PUBLICATION

Mitigating Successor Liability in Long Term Care Acquisitions

March 19, 2014

As in any business acquisition, purchasers in the long term care industry can encounter potential liability due to employment claims, seller violations of representations and warranties under the purchase agreement, tort actions, tax claims and the like. Unlike most other business parties, however, purchasers of skilled nursing facilities (SNFs) and assisted living facilities (ALFs) encounter a minefield of potential liability stemming from their participation in Medicare and Medicaid and the nature of the business of geriatric care. Buyers of SNFs and ALFs should be aware of the risks inherent in acquiring an operating SNF or ALF and should consider what strategies may be available to mitigate their successor liability risk in any given transaction.

Sources of Successor Liability. Pursuant to 42 C.F.R. 489.18(c), upon a change of ownership (CHOW) of a SNF, the existing operator's Medicare provider agreement is automatically assigned to the new operator, unless the new operator rejects the existing provider agreement and applies for a new agreement, a path that few purchasers elect to take since their Medicare payments are cut off until the new provider agreement is in place. To obtain a new provider agreement, a purchaser must fulfill all requirements for Medicare participation, including a full, unannounced survey. The Centers for Medicare & Medicaid Services (CMS) actively encourages purchasers to accept assignment of existing provider agreements by prohibiting State Survey Agencies (SSAs) from conducting the required unannounced survey until the SSAs have completed all of their higher priority workload. Moreover, according to a 2013 CMS directive, CMS looks with suspicion on any survey conducted shortly after a CHOW and speculates that any such prompt survey may have been announced to the new owner.

Two landmark legal cases demonstrate the rationale behind CMS's efforts to encourage purchasers to accept the automatic assignment of provider agreements. The Fifth Circuit held in *United States v. Vernon Home Health Care, Inc.*, 21 F.3d 693 (5th Cir. 1994) that an overpayment to the prior owner of a home health agency could be offset by CMS against Medicare payments to the new owner of the same home health agency. In *Deerbrook Pavilion, LLC v. Shalala*, 235 F.3d 1100 (8th Cir. 2000) the Eighth Circuit held that civil monetary penalties imposed on a prior operator of a nursing facility can be asserted against the new operator. Thus, a purchaser accepting assignment of an existing Medicare provider agreement can be open to full liability for any overpayments and civil monetary penalties against the prior owner under the same Medicare provider agreement.

Similarly, depending on the laws of the applicable state, a new operator can be subject to successor liability arising under the prior operator's Medicaid provider agreement. Moreover, purchasers are increasingly exposed to liability for overpayments made by both Medicare and Medicaid to prior operators and discovered through RAC, MAC, ZPIC and state-level audits. Such liability can extend for up to four years following a CHOW, and the sums at issue can be sizeable, due to the auditor's power of extrapolation.

One additional potential source of liability arises from tort claims by so-called "straddle residents." The residents inhabiting the SNF or ALF on the last day of a seller's tenure will be the same residents occupying the facility on the first day of a purchaser's ownership. In many cases, if one of these residents asserts a tort claim for an adverse event that occurred during the seller's ownership of the facility, both the seller and the purchaser will be named in any resulting lawsuits. At a minimum, the purchaser can expect to incur attorney's fees to extricate itself from such proceedings.

Strategies for Mitigating Successor Liability. While the specter of successor liability in the long term care industry can loom large, purchasers can consider several strategies to mitigate their potential exposure. As in any business transaction, a purchaser should insist on comprehensive representations and warranties from the seller as to compliance with a full range of health care and non-health care laws and regulations. Purchasers also should be wary of limiting survival of these representations and warranties and attempt to negotiate for survival through the term of the relevant statute of limitations.

Another point of negotiation in most purchase agreements is indemnification for breaches of representations and warranties and other potential sources of liability. Most sophisticated sellers strive to limit their indemnities through the inclusion of caps and baskets, and purchasers should assess potential liability exposure in determining what limits to accept. The purchaser also should consider requesting indemnities from a parent entity of the seller and/or individual seller principals, a post-closing escrow or letter of credit, or a holdback of some portion of the purchase price in an amount and for a time period sufficient to mitigate potential successor liability exposure, particularly in instances where the seller is a single-asset entity that is selling its only asset to the purchaser. When a liability is easily quantifiable and likely to occur, purchasers may seek to negotiate a purchase price reduction.

Conclusion. In acquisitions of long term care facilities, a purchaser will be wise to assess sources of potential successor liability stemming from acts and omissions on the part of the seller and seek, to as great an extent as possible, to quantify any such potential liability. In most transactions, purchasers will need to negotiate a combination of the strategies highlighted above for mitigating liability with a goal of shifting most of the exposure for pre-closing liability back to the seller.