HOW TO BUY AND SELL A HOSPITAL

Mergers and Acquisitions in Health Care

State Bar of California
Business Law Section

DATE: November 19, 2015
TIME: 12:00 PM to 1:00 PM

PRESENTERS:
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This Program Offers One Hour of MCLE Participatory Credit
INTRODUCTION
HOSPITAL CONSOLIDATIONS

- The trend of multi-hospital systems replacing freestanding community hospitals picked up speed after 1965.

- The five hospital consolidations noted in 1961 ballooned to upwards of 50 per year in the 1970s.

- By the 1980s, an estimated 30% of hospital beds in the United States existed within hospital systems.

- In 2008, the American Hospital Association estimated that almost half of the nearly 6,000 U.S. hospitals belonged to a hospital system.
HOSPITAL CONSOLIDATIONS continued

- Between 2004 and 2013, 28 hospitals in California closed and 20 opened.

- Hospital consolidations and closures continued at record-breaking levels in 2014 and throughout 2015.

- Consolidation also extended to medical device companies, pharmaceuticals and insurance companies.
HOSPITAL CONSOLIDATIONS continued

- The number of acute care hospitals in California declined by 4% between 2004 and 2013.

- The top eight hospital systems account for 40% of California hospitals.

- More California hospitals were profitable in 2013 than in 2014.

- The cost of uncompensated care (charity care and bad debt) increased by 45% between 2004 and 2013.
RECENT NONPROFIT HOSPITAL TRANSACTIONS

- Verdugo Hills Hospital (July 2013)
- Downey Regional Medical Center (August 2013)
- Emanuel Medical Center (January 2014)
- Saint John’s Health Center (January 2014)
- ValleyCare Health System (April 2015)
- Lodi Memorial Hospital Association (May 2015)
- Daughters of Charity Health System (pending)
NECESSARY INGREDIENTS

- **Hospital** – Preferably financially distressed or in trouble with state or federal government. Active license and/or patients optional.

- **Seller** – Willingness optional. For non-motivated sellers, see December 3 and 17 “how to” series on bankruptcy-related topics.

- **Buyer** – Money and experience optional.

- **Regulatory Approval** – For certain transactions only.*
RECOMMENDED INGREDIENTS

- **Management Company** – Recommended with certain buyers.
- **Broker** – Recommended, especially with financially distressed hospitals or buyers with no hospital experience.
- **Lender** – Recommended for buyers without money and those with unlimited cash.
- **QAF** – Offer limited while supplies last.
- **Regulatory Approval** – Lawsuit possible alternative.*
STEP ONE: MAKE AN OFFER
LETTER OF INTENT

- Short version vs. long version: What kind of road map do the parties prefer to follow throughout the transaction?

- Typically non-binding, but serves as a test of the integrity of each party.

- What provisions can be binding?

- How should the parties approach valuation?
CONFIDENTIALITY CONCERNS

Confidentiality can be an integral part of any hospital transaction.

Information about a possible sale can disrupt operations, cause physicians and employees to seek work elsewhere, and ultimately have a negative impact on a hospital’s bottom line.

At the same time, information about a possible sale can attract other potential buyers and drive the price of a possible sale, and maybe even create a “bidding war.”
VALUATION – What Is the True Value of a Hospital?

- Enterprise Value v. Price Per Hospital Bed
- Cash Flow Analysis
- Market Value
- EBITDA (earnings before interest, taxes, depreciation and amortization); EBITDAR (earnings before interest, taxes, depreciation, amortization and rent/restructuring costs); EBITDARM (earnings before interest, taxes, depreciation, amortization, rent and management fees)
TRANSACTIONS IN BANKRUPTCY COURT

- What happens to the hospital sale process in bankruptcy court?
- What is the scope of the bankruptcy court’s authority?
- Does the Office of the Attorney General play a role?
- What is a “Stalking Horse” bidder?
- How can a creditors’ committee impact the sale process?
OFFERS YOU CAN’T REFUSE

Sometimes a potential buyer has more to offer than just a sales price.

- Bridge Loans
- Management Services
- Inclusion in a Larger System
- Assistance in Avoiding Bankruptcy
- *May Include Exclusivity or No Shop Clauses*
WHAT THE GOVERNMENT NEEDS TO KNOW

A provider who is contemplating or negotiating a change of ownership must notify CMS. 42 C.F.R. § 489.18(b)

What can constitute a change of ownership?

- Removal, addition or substitution of a partner
- Transfer of title and property to another party
- Merger or consolidation (but transfer of corporate stock does not constitute change of ownership)
- Lease of all or part of a hospital (change of ownership for the leased portion)
STEP TWO: DUE DILIGENCE
BUYER DUE DILIGENCE

- Corporate Structure
- Financial Information
- Litigation/Insurance
- Licensing/Regulatory
- Human Resources
- Real Estate/Environmental/Seismic
SELLER DUE DILIGENCE

- Buyer’s financial stability
- Corporate structure, the scope of which may depend upon guarantees in the transaction
- Ability to close (regulatory approval or other non-financial contingencies)
- Interim management agreement (due diligence may expand)
- Knowledge qualifier
USING PUBLIC INFORMATION

- OSHPD Reports (http://www.oshpd.ca.gov/HID/DataFlow/HospMain.html)

- HospitalCompare (https://www.medicare.gov/hospitalcompare/search.html)

- UCC Filings

- Court Filings

- Community/Public Opinion
A LITTLE KNOWLEDGE IS DANGEROUS

Where is the wisdom we have lost in knowledge?
Where is the knowledge we have lost in information?

--Thomas Stearns Eliot
STEP THREE: PURCHASE AGREEMENT
ASSET OR STOCK PURCHASE AGREEMENT?

- **APA**: Buyer may not acquire all of the Hospital’s assets.

- **APA**: Negotiations often focus on excluded assets and assumed liabilities.

- **APA**: Schedules take center stage.

- **APA**: Used for mergers and acquisitions.

- **SPA**: Transfer of company shares title.

- **SPA**: Less flexibility than an asset purchase agreement.
PURCHASED ASSETS (APA)

- Real and Leased Property
- Quality Assurance Fee Payments
- Furniture, Furnishings and Equipment (FF&E)
- Accounts Receivable
- Information Systems/Proprietary Rights
- Inventory
ASSUMED LIABILITIES (APA)

- Accounts Payable
- Quality Assurance Fee Obligations
- Assigned Contracts
- Past Medicare Obligations
- Lease Obligations
EXCLUDED ASSETS (APA)

- Personal Articles
- Cash and Cash Equivalents
- Prepaid Loan Fees
- Employee-Owned Assets
- Seller’s Organization and Governing Instruments/Irrevocable Licenses
- Baseball Tickets
RETAINED LIABILITIES (APA)

- Employee Wages/PTO
- Historical Medicare Claims
- Broker Fees
- Past Tax Obligations
- Tail Policy
- Hockey Tickets
SCHEDULES, SCHEDULES, SCHEDULES
REAL ESTATE

- Often the most valuable asset in a transaction.
- The value of the real estate may be inextricably connected to the hospital license.
- Existing mortgage on real estate – friend or foe?
- Consider the scope of any appraisal.
- Hospital campus and/or medical office buildings should be considered in proper context.
WHAT MAKES UP THE PURCHASE PRICE?

- Deposit
- Holdback
- Adjustments (assumed liabilities or acquired assets)
- Outstanding obligations on assigned contracts
- Prorations
- Items payable at closing
REPRESENTATIONS AND WARRANTIES

- Organization and Good Standing
- Necessary Consents
- Corporate Records
- Financial Statements
- Disclosure of Liabilities (known or should be known)
CONTRACTS

- Material Contracts
- Assumed and Assigned Contracts
- Types of Consent Required
- Payer Contracts
- Employee Contracts
STEP FOUR: LICENSING
CALIFORNIA DEPARTMENT OF PUBLIC HEALTH

- Issues hospital licenses in California
- Primary regulatory agency for hospitals
- Oversees hospital administrative penalties
- Licenses hospital ancillary services, units and outpatient facilities
- Licensing forms: https://www.cdph.ca.gov/pubsforms/forms/Pages/HealthFacility-GACH.aspx
CENTERS FOR MEDICARE & MEDICAID SERVICES

- Oversees the Medicare and Medicaid programs in the United States

- Hospital Inpatient and Outpatient Prospective Payment System, as well as Inpatient Psychiatric Facilities

- Hospital Value Based Purchasing Program

- Hospital Readmissions Reduction Program

- CMS 855A (application for hospitals)
ASSIGNMENT OF MEDICARE PROVIDER NUMBER

Upon assignment of Medicare provider number, buyer retains data to calculate Medicare DSH payments (42 C.F.R. § 412.106), charge-to-cost ratios for outliers (§ 412.84(i)(3)(i)), IPPS “base period” for payment and cost report history, wage index (§ 412.230) and E.H.R. incentive payments (§ 495.105(c)).

However, buyer becomes responsible for any past Medicare liabilities and overpayments. 42 U.S.C. § 1395g(a).
BOARD OF PHARMACY

- The California Board of Pharmacy ("BoP") licenses pharmacies located within any licensed hospital, institution, or establishment that maintains and operates organized facilities for the diagnosis, care, and treatment of human illnesses to which persons may be admitted for overnight stay and meets all of the BoP regulations.
OTHER LICENSES/APPROVALS

- Board of Equalization
- Business Licenses
- CLIA
- Radiology
- FCC
- EDD
STEP FIVE: THE CLOSING
TRANSACTIONAL CLOSING ITEMS

- Escrow Instructions
- Bill of Sale
- Closing Certificates
- Assignments and Assumptions
- DEA Power of Attorney
- Deed(s) of Trust
- Closing Statement
- State and County Documentation
- Title Policies
- Wire Instructions
LOGISTICAL CLOSING ITEMS

- 11:59 p.m. to 12:01 a.m.
- WARN Act Considerations
- Badges and Keys
- Patient Valuables
- Medical Staff
- Patients and the Community
- Closing Day Purgatory
- When Is It Really Over?
WHAT COULD GO WRONG?

- Most transactions do not end at closing
- Most transactions do not close as originally planned
- Certificates of good standing have a shelf life
- Lenders
- Title Concerns
- Certifications and Opinion Letters
RECONCILIATIONS AND
HOLDBACKS
A CLOSING IS JUST THE BEGINNING

- Found Money
- Hidden Liabilities
- Holdback
- Indemnification Issues
- Tail Coverage
- Periodic True Ups
ACCESS TO AND RETENTION OF RECORDS

- Buyer should provide reasonable access to all hospital records relating to purchased assets (if needed by seller in the future).

- For how long should buyer retain hospital records?

- Application of “60 Days to Pay” regulation.

- What records should seller retain?
MANAGEMENT AGREEMENTS
MANAGEMENT-LEASEBACK AGREEMENT

- Buyer = Manager
- Seller = Licensee

- If Manager has not obtained an acute care license from CDPH for the continued operation of the hospital by the closing, a management agreement may be necessary.

- Licensee leases hospital facilities and equipment from Manager.
MEDICARE REASSIGNMENT PROHIBITION

- **General Rule**: No payment which may be made to a provider of services under [Medicare] for any service furnished to an individual shall be made to any other person under an assignment or power of attorney. (42 U.S.C. § 1395g(c); 42 C.F.R. § 424.73(a).

- **Exceptions**: (1) Payment to a government entity; (2) Assignment by court order; and (3) Payment to a billing and collections agent, subject to certain conditions.

- Use of Lock Box Agreements.
Craig B. Garner  
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Craig is an attorney and health care consultant, specializing in issues pertaining to modern American health care and the ways it should be managed in its current climate of reform.

Craig’s law practice focuses on health care mergers and acquisitions, regulatory compliance and counseling for providers. Craig is also an adjunct professor of law at Pepperdine University School of Law, where he teaches courses on Hospital Law and the Affordable Care Act.

Between 2002 and 2011, Craig was the Chief Executive Officer of Coast Plaza Hospital in Norwalk, California. Craig is also a Fellow Designate with the American College of Healthcare Executives and a Vice-Chair of the State Bar of California, Business Law Section, Health Law Committee.

Additional information can be found at www.garnerhealth.com.
Jessica Weizenbluth
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Jessica is an attorney specializing in health care law with a particular focus in regulatory compliance, business transactions and providing counsel to health care providers.

Jessica is licensed to practice in both California and Ontario, Canada. Jessica is a member of the California Society for Healthcare Attorneys, the Los Angeles County Bar Association and the American Bar Association, as well as being a member of the Beth Tzedek New Leadership Council.

Jessica’s previous experience included corporate compliance representation for Barlow Respiratory Hospital of Los Angeles, a term on the ethics committee at Baycrest Hospital, and the London Health Science Center.

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Thank You

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