

Critical Legal Issues to Consider When Buying or Selling a Nursing Facility

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Introduction

- ▶ Sales of nursing facilities have increased significantly over the last several years
- ▶ For the first time since 2015, the National Investment Center for Senior Housing and Care reported an increase in SNF occupancy levels for the first quarter of 2019, to an average occupancy level of 83.7%. This may mean that the record-low occupancies in nursing facilities since 2012 are ending, and an upward trend may begin.
 - Changing reimbursement systems, value based payments, staffing challenges, consumer preferences, ALF/PCH occupancy increases, all factor into the low occupancy levels.
 - As a result, increasing number of NFs have closed, and operators will continue to consider options to “repurpose” existing facilities (i.e. converting to personal care, low-income apartments, or memory care units) or downsize licensed bed capacity.

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Introduction

- ▶ Increasing defaults under REIT leases and lending arrangements create licensure issues, as lenders and landlords seek remedies against operators unable to meet lease/debt payment obligations
 - States beginning to assess whether such issues require additional regulatory control, including closer scrutiny of potential nursing facility owners and the debt structures for their facilities
- ▶ All of these factors have contributed to the increasing trend of nursing home sales
- ▶ Organizations seeking to sell or acquire nursing homes, should become familiar with the concepts we'll discuss today.

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Business Side of a Sale – Questions to Consider

- What are your goals?
- How will the transaction be structured?
 - Asset Sale/Purchase
 - Purchase of assets out of bankruptcy or receivership?
 - Stock Sale/Purchase
 - Operations Transfer and Lease of Facility
 - Merger
 - Affiliation
- What entity(ies) will buy and operate the facility?
 - Separate “OpCo” and “PropCo”?
 - Single Purpose Entity to own real property and hold licenses/operations?
- What is your financing source?

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Initial Transaction Documentation

- ▶ Mutual Non-Disclosure Agreement (NDA) or Confidentiality Agreement
 - Protects confidential information and trade secrets
 - Recommended as a means of protecting each organization, and avoiding a pre-mature disclosure of the planned transaction.

- ▶ Letter of Intent (LOI)
 - Why execute an LOI?
 - Exclusivity period
 - Timeline to reach formal agreement
 - The more detail the better on potential “deal breaker” issues

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Asset Purchase Agreement – Key Provisions

- Assets Transferred
- Assets Excluded
- Representations and Warranties
 - Typically include a wide range of Seller reps and warranties regarding operations
 - Disclaimers and As-Is Provisions
- Due Diligence Period
 - Duration
 - Scope

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Asset Purchase Agreement – Key Provisions

- Indemnification Provisions
 - Key areas include indemnifications from claims arising during the period of the Seller's operation of the facility
 - Tail Insurance
- Escrows
 - Deposit Escrow
 - Indemnity Escrow
 - Amount
 - Timeframe
- Non-Compete/Non-solicitation
 - Geographic Area
 - Duration

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Stock Purchase Agreement

- Key Provisions
 - No Assets Transferred – Stock, Only
 - Representations and Warranties
 - Often mirror those in an asset deal, since the buyer of the stock needs assurances
 - Due Diligence Period
 - Typically the same approach as an asset deal
 - Indemnification Provisions
 - Often mirror those in an asset deal, as the continued operation of the facility may be adversely affected by claims arising after closing that relate to pre-closing activities of the operator
 - Escrows
 - Deposit Escrow
 - Indemnity Escrow
 - Amount
 - Timeframe
 - Non-Compete/Non-Solicitation
 - Same concerns as an asset deal

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Asset Purchase vs. Stock Purchase

- ▶ An asset sale usually favors buyer
 - Buyer avoids some prior liabilities
 - Buyer has tax advantages
- ▶ A stock sale usually favors seller
 - Seller has tax advantages
 - Liabilities of the corporation continue on for the buyer
- ▶ The two transactions are treated differently by regulatory agencies

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Operations Transfer Agreement

- ▶ Often used in tandem with an asset purchase agreement
- ▶ Focus is on the transfer of the operations rather than the hard assets (real estate and equipment), which are the focus of the asset purchase agreement
- ▶ Contains representations and warranties of the operator as to the operations, residents, billing, and compliance

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Other Considerations

- ▶ Real Estate
 - A transfer is also a real estate deal, so the real estate and the building itself will require a thorough review, including a survey and an environmental review
- ▶ Environmental
 - Phase I/Phase II Reports
 - Potential remediation
- ▶ Human Resources (Management & Employees)
 - Benefit Plans
 - CBAs
 - Severance Packages
 - Employment Agreements

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Other Considerations

- ▶ Resolve Any Potential “Deal Breaker” Issues Early On
 - Determine the purchase price and timing up front
 - Are there any regulatory/compliance contingencies that must be cleared (e.g. outstanding CMPs or identified overpayments)?
 - What business terms are “non-negotiable” for you?
- ▶ Transaction Timelines and Closing Checklists
 - Critical for staying on target for closing and ensuring that every deliverable is completed on or before the closing date
- ▶ Opinion Letters for Buyers
 - Regulatory and Enforceability

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Regulatory Side of a Sale

- ▶ Regulatory issues and deadlines will drive the timing of the sale and its closing
 - Notice requirements
 - Review process
 - Surveys/Inspections as Necessary
 - Responding to any pending overpayments, provider assessment taxes or CMPs
- ▶ It is critical to educate the “business side” with these regulatory requirements, so that realistic expectations about closing and the conditions to closing are understood.

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Regulatory Side of a Sale

- ▶ Notices, Application process and timing
 - DOH
 - Requires 30 days written, advance notice prior to a change of ownership (CHOW) (See 28 Pa.Code § 51.4(a))
 - But DOH prefers providers submit notice more than 30 days in advance
 - No required form for notice, but notice typically includes:
 - The facility name
 - Facility location
 - Parties involved
 - Proposed effective date of the CHOW
 - Requires application to be submitted 30 days in advance of closing
 - DOH review process
 - First reviewed by regulators within the Division of Nursing Facilities
 - Then reviewed by DOH counsel
 - Pennsylvania is a “prior authorization” state, meaning the DOH will not allow a transaction to close until the applicable paperwork is reviewed and approved
 - No survey/inspection is required of the nursing facility CHOW process
 - Once DOH has finished reviewing the application, it will issue a letter of approval around a week before the projected closing
 - At closing, CEOs of buyer and seller entities need to execute letters confirming the closing date
 - Letters will be submitted to the DOH
 - DOH will then issue the new license retroactive to the actual date of closing

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Regulatory Side of a Sale

- DOH (cont...)
 - Requires a listing of all health care facilities that are currently, or previously, owned, operated, or managed by the new owner, and will also want to know about any adverse events, CMPs, etc. that have occurred at these facilities
 - Will contact non-PA state agencies to confirm the compliance/licensure status of any out-of-state health care facilities and use that information as part of its review process
 - Increased oversight of nursing home transactions
 - Increased financial review of prospective buyers
 - DOH is focused on ensuring that the prospective buyer has the financial ability to complete the transaction and ensuring that the terms of any Loan Agreements, Mortgages, or Leases do not enable the Lender/Lessor to displace any licensee without the Department's prior review and consent
 - Thus, DOH has requested the following information from prospective buyers:
 - Term Sheet or Loan Commitment Letter and Loan Agreement
 - Operating Agreements for Landowner/Lessor entities
 - Statement of current costs/expenses of facility and a 1 year projection of revenues and expenses from the proposed new operator
 - Lease Agreements

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Regulatory Side of a Sale

- DHS OLTL (For Medical Assistance participation/certification)
 - Requires 30 days advanced, written notice of a proposed CHOW (See 55 Pa. Code § 1101.43 and 55 Pa. Code § 1187.22(13))
 - There is no required form for the notice, but notice typically includes:
 - Facility name
 - Facility location
 - Parties involved
 - Proposed effective date of the CHOW
 - Regulation requires that the facility specifically request to continue participation in the MA Program following the CHOW.

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Regulatory Side of a Sale

- ▶ DHS OLTL (for Medical Assistance participation/certification)
 - DHS will not formally approve the new owner's participation in the Medical Assistance Program until it receives a copy of the license issued to the new owner by DOH.
 - As a practical matter, until DHS issues its approval, the new owner is prohibited from billing the Medical Assistance Program for services. Ultimately, DHS will issue its approval retroactive to the effective date of the transaction.
 - However, this can result in "cash flow" issues, while DHS's approval is pending. Typically, it can take one to three months from the actual closing date to receive DHS approval, so new owners are strongly advised to plan for this cash-flow contingency and address with their lender.

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Regulatory Side of a Sale

- ▶ Centers for Medicare and Medicaid Services ("CMS")
- ▶ Notice of a proposed change of ownership also must be provided to CMS within 15 days of the CHOW. See 42 CFR § 489.18.
 - As a practical matter, we recommend providing notice to CMS at the same time notice is provided to both DOH and DHS, with a copy to the facility's MAC. The packet of information forwarded by DOH will contain much of the documentation to be completed to effectuate the transfer of ownership from a federal Medicare perspective.
 - In addition, the new owner must submit a CMS Form 855A to the facility's Fiscal Intermediary before the proposed effective date of the transaction to effectuate assignment of the Medicare provider agreement.

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Regulatory Side of a Sale

- ▶ Centers for Medicare and Medicaid Services (“CMS”)
 - 855A Issues
 - Section 5 Organizations – must report/provide:
 - The percentage of direct/indirect ownership in provider
 - Any entity holding 5% or more mortgage/security interest in provider
 - Calculation:
 - Dollar amount of the mortgage, deed of trust, or other obligation secured by the provider or any of the property or assets of the provider
 - DIVIDED BY
 - Dollar amount of the total property and assets of the provider
 - Challenges of dealing with the banks, REITs, etc.
 - Bank issues – Must provide a letter from bank waiving right of offset if Medicare payments will be made to bank that has any loan with Medicare provider

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Regulatory Side of a Sale

- ▶ Centers for Medicare and Medicaid Services (“CMS”)
 - 855A Issues
 - Section 6 Individuals – must report/provide:
 - Percentage of direct/indirect ownership
 - Percentage of control of individuals who are not owners*
 - Managing employees
 - Whether reported individual provides contracted services
 - Effective date as director, officer, managing employee
 - State and country of birth
 - Person signing the 855A as the Authorized Official must be reported in Section 6
 - The Authorized Official cannot be an individual with only an indirect ownership in the provider (W-2 Managing Employees do not qualify). An Authorized Officer must either (a) have a direct ownership in the provider; or (b) hold an officer/director level position with the provider granting him/her the legal authority to bind the provider.

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Regulatory Side of a Sale

▶ Centers for Medicare and Medicaid Services (“CMS”)

- Until the MAC and CMS approve the 855A, the Medicare provider number remains assigned to the seller and the seller’s NPI. CMS will permit the new owner to bill the Medicare program under the seller’s NPI and Medicare number, while the buyer’s 855A is under review. However, until the approval is issued, and the assigned Medicare number is tied to the buyer and its NPI, Medicare will continue to make payments to the seller’s bank account. The new owner cannot use that number to bill and have Medicare funds directly paid to the new owner’s account.
 - Address this in the APA or OTA
- In our experience, it can take the MAC and CMS from three to six months to finalize their review of the 855. Ultimately, the CMS approval will be issued retroactive to the effective date of the change of ownership.

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Regulatory Side of a Sale

▶ Provider Assessment Issues

- Is the nursing facility associated with a CCRC, such that it is assessed/tax at the lower rate?
- Requirements to be taxed at CCRC rate:
 - SNF must be “owned or controlled” by an entity that holds a Certificate of Authority from the Insurance Department to operate a CCRC;
 - The CCRC must provide a continuum of care in residential living units (at least 2) that are either occupied or available for immediate occupancy by individuals under an Entrance Fee Agreement; and
 - SNF must be located on the same campus as the CCRC’s residential units or is located within 30 miles of the residential units (and the SNF is identified within the CCRC Disclosure Statement).
- Effective June 1, 2010, DHS placed a moratorium on the ability of SNFs to secure the lower CCRC rate. In other words, if the SNF wasn’t associated with a CCRC by June 1, 2010, then even if it becomes so later, satisfying the 3 criteria above, it will not qualify for the lower assessment rate.
- A SNF that fails to comply with the criteria can “lose” its CCRC status, and because of the moratorium, could never “re-enter” the assessment program at the CCRC rate. CCRCs are required annually to certify to DHS that they and their associated nursing facilities satisfy the above criteria.

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Regulatory Side of a Sale

▶ Provider Assessment Issues

- In order to meet Criteria #1 above, the nursing facility has to be owned or controlled by the CCRC license holder. Typically, this means that the nursing facility and the CCRC are owned and licensed under the same legal entity.
- If the legal entity holding the COA and the legal entity holding the SNF license are different, then the SNF risks losing its status as a “NF associated with a CCRC” and thus lose its eligibility for the lower provider assessment rate.
- To avoid risking the CCRC status for the nursing facility, the buyer will need to acquire not only the SNF but the CCRC operations as well.
 - This will result in a CHOW for the CCRC, which will require the parties to go through the CHOW process with the Pennsylvania Insurance Department.

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Regulatory Side of a Sale

▶ Pennsylvania Insurance Department (“PID”)

- CCRCs are licensed by PID, and are governed by the Continuing Care Provider Registration and Disclosure Act and its implementing regulations
- Proposed new owner/operator must submit a complete application to PID
- In most cases, PID will issue the license effective the closing day of the transaction
- In rare circumstances, PID has allowed the transaction to close, with the license issued post-closing and retroactive to the effective date
 - Only happens when closing falls on a holiday, or if PID is administratively over-burdened and needs to delay issuing the license
- PID is required to complete its review of a CHOW application in 90 days
- A completed application includes:
 - The Application form itself
 - A Statement in Support, and
 - The Disclosure Statement and Resident Agreement
- The PID is a much different type of application, requiring significant financial disclosures from the proposed buyer.

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Regulatory Side of a Sale

- ▶ Due diligence, Compliance, and Successor Liability Issues
 - Due diligence exchanged in conjunction with a planned sale is permitted under the “Health Care Operations” HIPAA Exception
 - If disclosable issues or overpayments are discovered during the due diligence phase, the current licensee/provider would have the obligation to disclose, as appropriate, to the applicable government agency
 - Cautionary issue for conducting a billing compliance audit as part of due diligence
 - Under Medicare rules, by accepting assignment of the Medicare Provider Agreement, the buyer assumes the responsibilities for:
 - Pending overpayments to the Program
 - Outstanding CMPs owed
 - Address known issues in the APA/OTA, and make resolution of such a condition of closing

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Conclusions and Q & A

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