HCPE PulsePoint

CURRENT ISSUES IMPACTING HEALTHCARE INVESTMENTS

Healthcare Private Equity: What to Expect for the Rest of 2024

Although the U.S. healthcare industry has weathered the storm over the past couple of years, we may be reaching calmer waters in the coming months. Dry powder held by U.S. private equity investors has reached an all-time high, and with capital on the sideline ready to deploy, pressure to get deals done is on the rise.

With that backdrop, navigating the healthcare M&A landscape continues to be increasingly challenging, especially with an ever-evolving regulatory landscape. Bass, Berry & Sims has been closely following key legislative and regulatory efforts at both the state and federal levels. In this article, we examine the impact they are having on private equity transactions in the healthcare industry.

Healthcare Transaction Notice and Approval Requirements: New State Frameworks

To date, 15 states have enacted some form of healthcare transaction notice or approval requirements, at times under the guise of state antitrust protection. They include California, Colorado, Connecticut, Hawaii, Illinois, Indiana, Massachusetts, Minnesota, New Mexico, Nevada, New York, Oregon, Rhode Island, Vermont, and Washington. In addition, Pennsylvania currently has pending legislation that would impose notification requirements for certain types of healthcare transactions.

These state requirements are in addition to any filing required under the Hart-Scott-Rodino (HSR) Act, and typically with much lower thresholds and broader reach. We are encouraging clients to keep in mind that depending on the state, these new requirements can add anywhere from 30 to in excess of 180 days to the timeline of your transaction. **You may find our recently released interactive map detailing these requirements here.**

There also has been recent activity at the state level that would materially impact private equity investment in healthcare generally and, in some cases, the use of the traditional management services organization (MSO) model. In Oregon, proposed legislation aimed at the MSO model failed in the most recent legislative session. In addition, California, Minnesota, Massachusetts and Washington introduced proposed legislation specifically directed at private equity investment in healthcare. The potential concern we see here is that if one of these states enacts any type of this legislation, the other states included in the 15 above could quickly follow suit. Private equity investors with investments in these states are encouraged to engage now with lobbyists at the local level in order to monitor the evolving state legislative landscape and to consider the effects of these requirements as they evaluate exit strategies.

Non-Competes: FTC Final Rule

On April 23, the Federal Trade Commission (FTC) voted to adopt a monumental final rule prohibiting employers from entering into non-compete restrictions with workers – a move that is poised to reshape how employers approach employment agreements. The rule applies both prospectively and retroactively, with some exceptions (noted below). The rule is set to go into effect September 4, 2024.

Unless an injunction is issued before then, on September 4, employers will be prohibited from entering into non-competes on a go-forward basis with their employees and independent contractors and will be required to send a notice to those employees and independent contractors currently bound by a non-compete alerting them to the invalidity and unenforceability of the existing non-compete. Existing non-competes with "senior executives" who earn more than $151,164 and are in a "policy-making position" are exempt from the retroactive prohibition and will continue to be enforced. Those in a "policy-making position," for purposes of the rule, include any "president, chief executive officer or the equivalent, any other officer of a business entity who has policy-making authority, or any other natural person who has policy-making authority for the business entity similar to an officer with policy-making authority." "Policy-making authority," in turn, is defined as the "final authority to make policy decisions that control significant aspects of a business entity or common enterprise and does not include authority limited to advising or exerting influence over such policy decisions or having final authority to make policy decisions for only a subsidiary of or affiliate of a common enterprise." Although this can be broadly read to cover most C-suite positions, it remains to be seen just how far down in the organization policy-making authority can be legitimately claimed. Adding express language to an employment agreement regarding final authority over a host of policy decisions for the common enterprise is one action that could bolster this argument.

The rule explicitly does not apply to non-competes entered into in connection with a sale of a business and is silent with respect to the continued enforcement of non-competes against equity-holders in a business. Even if the equity grant is issued in connection with a person's employment, the protectable interest as an "owner" of the entity is different than in the employment context, which supports the position that such non-competes should be enforceable.

Currently, a number of legal challenges are pending in federal courts across the country seeking to enjoin FTC from implementing the FTC ban:

- On July 3, a federal judge in the Northern District of Texas enjoined FTC from implementing the final rule—citing a lack of statutory authority and that the rule was unreasonably overbroad. Although the preliminary injunction only bans FTC's enforcement as it pertains to the parties to that particular lawsuit, the court indicated that it intended to issue a merits-based disposition on the challenge to the rule on or before August 30, 2024, where the judge could issue a nationwide injunction banning FTC's enforcement of the rule.
- Conversely, on July 23, a federal judge in the Eastern District of Pennsylvania ruled in favor of the FTC and declined to stay the FTC rule banning non-competes. The judge ruled that the plaintiffs in that case failed to demonstrate irreparable harm and that the plaintiffs' alleged harms were not sufficient to warrant the issuance of an injunction.
- Meanwhile, a third case is pending in the Middle District of Florida, with oral arguments scheduled for today August 14 on the plaintiff's motion for a preliminary injunction.

For more detailed information, you may read our Bass, Berry & Sims blog post here: Scope and Impact of the FTC's Non-Compete Rule for Employers | HR Law Talk (bassberryhrlawtalk.com)

State Non-Compete Laws

Although the FTC non-compete ban has been top of mind for most in recent days, state legislatures have been very active lately in restricting the use of non-competes, both through statutes and court rulings. California, Minnesota, North Dakota, and Oklahoma have adopted statutes rendering non-compete clauses void for nearly all employees with limited exceptions. A number of other states have enacted restrictive covenant statutes rendering non-compete clauses void based on the worker's earnings, consideration, notice, and other factors; additionally, some other states have restrictions around physician non-competes. Most recently, Pennsylvania passed the "Fair Contracting for Health Care Practitioners Act," which significantly restricts the ability of employers to enter into non-competes with physicians and other highly skilled licensed clinicians.

And in a somewhat surprising turn of events, there have been examples over the last 18 months of Delaware courts refusing to enforce non-competes that the court deems to be unreasonably broad (without blue-penciling them) and also interpreting restrictive covenants using the law of the state where the business is located or where the plaintiff resides, even if the agreement is governed under Delaware law. The courts have found that Delaware law should not apply to the dispute, but rather, public policy requires the law of the state where the activity is being conducted to apply.

Regardless of what happens with the FTC rule and any future state-law decisions, our expectation is that the scrutiny around non-competes will continue. We recommend thoughtfulness and intentionality when considering non-competes, with an aim toward reasonableness relative to the facts and protectable interests involved.

2023 Federal Merger Guidelines

The 2023 Merger Guidelines issued by the FTC and the Department of Justice (DOJ) lower the bar for determining that a transaction is likely anticompetitive while also expanding the types of transactions that the DOJ and FTC will consider anticompetitive.

- **"Roll-Up" Strategies in the Crosshairs:** DOJ and FTC will now consider the total impact of a series of prior acquisitions or consolidation in the market generally, when examining a merger, including the strategy behind the series of transactions.
- **Many More Mergers of Competitors Will Be Viewed as Presumptively Anticompetitive:** The 2023 Merger Guidelines update numerical thresholds that have long been used to measure whether a merger of competitors is deemed anticompetitive.
- **Skepticism Regarding Vertical Integration:** Transactions involving vertical integration will now face increased scrutiny from DOJ and FTC under the new Merger Guidelines.
- **Minority Acquisitions May Be Subject to Agency Review:** The new Merger Guidelines make clear that DOJ and FTC are not just interested in transactions that involve a change of control; they also will review transactions where a buyer acquires some decision-making influence.

For more detailed information, you may read our Bass, Berry & Sims resource here: Attorneys Outline Impact of New Merger Guidelines on Private Equity, Middle-Market Deals | Bass, Berry & Sims PLC (bassberry.com)

Proposed HSR Filing Requirements

The HSR Act requires parties to transactions that meet certain thresholds to notify the DOJ and FTC and observe a waiting period prior to closing unless certain exemptions apply. These thresholds are adjusted annually based on U.S. economic growth. In addition, and for the first time, based upon a law that became effective in 2023, HSR filing fees are also being annually adjusted. This year, HSR filing thresholds ($119.5 million size of transaction threshold) and most HSR filing fees significantly increased. In addition, in June 2023, the FTC announced proposed rules that would make sweeping changes to the HSR pre-merger notification program. Although the rules have not been adopted in final form, the key points in the proposed rules include the following:

- **Increased Time and Expenses:** Substantial increase in the time and expenses associated with an HSR filing.
- **Submission of Narratives:** Required submission of narratives related to the transaction rationale and the competitive impact, requiring the parties to take an affirmative position on the proper antitrust analysis of all filed transactions and expend significant resources involving economists and consultants.
- **Required Documentation:** Required document production for a filing that would be vastly expanded to include draft documents and various ordinary course business documents unrelated to the deal.
- **Mandatory Disclosures:** Mandatory disclosure of prior transactions for the past ten years, regardless of size (even below the size of transaction threshold), intrusive disclosures for private equity funds regarding their structure and the identity of their limited partners, financing sources and creditors.

The main takeaway here is if the final rules become effective in at least close to the form of the proposed rules, buyers and sellers can expect more time, more money, and more scrutiny in navigating the HSR filing process. For more in-depth information, please see our resource here: HSR Thresholds and Filing Fees Increased for 2024 | Bass, Berry & Sims PLC (bassberry.com)

Corporate Transparency Act

Coming into law as part of a large defense authorization bill in 2020, the Corporate Transparency Act (CTA) has been billed as the most significant reform to U.S. anti-money laundering laws in a generation. The new reporting requirements under the CTA include:

- A Beneficial Ownership Information (BOI) Report that must be filed with FinCEN within 90 days of formation for entities formed on or after January 1, 2024, and within 30 days of formation for entities formed on or after January 1, 2025.
- A grace period for entities in existence as of December 31, 2023, which have until January 1, 2025, to file the BOI Report.
- A number of exemptions. The exemptions most likely available to healthcare portfolio companies are the following:
    - **Subsidiaries of Certain Exempt Entities:** The "subsidiary" exemption from the BOI Report applies to certain entities whose ownership interests are "controlled or wholly owned," directly or indirectly, by one or more other exempt entities (excluding pooled investment vehicles). An exempt entity must, per the FinCEN FAQ, "fully, 100%" control the ownership interests of the "subsidiary" reporting company for the exemption to apply. Interestingly, for physician practice management platforms, this exemption is not available for affiliated physician practices that are owned by physicians in a traditional MSO model, as the physicians must maintain certain elements of control over the practice.

- **Large Operating Company Exemption:** This exemption requires two conditions: 1) more than $5 million in revenue AND 2) more than 20 full-time employees (who work more than 30 hours per week) – leased employees do not count. Of note, portfolio companies that own multiple operating subsidiaries but consolidate their employees into an upstream parent company for benefits administration purposes may have issues satisfying the second prong of this exemption.

For a deep dive into more complexities in the CTA, you can read Bass, Berry & Sims resources here: What Constitutes Control and How Much is Too Much? Considerations for Private Equity Firms and Their Physician Practice Management Companies under the Corporate Transparency Act | Bass, Berry & Sims PLC (bassberry.com)

Chris Climo and Katie Smalley Examine Key Considerations for Middle Market Owners and PE Investors under CTA | Bass, Berry & Sims PLC (bassberry.com)

Congressional Scrutiny: The Corporate Crimes Against Health Care Act and Health Over Wealth Act

On June 11, the Corporate Crimes Against Health Care Act was introduced by Massachusetts Senators Elizabeth Warren and Ed Markey. As currently proposed, the bill would:

- Create a new criminal penalty of up to six years in prison for executives whose activities result in patient death.
- Provide state Attorneys General and DOJ with clawback power on compensation paid to private equity and portfolio company executives with a 10-year look back and look forward and a 5x civil penalty.
- Prohibit payments from federal health programs to entities that sell assets or use assets as loan collateral made to a real estate investment trust (REIT).
- Require all healthcare providers receiving federal funding to publicly report mergers, acquisitions, changes in ownership and control, and financial data, including debt and debt-to-earnings ratios.
- Mandate a report to Congress by the Office of Inspector General (OIG) of the Department of Health and Human Services (HHS) on the harm of corporatization in healthcare.

In addition, on July 25, Senator Markey and Washington Congresswoman Pramila Jayapal introduced the Health Over Wealth Act. The proposed legislation would require heightened scrutiny and reporting obligations for both private equity firms and for-profit companies who have investments in certain types of healthcare entities, including hospitals, nursing homes, mental and behavioral health care, and other health facilities covered under the definition of providers of services or supplier under 42 U.S.C. 1395(d). As currently proposed, the bill would:

- Mandate public reporting of certain financial metrics by for-profit healthcare entities, with additional reporting by private equity firms, including the fees collected by the private equity firm and dividends paid by the healthcare entity to the private equity fund.
- Require an escrow account to cover operating and capital expenditures for five years in the event of a closure or reduction in essential healthcare services.
- Require minimum investments of capital in purchased entities and financial contributions to mitigate potential closure or reduction in essential healthcare services.
- Require private equity firms to obtain a license to invest directly or indirectly in a healthcare entity, and permit HHS to revoke investment licenses based on factors deemed appropriate by HHS.

- Establish a task force to monitor changes in the healthcare marketplace, including addressing and limiting the role of private equity and consolidation in healthcare.
- Authorize HHS to prohibit a private equity fund from purchasing voting securities of a healthcare entity or any merger or acquisition that would result in a private equity fund gaining control of voting securities of a healthcare entity until the task force has had sufficient time to identify and analyze potential abuses taking place.

Although these bills have been introduced, it remains to be seen whether they will gain significant traction in advance of this year's election cycle.

Federal Agency Scrutiny: Gathering and Using Data

Joint Request for Information: Consolidation in Healthcare Markets

On March 5, DOJ, HHS, and FTC collectively issued a joint Request for Information (RFI) seeking input on the effects of private equity-led transactions involving healthcare providers, facilities and ancillary products and services generally, and in particular, the effects of such transactions in cases where they would not be noticed to DOJ and FTC under the HSR Act.

The agencies state that the comments received in response to the RFI will inform how they identify enforcement priorities and future action, including new regulations aimed at promoting and protecting competition in healthcare markets and ensuring appropriate access to quality, affordable healthcare items and services. Revealingly, the FTC framed this multi-agency effort as an inquiry into the impact of "corporate greed in health care.

The agencies solicited information from various stakeholders, including patients, consumer advocates, doctors, nurses, healthcare administrators, employers, private insurers, and various other individuals and entities. Notably absent from the list of stakeholders from which the agencies sought comment were private equity firms themselves. The comment period originally was set to expire on May 6 but was extended to June 5. A total of 6,153 comments were received, primarily negative, although the American Investment Council submitted a letter expressing concern that the agencies may be unfairly targeting private equity investments in healthcare based on anecdotal observations while overlooking the ways in which private equity increases competition and more broadly benefits the industry.

For more detailed information, you may read our Bass, Berry & Sims resource here: Is Your Compliance House In Order? Tips for Ensuring Private Equity and Portfolio Company Compliance in the Wake of the Recent Request for Information | Bass, Berry & Sims PLC (bassberry.com)

Joint Request for Information: Corporate Consolidation Through Serial Acquisitions and Roll-Up Strategies

On May 23, DOJ and FTC issued a joint Request for Information, this time seeking input on the effects of consolidation through serial acquisitions and roll-up strategies. Smaller transactions may fall below the HSR Act thresholds for premerger screening, and DOJ and FTC expressed concern that corporate consolidation strategies that help companies become larger—"and potentially dominant"—through serial acquisitions and roll-ups harm competition while evading antitrust scrutiny. Although, unlike the March RFI, this RFI is not focused exclusively on the healthcare industry, the agencies describe it as complementing their initiative to understand how healthcare market transactions "may increase consolidation while threatening patient health, worker safety, quality of care, and affordance healthcare for patients and taxpayers."

The comment period was originally set to expire on July 22, but just before it expired the agencies extended the comment period to September 20. As of mid-August, the agencies have received over 400 comments.

Online Portal for Public Reporting of Anticompetitive Practices in Healthcare

On April 18, the DOJ, FTC, and HHS launched HealthyCompetition.gov, an "easily accessible online portal" that allows the public "to report healthcare practices that may harm competition." The agencies describe the portal as advancing broader efforts to lower healthcare and prescription drug costs through competitive healthcare markets that are fairer to patients, providers, payors, and workers.

Nursing Facility Ownership Disclosures

In late 2023, the Centers for Medicare & Medicaid Services (CMS) finalized a rule requiring greater disclosure of ownership and managerial control information for Medicare skilled nursing facilities and Medicaid nursing facilities. Although nursing facilities have historically been required to disclose ownership information, the new rule creates more expansive disclosure requirements. It requires disclosure of all governing body members and officers, as well as "additional disclosable parties," including individuals who or entities that exercise financial control over the facility; lease or sublease real property to the facility; or provide administrative services, clinical consulting services, accounting or financial services, operational policies or procedures, or cash management services.

It also specifically requires disclosure of ownership or control by private equity firms and real REITs. The rule broadly defines "private equity company" as "a publicly traded or non-publicly traded company that collects capital investments from individuals or entities and purchases a direct or indirect share of a provider," and it defines "REIT" by reference to the Internal Revenue Code's definition of REIT. The data CMS collects will be made public no later than early 2025.

The rule is part of the administration's broader goals and efforts over the last several years to collect and make public information about ownership in and transactions involving healthcare providers. For instance, in April 2022, for the first time ever, CMS publicly released data on changes of ownership from 2016-2022 for hospitals and nursing facilities. In September 2022, CMS released additional data on ownership of skilled nursing facilities. In December 2022, CMS released ownership data for all Medicare-certified hospitals. And in April 2023, CMS released ownership data for all Medicare-certified hospice and home health agencies.

Supreme Court Decisions: Curbing Agency Power

In late June, the Supreme Court issued three decisions that curb administrative agency authority and offer new opportunities to challenge regulatory actions. We are watching how these three decisions will affect challenges to agency actions, as well as future agency actions.

- ***Loper Bright Enterprises v. Raimondo:*** Overruling the *Chevron* doctrine—which, for the past 40 years, required courts to defer to administrative agencies' reasonable interpretations of ambiguous statutes—the Supreme Court held that the Administrative Procedures Act (APA) requires courts to exercise their independent judgment in deciding whether an agency has acted within its statutory authority. *Loper Bright* is a watershed decision for administrative law that levels the playing field. Rather than the agency winning whenever a statutory provision is ambiguous, and the agency's interpretation reasonable, courts will now rely on the ordinary tools of statutory construction to determine the best interpretation of the statute.

  Courts can and likely will continue to consider an agency's "body of experience and informed judgment" when interpreting statutes, so-called *Skidmore* deference. The extent to which courts do will depend on the thoroughness evident in the agency's consideration, the validity of its reasoning, its consistency with

earlier and later pronouncements, and "all those factors which give it power to persuade, if lacking power to control." The Supreme Court also acknowledged that it would be permissible for courts to rely on agencies' interpretations where the statute expressly calls for such deference. Still, removing the thumb on the scale that was often dispositive in favor of the agency is a huge win for regulated parties.

Going forward, healthcare industry participants will likely show greater willingness to challenge agency action, and they are more likely to be successful in their challenges. Regulations that impose substantive legal standards that are not clearly authorized by statute—or that otherwise impose obligations that are substantially more restrictive or prescriptive than those in the corresponding statute—are particularly vulnerable after *Loper Bright*.

- ***SEC v. Jarkesy:*** Holding that defendants facing civil monetary penalties from the Securities and Exchange Commission (SEC) for alleged securities fraud have the right to a jury trial, the Supreme Court invalidated the imposition of civil monetary penalties by the SEC's administrative tribunal. The Seventh Amendment secures the right to a jury trial for all claims that are legal (as opposed to equitable) in nature, and the Supreme Court held that agencies cannot circumvent this right by bringing enforcement actions in in-house tribunals.

  Whether a claim is legal in nature turns on the cause of action and the remedy it provides, with the latter carrying more weight. In applying this test to the enforcement action at issue, the Supreme Court found that the SEC's claim seeking monetary penalties—a form of monetary relief—was "all but dispositive." Money damages "are the prototypical common law remedy," and what determines whether a monetary remedy is legal in nature is whether it is designed to punish or deter rather than solely to restore the status quo. The "public rights" exception did not apply because it is a narrow exception (which, the Supreme Court points out, lacks a textual basis in the Constitution) that is limited to matters that historically could have been decided exclusively by the executive or legislative branches, which is not the case with the SEC's antifraud provisions. Because the SEC's penalties were designed to punish and determine, the claim was legal in nature, and the defendant was entitled to a jury trial.

  The Supreme Court's logic in *Jarkesy* lays the groundwork for regulated parties to challenge other agencies' use of administrative tribunals. HHS's authority to impose civil monetary penalties through administrative actions, for instance, could be in jeopardy. The success of any such challenge will turn on whether the remedy the agency seeks is legal in nature and whether the "public rights" exception applies.

- ***Corner Post v. Board of Governors of the Federal Reserve System:*** Expanding regulated parties' ability to bring facial challenges to administrative agency rules, the Court held that an APA claim against an agency action does not accrue until the regulated party is injured by the final agency action. Under the APA, the statute of limitations requires suits to be filed within six years after the claim first accrues. Before Corner Post, courts were divided as to whether the claim first accrues when an agency publishes a regulation or when the party is injured. When courts applied the former standard, it left some parties unable to bring facial challenges because, like the convenience store in Corner Post, they did not even exist or, even if they did, they may not have experienced an injury within the first six years after the regulation was published.

  Decoupling the injury from final agency action, the Court held that a cause of action does not accrue until a party is injured. This decision opens the door to bringing new challenges to agency actions that were finalized more than six years ago but that have more recently resulted in an injury to a regulated party.

Put together, these three Supreme Court decisions could result in a wave of challenges to administrative actions. In some instances, the outcome may be the same as it would have been under the old *Chevron* regime. But in others, it will not. Agencies will lose cases that, when *Chevron* was the law, they would have won. Courts will now grapple with and resolve statutory interpretation questions rather than having their hands tied. Agencies will need the best interpretation—not merely ambiguity in the statute and a reasonable interpretation—to win.

Those facing enforcement actions may end up in federal court (rather than an in-house administrative tribunal), with a more level procedural playing field and, with *Loper Bright*, a more level substantive one, too. If limited to bringing some actions in federal court, agencies may need to deploy more resources for a given enforcement action, and they may lose some leverage in settlement negotiations where, before *Jarkesy*, they could threaten in-house enforcement actions and, before *Loper Bright*, the deck was often stacked in favor of the agency. And finally, even longstanding regulations are vulnerable to facial challenges under *Corner Post*, which instructs courts that the statute of limitations begins running when injury occurs, not when an agency action is final.

In the coming years, federal courts will likely play a more significant and active role in adjudicating the legality of agency actions. For many in the healthcare industry, these three decisions may have little effect on day-to-day operations. But for others, the regulatory regime may change drastically. Courts may upend doctrines and rules that have long been settled. As courts begin to interpret statutes independent of—and without giving dispositive weight to—agencies' interpretations, there could be seismic changes for some regulated parties.

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