

Healthcare M&A 2019

Contributing editors
Warren Taylor, Philippa Chatterton and Charlotte Beston
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Lexology Getting The Deal Through is delighted to publish the first edition of *Healthcare M&A*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

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TRANSACTIONAL ISSUES

Structures

1 | What is the typical structure of a healthcare-related business combination in your jurisdiction?

There is no typical deal structure of healthcare-related business combinations. The determination of the deal structure is highly variable and ultimately depends on the structure of the target and its role in the German healthcare system.

The German healthcare system is predominantly financed by statutory health insurances, which insure more than 85 per cent of all citizens. The statutory healthcare system is strictly regulated and fundamentally divided into two sectors: (i) inpatient care (ie, stationary treatment of patients in hospitals, preventive and rehabilitation facilities, nursing homes) and (ii) outpatient care (ie, primarily provided in single or joint medical practices of admitted physicians). Medical services provided to statutorily health-insured citizens may only be invoiced if the services are provided by admitted medical service providers.

In the field of inpatient care, most hospitals and nursing homes are incorporated as companies with limited liability, unlisted stock companies or limited partnerships with a limited liability company as sole general partner (GmbH & Co KG). In the event that such hospital or nursing home becomes the target of a healthcare-related business combination, a share deal is very common for the same reasons a share deal is the preferred deal structure in other M&A business combinations. Namely, to facilitate a straightforward deal and to acquire the whole business of the hospital or nursing home solely by the acquisition of the shares in the respective target. Healthcare-related business combinations in the field of inpatient care are essentially private M&A business combinations (except for the healthcare and transaction-specific pre-closing conditions and explicit guarantees to be granted).

Contrastingly, in the outpatient care sector, the structure of healthcare-related business combinations (MVZ transactions) are different to a standard M&A business combination due to the regulatory peculiarities of the German healthcare system.

Pursuant to section 95 of the 5th Book of the Social Code, the provision of medical services in the SHI-accredited medical care is restricted and principally provided by admitted physicians (in single or joint medical practices) or otherwise, by admitted medical service centres (MVZ). MVZs are medical facilities consisting of at least two physicians and are operated by a legal entity most commonly in the legal form of a GmbH (MVZ GmbH). Thus, the medical services are provided by (self-)employed physicians. To qualify as an admitted service provider, a (private) investor in the sector of outpatient medical care has to establish an MVZ. According to section 95, paragraph 1a of the 5th Book of the Social Code and as further outlined below (see question 14), the establishment of an MVZ and the possibility to hold shares in an MVZ

GmbH is legally restricted. The requirements contained herein must be strictly observed prior to any investment in the outpatient care sector.

Medical practices (general or specialist medical practices or laboratories) are either operated by a single admitted physician, or in the case of a collaboration of several admitted physicians, incorporated in the legal form of a civil law partnership. To avoid the risk of inheriting all liabilities from the past, the acquisitions of medical practices are usually structured as asset deals. The MVZ GmbH as the buyer acquires the entire business of the practice (including all medical equipment, employment contracts and patient files) by way of singular succession. This necessitates the description of each individual asset transferred at completion of the transaction culminating in a more comprehensive documentation. In exceptional cases, a share deal may be considered, particularly in the case of a (partly) rollover transaction. This is the case if one or more of the admitted physicians envisages rolling over their participation in exchange for shares in the buyer primarily driven by tax-related matters.

In the case of an acquisition of an existing MVZ, a share deal (ie, the acquisition of all shares in the MVZ GmbH), is the preferred deal structure. Given that a new MVZ does not need to be established, the deal structure is far less complex.

To briefly summarise, the majority of the MVZ transactions are structured as follows:

The investor (directly or indirectly) establishes an MVZ GmbH as investment vehicle under which an MVZ is established.

Under the asset purchase agreement all assets that are necessary for ongoing operation of the medical practice (target practice) are sold and transferred to the MVZ GmbH as the buyer.

The completion of the transaction is subject to the issuance of the regulatory admissions required to operate the target practice and further conditions to closing of the case as may be.

Timeline

2 | How long do healthcare business combinations usually take, and what factors tend to be most significant in determining the timing to completion?

The length of time required to perform the due diligence investigation and to negotiate the transaction-related documentation naturally depends on the quality of documentation provided and the collaboration of all involved parties (seller, buyer and legal advisers). These factors are not unique to healthcare-related business combinations but are in fact, a common topic in every M&A transaction. However, the main factor determining the time til completion (ie, closing) in a healthcare-related business combination, is principally the mandatory involvement of the German healthcare authorities specific to an MVZ transaction.

As described above, the buyer has to qualify as an admitted medical service provider according to section 95 of the 5th Book of the Social Code. The competent authority able to issue such admission is

the admission committee of the competent Association of Statutory Health Insurance Physicians in the region where the medical services shall be provided. Simultaneously, the employment of the physicians in the new MVZ GmbH has to be approved by the admission committee. To be employed with the new MVZ GmbH the physicians have to renounce their admission as self-employed medical service providers. The timeline from filing an application to the actual admission as medical service provider granted by the admission committee, as well as the individual employment admission of the physicians, may take between four and eight months, depending on the timeline and requirements requested by the competent admission committee.

Sellers are generally only prepared to make applications and declarations before the admissions committee, particularly regarding their own admission as a physician, once negotiations of the transactions are advanced or, only once the purchase agreement has been signed. As a general observation and taking into account the admission timelines, a healthcare-related business combination typically takes between six and 12 months from the beginning of the due diligence process to the final completion of the transaction.

In the event an MVZ is to be acquired by way of transferring all shares in the existing MVZ GmbH, it is only the qualification of the buyer to hold shares in an MVZ GmbH that has to be approved by the competent admission committee. This substantially simplifies the admission process.

Representations and warranties

- 3 | What are the typical representations and warranties made by a seller in healthcare business combinations? What areas would be covered in more detail compared with a more general business combination?

Apart from the representations and warranties observed in standard M&A transactions, healthcare-related business combinations generally refer to the existence of all necessary requirements for the approval as an admitted medical service provider. This includes the existence of all necessary admissions and approvals by the relevant German healthcare authorities together with the existence of medical care mandates, if required for the practice.

With respect to MVZ transactions, typical representations and warranties comprise the admissions of the target practice and the physicians as medical service providers, according to section 95 of the 5th Book of the Social Code. Furthermore, that all necessary billing permissions have been issued and that the physicians hold all necessary educational certificates such as approbation certificates, medical specialist certificates and certificates of further education.

Additionally, it is typically warranted in the light of the very strict German criminal sentences in case of misconducts, that all medical services provided in the SHI-accredited medical care have been properly billed taking into account statutory health insurances.

Generally, the purchase agreement provides for far-reaching compliance warranties. Typically this would include the physicians guarantee, that they have complied with all the relevant regulations, in particular regulations regarding the prevention of corruption in the healthcare sector as well as all further professional regulations. By way of the 2016 implementation of sections 299a and 299b German Criminal Code, the German legislator made bribery in the healthcare sector punishable by law. Following this implementation, bribery in the healthcare sector has come into stark focus of German prosecution authorities. Thus, an applicable warranty is highly recommended for German healthcare business combination.

Due diligence

- 4 | Describe the legal due diligence required in healthcare business combinations. What specialists are typically involved? What searches would typically be carried out?

Typically legal due diligence is carried out in the fields of regulatory (in particular medical and doctoral professional law, admission law, billing permissions, medical care mandates, commercial (in particular cooperation agreements with hospitals, laboratories and other healthcare institutions), employment and pensions, real estate, IT and data security (in particular implementation of GDPR), compliance and legal disputes (in particular disputes regarding medical malpractice).

In almost every healthcare-related business combination, an in-depth search regarding the actual regulatory status of the target practice and the regulatory status after completion is carried out and has to be implemented in the transaction documentation. The ability to continue to participate in the SHI-accredited medical care to the existing extent and without any restrictions after completion is a key driver for the transaction and has to be of paramount concern when conducting the due diligence investigation and as a consequence should be reflected in the respective transaction documentation.

Further, the existing cooperation agreements with hospitals, laboratories and other healthcare institutions are usually examined carefully for potential compliance issues, particularly to the extent such cooperation agreements are essential for operating the target practice.

Risk exposure

- 5 | If due diligence is not correctly undertaken, what specific healthcare risks might buyers inherit?

The risk of not obtaining the necessary admissions and approvals from the competent healthcare authority is a major concern for a buyer in a healthcare-related business combination, as this is ultimately what is required to continue to operate the target practice in the same manner as it has been done to date. Since it can take four to eight months before the final decision of the competent admission committee is made, the buyer effectively receives certainty about whether or not the transaction can be completed very late in the transaction process. Therefore, it is essential the buyer conducts the entire transaction process in a manner, that arms him with a highly predictable decision. In order to do this, an extremely careful due diligence examination regarding the actual regulatory status of the target practice and its status after completion of the transaction is required.

A further healthcare specific risk is that the buyer is liable to the statutory health insurances for any incorrect billing of medical services provided by the target practice. As a very likely consequence, all payments received from the statutory health insurances relating to any incorrect billing have to be repaid (not only the profit) without any deductions. In the case of a share deal, the buyer will be legally liable for that risk. This risk is usually countered by a respective indemnification in the purchase agreement.

Specific diligence issues

- 6 | How do buyers typically approach specific material diligence issues in healthcare business combinations?

See question 4.

Conditions before completion

- 7 | What types of pre-closing conditions are most common in healthcare business combinations?

Apart from the standard M&A pre-closing conditions such as merger clearance (if required), in MVZ transactions, all required approvals to participate as a medical service provider in the SHI-accredited medical care shall be secured for the buyer by way of respective pre-closing conditions. Thus, the following pre-closing conditions are typically observed in healthcare-related business combinations:

The competent admission committee of the Association of Statutory Health Insurance Physicians has (i) granted the buyer the final admission as licensed service provider according to section 95 of the 5th Book of the Social Code and (ii) granted the buyer the final approval of the employment of all necessary physicians to be hired by the buyer.

Additional pre-closing conditions are, if applicable to the target practice, the final approval of the Association of Statutory Health Insurance Physicians to the buyer to operate the same branch practices as the target practice and the final approval to transfer or, newly issue, the statutory medical care mandate to the buyer.

If, and to the extent, the long-term use of the premises has to be ensured (which is quite often the case in practices requiring specially built locations or in the case of nursing homes), the conclusion of (new) or the amendment of the existing lease agreements should be provided as a pre-closing condition. The same applies with respect to cooperation agreements that are essential for the operation of the target practice.

Pre-closing covenants

- 8 | What sector-specific covenants are usually included to cover the period between agreement and completion in healthcare business combinations?

In light of the extensive timeline between signing of the purchase agreement and completion (see question 2), it is common and thus observed as a standard M&A covenant, that the sellers have to operate the practice in accordance with the past. More particularly, this includes the maintenance of the medical equipment in working order and correspondingly, to carry out any necessary repairs or mandatory maintenance work according to the statutory provisions.

W&I insurance

- 9 | What specific provisions are commonly seen in warranty and indemnity insurance policies for healthcare business combinations compared with general business combinations?

There are no specific provisions in warranty and indemnity insurance policies in healthcare-related business combinations.

Specific documentation

- 10 | Is there any sector-specific documentation typically used in healthcare business combinations? Does this differ depending on the structure of the transaction?

Apart from the regulatory applications (see questions 2 and 7), there are no specific documents required, in particular no such specific documentation is required to transfer the legal title of the shares or the healthcare assets.

Post-completion undertakings

- 11 | Which post-completion undertakings are common in healthcare business combinations? Which undertakings are common?

With respect to MVZ transactions, the special jurisdiction of the Federal Social Court has to be observed. According to such, the buyer of a target practice is only able to refill the position of an employed physician (eg, in case of retirement), if the former self-employed physicians who renounced their admissions as medical service providers in favour of being employed with the buyer, work as employed physicians with the buyer for at least three years. Further, a reduction of working hours of the employed physicians may only take place in accordance with said jurisdiction or, with the administrative practice of the Association of Statutory Health Insurance Physicians.

The purchase agreement therefore usually provides for an obligation of the parties to act in accordance with the jurisdiction of the Federal Social Court and the administrative practice of the Association of Statutory Health Insurance Physicians in the case of a replacement of an employed physician or in the case of a reduction of working hours. The observance of this obligation is the most important post-completion undertaking to secure the buyer's freedom to replace retiring physicians with physicians of his or her choice.

REGULATION

Laws and regulations

- 12 | What are some of the primary laws and regulations governing or implicated in healthcare-related business combinations? Are healthcare assets subject to specific regulation that would be material in a typical transaction? Is law and regulation of healthcare national or subnational?

In healthcare-related business combinations, the respective regulatory frameworks play an important role. The statutory regulations on medical and doctoral professional law, admission law, billing permissions and medical care mandates have to be strictly observed. By way of example, the regulatory framework of nursing homes is regulated in the 11th Book of the Social Code, and as already outlined above (see question 1), the regulatory framework for MVZ transactions is regulated in the 5th Book of the Social Code). For the comprehensive approval process in connection with MVZ transactions see the following questions in combination with questions 2 and 7.

The applicable regulations and the competent authorities, in particular the Association of Statutory Health Insurance Physicians, are organised regionally, which renders the application process and the decision-making process rather complex. Experience demonstrates that the decision-making bodies do not always share the same opinion on certain legal questions. From a practical perspective, it is therefore recommendable to contact the respective decision-making body early in the process to align on potential regulatory issues.

Consents, notification and filings

- 13 | What regulatory and third-party consents, notifications and filings are typically required for a healthcare business combination?

For the completion of healthcare-related business combinations, the consent of the competent bodies of the Association of Health Insurance Physicians authorities is necessary (see question 2 and 7).

In MVZ transactions the following admission and approvals are habitually required:

The competent admission committee of the Association of Statutory Health Insurance Physicians has to grant the buyer the admission as licensed service provider according to section 95 of the 5th Book of the Social Code.

The employment of the physicians formerly operating the target practice must be approved by the competent admission committee, which requires the physicians to renounce their admission as medical service providers in favour of the MVZ GmbH as their future employer.

If the target practice operates branch practices and those branch practices are to be continued following the completion of the transaction, the Association of Statutory Health Insurance Physicians has to grant the buyer approval to operate those branch practices.

In some medical disciplines (such as nephrology), the extent of the participation of a medical service provider in the medical care (in particular patient numbers) is determined by a medical care mandate. If the target practice operates in such a medical discipline, the medical care mandate also has to be transferred or reissued to the MVZ GmbH. The competent authority to issue the medical care mandate is the Association of Statutory Health Insurance Physicians.

Since most of the MVZ transactions are structured as asset deals, contractual relations of the target practice are not automatically transferred to the buyer with completion of the transaction. The consent of every contractual partner is necessary. Therefore, particularly regarding the cooperation agreements with hospitals or laboratories that are essential for operating the target practice, the consent of contractual partners can be necessary in healthcare-related business combinations.

Ownership restrictions

14 | Are there any restrictions on the types of entities or individuals that can wholly or partly own healthcare businesses in your jurisdiction?

Ownership restrictions must be observed in MVZ transactions. The possibility to establish an MVZ and, correspondingly, the holding of shares in a legal entity that operates an MVZ is restricted by law.

According to section 95, paragraph 1a of the 5th Book of the Social Code, an MVZ can only be established by admitted hospitals or providers of non-medical dialysis services according to section 126, paragraph 3 of the 5th Book of the Social Code. To establish an MVZ under an MVZ GmbH, the shareholder of the MVZ GmbH has to fulfil these requirements. The same applies to holding shares in an GmbH that operates an MVZ. Investors in MVZ transactions, therefore, must establish an appropriate transaction structure by purchasing or establishing the necessary entities that fulfil the legal requirements prior to the transaction.

Directors

15 | Are there any restrictions on who can be director of healthcare businesses in your jurisdiction?

Although there is no specific restriction on who may be a director in the sense of a corporate body, each MVZ must have a medical director who is required to be a physician employed with the MVZ. The medical director is responsible for the medical management and is not subject to directives in medical matters.

Operating outside the home jurisdiction

16 | What domestic regulatory issues might arise for a company based in your jurisdiction operating healthcare businesses in other jurisdictions?

There are no specific regulatory issues arising in such context. Primarily the legal obligations stipulating by the jurisdiction where medical

services are provided must be observed. If patient-related data is transferred to other jurisdictions, in particular outside the EU, the strict rules of the GDPR have to be obeyed.

Cross-border acquirers

17 | What domestic regulatory issues arise when the acquirers of healthcare businesses are based outside the jurisdiction?

There are no specific regulatory issues arising in such context. However, the applicable statutory regulations, in particular the restrictions on establishment of MVZs must be observed (see questions 12 and 14).

Competition and merger control

18 | What specific competition or merger control issues may arise in healthcare business combinations?

In principle, there are no sector-specific competition or merger control rules for healthcare business combinations. From a merger control point of view, in particular for the drafting of the respective application, the definition of the relevant market is key. The case law of the German Federal Cartel Office is rather strict and tends to apply restrictive markets.

State and private healthcare combinations

19 | Are there any differences for healthcare business combinations if the transaction relates solely to businesses servicing private clients rather than state-funded clients?

A significant difference can be observed in this regard. If the transaction relates to a business combination that only services private clients as opposed to publicly insured patients, the regulations contained in the German Social Code and the corresponding regulations concerning admission of physicians and dentists into the public healthcare system ultimately do not apply. Such transactions are considerably less complex and only require observance of the general prerequisites for operating private hospitals.

FINANCING AND VALUATION

Financing

20 | How do buyers typically finance healthcare-related business combinations?

The financing structure of healthcare-related business combinations depends considerably on investors and does not differ from the financing structures generally observed in private M&A business combinations undertaken by strategic or PE investors.

Security

21 | Describe the typical security structures in healthcare business combinations, including confirmation of any registration or notary fees in respect of the security documents.

The security structure of healthcare-related business combinations generally depends on the financing structure of the acquisition and does not differ from the standard security structures observed in private M&A business combinations. However, when considering financing and the related security documentation, it must be noted that an MVZ that is operated by a GmbH is obliged to provide a bank guarantee in favour of the Association of Statutory Health Insurance Physicians to secure any possible fee recourses by the statutory health insurances.

Financial assistance

22 | Are there any financial assistance rules that arise in healthcare business combinations?

There are no special financial assistance rules.

Price and consideration

23 | What pricing and consideration structures are typical in healthcare business combinations?

In the case of a share deal, the pricing and consideration structures depends on the parties involved. On the one hand, where PE investors are involved, a fixed purchase price in combination with a locked-box concept is the preferred pricing structure. On the other hand, strategic investors tend to prefer a purchase price adjustment at completion of the transaction (closing accounts).

Since most of the MVZ transactions are structured as asset deals, the most common pricing structure is a fixed purchase price. All price-relevant due diligence findings and other identified financial risks are typically accounted for in the amount of the fixed purchase price.

In some cases, the parties agree on an additional earn-out generally in combination with the integration of an adjusted EBITDA as the calculation basis or other similar parameters in a time period of up to three years post-closing.

Enterprise value

24 | How are healthcare-related businesses typically valued?

The enterprise value of healthcare-related businesses is typically valued on EBIT multiples.

TAX

Typical issues in combinations

25 | What are some of the typical tax issues in healthcare business combinations and to what extent do these typically drive structuring considerations? Are there certain considerations that stem from the tax status of a target?

In the case of a share deal, no special tax issues arise in healthcare-related business combinations. Possible tax liabilities are covered by comprehensive warranties and tax indemnifications as is the case in standard M&A transactions.

In asset deals, particularly in MVZ transactions in which the buyer acquires the entire business of the practice, any possible tax liability is limited pursuant to section 75 of the German Tax Code to taxes incurred in the year prior to completion of the transaction.

Tax risks for healthcare businesses

26 | What are the typical tax risks that are associated with healthcare businesses? What measures are normally taken to mitigate those typical tax risks in healthcare business combinations?

There are no typical tax risks that differ from such risks generally observed in standard M&A transactions.

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PUBLIC RELATIONS AND GOVERNMENT POLICY

Public relations

27 | How do the parties address the wider public relations issues in healthcare business combinations?

In contrast to inpatient care, such as in hospitals and nursing homes, the controversial topic of whether the participation of investors should be restricted by the legislature, repeatedly arises in the field of outpatient care. The legal regulation, which came into force on 1 January 2012 has already led to restrictions on the establishment of MVZs. As a consequence, only approved hospitals and providers of non-medical dialysis services are authorised for establishment. In 2018/2019, this discussion has resurfaced due to an initiative led by the Federal Association of Statutory Health Insurance Dental Physicians' in the legislative procedure concerning the latest legal regulation (TSVG). Throughout this procedure, the existing structures of outpatient care have been critically questioned and analysed. This discussion has highlighted that in the capital-intensive fields of outpatient care (eg, human laboratory, radiology and dialysis), the use of outside capital within the existing structures has contributed to the supply of high-quality and modern healthcare. Additionally, it can be concluded that MVZ structures lay the foundation for accommodating the requirements of the modern labour market, for example, part-time employment. Moreover, practising physicians are increasingly confronted with greater administrative and regulatory challenges, such as compliance with hygiene regulations, data protection, billing, the introduction of electronic patient records and the ePrescription. With the implementation of larger centralised entities that are able to process these administrative matters with greater efficiency, positive results have been and will undoubtedly continue to be observed. This not only concerns the practising physicians themselves who are significantly relieved of this administrative burden in their everyday practice but, more importantly, the cumulative effect ultimately enables and prioritises a specialised focus on providing an increased standard of care for each individual patient.

For the implications of the entry into force of the TSVG on 11 May 2019, see question 29.

Policy

28 | How do parties address the wider political issues in healthcare business combinations?

See question 27.

UPDATE AND TRENDS**Current trends and developments**

29 | What are the current trends, and what developments are expected in healthcare business combinations in your jurisdiction in the coming year?

The new regulations of the TSVG, which came into force on 11 May 2019, further restrict the ability to establish MVZs and, therefore, also the possibility of private investors to invest in the outpatient care sector, particularly in the dental sector. Investment structures established prior to 11 May 2019 are subject to grandfathering.

One of the material changes of the TSVG to the current investment practice is that providers of non-medical dialysis services according to section 126, paragraph 3 of the 5th Book of the Social Code will only be able to establish specialised medical service centres. In those specialised medical service centres, solely medical services in connection with the treatment of patients with kidney insufficiency may be provided. According to the explanatory memorandum to the TSVG, this also includes primary care, internal medicine, urology, cardiology and radiology services, but it remains to be seen how the Associations of Statutory Health Insurance will interpret this wording in detail. As a result, the establishment of independent MVZs not associated with the treatment of patients with kidney insufficiency will no longer be possible.

Further, the establishment ability of hospitals for dental medical service centres is restricted to dependency on the supply ratio in the planning area of the hospital.

Apart from the restrictions in the field of treatment of patients with kidney insufficiency and dental medical care, nothing has changed regarding the establishment ability of medical service centres by admitted hospitals. It is very likely that investors will prefer the use of admitted hospitals as investment vehicles in the future.

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