Compliance Role in Merger and Acquisition
Due Diligence

Health Care Compliance Association
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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

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

 Regulatory Agencies
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
Lineal Compliance Progression

Complete Integration Into Compliance Process By Closing

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

Ruder Ware
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

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

- Program
- Corrections
- External Review
- Outcome
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

<table>
<thead>
<tr>
<th>Physician</th>
<th>Contract</th>
<th>Start Date</th>
<th>End Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dr. Smith</td>
<td>OB</td>
<td>1-1-2012</td>
<td>11-1-2013</td>
</tr>
<tr>
<td>Dr. Jones</td>
<td>Trauma</td>
<td>5-1-2009</td>
<td>5-1-2011</td>
</tr>
<tr>
<td>Dr. Kilgore</td>
<td>Cardiology</td>
<td>4-1-2013</td>
<td>4-1-2015</td>
</tr>
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</table>

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(i)</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>4 Hours</td>
</tr>
<tr>
<td>Meet with County health director regarding outreach services of (specific department)</td>
<td>Section 4.3(f)</td>
<td>2/28/2013</td>
<td>2 Hours</td>
</tr>
<tr>
<td>Participation in leader of monthly department peer review committee meeting (meeting actually held on 2/28/2013)</td>
<td>Section 4.3(e)</td>
<td>2/28/2013</td>
<td>4 Hours</td>
</tr>
<tr>
<td>Lead multidisciplinary team meeting related to (specified)</td>
<td>Section 4.3(b)</td>
<td>2/28/2013</td>
<td>4 Hours</td>
</tr>
<tr>
<td>In request of the CEO sponsored visit of candidate for (specialty surgeon). Candidate actually visited on 2/7/2013</td>
<td>Section 4.3(n)</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