

## **Private Equity Dental Services Organizations: Corporate Practice of Medicine, Fee-Splitting, Regulatory Compliance**

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# Private Equity Dental Services Organizations: Structuring the Deal – Transactional Issues and Regulatory Compliance



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July 10, 2019

# What is a Dental Service Organization?

- Dental service organizations (DSOs), also known as dental support organizations, are management service companies that provide or administer business support services to dentists and dental practices.
- Some examples of the services DSOs provide include but are not limited to human resources, marketing, billing and collection, space and equipment rental, compliance, accounting, and vendor management.
- DSOs can be an internal management organization, but most are third-party management companies that contract with dental practices.

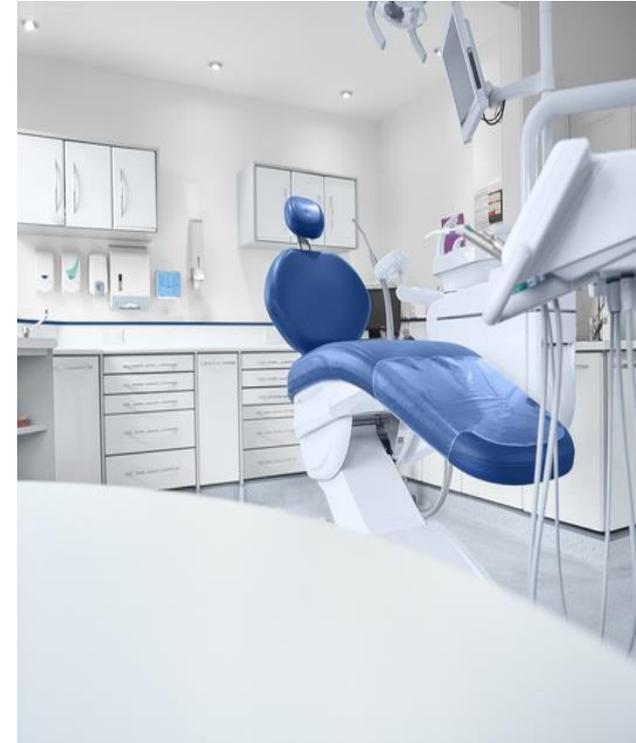
# Typical Structure: Dental Services Organizations

- DSOs provide their services to licensed dentist(s) who own a professional entity (either a professional corporation (PC) or professional limited liability company (PLLC) (professional entity)).
  - The professional entity employs dentists and all licensed health care providers.
  - The professional entity holds all clinical assets, dental records, and payor contracts.
- The DSO is a lay entity—— typically an LLC.
  - DSOs may have dentists and non-dentists as investors.
- DSOs and the professional entity establish a business relationship regarding non-clinical, administrative services through administrative services agreements.

Why all the interest in DSOs?

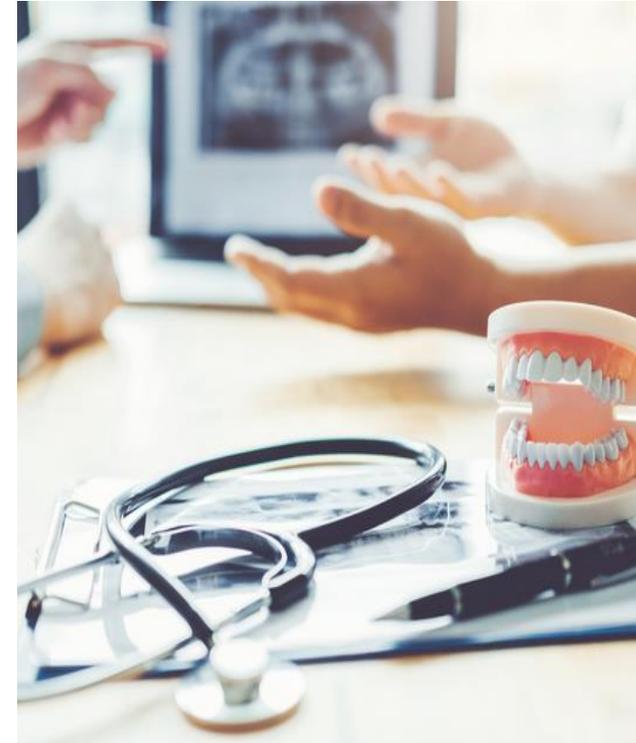
## Factors that Contribute to Private Equity Firms Considering and Entering into a DSO Arrangements

- The dental market continues to expand.
  - The dental market was \$73 billion in 2017, according to investment bank Harris Williams & Co.
- More consolidation leads to bigger chains of dental practices, that in turn can create greater efficiencies.
- This consolidation combined with these greater efficiencies can equate to greater growth which in turn can lead to quicker returns on investment.



## Factors That Contribute to Dental Practices Considering and Entering into DSO Arrangements

- With costs continuing to rise, DSOs can provide the infrastructure, recruitment, marketing, capital, and administrative support functions that relieve the high administrative costs and burden on smaller dental practices.
- A DSO can make a dental practice more efficient and allow the practice easier access to expand.
- DSOs allow dentists to spend more time on clinical services and less time on administrative tasks.

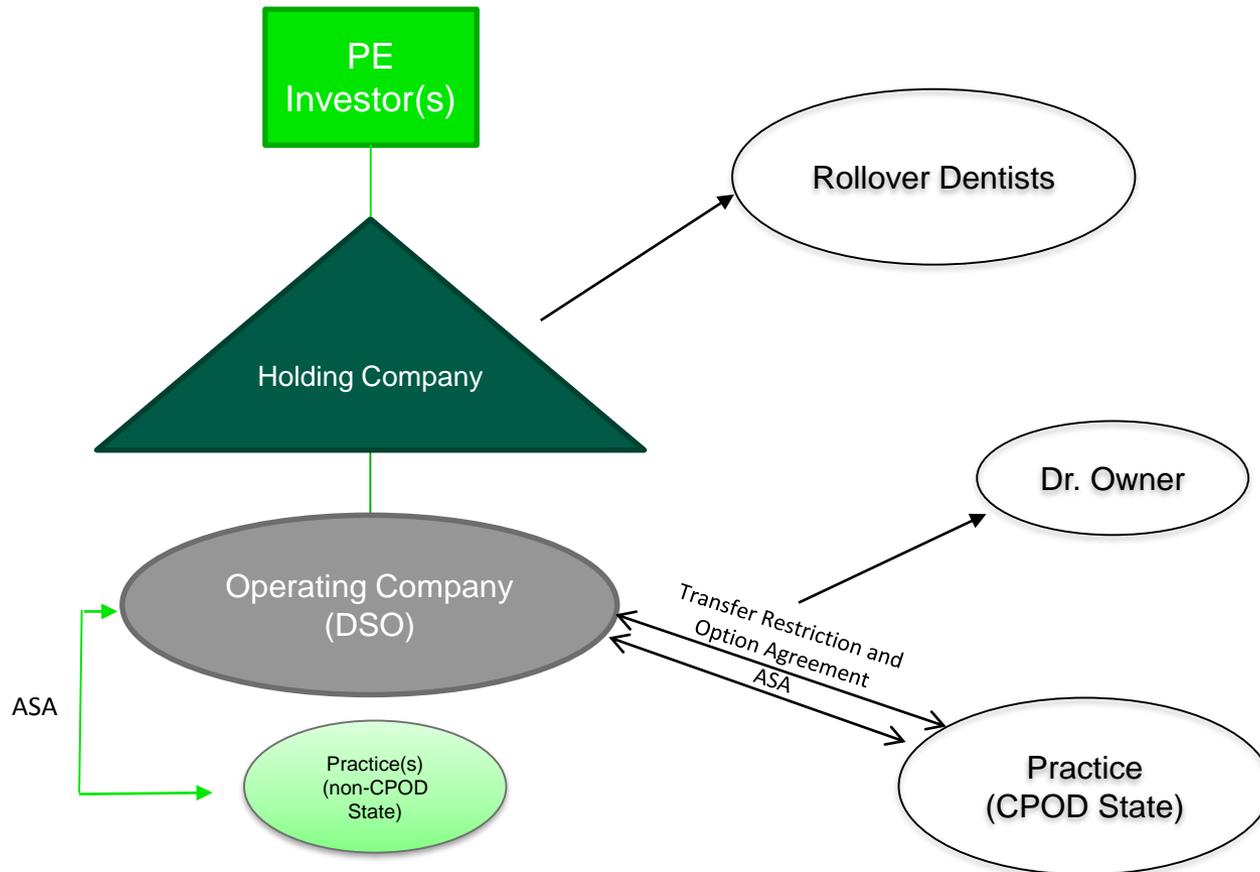


# Private Equity and Dental Practices

- Private equity has been pouring money into the dental field.
- KKR & Co. bought a 58% stake in Heartland Dental, a DSO, that valued the company at \$2.8 billion.
- Other investment firms such as Leonard Green & Partners and Berkshire Partners are also buying DSOs.
- As the market continues to expand, private equity firms are all scrambling to get a piece of the pie.



# Typical Private Equity Transaction Structure



# Transaction Structure: Dental Services Organizations

In jurisdictions that restrict Corporate Practice of Dentistry (CPOD), a transaction structure may include an investor-owned DSO.

- Non-clinical assets are transferred to the DSO, which provides business and financial management services.
  - Must transfer sufficient value to the DSO to attract the desired level of private equity investment, including through a long-term administrative services agreement (ASA).

The professional entity enters into ASA with the DSO, and the DSO collects fees from the professional entity in consideration for administrative and management services.

- Licensed dentists own the professional entity, which holds all clinical assets.
- Management fees must be “fair market value.”

# Transaction Structure: Additional Considerations

- Authority of the professional entity
- Complying with state statutory and regulatory restrictions
  - Example: Fee-Splitting—many states have adopted prohibitions against fee-splitting (some broader than others)
- Selection and ownership of medical equipment
- Control and supervision of clinicians—clinicians continue to make decisions with respect to the delivery of patient care
- Limitations on restrictive covenants, particularly with respect to clinical employees (following applicable state law)

# Distinct Due Diligence Considerations

- Private equity looks at the same corporate and transactional diligence as other acquirers, but has an additional strong focus on future earnings and growth.
  - Reimbursement considerations and diligence for private equity is largely focused on return on investment of the transaction.
  - Some private equity firms have a greater focus on health care regulatory compliance issues and others rely more heavily on outside consultants and attorneys regarding the diligence process.
- Thus, focus on regulatory diligence is specifically targeted on higher risk areas, including:
  - Compliance programs and HIPAA compliance
  - Billing and coding compliance

# Due Diligence: Compliance Programs and HIPAA Compliance

## Compliance program review and assessment should include:

- Interviews of compliance officers.
- Review of any past, present, or anticipated future regulatory or enforcement actions (i.e., existing Corporate Integrity Agreement (CIA), ongoing investigations, patient, payor, whistleblower or other litigation that could indicate current or future potential risk).

## HIPAA compliance review and assessment should include:

- Review HIPAA policies and procedures. (Do they exist? Any key policies and procedures missing?)
- Review existing business associate agreements (BAAs) and confirm that BAAs are in place where necessary.
- Confirm whether there are any previous, pending, or threatened Office for Civil Rights (OCR) investigations or audits.

# Due Diligence: Billing and Coding Compliance

## Billing and Coding Compliance

- Consider engaging an expert.
  - If third-party experts/consultants are engaged (e.g., valuation firm), consider having them engaged via legal counsel to preserve attorney/client privilege.
- Review random sample of medical records to ensure that diagnosis and procedures are accurately and appropriately coded.
- Review same for adherence to coverage policies and procedures.
- Review denials to identify trends and issues with billing practices.

# Responding to Due Diligence Risks

**Representations and warranties, indemnification, survival periods, hold-back, escrow, purchase price adjustment, etc.**

**Pre-closing remediation (i.e, self-disclosure, affirmative reporting, contract revision). Consider:**

- Do the corporate records prove that “former shareholders” are truly “former”?
- Do circumstances justify migrating assets to a management company even prior to eliciting a private equity partner?
- Can other issues be addressed ahead of time?
- For smaller organizations lacking a compliance plan and a compliance officer, can policies and procedures be added prior to going to market?
- Do Stark and other regulatory matters, including potential pre-deal self-reporting, apply?

**Representation and Warranty Insurance**

# Governance Issues

## Private Equity Considerations:

- Typically does not want to manage day-to-day operations of the entity
- May want designees on board or veto rights over extraordinary actions to protect its investments
- Reserved powers
- CPOD prohibitions, if any, may determine how much control the private equity firm can exercise

## Balancing Private Equity and Clinical Control:

- Physician Control
  - Board representation
  - “Relationship of the Parties” contractual provisions
  - Clinical Board Committee
  - Joint Operating Committee

**Ensure any governance structure complies with applicable state CPOD**

# Use of Rollover Equity

## What is “rollover equity”?

- In lieu of cash proceeds, equity holders in the target company (such as founding dentists and other key members) take a portion of their sale consideration in the form of equity that is “rolled over” into the new DSO.

**Rollover equity helps ensure that the interest of the key members of the target practice continue to be aligned with the incoming private equity investor.**



# Managing “Rogue” Dentist Shareholders

## Use Stock Transfer Restriction Agreement between DSO, practice and practice equity owners.

- Allows DSO to approve any future owner of the professional entity

## Employment Agreements with Practice equity owners

- Restrictive covenants (non-compete, non-solicitation, etc.; provided, however, that such covenants are drafted in compliance with relevant state statutes and regulations)



## Unique Considerations In Work With Founders

- How do you structure the transaction so founders retain sufficient “skin in the game”?
- Will the founder in a region be the DSO’s business development lead?
- Will the founder in a region have veto power over new practices?
- Is there a business imperative for sub-DSO’s?
- To the extent there is retained equity, is there a put/call?

# CPOD Doctrine

Many states have some form of CPOD either through a statute or case law.

**CPOD imposes restrictions on/creates requirements regarding:**

- Employment of professionals
- Ownership
- Fee-splitting
- Active practice

**CPOD violations typically occur when a dentist unintentionally provides services through an improper business entity (PC controlled by a DSO) rather than a professional entity (controlled by the dentist).**



# How can DSO Agreements Comply with CPOD?

## Agreements between dentists and DSOs should define:

- The term of the arrangement
- How fees are exchanged
- Who has control over clinical decisions
- Who oversees clinical and non-clinical employees

**State regulators, dental board, former sellers, patient class action suits, competitors, or payors can challenge DSO and PC agreements.**



# Fee-Splitting Prohibitions

## **Dentists are prohibited from accepting or tendering rebates or split fees in business dealings between dentists and any third party.**

- For example: A dentist who pays for advertising or marketing services by sharing a portion of the professional fees collected from prospective or actual patients with the advertiser has engaged in fee splitting.
- For example: A dentist who offers dental treatments or procedures with “social coupons” (i.e., Groupon) has engaged in fee splitting if the business arrangement allows the coupon marketing service to collect the fee from the prospective patient and provide the remaining balance to the dentist.<sup>1</sup>

## **Each state may have its own fee-splitting prohibitions in addition to ones established by the American Dental Association Code of Professional Conduct.**

## **Impacts structure of Management (Administrative) Services Fee—some states prohibit percentage fee arrangements.**

<sup>1</sup>American Dental Association. “Principles of Ethics Code of Conduct of Professional Conduct” Section 4.E.1.

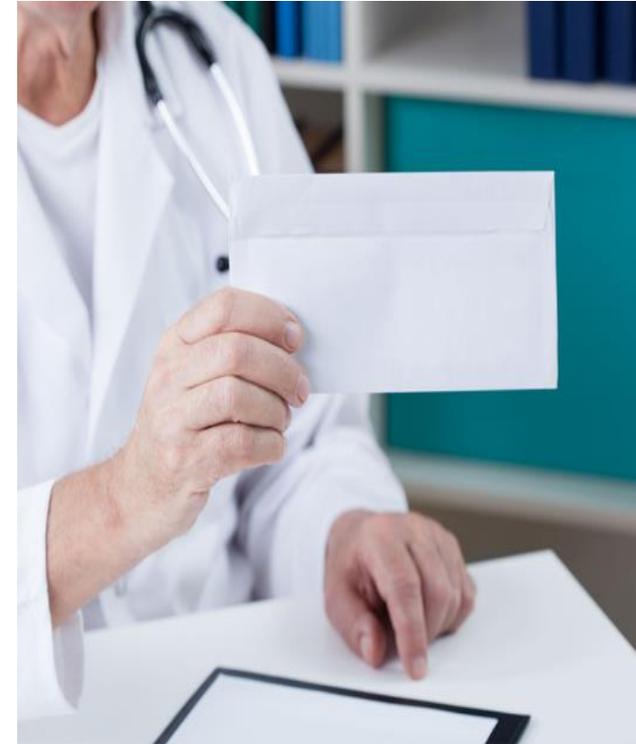
# Anti-Kickback Statutes

## Federal Anti-Kickback Statute

- Intent-Based Criminal Statute
- Safe Harbors
  - Group practice
  - Employment Personal Services
  - Space/Equipment Lease

## State Fraud and Abuse Laws

- Medicaid Fraud Laws
  - Billing Medicaid for unnecessary procedures, procedures that were never performed, or intentionally substandard work, and
  - Disregarding ethical treatment standards.



## Stark Laws (Physician Self-Referral Law)

### Dentists are physicians for purposes of the Stark Law.

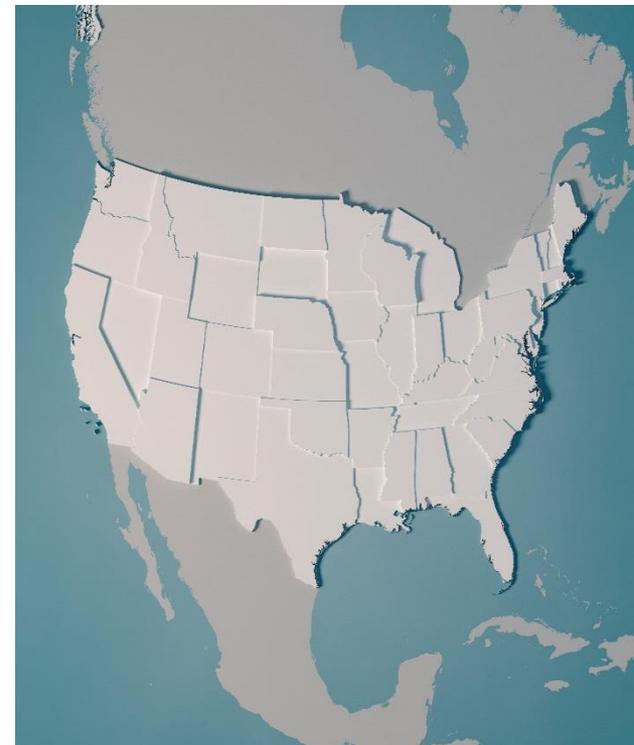
Under Stark law, a dentist may not refer Medicare or Medicaid patients to a designated health services entity where the dentist or immediate family member has a direct or indirect financial relationship, unless an exception applies.



# State-by-State Regulatory Issues

## Some states have specific regulations governing DSOs. For example:

- Florida's statute allows dentists to contract with DSOs for administration, human resources, marketing, and consultations about increasing productivity.
- Nebraska requires dentists to practice and advertise under his or her own name.
- North Dakota allows non-dentists to own up to 49% of a dental practice, but non-dentists cannot interfere with clinical decisions.
- Kansas and Texas require DSOs to register annually with the Secretary of State.
- Illinois requires each dental office location to register with the Secretary of State.



# Operational Challenges

- Tension between best practices and practice autonomy
- Creating a corporate culture
- Integration challenges: bringing on new practices
  - Stock v. asset deals and payor contracting
  - Credentialing



# New Regulation Risk: Drug Diversion

“Diversion means the transfer of any controlled substance from a licit channel to an illicit channel of distribution or use.” Chapter 961 Uniformed Controlled Substances Act.

Over 40% of patients are prescribed opioids following a tooth extraction, with an even higher 61% of adolescents being prescribed opioids.<sup>1</sup>

Dental providers found to be only behind primary care physicians as the leading prescriber of immediate release (IR) opioids, particularly hydrocodone and oxycodone. Dentists alone prescribe 1 to 1.5 billion doses of IR opioids annually.<sup>2</sup>

1) Baker, JA et. al. JAMA 2016, 315:1653-1654

2) Tufts Health Care Institute. The Role of Dentists in Preventing Opioid Abuse. Tufts Health Care Institute Program on Opioid Risk Management. 12th Summit Meeting. Executive Summary. Boston.

**According to the American Dental Association, Dental providers should be wary of potential diversion behaviors:**

- False symptoms
- Doctor shopping
- Multiple fraudulent phone-in's
- DEA# theft
- Patient ID theft

# Opioid Diversion in the Dental Practice

## Dental providers can use the following tools to prevent drug diversion in his/her office:

- Patient Screening/Verification/Intake and Patient Charts
- Controlled Substance Monitoring Databases
- Physical Assessment
  - Check the patient's nose—the most common route of drug abuse is nasal ingestion.
  - Check the patient's eyes for any pupillary construction.
  - Check for any track marks.

## Dental providers should incorporate the following best practices into their care of the patient receiving opioids for the treatment of acute dental pain:

- Providers should conduct and document a medical and dental history and a physical exam. If opioids are prescribed, the initial evaluation should include assessment and review of current and past medication.
- Providers should administer non-steroidal anti-inflammatory drugs (NSAIDs) as first-line analgesic therapy, unless contraindicated.
- If an opioid is administered, the dose and duration of therapy should be for a short period, and for conditions that typically are expected to be associated with severe pain.
- The Centers for Disease Control and Prevention guidelines suggest that most patients will not need to take opioids for longer than 72 hours following most surgical procedures.
- State regulations need to be considered.

# Recent Enforcement Trends Against Private Equity Investors

## Private equity investors have recently been targeted by the Department of Justice (DOJ) as defendants in False Claims Act actions.

- *United States ex rel. Medrano and Lopez v. Diabetic Care Rx, LLC dba Patient Care America et al.*, No. 15-CV-62617 (S.D. Fla.)
  - Among other complaints, the DOJ alleged the PE fund directly funded certain marketing schemes that were, in reality, illegal kickbacks.
- *United States ex rel. Martino-Fleming v. South Bay Mental Health Center*, Civ. Action No. 15-13065 (D. Mass.)
  - Alleging that, because the PE fund was directly involved in the operations of the facility that the PE can be held liable for the submission of false claims.

**Does this signify a shift in the DOJ's enforcement approach, or is this just the result of facts specific to these cases?**

# Private Equity Exit Strategies

**Private equity firms generally purchase “portfolio companies” with the intention of increasing the portfolio companies’ value, realizing a positive return, and then exiting the investment.**

**Exits usually occur between three (3) and seven (7) years following the initial investment.**

Exit Strategies:

- Initial Public Offering (IPOs)
- Sales to a third party (usually exercising drag-along rights)

# Questions? Contact Us!



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