

IF YOU HAVE QUESTIONS REGARDING THIS MATTER, PLEASE CONTACT:



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ALL THE SECURITIES LAWS TO KNOW BEFORE CONSIDERING A HEALTHCARE OFFERING

Physician joint ventures are growing in popularity as physicians look to collaborate with hospitals or management companies in order to provide a variety of services. These services include, but are not limited to, ambulatory surgery centers, diagnostic services, equipment leasing ventures, real estate investments, long term acute care hospitals, and general acute care hospitals.

Before entering into a joint venture, an investing physician should consult with counsel to ensure that his or her investment will be in compliance with various regulatory requirements. The two primary healthcare laws governing these types of ventures are the federal Stark Law and the federal Anti-Kickback Statute. Most physicians are aware of the Stark Law and the Anti-Kickback Statute even if they are not familiar with all of their intricacies. Many physicians, however, are unaware that an offering of securities in these types of ventures must also be in compliance with the federal securities laws.

Except with respect to the largest whole hospital ventures, most physician joint ventures will seek an exemption from having to register the offered securities with the Securities and Exchange Commission (the "SEC"). Registering securities with the SEC is a costly and lengthy process. The "Reg D" small entity exception created by the SEC in 1982 establishes several standards in order to qualify for an exemption from registration.

In general, the following conditions must be met in order to qualify for this "private placement" offering exemption:

First, the venture can have no more than 35 purchasers of the venture's equity interests. A number of rules must be considered once the offering has been structured in order to calculate the number of purchasers. Further, offerings made within six months of each other will be treated as a single offering, and the 35-purchaser limit will apply to the entire integrated offering.

For purposes of this limitation, however, investors who qualify as "accredited investors" do not count toward the 35-purchaser limit. An individual is an accredited investor if: (a) such individual, along with his or her spouse, has a net worth of more than \$1 million; (b) such individual had an income of more than \$200,000 (or more than \$300,000 with his or her spouse) in each of the last two years and reasonably expects to have an income at such levels in the current year; or (c) such individual is an officer or director of the issuer.

An entity may be an accredited investor if all of the equity owners are accredited investors or if the entity has assets in excess of \$5,000,000 and was not formed for the sole purpose of acquiring the investment interest.

Potential physician investors, due to their typical income level, generally qualify as accredited investors. An exception to this general rule is a young doctor who has not had the necessary income for the past two years and does not yet have a sufficient net worth.

It is preferable that all the investors qualify as accredited investors. If possible, the venture's offering documents should explicitly state that all investors must be accredited. If, however, the joint venture believes that it is beneficial to the entity to have certain non-accredited investors, such investors must be able to

demonstrate that they, either alone or with a qualified “purchaser representative,” have sufficient knowledge and business experience to be able to analyze the merits and risks of investing in the venture. Indeed, the law assumes that an accredited investor has the business knowledge and experience to understand the potential risk of the investment on his or her own, whereas a non-accredited investor is presumed not to understand the risks of investment in the entity.

While the joint venture may have the non-accredited investor and the investor’s representative sign a document memorializing the investor’s awareness of the investment risks, such a document cannot give the issuer the same assurance as having an accredited investor. In order to make the determination of accreditation, the subscription agreement to be signed by investors should elicit information about the investors and/or their representatives relating to their ability to analyze the merits and risk of the proposed investment. Among other things, the subscription agreement will contain a certification that the investor is an accredited investor, or if not, that he or she is otherwise qualified to invest.

Second, the offering cannot involve any type of “general solicitation.” This means that no form of advertisements regarding the offering can be used. The SEC has taken the position that in order to avoid a general solicitation, offers may only be made to persons with whom the issuer has a “pre-existing relationship.” In general, such a relationship should exist for physicians on the hospital medical staff or who have some other prior affiliation with the hospital, management company, or original physician investors.

Third, the venture must provide appropriate disclosure materials to purchasers. This is primarily done through the distribution of a private placement memorandum (“PPM”). Any information, including oral information, used in connection with the offering of the venture’s equity interests must be consistent with the PPM and should be reviewed by counsel prior to use. The PPM will include a detailed discussion of the terms of the offering, the legal structure and governance of the operating entity, disclosure of the potential risks (business risks, tax risks, competition, change in laws, etc.) associated with investing in the venture, and an overview of the venture’s financial projections. The PPM is, in essence, an insurance policy in the event that the financial projections included with the offering do not come to fruition.

In order to use the PPM as a defense if such claims arise, all information material to making a determination of whether or not to invest in the venture must be included in the offering documents. Therefore, if there are any material changes between the time the entity has issued the offering documents and the close of the offering, the entity must issue an amendment to everyone who received the offering in order to alert them to the change. If, at this point, potential investors have already executed subscription documents and paid the funds for their investment, they must be offered the opportunity to rescind their subscriptions and receive a refund of their investment.

For smaller offerings (both in aggregate dollar amount of the offering and in number of potential investors issued the offering documents), the venture may opt not to issue a PPM in favor of issuing a smaller offering memorandum containing brief discussions of the offering, the legal structure and governance of the venture, and the risks involved in the investment. This method is generally acceptable for offerings that are trying to raise less than one million dollars and that are offered to less than ten potential investors. If the offering is any larger,

the potential liability from failure to fully include all material terms in a scaled down offering memorandum outweighs the potential savings from not issuing a complete PPM.

Financial projections and other types of “forward looking statements” used in connection with the offering are a source of potential liability if they turn out to be materially different from actual results. Therefore, these types of disclosures must be carefully drafted and based on reasonable and fully disclosed assumptions. The accountants in this situation must maintain a delicate balance between clients who may be pushing them to be aggressive in order to have a better rate of return than other existing proposals and the desire to include every contingency, holding to the belief that it is always better to underpromise and overperform than the other way around.

In addition to receiving the PPM, each investor must be given a reasonable amount of time to ask questions and receive answers about the venture prior to the closing of the offering. Dinners are often hosted for potential investors of a large offering, at which the initial investors answer questions regarding the venture, the lawyers explain how the venture complies with the Stark Law and the Anti-Kickback Statute, the accountant or management company answers questions regarding the financial projections, and the developer shows diagrams of what the hospital or center will look like.

Finally, a notice on “Form D” must be filed with the SEC within 15 days of the first sale and with the applicable state at some point prior to the first sale. This is a standard “fill-in-the-blanks” type of form- but it still must be completed and filed.

By taking each of these steps, a venture can obtain exemption from the SEC registration requirements and can provide information about how it complies with the other applicable healthcare regulatory requirements.