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The 5% Solution…Is It Worth The Risk?

Since DMEPOS Competitive Bidding Program Round 2 winners were announced, I have received dozens of calls and emails from clients telling me they heard about a work-around whereby a non-contract supplier can access a contract supplier's contract by buying five percent (5%) of the stock of the contract supplier. This alleged work-around, properly known as "common ownership" but which I have named the "5% Solution," is not as simple and easy and most think, and is certainly not a magic bullet. In fact, it can have serious consequences for both a contract and non-contract supplier.

In this article, I address my experience with the 5% Solution and provide the top reasons I think it is a risky option for contract suppliers and non-contract suppliers, alike.

I. Common Ownership a/k/a the "5% Solution"

The 5% Solution originated from the CBIC's rule restricting "commonly owned" suppliers from submitting numerous bids under the DMEPOS Competitive Bidding Program. According to the DMEPOS Competitive Bidding Program -- Common Ownership and Control Fact Sheet (October 2009; updated November 2011; updated August 2012), two suppliers are deemed to be "commonly owned" if one of the suppliers has an equity (e.g., stock, limited liability company membership interest, or partnership interest) ownership interest totaling at least 5% of the other. If a contract is awarded to a commonly owned or controlled supplier, then the contract would include all locations in the CBA that have an ownership or controlling interest in each other. Stated differently, if a commonly owned or controlled supplier is awarded a Competitive Bidding Program contract, each locations listed with CMS/CBIC for that contract supplier will be considered a contract supplier.

This last statement is what got many attorneys, like myself, thinking – why establish common ownership before the Competitive Bidding Program contracts are awarded? Instead, wait until the contracts are awarded, then establish common ownership between a non-contract supplier and a contract supplier in order to add a non-contract supplier's locations to a contract supplier's contract.

II. My Experience with the 5% Rule

In early 2013, one of my larger clients (who had won numerous product categories in numerous CBAs in Round 2 of the Competitive Bidding Program) was approached by a large DMEPOS supplier that did not win a contract for any product categories in any CBAs. The DMEPOS supplier offered to purchase 5% of my client's stock in order to add that company's locations to my client's Competitive Bidding Program contract.

Considering that the Competitive Bidding Program rules and fact sheets did not address this situation, I reached out to the director of the CBIC and the CMS director in charge of the Competitive Bidding Program. My contact indicated that the question could only be answered by the Department of Health and Human Services' Office of General Counsel (OGC). After several weeks of back-and-forth communications, we finally received a favorable answer from OGC. Nevertheless, after we considered the potential problems associated with the common ownership of two competing DMEPOS suppliers, my client decided not to continue with the deal.

Since then, our Firm has dealt with this same issue at least a dozen times; and in each situation, our client has determined that the risks are not worth the potential rewards.

III. Potential Issues Affecting Contract Suppliers that Pursue the 5% Solution

There are numerous reasons why contract suppliers are reticent to enter into transactions with non-contract suppliers under the 5% Solution; however, I will only address the most obvious.

If Anything Goes Wrong, the Contract Supplier May Lose Its Competitive Bidding Contract…Or Worse.

Once a contract supplier updates its location list with CMS/CBIC by adding the non-contract supplier's location(s) to its Competitive Bidding contract, each of the non-contract supplier's locations will be considered a contract supplier. This means the (previously named) non-contract supplier and the (original) contract supplier will be considered one (1) entity that is collectively subject to the contractual obligations outlined in the Competitive Bidding Program contract, which include complying with **all** federal, state, and local laws and regulations (i.e. DMEPOS Supplier Standards, DMEPOS Quality Standards, Anti-Kickback Statute, HIPAA, licensing laws, Medicare rules, etc.). As such, any violation by the non-contract supplier could result in a breach of contract that affects both the non-contract supplier **and/or** the contract supplier. According to 42 CFR § 414.422(g)(2), in the event a contract supplier breaches its contract, CMS may take one or more of the following actions:

(i) Require the contract supplier to submit a corrective action plan;

(ii) Suspend the contract supplier's contract;

(iii) Terminate the contract;

(iv) Preclude the contract supplier from participating in the competitive bidding program;

(v) Revoke the supplier number of the contract supplier; or

(vi) Avail itself of other remedies allowed by law.

Given that the contract supplier cannot watch everything the non-contract supplier does, if the non-contract supplier violates **any** federal, state, or local law or regulation that results in a breach of contract, the violation would inure to the contract supplier. **As a result, not only could the contract supplier's Competitive Bidding Program contract be terminated, but the contract**

supplier could be precluded from participating in future rounds of the Competitive Bidding Program, have its supplier number revoked, be excluded from any state or federal health care program, or be civilly or criminally prosecuted. Unless the amount the non-contract supplier pays a contract supplier to obtain 5% of the contract supplier's stock is substantial (in which case, why didn't the non-contract supplier just pursue a full stock or asset purchase agreement to attain the contract), the contract supplier may not be willing to accept such high risks for a small monetary reward.

I have seen numerous contract suppliers lose their contract and/or have their supplier numbers revoked. For a contract supplier to suffer this potential damage as a result of a non-contract supplier's actions, almost any reward seems hardly worth it.

Below is a list of actions for which I have seen CMS revoke a supplier's license:

(i) Violating telemarketing rules;
(ii) Discounting co-pays;
(iii) Improperly paying marketing personnel;
(iv) Violating consignment closet rules;
(v) Violating HIPAA;
(vi) Fraud;
(vii) Audit overpayments;
(viii) Maintaining improper subcontracting relationships;
(ix) Hiring an individual on the OIG Excluded Persons list;
(x) Failing to be accredited for 2 days.

IV. Potential Issues Affecting Non-Contract Suppliers that Pursue the 5% Solution

The most obvious reason why a non-contract supplier is reticent to enter into a transaction with a contract supplier under the 5% Solution is the inverse of Section III above.

Once a contract supplier updates its location list with CMS/CBIC by adding the non-contract supplier's location(s)n to its Competitive Bidding Contract, each of the non-contract supplier's locations will be considered a contract supplier. This means the (previously named) non-contract supplier and the (original) contract supplier will be considered one (1) entity that is collectively subject to the contractual obligations outlined in the Competitive Bidding Program contract, which include complying with **all** federal, state, and local laws and regulations (i.e. DMEPOS Supplier Standards, DMEPOS Quality Standards, Anti-Kickback Statute, HIPAA, licensing laws, Medicare rules, etc.). As such, any violation by the contract supplier could result in a breach of contract that affects both the contract supplier **and/or** the non-contract supplier. According to 42 CFR § 414.422(g)(2), in the event a contract supplier breaches its contract, CMS may take one or more of the following actions:

(i) Require the contract supplier to submit a corrective action plan;

(ii) Suspend the contract supplier's contract;

(iii) Terminate the contract;

(iv) Preclude the contract supplier from participating in the competitive bidding program;

(v) Revoke the supplier number of the contract supplier; or

(vi) Avail itself of other remedies allowed by law.

Given that the non-contract supplier cannot watch everything the contract supplier does, if the contract supplier violates any federal, state, or local law or regulation, the violation would inure to the non-contract supplier. **As a result, not only could the non-contract supplier lose the ability to bill under the Competitive Bidding Program contract, but the non-contract supplier could be precluded from participating in future rounds of the Competitive Bidding Program, have its supplier number revoked, be excluded from any state or federal health care program, or be civilly or criminally prosecuted**. Unless the amount the non-contract supplier may gain from accessing the contract supplier's Competitive Bidding contract (minus the amount the non-contract supplier pays the contract supplier to attain 5% of the contract supplier's stock) is substantial (in which case, why didn't the non-contract supplier just pursue a full stock or asset purchase agreement to attain the contract), the non-contract supplier may not be willing to accept such high risks for a small monetary reward.

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In addition, as a 5% or greater owner of the contract supplier's company, the non-contract supplier may be liable for any overpayment, recoupment, false claim, fraudulent action, or other violation performed by the contract supplier, including those violations that may have occurred before the contract supplier even purchased the 5% ownership interest.