

STEPS TO TAKE WHEN CONSIDERING AFFILIATING WITH ANOTHER HOSPITAL

The hospital industry is consolidating. Dramatic changes in health law, an increasing squeeze on hospital reimbursement, large capital costs required to provide sufficient information technology support and, in many cases, aging physical plants are factors motivating hospitals to consider affiliating with other hospital systems or entities.

What steps should your nonprofit hospital take if you sense a need to consider whether to affiliate with another hospital or hospital system?

STEP 1: DETERMINE WHAT IS BEST FOR YOUR COMMUNITY

The Board of Directors of a nonprofit, tax-exempt hospital needs to determine how to satisfy its fiduciary duty in light of the needs of the community that the hospital serves. The Board needs to establish a process by which it will identify what can best satisfy the needs of its community.

For example, if selling the assets of the hospital to a third party would create a significant risk that within several years the hospital would cease to provide the same broad level of services that may be currently provided, the Board will need to consider whether such a sale is consistent with its fiduciary duty. Making a determination of what is required to satisfy fiduciary duty should not be a rushed decision.

In determining what your community needs, you may want to consider such factors as: i) a Board of Directors that continues to be comprised of individuals living in the community served; ii) a significant measure of local autonomy in Board decision making, even if the hospital gives up its legal independence to a third party partner; iii) what IT or physical plant capital expenditures need to be assured during the five years following the closing of the strategic transaction; and iv) in the case of Catholic or other faith-based hospitals, whether moral convictions related to faith will continue to be reflected in the care that is delivered.

STEP 2: IDENTIFY A PROCESS TO BE FOLLOWED TO ACCOMPLISH WHAT IS BEST FOR YOUR COMMUNITY

Once you have determined what is in the best interest of your community, you need to establish a process that you will follow by which you will identify options, including affiliation proposals from third parties, and determine which option is best. Pursuant to this process, you may want to agree upon key criteria that must be satisfied in order for you to enter into any particular transaction. You might then seek proposals from other hospitals or hospital systems that may have an interest in affiliating with you.

STEP 3: DESCRIBE THE KEY TERMS OF THE PROPOSED ARRANGEMENT IN A LETTER OF INTENT

If you have reviewed potential affiliation options received from third parties in light of the Board's fiduciary duty and previously agreed upon process and have determined that a particular third party has expressed interest in an arrangement that satisfies your criteria, you may want to seek to negotiate a non-binding letter of intent or a "term sheet" with that third party. Such a letter of intent should spell out the key agreements on the key governance, delivery of care and economic issues so that it is clear that the parties have a meeting of the minds.

STEP 4: COMPLETE DUE DILIGENCE AND DEFINITIVE AGREEMENTS

Once it is clear that your hospital and a third party are in agreement, as reflected in an executed letter of intent, on an affiliation structure that satisfies the fiduciary duty of your Board, the parties can undertake and complete due diligence activity and the execution of appropriate legal documents.

If the hospital has accurately identified the needs of its community, established an appropriate process for investigating affiliation and come to an agreement with a third party through a non-binding letter of intent on an appropriate affiliation structure, the parties will be well on their way to accomplishing the affiliation transaction.

If a major problem is identified on either side in the due diligence process, or necessary regulatory approval cannot be obtained, the affiliation may not be accomplished. But in many cases, the due diligence and legal work will be less difficult than the steps taken in identifying the best approach for the community and an appropriate process by which to seek it.

If you have any questions regarding this information or wish to discuss the above considerations, please contact Douglas P. Long at dlong@hallrender.com or 317-633-4884 or your regular Hall Render attorney.