IN THE TRENCHES:

11 Lessons Learned from Advising on Independent Hospital Partnerships
As the delivery of healthcare continues to evolve amidst a challenging operating environment, independent hospitals/health systems have been at the epicenter of the increased velocity of change that is disrupting legacy operating models and leaving organizations to face difficult strategic decisions. Sitting in the board rooms of many of these organizations and having the privilege of working alongside the senior executives and board members who are in the trenches on a daily basis, ECG Management Consultants’ Mergers, Acquisitions, and Partnerships practice and Polsinelli’s Healthcare M&A practice have learned many lessons—both from successes and challenges. These lessons should be considered by all stakeholders—board members, management teams, physician leaders, etc.—of independent hospitals/health systems that are contemplating their long-term strategic partnership alternatives and ultimately seeking to optimize the outcome of a potential partnership process that will secure and enhance healthcare delivery in their communities.
Lesson 1 — Choosing an appropriate partnership model ... for the present and the future:

An independent hospital/health system can have a great deal of influence over the affiliation model that is chosen by communicating clear and strong preferences to potential suitors. That stated, it is important for an organization to keep an open mind and avoid the desire to choose a model simply because it is the path of least resistance or is most likely to win over stakeholders. For instance, choosing a loose affiliation model with the plan to fully integrate at a later date if things go well may ultimately harm the organization by reducing the leverage held at the time suitors are initially approached. Once any form of affiliation is in place, it will be difficult to “unscramble the egg,” and the organization may have little remaining negotiating power when it comes time to fully integrate with a partner. However, certain circumstances warrant a looser form of affiliation at the outset, particularly when full integration is conditioned upon the chosen partner meeting certain performance criteria. Competent legal counsel and financial advisers can aid an organization’s board and management team in weighing these considerations to develop the most ideal affiliation model.
Lesson 2 — Considering all options:

Management teams and board members often have a handful of likely suitors in mind and are hesitant to expand a search beyond this group of potential partners. Oftentimes these likely suitors already have a presence in the region or religious values that align with the organization. We have found, however, that expanding the search often opens the door to options that might be a better fit for the organization. For instance, a health system without a presence in the market might be looking to expand its footprint into the region and would be willing to offer more attractive economic terms to win the deal. Similarly, a secular health system might be willing to make commitments to preserving the organization’s religious identity and values, while offering better deal terms than a religious system might offer. Even if the organization ultimately decides to partner with one of the handful of suitors initially identified, having discussions with “outside-the-box” parties might illuminate deal terms that the organization would not have otherwise considered. As the interest of a variety of potential suitors is gauged, all discussions should be governed by appropriate confidentiality, nondisclosure requirements, and, where appropriate, commitments to exclusivity in negotiations.
Lesson 3 — Aligning boards and senior leadership teams:

From the onset of any partnership evaluation and execution process, it is critical for board members and senior leadership teams to align on a defined set of partnership goals and objectives. This mutual set of guiding principles must be formed with input from the vantage point of all leadership positions—clinical, managerial, and board governance. Throughout the partnership process, the goals and objectives that have been set forth must anchor key decision milestones, as the ups and downs of a partnership process can cause stakeholders to waver from prioritizing those goals. ECG’s and Polsinelli’s M&A teams advocate for a steering committee with representation from all organizational stakeholders to shepherd all facets of the partnership process, ensuring that the guiding principles serve as guardrails at all critical junctures in the process. Further, board members’ and officers’ fiduciary duties as they relate to the partnership process should be clearly defined at the outset, and the board and officers should be reminded of those duties periodically throughout the process, particularly when important decisions are being made. If the organization’s decision is ever questioned or challenged, it will be important to have a clear record of how the board and officers discharged their fiduciary duties.

We have found that expanding the search often opens the door to options that might be a better fit for the organization.

Lesson 4 — Engaging antitrust counsel early in the process:

An organization should engage antitrust counsel very early in the process, before any potential suitors are approached. Any board or management discussions or deliberations about a potential partnership or affiliation, no matter how early in the process, have the potential to be subject to scrutiny by antitrust authorities. Competent antitrust counsel can develop protocols and best practices to ensure that all board and management discussions are conducted in a legally compliant manner and that relevant materials are appropriately preserved for inclusion in FTC or state antitrust filings. Antitrust counsel will also serve an instrumental role in ensuring that due diligence and negotiations with a partner health system are conducted in a manner that complies with all antitrust laws.
Lesson 5 — Looking five years into the future:

As independent hospitals/health systems struggle to maintain their relative market positions amidst increased competition from both traditional and nontraditional providers that are all vying for high-margin procedures and disrupting legacy operating models, organizations’ financial positions have deteriorated, as evidenced by Moody’s most recent not-for-profit and public healthcare preliminary credit medians report¹ (see figures A and B below).

Despite a slight uptick in liquidity performance in 2018 due to increased focus on performance improvement initiatives and a more disciplined approach to strategic capital investments, as hospitals/health systems seek to partner with providers who can bolster their long-term strategic and financial position, it is critical to analyze the baseline stand-alone projected outlook and the key economic drivers that can impact the organization’s future-state viability. This analytical framework can be used to inform the basis for not only answering the question of whether a provider should explore their partnership options but, more importantly, how the organization should position itself to optimize the terms and conditions of a proposed deal.

Lesson 6 — Analyzing capital position:

In addition to understanding the key variables that have the potential to disrupt future-state operations, independent hospitals/health systems that are contemplating a strategic partnership must also understand the evolution of their capital position relative to meeting their organizational goals and objectives, in light of any structural challenges. Specifically, analyzing the requisite resources needed to fund future obligations is crucial in framing a partnership decision, in addition to ultimately negotiating the key terms and conditions of a partnership. If there is a projected mismatch of resources needed to fulfill an organization’s strategic objectives, then providers must prudently consider either how to bridge the gap as a stand-alone organization or what partnership options are available to bolster the organization’s capital position and enhance the delivery of care on a sustainable basis.

Lesson 7 — Aligning community stakeholders:

Frequently, independent hospitals/health systems play a key role in the economy of the communities they serve. Whether the organization is a county-owned critical access hospital, a safety-net provider that relies on government funds to stay afloat, or a district hospital with local government oversight, the involvement of community entities and the associated political forces surrounding such hospitals/health systems play a critical role in any partnership process. Consequently, it is imperative that hospital/health system boards and management teams critically evaluate the appropriate role that these stakeholders will play as a partnership process evolves. For instance, decisions will often have to be made as to whether a county commissioner should sit on the steering committee, what role the local hospital authority will play in a contemplated change of control transaction, and how community philanthropic efforts can be improved with a new partner organization. These questions, and many more, can often make or break a strategic partnership and must all be carefully and critically analyzed in the context of the partnership process.
Lesson 8 — Understanding the current operational state:

While management and key stakeholders will have a firm understanding of the organization's operations and surrounding market dynamics, it is necessary for these insights to form the rationale for evaluating future-state considerations. Whether due to increased local competition for services, loss of key providers, or weakened financial performance, all involved parties should have a keen understanding of existing conditions. Moving forward into a potential partnership process under false pretenses will likely not result in an optimal outcome, as the aforementioned misalignment will be counterproductive for all stakeholders. Further, a thorough understanding of the current operational state will help to ease the postclosing transition of aligning with the operations, vendors, and systems of the new partner.

Similarly, the organization’s financial adviser should run an efficient and effective competitive selection process while providing sound advice on all financial matters related to the transaction.

Lesson 9 — Knowing the approvals that are required and how long they will take to obtain:

It is important when developing a transaction implementation plan to identify all approvals that will be needed from third parties and government authorities, rather than selecting an arbitrary completion date and hoping for the best. Such approvals could include those from a certificate of need agency or the attorney general, as well as nongovernment approvals like consent from the organization's bondholders or a religious sponsor. An unanticipated third-party approval that is identified in the middle of negotiations and alters the closing timeline can be a major wrench in the transaction process, and legal counsel can work with an organization's board and management team to avoid such a scenario by identifying all required approvals and accounting for them in a comprehensive transaction timeline.
Lesson 10 — Identifying and addressing legal shortcomings:

Legal counsel should conduct focused, early-stage introspective, or “know thyself,” due diligence on the organization with respect to key legal matters (e.g., physician relationships, health information privacy and security, environmental issues) so that the organization has visibility into significant problems and can begin to address them before they are discovered by the potential partner in its due diligence efforts. This proactive approach helps avoid situations where the organization is caught off guard by the discovery of a problem during the potential partner’s due diligence investigation that can slow down the partnership process, cause renegotiation of deal terms, or even sink the deal.

Lesson 11 — Defining roles clearly:

Prior to undertaking a potential partnership process, those involved in the preparation, execution, and ultimate decision-making should have a demonstrable understanding of everyone’s role. The organization’s advisers should be exactly that—an unbiased sounding board for the client’s thoughts and a good steward of the process. On the opposite end, the hospital/health system as the client is the ultimate decision-maker and should thoughtfully retain the summarized information provided by all advisers in order to make the most responsible decisions. When roles and responsibilities overlap, or otherwise become unclear, suboptimal results will occur. It is also important for the organization to select advisers with broad expertise. For instance, the law firm chosen to represent the organization should be able to handle all legal aspects of the deal, from negotiation and documentation of deal terms to ancillary areas like healthcare regulatory, real estate and environmental, and antitrust. Similarly, the organization’s financial adviser should be able to run an efficient and effective competitive selection process while providing sound advice on all financial matters related to the transaction. Lastly, it is important for these advisers to work together collaboratively and to know/stay in their respective lanes. With everyone’s collective focus on achieving the desired outcome via the partnership process, it is important to remember that the relationship between the client and adviser is a partnership unto itself that requires extensive time, energy, and effort to ensure all parties work cohesively and efficiently.
Since the drivers of, and market conditions that contribute to, consolidation are deep-rooted and persistent in the healthcare industry, it is likely that most independent hospitals/health systems have at least explored the strategic advantages of various affiliation and partnership models. Applying these 11 lessons throughout the process of examining such options—from the contemplation of engagement of an adviser through the last detail of the definitive transactional agreement—will help to facilitate productive partnerships and new affiliations by, hopefully, avoiding the landmines that can sometimes cause these deals to fall apart and, ultimately, will also help to guarantee continuing access to high-quality healthcare for the communities served.

**About ECG**

ECG offers a broad range of strategic, financial, operational, and technology-related consulting services to healthcare providers. As a leader in the industry, ECG provides specialized expertise, such as in strategic and business planning, specialty program development, and hospital-physician relationships, to community hospitals, academic medical centers, health systems, and medical groups. ECG’s strength is built upon approximately 240 healthcare professionals practicing in offices located in Atlanta, Boston, Chicago, Dallas, Minneapolis, San Diego, San Francisco, Seattle, St. Louis, and Washington, DC.

For more information, visit [www.ecgmc.com](http://www.ecgmc.com).

**About Polsinelli**

Polsinelli is an Am Law 100 firm with more than 850 attorneys in 22 offices nationwide. Recognized by legal research firm BTI Consulting as one of the top firms for excellent client service and client relationships, the firm’s attorneys provide value through practical legal counsel infused with business insight, and focus on healthcare, financial services, real estate, intellectual property, middle-market corporate, labor and employment, and business litigation. Polsinelli PC, Polsinelli LLP in California.

For more information, visit [www.polsinelli.com](http://www.polsinelli.com).
the Authors

MICHAEL MULLINS
Principal
ECG Management Consultants
mamullins@ecgmc.com

AARON NEWMAN
Senior Manager
ECG Management Consultants
atnewman@ecgmc.com

NICHOLAS DAVIS
Senior Analyst
ECG Management Consultants
nb.davis@ecgmc.com

LISA KATZ
Shareholder
Polsinelli
lkatz@polsinelli.com

CULLIN B. HUGHES
Shareholder
Polsinelli
chughes@polsinelli.com

GARRETT JACKSON
Associate
Polsinelli
gt.jackson@polsinelli.com