HOW INDEPENDENT AND SMALLER HOSPITALS CAN STAY AFLOAT IN THE WAKE OF TRANSACTION SCRUTINY AND MEDICAID CUTS

On July 4, 2025, President Trump signed into law the "One Big Beautiful Bill Act" ("Reconciliation Package"). The large-scale Medicaid cuts contained in the Reconciliation Package, coupled with recent trends of increased federal and state scrutiny of health care transactions, are expected to result in smaller, independent or rural hospitals looking for non-traditional avenues to keep their doors open. Specifically:

1. The Congressional Budget Office estimates that the Reconciliation Package will result in a $911 billion cut to federal Medicaid spending over the next decade. These cuts come as a result of stringent work requirements for the Affordable Care Act expansion population, limitations on states' capabilities to collect Medicaid funding through provider taxes, increased barriers to enrolling in and renewing Medicaid coverage and restrictions on state-directed payments to hospitals, nursing facilities and other providers. Consequently, the number of uninsured Americans is set to increase by 10 million.
2. Since the U.S. Department of Justice ("DOJ") and the Federal Trade Commission issued updated merger guidelines aimed at increasing transparency into proposed mergers and acquisitions in December 2023, health care transactions have been the target of increasing federal and state scrutiny. At the federal level, the DOJ and the Department of Health and Human Services have launched a joint inquiry into "private-equity and other corporations' increasing control over health care." In the name of transparency, states continue to consider and enact transaction notification legislation that requires extensive document disclosures and state review or approval in order for a health care transaction to proceed. The increased federal and state scrutiny has proven to be expensive and creates uncertainty with respect to timing, which has led to hesitation in pursuing transactions.

In order to overcome these headwinds and plan for the future, small, independent and rural hospitals (among others) are increasingly examining non-traditional and creative structures to reduce costs and create stability.

NON-TRADITIONAL AVENUES TO MAINTAIN FINANCIAL VIABILITY

In the wake of financial uncertainty and heightened scrutiny of health care transactions, it is anticipated that hospitals and other providers will need to consider creative options to reduce costs and create financial stability in order to continue providing critical services to their communities. While all providers' priorities and strategies are different, it is imperative that they work to update their three- to five-year goals and projections based on the Reconciliation Package and other changes in the market.

If the three- to five-year outlook appears strong, then leadership should keep a close eye on the established metrics to ensure performance is in line with the projections or otherwise adjust as needed, potentially considering some of the options outlined below. It's critical to remember that hospitals and other providers have more leverage when considering potential partners, affiliations or other negotiated strategies before operational performance has heavily declined.

If the three- to five-year outlook looks bleak, it's best to start considering different options, including non-traditional affiliation options that can help increase financial and operational performance without going through a state or federal review and/or approval process. While there are many possibilities depending on the specific situation of a provider, outlined below are some models for leadership and the board of directors to consider:

- **Operational Area Specific Contracts**. First and foremost, providers must improve operational performance in order to survive in this market. One way to do this is to look for proven operators in the market. Engaging a third-party entity to conduct or manage certain operational areas or back-office activities can help increase the quality and efficiency of those services. It is important to thoroughly vet such partners to ensure a proven track record exists or to make sure there is an ability to terminate the arrangement if the desired outcomes are not being achieved.
- **Creating Strong Physician Relationships**. A hospital or health system can often maintain independence when it has and maintains strong physician relationships. This can often include entering into meaningful relationships with physicians to build on such physician expertise and create an ownership mentality with the local physicians to encourage active participation in the hospital. Management

arrangements, value-based enterprise arrangements, joint ownership in ambulatory surgery centers or other ancillary services can all move the needle towards strong physician partnerships.

- **Joint Governance Model**. Looking for other providers with different strengths to create synergy through shared governance is another option. Two or more providers bringing different strengths to the table could create a new legal entity with governance and oversight responsibilities. This could enable the transfer of best practices and operational efficiencies and allow for shared infrastructure. In some states, this may trigger a notice to the government if the new entity is a parent of the existing providers, so each state's requirements should be thoroughly reviewed before moving forward.
- **Joint Operating Model**. Almost the inverse of the Joint Governance Model, the Joint Operating Model is where two or more providers form a jointly owned new legal entity, which provides certain operational services to all of the participating providers, such as administrative and back-office support. This allows each hospital to maintain its independence but allows for shared savings in administrative support functions.
- **Management or Affiliation Arrangements**. Hospitals, health systems and other providers can agree to work together without having common ownership or governance. Considering strategic partners in the market can provide creative solutions to ongoing hurdles. Examples of these types of arrangements include a management agreement with a larger system with proven success for a particular service line that is struggling in the current market, and an affiliation agreement whereby each provider agrees to promote and utilize the strengths of the other provider so duplication of services is avoided in the community if it's not needed.

It is not uncommon for hospitals to have an unwavering commitment to maintaining independence. However, the priority above all else must be keeping the hospital doors open and providing a full array of services to the community. Hospital leadership needs to be honest about the future state and take steps to insulate the hospital from impending challenges.

PRACTICAL TAKEAWAYS

Medicaid cuts and widespread scrutiny of health care transactions have left smaller and independent hospitals in a position where they may need to come up with unique strategies to improve their operational performance in a financially efficient manner. Time is of the essence – by taking a proactive planning approach and considering various types of relationships with third parties, leadership can best position their hospitals to continue to serve the communities.

If you have any questions or would like additional information about this topic, please contact:

- Bill Thompson at bthompson@hallrender.com or (317) 977-1424;
- Katie Miller at kmiller@hallrender.com or (317) 977-1404;
- Kelci Laster at klaster@hallrender.com or (317) 977-1401; or
- Your primary Hall Render contact.

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