CLIENT ALERT: Upward Trend in Private Equity Investment in Professional Practices

The last decade has seen a steady increase of infusion of private equity investment in the healthcare sector, a trend that continues to grow each year, both in the quantity and types of transactions.

One of the foremost areas of investment is in the management of physician and dental practices which is fueled by (i) the highly fragmented markets served by these providers that promise to be more efficient and profitable with consolidation and upgraded management, (ii) the perceived ability of the health care sector to withstand economic downturns and (iii) a progressively aging population in need of increased services.

The availability of investment dollars is attractive to physicians who not only wish to expand their practices and increase profitability and bargaining power with insurers, but also want to spend more time involved in patient care instead of administrative, compliance and IT matters.

This intersection of interests has resulted in successful private equity investment in certain specialties such as dermatology, pain management, ophthalmology and certain types of dental practices. The profitability experienced in these ventures has led to an expansion of such investment into other specialties such as urology, gastroenterology, radiology and orthopedics, and in the last few years, to primary care practices.

There are, of course, potential drawbacks for either party in entering into this type of transaction. The unpredictability of reimbursement rates is an obvious risk. In addition, private equity firms usually enter into these transactions with the goal of achieving high returns in a fairly short time frame, which might conflict with the quality of care that the professional practice is accustomed to providing. Failure to meet expected economic goals might result in the private equity firm being contractually allowed to assume a greater ownership stake in the venture and the practitioners having less control of their practice than they anticipated. There may also be an inherent conflict between the fast track financial expectations of private equity firms and the ongoing shift from fee-for-service reimbursement to a model based on quality of care and treatment outcomes.

When entering into and structuring transactions of this type, both parties must be mindful of, and careful to comply with, state and federal fraud and abuse statutes and regulations, including the prohibition of kickbacks and self-referral of patients. Another concern is compliance with New York's prohibition against the corporate practice of medicine, a limitation that some investors from states that allow ownership of medical practices by non-licensed persons may not be familiar. Failure to comply with applicable law may result in significant civil, and in the case of the federal Antikickback Statute, criminal penalties. Licensed practitioners have an even greater concern because a violation of these laws may be deemed to be unprofessional conduct which can result in suspension or revocation of their license to practice.

In addition, the Federal Government has stepped up its enforcement efforts. In a closely watched Florida case, *United States ex rel. Medrano and Lopez v. Diabetic Care Rx LLC d/b/a Patient Care America, et. al.* the Department of Justice bringing an action under the False Claims Act against a private equity firm based on that firm's alleged involvement in decisions to drive up the value of the pharmacy business in which it had invested, including the payment of commissions to contractors to generate business, that resulted in improper government reimbursement.

Investors and practitioners considering a private equity transaction are best served by early and thorough due diligence. Consultation with knowledgeable legal, accounting and financial advisors early in the negotiation process is advisable.