

For Immediate Release

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Trends Backgrounder: Merger/Buyout Compliance Due Diligence

As consolidation of hospitals, managed care and other health care organizations has increased in recent years, the need to perform compliance due diligence has become more important. Compliance due diligence is the process by which an organization strives to ensure it is aware of any compliance problems or signs of compliance problems it may be inheriting in a buyout or merger.

"As with any industry, the health care due diligence process attempts to uncover problems related to environmental, employment, benefits and tax laws," explained Lee Doty, Esq., a partner at the law firm Drinker, Biddle & Reath, who is speaking on the subject at the Health Care Compliance Association Institute. "But health care due diligence also deals with unique issues, including medical malpractice and fraud and abuse, the latter of which is a major focus of the federal justice system right now."

Avoiding the Transfer of Liability

"Before beginning compliance due diligence, it's important to determine the kind of transaction under consideration, such as a merger, asset purchase or change of membership. This will determine the degree of due diligence needed and how much responsibility for any liability, including health care fraud liability, will be transferred from one organization to another," Ms. Doty continued.

For example, when an institution buys only the assets of another organization, it does not automatically assume all of that organization's liabilities. However, if the seller is treating Medicare patients, the buyer may be bound by all the terms and conditions of the seller's Medicare Agreement, including the duty to repay the government for overpayments, even in an asset deal.

Buyers always try to structure an agreement to minimize their exposure to liability, but with health care fraud and abuse, the extent of that exposure cannot be fully predicted. For instance, if the acquired organization had a significant billing problem, a buyer could end up paying more in fines than the value of the sale itself because of high fines applied to each false claim and the treble damages imposed under the False Claims Act.

Due Diligence Steps to Minimize Risk

Ms. Doty explained that to minimize these risks, there are several major steps an organization should take in due diligence compliance:

1. Find out if the seller has an effective compliance program in place, determine if compliance problems have been found to exist and what initiatives have been implemented to correct them. As an outsider, it's impossible to uncover all of an organization's problems during due diligence, but some level of comfort can be achieved if an effective compliance plan is in use.

2. Set up a due diligence team made up of appropriate experts, including billing, tax, bond and financing, accounting, legal and operations professionals.
3. Identify all the issues that will need to be targeted and decide how deep to go on each of them. Particular attention should be paid to fraud and abuse issues of concern to the Office of Inspector General, such as cost reports and certain diagnosis related groups. The depth will be dictated by the size of the transaction, the timing of the transaction, whether the seller has a good reputation, and if the seller will continue to exist after closing.
4. Review contracts of physicians and suppliers whose supplies might be covered under a cost report. The latter can include clinical laboratory service and pharmaceutical agreements, for example. Determine if appropriate consideration is being paid for services and products or whether one party or another appears to be receiving a benefit in return for referrals of patients.

When a problem does turn up during due diligence, the buyer will negotiate to ensure that the seller maintains responsibility for it after the sale. This may involve putting money in escrow to cover any anticipated future costs associated with the problem or indemnifying the buyer up to a certain amount of money. But often, the buyer ends up taking on the problem and the responsibility to fix it.

One particularly tricky step in due diligence is documentation of potential problems. "If a document concludes, based on preliminary evidence gathered during due diligence, that there is a major civil or criminal problem when ultimately it is determined that there is a justification, this may cause unnecessary headaches in the future. This would occur if the government tries to claim the buyer had knowledge of the problem but failed to come forward to disclose it," Ms. Doty noted. Therefore, it's best not to jump to any conclusions in due diligence documentation.