

**Integrated Delivery System
Mergers and Acquisitions:
*Practical Preparation for the Practice
Professional***

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Overview

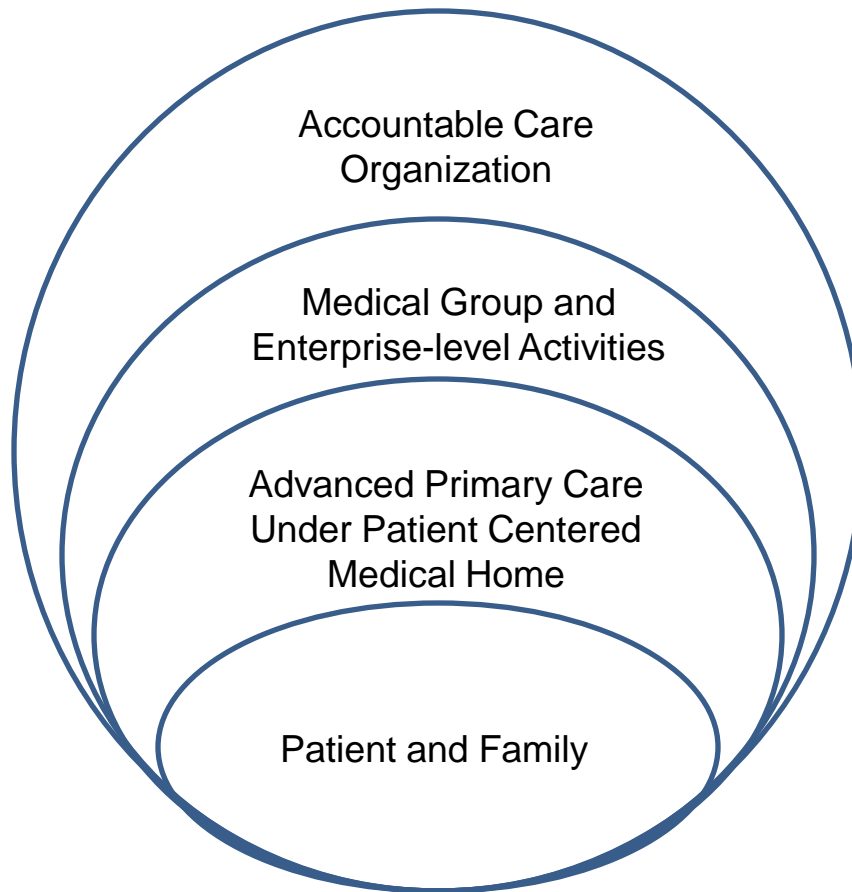
- National Trends
- Integration or Employment?
- Administrator's Role
 - Professional Preparation
 - Acquisition Basics
 - Due Diligence/Negotiation
 - Other Considerations
- Next Steps: After the Acquisition

National Trends: PPACA

Patient Protection and Affordable Care Act

- Accountable Care Organizations
 - Demonstration Projects
 - Future Reimbursement Mechanism
 - Continuum of Care
- Patient Centered Medical Home
- Electronic Health Records
 - Clinical outcome measures drive reimbursement

Care Transformation Model

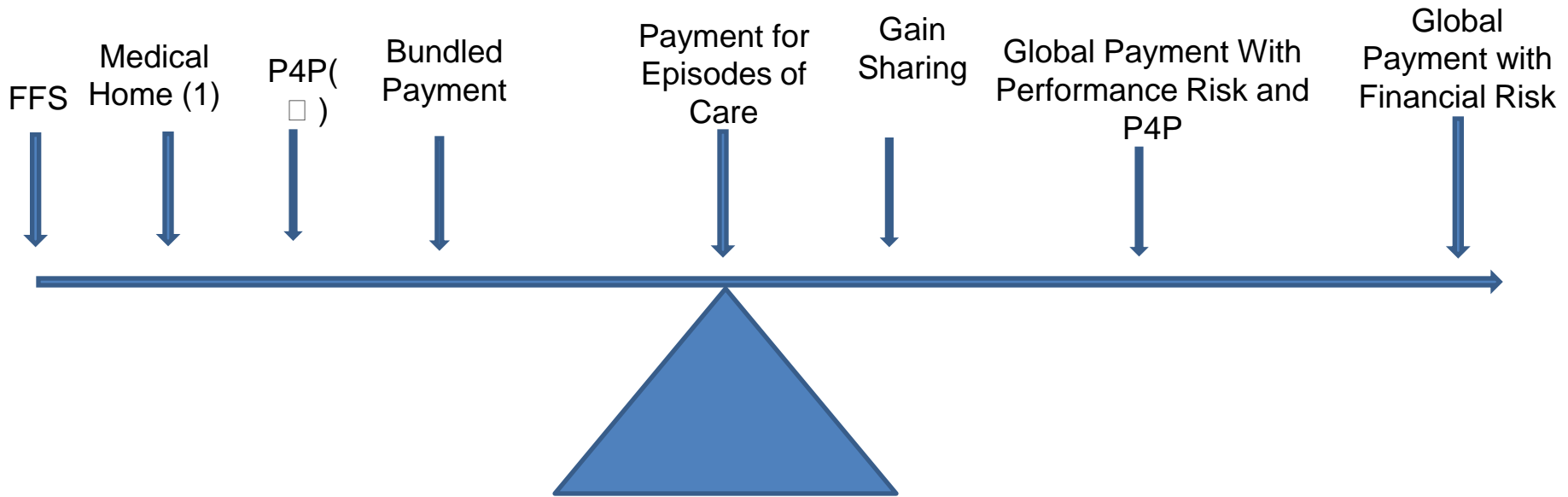


Potential Fiscal Direction Due to PPACA Initiatives:

- Bundled Payments
- Chronic care DRGs (payment for a time period versus an episode or an event)
- Incentives for hospitals and physicians to integrate to deliver complete medical services as a “Qualified Integrated Entity.” (aka ACO)

Shifting Payment System

As reimbursement shifts from payments based on fee-for-service (FFS) (volume) to a more value-based system, risk will shift from payors to providers.



Increasing risk will place greater emphasis on integrated care models

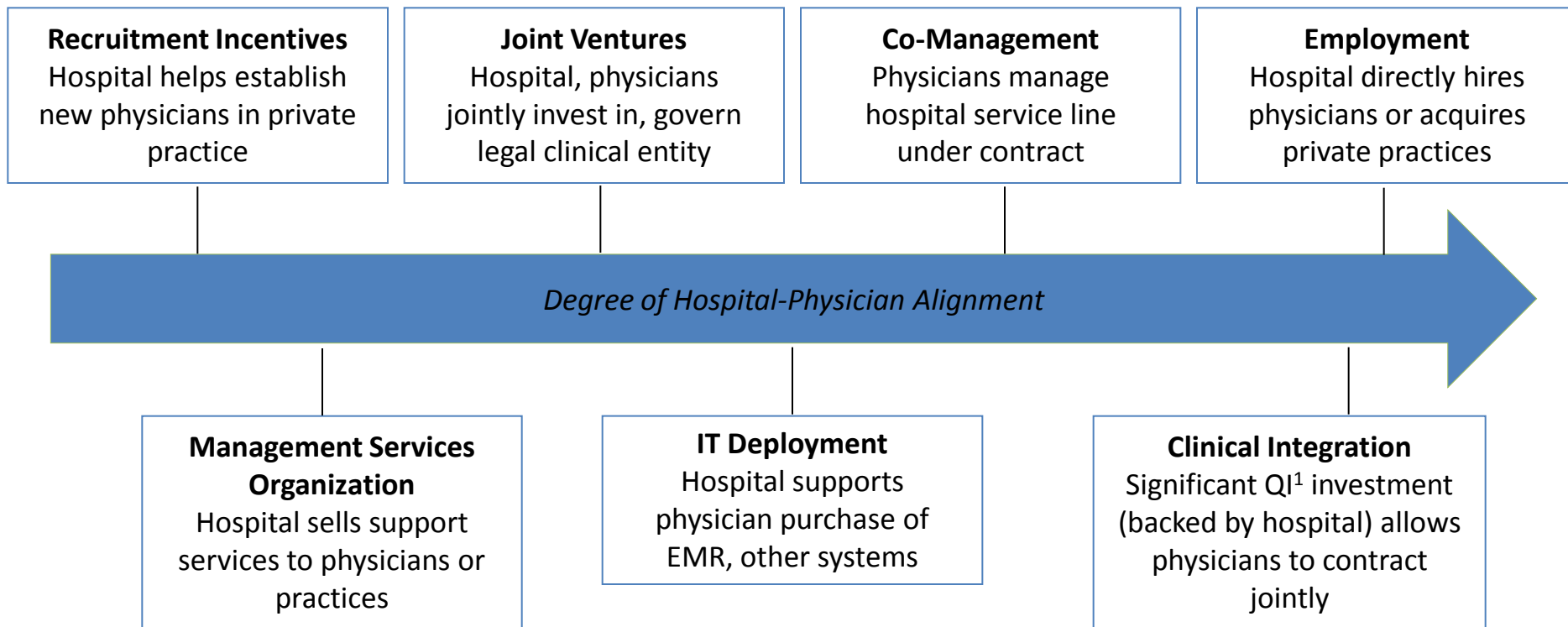
(1) Medical Homes that receive extra dollars for patient management

(□) P4P = Pay for Performance

Source: Keith D. Moore and Dean C. Coddington, Healthcare Financial Management Association, "Accountable Care: The Journey Begins," August 2010.

A Range of Alignment Options:

Selective List of Common Physician Alignment Models



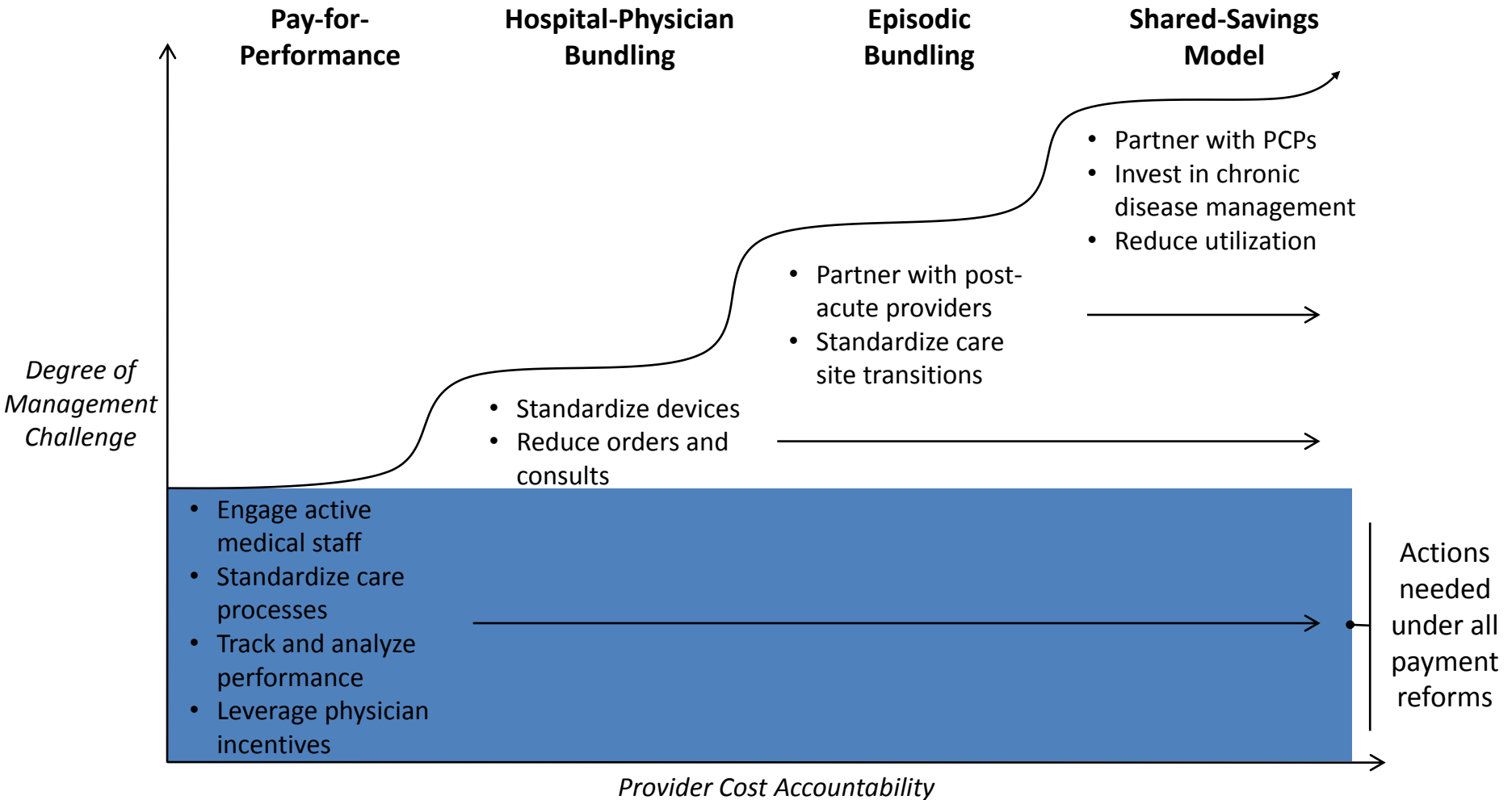
Practice Integration vs. Physician Employment Drivers

- Regional/Geography
- Demographics
- Employer/Payers
- Competition
- Technology

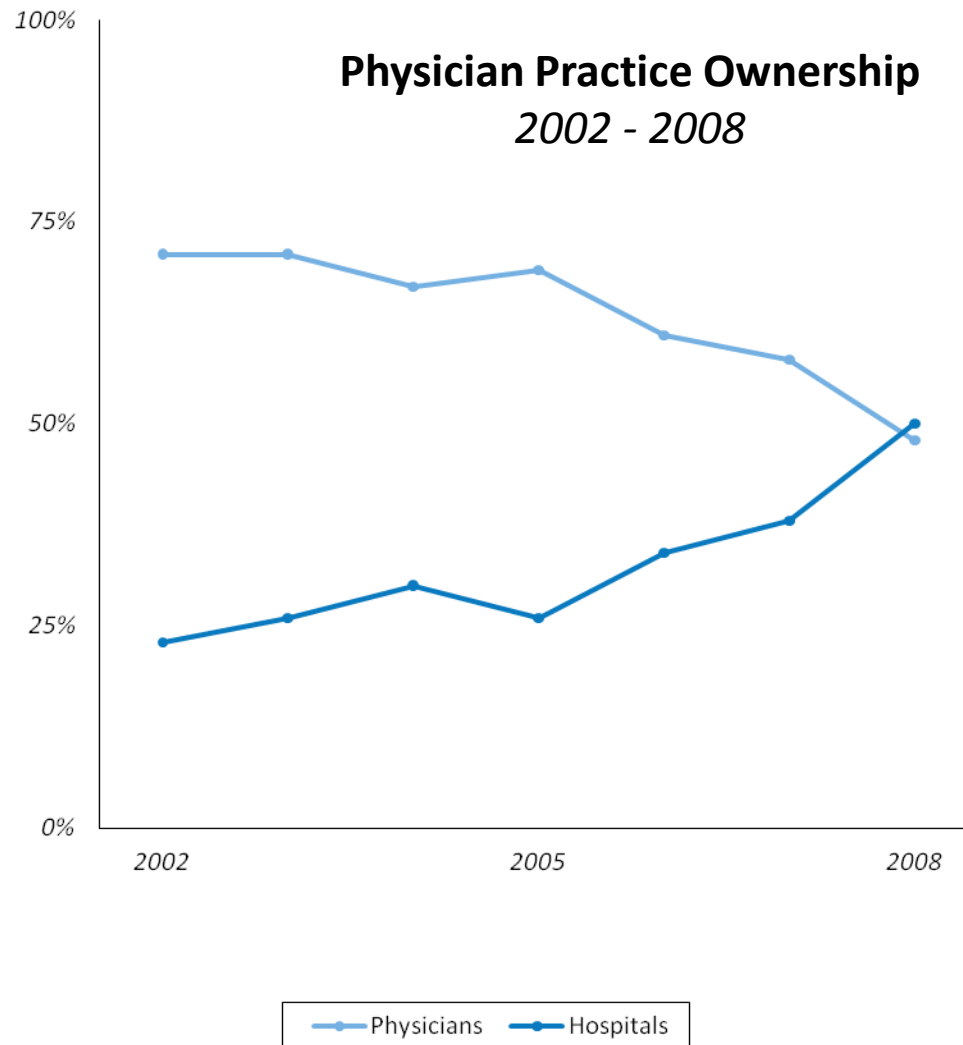
Forcing Tighter Ties:

Payment Reforms Place Greater Burden on Care Coordination

Strategic Responses to New Payment Methodologies



Physician Employment a Growing Trend



• Source: Harris G, "More Doctors Giving Up Private Practice," *The New York Times*, 25 March, 2010, available at <http://www.nytimes.com/2010/03/26/health/policy/26docs.html>; Health Care Advisory Board interviews and analysis; SOUTHWIND.

Driving Forces for Physicians

- Reimbursement declining in certain specialties leading to decreased physician compensation
- Healthcare reform is requiring physicians and hospitals to measure quality
- Bundled payments and integration of payments under Accountable Care Organizations
- Capital costs of installing EHR/EMR
- Practice demographics

Source: McGuire Woods and PivotHealth, Physician Practice Acquisitions: Deal Considerations & Post-Transaction Integration, January 2011

Driving Forces for Hospitals

- New breed of physicians want a “JOB”
- Facilitate succession planning
- Physicians seeking shelter
- Meet specialty capacity needs
- Malpractice crisis
- Platform for expansion
- Unfriendly aggregators
- “Glue” - PCPs no longer working in the hospital
- Foundation structure for integrated model
- Vehicle for quality improvement

Redefining Employment

Shift Requires *New Thinking* for Both Hospital and Physicians

- Employment Is...



A safe harbor that permits the not-for-profit, tax exempt hospital to underwrite physician practices

- Employment Is Not...



- “Selling out”
- “Cashing out”
- Working for the hospital
- Having someone else manage the practice
- Big, up-front money
- Long-term, guaranteed compensation

The Practice Administrator's Role: Your Professional Opportunity

- Take the lead
- Political climate
- Presentation skills, leave an impression
- Credentials and credibility
- Find your future

The Practice Administrator's Role: Defining Governance

- Patient Centered, Physician-Led,
Professionally Managed
- Site/Practice Dyad Management Model

Physician-Led, Professionally Managed Governance

Joint Policy Board(JPB) Governance Structure

JPB

Representation

- 3 Owner representatives
- 3 Employed clinics physicians representatives
 - PAC chair
 - Other employed physicians

IDS Board
(Parent Board)

Medical Group
Joint Policy Board (JPB)
50% Regional Clinic MDs
50% IDS Owners

Physician Advisory Committee
(PAC)

PAC Representation

- 7-9 employed physicians elected by all employed Clinics physicians
 - Primary care/specialty representation (2/3, 1/3)
 - VP/COO (Non-voting member)
 - VP, CMO (Non-voting member)
- Chair elected by PAC

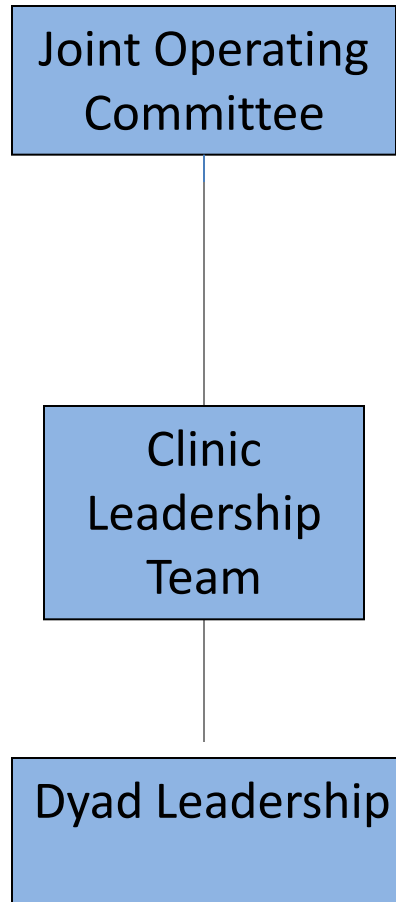
Site/Practice Dyad Leadership Model

Clinic Leadership Team

- Physician Site leaders from each site
- Administrators from each site

Dyad Model

- Physician Site Leader
- Administrator



Joint Operating Committee

- Employed physicians elected by all employed Clinics physicians
- Hospital administration

The Practice Administrator's Role: Acquisition Basics



Typical Process

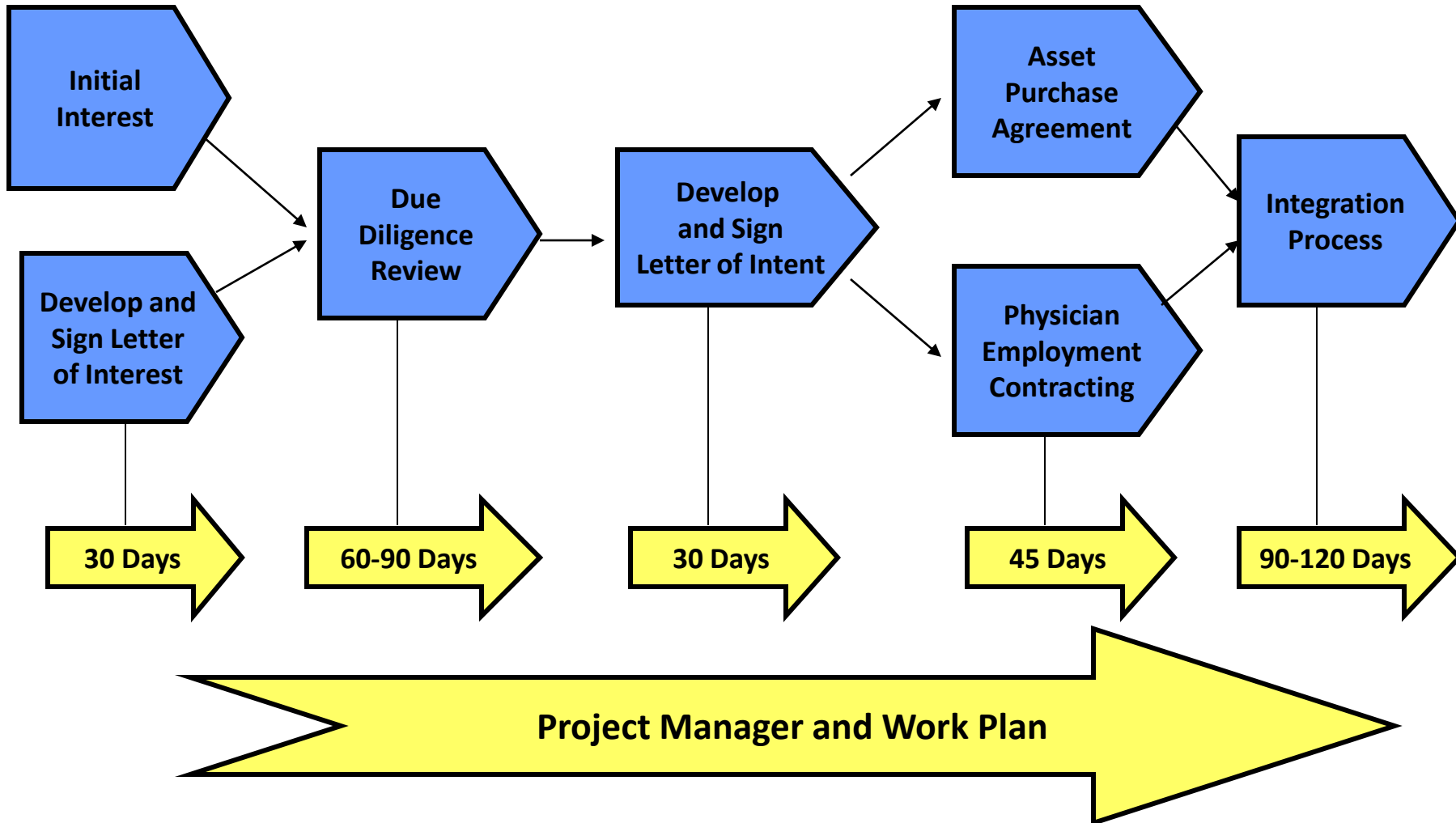
- Confidentiality Agreement
- Valuation of Assets
- Letter of Intent
- Draft Documents and Negotiation
 - Asset Purchase, Stock Purchase or Merger Agreement
 - Employment Agreements
 - Leases
- Obtain Hospital and/or Physician Shareholder Approval

Source: McGuireWoods and PivotHealth, Physician Practice Acquisitions: Deal Considerations & Post-Transaction Integration, January 2011

Typical Process cont.

- Sign Transaction Documents
- Obtain Third Party Assignments and Consents
- Physician Medical Staff and Payor Credentialing
- Closing

Acquisition Process Map



The Practice Administrator's Role:

Initial Interest:

- Facilitate the decision to proceed with discussions
 - Foster a collective purpose and vision
 - Unite physician leadership around facilitating a transaction toward a significant end point
 - Enable front line physicians to understand the rationale for change
 - Service as a liason with health system leadership

The Practice Administrator's Role:

■ Initial Interest (continued)

- Establish a multi-disciplinary team
 - Physician leadership
 - Dedicated health system executives
 - Experienced operationally focused consultants if needed
 - Legal counsel
 - Independent third-party valuation firm
 - Board retained investment banking firm

The Practice Administrator's Role

Initial Interest (cont.)

Establish a business plan to include:

- Legal structure
- Governance
- Leadership (physician and administrative)
- Scope of services
 - Clinical
 - Diagnostics
 - Educational
 - Research
 - Other

- Management and support resources
- Facilities (inpatient/outpatient)
- Marketing and branding/referral base
- Integration points
- Funding/philanthropy

The Practice Administrator's role

■ **The Letter of Interest**

- Components to be sure are included in this document:
 - Confidential
 - Exclusive
 - Non-binding
 - Establish time limit

- Keep Letter of Interest simple

The Practice Administrator's Role in the Due Diligence Process



Due Diligence Process

Practice

- Financial statements
 - Balance sheet
 - Income statement
- Practice demographics
 - Productivity
 - Compensation
- Operations
- Integration
- Things we don't know

Health System

- Capital constraints
- Financial thresholds (e.g. IRR)
- Approval process
- “Deal breakers”
- Stakeholder education
- Operational readiness
- Political response

Due Diligence Process (cont.)

- Sharing only what is authorized per the Letter of Interest
- Hospital System access to and understanding of information across all group(s)
- Transparency
 - Sharing of assessment with each group (no sharing across groups)
 - Validation of data
 - Aggregated view to understand group economics – when comfort level exists

The Practice Administrator's Role: Negotiation Process



Letter of Intent & Negotiation

- Non-binding in nature and content
- Set appropriate purchase price
 - Understand exclusions
- Definitive agreements
- Legal Considerations
 - Fair Market Value
 - Commercial reasonableness
 - Other legal issues

Other Considerations:

- Assignment of leases
- Identification of and divestiture of conflicting investments
- Identify all management agreements
- Document all legal transactions contemporaneously

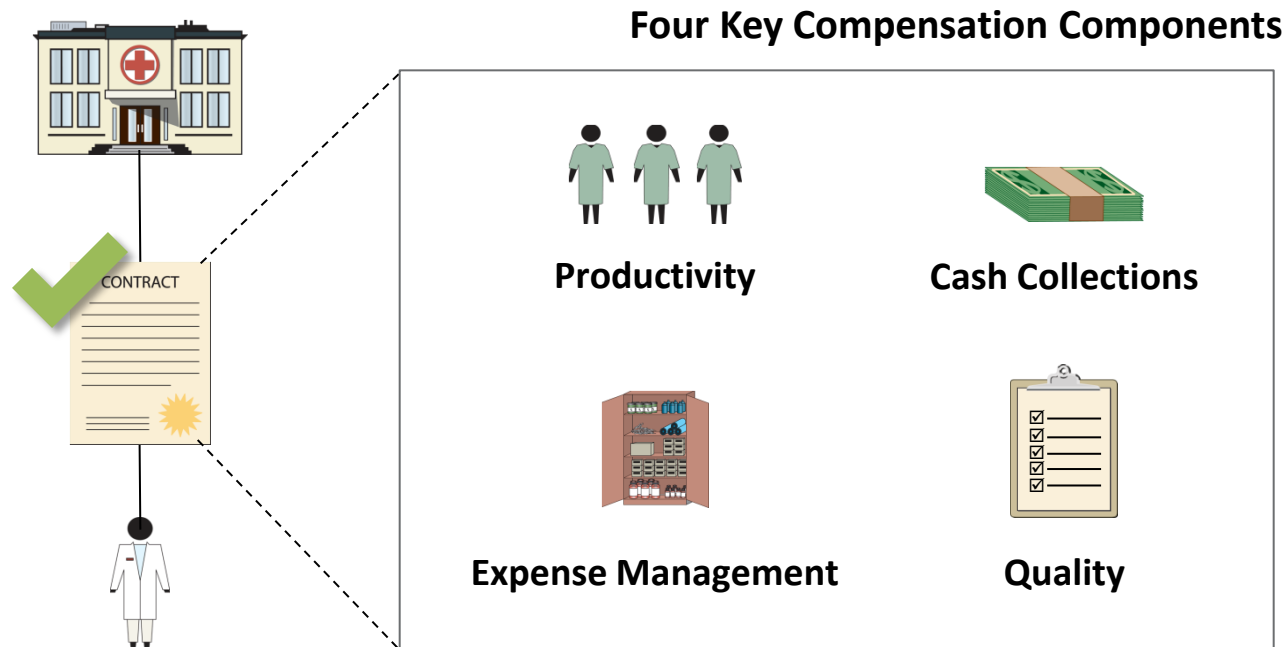
NOTE: Be flexible

Professional Liability

- Physician coverage and entity coverage
 - Tail obligations typically 1.2 to 2 times annual premium
 - Entity tail insurance expense considered in financial analysis/negotiation
 - Alternatives
 - Remain with current carrier
 - Move to system captive
 - Secure third party coverage
 - Develop hybrid
- Liability of practice but business decision of buyer

Physician Compensation Plan

➤ Align Incentives Around Practice Performance



- **Guiding Principles**

- **Risk:** Those who take the financial risk will be the managers
- **Downside:** Physicians (like all humans) are more motivated by significant downside threat to their income than by upside incentives

Standardized Employment Agreement

- Three to Five year initial term
- 24 x 7 coverage through group participation
- Provision of indigent and charity care
- Review of outside activities for conflict of interest
- Provision of professional liability and shared tail expense within first 4 years
- Specify duties resulting in incremental compensation

Standardized Employment Agreement cont.

- Restrictive covenant with ability to return to private practice
 - Employer terminates this Agreement “for cause”
 - Employer terminates this Agreement “without cause”
 - Either party elects not to renew this Agreement after the Initial Term
 - Either party terminates this Agreement pursuant to legal necessity

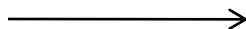
The Practice Administrator's Role: After the “deal is done”



Operational Integration

- After execution of Definitive Agreements:
 - Implementation plan outlining steps necessary to become operational under new tax ID number
 - Operations
 - Revenue cycle
 - Information systems
 - Human resources
 - Finance and accounting
 - Marketing and Business Development
 - Other

What's Next? Strengthening the Ties

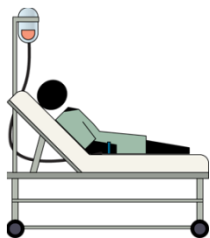


Attracting New Players

Third group, located at competing hospital, hears of compact and expresses interest in shifting business

Seeking Tighter Alignment

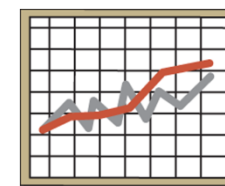
All three physician groups choose to merge into institute, to be owned by hospital and directly employ physicians



Cardiovascular
Service Line
Operations



Heart Institute
Governance and
Management



Quality and
Service
Improvement
Efforts

Acquisition Tools (handouts)

- Due Diligence Work Plan
- Integration Work Plan