

Regulatory Implications for Change of Control in Hospital M&A

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This is the fourth article in a series that Juniper Advisory is publishing with The Governance Institute to highlight trends and issues related to healthcare business combinations. Thus far, the series has addressed: 1) various forms of acquisition currencies in non-profit hospital M&A, 2) valuing financially challenged hospitals, and 3) ensuring fair measures of financial and non-financial terms in a transaction.¹ This article will examine a key consideration of a hospital merger, and one that has generally established a bar for regulatory review: change of control.

Evolving Transaction Structures and New Regulatory Guidance

Often, one of the chief terms to be negotiated during a hospital merger is who will govern the hospital post-transaction. Will the existing hospital board retain control through an affiliation? Will the acquiring system assume control? Or will a new board be created—and if this is the case, how will it be constituted and perpetuated?

¹ To view the other articles in this series, go to www.governanceinstitute.com/Independent_Hospital.

Key Board Takeaways

The FTC has provided new guidance on non-profit hospital business combinations that will result in more hospital transactions being reportable under the HSR Act. Any affiliation that may result in a change in a hospital's beneficial ownership, not just a change in governance, will likely need to be reviewed by the FTC. As a result, boards of hospitals that are pursuing a partnership will need to take extra measures to ensure that their organizations:

- Demonstrate the rigor of their partnership selection and decision-making process.
- Document their objectives and the benefits of the partnership.
- Allow for additional time to close to accommodate HSR review.

The consolidation we saw in the healthcare industry in the 1990's often entailed straightforward merger transactions with a clear change in control. However, in more recent years, we have seen increasingly varied structures with unique outcomes and governance solutions. Many hospitals, particularly those that are well-resourced, find looser affiliations (e.g., joint ventures, joint operating agreements, and the like) to be the best of both worlds—providing access to a partner's high-quality clinical services, scale, expertise, and access to capital while retaining their identity and local governance.

In addition to the acquisition of assets or voting securities, the formation of a new true joint venture entity, combining all or a portion of the operations of separate entities

into a new joint venture entity (whether a corporation, limited partnership, or limited liability company), is generally reportable under the Hart-Scott-Rodino (HSR) Act, unless thresholds are not met for the size of the parties or size of the transaction or an exemption is available. The formation of certain not-for-profit entities is also not reportable under the HSR Act, but this exemption does not extend in the context of a merger or consolidation.

There are many other models for partnerships with a range of organizational oversight and day-to-day management terms but no formal change in board composition or new entity formation. As a result, such partnerships often seemed to fall outside of the Federal Trade Commission's (FTC) threshold for

HSR Act notification. To address the perceived underreporting of non-profit hospital combinations, the FTC's Premerger Notification Office (PNO) issued new guidance in October on how to analyze transactions between non-profit hospitals for reportability.

The crux of the guidance states that it is not only change in control of the board of directors that triggers HSR review, but also potentially change in "indicia of beneficial ownership over the assets of another party"² based on the context of the transaction. Or, as the FTC's Web site wryly states, "control no longer controlling for HSR reporting."³

In layman's terms, the FTC has called out a number of factors to consider in analyzing whether or not a transaction is reportable, including change in:

- The affiliating hospital's corporate member
- Authority to approve articles, bylaws, and governance

2 United States Federal Trade Commission, Premerger Notification Office, "[Analysis of Not-for-Profit Combinations under the HSR Act and Rules](#)," October 26, 2018.

3 Premerger Notification Office Staff, "[Control No Longer Controlling for HSR Reporting of Not-for-Profit Combinations](#)," Federal Trade Commission, October 28, 2018.

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documents of the affiliating hospitals

- Right to approve sale or lease of affiliating hospital's assets
- Ability to appoint/approve affiliating hospital's executives
- Oversight of the affiliating hospital's strategic plan, contracts, or capital budgets and expenditures

This new guidance will no doubt result in more hospital partnerships being reported to the FTC's PNO—and often the Department of Justice—which will extend the process timeline for those transactions to allow for the 30-day waiting period.

Insights for Hospitals Considering Transactions

As we discussed in the series' September article,⁴ state attorneys general and federal regulators

4 Rex Burgdorfer and Ken Marlow, "[Demonstrating Fairness in a Market Approach to Hospital M&A](#)," Hospital Focus, The Governance Institute, September 2018.

are placing increased scrutiny on non-profit hospital transactions. The nuances of the new FTC guidance and other developments underscore the importance of rigor and discipline in transaction process design. Regulators want to understand why a hospital board considered a change of ownership, how a partner was selected, if the value is fair, and if the result will be anticompetitive for the market. Well-documented objectives and the implementation of an organized process to provide fiduciaries with a basis of comparison is critical to achieving a successful outcome.

As more varied and complex non-profit hospital combinations are proposed, we can expect local and federal regulators to put forth increasingly stringent regulatory guidance. Hospitals should not be discouraged from pursuing such partnerships provided that they have achieved market norms, adhered to solid decision-making principles, achieved fair terms, demonstrated appropriate due diligence, and crafted an arrangement that is in the best interests of the communities the hospitals serve.

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