More Acquisitions and Consolidations among Medical Groups

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This week's announcement that long-time Nossaman client HealthCare Partners is being acquired by dialysis clinic operator DaVita Inc. reflects three continuing trends in the health care industry: (1) large physician groups being acquired by larger public companies that have complementary businesses in the health care industry; (2) the owners of the physician groups receiving substantial cash payments rather than ownership interests in the combined company (although HealthCare Partners owners are receiving some DaVita stock in addition to mostly cash in their deal); and (3) the physician groups retaining to some degree their management teams and independence after the acquisition.

Of course, these deals are in the news because of their size and the fact that the buyers are public companies. In addition to the pending DaVita/HealthCare Partners transaction, OptumHealth, a unit of UnitedHealth Group, acquired long-time Nossaman client Monarch HealthCare, A Medical Group, Inc. last year, and WellPoint, Inc. acquired CareMore Health Group. (CareMore was not physician-owned at the time of the WellPoint deal.) However, we continue to see consolidation among smaller (but still significantly sized) medical groups, IPAs and even larger health care systems as well. We see these developments on multiple levels: from medical groups combining together to broaden or deepen coverage, to increase purchasing power and to achieve economies of scale – to sizeable IPAs and health systems partnering with other large healthcare organizations (such as the Monarch-Optum transaction described here) seeking access to greater capital resources, technology or a larger platform.

The medical group M&A activity is being fueled in large measure by federal health care reform – the Patient Protection and Affordable Care Act – including the financial incentives offered to Accountable Care Organizations (ACOs). Medicare reimbursement is again undergoing fundamental change, with fee-for-service payments being reduced and financial incentives for more cost-effective care taking their place. But health care efficiencies are best achieved across larger patient populations with a wider range of patient conditions. Because California physicians have been operating under the capitated model for so many

years, our practitioners are very experienced in providing cost-effective care. The larger medical groups – like Monarch and HealthCare Partners – are better positioned to demonstrate cost savings because of the number of patients for whom they are financially (as well as medically) responsible, which helps to drive those efficiencies and control the per-patient cost of care. This same phenomenon is encouraging smaller groups to combine their patient bases to achieve similar results and be better positioned for ACO's and other health care reform measures designed to reward cost-effective care and penalize excess treatment.

It is no secret that physicians are key to controlling health costs. Pharmaceuticals, hospitalizations, procedures and nursing homes drive the costs – and they must be controlled for any semblance of the current health care system to survive – but it is physicians who prescribe, who hospitalize, and who order those procedures. As medical groups combine, they learn enhanced cost-control methods from each other and are able to apply them to larger patient populations. To the extent that health plans like WellPoint, health services companies like Optum, and health care service providers like DaVita can facilitate such cost-control initiatives – and learn to apply them in their own businesses – they should be able to improve their bottom lines, and the health care system should benefit at the same time.

In addition to being the key to controlling health care costs, physicians are essential building block for ACOs. Non-physician providers who wish to participate in ACOs obviously must partner with participating physicians in some way. It is not surprising that both Monarch and HealthCare Partners have been "pioneer" participants in the ACO movement. However, it is notable that few hospitals to date have taken the lead to successfully establish ACO arrangements with physicians.

Those non-physician Medicare providers who choose not to participate in ACOs run the risk of being squeezed out by reduced reimbursement with no counter-balancing revenue enhancement. And for those non-physician providers who still view physicians as a hostile competitor bloc for an ever-shrinking pool of health care dollars, the trend toward medical group consolidation must be unsettling. The current medical group acquisition phenomenon reflects a heightened tendency toward non-physician collaboration with physician groups, albeit at a hefty price in some cases.

Nossaman has a broad and deep health care practice representing clients in all segments of the industry across California and beyond. Nossaman lawyers represented Monarch in the Optum deal and are representing HealthCare Partners in the DaVita deal. We understand medical foundations and ACOs and know how to set them up. We are therefore well positioned to advise and represent clients considering transactions of the types discussed above.