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HEALTHCARE LAWYERS

Client Alert: CHOW or CHAI (COI) Anyone? The Confusing Intersection of Medicare Regulations and Ownership Transfers

Healthcare M&A Update

CHOW or CHAI (COI) Anyone?

The Confusing Intersection of Medicare Regulations and Ownership Transfers

The Centers for Medicare and Medicaid (CMS) distributes more than $1.5 trillion annually, comprising one-third of all U.S. healthcare expenses. Given the government's substantial participation in healthcare, many providers are highly dependent upon payments made by CMS. This dependency creates significant cashflow risks should there be any interruption in ongoing government payments to a provider, whether on account of potential fraud and abuse, or resulting from simple filing errors and oversights.

One of the biggest regulatory hurdles in any contemplated transaction (e.g. sale, purchase, financing) involving a healthcare organization is ensuring a smooth transfer of ongoing Medicare and Medicaid (or other insurance) reimbursement. When it comes to **healthcare M&A activity,** CMS rules (as well as those of state health agencies) are fastidious when it comes to ownership transfers. This means that for individuals or corporations who contemplate the sale, purchase, or merging of a healthcare business with substantial reliance on Medicare and Medicaid, there are unique regulatory challenges that must be part of one's comprehensive due diligence. Below, we review some of these issues.

CHOW & CHAI

CMS's "change of ownership" (CHOW) requirements are fundamentally the same whether a transaction involves a Medicare Part A facility (i.e. skilled nursing, hospice, inpatient hospital) or a Medicare Part B facility (i.e. clinical laboratories, outpatient rehabilitation, ambulatory surgery centers). However, one thing to note is that CMS has a broad definition of what constitutes a "change of ownership." In addition to standard purchases or mergers, CHOW requirements can also be triggered when existing ownership merely wants to change its legal identity. For some cases, CMS has a "change of *information*" (COI or CHAI) option that may be more suitable. In other transactions, a new party may decide neither to assume the target provider's existing Medicare identity, or to absorb and merge the acquiree's business into its own provider identity. Instead, new owners opt to start from scratch and seek a completely "new enrollment." CMS considers this scenario to be a "change of ownership" as well.

CHOW Transactions

When is a transaction subject to CHOW?

CHOWs can be appropriate in both asset purchase and share purchase contexts. The Code of Federal Regulations addresses the various scenarios that constitute a change of ownership. (C.F.R. § 489.18)

1. In the case of a **partnership**, the removal, addition, or substitution of a partner, is considered a change of ownership.

2. For a **sole proprietorship,** transfer of title and property to another party constitutes a change of ownership.
3. **Asset sales** involving corporations, LLCs, or LLPs, can also be subject to change of ownership rules, though this is not reflected in the original statute.
4. **Mergers** — The merging of one provider corporation *into* another corporation, or creating a new corporation by consolidating others, will constitute a change of ownership. But the acquirer that absorbs another corporation, or acquires the target firm's corporate stock, *may* keep its existing enrollee status. This will likely raise questions relating to "change of information" filings that need to be addressed as well.
5. A **lease** of all or part of a provider facility constitutes a change of ownership, though it will only be applicable to the *leased* portion of the facility. Questions around this provision often come up when hospitals hire an outside provider group with a particular specialization to occupy a particular location within the hospital structure (i.e. emergency care, occupational therapy, or radiology…).
6. A change in a provider's **tax identification number** (**TIN**) is sometimes a good indicator that a CHOW has occurred. However, the mere replacement of a TIN does *not* constitute a change of ownership. Rather, this would be considered a change in information.

In light of these broad definitions, when a provider's leadership begins to consider "corporate restructuring" or is contemplating a potential outsourcing or insourcing of a particular department or specialty in a hospital setting, this is often a good moment to find out whether these changes subject one or both parties to CHOW.

CHOW Application

When a transaction is subject to CHOW, *both* prospective buyer *and* seller are required to notify CMS as well as the applicable state survey agency (e.g. California Department of Public Health). Each will fill out a CMS 855-A form and submit it to the provider's Medicare Administrative Contractor ("MAC"). MACs are privately contracted reviewers, and vary from state to state. (Noridian currently serves California.) The job of the MAC is to review the application and send its recommendation to the CMS Provider Enrollment & Oversight Group (PEOG), along with an additional copy sent to the state survey agency. Meanwhile, each state has its own application process. California provides a helpful checklist for CHOW submissions. Once these are completed, both the MAC and the state agency provide their evaluations to the CMS Regional Office, who make the final decision. Historically, this process involves duplicate or triplicate assessments and a great deal of wearying coordination. Parties to the transaction need to coordinate the timing of their filings. Meanwhile, three sets of reviewers (state, federal, and MAC)— evaluate every application, whether it is a relatively straightforward change of ownership, or, a complex consolidation and acquisition arrangement involving multiple parties. This process can take several months, and cannot be hastened by early submissions, as CMS will not initiate a review more than 30 days before closing. This typically means that a buyer will start to furnish medical services, and will need suitable liquidity, until it is granted authorization to submit claims. In the last year, CMS has taken steps to reduce its own workload by giving more weight to the MAC and state agency conclusions. These changes may eventually hasten the process in a meaningful way.

CHAI (COI) Transactions

There are scenarios that do not constitute a change of ownership, but rather a "change of information" (CHAI or COI). The immediate benefit to the provider is that its existing Medicare enrollment remains the same, so there is no pause in billing and collection. A typical situation is one where the legal entity that owns and operates the provider is unaltered, but the composition of persons (or businesses) owning the legal entity is modified in some manner. These transactions are usually accomplished through corporate stock sales. Another CHAI (COI) scenario can take place when one Medicare provider acquires the *assets* of another Medicare enrollee. When this occurs, the purchaser notifies CMS that it is rejecting the automatic reassignment of acquiree's Medicare enrollment.

One primary motivation behind an assets-only transaction is that it permits the purchaser to *avoid successor liability*. The post-closing relationship between the main provider and the acquired asset requirements are determined by statute. (42 CFR § 413.65) CMS will need to be informed of the new locations and verify that any acquired facilities are operated as a satellite location of the main provider. This option often holds appeal to reduce risks of post-payment recoupment or other issues that predate the transaction closing.

The Assets or the Entity?

In general, sellers prefer transactions that minimize liability post-closing, therefore opting for CHOW-type transactions that will transfer their Medicare enrollee status to the buyer. According to CMS, unless fraud was involved, the new provider assumes responsibility for the seller's accrued overpayments and penalties under the Medicare program. (42 CFR § 489.18) Buyers, on the other hand, may prefer to purchase an entity's assets

instead of the entity itself, opting to avoid the assumption of the seller's liabilities. With respect to both parties, there are alternative strategies to mitigate risks for buyers engaged in a CHOW transaction such as post-closing reserves and indemnification provisions, as well for sellers considering a CHAI-type transaction. The use of indemnification clauses, tailored warranty agreements, and escrow holdbacks can help smooth concerns related to executing a healthcare M&A transaction.

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