Compliance Role in Merger and Acquisition
Due Diligence

Health Care Compliance Association
17th Annual Compliance Institute

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National Harbor, Maryland
April 23, 2013

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Increase Focus On Compliance Issues

- Health Care Reform
- Increasing Mergers, Acquisitions and Affiliations
- Increased Focus On Fraud and Abuse
- Move Toward Provider Self Examination
- Focus On Transactional Stage
  - Holding Acquirer Liable When Possible
  - Law Does Not Always Permit Successor Liability
  - Self Disclosures Part of Transactional Due Diligence
Ethics Fellowship Report (www.ethics.org)

- Reviewed Compliance Best Practices
- Identified Due Diligence As Emerging Area
- Suggests Compliance “Seat At The Table”
- Early Look At Due Diligence Role

Will Cover

- Involvement of Compliance in Due Diligence
- Extent and Nature of Compliance Due Diligence
- Factors Influencing Scope of Due Diligence
- Compliance Influence on “The Deal”
- Common Compliance Due Diligence Requests
What Is Due Diligence?

The investigations of a person or business to:
- Gather information
- Assess the transaction
- Decide on transaction
- Adjust Terms
- Adjust Value

Stages of Health Care Transaction
- Exploration
- Letter of Intent
- Initial Due Diligence
- Agreement Stage
- Pre-Closing Due Diligence
- Transaction
Stages of Health Care Transaction

- Explore
- Introductory Review
- Pre-Due Diligence
- Agreements
- Transactional Due Diligence
- Adjustments
- Basic Terms
- Closing

Compliance/Legal Counsel Roles

- Historically Purely Legal Area
- Expansion of Independent Compliance Office
- View from the “Lawyer” Side
- Recent HCCA Survey
- The Tide Has Turned
- Due Diligence – Rubber Hits The Road
Compliance’s Seat At The Table

- New Division Will Be Compliance’s Problem
- Integrate Into Compliance Process
- Move Integration Forward
- Begin At Due Diligence Stage
  - Fix Problems Before You Inherit
  - Adjust Transaction if Necessary
- From Initial Due Diligence Stage

Become Part of the Due Diligence Team

- Insist On Your Seat At The Table
- Involvement at LOI Stage
- Compliance At Initial Due Diligence Stage
- Participation in Due Diligence Request
- Involvement In Structure
- Acquisition Policies to Solidify Role
Fly In The Ointment

- Unpopularity of Compliance
- The Compliance Groan
The Compliance Hero

- Hey, I Saved the Day
- Hey, You Ruined My Day
- Buzz Kill for the Deal Minded

The Iceberg That Sank The Titanic

- Your Compliance Problem Is Already Adrift In The Ocean
Relationship – Compliance and Due Diligence

Compliance Issues
Resolution
Self Disclosure

Introductory
Review

Basic Terms

Pre-Due Diligence

Adjustments

Closing

Document Input

Pre-Due Diligence

Agreements

Transaction Due Diligence

Introductory
Review

Resolution/Due
Diligence

Identify

Explore

Lineal Compliance Progression

Complete Integration Into Compliance Process By Closing

General Issue Identification

Provider Specific Risk Identification

Information Requests

Program Effectiveness Review

Risk Area Review
Transactional Due Diligence Checklists

- What Agreements Are There
- What Has Happened
- Representations and Warranties
- Indemnification

Common Due Diligence Areas

- Corporate Status
- Material Contracts
- Liens on Assets
- Conditions of Assets
- Licensure and Certification
- Taxes
- Labor Issues
Compliance Due Diligence

- Government Investigations
- Billing Reviews and Audits
- Effectiveness of Compliance Program
- Integration With Buyer’s Compliance Program
- Undocumented Referral Exceptions
- Follow the Money

PPACA Made Compliance Programs Mandatory

- Nursing Facilities Beginning March 2013
- Condition of Participation
- Certify Effective Compliance Program
- CMS to Issue Regulations
- Impact On Due Diligence
Compliance Involvement

- Identify Issues Early
- Require Pre-Transaction Cure
- Self Disclosure/Repayment/CIA
- Resolution Can Take Time
- Impact Deal Structure

The “Small Deal” Exception

- “Small Deals” Do Not Require Compliance Due Diligence
- Small Providers = Small Problems
- Transaction Size Does Not Support Due Diligence
- Need To Get Deal Done
- Of Course, There Is No Such Exception
- Small Deals = Disproportionally High Compliance Risk
Small Home Health Example

- Assume Provider Agreement
- Face-to-face non-compliance
- Systematic Billing Problems
- Successor Liability
  - Overpayment
  - False Claims Act Liability

Potential Liability

- Overpayment Amount
- 60-day Repayment Ruled
- Failed to Perform Due Diligence
- False Claims Act Liability
- Does Due Diligence/Transaction Trigger Knowledge Standard?
Successor Liability Issues

- What is Successor Liability?
- Asset Transaction
  - Liability for Obligations Not Specifically Assumed
- Stock Transaction
  - Liability for Obligations Intended to be Excluded

Types of Successor Liability

- Common Law
- Statutory
- Medicare
- Contractual
- Practical/Ongoing
Successor Liability Exposure

- Nursing Home Cases
- Move Toward Successor Liability
- Overpayments
- Extended to Penalties
- FCPA Cases
- Statements Regarding Due Diligence
- Where are Limits of Successor Liability?

Common Law Successor Liability

- DeFacto Merger
- Fraudulent Conveyance
- Mere Continuation of Seller
- Super Claims (Environmental, Product Liability)
- Arm’s Length; Non-Contiguous Control/Ownership
Practical Successor Liability

- Practices Inherited
- Mutual Reliance Transactions

Medicare Successor Liability

- Assignment of Medicare Provider Agreements
- 42 C.F.R. 489.18(c)
- CHOW
- Existing provider agreement automatically assigned to the new owner
Implications of CHOW – 42 C.F.R. 18(d)

- An assigned agreement is subject to all applicable statutes and regulations and to the terms and conditions under which it was originally issued, including:
  - any existing plan of correction;
  - compliance with applicable health and safety standards;
  - compliance with ownership and financial interest disclosure requirements; and
  - compliance with civil rights requirements.

CMS State Operations Manual

- Medicare sanctions and penalties are assigned to the new owner with the following exception...
  - The new owner is not responsible for money owed to the Federal Government due to a determination that the previous owner is personally guilty of fraud
  - (however, if a determination of fraud is made against the corporation and if the corporation is purchased and not incorporated as a new and separate corporation by the new owner, the new owner is subject to all the Medicare penalties, sanctions, and liabilities).
Successor Liability Cases

  - Successor liability for overpayments
  - Where provider agreement is assigned
  - Liability for past owner overpayments
- Dearbrook Pavilion, LLC v. Shalala, 235 F.3d 1100 (8th Cir. 2000)
  - Extended Vernon to civil monetary penalties
  - Specific regulation relating to skilled nursing facilities
    “A facility’s prior compliance history should be considered, regardless of a change in ownership. A facility is purchased “as is.” The new owner acquires the compliance history, good or bad, as well as the assets.”

Extension to False Claims Act

- Successor liable for FCA liability?
- Arguments on the other side
- FCA requires “knowledge”
- Can “knowledge” be transferred?
- Imputed knowledge if fail to do “due diligence”
60 Day Repayment Rule

- We believe defining “identification” in this way gives providers and suppliers an incentive to exercise reasonable diligence to determine whether an overpayment exists. Without such a definition, some providers and suppliers might avoid performing activities to determine whether an overpayment exists, such as self-audits, compliance checks, and other additional research.

James G. Sheehan – Assistant U.S. Attorney

- Problems in acquired entities/due diligence
- Personal “top 10” fraud abuse priority areas
- Expressed little tolerance for inadequate “due diligence”
Physician Practice Acquisition

- Not Assuming Provider Number
- Assuming Past Practices
- Practical Risks
- Ongoing Practices
- Physician Mergers?
  - Continuation of Practice
  - Divisional Governance

Front Door Due Diligence

- Contractual Provisions
- Part of Inspections
- Let Compliance Come First
- Bring Into Compliance Program
- Hockey Goalie
Scope of Due Diligence

- Complete Audit
- Process Review
- Rely on Representations and Warranties
- Somewhat Subjective Judgment
- Deal Structure Is A Factor
- Successor Liability Is A Factor

Scope of Compliance Due Diligence

- Rely On Contract Terms
- Process Only Review
- Risk Area Review
- Complete Audit
- Complete Audit
Factors Determining Scope

- Structure of the Deal
- Nature of Provider (High Risk Segment?)
- Provider Number Assumed?
- Size of Transaction?
- Size of Current Compliance Program? (Scalability)
- Terms of Agreements
- Subjective Judgment
- On Step Leads to the Next

Common Healthcare Transaction Structures

- Asset Acquisition
- Stock Acquisition
- Merger
- Member Substitution
Benefit of Asset Transaction

- Only Assume Agreed Liabilities
- Only Purchase Designated Assets
- Interruption in Revenues

Deal Structure Compliance Issues

- Structure of the Deal
- Fair Market Value
- Compensation Terms
- Real Estate Sale Example
- Points Out Need for Compliance Involvement
Due Diligence of Target

- Latent Billing Issues
- Compliance Program Operation
- Undocumented Referral Arrangements
- Specific to type of Provider
- Refer to OIG Guidance
- Usual Risk Identification Process

Key Contract Terms

- Representations and Warranties
  - Specific to compliance
- Indemnification
- Right to Audit
- Right to Receive Compliance Documents
- Compliance Conditions to Closing
Sample Contract Provisions

- Representations and Warranties
- Indemnification
- Conditions to Closing
- Compliance Due Diligence

Compliance Representations and Warranties

- In material compliance with all laws of all governmental entities, including but not limited to...
- Has timely filed all material reports, data and other information required to...
- Has not received notice of violation of any law...
- Not excluded from any Medicare or state Medicaid program
- Not convicted or pled guilty or nolo contendere...
- Not aware of any pending investigation or enforcement action
What Is Missing?

- External Audits
- Internal Audits
- Operation of Compliance Program
- No Reason to Know of any Billing Problems
- No Undocumented Referral Arrangements
- Specific Compliance Issues

Impact of Compliance Due Diligence

- Identify Specific Reps and Warranties
- Create Specific Carve Outs From Caps and Baskets
- Exception From Time Limits
Tie Into Indemnification Provisions

- Seller Indemnifies for Violation of Representations and Warranties
- Key Issue
  - What is the Value of the Indemnification?
  - No Replacement for Knowing the Answer Up Front
  - Caveat – Specific indemnity proves knowledge

Indemnification

- Seller...hereby indemnifies and holds harmless against any losses suffered by purchaser arising out of or resulting from:
  - The breach or failure of any representation or warranty...
  - Any ability, obligation, claim... due to or arising by reason of any transaction or event occurring prior to Closing...
Due Diligence Disclosures

- ... full and free access to and the right to inspect
- properties, assets, premises, books and records, contracts and other documents and data related to Seller’s business and the Assets;
- ...financial, operating and other data and information related to Seller’s business as Buyer may request;
- What is missing?

Compliance Due Diligence Provisions

- Right to Audit and Monitor?
- Patient Records to Audit Claims?
- Coding and Billing?
Compliance Closing Condition

- Transaction normally includes conditions to purchase obligation
- Compliance with laws, regulations, etc.
- Specific Provision Requiring Solution to all Compliance Problems?

Compliance Focused Contract Language

- From Compliance Standpoint
- General Language in Contract May Not Cover All Compliance Issues
- Areas To Consider
  - Access to specific information
  - Ability to audit, monitor, etc.
  - Representations and warranties
  - Specific indemnifications
  - Exclusion from limits on indemnity
  - Closing conditions
Compliance Due Diligence Request

- Vintage Attorney Request
- Transactional Attorney Focus
- What Liens On Property?
- What Contracts Are In Place?
- What Needs to be Assigned?
- What Consents Need to be Received?
- What Government Actions are Taken?

Compliance Focused Request

- Permit Your Own Compliance Request
- Coordinate with Legal
- What Compliance Process is in Place?
- Has it Been Effectively Operated?
- Risk Area Specific Information
- Right to Audit Before Closing
- Impose Compliance Process Up Front
- Create Compliance Due Diligence Checklist
Define By Common Risk Areas

- OIG Guidance
- Sector Information
- OIG Work Plan
- Same Process You Use With Your Program

Effectiveness Cycle
Compliance Program Process Review

- Structure In Place
- All seven 8 elements included in the program
- Effectiveness of Process
- Key Elements
- Compliance Budget/Funding
- Compliance Officer
- Board Engagement
- Regular Reports
- Training
- Hotline
- Anti-Retaliation

Measuring Effectiveness

- Outcomes Review
  - Indications that the process is working
  - Compliance Topics on Board/Committee Agendas
  - New risk areas identified
  - Reports Being Addressed
  - Comparing issues year to year
  - Work Plans Created and Followed
  - Tracking corrective actions
  - Reviewing concurrent audits
  - Educational session pre-and post-tests
  - Tracking “bill denials”
  - Organizational survey results
  - Audit results
Follow The Money

- Not Just Review of Documents
- Undocumented Referral Relationships
- Contract Control Systems
- Attorneys Will Tend to Look at What Exists
- Compliance Looks At What Should Exist

Employed Physicians

- FMV Documentation
- Flawed Production Compensation
- What Type of Target
- Group Practice
- Facility/Hospital?
Medical Director Payments

- Expired Contracts
- Amount of Compensation
- Services Required
- Documentation of Services
- Time Reporting Issues
- Provider-based Referral Flow Reversed (Uncompensated Services)

Finding What Should Exist

- Match Payment Items to Contracts
- Highlight Where There Is No Relationship Between Payment and Contract

Review Conducted 4-23-2013

Payments – Jan./Feb. 2013

<table>
<thead>
<tr>
<th>Recipient</th>
<th>Amount</th>
<th>Payment Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dr. Smith</td>
<td>$2,000</td>
<td>1-1-2013</td>
</tr>
<tr>
<td>Dr. Jones</td>
<td>$6,000</td>
<td>1-1-2013</td>
</tr>
<tr>
<td>Dr. Smith</td>
<td>$5,000</td>
<td>2-1-2013</td>
</tr>
<tr>
<td>Dr. Jones</td>
<td>$6,000</td>
<td>2-1-2013</td>
</tr>
<tr>
<td>Dr. Kilgore</td>
<td>$2,000</td>
<td>2-1-2013</td>
</tr>
<tr>
<td>Dr. Davis</td>
<td>$3,000</td>
<td>2-1-2013</td>
</tr>
</tbody>
</table>

Physician Contract / Dates

- Dr. Smith: OB 11-1-2012 - 11-1-2013
- Dr. Jones: Trauma 1-1-2009 - 1-1-2011
- Dr. Kilgore: Cardiology 4-1-2013 - 4-1-2015

Kilgore and Davis Require Further Investigation
Is There An Obvious Explanation?

<table>
<thead>
<tr>
<th>Activity</th>
<th>Contract Duty</th>
<th>Date</th>
<th>Time</th>
</tr>
</thead>
<tbody>
<tr>
<td>Develop protocol for (specific purpose) for consideration by committee at 2/25/2013 meeting</td>
<td>Section 4.3(c)</td>
<td>2/28/2013</td>
<td>4 Hours</td>
</tr>
<tr>
<td>Design Educational Program to Be Provided to Nursing Staff scheduled for 2/28/2013</td>
<td>Section 4.3(f)</td>
<td>2/28/2013</td>
<td>6 Hours</td>
</tr>
<tr>
<td>Meet With County Health Program regarding outreach services of (Insert) Department</td>
<td>Section 4.3(h)</td>
<td>2/28/2013</td>
<td>2 Hours</td>
</tr>
<tr>
<td>Participation as leader of monthly department peer review committee meeting (meeting actually held on 2/5/2013)</td>
<td>Section 4.3(k)</td>
<td>2/28/2013</td>
<td>3 Hours</td>
</tr>
<tr>
<td>Led multidisciplinary care team meeting related to (specified)</td>
<td>Section 4.3(b)</td>
<td>2/28/2013</td>
<td>3 Hours</td>
</tr>
<tr>
<td>At request of the CEO, sponsored visit of candidate for (specialty surgeon) Candidate actually visited on 2/7/2013</td>
<td>Section 4.3(n); Miscellaneous duties requested by hospital</td>
<td>2/28/2013</td>
<td>3 Hours</td>
</tr>
</tbody>
</table>

Social Media Due Diligence

- What is Out There?
- Identify Compliance Issues
- What Are People Saying Out There?
- Overlooked Source of Compliance Identification
- “Friend” Your Target
Dealing With Discovered Problems

- If you look, you will find something
- Size, risk, scope of problem
- Process – Bringing Problems to the Team
- Solve Problem?
- Adjust Transaction?
- Hopefully Minor

Non-Successor Liability Situations

- Condition of Closing
- Fix Problem Going Forward
- Will Future Potential Liability Affect Target’s Ability to Perform?
- What Are Post Closing Obligations?
- Are You Sure There Is No Potential For Successor Liability?
- Legal’s Job To Figure This Out?
Successor Liability

- Self Disclosure
  - CMS
  - OIG
- Work Out Repayment Prior to Closing
- Corporate Integrity Agreement
- This Process Takes Time
- Identify Early

Begs the Question

- Scope of Successor’s Liability
- New Theories of Successor Liability?
- Common Law Theories of Successor Liability?
  - Continuation of prior ownership
  - Purpose to avoid liability
  - Other Theories
- Extension to “Knowledge” Based Penalties?
- Failure of “Due Diligence” Theories
- The Next Successor Liability Case Has Yet To Be Brought
Pre-Closing Self Disclosures

- Case Law – Not Enough to Obtain Contractual Indemnification
- CMS Can Still Hold LIABLE
- Successor Liability if Know
- If Address in Indemnity – You Know
- Risk of Papering Specific Indemnification

Important Points

- Compliance Needs A Seat At The Table
- Compliance Brings A Fresh Angle To The Transaction Team
- Edges of Successor Liability Not Well Defined
- Have Your Own Compliance Due Diligence Request
- Impact The Transaction
- Integrate Into Compliance Program Operation