Health Care Alert

PULLMAN & COMLEY

A publication of Pullman & Comley, LLC

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Is Now the Time to Buy or Sell? A Transactional Primer for Home Health Agencies

March 5, 2021

by Stephen M. Cowherd and Karen P. Wackerman

The focus that the COVID-19 pandemic has brought to nursing homes and similar facilities over the past year has created both an opportunity and a challenge for home health agencies (HHAs) throughout the country. Care in the safety of home has never been more desirable, and the continued arc of the age wave demonstrates that demand for these services is unlikely to abate in the future. On the other hand, competition for qualified staff, declining reimbursements and the increasing costs of doing business are forcing more and more HHAs to consider whether they have the resources and willingness to compete in a highly regulated environment that favors integration with health systems, larger HHAs or other specialty providers in order to survive and thrive.

In this, the first of four quarterly newsletters Pullman & Comley will publish on this changing and vitally important aspect of the health delivery system, we focus on the types of transactions that help owners of HHAs accomplish their goals no matter whether it’s time to grow in size and service area or maximize the profit potential of a strategic sale. We also examine some of the common issues owners of HHAs should understand and be prepared for when weighing these alternatives.

<u>Form of Transaction</u>

The structure of the transaction will be dictated by a number of factors, including the goals of the parties, the liabilities of the selling HHA, tax issues, timing, and other considerations.[1]

Asset Purchase

The most common type of combination of companies is an asset purchase. One company (the buyer) buys certain assets and assumes certain liabilities of another company (the seller). Buyers often prefer this structure because they generally can avoid assuming most of the liabilities of the seller and simply come away with their chosen assets. The seller will be left with the selling entity and whatever assets and liabilities remain. In our experience, this type of transaction is often the only vehicle that a for-profit entity can use to acquire a nonprofit provider.

Though asset deals are in many ways the simplest type of transaction to undertake, the parties will often need to devote substantial time and energy to obtaining approvals from regulatory authorities, insurance companies and third-party contractors to accomplish such things as assigning licenses, favorable payor agreements and supply arrangements to the buyer. Whether you are seeking to acquire or be acquired, taking an inventory of these issues months in advance is key to identifying potential business partners and avoiding the problem areas that typically scuttle or prolong these transactions.

Stock or Membership Purchase

Another common form of transaction is a stock (or for limited liability companies, membership interest) purchase. In these deals, the buyer purchases all of the equity of the target company from the owner. Many buyers like to do this because it often minimizes the amount of approvals and assignments that need to be obtained from regulators, contract parties, etc. because the target still exists as an entity. Sellers may prefer this structure as well because they typically are not left with any assets or liabilities that need to be handled after closing.

However, the due diligence aspects of these transactions (to be discussed in a future installment of this newsletter) can be daunting, as the buyer is literally stepping into the shoes of the seller and thus is exposed to all potential liabilities connected with the way the business was operated in the past. Some of the common techniques used to mitigate these risks are holdbacks of portions of the purchase price and complex indemnification agreements that continue to hold the seller ultimately liable for statute of limitations periods or specific periods of time. These types of transactions can often be predicated on pre-sale voluntary disclosures to regulatory agencies and third-party payers. Accordingly, the watchword to for buyers is to identify the potential problem areas early while sellers should be attempting to rectify these matters even before going to market.

Merger or Consolidation

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In a merger, one entity merges with and into another entity pursuant to the requirements of state law. The merging company disappears as a separate entity but its rights and liabilities (like the equity purchases above) are generally are inherited by the resulting merged company. Many states, including Connecticut, New York and Massachusetts, also allow consolidations, in which two entities merge into a newly-formed entity that is the surviving company. There is a similar disadvantage to a merger as in a stock purchase, in that the surviving company inherits the liabilities of the company that merged into it.

In the merger scenario, one common way that acquirers can seek to at least isolate the liabilities of the seller (beyond the methods already discussed) is to engage in what are known as "triangular mergers" where the acquirer creates a wholly-owned subsidiary (often a shell company), which in turn merges with the selling entity, resulting in the acquirer being the sole remaining equity holder in the subsidiary. There are also reverse triangular mergers which are the same as a triangular merger, except the subsidiary that is created by the acquirer merges into the selling entity. This leaves the selling entity as the surviving entity, which remains as a subsidiary of the acquirer. Reverse triangular mergers are used when it is important to maintain the identity and existence of the seller entity.

Member Substitution

In some states, including Connecticut, nonprofit or "nonstock" entities may have members. One option in such a state is for a nonprofit to acquire another nonprofit by having the buyer become the sole member of the seller, making the seller essentially a subsidiary of the buyer. This primarily involves changing the corporate documents of the seller to provide that it may have members and setting forth the rights of the buyer/sole member in the seller's bylaws. The effect of a member substitution is similar to that of a stock purchase. Unless the seller is part of another nonprofit or a separate charitable foundation is to be established for purposes of receiving the sale proceeds, usually no purchase price is paid in member substitution transactions because the seller has no shareholders to accept payment.

CARES Act Considerations

No discussion of embarking on a sale or acquisition transaction in the current environment would be complete without considering the status of any Coronavirus Aid, Relief, and Economic Security (CARES) Act program benefits received by any of the parties participating in the transaction. Accordingly, the requirements of any Provider Relief Fund payments or Accelerated and Advance Payments (AAP) received from Medicare must be reviewed to ensure compliance is maintained with appropriate HHS and CMS rules. It is possible that an HHA participating in the transaction may have problems accounting for the use of Provider Relief Fund payments it received or may need to reimburse CMS for overpayments under the AAP, which could affect any financial analysis of the deal and create liability for the purchaser or surviving entity of a merger. In addition, as with all entities that are recipients of a Paycheck Protection Program (PPP) loan under the CARES Act, the change of ownership of an HHA that is a PPP borrower requires consent of the lender and possibly of the

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Small Business Administration which guarantees PPP loans if its PPP loan has not yet been forgiven. Depending upon the form of transaction, the buyer may assume responsibility for the seller's PPP loan. In that event, the buyer should ensure that the seller has kept proper records regarding its PPP loan.

In sum, the factors that are driving growth and consolidation of HHAs will likely continue. As will be discussed in future newsletters, the complexity of the operations and regulation of HHAs also warrants additional and careful business planning before proceeding with a transaction. Knowing the type of transaction alternatives that are available to both buyers and sellers in this space is just the start.

[1]Note that the tax issues that must be considered in any transaction are beyond the scope of this article.