

Healthcare Factoring and Medical Invoice Factoring, Explained



What is factoring?

Healthcare factoring, sometimes called “medical factoring” or “medical receivables factoring,” provides instant capital to medical providers, including, physicians, medical practices, diagnostic and imaging facilities, nursing homes, hospitals, home health care companies, and surgery centers to fund ongoing business operations. The term “factoring” refers to the outright purchase and sale of accounts receivable (“A/R”) invoices at a discount from a provider’s full billed charges. Factoring companies engaged in the business of purchasing accounts receivable are called “factors.” Healthcare providers selling their accounts receivables in the factoring transaction are referred to as “sellers.” The seller’s customers, who are in some instances the patients receiving healthcare services from the provider, and in others insurance carriers or government payers, are generally referred to as “account debtors.” The cash which a factor disburses to the seller as payment for the accounts receivable for services rendered to the debtor are typically called an “advance.”

Why is medical receivables factoring advantageous?

Factoring receivables is an attractive option for healthcare providers in that it involves the transfer of an asset rather than a loan of money. Factors primarily focus on the ability to collect the account receivable being purchased rather than the credit worthiness of the healthcare provider. This makes factoring a suitable transaction for many growing businesses when traditional medical financing or commercial lending proves impractical or unavailable. Factoring also provides immediate cash access with little to no wait period, as factoring companies disburse payments quickly following invoicing. Factoring companies also provide relief through the handling of all invoicing, and transfers the responsibility of collecting payment from no-pay and slow-pay clients from the provider to the factor. Factoring is a common practice for healthcare providers working in the personal injury industry, and less common in the [Worker’s Compensation industry in light of recent legislative developments](#).

Recourse vs. non-recourse invoice factoring

When invoices are purchased, there is always a risk that a receivable may not be collected for a variety of reasons. “Recourse” factoring places this risk of non-collection on the invoice seller, who typically agrees in such cases to buy back any uncollected invoices from the factor. “Non-recourse” factoring, on the other hand, places the risk of non-collection on the factor itself, who is responsible for carrying 100 percent of the risk that some or all of the purchased invoices may not be collectable.

Although both methods may be used depending on the circumstances, non-recourse factoring is often a more

attractive option for healthcare providers who are willing to sell their invoices for a discount in exchange for the certainty of knowing that they bear no risk for unpaid accounts.

How does factoring work?

Once the factor and the provider have executed a formal factoring agreement, the factoring relationship begins. The specific process by which a provider submits invoices, receives payments and receives reports will depend, among other considerations, on the type of factoring arrangement, the size of the factor's operation, and the quantity of provider invoices. In general, the process of medical factoring contemplates the following events.

Invoices are generated

In the vast majority of cases, factors require providers to generate invoices with the factor's remittance address and letterhead already on them. Usually, the factor will provide the provider with documentation containing the remittance instructions and a statement that the invoice has been assigned to the factor. The provider collects invoices with the necessary support documentation attached and submits them to the factor.

Some factors insist on sending invoices directly to the debtors, i.e. patients, and so require providers to submit only original invoices. Other factors allow the providers to handle the mailing chores, however, and will therefore accept invoice copies. Upon receipt of a provider's submission, the factor typically enters each invoice into its records system and generates a report listing the specific invoices.

Invoices are verified

A factor must also verify invoices generated by the provider in connection with its rendering of services to the debtor patient. During verification, a factor seeks to satisfy itself that: 1) the account debtor has received and accepted services indicated on the invoice(s); 2) the debtor's payment is not contingent on the fulfillment of any additional conditions; and 3) the account debtor intends to make payment in full, without asserting any offsetting claims or credits.

Money is advanced

Once the factor has processed the invoices and completed verification, it will normally issue an immediate advance to the provider. Depending on the factor's procedures, it may require the provider to execute some type of transaction confirmation document prior to making a disbursement. This confirmation document will list the factored invoices and state the amount of the factoring advance. Factors generally try to disburse advances as soon as possible after receiving provider invoice submissions, varying between same-day turnaround to 48 hours.

Notification to debtors

In order to preserve its collection rights against patient debtors, a factor must first notify them that it has taken title to provider invoices. This notification usually occurs in two ways. As mentioned, most factors provide providers with notification documentation, which the provider routinely affixes to its invoices. In addition, the factor may send separate notification letters to the account debtors. Quite often, these letters go out on the provider's own letterhead and carry the signatures of both the provider and a representative of the factoring company. Factors usually send notification letters only once to each patient debtor. The letters usually carry a warm, upbeat tone and explain how the factoring relationship will enable the client to serve the account debtors even more effectively than in the past. While notification letters usually state that an assignment of invoices has taken place, they normally avoid making reference to the term "factoring." Most factors deposit debtor checks immediately upon receipt and complete posting of payments within one or two days.

Rebates to invoice sellers

Under some factoring agreements, medical providers accrue what is known as "reserve account balances" as the

factor collects patient debtor payments. After first deducting its factoring fees and other charges, the factor remits these reserve account balances back to the provider in the form of “rebates.” Factors generally follow one of three different policies with respect to issuing rebate payments: (1) the factor pays rebates as individual invoices are collected, subject to a processing lag; or may make such payments periodically, such as once each week; (2) the factor pays rebates only after collecting sufficient amounts on individual invoices to recover advances and fees; and (3) the factor pays rebates only after collecting full payment for all invoices in a given time period. Regardless of which policy they employ, many factors impose a standard waiting period to allow for clearing of account debtor checks. In some cases, the factor may continue to accrue fees during this period.

Reporting to sellers

Reporting occurs continuously throughout the factoring relationship, since the seller client must have accurate information in order to properly manage the program. Certain reports are triggered by specific events, such as the collection of invoice payments and the generation of rebates. Others are issued periodically to keep clients aware of their overall account performance and costs. Reports typically include the following information: (1) detailed aging of all currently outstanding factored invoices; (2) reserve account balances showing detailed charges and credits; (3) balance of outstanding advances; (4) factoring fees paid by the client and accrued fees currently due the factor; (5) collection reports detailing invoices collected, collection dates, and including breakdowns (by invoice) of funds advanced to client, fees earned by the factor and rebates due the client; and (6) detailed “cash out” reports showing the net amount which would be due the factor if all outstanding invoices were paid off on a given day. In addition, the factor should have standard and timely procedures for keeping clients informed regarding disputes, unexplained payments (checks from account debtors that do not correspond to any readily identifiable invoice) and other routine anomalies.

Case Law Affecting Medical Lien Factoring

Reasonable Value of Medical Services

Oftentimes, healthcare factoring companies purchase medical liens from providers services provided to plaintiffs in third-party lawsuits. Most services involve imaging and diagnostic services, but can also include high priced orthopedic surgeries and other types of care, including services related to [Workers' Compensation claims](#). As part of their damages calculation, personal injury plaintiffs present the medical providers invoices based on the healthcare factoring company's expectation to be paid the full amount of their lien following settlement or trial. California law currently allows a plaintiff to recover the lesser of (1) the amount paid or incurred for past medical expenses, and (2) the reasonable value of the services.

Not surprisingly, this rule has spawned litigation. For example, in *Dodd v. Cruz*, personal injury defendants (whose legal expenses are covered by an insurance carrier) were allowed to discover the amount paid by third party factoring companies to medical providers for past medical expenses incurred by plaintiff on a lien. Although the rationale of *Dodd* is unsound and the case was subsequently de-published in 2014,¹ some factors may face similar arguments from personal injury defendants as medical lien factoring becomes more commonplace.

Similarly, the case of *Children's Hospital Central California v. Blue Cross of California* may also be used in an attempt to justify the disclosure of information about factoring arrangements. Specifically, *Children's Hospital* is likely to be cited by parties seeking broad discovery from providers and/or factors regarding the amount they have offered or accepted as payment in full for patient accounts in an attempt to gather evidence of the “reasonable value” of medical services; a tactic which, if successful, could affect damages calculations in personal injury disputes. Nelson Hardiman is well-versed in this area and has successfully [defended healthcare factoring companies from such improper “fishing expeditions”](#) and third party subpoenas from personal injury litigants in the past.

Amount Factor Pays As Proprietary Trade Secret

An argument can be made that the amount a medical receivables factoring company pays to acquire a receivable is proprietary in nature and subject to trade secret protection. Under California's Uniform Trade Secret Act (“UTSA”)[1], information is a trade secret if it (1) derives economic value from not being known to the public or competitors and (2) is the subject of reasonable efforts to maintain its secrecy. Courts in California and other

jurisdictions have long held that trade secret information which the owner intends to keep confidential includes a company's pricing information.^[2] Under the UTSA, pricing information is a protected trade secret if it is information that derives economic value not generally known to the public and is the subject of reasonable efforts to maintain its secrecy. California courts have recognized pricing information to fall within the meaning of the UTSA if a company has expended "time and effort" to develop the information and has used efforts to keep the pricing information secret and not readily available to the public or in the industry.^[3]

For many medical receivables factoring companies, its contracts with healthcare providers for the purchase of accounts receivable, and the pricing information contained in such contracts, are based on years of business in the medical receivables factoring industry and are the culmination of significant expense and effort on the part of the factoring company. To most medical receivables factoring companies, the specific price it pays for an account receivable has substantial economic value and is unknown to its competitors in the industry (for the simple reason that if such pricing information were made public, competitors would be able to institute predatory pricing actions in the marketplace to severely hamper the factoring company's ability to compete). Many medical receivables factoring companies make efforts to guard the secrecy of their business information and the specific terms of a factoring company's deals with providers are not general business knowledge. For example, many factoring companies require business partners to agree to a confidentiality provision prohibiting disclosure of the information and limit access to pricing information strictly to individuals requiring access in order to effect the terms of the parties' agreement.

^[1] [Civil Code § 3426.1\(d\)](#)

^[2] See [Whyte v. Schlage Lock Co.](#), (2002) 101 Cal. App. 4th 1443, 1455-56; [Pepsico v. Redmond](#), (7th Cir. 1995) 54 F. 3d 1262 (holding that information regarding how a former employer planned to price its sports drinks was a trade secret); [Lumex, Inc. v. Highsmith](#) (E.D.N.Y. 1996) 919 F. Supp. 624, 626-630 (holding that equipment pricing structures were trade secrets).

^[3] See [Morlife, Inc. v. Perry](#), (1997) 56 Cal. App. 4th 1514, 1521-22.

Concluding thoughts

Healthcare factoring provides a practical solution for providers aiming to improve or maintain a positive cash flow when their customers (patients, insurance carriers, government payers, and other third party payers) take months and even years to make payment for services or goods. Factoring medical receivables also presents an attractive alternative to traditional commercial medical financing in that it does not involve loans or the creation of debt.

Nevertheless, healthcare providers involved in medical lien factoring should make efforts to ensure that factoring processes are well-organized and kept up-to-date in light of recent case law affecting the industry, and factoring companies should be wary of improper subpoenas and discovery requests from personal injury litigants that may seek to divulge confidential and proprietary pricing arrangements.

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¹Under California law, a de-published case is not citable to any court. Therefore, *Dodd v. Cruz* is no longer good law. Any arguments to a trial court by way of discovery motion or motion *in limine* should not include citation to this case.

[More information and resources:](#)

[International Factoring Association](#)
[American Factoring Association](#)
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