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Restructuring a Lab: What to Test For

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Across the U.S., more than 320,000 clinical laboratories[1] quietly support the flow of patient care, public health and hospital operations. Approximately 80 percent of these laboratories are small businesses and heavily dependent on stable reimbursement to survive. As with many sectors of the health care industry, Medicare and Medicaid are the proverbial "800-pound gorilla" in this sector. Medicare is the largest payer of clinical laboratory services in the U.S.[2] For example, in 2024, Medicare Part B spent $8.4 billion on clinical diagnostic laboratory tests.[3] Medicaid programs also contribute significantly to these testing costs.[4] For example, California's Medicaid program spent more than $212 million on laboratory testing in 2019.

Unlike hospitals or large physician groups, most laboratories do not have diversified service lines or reserves. Instead, they depend on a predictable flow of test orders, clean billing and steady collections.

In the modern health care landscape, "predictable" is a term few laboratory operators would use. A perfect storm of regulatory tightening, reimbursement cuts, aggressive audits and supply-chain volatility has pushed many laboratories into financial distress. For restructuring professionals, these entities present unique challenges: They are heavily regulated, operationally complex and exceptionally vulnerable to cash-flow disruptions. In this setting, performing the actual diagnostic test often feels like "Chemistry 101" compared to high-stakes navigation of the business side.

By the time a laboratory reaches a restructuring advisor, the warning signs are already severe: cash balances nearing zero, accounts receivable aging out beyond recovery, payers withholding or suspending payments, and regulators applying pressure. Turning a laboratory around — or determining whether it can be turned around — requires a rapid, structured diagnostic process that blends careful analysis of legal issues, financial modeling, operational inspection and an understanding of how payers evaluate laboratory behavior.

This article provides a practical and practitioner-driven framework for diagnosing and restructuring a financially distressed clinical laboratory. This preserves the nuance, tone and industry detail that is essential to understanding how these businesses operate under pressure.

Industry Forces Pushing Laboratories Toward Insolvency

Clinical laboratories have faced significant financial strain from more than $4 billion in Medicare payment cuts to clinical laboratories during the past three years,[5] disproportionately impacting smaller, independent facilities. Medicaid programs nationally have similarly cut reimbursement rates for laboratories.[6] Under the Protecting Access to Medicare Act, clinical laboratory fee schedule rates for nearly 800 tests were slated for cuts of up to 15 percent[7] beginning in 2026. Although Congress has delayed these reductions for at least one year, the threat remains active.

This pressure is particularly severe for laboratories serving Medicaid-heavy populations. Loss of Medicaid eligibility and federal funding reductions force these laboratories to absorb uncompensated care. For many, this means performing essential tests for underserved populations with no reimbursement at all.[8] In this business, where margins are already thin, this dynamic is financially unsustainable.

Simultaneously, laboratory costs are rising. The post-pandemic labor market drove technician wages sharply upward. Inflation hit equipment leases, reagent pricing and consumables. Supply-chain weaknesses increased shipping costs, created delays and injected unpredictability into laboratory forecasting. A 2025 *Lab Manager* analysis noted that tariff-driven inflation has kept laboratory materials and equipment at historically elevated cost levels, and these are conditions that might persist for years.[9] The equation is simple: income falling, plus expenses rising, equals accelerated distress.

1 "About the Clinical Laboratory Industry," Am. Clinical Laboratory Ass'n, acla.org (unless otherwise specified, all links in this article were last visited on March 25, 2026).
2 "Medicare Payments for Clinical Diagnostic Laboratory Tests in 2024," U.S. Dep't of Health and Human Servs. Office of the Inspector General (June 16, 2025), oig.hhs.gov/reports/work-plan/browse-work-plan-projects/medicare-payments-for-clinical-diagnostic-laboratory-tests-in-2024.
3 *See* "Total Medicare Part B Spending on Labs Tests Rose in 2024, Driven by Increased Spending on Genetic Tests," HHS Office of the Inspector General Highlights (January 2026), oig.hhs.gov/documents/evaluation/11453/OEI-09-25-00330.pdf.
4 Jondavid Klipp, "Medi-Cal Seeks Approval to Slash Lab Rates," *Laboratory Economics* (Aug. 15, 2020), laboratoryeconomics.com/medi-cal-seeks-approval-to-slash-lab-rates.
5 Michelle Gaulin, "Rising Tariffs Reshape Laboratory Budgets for 2026," *Lab Manager* (Oct. 24, 2025), labmanager.com/rising-tariffs-reshape-laboratory-budgets-for-2026-34483.
6 Klipp, *supra* n.4.
7 Protecting Access to Medicare Act of 2014, Pub. L. No. 11393, 128 Stat. 1040.
8 "How Will Medicaid Cuts Disrupt Clinical Lab Reimbursements?," Today's Clinical Lab (July 8, 2025), clinicallab.com/how-will-medicaid-cuts-disrupt-clinical-lab-reimbursements-28339.
9 Gaulin, *supra* n.5.

The Industry Bears the Burden of Its Bad Actors

A handful of high-profile fraud cases have cast a long shadow over the entire industry. In toxicology and molecular diagnostics, regulators have uncovered billing schemes involving code-stacking,[10] unnecessary repeat tests and questionable referral arrangements.[11]

One widely cited example involves the use of mass spectrometry to analyze multiple drug classes from a single urine sample. While the technology was legitimate, some operators unbundled the process to bill each analyte separately — with costs sometimes exceeding $2,000 per specimen. The *Precision Toxicology* case, where the company agreed to pay $27 million to resolve False Claims Act allegations, the settlement addressed claims that the laboratory billed for medically unnecessary tests and provided illegal kickbacks to physicians to secure referrals.[12] Even fully compliant laboratories felt the aftermath, as payers tightened coverage criteria, reduced allowable reimbursement and heightened audit scrutiny. Ultimately, a laboratory does not need to behave badly to suffer the consequences of those who did.

AI-Driven Audit Models Are the New Normal

Payer audit processes look nothing like they did five years ago. Today, commercial insurers and Medicare Administrative Contractors use (1) AI-driven anomaly detection, (2) machine-learning utilization models, (3) peer laboratory comparison scoring, (4) automated medical necessity assessment, and (5) predictive modeling for "fraud likelihood" to search for a basis to refuse to pay for laboratory testing.

These systems flag unusual test combinations, unexpected ordering patterns, sudden volume changes or high average reimbursement. According to a February 2026 *JD Supra* enforcement review, genetic cancer tests and respiratory pathogen panels are now classified as "high risk" and routinely flagged for prepayment review.[13]

When an AI flag triggers an audit, payment delays can stretch from weeks to months, creating an immediate cash-flow crisis even when the laboratory's billing is 100 percent legitimate. For many laboratory executives, the process feels less like a routine review and more like a verdict before the trial has even begun.

Operational Fragility in the Supply Chain and Cost Structure

Laboratories operate on a fragile equilibrium depending on a seamless chain of stable reagent supply, specialized transport, high-maintenance instrumentation, integrated Laboratory Information Systems (LIS) and certified technologists. Any failure in a single link can halt testing or compromise patient results entirely.

Today, this chain is under immense stress. Tariffs have driven up the costs of essential plastics and chemicals, while transportation disruptions have increased courier risk and reliability. Simultaneously, chronic labor shortages force laboratories to overextend their staff or rely on expensive temporary per-diem coverage. When such operational complexity escalates alongside constricting reimbursement, even the most competent and well-intentioned management can see a laboratory slide rapidly into distress.

> **In an industry defined by intense scrutiny and razor-thin margins, there is no room for error.**

Legal and Regulatory Triage: The First 72 Hours

When a laboratory enters distress, legal risk is the first diagnostic category that a restructuring advisor must assess. If a laboratory faces significant regulatory exposure, it might not be salvageable, regardless of financial potential. To determine viability, advisors must quickly address several critical questions:

- Are there ongoing audits or investigations from federal regulators, state agencies or commercial payors?
- Are there credible allegations of fraud under the federal False Claims Act[14] or similar state statutes[15] that could trigger immediate payment suspensions?
- Have any Marketing Services Agreements (MSAs) or sales incentives created liability under the federal Anti-Kickback Statute,[16] the Stark Law[17] or the Eliminating Kickback in Recovery Act?[18]
- Are any key managers or owners linked to prior enforcement actions or bad-actor exclusions?
- Has the laboratory failed recent Clinical Laboratory Improvement Amendments (CLIA)[19] or do its ore ordering patterns appear as extreme outliers compared to its peers?

Many laboratories underestimate their regulatory risk by failing to realize that even a narrow investigation can pose an existential threat. Conversely, a laboratory's CLIA certification[20] and state licenses[21] represent a significant transferable operational value. In a § 363 bankruptcy sale, these credentials often serve as the centerpiece of the transaction,[22] although the buyer will still have to comply with the requirements to submit a change of ownership for the business to CMS and the state. The CLIA certificate and the state license have real value to a buyer, because they frequently carry Medicare/Medicaid/insurance provider status, which

10 "Code-stacking" refers to the practice of billing multiple current procedural terminology codes for different steps or components of a single diagnostic test, rather than using one comprehensive code.
11 These referral arrangements often involve financial incentives that induce, reward or base compensation on the volume/value of referrals, including above-fair-market-value payments, free staffing for routine office tasks or paying physicians "processing fees" that exceed actual costs.
12 "Precision Toxicology Agrees to Pay $27M to Resolve Allegations of Unnecessary Drug Testing and Illegal Remuneration to Physicians," U.S. Dep't of Justice (Oct. 2, 2024), justice.gov/archives/opa/pr/precision-toxicology-agrees-pay-27m-resolve-allegations-unnecessary-drug-testing-and-illegal.
13 Danielle Tangorre,"DOJ Enforcement of Clinical Laboratories: Trends from Q4 2025," JD Supra (Feb. 2, 2026), www.jdsupra.com/legalnews/doj-enforcement-of-clinical-6465001.
14 31 U.S.C. §§ 3729-3733.
15 *See, e.g.*, California False Claims Act, Cal. Gov. Code §§ 12650-12656.
16 42 U.S.C. § 1320a-7b(b).
17 42 U.S.C. § 1395nn.
18 18 U.S.C. § 220(a).
19 42 CFR § 493.3.
20 42 C.F.R. § 493.
21 Cal. Code Regs. tit. 17, § 1039.
22 11 U.S.C. § 363.

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allows a buyer to bypass months — or even years — of administrative setup.

In a § 363 sale, these credentials allow buyers time to (1) avoid long startup timelines; (2) bypass regulatory delays; (3) retain existing payer enrollments; and (4) acquire a recently inspected license. Consequently, licensing status is often a decisive factor in whether a laboratory can be sold as a going concern. Once legal viability has been confirmed, advisors must shift their focus to the financial framework of the laboratory's revenue cycle management (RCM) and personnel. As with most sectors of the health care industry, RCM determines whether the facility survives or fails.

The most common RCM issues include high volumes of unworked denials, outdated billing templates, incorrect CPT coding on molecular tests, patient demographic errors, missing documentation for medical necessity, poor tracking of appeals, lack of denial-trend reporting and LIS/billing system mismatches. Clean claims should result in payment within weeks, although distressed laboratories often see claims languishing for 120 days or more if there is no consistent follow-up.

Accurate cash-flow forecasting reveals the truth about viability. A 13-week forecast should incorporate payer remittance timing, seasonal cycles (year-end spikes, Q1 troughs), reagent consumption patterns, courier and logistics costs, staffing variability, episodic compliance fees and equipment service obligations. Many laboratories discover that they cannot reach a cash-flow break-even, even under optimistic assumptions.

Operational diagnostics must evaluate staffing skill mix and credentialing, equipment uptime and maintenance, courier routing and turnaround time, specimen-integrity protocols, LIS performance and error rates, and reference laboratory outsourcing flows. Instability in the laboratory manager or medical director role is especially concerning, as high turnover often indicates deep structural issues.

Every distressed laboratory seems to have at least one problematic contract: These can include (1) reagent rental agreements tied to unrealistic volume minimums; (2) courier contracts priced at emergency rates; (3) underperforming outsourced billing vendors; or (4) expensive service contracts for aging analyzers. Chapter 11 provides an opportunity to reject or renegotiate these contracts, sometimes dramatically improving the operating model.

Restructuring Pathways

After performing legal, financial and operational diagnostics, advisors must determine the correct restructuring pathway. A chapter 11 reorganization can be a viable strategy for laboratories with profitable core testing lines, reversible RCM issues and manageable regulatory exposure, as well as cooperative payers and creditors. Restructuring a laboratory is not "just another health care bankruptcy." It requires deep familiarity with the science of diagnostic testing, payer audit behavior, regulatory risk patterns, the intricacies of laboratory operations and the financial pathways that determine viability.

Reorganization through chapter 11 can preserve going-concern value while fixing structural issues, often providing distinct advantages over an out-of-court restructuring. For example, a laboratory in a dispute with Medicare generally must exhaust administrative remedies before it can get a federal court to hear its case. However, some bankruptcy courts have held that they may exercise jurisdiction over a Medicare dispute without requiring prior exhaustion of a critical lifeline when financial distress is tied directly to the Medicare program.[23]

Medicare payment suspensions have become an increasingly common and disruptive challenge for laboratories. Medicare has broad authority to impose a payment suspension based on "credible allegations of fraud," and these suspensions result in Medicare reimbursements to the laboratory being immediately halted, with the payments held in escrow indefinitely. A laboratory facing a suspension has limited due-process rights, and the result is that many laboratories collapse within weeks of a suspension. However, a chapter 11 case can provide a forum allowing a laboratory faced with a payment suspension to invoke the automatic stay, providing some leverage to negotiate a resumption of payments while it negotiates a settlement.[24]

Another viable option for a financially distressed laboratory is a sale of the assets under § 363. This option can be most useful when a laboratory's operational infrastructure holds value, but its liabilities are too great to allow a restructuring even in bankruptcy. The laboratory owners can generate value because buyers through bankruptcy gain transferable CLIA certification, state licensure, established LIS and workflows, trained staff and provider contracts. Thus, many distressed laboratory owners ultimately achieve better outcomes via a sale than via a reorganization.[25]

If the analysis reveals that a laboratory can neither reorganize nor sell its assets, a structured wind-down is the only viable path. This outcome is often unavoidable when a laboratory faces nondischargeable False Claims Act judgment, an insurmountable Medicare suspension or pervasive compliance failures that deter all potential buyers. In these scenarios, the wind-down must be executed with surgical precision prioritizing proper specimen disposal, securing patient records in accordance with HIPPA and state retention laws, and managing communication with ordering physicians and patients to ensure a seamless transition of care.

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23 *See, e.g., In re Benjamin*, 924 F.3d 180 (5th Cir. 2019); *but see In re Bayou Shores SNF*, 828 F.3d 1297 (11th Cir. 2016); *In re Bayou Shores SNF*, 828 F.3d 1297 (11th Cir. 2016).

24 *See Borrego Community Health Found. v. California Dep't of Health Care Servs., et al.*, Findings of Fact and Conclusions of Law Regaring Emergency Motion to (I) Enforce the Automatic Stay or (II) Alternatively for Temporary Restraining Order, Adv. Pro. 22-90056, Adv. Pro. Docket No. 65, Case No. 22-02384-LT11 (Bankr. S.D. Cal. Oct. 26, 2022); *True Health Diagnostics LLC v. Azar (In re THG Holdings LLC)*, 604 B.R. 154 (Bankr. D. Del. 2019); *In re Medicar Ambulance Co. Inc.*, 166 B.R. 918 (Bankr. N.D. Cal. 1994).

25 *See generally In re Verity Health Sys. of California Inc.*, 606 B.R. 843 (2019).

Conclusion

Ultimately, a successful restructuring depends on executing a rigorous, diagnostic approach: Triage quickly, stabilize cash, and assess legal exposure with clear-eyed realism. Advisors must fix (or replace) RCM systems, renegotiate operational chokepoints, and maintain transparent communications with all stakeholders before choosing the final path, whether it be a reorganization, sale or wind-down.

In an industry defined by intense scrutiny and razor-thin margins, there is no room for error. Only a structured, experienced and decisive approach gives distressed laboratories a realistic chance of survival — or the grace of a dignified exit. abi