Health Care System Expansions: Challenges and Legalities Regarding Mergers and Acquisitions

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Agenda

- Introduction
- Types of Arrangements
- So You Want to Do a Deal…Now What?
- Challenges to Deals and Selected Structures
- Importance of Diligence to Any Transaction
- Market Observations and Real-Life Examples - Health Care Transactions Across the Country and Spectrum
Introduction
Significant Increase in Transaction Activity

According to a recent analysis by Kaufman, Hall & Associates, LLC:

- Ninety-five hospital transactions were announced in 2014, representing another year of strong merger and acquisition activity.
- 2014 was the third consecutive year in which at least 95 hospital transactions were announced.
- Of the 95 transactions in 2014, 80 involved acquisition of not-for-profit organizations and 15 acquisition of for-profit organizations.
Exception Rather Than The Rule

- Conversations at Board and Management Levels
  - Unique if your organization is not considering or pursuing a potential transaction
  - Commonly held belief that “bigger is better” to weather changes in reimbursement and health care reform

- No deal type is off the table
  - Hospital transactions in 2014 represented an acceleration in larger, more flexible, and less traditional combinations
  - Payors as providers (West Penn Allegheny Health System/Highmark)
Types of Arrangements
Overview of Common Transaction Structures

- **Merger:** A plus B = B
- **Consolidation:** A plus B = C
- **Acquisition:** A acquires all or portion of B
- **Affiliation:** Change in control through transfer of corporate membership rights in a non-profit corporation (also referred to as “membership substitution”)
- **Joint Venture:** Creation of a jointly held entity to pursue specific product, service line or operations
- **Management/Service Contract:** Specific agreement to acquire specific product, services or expertise
Integrated Transaction Structures

- Asset Acquisition
- Merger or Consolidation
- Parent Holding Company/Co-Membership Affiliation
- Joint Venture
- Joint Operating Company
- Whole Hospital Joint Venture
- Whole Hospital Lease

**Note:** Depending on their particular facts, these options may be capable of achieving sufficient integration to support joint managed care contracting for hospital and/or physician services.
Integrated transaction structures would:

- Require regulatory approvals (establishment / change in control) for purposes of licensure, accreditation, etc.
- Require consolidated financials
- Likely require bondholder, lender approvals
- Impact the acquirer’s credit position, typically require bond approvals to consummate transaction
- Permit joint contracting
- Entail extensive pre-closing due diligence
Moderately Integrated Transaction Structures

- Broader Operational Management Agreement
- Shared Services Agreement
- Existing or New Services Joint Venture
- Purchase of Non-Core Assets
- Branding/Licensing Arrangement

**Note:** These options lack sufficient integration to support joint managed care contracting for hospital and/or physician services
Less Integrated Transaction Structures

- Right of First Refusal; Option to Acquire; Exclusivity
- Consolidated Department
- Discrete Service Line Management Agreement
- Discrete Lease of Key Management Personnel
- Property or Equipment Lease
- Overlapping Board Members

Note: These options lack sufficient integration to support joint managed care contracting for hospitals and/or physician services
Deal Trend: Merger of Equals

- Large, financially well-positioned health care systems across the country are increasingly pursuing “mergers of equals”

- Unique set of transaction issues, including:
  - Governance
  - Management
  - Headquarters
  - Employee Matters
  - Public Relations/Perception
So You Want To Do a Deal…Now What?
Making the Decision: Partner and Structure

- Potential Partner and Structure Considerations
  - Affiliating with an established system (regional v. national)
  - Forming a new system
  - Non-profit v. for-profit
  - Financial commitments and wherewithal
  - Different priorities for different situations
Making the Decision: Partner and Structure

- In considering potential transaction partners and structures, non-profit health systems will typically and appropriately focus first on the advancement of their charitable, non-profit mission, as well as other relevant factors:
  - Triple-Aim of federal health reform
    - Quality of care improvements
    - Efficiency of care improvements
    - Improvements in patient experience and overall public health
  - Enhanced access to care
  - Achieving efficiencies and economies of scale
  - Facilitating managed care contracting
  - Increasing access to technology
  - Improving access to capital
In choosing a partner and potential structure (subject to due diligence), non-profit health systems should also consider:

- Proper independent fiduciary oversight and judgment throughout the process
- Proposed transactions can fail, or be subjected to withering scrutiny, when the governing board is not involved from the start of the project
- Elimination/management of officer, director conflicts of interest associated with specific transaction is essential
- Compliance with applicable laws and regulations
Key Decision and Negotiation Points

- Purchase price (as applicable)
- Purchased Assets and Assumed Liabilities (as applicable)
- Governance/board structure
- Funds flow, financing arrangements
- Capital commitments
- Employees: retention, benefits
- Medical Staff
- Managed care contracting
Key Decision and Negotiation Points

- Closing agreements and term provisions
- Due diligence; representations and warranties; indemnification
- Post-closing covenants
  - Transaction specific
  - Religious and mission commitments
- Pre-closing conditions and covenants
- Unwind, termination, withdrawal
Challenges to Deals and Selected Structures
Antitrust Concerns

- Heightened level of government enforcement
- Importance of initial antitrust feasibility analysis
- Areas of conduct, market concentration attracting government concerns
- Conduct to avoid
- The HSR process and “4(c)” documents
- “Gun Jumping” and anti-competitive agreements
The complex health care regulatory picture sets health care transactions apart from other corporate deals.

Due diligence, well-structured and completed timely, should identify the key issues relevant to negotiating key points and preparing for the transaction. Focus often on successor liability, particularly for federal health care program participation.

Unusual circumstances, such as where facility Medicare participation, licensure or accreditation is at risk, or where the seller or its operations is the subject of a government investigation or in significant financial distress, may complicate the process.
Financing Issues

- Analysis of Outstanding Debt
  - Including Tax Exempt Bond Debt
  - Covenants and Limitations; Approvals

- Availability of Financing to Consummate Transaction

- Lingering Liabilities
  - Pension
  - Contingent Liabilities
Real Estate

- Property Tax Exemption Matters
- Title Restrictions- Know Your Documents!
- Environmental Liabilities
  - Phase I/II Results
  - Database Searches
Benefits

- Considerations Often Dependent on Transaction Structure
- Same or similar benefits?
- PTO/Accruals
- Status/Seniority
- Pension Liability
Employee and Medical Staff Matters

- Collective Bargaining Arrangements
- WARN Act Obligations
- Redundancies
- Messaging to Employees and Medical Staff
- Retention Bonuses/Severance Arrangements
- Involvement of Medical Staff Leadership
State Regulatory Requirements

- **Attorney General (AG) Review**
  - Certain states (including New Jersey and Ohio) require AG approval of nonprofit/nonprofit hospital transactions
  - Many states have some manner of “conversion statute” that outlines statutory requirements for non-profit entities to convey all or a meaningful amount of their charitable assets to a for-profit corporation. Typically the conversion statute requires that the potential transaction be subject to AG review; some states also require public hearings and judicial proceedings before a deal can close.

- **Certificate of Need/Certificate of Exemption**
Religious Affiliation

- Approvals
- Ethical and Religious Directives and Compliance Monitoring
- Sponsor Roles and Reserved Rights
Importance of Diligence to Any Transaction
Diligence Overview

Key considerations:

- Your role in a transaction
  - “Buyer”
  - “Seller”
- The structure of the deal
  - Transaction type
  - Level of integration
  - Relative risks and allocation of liabilities
Diligence Overview

- What is “Reverse” diligence?
  - Scope and concerns
  - How reverse diligence can serve as “reputational diligence” and/or “mission diligence”
  - Timing concerns
Diligence Overview

Considerations relevant to the diligence process

- Preliminary “go-no go” diligence v. transaction focused diligence
- Preparing (and possibly negotiating) an appropriate diligence request list
- Utilizing internal v. external resources in diligence
- Timing issues
- Pros and cons of electronic data rooms
- Role of specialists/experts in diligence; trends
- Diligence reports…and what you do with the findings
Deal Makers, Deal Killers and Deal Re-Openers

- Issues identified in due diligence
  - You found something concerning...now what?
  - Deal killers v. deal re-openers v. deal “norms”
    - Real life examples
    - Technical Stark law violations
The Devil (and Potential Liabilities) is in the Details

- Who fixes the issues (and who pays for it)?
- Who needs to know about it and how?
- Escrow/holdback and potential pitfalls
- Impact overall deal
  - Renegotiation of deal terms
  - Impact on purchase price
  - Timing concerns
Market Observations and Real Life Examples - Health Care Transactions Across the Country and Spectrum
Market Observations

- Increasing interest in “less than fully integrated” deal structures
- Uptick in “mergers of equals” across the country
- Increase in transactions without meaningful geographic proximity
- Sole community hospitals are going extinct (likely some manner of affiliation in the works)
- EVERYONE is talking, no one wants to be without a dance partner
If your organization is **not** considering a transaction:

- Assess potential opportunities to further mission and/or corporate objectives and prepare for the collateral effects of the deals going on in your service areas

If your organization is **considering** a transaction:

- Determine objectives of the transaction
  - All actions should be in furtherance of these objectives
- Preliminary antitrust analysis
- Consider “pre” due diligence (i.e., getting your house in order)
- Keep this slide deck close at hand!