

A Conversation With Les Levinson: Managing Liability In Health Care M&A

A partner at the New York law firm Edwards Angell Palmer & Dodge LLP and chair of the firm's health care practice group, Les Levinson recently wrote a client advisory with Eric Fader on the issue of liability in health care mergers and acquisitions (www.eapdlaw.com/newsstand/detail.aspx?news=1668). We had the chance to follow up with Mr. Levinson in mid July, and record our conversation below. Mr. Levinson may be reached directly at llevinson@eapdlaw.com or at (212) 912-2772.



Irving Levin Associates: Given the recent economic downturn and an increase in liabilities that a company may be carrying, are you seeing more distressed sales of health care properties and businesses than before?

Les Levinson: We're seeing more discussion than before, but not necessarily a significant increase in activity at this point due to the liquidity factor that is still present in the economy. Even companies that you might think would be going through bankruptcy or restructuring are not doing so because of the lack of DIP (debtor in possession) or take-out financing. Also, there is not as much rebalancing of investment portfolios as in the past because the credit markets are still constrained. However, there does seem to be some light in the tunnel so we may see a little more relaxation of credit in the fourth quarter. Some banks are turning around; take for example the recent restructuring of CIT, which has been an active lender in health care.

ILA: American hospitals recently floated a proposal to voluntarily forego as much as \$155.0 billion in government reimbursement over the next 10 years. Since some already operate on razor-thin margins, do you see this as prompting more sales of hospitals?

LL: The legislative process is the dominant news of the day, and our firm will be publishing client alerts as the legislation moves forward. The various parts of the health care system, such as hospitals and pharmaceutical companies, have concluded that they will have to contribute to the cost reductions; by working proactively now and showing a willingness to engage in the legislative process, they hope to have more input to it. However, from where we stand today, it seems unlikely that we will have health care legislation by the August recess.

While the belt-tightening may result in more hospital sales, it could also lead to the closure of some hospitals.

ILA: What, if any, is the downside of an asset sale (where the liability is not transferred to the buyer) over the stock purchase of a company?

LL: Absent specific considerations, such as gaining a large tax loss carryforward, and apart from deals in the public company arena, virtually all buyers would prefer to structure their transactions as an asset sale. It allows them to pick and choose the liabilities they want to accept or decline.

ILA: Your client advisory notes that if a transaction is found to be a de facto merger or consolidation, this finding could lead to a buyer inheriting the liabilities of the seller. Many not-for-profit organizations, e.g., hospitals and nursing homes, typically structure a business combination as a merger. How do they limit their liability apart from resorting to bankruptcy?

LL: When putting together a merger, you need to take certain steps to limit liability as best as possible. As always, good due diligence is critical. In a non-public deal you can contractually provide for post-closing indemnities for the buyer as well as by creating an indemnity fund; parties may also on occasion use representation and warranty insurance offered by some insurance companies.

In cases of bankruptcy or restructuring, you can have a confirmed plan of bankruptcy or a 363 sale, which is a sale of assets under the supervision of the bankruptcy court. In such a case, the court's approval of the sale would preclude treating the deal as a de facto merger in which the liabilities flow through to the buyer.

ILA: Bills to reform health care are currently before Congress. While there is a great deal of uncertainty over the shape that reform will ultimately take, do you see any potential changes to the legal treatment of liability going forward?

LL: No. Issues such as the one you are referring to, most notably tort reform, will most likely not be taken up in this session.

ILA: What one thing would you like for our readers to take away on the issue of liability when structuring a health care transaction?

LL: Strive to be clear in your objectives, in what you're trying to accomplish in the transaction, as this will drive the process from due diligence to how the deal should be structured as well as issues of timing.