



McDERMOTT HEALTH 2023 ANNUAL REPORT

**PHYSICIAN
PRACTICE
MANAGEMENT 2022
YEAR IN REVIEW**

McDermott
Will & Emery

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LEARN MORE

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INTRODUCTION

The physician practice management (PPM) sector is expected to continue its rapid pace of growth in 2023, with new PPMs emerging to seize opportunities in cardiology, orthopedics, ophthalmology, urology, gastroenterology, primary care, women's health and other specialties. However, a tight labor market, wage inflation and fixed reimbursement pose challenges to all areas of healthcare, including the PPM sector. In addition, new proposed rules governing physician transactions and employment agreements have the potential to fundamentally alter the PPM industry. This report offers insights from significant PPM developments in 2022 and provides a strategic look ahead at the regulatory and transactional issues that will shape business outcomes throughout 2023.

2022 STATE OF TRANSACTIONS AND WHAT'S ON THE HORIZON

While many physician practice owners may have once considered their businesses recession-proof, the COVID-19 pandemic demonstrated that being part of a larger organization during times of adversity can be beneficial. This perspective drove tremendous activity involving PPM transactions in 2022. As of Q3 2022, there were 170 publicly announced transactions involving physician groups, representing an uptick of 16% from Q2 2022 and a 63% increase over Q3 2021. Private equity investors and their portfolio companies dominated the space, [accounting for](#) almost three-quarters of physician practice deals in Q3 2022. Transaction values also continued to hit record numbers, although valuations increasingly have factored in rising costs and stagnant reimbursement rates.

While a tightened credit market may make buyers more selective, and notwithstanding those other economic and regulatory headwinds detailed elsewhere herein, 2023 will likely be another active year for PPM transactions.

PHYSICIAN ALIGNMENT: KEY TO STAYING COMPETITIVE

A key feature of a successful PPM is to ensure strong alignment between PPMs and their affiliated physicians that extends beyond compensation to safeguard the business and retain talent. Involving physicians in decision-making and leadership is part of any successful alignment strategy. Investment in technologies and ancillary services intended to improve clinical outcomes and access to care, or to make clinical practice more efficient, is also important to the long-term success of the PPM business model.

Equity tools can drive alignment by incentivizing physicians to engage in recruitment, training, management and identifying opportunities for future growth (either organic or through acquisition). Equity strategies range from rollover equity issued at the time

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of the transaction, to equity purchase programs available to non-seller physicians who achieve partnership status within the organization. These equity tools are usually paired with a compensation program that uses one or more different elements, often including productivity-based payments or profit-sharing pools. PPMs do not have to choose a single compensation design; these options can be combined, offering flexibility to different groups of physicians.

As compensation plan design become more complex, however, it is critical to involve legal counsel to design and implement these arrangements. Compliance with federal and state self-referral and antikickback laws (including the Stark Law) will often drive the plan's structure and will be a focus in diligence for any recapitalization.

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SAFEGUARDING ENFORCEABILITY AND COMPLIANCE IN PROVIDER EMPLOYMENT AGREEMENTS

As physician practices structure their employment relationships with physicians and other providers, they should be mindful of related legal considerations, such as the requirement to properly classify exempt and non-exempt employees and the enforceability of restrictive covenants.

Physician practices use a variety of compensation models that include salary and productivity-based compensation, and PPMs often service practices in more than one state, creating potential multijurisdictional complications around obligations for overtime payment requirements. While all physicians who are licensed and in practice are considered exempt from minimum wage and overtime payment requirements under federal law, certain states have different standards that may result in physicians in those states being eligible for overtime compensation. For example, in California in 2023, physicians must meet an hourly compensation threshold of \$97.99 or a salary threshold of \$64,480 to be properly classified as exempt as practicing physicians (and these thresholds change annually). PPMs should work closely with [employment counsel](#) to consider the various state law requirements and ensure compliance.

Restrictive covenant enforceability is another area of the provider employment contract that warrants close review. While most states allow noncompete clauses provided they are reasonable, certain states impose restrictions on any noncompetes executed by physicians, nurses and dentists. For example, certain states allow noncompete clauses generally but place additional limitations or requirements on healthcare-related restrictions, such as requiring a provision allowing physicians to buy out the noncompete or applying limitations on injunctive relief. Some other states currently prohibit noncompete clauses in physician contracts without exception, even where noncompetes in other industries are permitted.

Further, as discussed in greater detail below, the Federal Trade Commission (FTC) has proposed eliminating noncompetes in employment and contractor agreements, and the FTC, DOJ and National Labor Relations Board have applied heightened scrutiny to restrictive covenants in the healthcare industry generally, and particularly with regard to physicians in niche specialty areas where demand exceeds supply. As such, all employers—including and particularly physician practices—should ensure they have closely reviewed their non-

solicit, confidentiality and trade secret covenants to ensure maximum protection, and they should consider and discuss other tools for physician alignment.

PROACTIVE PLANNING TO REDUCE RISK IN 2023: REGULATORY AREAS TO WATCH

As PPMs continue to operate in a highly regulated space, they should be mindful of the evolving federal and state developments. In early 2023, a number of regulatory developments are top of mind for PPM stakeholders, including:

- the government’s shifting approach to oversight of transactions in the healthcare industry (including those involving PPMs)
- the federal government’s proposed rule with respect to noncompete agreements and
- the implementation of the No Surprises Act, which aims to protect patients from unexpected expenses for out-of-network services.

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Antitrust Scrutiny and Transactional Review

The healthcare industry is currently under [heightened antitrust scrutiny](#) at both the federal and state levels. In 2021, President Biden issued an [executive order](#) that identified healthcare as one of four sectors that

would be part of an enforcement focus by the Federal Trade Commission (FTC) and the US Department of Justice (DOJ). Leaders at those agencies have publicly suggested healthcare private equity investment models may be anticompetitive, with a focus on short-term profits and debt. Firms with healthcare transactions that exceed the FTC's Hart-Scott-Rodino Act notification threshold should expect to receive questions from the FTC, even if the transaction would not have drawn scrutiny in the past. Regulators appear to be taking a new approach to evaluating transactions' potential to impede competition, by looking at market power generally rather than in a specific geographic area. DOJ and FTC have also increased their focus on how mergers might impact labor, particularly whether a transaction could suppress the wages of nurses and mid-level practitioners.

Stakeholders should closely monitor these developments and... ensure that existing and future investment strategies are structured to navigate the changed regulatory landscape.

Many states (such as Connecticut, Oregon, Nevada and Washington) in recent years have proposed or enacted processes for review of certain transactions involving healthcare providers and practices. Other states, including California, New York and Illinois, have active proposals to create and implement similar processes. These laws reflect the same trend toward additional oversight of consolidations involving healthcare providers. As more states move to enact or strengthen existing laws of this nature, PPM transactions may see delays in closing and more potential regulatory reviews. Stakeholders should closely monitor these developments and, if state actions are taken on such proposals, ensure that existing and future investment strategies are structured to navigate the changed regulatory landscape.

Noncompete Agreements in the FTC's Crosshairs

On January 5, 2023, FTC issued a [proposed rule](#) that would prohibit employers from using noncompete agreements with their employees or independent contractors. If adopted, this rule would make it illegal for an employer to enter into a noncompete agreement with a worker (employee or independent contractor), maintain a noncompete with a worker or represent to a worker that the worker is subject to a noncompete. Employers would also be required to rescind existing noncompetes and inform workers that they are no longer enforceable. The FTC's proposed rule would not affect other restrictive covenants, such as nondisclosure agreements, unless they are so broad in scope that they essentially function as a noncompete agreement.

Noncompete agreements are [prevalent in the physician practice industry](#), as stakeholders have long recognized their importance as a tool for physician alignment. Physicians execute these agreements in connection with their practice employment, practice sales and similar transactions, and ownership of medical practices. While the proposed rule is directed at restrictive covenants in the employment context, all physician noncompete agreements may be impacted, for the following reasons:

- The proposed rule applies to any contractual term that prevents an employee from seeking or accepting employment post-termination, with no carve-out for noncompetes in LLC agreements or related corporate entity restrictions.
- The exception for noncompete clauses entered into in connection with sale transactions is limited to "substantial owners" holding at least 25% of the ownership interest in a business entity, a threshold too high to apply in the context of larger physician practice sales.

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The proposed rule falls under Section 5 of the FTC Act, which does not apply to nonprofit entities, including nonprofit health systems and universities. As a result, the proposed rule states that it would not apply to an entity that is not “organized to carry on business for its own profit or that of its members.”

No Surprises Act

The [federal No Surprises Act](#), which went into effect on January 1, 2022, is aimed at providing new billing protections to patients in cases where they received emergency care or non-emergency care from out-of-network providers at in-network facilities, or air ambulance services. The law sets up a dispute resolution process between the payers and providers to take patients out of the middle of billing disputes. The US Departments of Health and Human Services (HHS), Labor and the Treasury have issued a series of rules to implement the law.

Among the key issues addressed in these rules was the consideration of the qualifying payment amount (QPA) in the dispute resolution process. The initial rules directed the independent dispute resolution (IDR) entity charged with determining a fair payment to start with the presumption that the QPA is the appropriate out-of-network rate for the service under consideration, and to select a payment offer closest to that figure. This interpretation of the statute quickly resulted in litigation, with various medical societies suing the federal government for issuing regulations that were inconsistent with the statute. Two federal courts ultimately vacated the government’s regulatory text on the QPA presumption in the determination of the out-of-network rate.

In [August 2022](#), the federal agencies issued a new final rule that addressed some of the issues raised in those lawsuits. The final rule expanded the amount of information that payers must disclose to providers on the QPA and instructed IDR entities to consider QPA first and then give weight to other factors that are not accounted for in the QPA. Finally, the rule expands the information that the IDR entity must provide about its payment determination to include an explanation of the other factors considered and why they were not already accounted for in the QPA. The provisions of the final rule related to the treatment of the QPA by IDR entities have now been vacated as well.

The rest of 2023 will likely be busy with regulatory action related to the No Surprises Act, with additional rules and guidance expected. PPMs should carefully follow developments in this area because implementation of the statute is impacting commercial negotiations and business relationships between payers and providers.

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HOT SPECIALTIES FOR 2023

PPM investors have recently increased focus on a number of specialties including gastroenterology, cardiology and orthopedics.

- **Gastroenterology** benefits from high utilization of evaluation and management codes, which were increased in 2021, and from the closing of the colonoscopy loophole, which has expanded access to services. Increases in the ambulatory surgery center fee schedule for gastroenterology procedures is also driving growth in this specialty.
- **Cardiology** is receiving increasing focus from investors as a new PPM area with tremendous

growth potential. The number of cardio-specific ambulatory surgery centers has increased dramatically in the past few years, as cardiologists and investors see opportunities to move procedures from hospitals to outpatient surgery centers, but is still far below numbers seen in gastroenterology, indicating plenty of room for expansion in this sector. Diligence is particularly important in cardiology since some codes, such as those related to vascular procedures, could be negatively impacted by the Centers for Medicare and Medicaid Services' clinical labor repricing initiative.

- **Orthopedics** is another specialty with stable reimbursement rates and growing interest. Orthopedics may be especially enticing for some private equity investors because the specialty lends itself to value-based care models. Investors should be mindful of nuances related to billing for ancillary services, such as the rates for physical therapists versus physical therapy assistants.

FINAL THOUGHTS HEADING FURTHER INTO 2023

The McDermott Health team is keeping a close eye on the healthcare dealmaking landscape. As economic and regulatory influences exert pressure on the PPM space, physicians, investors, development officers and other stakeholders should consider taking the following actions:

- Continue to focus on physician alignment through equity models, thoughtful compensation plans, and alignment on ancillary services and ambulatory surgery centers.
- Update employment agreements to account for changes in state laws on covenants not to compete and monitor developments in federal law on noncompetes. Consider providing comments on

the FTC proposed rule regarding noncompete covenants.

- Continue to monitor federal and state antitrust developments and enforcement.

EVEN MORE FROM McDERMOTT HEALTH



With decades of experience in the PPM space, the McDermott team is poised to help executives, physician owners, private equity, bankers and other industry players achieve their business goals against this background of economic uncertainty. Our 2023 Physician Practice Management and ASC Symposium in Nashville will address the issues presented here and more. [Reserve your spot today to join us in April.](#)

GO FURTHER WITH McDERMOTT

McDermott has had the opportunity to work with our clients on PPM transactions that expanded business lines and geographies, established new platforms and more, including the following:

Summit Health-CityMD

a leading provider of primary, specialty and urgent care, as healthcare regulatory counsel in its sale to VillageMD, a leading national provider of value-based primary care services. The transaction is valued at approximately \$8.9 billion with investments from Walgreens Boots; Alliance, Inc.; and Evernorth, a subsidiary of Cigna Corporation. The combined company will become the largest independent provider group in the United States and will create a multi-payor platform that will deliver quality, affordable care for all patients.

IVI-RMA Global

a Valencia, Spain-based premier fertility group with significant operations across the United States that leads the industry in research, success rate and patient care, as U.S.-based counsel in its EUR 3 billion sale to KKR & Co., a leading global investment firm.

Oral Surgery Partners

a portfolio company of Sheridan Capital, in 25 add-ons to date, including nine in 2022. Oral Surgery Partners now operates in 15 states.

U.S. Urology Partners

a portfolio company of NMS Capital, in its acquisition of Urology of Indiana. U.S. Urology has now partnered with more than 150 providers operating through more than 40 clinical locations in four different states.

U.S. Urology Partners

in its acquisition of Ormond Beach-based Florida Urology Center, an ASCs Inc. affiliate.

U.S. Urology Partners

in its acquisition of certain equity interests in Vantage Central Ohio Radiation Therapy, LLC.

Unified Women's Healthcare

a PPM platform focused solely on women's healthcare, in its acquisition of Gennev, the United States' leading digital menopause care delivery platform. This transaction complements Unified's existing OB/GYN and fertility-focused services and expands its ability to care for women through every moment and milestone of their healthcare journey. This transaction also represents Unified's first digital-health-focused acquisition. Unified Women's Healthcare continues to expand its footprint with new platforms in Pennsylvania, Michigan and Illinois.

Amulet Capital Partners

and its portfolio company, US Fertility, the United States' premier business support services platform focused on providing administrative services to fertility physician practices, in connection with a recapitalization resulting in Amulet acquiring additional equity giving it a majority stake in US Fertility. The recapitalization was in connection with the formation of a single asset continuation fund by Amulet, which will facilitate future acquisitions and additional growth with new limited partners. The continuation fund received commitments of approximately \$331 million from new investors and Amulet's existing limited partners.

OMERS Private Equity and Forefront Dermatology

in an agreement with Partners Group, a global private markets firm, to acquire an interest in Forefront Dermatology from OMERS Private Equity. As part of the transaction, physicians and executive team members will remain significant shareholders in Forefront Dermatology, and OMERS Private Equity will continue to invest through a minority equity stake. Forefront Dermatology operates more than 200 dermatology clinics across the United States and is the largest physician-led single specialty group providing dermatological services in the United States.

US Heart & Vascular

a cardiovascular PPM services organization (and portfolio company of private equity firm Ares Capital Management), in connection with the acquisition and management of cardiovascular physician practices across the United States. The McDermott team has three acquisitions pending in Houston, Texas, and one acquisition pending in Detroit, Michigan, with the client having other pending acquisitions across the country.

Lee Equity Partners

in its creation of Solaris Health Holdings, LLC, the United States' largest urology-focused PPM platform. Since Solaris's inception, McDermott has represented it in 11 acquisitions, including expansions into Florida, Pennsylvania, Illinois, Colorado and Maryland, among others.

Duly Health Care (formerly known as DuPage Medical Group)

a Chicago-based multi-specialty practice management business with clinical operations in Illinois and Indiana, in its various acquisitions and add-on transactions. For instance, McDermott is representing Ares Capital Management with respect to its control investment in Duly Health Care.

Upstream Rehabilitation

a leading national provider of outpatient physical and occupational therapy services and a portfolio company of Revelstoke Capital Partners, as healthcare regulatory counsel in its acquisition of Results Physiotherapy, a manual therapy-based outpatient orthopedic physical therapy organization. With this deal, Results Physiotherapy has expanded Upstream's portfolio to more than 1,000 owned and managed clinics across 28 states, making it Upstream's largest acquisition to date.

Pinnacle Dermatology Management

the largest multistate female-founded dermatology management services organization in the United States, with 90 clinical locations across 11 states, in its \$335 million acquisition of QualDerm Partners, a multistate dermatology services organization. Pinnacle Dermatology Management is a portfolio company of BayPine, and QualDerm was a portfolio company of Granite Growth Health Partners. The combined organization now provides dermatology services in 17 states.

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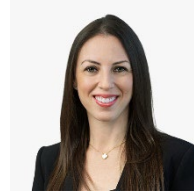
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