Venture capital and private equity investments

Model checklist

Physicians considering venture capital (VC) or private equity (PE) investment in their practice should understand key issues when negotiating with the potential investor. Transactions with VC or PE firms often have unique terms and practical considerations, including the firms' differing structures and strategic goals. The checklist below details top issues for practice physicians to consider when potentially partnering with a VC or PE investor. In addition to this model checklist, the American Medical Association offers a corresponding "Venture capital and private equity investment: Snapshot" , which broadly outlines several important considerations, and a more in-depth "How to evaluate contractual agreements" featuring model contract language.

VC/PE investment 101

- ☐ **VC or PE investment structure**
  A VC/PE investment will usually involve a practice entity owned by one or more physicians and a management entity directly or indirectly owned by the VC fund/PE firm. The practice should thoroughly evaluate the VC or PE firm seeking to invest from both a financial and "corporate culture" standpoint. Physicians should be aware that the VC or PE entity will have significant influence over practice operations post-transaction. The value of such investment, which can be substantial in terms of capital and infrastructure benefit, should be weighed against any potential loss of physician autonomy, along with any changes to cultural, strategic and/or operational factors as detailed below.

- ☐ **Style of practice, specialty and risk tolerance**
  Physicians should consider how an investment will affect their day-to-day medical practice. Some investors focus on specific clinical specialties, practice settings, payment arrangements or technological tools. These investors may have specialized capabilities allowing practices to access unique resources. Practices may be able to retain more clinical and operational independence with VC or PE partners than with other traditional health care investors (such as hospitals, clinically integrated networks, etc.). However, risks unique to these investors include a potential sale to a third party, potential changes to clinical practices and greater incorporation of non-physician staff, disruptions due to new technology or payment arrangements and, in some cases, compliance risk. Physicians should carefully evaluate investor strategies to understand the ongoing practice impact.

Retaining practice independence

- ☐ **Physician ownership**
  Under a VC/PE investment model, physician ownership in a practice is usually reduced to one (or a small number of) physician(s). The investor may have the right to replace any of these owners at will, or if certain contractually described events occur. Physicians should understand these rights, in addition to any limitations and/or corresponding processes when entering into an agreement with VC/PE-backed investors. Otherwise, physicians may find themselves with a new clinician partner that they do not know or did not choose themselves.

- ☐ **Required debt funding**
  The investor will also often advance funds to the practice to fund practice improvements and cover initial practice expenses (including the management fee), which are treated as debt. Initially, this debt may exceed the practice's collections such that it must carry forward the balance with interest under a "Deficit Funding Loan Agreement." In the event of a future termination or unwinding of the investor arrangement, the practice may remain responsible for the repayment of any such debt. The AMA has a snapshot, model checklist and contractual guide on unwinding existing arrangements.

Compensation modifications

- ☐ **Terms of sale**
  The investor usually requires practice owners to sell their ownership and become employees of the practice. Physicians should evaluate the terms of the purchase, including the purchase price, employment compensation, and the duties of the manager. While initial negotiating documents like Letters of Intent (LOI) often are not binding, investors are often resistant to change LOI terms in later stages of negotiation. Therefore, it is wise to engage an attorney early in the process.

- ☐ **Purchase price and physician compensation**
  Private investment usually offers an attractive up-front purchase price based on a multiple of the practice's earnings. However, investors often require a modified physician compensation plan. For example, physician compensation may move to a "draw" structure with potential bonuses or penalties based on expected productivity. Payment for ancillary or administrative services also may be impacted. After receiving a one-time lump sum payment for the practice, some physicians may earn less over the long term than if current earnings were to remain stable; others, however, may still receive bonuses among other added compensation. Physicians should understand any updated compensation terms and assess the tradeoff between predictable compensation and potential bonus structures.

Infrastructure investment

☐ **Management services**
The purchase agreement often obligates investments in the practice's infrastructure in the form of management and administrative services such as human resources, revenue cycle, analytics, risk management, facility and equipment management, IT, payer contracting and strategic planning. While these investments can present a significant upside for practice operations, wholesale changes (such as to electronic health record [EHR] systems, revenue cycle management and similar practice infrastructure) can be disruptive. Physicians should fully understand and evaluate any such planned changes before finalizing any deal.

☐ **Capital investments**
Capital investments can help practices remodel space, buy new equipment, stand up new service lines, and invest in improved patient experience and clinical workflow. Practices should evaluate any costs that the practice may be required to bear, physician input into any such capital improvements (including strategies to integrate new investments into physician workflow), and whether the physicians will be able to share in the savings or increased revenue resulting from such improvements.

☐ **Standardization techniques and economies of scale**
An investor who has invested in several physician practices will likely seek to standardize and use economies of scale to manage the practices in an efficient and profitable manner. Physicians should have a clear understanding of the scope of potential changes related to becoming a part of a larger network of practices, and whether they are comfortable with the impact of such changes on their practice.

Administrative and management services

☐ **Degree of control and oversight**
Physicians should fully understand how much control and oversight an investor may have on their practice, and the administrative responsibilities of each party. A practice should clearly identify the responsibilities and decisions that it is willing to share, and those that it wishes to retain, when negotiating contracts with outside investors.

☐ **Change in administrative practices**
Investors often assemble a clinical and business team responsible for establishing standardized administrative and management processes across all of the investor's practices. Physicians should be prepared for a thorough evaluation of their existing processes and have a clear understanding of the impact that an investor is likely to have on its administrative and management functions.

- ☐ **Dispute resolution procedures**
  Physicians should understand the consequences of disagreements with the investor, including whether there are any limitations on the investor's ability to terminate their employment and whether the investor can require a physician to sell their shares of the practice. Physicians should negotiate dispute resolution procedures so that the parties have an agreed upon mechanism to resolve disagreements before resorting to terminating an agreement or unwinding a relationship.

- ☐ **Managing legal changes**
  VC/PE investment is a focus of regulatory activity. Practices should understand how state and federal regulations may affect an investment (by impacting the timeline or introducing potential opportunities for the deal to "die"). Agreements should also specify how the parties intend to manage changes in any applicable law(s) and may specify communication protocols.

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