

PULLING THE PLUG?

BY KAREN S. LOVITCH

Mergers and acquisitions activity in the healthcare industry has flourished in recent months as companies are increasingly on the lookout for targets to acquire as part of overall growth strategies.

In the second quarter alone, \$73.5 billion was spent to finance 243 healthcare mergers and acquisitions, a 44% increase from the \$51.1 billion spent in the first quarter of 2011, according to a recent report by HealthLeaders Media.

The transactions cut across all major sectors of the industry, with medical devices, pharmaceuticals, biotechnology and e-health accounting for the bulk of M&A activity. Hospitals, physician practices and other healthcare providers are also in play.

The active M&A market is occurring against a backdrop of stepped-up government enforcement against healthcare fraud. As a result, healthcare companies targeting acquisitions may encounter government investigations of healthcare fraud.

However, the fact that a potential target is under investigation doesn't necessarily mean the plug should be pulled on a deal. An acquiring company should approach the government probe as just another factor to assess during the due diligence phase.

After gathering the relevant information, an acquiring company may in fact determine that it can manage and plan for a target company's potential penalties as part of the business transaction. On the other hand, the fraud allegations might be so serious that the monetary risks are too great, and the feasibility of the target company continuing to operate as a viable business is in doubt.

This article briefly describes the key federal laws combating healthcare fraud, as well as the overall context of robust government enforcement activities, and provides a suggested framework for evaluating the potential impact of a government investigation on a proposed acquisition.

The False Claims Act prohibits individuals and businesses from knowingly submitting to the federal government false claims for payment, as well as submitting false records for payment. The law authorizes whistleblower suits.

The False Claims Act, passed during the Civil War to combat rampant corruption, has been increasingly applied in recent years against healthcare fraud, especially false billing. Since January 2009, more than \$9 billion has been recovered under the False Claims Act in cases involving fraud against federal healthcare programs, according to government reports.

The Stark Law prohibits physicians from profiting from their own referrals. This federal law bans referrals of Medicare and Medicaid patients for certain health services to entities in which physicians (or their immediate family members) have a financial interest. The Stark Law imposes strict liability, meaning the government doesn't have to prove knowledge or intent. Potential penalties include: denial of payment for prohibited healthcare services; a refund of payments made by the government; a \$15,000 civil fine; and a \$100,000 civil fine for each referral arrangement considered a scheme to circumvent the law.

The federal anti-kickback law makes it a felony for anyone to offer or receive payment in exchange for referring a patient for Medicare- or Medicaid-covered services and supplies. As long as one purpose of an arrangement is to induce referrals, it is irrelevant if other legitimate reasons exist for the remuneration. The reach of the law includes principals, who can be liable for the acts of their agents. Violation of the anti-kickback law is punishable by fines up to \$25,000 and imprisonment up to five years.

Combating healthcare fraud has become a top priority of federal and state agencies. For example, in May 2009 the departments of Justice and Health and Human Services joined forces to fight Medicare fraud through data analysis techniques and an increased community policing. The interagency strike force --

known as the Health Care Fraud Prevention and Enforcement Action Team, or HEAT -- has agents operating in Miami; Los Angeles; Detroit; Houston; Brooklyn, N.Y.; Tampa, Fla.; and Baton Rouge, La.

Since HEAT began operating, the government reports that it has obtained indictments of more than 460 individuals and organizations alleging fraudulent bills under Medicare for more than \$1 billion.

Should an acquiring company discover that the government is investigating a target company, a prudent first step is to hire counsel with experience in assessing the impact of a healthcare fraud inquiry on a pending transaction.

The most crucial action for an acquiring company is to gather as much information as possible during due diligence efforts, addressing at least the following questions:

Which government agencies are involved (federal, state or both)? What are the allegations? How far along is the investigation? Are the alleged violations civil or criminal?

Has the government served a subpoena on the target company, or has the government instead issued an informal request for information? Have any employees been interviewed, and, if so, what happened at those interviews? (The acquiring company should attempt to obtain copies of subpoenas, any informal requests for information and a redacted copy of any confidentiality agreement that applies to an investigation.)

How much money is at stake, and what potential penalties could be imposed? Are criminal charges likely? Will individual employees of the target company be prosecuted?

Will the target company be excluded from Medicaid and Medicare billing? (If so, that's a likely death knell for the company, since those billings are essential for profitability.)

It's harder to size up the potential liabilities of a target company if a government probe is in its early stages since relevant information may not be available yet. Nonetheless, it's imperative to obtain as much information as is available and to continue monitoring the investigation.

A more fully developed investigation puts the acquiring company in a better position to assess the risks involved, such as when the target company is negotiating a settlement with

the government. The acquiring company should request a copy of the most current draft agreement to help pinpoint monetary and criminal exposure.

It's also important to determine if the government is demanding a corporate integrity agreement, which is sometimes required in more serious cases. Companies try to avoid them because compliance can require potentially onerous amounts of time and money.

Once due diligence is completed, the key strategic question for an acquiring company is how much risk it is willing to assume weighed against expected business gains from completing the acquisition.

For example, will the monetary penalties against the target company place it in jeopardy? If a few hundred thousand dollars is at issue, and the target company is otherwise healthy, then the acquiring company might decide to proceed with the acquisition. But if the allegations are serious and the target company doesn't have tremendous resources, the proposed acquisition might be dead on arrival.

The acquiring company should determine what amount it could reasonably pay in the worst-case scenario. For example, a worst-case situation might involve the target company paying money owed to the government, plus civil penalties, plus triple damages.

One way to minimize risk is to negotiate a provision in the acquisition agreement that the target company remains responsible for some or all of the payments to the government. Or you could place money in escrow to pay toward a settlement. For example, if the acquisition price is \$50 million, you could place \$5 million of that in escrow, pending resolution of the government investigation.

Another tactic, if appropriate, is to negotiate changes in management as part of an acquisition. For example, the acquiring company might learn that the target company's general counsel mishandled the investigation, or its vice president of sales is implicated in potential fraud. The acquiring company can insist on having a clean slate moving forward.

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