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Post-Coronavirus Physician Practice Acquisitions: Proceed with Caution

As the coronavirus (COVID-19) global pandemic has wreaked havoc on the U.S. economy generally, and the healthcare industry specifically, the previously-active healthcare transactional environment has been largely stunted. Despite (or perhaps because of) this economic turbulence, stakeholders expect that merger and acquisition (M&A) activity will soon resume with a vengeance.[1] This potential opportunity, however, is not without pitfalls, due in part to the concern from stakeholders and regulators that well-capitalized entities may use this economic and public health crisis to prey on debilitated physician practices.[2] This concern was highlighted in the *Federal Trade Commission's* (FTC's) May 2020 announcement that it will continue its enforcement of competitive market practices and, post-COVID-19, will pay close attention to opportunistic healthcare consolidation.[3]

Over the past few decades, one of the most prevalent trends in the U.S. healthcare industry has been the consolidation of independent physician practices. Between 2016 and 2018, hospitals acquired 8,000 medical practices, and 14,000 physicians left private practice to work in hospitals.[4] However, physician practice acquirers are not relegated to just hospitals – both large insurers and private equity (PE) firms have entered the space as well.[5] In fact, the number of PE-acquired physician practices has grown dramatically, with the number of deals more than doubling between 2013 and 2016,[6] and, in 2018, such deals totaled 855, with $100 billion in capital invested.[7] Similarly, healthcare M&A activity at the beginning of 2020 was off to a strong start until the COVID-19 pandemic brought the U.S. economy to an abrupt halt.[8]

As noted above, the pandemic has caused widespread economic destruction, officially resulting in the U.S. entering an economic recession in February 2020, after a record 128 months of expansion.[9] The double-digit unemployment rate[10] and plunging economic output has not skipped the healthcare sector. The uncertainty of COVID-19 transmission and larger economic headwinds have caused investors to pause, delay, or cancel planned transactions.[11] This impact is illustrated by the total number of M&A transactions as of first quarter 2020, with only 366 healthcare deals closing,[12] a 10% decrease compared to the same quarter in 2019.[13] Additionally, recent trends show that April and May both had the lowest monthly totals of transactions in 2020, at 106 each.[14] Although health systems and other healthcare industry providers seem to have currently paused their M&A activity, transactions are expected to remain relatively strong throughout the remainder of 2020.[15]

The anticipated growth in M&A activity during the latter half of 2020 is expected to engender strict regulatory scrutiny, as demonstrated by the FTC's May 2020 announcement.[16] Physician groups that have been financially devastated by COVID-19 may rush to join larger organizations such as hospital systems, national healthcare companies, and large platform groups backed by PE firms,[17] while hospitals and health systems may seek to grow and diversify their service lines (in order to prevent the revenue drops experienced in the early months of the pandemic) through acquisitions and other arrangements.[18] Regulators and lawmakers are specifically concerned that there could be a heightened probability of predatory consolidation resulting from the billions of dollars that financially-healthy providers received in federal aid to offset COVID-19 losses.[19] The $175 billion in grants allocated to the *Department of Health and Human Services'* (HHS's) *Public Health and Social Services Emergency Fund* to financially sustain healthcare providers during the pandemic could help large, well-capitalized companies buy smaller practices that were weakened financially by COVID-19's induced economic recession.[20] Moreover, the FTC's earnest proactive affirmation of healthcare M&A oversight indicates that the agency has an elevated concern that these larger organizations will pounce at the opportunity to add undervalued assets to their operations via vertical merger and/or horizontal consolidation.[21]

The FTC's statutory authority for fostering a competitive marketplace stems from three key federal antitrust laws: the *Sherman Act*, the *Clayton Act*, and the *Federal Trade Commission Act* (FTCA).[22] Section 1 of the *Sherman Act* prohibits contracts, combinations, and conspiracies "*in restraint of trade*,"[23] which, in healthcare, is likely to appear in contracts between providers and insurers.[24] Section 2 of the Sherman Act prohibits monopolization, attempted monopolization, or conspiracy to monopolize.[25] Section 7 of the *Clayton Act* prohibits mergers and acquisitions that may substantially lessen competition or tend to create a monopoly.[26] Lastly, Section 5 of the FTCA prohibits "*unfair methods of*

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competition," which include all violations of the Sherman Act and Clayton Act, as well as "*unfair or deceptive acts and practices*."[27] These federal antitrust laws work in concert with applicable state laws to thwart anticompetitive practices.

The "*failing firm defense*" has become commonly used by merging parties that attempt to elude the FTC's review of anticompetitive consolidation practices. This defense posits that the weaker firm is failing, and thus has no other option but to be absorbed by the larger acquiring firm.[28] The hope is, if the "*failing firm defense*" can meet all of the elements,[29] the FTC and/or state attorneys general will approve the horizontal merger because it is preferable to have the assets in the hands of the acquirer than to see the assets exit the market completely. The FTC is predicting a possible wave of these failing firm claims in consideration of the current state of the economy, which may support the acquiring firm's defense.

With over 90% of U.S. hospital markets considered highly concentrated, and 60% of overall healthcare dollars paid to short-term acute care hospitals, physicians, and other healthcare professionals, the FTC's proactive approach to stymie predatory transactions seems practical.[30] Despite claims that consolidated organizations have larger economies of scale, and thus are able to offer better care and at lower costs, studies have indicated that consolidations (especially among hospitals) lead to increased pricing due to more negotiation leverage,[31] as well as poorer outcomes (higher rates of mortality, higher readmission rates, etc.).[32] Because of the increasing M&A activity over the past few years, researchers have suggested that increased antitrust enforcement may address such price and quality issues by preventing harmful consolidations that could dominate the market.[33] The FTC's May 2020 announcement indicates that it has been listening to such concerns, and may be more forthright in deeming such potentially predatory deals anticompetitive and rejecting them.[34]

Healthcare providers may have a myriad of reasons for entering into a transaction or other arrangement once the COVID-19 pandemic slows down. Some providers may not have the requisite resources to survive, and seek out an acquirer for their practice. Other providers (particularly hospitals and large, multispecialty groups) may wish to diversify their service lines going forward in order to prevent any cash flow issues exposed by the pandemic. Still others may have been well-positioned for such a crisis and may consequently come out on the other side of the pandemic in a stronger position, which position they may utilize to acquire those distressed providers. No matter the motivation, providers may want to proceed with caution, given that the federal government has made it clear that they will be scrutinizing transactions that stem from COVID-19. Specifically, providers may want to be cautious of the following:

- That the seller conducted a sufficient search for, and analysis and selection of, a buyer, as "*the most financially challenged firm must do more than window shop the* assets;"[35]
- That the acquirer can support the assertion that they are the only available purchaser;[36]
- That the seller has documented, if applicable, where they "*lack[] sufficient reserves to make identified capital improvements, resulting in declines in its competitive significance*;"[37] and,
- That the transaction does not implicate any other federal healthcare laws, such as the Stark Law or the Anti-Kickback Statute.

Proceeding with a physician practice acquisition in 2020 will inevitably have its own set of challenges. Despite the current unique circumstances surrounding the healthcare industry, providers will be well-served to proceed cautiously with transactions, and be mindful of the fact that the COVID-19 pandemic is not a "*get out of jail free*" card.

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