Managing Risk in High-Acuity Behavioral Healthcare: Critical Considerations for Operators and Investors

The behavioral health treatment sector has seen significant growth and *increased* private equity investment in recent years, particularly in sectors serving high-acuity patients in residential and in-person settings. Residential treatment centers, psychiatric hospitals, and substance use treatment facilities have expanded to serve the increasing number of people struggling with serious mental illness. Investors and operators have sought opportunities to build operational and financial efficiency required to scale, while balancing the need to deliver evidence-based treatment modalities to patients with difficult and nuanced mental and physical healthcare needs.

Many have successfully navigated this complexity, others have failed to ensure that business and clinical risks are properly understood and mitigated, resulting in serious patient harm and large negative financial consequences. The comprehensive April 2024 Senate Finance Committee report titled *"Warehouses of Neglect,"* as well as a wave of record-breaking settlements, highlight the critical importance of robust risk management practices in this sector.

In January 2024, a jury *awarded* more than $535 million in damages stemming from a peer-to-peer sexual assault incident at a UHS behavioral health facility in Illinois, marking one of the largest jury verdicts ever in the behavioral healthcare sector. This landmark case underscores both the human and financial consequences of inadequate risk management in behavioral healthcare settings.

Other recent settlements include a $405 million *judgment* in 2023 against Acadia Healthcare in a civil abuse case and a $122 million False Claims Act *settlement* by UHS in 2020. These outcomes highlight the urgent need for behavioral healthcare providers to prioritize robust risk management strategies, compliance measures, and staff training to mitigate both financial exposure and harm to patients.

A SHIFTING REGULATORY LANDSCAPE

State and federal governments have created legislation designed to more directly and forcefully ensure transparency and patient safety, responding to heightened public and regulatory scrutiny of systemic issues. California's recent passage of The Accountability in Children's Treatment Act *(SB 1043)* signals an emerging trend toward stricter oversight and transparency requirements in behavioral healthcare.

SB 1043:

+ Mandates public reporting of seclusion and restraint incidents
+ Requires detailed documentation and notification processes
+ Establishes new oversight mechanisms

This development, alongside the Senate Finance Committee's investigation, suggests a future of increased scrutiny and accountability for behavioral health providers.

For operators and investors alike, it is critical to not only achieve and maintain legal and regulatory compliance, but to invest in risk management as an asset that can protect patients, employees, and investors while also maintaining and strengthening exit valuations.

OPERATIONAL RISK MANAGEMENT

Recent settlements and regulatory actions highlight several critical operational areas demanding immediate attention. Staff screening and supervision practices must evolve beyond basic background checks. Physical security needs now extend far beyond traditional access control. Documentation requirements continue growing more complex, while clinical oversight demands both standardization and flexibility.

Most concerning for operators and investors alike is that operational failures can cascade into catastrophic losses. A single gap in security protocols or documentation practices can lead to incidents with costly liability exposure. The interconnected nature of these risks demands a comprehensive, systematic approach to risk management.

INSURANCE AND RISK TRANSFER EVOLUTION

Strong investments in the operational aspects of risk management reduce inherent risk and support mitigation of premium levels. Well-designed insurance and risk transfer programs ensure that when events occur that lead to lawsuits or insurance claims, investors and operators are protected. Regulatory scrutiny and nuclear lawsuits are larger and more common. Simple and traditional approaches to insurance in behavioral healthcare are becoming insufficient on their own to protect businesses from potentially catastrophic loss. Today's risk landscape demands sophisticated, multi-layered coverage structures that address everything from regulatory investigations to cyber threats. Directors and officers' coverage has taken on new importance as scrutiny of leadership decisions intensifies, while professional liability policies must adapt to unprecedented settlement values. Standard coverage lines like general liability and property insurance require careful structuring to address risks unique to behavioral health settings.

INVESTMENT CONSIDERATIONS

For private equity investors, the risk management landscape has fundamentally changed. Due diligence must now encompass a broader range of factors beyond traditional financial metrics. The post-acquisition period has become critical, as early investment in risk management infrastructure can prevent costly incidents later.

Insurance adequacy reviews take on special importance during transactions. Coverage gaps or inadequate limits identified during due diligence can serve as powerful negotiating tools, while post-closing coverage enhancements can provide critical protection during operational improvements.

THE PATH FORWARD

The behavioral healthcare sector stands at a crossroads. The Senate Finance Committee's report and California's groundbreaking legislation make clear the status quo in risk management is no longer acceptable. Organizations must prepare for a future of increased transparency and accountability, while investors need to factor these changes into their investment theses and operational plans.

Success in this evolving landscape requires a comprehensive approach that protects both patients and organizations. Those that adapt quickly to these new realities will find themselves well-positioned for sustainable growth, while those that lag may face increasing regulatory scrutiny and financial exposure.

The future of behavioral healthcare will be shaped by organizations that can deliver quality care while maintaining robust risk management systems. The importance of getting this balance right will only grow as regulatory requirements expand and scrutiny increase.

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