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Sellers Prepare: Health Care Due Diligence

Law360, New York (May 18, 2012, 4:38 PM ET) -- Health care transactions present unique due diligence challenges. The buyer must evaluate the seller's compliance policies and procedures, arrangements with referral sources, patient and payor data, clinical data and compliance with federal and state licensure, certification and reimbursement regulations. The seller will be more attractive to the buyer if due diligence is well-organized, clearly identified and complete.

The seller should provide an organizational chart of its entire affiliate structure. The organizational chart should identify all owners, subsidiaries and joint venture partners, as well as the management team. The seller should identify which affiliates or owners are physicians and all other referral sources within its organization. The seller should deliver all agreements with physicians and other referral sources; any joint venture, partnership or other agreements involving ownership; purchase and sale agreements, subscription agreements and options of all types; all contracts, agreements or arrangements with affiliates; and all employment and consulting agreements.

The buyer will review the seller's compliance policies and procedures including those addressing patient medical records, confidentiality, infection control, emergency preparedness, and any clinical or practice specific areas. The buyer will assess the seller's implementation of its policies and procedures, its reporting process, and the seller's response to any compliance breaches. The seller should be prepared to provide a summary of government investigations, agency inspections and litigation initiated or resolved within the past 10 years.

If payor mix is important to reimbursement for the seller's services or products, the seller should be prepared to provide information about its current sources of revenue. The buyer will analyze the charges attributable to each type of payor, including Medicare, Medicaid, commercial payors and self-insured patients. The buyer will review billing and claims data to perform due diligence on the seller's compliance with reimbursement and payment regulations. The seller may be required to resolve issues identified during the buyer's due diligence prior to closing the sale.

Fixed assets are often important to the continued operations of a health care business. Therefore, the buyer will assess the physical condition and value of equipment, furnishings and fixtures during due diligence. The seller should be prepared to provide the buyer with a fixed asset list prepared in accordance with GAAP, lien report and any related debt instruments. The seller should obtain payoff documentation from each lien holder and make arrangements for paying off all such liens, either prior to closing or at closing out of closing proceeds. If the buyer makes those payments on the seller's behalf out of purchase price proceeds, the seller and its creditors should grant the buyer the right to file all related lien termination statements.

The buyer will review material contracts to determine if it will assume them at closing.

Material contracts may include third party payor agreements (governmental and commercial); vendor and service agreements; inventory and supply agreements; real and personal property leases; management agreements; clinical agreements; joint venture agreements; noncompete agreements; and licenses of patents, copyrights, trademarks and other intangible property rights. Since the seller likely will be responsible for obtaining all required third party consents to assignment, they should allow sufficient time to work with its third party contract partners. If any third party consents cannot be obtained by closing, the buyer may require the seller to maintain certain contracts for the benefit of the buyer following the sale until assigned.

The seller's employees are often critical to a health care business. As a result, the buyer may require that employees remain with the business following a sale. The seller should be prepared to arrange for the buyer to meet and screen employees during due diligence. The buyer will evaluate employee salaries, benefits and bonus, pension, insurance, retirement and other arrangements with the seller. A number of states require that the seller obtain employees' written consent before they can provide their employee records to the buyer. The seller needs to think carefully and strategically about when it announces the proposed sale to its employees.

Licenses and certifications are an essential requirement for most health care businesses. The seller should be prepared to provide the buyer with all federal, state and local licenses, certifications, registrations, qualifications and permits, including state and federal health care licenses, certificates of need, Medicaid and Medicare provider agreements and numbers, National Provider IDs, DEA and state drug certifications, and CLIA waivers or certifications. The seller should be familiar with the applicable state and federal change in ownership requirements relating to such licenses and certifications in connection with the proposed transaction and the timing involved.

Most states will require the seller, if it is a nonprofit or charitable corporation, to submit the proposed sale to the state's attorney general for approval or to seek court approval. The seller will be responsible for submitting all filings and obtaining all required approvals. The seller should discuss this process with the buyer early in the due diligence process. The buyer will need to consent to the submission of any confidential information about the buyer and the terms of the sale. The seller should be prepared to seek confidential treatment of sensitive information from the attorney general or court as part of this process.

The buyer will request the seller's corporate formation and governance documents, historical tax returns and financial statements. If the seller's financial statements are not certified, it may be worth the cost to obtain certified financial statements for a three to five year period prior to the sale. If the business is part of a larger organization, the seller may need to prepare financial statements solely for the business segment being sold.

The seller can and should put its best foot forward with its presentation and prompt delivery of due diligence. The seller that sets up an organized, indexed due diligence data room (preferably electronic) will be more attractive to potential buyers. If the seller is running a bid process, this ensures that each potential buyer has access to uniform information, enabling the seller to better assess the offers it receives. Due diligence must be thorough and responsive to the buyer's requests, and regularly updated. Well-run due diligence will help ensure a smooth process and a successful closing.

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