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Ownership Successor Liability

Selling a facility does not guarantee the previous owner's release from all obligations if the transaction is merely a transfer of assets.

In this difficult economic environment, health care facilities unable to meet ongoing financial obligations may negotiate payment plans with their creditors or file for bankruptcy protection. Others may consider selling their assets to a new entity in order to get a fresh start, but leaving a facility behind does not guarantee a release from its liabilities.

Under the common law of virtually all states, if one corporation is considered the successor to another, the successor is liable for the acts and obligations of the predecessor if ownership was acquired by means of a merger or consolidation.

However, if the transaction is merely a transfer of assets to another entity, the assets may generally be transferred without also transferring liabilities.

Liability Exceptions

There are several exceptions to the general rule that could lead the buyer of a corporation's assets to be liable as its successor: if the buyer expressly or indirectly agreed to assume the obligations of the predecessor, if the transaction is found to be a *de facto* merger or consolidation of the two entities, if the purchaser is determined to be a mere continuation of the seller, or if the transaction is fraudulently entered into to escape liabilities.

If a creditor of the predecessor company can demonstrate that one of these four exceptions applies, a court could enforce the predecessor's obligations against the successor company.

The analysis becomes more complicated in situations where only certain obligations are assumed or where there is no express agreement for the assumption of liabilities, but the purchaser voluntarily pays certain debts of the seller.

A creditor may argue that the voluntary assumption of some debts by the purchaser obligates it to assume others, but this fact alone will not be sufficient to find an implied assumption of liability in the absence of other factors.

> Several exceptions to the rule could lead the buyer to be liable as successor.

Determination Of *De Facto* Mergers

If a transaction is not intentionally structured as a merger or consolidation by the parties, the successor corporation may nonetheless be held responsible for the predecessor's liabilities if a court determines that the parties have engaged in a *de facto* merger or consolidation.

This determination is based on an analysis of four independent factors under common law: whether there is continuity of management, employees, physical location, assets, and general business operations; whether ownership remains the same, such as shareholders of the seller corporation becoming shareholders of the purchaser; whether the cessation of ordinary business and liquidation of the seller corporation takes place as soon as possible; and whether the purchaser assumes the obligations of the seller that are ordinarily necessary for the uninterrupted continuation of the business of the seller.

All four criteria need not be met in order for a *de facto* merger to be found to exist. Furthermore, there need not be a finding of fraudulent intent on the part of the parties.

A "mere continuation" exception will apply when the acquiring company is deemed to be a continuation of the selling corporation in a different form, rather than only a continuation of the seller's business.

This applies when a purported asset sale is deemed to be, in effect, a form of corporate reorganization. In making this determination, a court will analyze whether the directors and shareholders of the acquiring company are basically identical to those of the seller, and whether the selling corporation ceases to exist after the transaction.

Lifting Corporate Protections

A court may find that a successor company is responsible for the obligations of the predecessor company if it determines that the transaction was entered into fraudulently in order for the predecessor to escape certain liabilities.

This determination requires a de-

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tailed factual analysis, including, among other things, whether there is a close relationship between the parties to the transaction, whether the purchaser paid fair consideration for the assets, and whether the seller retained any control over the assets after the transaction.

The general rule and the exceptions outlined above will apply to a transfer of assets from one health care entity to another. If the predecessor company is a corporation or limited liability company that owns a nursing facility, home health agency, or similar facility, the individual equity owners of the predecessor company should have no liability for the obligations of that company unless one of the above exceptions applies or unless there is a legal justification for piercing the corporate veil—removing the protection it provides—and pursuing the individuals.

The corporate veil may be pierced if the company, for example, failed to observe corporate formalities such as maintaining records and holding meetings, commingled its funds with those of its shareholders, allowed shareholders to use the funds for personal expenses, or purportedly operated while actually insolvent.

If the corporate veil cannot be pierced, and none of the above exceptions applies, any outstanding liabilities of the predecessor company will be payable only from its own corporate assets.

■ A *de facto* merger can be determined by several factors.

Personal Liability

The result may be different when a closely held health care practice closes its doors or sells its assets. If a professional corporation with a single physician shareholder is determined by Medicare to be liable for overpayments, the fact that the services were performed, or perhaps not performed, through a corporation will not shield the individual physician from liability for repayment.

Under state law, it may be unusual for a court to pierce the corporate veil in the absence of fraud; however, when the U.S. Department of Health and Human Services seeks recovery of Medicare overpayments, federal law applies. Under federal case law, the corporate veil may be pierced, if necessary, to prevent circumvention of a statute or avoidance of a clear legislative purpose.

Courts have held that the federal government's goal of paying only the reasonable cost of Medicare services is a sufficient legislative purpose to justify piercing the corporate veil, in the case of a Medicare overpayment.

In the case of *United States v. Pisani*, the federal government sought to recover from an individual physician Medicare overpayments that had been made to his single-shareholder corporation. The Third Circuit held that federal law controlled and pierced the corporate veil to hold the physician personally liable for the overpayments.

In *United States v. Normandy House Nursing Home*, the court found that the defendant doctor was the alter ego of a nursing facility corporation, which again allowed the corporate veil to be pierced.

While both cases involved the Medicare program, the relevant analysis would apply equally to overpayments under other federal programs or joint federal/state programs, including Medicaid, but not to cases brought by private insurance carriers.

Consideration of whether to sell, purchase, or close a health care facility requires an analysis of issues that are more complicated than those affecting businesses in other industries. Careful planning will help ensure the maximum possible protection from potential liability for both sides. ■