Dollars and Sense: A Guide to Selling a Durable Medical Equipment Supplier

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Topics

- DMEPOS Industry
- Transaction Process
- Key Considerations
- Tips for Sellers
DMEPOS Industry

- Population is Aging
  - Estimated that the world’s population over 60 will double from 12% to 22% from 2015 to 2050
  - People want to stay in their homes
  - Demand for DMEPOS will only increase

- In 2020 the DME Market was estimated to be a $52.9 billion industry
  - Expected to see a compounded average growth rate of 5 to 6 percent through at least 2026
DMEPOS Industry

- Market changes in the last decade
  - Competitive Bidding
  - Consolidation
  - Managed Care Organizations (Medicare and Medicaid)
  - Reimbursement Cuts
  - COVID-19
Transaction Process

Letter of Intent; Diligence; Purchase Agreement; Closing and Transition
The Transaction Process

LOI / Term Sheet

Draft/Negotiate the Purchase Agreement

Due Diligence

Draft / Update Schedules

Closing
Letter of Intent: Seller’s Perspective

- The purpose is to formalize a non-binding meeting of the minds to justify the time and expense required to pursue the deal

- Seller’s perspective:
  - More specificity
  - Purchase Price
  - Payment timing and structure
  - Limitations on post-closing exposure (i.e., baskets and caps)
  - Confidentiality (if no separate CA or NDA)
LOI: Buyer’s Perspective

- Buyer’s perspective:
  - Specificity with room to negotiate pending diligence results
  - Possibility of escrow funds and/or holdbacks
  - At a minimum, mention representations and warranties are expected to be customary for transactions of like kind and size
  - Usually silent on indemnification expectations
  - Exclusivity
Diligence Categories

- Corporate / Organizational Structure
- Financial/Tax
- Employment
- Litigation (and other administrative investigations/proceedings)
- Material Contracts
- Intellectual Property
- Regulatory
Diligence: Scope

- Equity acquisition
  - The Buyer is stepping into Seller’s shoes as the owner of company
  - Takes the good, the bad, and the ugly
  - Diligence is crucial and typically much more detailed

- Asset acquisition
  - The Buyer typically acquires the assets free and clear of all liens, security interests, and other encumbrances
  - No, or very few, liabilities are assumed
  - Diligence is still crucial, but not as detailed as compared to an equity deal
  - For example, less emphasis on employees, contracts, and taxes (depending on what Buyer is assuming)
Diligence: Scope

- Equity acquisition of Medicare DME Supplier
  - No gap in billing
  - Must update Medicare of change within 30 days of the date of the change
  - MCO agreements may transfer

- Asset acquisition of Medicare DME Supplier
  - Will need to apply for a new PTAN
  - Will be retroactive to date of acquisition or compliance with supplier standards as applicable
  - Will need to hold claims until new PTAN is issued.
  - MCO agreements will not automatically transfer
Diligence: Employment Considerations

- A Buyer wants to know who the employees are, their current roles, years of service, benefits, and other compensation.
- This creates a snapshot of the company’s payroll obligations and helps identify employment issues (e.g., misclassification) moving forward.
- It also sets a baseline – a Buyer does not want to be surprised post-closing with employees saying “[Seller] promised me __________”.
- Buyers want to see all employment agreements, non-competes, non-solicitation agreements, confidentiality agreements, independent contractor agreements, workers’ comp claims, and benefit information (if any).
Diligence: Financial/Tax Considerations

- A Buyer wants to know how the company is taxed
- The easiest way to determine this is request tax returns for the last 3 years
- On the financial side, Buyers want to see balance sheets and income statements and determine whether any debts or other liabilities exist outside of such financial statements
- Therefore, Buyers typically request financial statements (audited or unaudited) for the last 3 years and a schedule of all outstanding debt
Diligence: Corporate Considerations

- These requests are much more important in an equity transaction

- Buyers want to see:
  - all formation and governing documents (e.g., bylaws, shareholder agreements, company/operating agreements, etc.)
  - stock books and equity ledgers
  - organizational charts (showing all direct and indirect owners and all officers, directors, and managers)
  - whether any options or convertible securities exist
  - a list of jurisdictions in which the company owns property and/or operates
  - any previous transactions the company was a party to outside the ordinary course of business
Diligence: Contract Considerations

- In an asset deal, no contracts may be assumed by the Buyer.
- However, even if a Buyer is obtaining its own contracts, it may be helpful to review the Seller’s contracts to understand the current customers, vendors, and terms with each.
- In an equity deal, Buyers want to see all contracts but especially those that are valuable to the enterprise.
- In doing so, the review places an emphasis on identifying pre- and post-closing notice and consent requirements.
  - These third-party issues are capable of delaying, or even killing, transactions.
Diligence: Litigation Considerations

- From a strictly legal perspective, Buyers do not want to buy assets or a company that is, or could be, the subject of litigation, audits, investigations, or other administrative proceedings.

- Therefore, it is critical for Buyers to confirm:
  - That all prior claims and litigation have been completely settled and there are no continuing obligations.
  - There are no pending lawsuits, audits, investigations, or other administrative proceedings.
  - There are no threatened claims, audits, investigations, or other administrative proceedings.
Regulatory Diligence: Permits & Enrollments

- Common Licenses and Enrollments in Governmental Programs
  - License to provide services
  - Accreditation
  - Medicare Provider Agreement
  - Enrollment in Medicaid and Medicaid Waiver Programs
  - Managed Care Organizations
Regulatory Diligence: Permits & Enrollments

- Identify all payors, licenses, and enrollments in governmental programs
- Review information reported to payors, licensing agencies, and governmental programs
- Request information to assess compliance with standards and participation requirements
- Identify notices required to maintain licenses, contracts, and enrollments
Regulatory Diligence: Audits & Records

- Common Requests
  - Information relating to third-party payor audits
  - Sample of patient records and related claims
  - Information relating to billing practices
Regulatory Diligence: Mock Surveys

- Can help identify compliance issues before a sale or during diligence
- Independent third party examines the facility in “real world” conditions
- Provide an outsider’s perspective of the practices of the facility
Regulatory Diligence: HIPAA & Compliance

- Examples of requests
  - Copies of (a) resolution and/or minutes of the Board of Directors of the Company or other similar management body, related to the adoption of the Company’s corporate compliance program, (b) minutes and/or other records of compliance committee meetings, (c) corporate ethics and compliance code of conduct; (d) policy and procedure manuals, including policies and procedures related to coding, billing, and contracting, (e) all compliance training materials, including a log of training conducted over the last two years, (f) any compliance risk assessments performed and internal review or compliance audit reports; (g) the log of all matters reported to corporate compliance department and/or chief compliance officer; and (h) any related agreements to such compliance efforts over the past three years (including a log of all calls to the Company’s compliance hotline)
  - Provide copies of all records relating to internal and external grievances and complaints filed with the companies within the past 24 months
Regulatory Diligence: HIPAA & Compliance

- Examples of requests
  - Listing of compliance officer, compliance committee members and all other compliance personnel, including name, position and compensation (e.g., salary, bonus). Attach a copy of a job description for each position.
  - Listing of HIPAA Privacy Officer and HIPAA Security Officer and copies of related job descriptions
  - Copies of HIPAA Privacy and Security policies and procedures
  - Copy of template Business Associate Agreement and Notice of Privacy Practices
  - Copies of last two security risk assessments and risk management plans prepared by the target HHA's in accordance with the HIPAA Security Rule
Regulatory Diligence: Referral Arrangements

- United States ex rel. Medrano and Lopez v. Diabetic Care Rx LLC, d/b/a Patient Care America, et al., No. 15-CV-62617 (S.D. Fla.)

- Key Federal Laws
  - False Claims Act
  - Anti-Kickback Statute
  - Stark Law

- Exceptions and Safe Harbors
Regulatory Diligence: Referral Arrangements

- Common arrangements that should be reviewed
  - Medical Director Agreements
  - Relationships with family members of physicians
  - Leases with referral sources
  - Preferred Provider Agreements
  - Service arrangements with referral sources
  - Historical ownership
  - Marketing practices
Diligence: How Buyers Manage Risk

- Restructure Transaction
- Address all risks pre-closing
- Allocate risks in the purchase agreement and ancillary documents
  - Typically achieved by adjusting scope and survival of disclosures required by the Schedules, representations and warranties, and indemnification obligations
Anatomy of a Purchase Agreement

- Transaction Structure/Purchase Price
- Representations and Warranties
- Covenants
- Indemnification
- Miscellaneous Provisions
- Exhibits (Ancillary Documents)
- Disclosure Schedules
Reps and Warranties

- Representations are statements or presentations of facts made to induce the other party to act.
- Warranties are stipulations that certain facts, in relation to the subject of the contract, either are true or will continue to be as stated or promised in the purchase agreement.
- These are the first steps in allocating risk in a transaction.
- Sellers want these to be as narrow as possible.
Reps and Warranties Involving Health Care Issues

- Licenses, permits and accreditation
- Consents and governmental approvals
- Compliance with laws
- Billing practices
- Contracts and commitments
- Litigation and compliance
Indemnification

- Risk is inherent in each transaction
- Buyers always have more exposure due to the information imbalance
- No matter how thorough diligence is, certain issues do not manifest themselves until after the transaction has closed
- Indemnification is the mechanism for allocating the risk – it provides for compensation in the event of specific harms or losses
- Buyers want the scope of indemnification to be as broad as possible, but Sellers want this to be as narrow as possible
Closing

- Regulatory documents and issues aside, closings can typically be done electronically by exchanging each party’s signatures.
- If this is done, make sure the documents allow execution by counterparts and electronic signatures.
- The transaction is “closed” when all signatures have been exchanged and “funded” when Seller receives the cash payable.
Transition Services Agreements

- Allows the parties to coordinate a smooth and successful transition in an effort to minimize interruptions to patients.
- Typically, the Seller agrees to assist the Buyer with specific services for a limited time post-closing.
- Sellers are typically compensated, but the payment terms must be reviewed by a health care attorney to avoid kickback issues.
Tips for Preparing for a Sale

Valuation and Fit; Brokers; Corporate Documents; Financial Statements; Regulatory Documents and File
Preparing for a Sale: Valuation and Fit

- Many valuations are based on a multiple of Earnings Before Interest, Taxes, Depreciation, and Amortization (o/k/a EBIDTA)
- Sellers can consult with Brokers, Investment Bankers, and Accountants to get an understanding of what their business may be worth
- Sellers are now doing diligence on Buyers – depending on how the deal is structured, Sellers may look for things other than a high purchase price (e.g., how much cash is tied up in escrow, no earnouts, post-closing benefits, title/role/responsibilities, who will take care of their employees, etc.)
Preparing for a Sale: Brokers

- Brokers can:
  - Connect parties willing to buy and sell
  - Navigate the LOI/Term Sheet negotiation process
  - Assist with collecting diligence items and responding to diligence requests
  - Help resolve core issues that can delay, or terminate, transactions
Preparing for a Sale: Corporate Documents

- Make sure the entity has up-to-date meeting minutes naming officers, directors, and/or managers with current terms
- Update stock books and equity ledgers
- Collect and account for all original equity certificates
- Determine whether transaction requires any amendments to formation or governing documents
- Collect signed and complete copies of all material contracts
Preparing for a Sale: Financial Statements

- Determine whether the company’s financial statements are prepared in accordance with GAAP
- Audited financial statements are preferred, but unaudited versions should also be acceptable
- Make sure the financials provided are aligned with tax filings
- Enlist the help of a CPA
Preparing for a Sale: Regulatory Documents

- Update information on file with regulatory agencies
  - PECOS
  - NPPES
  - Information on file with state licensing agencies and Medicaid

- Prepare file of commonly requested diligence items
  - Licenses
  - Revalidation and/or Medicare Approved Enrollment Record (PECOS)
  - Compliance and HIPAA policies and procedures
  - Payor contracts
  - Spreadsheet tracking audits
  - Medical Director Agreements, invoices, and payment records
Questions?
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Thank you

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