# PUBLICATION

## A Primer for Lending on Governmental Health Care Receivables

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**While the best asset to have is cash, the next best assets to have are accounts receivable, which are the right to payment for services rendered or goods provided. In the health care industry, receivables are the right to payment for health care services rendered by a health care provider, which can be a hospital, physician's office, pharmacy, or another medical provider. This article will examine the health care receivables generated by skilled nursing facilities, with a focus on receivables to be paid by governmental programs (e.g., Medicare and Medicaid).**

In the context of this article, governmental health care receivables are the right to payment by Medicare or Medicaid programs to a skilled nursing facility for the provision of certain covered services. These receivables differ from the ordinary accounts receivable in several distinct and important ways.

- First, government receivables are highly regulated. A skilled nursing facility receiving such must be certified to participate in the Medicare and Medicaid programs and can lose the right to such payments if it fails to adhere to minimum standards of care and other standards required by such programs.

- Secondly, while most accounts receivable have standard payment terms (with the provider of the goods or services knowing that, at a minimum, it will be paid within a set time frame), governmental health care receivables are not paid within a date certain payment time.

- Thirdly, and probably most importantly, governmental health care receivables are not assignable by the payee/provider of goods and services. Ordinary course accounts receivable can be directly assigned to a lender as collateral; governmental health care receivables are expressly prohibited by statute from being assigned (see 42 U.S.C § 1396a(32) and 42 U.S.C. § 1395g(c)).

The drafters of the Medicare and Medicaid statutes sought to prohibit factoring of governmental health care receivables, which is the sale of the right to such payment, often at a discount, to a factoring lender, which then directly collects the payments over time. While the motivations behind such prohibitions are beyond the scope of this article, it is clear that the drafters wanted to avoid potential predatory collection actions by the purchaser of such accounts.

Given the unique characteristics of government health care receivables, how can an operator of a skilled nursing facility obtain accounts receivable financing? In its most basic form, a lender providing accounts receivable financing establishes "lockbox" accounts, controlled exclusively by the lender, into which payors make direct payments in respect of the accounts receivable. At first blush, lockbox accounts are problematic because reimbursements from government agencies must be directed into an account under the sole control of the provider of the services. Governmental receivables cannot, therefore, be directed into an account under the exclusive control of the lender. However, as long as the payment from the government agency is sent to a bank account from which the operator is free to make withdrawals, the payment is deemed made directly to the provider. Lenders and their borrowers can utilize alternate cash collection arrangements that keep the governmental agency requirements intact. A typical cash management arrangement involves the following:

- Governmental health care receivables are directed to a deposit account in the name of the provider and under the control of such provider. Such deposit account is only used for the collection of governmental receivables. The depositary bank, provider and lender enter into a deposit account instructions and service agreement (DAISA) that provides for a daily sweep of the funds collected in such deposit account to another account in the provider's name. The DAISA typically provides that any alteration of the sweep instructions not approved by the lender is an event of default under the loan documents.

- The account into which the funds from the governmental receivables deposit account are collected is usually an account covered by a deposit account control agreement (DACA), among the depositary bank, lender, and provider. This arrangement serves, inter alia, to perfect the lender's security interest in the cash collected in such account. The funds collected in this account are usually swept daily to an account in the lender's name and applied to the balance of the revolving loan.

It is important to remember that the anti-assignment provisions do not preclude a lender from taking and perfecting a security interest in health care receivables. Instead, these provisions limit the enforcement of the security interest with regard to the payor of the accounts receivable. Health care insurance receivables are specifically included the definition of "accounts" in which a security interest may be granted and perfected. UCC §9-102(a)(2). A "healthcare insurance receivable" is defined as an "interest in or claim under a policy of insurance which is a right to payment of a monetary obligation for health-care goods or services provided". UCC §9-102(46). Perfection of a security interest in accounts under the UCC is accomplished by filing a UCC-1 financing statement with the Secretary of State of the state in which the provider is located. UCC §9-307. Section 9-408 of the UCC expressly acknowledges the anti-assignment provisions are applicable to health care receivables and invalidates contractual agreements and statutes that impair the creation, attachment, or perfection of a security interest or that provide that the creation, attachment, or perfection of a security interest gives rise to a default, breach, right of recoupment, claim, defense, termination, or remedy under a health care insurance receivable.

Section 9-408 of the UCC allows the grant of a limited security interest in health care receivables by the provider. This alters how a lender can enforce its lien and realize on the collateral in the event of default by a provider-borrower. The value to the lender of a security interest in health care receivables derives from the payments due and not from the present right to possess and control such receivables. The security interest permitted under UCC §9-408 therefore allows the lender to have a perfected, present security interest in future payables (the proceeds from the receivables). Such perfection protects the lender's interest in the proceeds of the health care receivables, protects the lender from further sale or assignment of the receivables, and preserves the priority of the lender's security interest over other secured creditors.

While the lender is able to perfect its security interest in the health care receivables through the filing of a UCC-1 financing statement and in the cash collected in deposit accounts through the use of deposit account control agreements, the lender does bear the risk that the provider will use the funds collected in the governmental receivables account other than as directed by the lender. A lender, therefore, must build provisions into its loan documents that address, and attempt to mitigate, these risks. A lender can reduce its risk by (a) increasing its initial and ongoing due diligence investigations into the provider, (b) limiting what health care receivables constitute "eligible accounts" to be included in the borrowing base, and (c) including additional representations, warranties, and covenants in the loan documents giving the lender more latitude with respect to remedies and other enforcement rights in the event of a default by the provider-borrower.

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