Healthcare Financing Anti-assignment Limitations

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This practice note describes how to structure financing transactions for healthcare providers to overcome anti-assignment and collection limitations on Medicare and Medicaid receivables. The Uniform Commercial Code (UCC) generally prohibits restrictions on assignment, making it possible for secured lenders to obtain a perfected security interest in these assets. However, other regulations make it difficult for lenders to collect on these receivables. Lawyers, therefore, use a "double lockbox" mechanism to work around these federal regulations. You should be familiar with this structure and its legal status as defined in recent case law.

For further guidance on the topics discussed in this practice note, see:

- Security Interests Resource Kit
- Due Diligence for Financing Resource Kit
- Events of Default Resource Kit
- Perfecting Security Interests by Possession, Filing, and Control
- Assets Commonly Excluded from the Security Package
- Cash Management Arrangements
- Accounts Receivable Eligibility Criteria
- Affirmative Covenants in Credit Agreements

Introduction

Receivables, or "accounts" as defined under the UCC, are a valuable and common asset type to pledge to lenders in secured financings. They are simple to perfect, requiring only a general grant of the asset type in a security agreement along with the filing of a UCC financing statement. However, many contracts that give rise to the underlying receivables also contain restrictions that on their face would prevent their assignment to lenders. These contractual anti-assignment clauses would be broad enough to greatly diminish the value of receivables as a form of collateral.

The UCC solves this by rendering most contractual anti-assignment clauses ineffective. Under U.C.C. § 9-406, a term in an agreement between an account debtor (i.e., the party that owes payment to the borrower under the receivable) and the assignor or borrower that "prohibits, restricts, or requires the consent of the account debtor or person obligated on the promissory note to the assignment or transfer of, or the creation, attachment, perfection, or enforcement of a security interest in, the account" is generally ineffective. A term that would result in a default of a contract if the underlying account is pledged is

similarly rendered ineffective. This has allowed for borrowers to freely assign these assets and has made Asset-Based Loan (ABLs) financings more accessible to borrowers with large amounts of receivables.

However, a key aspect to an assignment from a lender's perspective would be its right to receive payments from the account debtor. The UCC has some lender-friendly provisions here but contains some restrictions relevant to the assignment of Medicare and Medicaid receivables. The anti-assignment override provided by the UCC would not be of use to a lender that is unable to collect on those receivables from an account debtor (i.e., the government) during, say, an exercise of remedies. Fortunately for lenders, U.C.C. § 9-406(a) would require an account debtor to make a payment to an assignee (i.e., a lender) if adequate notice is provided to the account debtor. However, U.C.C. § 9-406(b) limits this right of payment if it is otherwise restricted "under law other than this article."

In fact, the Medicare and Medicaid anti-assignment provisions, with limited exceptions, prohibit anyone, except the healthcare provider, from receiving payments from federal government healthcare programs. In order to comply with the anti-assignment provisions, a provider cannot assign its right to be paid to any other entity, including its lenders. However, as described below, there are cash-management techniques, which if properly structured, will enable the parties to arrange compliant financing transactions.

Anti-assignment Provisions – The Regulatory Framework

Pursuant to 42 C.F.R. § 424.73, except with respect to certain limited exceptions, "Medicare does not pay amounts that are due a provider to any other person under assignment, or power of attorney, or any other direct payment arrangement." There are several exceptions to this anti-assignment provision, which apply only under limited circumstances but are generally described as payment to a government agency or entity, payment under assignment established by or in accordance with a court order, and payment to an agent who furnishes billing and collection services to the provider, all subject to certain conditions being met (42 C.F.R. § 424.73).

There are also specific anti-assignment provisions pertaining to each of Medicare Parts A and B. Part A covers hospital insurance benefits for the aged and disabled, while Part B includes supplementary medical insurance benefits for the aged and disabled. For Part A, 42 U.S.C. § 1395g(c) states in relevant part that "No payment which may be made to a provider of services under this title [42 U.S.C. § 1395 et seq.] for any service furnished to an individual shall be made to any other person under an assignment or power of attorney . . . " with certain specified exceptions, such as with respect to an assignment to a government agency. For Part B, 42 U.S.C. § 1395u(b)(6) states in relevant part that, with certain listed exceptions, "No payment under this part [42 U.S.C. § 1395j et seq.] for a service provided to any individual shall . . . be made to anyone other than such individual or (pursuant to an assignment described in subparagraph (B)(ii) of Paragraph (3)) the physician or other person who provided the service . . . ."

In addition, 42 C.F.R. § 447.10, as outlined in Subsection (a), implements Section 1902(a)(32) of the Social Security Act "which prohibits State payments for Medicaid services to anyone other than a provider or beneficiary, except in specified circumstances." Pursuant to Subsection (d), "Payment may be made only (1) To the provider; or (2) To the beneficiary if he is a noncash beneficiary eligible to receive the payment under § 447.25," or as otherwise outlined in other sections of 42 C.F.R. § 447.10 (covering, for example, reassignments and payments to a billing agent, such as a billing service or an accounting firm in specified circumstances).

The Double Lockbox Mechanism

It is crucial for both borrowers and lenders, and their counsel, to understand and comply with all aspects of the anti-assignment provisions. The Medicare Claims Processing Manual (Manual), Chapter 1, Section 30.2.5, provides useful guidance to lenders in dealing with Medicare and Medicaid receivables. Specifically, the Manual states that payments due a provider may be sent to a bank for deposit in such provider's account if certain conditions are met, including that the account be "in the provider/supplier's name only and only the provider/supplier may issue any instructions on that account. The bank shall be bound by only the provider/supplier's instructions. No other agreement that the provider/supplier has with a third party shall have any influence on the account. In other words, if a bank is under a standing order from the provider/supplier to transfer funds from the provider/supplier's account to the account of a financing entity in the same or another bank and the provider/supplier rescinds that order, the bank honors this rescission notwithstanding the fact that it is a breach of the provider/supplier's agreement with the financing entity."

Further, the Manual states that the bank "may provide financing to the provider/supplier, as long as the bank states in writing, in the loan agreement, that it waives its right of offset. Therefore, the bank may have a lending relationship with the provider/supplier and may also be the depository for Medicare receivables." In accordance with the Manual, despite what a provider and lender may agree to in writing, the lender cannot purchase the provider's Medicare receivables.

Accordingly, in light of the above manual provisions, a common and well-accepted mechanism for providers and lenders to structure payments is to have the provider open multiple deposit accounts, with one in the name of provider that receives only Medicare and Medicaid payments. The provider then enters into a compliant arrangement with the bank that generally vests sole control of the account with the provider while having standing (yet revocable) instructions to sweep the monies from the account into another provider bank account that the lender can access and possibly control. This concept is often referred to as the "double lockbox." Parties regularly elect to have the sweep occur daily in order to ensure funds are not accumulating in the government payments account. For a form lockbox agreement, see Lockbox Agreement.

In setting up a double lockbox, there are various details involved and both providers and lenders need to carefully address those to avoid running afoul of any applicable federal or state restrictions. An example of typical language in loan documents that utilize this double lockbox mechanism is as follows:

> If any of the Account debtors is a Governmental Authority, including, without limitation, Medicare and Medicaid (each a "Governmental Account Debtor"), Borrower shall ensure that all collections of such Accounts shall be paid directly to Accounts # XXXXXX, XXXXXX, XXXXXX, at Lender for Borrower (collectively, the "Governmental Accounts"). All funds deposited into the Governmental Accounts shall be transferred into the Borrower's Operating Accounts by the close of each business day pursuant to that certain Sweep Account Agreement dated as of the date hereof (as amended, restated, replaced, extended, supplemented or otherwise modified from time to time, the "Sweep Agreement") by and between Borrower and Lender.

While there has not been a significant amount of litigation concerning the validity of these arrangements, they have typically passed judicial muster. For example, in DFS Secured Healthcare Receivables Trust v. Caregivers Great Lakes, Inc., 384 F.3d 338, 350, 2004 U.S. App. LEXIS 19165, at *29–30 (7th Cir. Ind. September 13, 2004), when referring to 42 U.S.C. § 1395g(c), the court stated that "On its face, this statute stands only for the proposition that Medicare funds cannot be paid directly by the government to someone other than the provider, but it does not prohibit a third party from receiving Medicare funds if they first flow through the provider."

Further, in Lock Realty Corp. IX v. U.S. Health, LP, 2007 U.S. Dist. LEXIS 14578, at *6–8 (N.D. Ind. Feb. 27, 2007), the court favorably cited DFS Secured Healthcare Receivables Trust and other cases that support the right to assign Medicare and Medicaid receivables and of third parties to collect on those amounts if they first flow through the provider. These other cases include:

- In re Missionary Baptist Foundation of America, Inc., 796 F.2d 752, 759 (5th Cir. 1986) (affirming the decision of the district court and holding that the bank took a valid security interest in the debtor's accounts receivable due from medical care payments)
- Credit Recovery Systems, LLC v. Hieke, 158 F. Supp. 2d 689, 693 (E.D. Va. 2001) ("[T]he Court notes that neither the Medicare nor Medicaid statutes expressly proscribe a provider's assignment of the general right to receive Medicare or Medicaid receivables to a non-provider.")
- In re American Care Corp., 69 B.R. 66, 67 (Bkrtcy. N.D. Ill. 1986); In re East Boston Neighborhood Health Center Corp., 242 B.R. 562, 573 (Bkrtcy. D. Mass. 1999) ("Nothing in these statutes prohibits the Debtor, as provider, from granting a security interest in its receivables under these programs or invalidates such security interests. By prohibiting the governmental insurer from making payment on the receivables to anyone other than the Debtor, the statutes may impair the Defendants' ability to seek payment on the receivables from the governmental insurer without the provider's cooperation, but that cooperation may well be available, and the statutes do not impair the Defendants' ability to enforce their security interests once payment has been issued.")
- In re American Care Corp., 69 B.R. 66, 67 (N.D. Ill. 1986) (denying junior creditor's motion to terminate adequate protection payment to senior creditor who was entitled such protection pursuant to its valid security interest in Medicare receivables)

The court in *Lock Realty Corp. IX*, concludes, "The financing arrangements in this are case are valid and in accord with the federal anti-assignment statute, so Lock Realty cannot enforce its judgment to the extent satisfaction would infringe on a superior interest in the receivables." The court in *Lock Realty Corp. IX* also provided further insight on proper structuring by stating:

In other words, the intervenors' rights in the funds flow through Americare since neither party can receive Medicare funds pursuant to their arraignment without subsequent judicial enforcement of the security agreement. Because the financing arrangements don't provide a non-provider with the opportunity to submit a false claim, the concerns addressed by the anti-assignment statute aren't implicated. See, e.g., Bank of Kansas v. Hutchinson Health Services, Inc., 12 Kan. App. 2d 87, 735 P.2d 256, 259 (Kan. Ct. App. 1987). A court-ordered assignment pursuant to 42 C.F.R. § 424.90, directing payment from AdminiStar to Health Care Services or National City Bank doesn't violate federal law.

Conclusion

As the above illuminates, it is both possible and commonplace for lenders to offer financing to healthcare providers using Medicare and Medicaid receivables as collateral despite the existence of the anti-assignment provisions by using well documented, commercially acceptable, and compliant financing and collateral agreements. However, given the continued evolution in the way healthcare services are provided and financed, counsel for both providers and lenders must continue to stay abreast of all applicable laws, rules, regulations, and other interpretive guidance to ensure continuing compliance with all laws applicable to healthcare financings.

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