2024

L. EDWARD BRYANT, JR.
NATIONAL HEALTH LAW
TRANSACTIONAL COMPETITION

OFFICIAL PROBLEM

Introduction

Your firm acts as outside legal counsel for Beazley Specialty Hospital ("Beazley"), a physician-owned, hospital serving patients in the State of Pearson. Beazley was established in 2005, after receiving a certificate of need from Pearson the year prior. Beazley is governed by a ten-person board of directors (the "Board of Directors").

Beazley is licensed by the State of Pearson as a specialty hospital. Beazley performs a variety of orthopedic and spinal procedures and over the past several years it has developed a lucrative endoscopy service line. It also offers a significant pain management service line. Beazley is looking to expand the service lines it is providing, particularly to offer a cardiac service line. While Beazley can provide overnight stays, a majority of its services are performed on an outpatient basis. Beazley has a payor mix of around thirty-five percent (35%) from government programs and sixty-five percent (65%) from commercial insurers.

Beazley is deeply committed to improving the health, well-being and vitality of the community it serves. Beazley is one of five hospitals in the greater Pearson metropolitan area. Pearson is a large urban area and Beazley is in a prime location. All other hospitals in the greater Pearson area are affiliated with one of four systems. Beazley is known throughout Pearson and neighboring cities as a high quality provider. It is at the high end of Medicare quality reporting initiatives.

The Beazley facilities are aging, but well-maintained. Over the past few years, Beazley has experienced a labor shortage, in particular with its nursing staff. As a result of labor market challenges, market inflation and supply chain issues, Beazley's expenses are much higher compared with pre-pandemic levels. Beazley is now experiencing a slight decrease in revenue and decrease in patient volumes largely driven by patients delaying care and concerns about limiting out-of-pocket expenses during a much-anticipated economic recession.

While Beazley's limited services enable it to "cherry pick" its cases and drive profitability, Beazley sees certain of its case load moving to outpatient surgicenters, and has begun to feel some stigma from community members due to its failure to provide much charity care. To remain viable, Beazley desires to expand its footprint in Pearson and diversify its care delivery model to other service lines, physical therapy and more home-based care. Beazley believes that expanding the scope of services in additional outpatient and in-house settings will increase profits and would cement Beazley's ability to serve the local community.

Strategy

Beazley is exploring two different options for expansion in response to its Confidential Information Memorandum. The business team at Beazley has identified the two most attractive options: (a) a transaction with ALC Health System ("ALC"), a non-profit health system and (b) an investment by DAC Capital Partners, a private equity company ("DAC").

Target Options

A. ALC is a not-for-profit health system with 10 hospitals, 40 ambulatory clinics and 4 nursing homes in the State of Pearson. Through a prior acquisition, two of ALC's hospitals operate as Catholic facilities. As an integrated health care delivery system, ALC provides inpatient and outpatient hospital services, primary and specialty physician services, and telehealth services, among others. ALC has 2,500 employees, 500 hospital beds and had approximately 9,000 annual admissions in 2022. ALC has a strong financial background and has had positive revenue for the past three years. ALC recently acquired a home health company in the past year that provides home health and hospice services to patients in an in-home setting. This transaction was subject to review by the

Federal Trade Commission. It also has established several outpatient surgical facilities in joint ventures with community physicians. ALC has a robust compliance plan, which was put in place following a Corporate Integrity Agreement ("CIA") with the Department of Health and Human Services ("HHS"). The CIA ended in 2021. The CIA was implemented due to medical director reimbursement issues. ALC was served a Civil Investigative Demand by the Department of Justice in 2022, which was triggered by a joint *qui tam* complaint relating to an allegation of bonus compensation and employment being tied to admission numbers (i.e. volume of patients).

B. DAC is a private equity firm that specializes in the dental and orthodontic market, but has recently expanded its reach into the medical field. Established in 2015, DAC is headquartered in the State of Loyola. DAC would like to make a major commitment to capital projects, including construction projects for an ambulatory surgery center and urgent care center. DAC recently purchased a large physician practice in Pearson, which entailed forming a management services organization to provide administrative and support services to the medical group. DAC's target equity investments range from between $30 to $150 million. In connection with DAC's offer, DAC would like to have three seats on the Board of Directors of Beazley. DAC has also contemplated earn-outs and roll-over equity as part of its investment.

Pearson Law

Pearson prohibits the corporate practice of medicine by restricting business corporations from engaging in the practice of medicine or employing physicians to render medical services. Pearson has a "mini" Hart-Scott Rodino Act that requires at least 180 days prior to the effective date of the transaction, a Notice of a Material Change transaction must be filed with Pearson's Attorney General, and approval must be obtained prior to the transaction closing. The "Notice of Material Change" applies in the case of a change of ownership of at least 50% of stock or assets. Pearson law generally prohibits physicians from splitting a professional fee in exchange for marketing or management of the physician's practice, or negotiating fees on behalf of the physician.

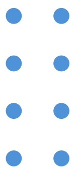
Assistance Required

Beazley is seeking your counsel to develop and sort through options available for, and legal risks associated with a strategic affiliation with ALC or DAC.

In the course of providing your advice, Beazley has asked that you specifically address the following questions:

1. Briefly discuss the main strategic, cultural, and business considerations that Beazley should consider.
2. Discuss the potential regulatory and compliance issues related to each option. Identify the level of risk and exposure and propose how these risks can be addressed.
3. Define the universe of options available to Beazley, and describe the key pros and cons. This should include structure options.
4. Set forth your recommendations on how Beazley should proceed with the various options you propose. Include any high-priority supplemental due diligence requests to address with ALC and DAC.

Team 5 Solutions, LLC



Transactional Memorandum

Beazley Specialty Hospital

2024

Prepared by :

Team 5 Solutions, LLC

(123)-456-7890
www.team5solutions.com
team5@team5solutions.com

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I. Introduction

Entering transactions with other hospitals and accepting investments from private equity firms provide healthcare systems with opportunities to continue to grow their business and serve more patients. However, there are many moving parts and aspects that must be considered to ensure a successful transition. Beazley is considering either a transaction with ALC Health System ("ALC") or an investment from DAC Capital Partners ("DAC") to further their goals of increasing profits and cementing their ability to serve the local community. The following memorandum reflects essential considerations and recommendations for Beazley to make the most informed decision moving forward.

This memorandum proposes several options involving both ALC and DAC. With ALC, Beazley could consider a merger, stock sale, joint venture, or asset sale. If Beazley instead decides to work with DAC, Beazley could consider a merger, joint venture, asset sale, or a management buy-in.

Ultimately, our firm recommends a joint venture. Beazley and ALC appear to have the best synergy out of the proposed partner options. ALC is a nonprofit system similarly devoted to patient care, making it a preferable partner compared to DAC. Therefore, if Beazley's primary goal is to cement their ability to serve the Pearson community, a joint venture with ALC would be best to accomplish that objective. However, DAC offers different opportunities, especially regarding finances. Therefore, if Beazley's primary goal is to increase their profits, a joint venture with DAC would be best to accomplish that objective. While, we believe that a joint venture is the best option, regardless of the partner, our firm remains committed to working through each option with Beazley.

II. Strategic, Cultural, and Business Considerations for Beazley

Forming partnerships or acquiring organizations within the healthcare industry can be both expensive and time-consuming. However, the outcome of the transaction can be beneficial to all parties involved. Before moving forward with any transaction, Beazley should review the strategic, cultural, and business considerations in light of their goals of increased profits and cementing their ability to serve the local Pearson community.

A. Strategic Considerations

Beazley's end goal is to increase their profits and solidify their ability to serve the local community. Therefore, any potential transaction should be structured with those goals in mind. The expansion Beazley desires requires ample resources in a desirable location, a well-trained staff, a loyal patient base, and a population in need of medical care. Whatever structure Beazley chooses to move forward with should work to minimize any liability inherited, maintain regulatory compliance with applicable state and federal statutes and regulations, uphold operations standards, and maintain or better Beazley's culture.

Beazley is known throughout Pearson and the neighboring cities as a high-quality provider. Therefore, a sub-goal of solidifying Beazley's ability to serve the local community is protecting and growing Beazley's reputation in Pearson's community. Questions in consideration of that sub-goal include whether a transaction with ALC or an investment from DAC would benefit or harm Beazley's reputation. Similarly, Beazley must consider talent retention before finalizing any deal. Choosing a transaction with ALC could decrease the level of talent at Beazley if ALC's staff is not the same level of talent or if Beazley's staff refuses to work with ALC's staff and chooses to leave Beazley. Additionally, Beazley's talent could decrease as the result of investment from DAC, because some staff might not appreciate the idea of a private

company investing funds into their hospital. In the past, requiring staff to sign a non-compete agreement would have been commonplace, but recent Federal Trade Commission ("FTC") regulations and the current employment law landscape signal that non-compete agreements may not be enforceable down the road. Therefore, non-compete agreements by themselves will not adequately protect Beazley from the risk of talent leaving as the result of any deal.

Strategic benefits from either a transaction with ALC or an investment from DAC include improved financial standing, a larger geographical service area, the ability to serve an increased number of patients, an increased revenue, potential expansion of facilities, and the ability to expand into new markets of care.

Potential strategic drawbacks from either deal include more strict scrutiny in light of recent FTC trends, legal, accounting, and budgeting concerns, a need for uniform compensation and fee structure, and the potential to have to uphold another system's non-profit status. Some of these drawbacks could be resolved or minimized with thorough due diligence, but Beazley must take them into consideration when deciding which deal structure best meets their goals.

B. Cultural Considerations

As previously stated, maintaining Beazley's reputation in the community is essential to any transaction moving forward. Therefore, upholding or bettering Beazley's culture must be a top consideration when deciding what deal structure fits Beazley's goals the best.

There are typically three ways to develop culture post-transaction: (1) adopt one hospital's culture to be carried on, (2) create a new culture by integrating both practices, and (3) create an entirely new culture. To ensure a smooth transition with ALC or DAC, Beazley must consider the factors motivating each party into any sort of transaction. Also, Beazley must consider any cultural issues that may cause patients to be averse to the proposed new entity.

If Beazley decides to work with ALC, Beazley must be mindful of their nonprofit obligations. As a nonprofit, ALC is required to focus efforts and money into community well-being, living out their nonprofit mission, and complying with extra IRS reporting requirements. Additionally, because ALC operates two Catholic hospitals and certain services currently provided by Beazley may be prohibited under Catholic directives, Beazley must determine whether there are additional religious considerations they would be responsible for upholding if they chose to move forward with a transaction with ALC. Beazley must also consider the public perception of outside money coming in, as would be the case with an investment from DAC. Public relations questions, such as "how will this play to the community at large?", must be asked to ensure any deal would uphold Beazley's reputation and not take away from any goals Beazley hopes to accomplish. Additionally, Beazley must consider whether the attitudes and goals of DAC will line up with the historic culture of success that Beazley has developed.

Ultimately getting to know those who would be in close contact with Beazley's management would be essential to ensuring a good cultural fit, no matter which deal structure Beazley chooses.

Furthermore, Beazley should consider whether their existing Human Resources Department is capable of handling the needs of a transaction or investment. Beazley should take steps such as implementing decision-making processes or hierarchies in a way that is appealing for employees to blend both entities' cultures efficiently. Beazley should also consider the existing customer service models of the two entities, the future goals of the entities, plan for effective staffing and training, and put in place applicable administration policies. Without a well-thought-out approach to either transaction, Beazley's culture could conflict with ALC or DAC, ultimately damaging Beazley's sought-after culture and reputation.

C. Business Considerations

When it comes to business considerations, Beazley must determine which deal, whether the transaction with ALC or the investment from DAC, would allow Beazley to best accomplish their goals. For example, while the idea of an outside investor often sounds appealing, there are typically limitations to that investment, such as a time limit or a cap on the amount of money to be invested. There are also limitations related to a transaction with ALC, such as upholding a nonprofit status, length of time the transaction might take to occur, and increased upfront cost to the parties.

Many times, the choice of a partner boils down to financial costs and benefits associated with either the transaction or the investment. Therefore, financial planning also plays a key role in the financial viability of a combined business structure. Beazley must ensure that whichever party they decide to proceed with serves as a positive indicator for the proposed expansion into new markets in Pearson, making new patients eager and excited to engage with the resulting entity. Business considerations seen in most healthcare transactions include the potential liability under federal fraud and abuse statutes, tax implications resulting from the transaction, employment and personal agreements, outstanding legal obligations, and reputational concerns.

The potential for regulatory issues is often high in healthcare transactions. So, a thorough investigation of the regulatory history of ALC, as well as analysis of applicable state and federal laws, should occur before any deal moves forward. Some of the federal and state fraud and abuse statutes that seek to prevent such abuse include, but are not limited to, the Corporate Practice of Medicine ("CPOM"), Hart-Scott-Rodino Act ("HSR"), Anti-Kickback Statute ("AKS"), Federal Self-Referral statute ("Stark Law"), False Claims Act ("FCA"), and relevant state laws. Notably, Pearson has a "mini" Hart-Scott Rodino Act, requiring filing a Notice of Material Change with

the Pearson Attorney General at least 180 days prior to the effective date of the transaction. Attorney General approval must also be obtained prior to the transaction closing. Also, any transaction must not allow physicians to split fees in exchange for marketing or management of the physician's practice, as Pearson law prohibits such conduct. A thorough investigation into all of Pearson's statutes and regulations regarding healthcare transactions is a necessary part of due diligence to ensure compliance in whatever deal structure Beazley chooses.

Employment agreements, including restrictive covenants, pensions, benefits, retention bonuses, severance agreements, paid time off, and insurance, are also an essential concern for Beazley to consider when negotiating. Beazley should also know if either ALC or DAC have legal obligations that Beazley would assume as the result of any transactions. While the level of assumption depends on which deal structure is chosen, minimizing liability resulting from a transaction should always be a goal for Beazley. Regardless of the deal structure, any final contract should provide Beazley with warranties that indemnify Beazley from ALC's or DAC's past regulatory or statutory violations. Additionally, considerations under Medicare and Medicaid regulations should be examined. In several of the discussed structures below, a new provider number from the Centers for Medicare and Medicaid Services ("CMS") would be required. However, several deal structures may allow for assignment of a previously used CMS number. Acquiring a new number can be an issue because of the extensive length of time the process for acquiring a new CMS number takes, which could result in the new entity having a cash flow issue from the beginning. However, getting a new CMS number provides a fresh start, meaning no previous Medicare or Medicaid related liabilities flowing into the new entity.

Future due diligence will be essential to disclosing additional strategic, cultural, and business concerns. For now, Beazley should maintain its focus on the issues addressed in this section while continuing to strive towards the goals of increased profits and serving its community.

III. Potential Regulatory and Compliance Issues

A. Antikickback, Stark Law, False Claims Act Generally

Fraud and abuse laws are critical for Beazley to consider because around 35% of their payors are governmental programs. Fraud and abuse laws include AKS, Stark Law, and the FCA.[1] Consequences for violations of these laws can include imprisonment and fines, civil monetary penalties, loss of licensure, removal of medical staff privileges, and exclusion from federal health care programs.

Under Stark Law, if a physician, or their immediate family member, has a "financial relationship" with an entity, the physician may not refer Medicare or Medicaid patients to that entity for "designated health services" (DHS), and the entity receiving such a referral may not bill for such services unless an exception applies.[2] In the context of healthcare transactions, the Stark Law is important for two key reasons. First, the law impacts who can be a shareholder or owner of certain types of entities. Second, given the broad impact that the law has on financial relationships between physicians and other healthcare service providers, it can be a source of both past and future liability. These potential liabilities must be subjected to careful consideration and due diligence.

The AKS generally prohibits knowing and willful solicitation, receipt, offer, or payment of any remuneration in return for the referral of items or services covered by Medicare or

[1] 42 U.S.C. § 1320a-7b; 42 U.S.C 1395nn; 31 U.S. Code § 3729.
[2] 42 C.F.R § 411.351 (defining "*Designated health services*" to include clinical laboratory services, physical therapy, occupational therapy, radiology services, durable medical equipment, outpatient prescription drugs, inpatient and outpatient hospital services, and more); 42 U.S.C. 1395nn.

Medicaid.[3] Certain types of transactions and arrangements are specifically exempt from the AKS (i.e., safe harbors).[4] If an arrangement does not fit within a listed exemption, it can be evaluated on a case-by-case basis by the Office of Inspector General ("OIG").[5]

In addition, many states have their own versions of the Stark Law and AKS. It is not uncommon for state laws to be broader in scope than federal laws or for there to be fewer exceptions under state law. Thus, it will be necessary to research Pearson law in order to ensure that Beazley complies with all relevant state regulations.

AKS and Stark Law are significant drivers of FCA litigation. Some courts have held that claims tainted by Stark Law violations are false under the FCA and thus can lead to FCA liability. Also, AKS violations can give rise to FCA liability because, by statute, claims tainted by AKS violations are deemed false for purposes of the FCA. The FCA holds liable anyone who knowingly submits or makes a false claim to Medicare or Medicaid.[6]

Accordingly, regardless of whether Beazley decides to proceed with ALC or DAC, Beazley must analyze physician relationships to ensure compliance with AKS and Stark Law. Further, Beazley is advised to make sure that claims sent to CMS regarding spending under Medicare and Medicaid are accurate, as any information reported with actual knowledge of its falsity or reckless disregard of the truth may be punishable under the FCA.

B. Corporate Integrity Agreements and Civil Investigative Demands

ALC recently dealt with a Corporate Integrity Agreement ("CIA") and a Civil Investigative Demand ("CID").

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[3] 42 U.S.C. § 1320a-7b.
[4] 42 C.F.R § 1001.952.
[5] 42 C.F.R §§1001.951-1001.952.
[6] 31 U.S.C. §§ 3729 – 3733; *see also id.* § 3729(b)(1)(A)(i)–(iii) (defining "knowingly" as a person having "actual knowledge of the information," "acts in deliberate ignorance of the truth or falsity of the information," or "acts in reckless disregard of the truth or falsity of the information").

A CIA is a document that outlines the obligations that a company agrees to with a federal or state government agency as part of a civil settlement. The OIG negotiates a CIA with health care providers and other entities as part of the settlement of federal health care program investigations arising under a variety of civil false claims statutes.[7] ALC was involved with a CIA due to medical director reimbursement issues. In other words, ALC agreed to obligations, and in exchange, the OIG agreed not to seek their exclusion from participation in Medicare, Medicaid, or other federal healthcare programs. This CIA ended in 2021.

A CID is an administrative subpoena that allows federal government agencies to request extraordinary amounts of information from private entities without going through any formal court procedures. The Attorney General, or an appropriate designee, may issue a CID if there is reason to believe that a person or entity is in possession of documents or information relevant to an FCA investigation.[8] ALC was served a CID by the Department of Justice in 2022 relating to bonus compensation and employment being tied to the admission of patients.

If Beazley agrees to a deal with ALC, Beazley must stay diligent with legal compliance and even consider adding extra safeguards and reviews.

IV. Structure Options Available to Beazley

Beazley has several structure options available to them to achieve their economic and cultural goals with both ALC and DAC. Broadly speaking, options available to Beazley include, but are not limited to, a merger, a stock sale, a joint venture, an asset sale, or a management buy-in agreement with DAC. While each of these may be a possibility for Beazley, each type of structure presents its own regulatory and business risks. Regarding ALC, Beazley's best options

[7] "Corporate Integrity Agreements." *Corporate Integrity Agreements | Healthcare Compliance | Office of Inspector General | U.S. Department of Health and Human Services*, oig.hhs.gov/compliance/corporate-integrity-agreements/index.asp.
[8] 31 U.S.C. § 3733.

will be to pursue either a joint venture or an asset sale. Regarding DAC, Beazley's best options will be either a joint venture, an asset sale, or a management buy-in agreement.

A. Mergers

A merger occurs when two firms combine to form a single entity.[9] Mergers can take many forms including statutory mergers, consolidations, triangular mergers, and reverse triangular mergers.[10] The main difference among the different types of mergers is what type of entity remains post-transaction. Post-merger, there are many options: a new corporation can be formed, the target entity can merge into the acquiring entity, or the buyer may even merge the target entity with one of their wholly owned subsidiaries.[11]

While mergers are often utilized in both the corporate and health care context, a merger with either ALC or DAC, as explained below, would be impractical for Beazley.

1. Merger with ALC

A merger with ALC is impractical because it is likely to be blocked by the FTC. The FTC aims to encourage competition in the health care market because it allows patients to receive better care at lower prices, by preventing one hospital or health system from monopolizing the market in a certain area.[12] This is likely to occur if Beazley were to pursue a merger with ALC, as ALC is one of only four health systems in the state of Pearson and they already own and operate a substantial number of health care entities in the state. Additionally, a recent acquisition of a home health company by ALC was subject to review by the FTC.

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[9] Arthur R. Pinto & James A. Fanto, *Understanding Corporate Law*, (Carolina Academic Press eds., 6th ed. 2023).
[10] *Id.*
[11] *Id.*
[12] Fed. Trade Comm'n, Health Care Competition, https://www.ftc.gov/news-events/topics/competition-enforcement/health-care-competition.

2. Merger with DAC

A merger with DAC is impractical because Beazley is a physician-owned hospital. Physician-owned hospitals are subject to certain limitations under the Stark Law and the Affordable Care Act ("ACA").[13] Historically, physician-owned hospitals raised concerns about physician self-referrals under the Stark Law.[14] So, to combat self-referrals, the Stark Law imposed a prohibition on physician-owned hospitals. Despite this prohibition, Stark Law created the whole hospital exception, which allowed for physician ownership so long as the physician's ownership was in the hospital as a whole and not just one department.[15]

The ACA repealed this exception but created a grandfathering regime that allowed hospitals with physician ownership at the time of its enactment to retain physician-ownership.[16] To remain within the grandfathering regime, however, these hospitals cannot increase the percentage of physician ownership to the point that it exceeds the percentage of physician ownership that the hospital had on the day the ACA was enacted.[17]

Since Beazley is a physician-owned hospital that was founded in 2005, it is likely that they fall within this exception. This condition places substantial limits on the types of transactions that Beazley may be a part of.[18] Thus, for Beazley and DAC to successfully execute a merger, DAC would first have to buy out the physician owners. This does not align with what DAC stated their intentions are with regard to an investment in Beazley. DAC does not appear to be interested in owning Beazley. Rather, DAC is interested in projects like constructing an ambulatory surgery or urgent care center.

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[13] Asbahi et al., *Health Care Transactions Manual: Understanding the Consequences of the Health Care Deal*, 197, (Kim H. Looney et al. eds., 1st ed. 2020).
[14] *Id.*
[15] *Id.* at 198.
[16] *Id.*
[17] *Id.*
[18] *Id.*

B. Stock Sales

Stock sales are a type of transaction in which the buyer purchases stock in the target entity.[19] Typically, what a stock sale really entails is "the purchase of membership interests" in the target company.[20] A stock sale is not a viable structure option for Beazley for two main reasons.

First, a stock sale is not a viable option because Beazley is a physician-owned hospital likely operating under the grandfathering regime of the ACA. This means that changes in Beazley's ownership structure may violate the Stark Law. Second, a stock sale, specifically with ALC would not be viable because ALC is a nonprofit health system. Thus, ALC does not have any stock to sell, and, in turn, it is unlikely that ALC would purchase stock from Beazley, as Beazley operates as a for-profit hospital.

C. Joint Venture

A healthcare joint venture is a type of partnership that occurs when two parties join together to provide specific health care services.[21] Joint ventures can be strictly contractual or can be pursued through a distinct legal entity, such as a limited liability company ("LLC").[22] Some of the most common types of joint ventures engaged in by health care entities include ambulatory surgery centers ("ASC"), urgent care centers, and radiation therapy centers.[23] As explained below, a joint venture with ALC or DAC is worth consideration.

An important consideration in structuring a joint venture with either ALC or DAC is the fact that Beazley is a physician-owned hospital. This means that Beazley is likely subject to the

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[19] *Id. at 189.*
[20] *Id.*
[21] *Id.* at 212.
[22] *Id.*
[23] *Id.*

"whole hospital" exception under the ACA and must not change its ownership structure to avoid violating the Stark Law.[24] However, this issue can be readily avoidable, so long as Beazley uses a subsidiary to do so.

1. Joint Venture with ALC

A joint venture with ALC would be most advantageous to Beazley for many reasons. First, joint ventures are particularly useful when a health care entity wants to expand the services that they are providing.[25] Since one of Beazley's primary goals is to expand their service line, particularly to offer a cardiac service line, a joint venture presents a unique opportunity to do so. A joint venture with ALC is particularly advantageous in this regard because ALC is already providing specialty services and could thus bring their expertise on the matter to a joint venture with Beazley.

Next, joint ventures are beneficial to health care entities in that they allow the parties to the joint venture to split expenses, such as capitalization and operating costs.[26] ALC has a strong financial background and has had positive revenue for the past three years, suggesting that they are financially capable of taking on a joint venture. This would benefit Beazley because it would allow them to limit their expenses and, in turn, increase profits. Further, since ambulatory surgery centers are a common type of joint venture for hospitals and health systems alike,

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[24] Asbahi et al., *Health Care Transactions Manual: Understanding the Consequences of the Health Care Deal*, 197-98 (Kim H. Looney et al. eds., 1st ed. 2020).
[25] *Id.*
[26] *Id.*

Beazley could simultaneously pursue their goal of offering a cardiac service line, while mitigating the expenses it takes to run the new service line.

Finally, a joint venture with ALC would help Beazley to further the goals they have within the community. Being a nonprofit, ALC acts to further their mission statement.[27] Since Beazley has recently felt some stigma from the Pearson community because they do not provide much charity care, aligning themselves with a nonprofit company who seeks to better their community, such as ALC, will help Beazley bolster their reputation.

Despite these benefits, a joint venture with ALC also presents Beazley with several regulatory and business challenges. First, ALC has already established several outpatient surgical facilities in joint ventures with physicians in the Pearson community; while this seems positive on its face, it suggests that ALC may not have or want to expend the necessary resources to engage in another joint venture.

Second, joint ventures between parties in a position to make or influence referrals to one another must be carefully analyzed under AKS. Accordingly, the OIG has issued a few notable advisory opinions and fraud alerts regarding joint ventures that Beazley and the legal team will want to research deeper if Beazley decides to proceed with this joint venture option.[11] Through their guidance, the OIG has expressed concern regarding joint ventures involving parties in a position to make or influence referrals. Notably, the OIG indicated that it is more likely to view joint ventures favorably where investors in a position to make or influence referrals are required to make legitimate capital contributions, which pay reasonable returns proportionate to the investors' reasonable capital contributions, which require the joint venture participants take real

[27] Nicholas P. Cafardi & Jaclyn Fabean Cherry, *Understanding Nonprofit and Tax Exempt Organizations* (Carolina Academic Press eds., 3rd ed. 2022).

business risks, and which include safeguards to mitigate the perception that such investors are expected to make referrals.[12]

An additional challenge in a joint venture with ALC is that Beazley and ALC would need to come up with the capital necessary to fund the joint venture. For example, if Beazley and ALC wanted to construct an ambulatory surgery center, each would be responsible for coming up with their portion of capital needed to construct the ASC. While ALC has a positive financial background, Beazley has experienced a decrease in profits following the pandemic.

2. Joint Venture with DAC Capital

A joint venture with DAC would proceed much like a joint venture with ALC. To start, Beazley and DAC would first need to form a subsidiary through which they would operate this joint venture. This would be achieved by negotiating the terms of the joint venture agreement, which would set forth the terms by which the joint venture would operate, the scope of the joint venture, and the rights and responsibilities of each party involved in the joint venture.[28]

This structure would be especially beneficial to Beazley in that it would allow Beazley to achieve several goals at once. First, Beazley could limit the amount of capital that they provide in the joint venture agreement and thus ensure that they are able to maximize profits. Additionally, it would be beneficial in that it would allow Beazley to comply with DAC's request that they have three seats on the board of directors.

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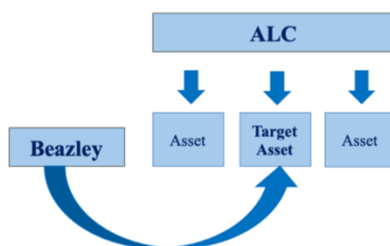
[28] *Id.*

Though this structure has many benefits, it does still have risks. For instance, private equity companies primarily focus on profits and efficiency.[29] While this may be beneficial from a profit's standpoint, it raises concern about the quality of health care being offered.[30] This poses a risk for Beazley because their reputation is important to them, and they are currently known throughout Pearson as being a high-quality provider. If Beazley chooses this structure and, subsequently, the quality of care they provide decreases, this could have negative impacts on their community reputation.

D. Asset Sale

An asset sale is a type of transaction in which a buyer purchases all or substantially all of the target entity's assets.[31] In traditional corporate law, asset purchases are especially attractive to buyers because they allow them to handpick which assets and which liabilities, they will take on post-transaction.[32] However, in the health care context, a major liability, Medicare liability, cannot be easily avoided by structuring a deal as an asset sale.[33] As explained below, an asset sale with ALC or DAC is worth consideration.

1. <u>Asset Sale with ALC</u>



[29] Erin C. Fuse Brown & Mark A. Hall, *Private Equity and the Corporatization of Health Care*, 76 Stan. L. Rev. (2024).
[30] *Id.*
[31] Asbahi et al., *Health Care Transactions Manual: Understanding the Consequences of the Health Care Deal*, 187 (Kim H. Looney et al. eds., 1st ed. 2020).
[32] *Id.*
[33] *Id.*

In addition to a joint venture, an asset sale between Beazley and ALC could provide Beazley with the necessary resources to achieve their goals. In an asset sale, the buyer typically purchases a substantial amount, if not all, of the target company's assets.[34] Those assets that the seller chooses to retain are called "excluded assets."[35] Since ALC is a not-for-profit health system, special considerations are at play when structuring an asset sale.

First, since an asset sale between ALC and Beazley would involve a nonprofit selling their assets to a for-profit entity, most nonprofit statutes require that the assets be sold at fair market value.[36] Typically, the proceeds from the sale of the nonprofit's assets must be used to further the nonprofit's charitable mission.[37]

This structure is beneficial to Beazley in that it would allow them to pick which of ALC's assets they would like to acquire. Additionally, ALC already possesses several assets that align with Beazley's expressed goals. For example, ALC already provides certain specialty services and owns a home health company, two things which Beazley has stated they want to get involved in. However, this structure poses an obstacle to Beazley in that they would need to come up with the funds necessary to purchase one or multiple of ALC's assets. Since Beazley has been experiencing decreased revenues post-pandemic, it is unlikely they will obtain the necessary funds to complete an asset sale.

Additionally, an asset purchase in a physician practice context usually will require consents to the assignment of leases and agreements. Importantly, an asset purchase will require

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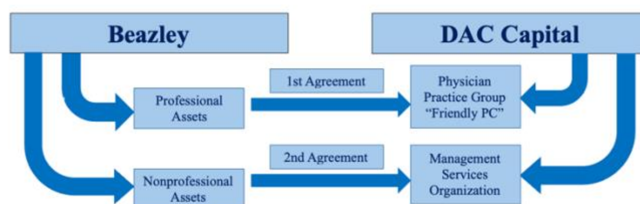
[34] Asbahi et al., *Health Care Transactions Manual: Understanding the Consequences of the Health Care Deal*, 187 (Kim H. Looney et al. eds., 1st ed. 2020).
[35] *Id.*
[36] Nicholas P. Cafardi & Jaclyn Fabean Cherry, *Understanding Nonprofit and Tax Exempt Organizations*, (Carolina Academic Press eds., 3rd ed. 2022).
[37] *Id.*

either new Medicare, Medicaid, and other governmental and commercial payer agreements or assignments of existing payer agreements.

In an asset purchase, the buyer generally takes the practice free from liabilities and contingencies for alleged pre-closing malpractice events. Therefore, Beazley may start fresh, without exposure to potential Medicare, Medicaid, private overpayment claims, or malpractice contingencies.

2. Asset Sale with DAC Capital



If Beazley wants to pursue an asset purchase with DAC, they should do so using the "friendly PC model", because Pearson is a corporate practice of medicine state.[38]

A Friendly PC or PLLC is the industry term for a professional entity that is closely aligned with a Management Services Organization ("MSO") (see below for a full MSO discussion). The MSO will typically enter into an agreement, sometimes in the form of a succession agreement or directed stock transfer agreement, with the owner of the professional entity to restrict the owner's transfer of shares in the entity.[14] The agreement will also typically provide for the appointment of a substitute-friendly physician in the event that the original friendly physician needs to be replaced. The agreement will identify certain triggers that would require the replacement of the friendly physician (e.g., death, disability, loss of medical license, exclusion from Medicare or Medicaid, etc.). The purpose of such an agreement is to ensure that

[38]Asbahi et al., *Health Care Transactions Manual: Understanding the Consequences of the Health Care Deal*, 187 (Kim H. Looney et al. eds., 1st ed. 2020).

the practice entity is owned by a physician who is truly friendly to the MSO. In general, the MSO's role in the relationship is to assume as much responsibility for the non-clinical business operations and management of the practice as it can without engaging in the practice of the profession.

Many states, including Pearson, have laws prohibiting the corporate practice of medicine. However, few states limit who can be an owner of an MSO. Thus, while in Pearson, an unlicensed or lay business entity (i.e., a PE firm) cannot own a professional medical practice, such a person or entity may be an owner of an MSO. MSOs own the assets used by a licensed person to operate a professional practice, play a significant role in the practice's management, receive ongoing fees from the practice for the management services provided, and can benefit from the growth in value of the platform through the eventual sale to another management company, a public offering, or a similar liquidity event.

DAC has experience with the Friendly PC model. Namely, DAC recently purchased a large physician practice in Pearson and uses the model. In due diligence, Beazley will want to talk with DAC to learn about this prior transaction and specific deal structure. Additionally, Beazley will want to inquire about DAC's reputation with other hospitals in Pearson. Specifically, Beazley will want to learn if DAC's recent hospital investment saw a large turnover or a culture shift after working with the MSO.

An asset sale with Beazley as the target company would need to be structured into two separate agreements.[39] In the first agreement, Beazley would need to sell their professional assets to a friendly professional corporation.[40] As mentioned above, DAC already owns a large physician practice in Pearson, which would act as the friendly professional practice for this

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[39] *Id.* at 258.
[40] *Id.*

transaction. There is no concrete definition of what all is encompassed in the term "professional assets" though it likely includes patient records and employment contracts.[41]

In a second agreement, Beazley would agree to sell their non-professional assets to an MSO.[42] Here, DAC has already created an MSO to manage their physician practice and could use that same MSO to acquire Beazley's non-professional assets.

This structure is not without risks, as states differ on how narrowly they interpret their corporate practice of medicine doctrine. The corporate practice of medicine doctrine is intended to prevent non-physicians from interfering with a physician's professional judgment by prohibiting entities that are not owned or controlled by physicians from employing physicians to practice medicine and profiting from such professional services.

A few states explicitly allow hospitals and other corporate lay entities to employ physicians or provide professional medical services. However, Pearson is not one of those states. Pearson prohibits the corporate practice of medicine by restricting business corporations from engaging in the practice of medicine or employing physicians to render medical services. If Pearson construes their corporate practice of medicine statute broadly, there is a risk that the sale of non-professional assets to DAC's management company would be barred by the doctrine. However, if the statute is construed narrowly, the two-step asset sale should not violate Pearson's corporate practice of medicine doctrine.

E. Management Buy-In Agreement

A management buy-in is an acquisition strategy commonly used by private equity firms, so this option is only available to Beazley if they decide to pursue an investment from DAC.[43] In

[41] *Id.*
[42] *Id.*
[43] Investopedia, Management Buy-In: Everything to Know About MBI, https://www.investopedia.com/terms/m/mbi.asp.

this structure, an external management team purchases controlling ownership in the target company and replaces their current management team with its own management team.[44] After the acquisition, the buyer can implement their own business strategy to ensure that the target company is running efficiently.[45] Included in these new duties are the ability to select members for the target entity's board of directors.[46] Management buy-ins follow a process of analyzing the target company, negotiations with the target company, and finally concludes when the two companies agree to specific terms and pricing.[47]

A management buy-in with DAC could benefit Beazley in many ways. First, the negotiations process would allow Beazley to propose the specific terms of the agreement with DAC. In doing this, Beazley could add specific terms to the agreement that further their goals. For instance, Beazley could specify in the acquisition agreement that building an ambulatory surgery center is nonnegotiable for them. In the same way, DAC could also advocate for their interests. For instance, DAC could state that having three seats on Beazley's Board of Directors post-transaction is nonnegotiable. In this way, Beazley and DAC could set the specific terms of the agreement and advocate for their specific interests and goals.

Additionally, if Beazley and DAC want to add earn-outs or rollover equity as part of their deal, they could do so within the terms of the management buy-in agreement. Earn-outs would be an ideal solution for Beazley and DAC if they are unable to agree on the price in the buy-in agreement. Earn-outs are typically utilized when the target entity wants to sell their business for more than the buyer is willing to pay. The structure of the earn-out depends on the specific business, but generally states an initial purchase price plus additional compensation to be

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[44] *Id.*
[45] *Id.*
[46] *Id.*
[47] *Id.*

determined at a future date.[48] Rollover equity can also be a useful tool for negotiating the price of the management buy-in agreement between Beazley and DAC. Rollover equity would allow Beazley's current owners to retain some equity in the hospital post-acquisition.[49] This would be beneficial to DAC in that it could allow them to purchase the hospital at a lower price than anticipated.[50] Additionally, since private equity firms typically only hold onto investments for a few years, using rollover equity would allow Beazley's current owners to retain some interest in the hospital, thus, allowing them to be involved in any future transactions should DAC decide to sell.[51]

While this structure has its benefits, it also poses both cultural and regulatory risks. From a cultural perspective, private equity ownership in hospitals often raises concerns about quality of care and overall staff morale.[52] Since securing a good reputation in Pearson is one of Beazley's goals, any type of transaction with a private equity company could pose significant challenges.

Additionally, this type of transaction may create AKS liability for Beazley. If the purchase price includes an earn-out, which DAC has contemplated, caution around AKS risk is advised. An agreement between DAC and Beazley cannot tie earn-outs to productivity; if the agreement restricts the earn-outs based on productivity and volume, providers may be incentivized to overbill to meet earn-out requirements.

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[48] *Id.*
[49] David A. Gaynor II & Brian W. Kerby, Q&A: The Benefits of Rollover Equity in Healthcare Transactions (June 11, 2019), https://www.crowe.com/insights/healthcare-connection/qa-benefits-of-rollover-equity-in-healthcare-transactions.
[50] *Id.*
[51] *Id.*
[52] Erin C. Fuse Brown & Mark A. Hall, *Private Equity and the Corporatization of Health Care*, 76 Stan. L. Rev. (2024).

V. Ultimate Recommendations and Subsequent Due Diligence

Before Beazley moves forward with either a transaction with ALC or investment from DAC, they must exercise reasonable caution and complete a thorough due diligence process to assess potential business, legal, and financial liabilities. The information gained through the due diligence process will help Beazley identify potential risks and will ultimately lead Beazley to the most desirable deal structure. The following section clarifies the areas that Beazley should focus on before making a final decision.

A. Ultimate Recommendation

Given that Beazley has several options available to them to structure the transaction, the ideal structure will depend on what Beazley's primary goal is. If Beazley is primarily concerned with expanding their service lines and increasing profits, their best option will be a joint venture with DAC. This is because private equity firms structure their investments to maximize efficiency and profits. Additionally, if Beazley and DAC choose to construct an ambulatory surgery center, this will allow Beazley to open a specialty service line, particularly to offer a cardiac service line.

If, however, Beazley's main goal is solidifying their reputation and ability to serve Pearson, a joint venture with ALC will be their best option. This is because ALC is a nonprofit corporation in Pearson that has a positive reputation in the community. Additionally, Beazley and ALC can split the costs of the joint venture and choose what to pursue with the joint venture.

B. Next Steps

Moving forward, Beazley should determine their primary goal of the transaction. As stated above, if Beazley's main goal is cementing their reputation and ability to serve Pearson, Beazley should move forward with a joint venture with ALC. But, if Beazley's primarily goal

with expanding their service lines and increasing profits, their best option will be a joint venture with DAC.

After the transaction's primary goal is determined and Beazley's new business partner is chosen, we will work with the legal team of either ALC or DAC to draft a letter of intent for both parties to sign. We will then work to complete a thorough due diligence process, in which the high-priority issues are discussed below. Additionally, the parties should work to gain all necessary approvals and give all required notices, especially those required under Pearson's Hart-Scott Rodino Act and the Federal Hart-Scott Rodino Act. Furthermore, we will assess Beazley's new partner's basic business strategies on growth, debt tolerance, risk tolerance, regulatory compliance, employee compensation, and marketing.[53] Then, Beazley will enter preliminary negotiations with the company Beazley chooses to join in a joint venture to determine how the joint venture will be capitalized, giving careful consideration to the governance rights and determining the nature and extent of the joint venture participant duties.

C. High Priority Due Diligence

High-priority due diligence related to regulatory and compliance issues includes gaining more information related to the medical director reimbursement issue that led to the Department of Health and Human services implementing a CIA at ALC. Additionally, more information related to the qui tam complaint leading to the CID will be necessary prior to moving forward. Lastly, some of the transactions discussed could trigger state certificate of need requirements, which generally require the parties to navigate a complex and time-consuming process to secure regulatory approval before finalizing certain transactions.

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[53] Asbahi et al., *Health Care Transactions Manual: Understanding the Consequences of the Health Care Deal*, 218, (Kim H. Looney et al. eds., 1st ed. 2020).

Additional high priority due diligence related to the proposed deal structures include more information regarding the physician-ownership structure of Beazley in order to ensure Beazley fits within the ACA whole hospital exception discussed above. Beazley will also want a full list of every joint venture that ALC is engaged in.

With regards to DAC, Beazley should discuss DAC's plans for the future, including any changes to employment policies and procedures. Further, Beazley should understand how many years DAC desires to stay invested in Beazley. Lastly, Beazley will need to know more about DAC's prior transactions and previous deal structures with other large physician practices in Pearson. Talking with other physician practices who have partnered with DAC in the past would allow Beazley to gain clear insight into how that practice's culture was impacted after DAC's MSO started managing.

Finally, our firm will help ensure that any deal constructed will abide by all applicable state and federal laws and regulations.

VI. Conclusion

In conclusion, if Beazley's board decides the primary goal is cementing their reputation and ability to serve Pearson, a joint venture with ALC will be their best option. On the other hand, if Beazley's board decides their primary goal is to expand their service lines and increase profits, Beazley's best option will be a joint venture with DAC.

Beazley should consider the aforementioned strategic, cultural, and business considerations when forming their plan to proceed in a joint venture with either ALC or DAC, while also considering the potential liability risks and due diligence concerns.