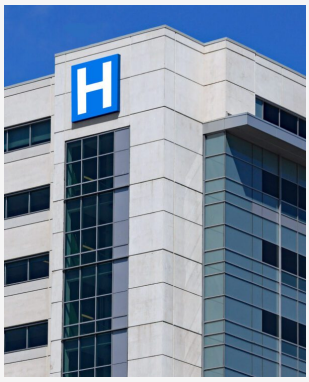
OSLER

The latest in Canadian health clinic acquisitions

DECEMBER 13, 2021 7 MIN READ



Related Expertise

- Health
- Mergers and Acquisitions

Authors: Joyce M. Bernasek, Susan Newell, Michael Watts, Tearney Johnston-Jones

The ongoing surge in merger and acquisition transactions since 2020 has been widely commented on throughout the past year. As the initial hesitancy towards engaging in M&A activities early in the pandemic wore off, private equity firms became increasingly active, motivated by a need to deploy unused capital that had built up during earlier lulls before the expiration of applicable investment periods. In addition, M&A activity in Canada has been driven by historically low interest rates and increasing confidence in the economy's recovery as the pandemic starts to ease. With access to idle pools of funds, low interest rates and a dramatic rise in activity levels, foreign investors have entered the Canadian marketplace with fervor, particularly in the health sector.

Canada's health industry landscape: No longer perceived as the land of "free healthcare"

The Canadian health industry has been increasingly attractive to investors, particularly health clinics specializing in veterinary medicine, dentistry and orthodontic services, as well as virtual care. This growing attraction flies in the face of the mistaken view that the Canadian healthcare system is an entirely public healthcare system – a view held by many despite the fact that most health clinics in Canada are privately owned and operated.

Clinic ownership in Canada remains fragmented and has not yet encountered the mature clinic roll-up consolidation observed in the U.S. and other jurisdictions. In addition, the Canadian health industry has historically been viewed by many foreign stakeholders as a difficult sector to enter for a variety of reasons: (a) the sector is predominantly provincially regulated, meaning the provision of health services is geographically siloed; (b) certain health professions are often funded through complex government health insurance regimes; and (c) in certain health professions, provincially regulated health professionals must be the sole (or majority) shareholders, directors, officers of and/or fulfill specific management roles in any corporate entity carrying on the practice of a regulated health profession (a Health Corp.).

Roll-up transactions and private equity investment

The U.S. market has long observed both private equity investment in health clinics and "roll-up" transactions in which a private equity investor acquires a number of clinics. Increasingly, public companies are participating in clinic acquisition strategies, with generalist companies looking at multiple service providers and specialized companies focusing on more targeted investment opportunities.

In addition to increased capital market activity, similar private equity investments in the health sector are now regularly occurring in Canada, with Canadian and foreign private equity investors taking advantage of investment opportunities. In the veterinary medicine and dental industries in particular – two sectors which are not funded by government health insurance plans (with limited exceptions) – clinic aggregation activity continues to increase.

Financing considerations

There are several interesting financial considerations for leveraged health clinic acquisitions. As noted above, depending on the health profession, there may be a requirement for the Health Corp. ownership structure to have only a licensed health professional or professionals as its shareholder(s), director(s), officer(s) and/or supervisor(s). This requirement raises potential issues of enforcement for lenders. Consideration must be given in an enforcement scenario to the ability to appoint a replacement health professional, if necessary, to take control while continuing to satisfy applicable regulatory requirements. The guarantee and security packages available to lenders will be subject to the ability of lenders to obtain "step in" rights under key servicing agreements with clinic operators, as well as any applicable statutory restrictions preventing the transfer of licences or the granting of security in licences.

Health regulatory considerations

Roll-up transactions in Canada may be structured in a variety of ways to satisfy the applicable regulatory requirements. This can include strategies for addressing prohibitions against the practice of a regulated health profession by a corporation. It is generally permissible for a regular corporation (i.e., a corporation without restrictions as to its shareholder, director or officer compositions) (a Management Corporation) to provide services to a Health Corp., including the performance of all necessary management and back-office services, equipment, technology and personnel (other than regulated personnel) necessary for a turnkey operation.

Generally, there will be some degree of reliance on the regulated health professional to fulfill certain prescribed roles within the Health Corp. (in addition to the professionals providing services within the clinics). However, there are a number of strategies that may be implemented by the investor or service provider to mitigate the risks associated with this reliance. For certain health clinics in some jurisdictions, an entity can satisfy the applicable regulatory requirements by leveraging multiple classes of shares, with a health professional holding certain shares and entering into a shareholders' agreement to allocate the financial and decision-making powers to the Management Corporation.

Another structure often implemented to meet the regulatory standards involves a services agreement between the Management Corporation and the Health Corp. Such an agreement provides the Management Corporation with financial control over the Health Corp. through the payment of a management fee that is either based on revenue or is simply a flat fee. In this structure, the oversight and responsibility for carrying on the professional health

services and the engagement of the health professionals remain solely with the Health Corp. Such a structure can be replicated (and modified as necessary) to satisfy the applicable regulatory requirements in each jurisdiction.

In the context of arrangements between a Management Corporation and a Health Corp., there are also public policy and regulatory issues that arise in connection with the protection and enforcement of goodwill associated with the clinics as a result of the Health Corp. being responsible for providing the health services. These matters are typically addressed in the services agreement or other agreements between the parties through restrictive covenants and termination provisions.

In these cases, the Health Corp.'s shareholders would also have contractual restrictions on their ability to transfer the shares of the Health Corp. The Management Corporation will typically have a contractual right to appoint a different regulated health professional to hold the shares of the Health Corp. and to satisfy other regulatory requirements, if necessary. This option ensures that the Management Corporation has the ability to continue to derive economic value from the business without undue reliance on any one health professional.

Certain health professions also require the operator of the clinic or regulated health business to hold a licence to be able to conduct activities or bill the government's health insurance plan for certain fees. In some circumstances, consent from a regulatory authority is required for the transfer of that licence or to permit any change of control or change in the directors or management of the entity holding the licence. In other circumstances, a licence may be considered personal to the holder and a new licence application will be required if the entity holding the licence is subject to change. Depending on the type of licence and the relationships between the parties, it may be possible to rely upon a transition service agreement to continue operations under an existing licence while a new licence application is pending.

Additional considerations

In addition to key financing and regulatory considerations unique to the health sector, there may be other complexities relating to privacy matters and the ownership of records associated with clinic operations. These may require compliance with various private sector and health-specific privacy legislation standards to operate clinics across numerous jurisdictions.

Depending on the structure of the licensing and management arrangements, franchise disclosure and other considerations may also be applicable to roll-up transactions in the Canadian provinces that regulate franchising, namely Ontario, British Columbia, Alberta, Manitoba, Prince Edward Island and New Brunswick.

Conclusion

With significant foreign investment now funding the Canadian private health sector, it is clear that Canada is no longer perceived as having only a publicly-funded healthcare system. The change in this perception has been amplified by the COVID-19 pandemic. We anticipate that continued investment and acquisition by strategic players and private equity within the health industry will continue in the coming years.

New methods of service delivery, including a shift towards greater reliance on private healthcare participants outside of the government funded system, as well as investment from private equity and the efficiencies that can be realized through the aggregation of

service delivery, will continue to be both necessary and desirable to improve the efficiency of the delivery of health services and the quality of care. There are many unique and sometimes complex issues to consider in the context of these transactions, but these considerations can be successfully addressed in a variety of contexts and are no longer perceived as barriers to investment.