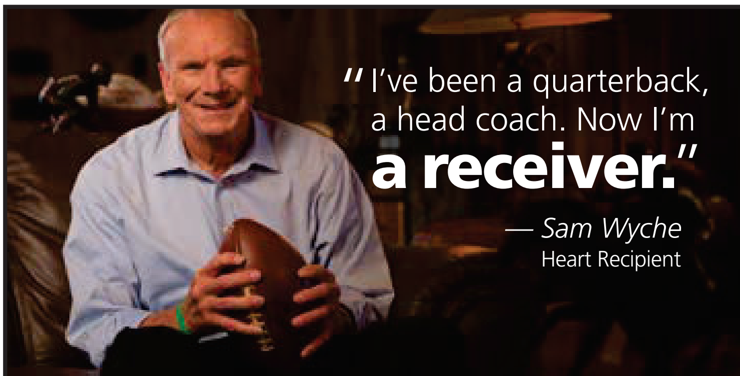
laws, Michigan healthcare providers must comply with additional licensure-based laws. Healthcare transactions must also account for rules regarding changes in ownership of licensed healthcare entities, which often require prior or contemporaneous notice to, and approval from, relevant state agencies.

A crucial part of any private equity investment in a healthcare entity is the due diligence process. This process generally involves evaluating all aspects of the healthcare entity's operations and structure. During the due diligence process, the healthcare entity's current organizational structure, legal and billing compliance, licensure, operational and legal risks, contractual arrangements, tangible and intellectual property, prior and current litigation, financial information, and other relevant information and documentation is provided to and analyzed by the private equity investors. The due diligence process may reveal a variety of issues that the parties may decide to address prior to, contemporaneous with, or following closing, as appropriate. For example, in the event a non-professional entity owned by the private equity investor will assume the non-clinical assets of the physician practice, the parties may evaluate contractual restrictions (e.g., assignability of a lease) and other concerns related to such assets prior to closing. Typically, either during or after the due diligence process, the parties will begin to draft and negotiate the agreements and supporting documents necessary to effectuate the transaction. Legal review of these documents is imperative in order to protect the rights of the healthcare provider.

While private equity investments offer exciting opportunities for Michigan healthcare providers, these arrangements must be structured properly under federal and state laws. Private equity firms often invest in multiple healthcare providers nationwide and Michigan's restrictive CPOM doctrine requires private equity investments in Michigan to be structured differently than in many other states. When considering a private equity investment, Michigan healthcare providers may first want to evaluate their current compliance with federal and state law, examine utilization patterns, and otherwise assess their practice in anticipation of the due diligence process and to mitigate compliance concerns that may impact the private equity investment. Once the private equity investor and healthcare provider agree to an investment, the parties must structure the arrangement to comply with complex federal and state laws including, but not limited to, Michigan's CPOM doctrine, the federal AKS and Stark law, and Michigan fraud and abuse laws governing self-referrals, kickbacks, and fee-splitting. While non-compliance may result in business risk to both parties, healthcare providers face additional risks such as false claims liability, licensure sanctions, and termination from participation in Medicare, Medicaid, and commercial payor networks. Accordingly, a comprehensive legal review of private equity investments is necessary to evaluate compliance with federal and state law in light of the lucrative financial opportunities offered to healthcare providers.

[1] MCL § 450.1283(2); MCL § 450.4904(1).
[2] MCL § 450.1286; MCL § 450.4905(1).
[3] 42 USC § 1320a-7b(b); 42 USC § 1395nn.
[4] 42 USC § 1320a-7b(b).
[5] 42 USC § 1395nn.
[6] See MCL § 333.16221; MCL § 400.604; MCL § 752.1004; MCL § 750.428.



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