People’s Health System: Paving the Way for Modern Health care in Beazleyville

Team Five and Associates
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I. INTRODUCTION

Critical Access Hospitals ("CAHs") are at the crossroads of two very different eras in health care. Historically, health care in the U.S. has varied between consolidation and segmentation. CAHs like People’s Hospital, that bills on a fee-for-service schedule, are remnants from an era of segmentation. Presently, market pressures to reduce the costs of care are shifting reimbursement models towards value-based billing and other innovative models such as narrow network products. Because of the declining reimbursement associated with these models, there has been an explosion of consolidation within the health care industry. For People’s to participate meaningfully in these payment models, it will have to enter this new era of consolidation to position itself for success.

Much of the country's population depends on CAHs to receive health care: every year these providers serve 8 million patients in emergency departments, 38 million patients on an outpatient basis, and 809,000 patients on an inpatient basis.\(^1\) CAHs receive favorable government reimbursement, paid out at 101% of reasonable costs.\(^2\) Many CAHs struggle despite their key role in health care, necessity in the U.S., and favorable reimbursement. In 2013, 38.5% of CAHs had negative operating revenue and 30.3% of CAHs had a negative total margin.\(^3\)

The reality of financial struggles and increasing regulatory burdens is something with which People's is familiar. People’s has historically been a cornerstone of the community with its health care services, including a CAH, a skilled nursing facility (“SNF”), and a jointly owned outpatient surgery center. Despite this history, People's currently holds $55 million in debt, is struggling to offer a competitive health care product, and is losing market share to health systems

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\(^3\) *In Critical Condition*, supra note 1.
that are beginning to attract Beazleyville residents away from People's. There are several methods, however, that People's could consider to make itself more competitive in the marketplace, which could simultaneously take advantage of the favorable aspects of the CAH designation while also modernizing to offer higher quality and lower cost care. Consolidation and collaboration has been a popular and increasingly common option for all types of hospitals. Between 2009 and 2012, hospital mergers have increased two-fold from 50 to 105.\(^4\) Viable options for People’s could potentially range from integration through a joint venture (“JV”) all the way to a sale or auction of the system. Irrespective of whether People's pursues any of the options presented herein, it is important to address any compliance issues to minimize liability for the future and increase their appeal to potential partners. People's must carefully consider the strategic, business, and legal outcomes while taking into account public opinion and its status as a provider of last resort. People's has a genuine opportunity to remain a viable and important part of the Beazleyville health care marketplace, so long as the system is willing to adapt to the changing environment.

This memo will first lay out a process for determining which strategic option will best help People's succeed in the current and future health care marketplace. The memo then presents the benefits and downsides of a variety of strategic options, presented in order from most to least desirable. Next, the memo will outline potential legal implications that should be considered as People's is choosing its next course of action. Finally, the memo will analyze a series of outstanding compliance concerns that need to be resolved before People's can proceed to the next iteration of its health care system.

II. PROCESS FOR DECISION-MAKING

In determining its strategic options, People’s should follow a process that will guide the system in making the best and most informed choice for its future.

**PROPOSED PROCESS**

![Diagram of proposed process]

**Step 1: Determine People’s place in the market**

While People’s previously was the only health care option in Beazleyville, three other health care systems (Tri-City, Samaritan, and Cornish), have entered the market and decreased People’s overall market share to 70%. Additionally, People’s will likely lose market share both due to (1) its difficulty to offer the high quality of care that Beazleyville residents have come to expect and (2) the fact that multiple health entities have shown definite interest in further entering the Beazleyville health care market. Unless People’s acts in some way to stem the outflow of patients to these other health care systems, People’s will continue to lose market share.

**Step 2: Identify People’s strengths and weaknesses**

In making a decision, People’s should be aware of its strengths and attempt to address its weaknesses. Below are People’s most notable strengths and weaknesses to take into account.
### Strengths

- Generous reimbursement structure under CAH designation
- Trust of the community
- Significant market share

### Weaknesses

- $55 million in debt
- No leverage for negotiating with major payors in the area
- Old-fashioned staff and unsophisticated EHR
- Inability to independently offer tertiary services

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#### Step 3: Identify and analyze spectrum of options

- Maintain the status quo and do nothing
  - This is not a viable option. In its current state, People's has large amounts of debt and losing market share. Doing nothing could eventually spell the end for People's.
- Request tax increase from City
  - This is likely not a viable option. City residents are already subject to a property tax levy, and are already concerned with having to potentially "hold the bag" for People's current debt. This option would likely be met with extreme public opposition.

- Joint Venture/Management Services Agreement\(^5\)
- Lease\(^6\)
- Sale\(^7\)
- Auction\(^8\)

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#### Step 4: Identify all Key Constituencies that could be affected by People’s taking action

When considering courses of action, People's must keep in mind major interests and objectives of its key constituencies. People’s should attempt to accommodate as many of these interests and objectives as possible.

<table>
<thead>
<tr>
<th>Constituency</th>
<th>Interests and Objectives</th>
</tr>
</thead>
<tbody>
<tr>
<td>People’s Board</td>
<td>Maintenance of control over direction of health care system</td>
</tr>
<tr>
<td>People’s employees</td>
<td>Continuation of employment in the next iteration of the health care system</td>
</tr>
<tr>
<td>Physicians</td>
<td>Continuation of employment, retention of similar arrangements the with health care</td>
</tr>
</tbody>
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\(^5\) See infra, Section III C, D.
\(^6\) See Infra, Section III B.
\(^7\) See infra, Section III A.
\(^8\) See infra, Section III E.
Step 5: Define partnership goals and expectations

Defining partnership goals and expectations is an important step to ensure that community interests are being addressed in any transaction. As part of any transaction with a partner, Beazleyville will be giving up at least a portion of control of operations. To ensure that the partner carries on activities that are important to the community interests, People’s must build these terms into the transaction agreement to ensure that the partner performs its obligations. These goals are key to the negotiating process.

Step 6: Legal due diligence

People’s should perform legal due diligence before taking any significant action. This would involve assessing the general legality of any potential transaction, as well as taking stock of any remaining liabilities. These legal issues are further discussed later in the memo.

Step 7: Develop a public relations campaign to convey the benefits of the chosen course of action

Once a course of action is determined, it is crucial for People’s to develop a public relations campaign that effectively conveys the benefits of that course of action. Since People’s is a public entity, most aspects of any action taken will be public record and transparent to the people of Beazleyville. People’s will therefore have to justify any transaction they choose to pursue, explain
why it acted and negotiated in the manner it did, and clearly convey why the transaction was necessary and beneficial to the community.

III. PARTNERSHIP OPTIONS

A. Sale

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Disadvantages</th>
<th>Applicable laws</th>
<th>Must haves</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Pay off public debt</td>
<td>• Perceived loss of direct control</td>
<td>• FMV</td>
<td>• Mission statement and values upheld</td>
</tr>
<tr>
<td>• Capital infusion</td>
<td>• Inability to preserve goals and organizational mission</td>
<td>• State &amp; local regulations</td>
<td>• Price in excess of total liabilities</td>
</tr>
<tr>
<td>• Reduced risk for the City</td>
<td>• Potential for high degree of public opposition</td>
<td>• Anti-trust</td>
<td>• Maintain existing on-call physician arrangements</td>
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<tr>
<td>• Additional revenue for community initiatives</td>
<td></td>
<td>• Tax exemption</td>
<td>• Preference for existing hospital employees</td>
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<tr>
<td>• Reduce taxpayer burden</td>
<td></td>
<td>• Contract law</td>
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<td></td>
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<td>• Stark and AKS</td>
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<td>• CHOW</td>
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The most obvious option for People’s is a sale to one of its several suitors. A sale of the system’s assets would generate a large cash payment up front that would then be used to retire the system’s debts and, to the extent possible, establish a trust fund to serve community health care needs. Transferring ownership of a public hospital such as People’s to a private entity, whether that entity is non-profit or for-profit, is known as privatization. Effectuating this type of transaction
would result in a complete divestiture of the hospital plant and remaining system property and would effectively remove Beazleyville from the hospital business.

A sale can address many of the industry pressures towards consolidation like low occupancy, declining reimbursement, and increased competition from outpatient facilities. Selling People's to a larger, regional system would allow the hospital to care for patients outside of its current geographic area, see economic benefits from an increase in size and scale, and raise capital without affecting residents. An example of a successful sale is the sale of Detroit Medical Center ("DMC") to Vanguard in January 2011. Vanguard purchased DMC's assets for $365 million. As part of the transaction, Vanguard set aside $350 million for immediate capital improvements with another $500 million for specific capital improvements over five years. The sale demonstrated that privatization can have positive benefits for the delivery of and access to care.

Community hospitals exist in a legal framework that prohibits them from operating outside of the geographic or political boundaries of the city or county to which they belong. People's inability to expand and target patient populations outside of its own territory will leave the system facing even lower occupancy rates as competitors edge into People’s service area. A sale would eliminate this constraint and allow People's to expand its reach and attract new patients.

The relative size of community hospitals leads to unbalanced bargaining power that favors payors and suppliers over hospitals. As a single hospital system, People’s lacks the necessary leverage to obtain favorable reimbursement rates compared to its multi-hospital system competitors. Its size also prevents People’s from being able to negotiate lower costs on inputs such as surgical supplies, pharmaceuticals, or durable medical equipment. Further, its size makes People’s unable to spread the costs of internal departments such as human resources, billing and payment, or information technology. Simply stated, People’s inability to utilize economies of scale
is raising its operating costs while simultaneously reducing reimbursement. A sale to a larger system would help alleviate these concerns and bring down the cost of care at People's.

As a community hospital, People’s cannot raise capital independent of the City—it is tethered to Beazleyville’s budget. This inability to raise capital will prevent People’s from upgrading its facilities and its EHR. Shifting consumer preference towards aesthetically appealing and technologically savvy providers will leave People’s unable to compete against their better endowed competition. A sale to a larger system should include contractual covenants that require infrastructure upgrades to People's facilities to ensure a higher quality of care for the community.

Since a sale would remove Beazleyville from owning and operating a hospital, it would also reduce the City's financial and legal risk that stems from hospital operations. In the event of an economic downturn, People’s would likely face continued declines in admission and less support from state and local governments as tax revenues decline. These issues, combined with People's limited financial lifelines, will likely end with People’s facing closure or requiring a bailout from the community taxpayers. Since neither option is good for Beazleyville, People’s should consider a sale while it is still in an attractive position to do so.

As mentioned above, a sale would remove Beazleyville from hospital operations, which would effectively eliminate any operational control the city has over the hospital. Beazleyville should thus choose a partner who aligns strongly with its goals and expectations in order to reduce problems in the future.

Beazleyville has several for-profit and non-profit options to choose from if it decides to sell. The Beazleyville city council, in conjunction with the hospital board, should send out requests for proposals to gauge interest of local health systems. The most logical choice for People’s at this time is Tri-City because of the pre-existing JV between the two organizations. Unfortunately, it is
likely that Tri-City will not pay a premium for further integration with People’s because they have maximized much of their utility through this existing relationship. Cornish may be more inclined to obtain People’s because doing so would aid in the development of their narrow network insurance product. Other systems such as Samaritan would could use People’s to improve their position in the regional market. While it is important that any transaction is structured in a way that does not take referrals into account, it is still likely that imaging referrals will shift from Tri-City to whomever purchases People’s. Another possible but unlikely alternative is selling to the for-profit start-up MedCor. While they have issued an open proposal to purchase People's at a very attractive price, it would be difficult to sell the proposal to Beazleyville constituents due to MedCor’s likely focus on profits over mission.

**B. Lease**

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<tr>
<th>Advantages</th>
<th>Disadvantages</th>
<th>Applicable laws</th>
<th>Must haves</th>
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<tbody>
<tr>
<td>- Reduced public opposition</td>
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<td>- Retain some level of control</td>
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<td>- Reduced risk for the City</td>
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<tr>
<td>- Increased ability to maintain goals and organizational mission</td>
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<tr>
<td>- Reduced amount of capital</td>
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<td>- Practical infeasibility- lessee may not want any city oversight</td>
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<tr>
<td>• FMV</td>
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<td>• State &amp; Local regulations</td>
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<td>• Anti-trust</td>
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<td>• Tax exemption</td>
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<td>• Contract law</td>
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<td>• CHOW</td>
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<tr>
<td>• Mission statement and values upheld</td>
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<tr>
<td>• Price in excess of total liabilities</td>
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<tr>
<td>• Maintain existing on-call physician arrangements</td>
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<td>• Preference for existing hospital employees</td>
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The lease of the hospital plant and system facilities to a private entity may be an alternative option if there is strong public opposition to a sale. A lease would allow People's to retain title to the facilities while allowing a private company to manage and operate the hospital. While there are several types of leases available, for People’s an operating lease is the best option. An operating lease is a contract that allows for the use of the asset but involves no transfer of ownership interest.
or title. These types of leases are also generally structured on a long-term basis. A long-term basis indicates that a lease is over thirty years.

When considering a long-term lease, it is important to determine the lessee’s willingness to invest further capital throughout the term of the lease. Ideally, the lease will require continuing capital investments throughout the term to prevent the facilities falling into disrepair as the lessee faces diminishing return on investment. To the extent possible, long-term operating leases are structured to provide a large upfront payment, a capital investment in the facility designated for renovation, and annual rent payments.

Presuming a compatible lessee, the benefits of a lease would closely mirror those of a sale. Specifically, a lease would allow People’s to participate in innovative health plans, increase occupancy rates, and lower the cost of inputs and operating costs, all while increasing reimbursement rates. Leases, like sales, also remove a fair deal of risk from Beazleyville. Removing Beazleyville from hospital operations insulates the City financially from industry volatility and fluctuations.

That said, leases are not without their drawbacks. First, a lessee may not be interested in leasing the entirety of People’s assets. A lessee will likely want only those assets it believes to be profitable. This could result in the City leasing the hospital plant but not the SNF or outpatient clinic. In this scenario, the City would have ongoing costs and responsibilities associated with running these remaining facilities. Lessees also would likely have little interest in investing capital in the plant or facilities towards the end of the lease term. The conclusion of a long-term lease generally ends with a city regaining control over an aging or dilapidated facility. Further, leases, by default, give operational control of the hospital to the lessee. While the City Council may still have some say over what happens to the plant and facilities, it will generally lack the ability to
affect operational behaviors other than those that were contractually imposed. Finally, because Beazleyville still holds title to the hospital plant and other premises, it may be responsible for any outstanding debts not covered by the lessee’s capital infusion. This could mean the City would be unable to lift the property tax levy until all of its debts have been repaid.

C. Joint Venture

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Disadvantages</th>
<th>Applicable laws</th>
<th>Must haves</th>
</tr>
</thead>
<tbody>
<tr>
<td>• High degree of control over operations</td>
<td>• Likely reduced level of capital infused</td>
<td>• FMV</td>
<td>• Mission statement and values upheld</td>
</tr>
<tr>
<td>• Potential for capital infusion</td>
<td>• Relationship could fail and unwinding the deal is complicated</td>
<td>• State &amp; local regulations</td>
<td>• Board control</td>
</tr>
<tr>
<td>• Management expertise</td>
<td>• Contention over operations and integration of services</td>
<td>• Anti-trust</td>
<td>• Large capital infusion</td>
</tr>
<tr>
<td>• Increased access to resources not currently available</td>
<td></td>
<td>• Tax exemption</td>
<td>• Preference for existing hospital employees</td>
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A JV with another health system in the surrounding area is an option that could allow the Board to retain some control over People’s while receiving many of the benefits associated with a larger system. A JV is comprised of two health care entities who jointly own and operate a hospital. JVs are formed among private entities, but it is also possible to establish one between a public and private entity. For a public-private JV to occur, People's and a partner would form a new non-profit entity that would be vested with People’s assets. The private entity would put up capital as consideration for its ownership interest in the new entity. Based on the terms of the arrangement, the board for the new entity would consist of a number of members representing People's as well as a number representing the partner. The deal would likely be structured to require the private

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entity to set aside additional capital for infrastructure improvements. Raising capital in the future will be done through the private partner, as opposed to the City.\textsuperscript{10} The infusion of capital as a result of a public-private partnership was particularly successful in the case of California's Sequoia Healthcare District. Sequoia netted $30 million in cash by affiliating with Catholic Healthcare West ("CHW"),\textsuperscript{11} and the partnership between the two entities allowed Sequoia Hospital to stage a successful turnaround.

In a JV, governance is shared between partners relative to their ownership interests. Day-to-day management often becomes the responsibility of the private partner in the JV. The private partner will be paid a percentage of the revenue as management fees that will be negotiated as a part of the transaction. As part of these day-to-day operations, the private partner will introduce new clinical guidelines that will integrate the JV into its existing operational framework. Outsourcing management services and integrating People's into a larger network will help People's attract more patients without selling the hospital or losing full operational control.

Although access to capital, sophisticated management services, and the ability to retain some level of governance make a JV an attractive option for People’s, there are drawbacks to consider. First, JVs are complex transactions that are not easily unwound. This can lead to uncertainty in the future if relationships go sour and collaboration is not as easy as intended. Second, and on a similar note, the stakes are much higher when choosing the right partner. While People’s is in need of increased capital resources, it will still want a partner with which it will be culturally compatible to bring an improved level of care to Beazleyville. If the relationship between the partners fails, then the consequences can be quite catastrophic and difficult to solve. Lastly,

\textsuperscript{10} Bales, supra note 9.
because of the complexity of the transaction and the involvement of the parties, JVs may take longer to effectuate than other relationships. This length of time can increase the chances of failure and create an uncertainty that may adversely affect members of the community, physicians, and both partners in the transaction. Further, People’s financial health may continue to deteriorate during this period of time.

People’s could approach three different health systems to gauge interest and compatibility for a JV. The first option is Tri-City. People’s and Tri-City already operate a JV for tertiary care. Members of the Beazleyville community are familiar with Tri-City as they have already been traveling there for health care services. This familiarity and existing relationship indicate that People's may be culturally compatible with Tri-City. However, it may be difficult to expand this relationship further because it is likely that Tri-City will have less to gain than other potential partners. Since Tri-City already has the benefit of People’s physicians and sharing patients with People’s, Tri-City must determine if it will obtain sufficient value in partnering with People’s. As a result of the existing relationship, it may be reluctant to invest a large amount of capital that would be necessary for People’s to be successful and competitive with other providers. These capital improvements will be particularly crucial if Cornish decides to establish its narrow network product in the Beazleyville market.

Cornish is another potential partner for a JV. The benefits of having Cornish as a partner lay in its previous success. Cornish has indicated that it would like to unveil a narrow network product in the Beazleyville area. If People’s completes a JV with Cornish, it could gain the benefit of being included in the narrow network, a competitive edge that could reverse the current outflow of patients. Further, Cornish has begun poaching People’s physicians in order to complete this endeavor. By entering into a JV with Cornish, People’s could avoid the physician-grabbing and
dis-incentivize Cornish from establishing a medical clinic in Beazleyville. The drawback to a JV with Cornish is in the fact that People’s has not had a working relationship with Cornish in the past. This could make the transaction very risky. Ultimately, a JV with Cornish may alienate Tri-City in current or future collaboration with People’s.

The last potential partner is Samaritan. Cornish and Tri-City both have strategic advantages in the Beazleyville market from which People’s could benefit greatly. By choosing Samaritan and not going with either of those two partners, People’s would lose out on being included in a narrow network or building on an existing relationship. While Samaritan is a possible option, it seems as though the best option is to partner either Cornish or Tri-City as a partner in a joint venture.

### D. Management Services Arrangement

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<thead>
<tr>
<th>Advantages</th>
<th>Disadvantages</th>
<th>Applicable laws</th>
<th>Must haves</th>
</tr>
</thead>
<tbody>
<tr>
<td>High degree of control over operations</td>
<td>No increased access to capital, reductions in costs, or increases in bargaining power</td>
<td>FMV</td>
<td>Mission statement and values upheld</td>
</tr>
<tr>
<td>Management expertise</td>
<td>City retains liability over hospital operations</td>
<td>State &amp; local regulations</td>
<td>Preservation of existing on-call physician arrangements</td>
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<tr>
<td>Potential for improved quality of care</td>
<td></td>
<td>Contract law</td>
<td>Retention of existing hospital employees</td>
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<tr>
<td>Public ownership and reputation preservation</td>
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<td>Stark and AKS</td>
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A management services arrangement ("MSA") is another option that People’s may choose to utilize when partnering with another health care system. This entails enlisting a team of professionals to manage the operations of the hospital, while the Board still retains control. Often times, the party providing management services also owns part of the hospital (as discussed in the
Joint Venture Section). CAHs often enter into MSAs with larger health systems because of increased regulatory burdens, decreased reimbursement, and general cost increases. Outsourcing operations through an MSA could help reduce costs and increase efficiency at People's. Economies of scale allow larger management partners to spread the costs of human resources and IT departments over several entities and decrease People's operating costs. Additionally, such an arrangement would allow People’s to benefit from the expertise brought in by the partner. The ability to retain the existing Board but shift management responsibility to a new entity would bring many positive benefits without losing People's sense of identity. An MSA is not without its flaws, however. This type of arrangement may be insufficient to alleviate all of People's concerns. While there may be a cost savings, it will not be possible for People's to obtain the capital it needs to update its facility and attract patients traveling to other providers.

E. Auction

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Disadvantages</th>
<th>Applicable laws</th>
<th>Must haves</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Maximize sale price</td>
<td>• Total loss of control over operations</td>
<td>• State &amp; local regulations</td>
<td>• Tax exemption</td>
</tr>
<tr>
<td>• Potential to cover debt</td>
<td>• Little input over purchaser</td>
<td>• CHOW</td>
<td></td>
</tr>
<tr>
<td>• Potential for assets to be sold separately to create maximum value</td>
<td>• No focus on mission and vision</td>
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<tr>
<td>• Potential for capital in excess of the debt to be used for community initiatives</td>
<td>• Potential for extreme public opposition</td>
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People’s most drastic option is, in lieu of a more directed sale, to auction off its hospital system assets to the highest bidder. This process would involve soliciting cash bids from both for-profit and non-profit systems for People’s CAH, SNF, and any equipment or supplies from its JV with Tri-City. People’s would then sell these assets to the highest bidder and recoup a sum of cash from the bid. Since People’s is a public entity, the Beazleyville city government would oversee the future use of the money from the bid(s).

An auction could provide many immediate benefits to People’s. The influx of cash could potentially allow the City to clear the $55 million in debt that accrued from renovating the hospital. Any remaining cash could then be used as funding for the City to invest in Beazleyville community projects other than the hospital. Since People’s assets are likely declining in value due to the increasingly saturated health care marketplace around Beazleyville, auctioning off People’s assets now may maximize profit and reduce the risk that the value of the system’s assets will decline further. An asset auction would also avoid the need to raise an added tax on the people of Beazleyville and would mitigate the recent bad press about residents potentially having to “hold the bag” for People’s debt. Finally, the structure of an auction itself, with several competing bids, could drive up the ultimate amount paid for the assets and maximize the final price in a way that a directed sale could not. Indeed, there already appears to be at least one willing buyer (MedCorp) prepared to offer a generous price for the system, pushing bidding upward.

Conversely, numerous problems could arise from an auction sale. People’s would have almost no control over the ultimate buyer. More importantly, unlike a directed sale, People’s could not condition the auction to require the buyer to operate a certain way. Selling the system in an auction shows little regard for the future brand of the hospital and does little to protect its original
mission to serve the community of Beazleyville. Since People’s is a public entity, the auction process would be transparent and may even be subject to a referendum or popular vote. This transparency may make the auction infeasible if the people of Beazleyville believe it to be harmful to the community and subsequently campaign against the sale.

If People’s decides to hold an auction for its health care system, we would recommend structuring it as a two-stage auction similar to the approach taken in auctioning off Hutcheson Medical Center in Georgia in 2015. The first stage would involve taking bids for the entire health system as a whole. People’s would then oversee a second stage in which bids would be taken for each separate part of the health system—the hospital, the SNF, and any excess equipment or supplies from the JV clinic with Tri-City. People’s Board of Trustees would then review the bids from each stage of the auction and determine whether it is more advantageous to sell the health system as a whole or in parts. Such an auction structure would give People’s more options as well as the potential to maximize the overall value of each part of the system.

If an auction route is chosen, the City government should consider some kind of public relations campaign that outlines the benefit of the money that would come in from the auction sale, stressing the fact that the money could relieve the city of the $55 million debt and will likely make more funds available for other community projects. Such efforts could lessen public blowback and help to sell Beazleyville citizens on the auction sale, which could be key if a public vote is necessary.

Ultimately, an auction is too drastic a course of action for People’s. When health systems have auctioned off their assets in the past, they have done so because they were disqualified from
Medicare and Medicaid\textsuperscript{14} or had declared bankruptcy.\textsuperscript{15} People’s is not nearly in as dire of straits since the system still serves 70\% of the Beazleyville market and has a favorable CAH designation for its acute care hospital. Essentially, People’s still has enough leverage to negotiate an arrangement where it can gain a more prominent place in the market while protecting its mission.

**F. Recommendation**

Considering the range of options available and the information at hand, we recommend a sale to either Cornish or Tri-City. We believe that a sale would help People’s gain the capital needed to improve People’s infrastructure and EHR, allowing it to offer a higher quality of care. A sale to another health system will also appeal to patients in Beazleyville by offering services that they previously traveled out of Beazleyville to access. Lastly, a sale will likely decrease operating costs as well as the costs of inputs, helping to drive down the cost of care for Beazleyville residents.

Cornish and Tri-City each could be a strong partner for People’s, and the overall determination will depend on negotiating factors with each system. Both systems are popular with Beazleyville residents, as residents have shown that they are willing to travel to receive care at each system. A sale would allow Cornish access to a provider in the area and help with the rollout of its narrow network product. Further, Cornish is interested in People’s physicians, signaling a strong negotiating point between the parties. Tri-City is also an attractive option because of People’s existing relationship with the system. Building on this collaboration assures cultural compatibility, which is important for long-term success of the transaction.


**G. Legal Considerations**

An analysis of the following legal considerations will help determine whether a given option is feasible as well as what People's must do to proceed with the transaction. Many of the proposed transactions have overlapping legal issues that include: the determination of Fair Market Value ("FMV"), state and local governmental procedures, anti-trust issues, tax exemption issues, contract law considerations, and the Stark Law and Anti-kickback Statute ("AKS").

An FMV determination is both a federal and state law issue. While some states distinguish transactions involving for-profits and non-profits by allowing the non-profit participants to circumvent an FMV assessment, it is in the best interest of People’s to determine the FMV for their assets for two reasons. First, identifying and receiving the FMV as the sale price is likely to reduce public opposition to the sale. Second, while this, like most health care transactions, will be conducted at “arm’s-length,” identifying and receiving FMV helps minimize the possibility that any Federal laws or regulations will be violated.

Identifying the applicable state and local governmental procedures is also critical to any potential transaction, especially one that involves privatization. Many state and local regulations require a public referendum for any major changes regarding the ownership of publicly owned assets. Further, city regulations may require a vote by the hospital board or a vote by the city council in addition to public approval. State and federal regulations may require filing CHOW paperwork to maintain compliance as well as to avoid disruptions in payment from payors like Medicare and Medicaid. It may also be necessary to obtain approval for the transaction from the relevant state authority; this may include filing for a certificate of need to show the necessity of

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16 An “arm’s-length” transaction is defined as one in which the buyer and seller act independently and have no relationship to each other, ensuring that all parties in the deal are acting in their own self-interest not subject to any pressure or duress from the other party.
the transaction, as well as registering with the state department of revenue to determine property and other tax implications. Additionally, certain state regulations (such as the Illinois Hospital District Law, for example) may prevent the hospital board from leasing the hospital to a for-profit entity. Districting laws may also govern the dissolution of hospital boards and governing associations.

Anti-trust laws can also have a large impact on proposed courses of action, especially when providers in rural areas consolidate. Because People's has a large share in the Beazleyville market, it is important to comply with anti-trust laws like the Sherman Act and the Clayton Act. A Hart-Scott-Rodino analysis will be necessary if People's consolidates with partners in the area. Depending on what that analysis reveals, People's may need to notify the Federal Trade Commission ("FTC") and submit a filing. We would need to know what the FTC considers the relevant and geographic market in order to truly know whether it may block a proposed merger.

Tax exemption is also important to consider when identifying partners for potential transactions. If People's enters a JV with a non-profit entity, People's will be responsible for maintaining the tax exempt status of the JV. Tax exemption laws require that no individual receive private inurement from a non-profit entity. People's or its partner must designate any income generated from business outside of the scope of its core business as unrelated business income. Additionally, compensation paid to physicians, medical directors, or management-level employees should not exceed FMV without valid justification.

Regardless of the option that People's chooses, it will be important for People's and Beazleyville to protect their interests through explicit and well written contractual covenants. Important provisions such as breach, remedy, and indemnification must be carefully tailored and negotiated to protect People's interests.
Finally, People's should do its diligence to avoid any Stark or AKS violations, especially in a transaction that calls for direct cooperation with another health care entity. The federal AKS prohibits the knowing or willful exchange, or offer to exchange, anything of value in order to induce or reward the referral of health care program business. The Stark Law applies more specifically to physicians, prohibiting physician referrals for designated health services to an entity if that physician has a financial relationship with that entity. People's should carefully analyze any agreement made with another health care entity in order to ensure that the arrangement steers clear of any Stark or AKS violations. People should also closely review its current arrangements to ensure that People's does not have any outstanding liability that could hinder a future transaction.

IV. NEGOTIATING POINTS

Based on People’s strengths, mission, and areas in which it hopes to better serve the community, Beazleyville should attempt to negotiate certain conditions as part of any transaction in which they engage. Certain points may be more relevant to particular transaction types; however, there is likely to be significant overlap among the negotiating points.

Regardless of whether People’s engages in a sale, JV, lease, or MSA, it is important that it receives written assurances that the new owner, lessee, or management company will provide equal levels of care to local indigent populations. This issue is a primary concern because as a community hospital, People’s is the provider of last resort in Beazleyville. As such, any partner must ensure that these residents continue to receive care regardless of their socio-economic status. This is a non-negotiable starting point for any transaction.

People’s should seek a price in excess of the total liability owed by the system. This would relieve the City government of its responsibility for People’s debt and eliminates the need to find sources of revenue to service that debt. In the event that People’s receives an offer in
excess of its debt, it may be able to remove the property tax levy currently in place. This would make any potential transaction more palatable to the community and minimize public opposition. In the event that the debt is not completely satisfied by the capital infusion, the property tax levy should remain in place until People’s debt has been satisfied.

As part of any type of transaction with the exception of an MSA or auction, People’s should attempt to obtain capital investments in its plant infrastructure and EHR. While potential partners may be wary about additional capital investments after paying a purchase price to Beazleyville, People’s can argue that capital improvements will benefit both residents and the new owners. These benefits would create an environment conducive to delivering high quality care which will increase patient volume, subsequently increasing revenue for the new partner.

People’s should request that any potential partner honor commitments made by People’s for existing physician and employee agreements. It is important that People’s advocate on behalf of these individuals as they are unlikely to be represented by the new party. In the event that a new owner takes possession of the hospital it is likely that they will maintain the existing physician arrangements. At the least, People’s should request that the new owner give at least some preference to existing employees.

With the exception of a sale or auction, People’s should attempt to negotiate as much oversight with respect to hospital governance. In a lease, it would be advisable that the contractual terms reflect the will of the Beazleyville City Counsel and continue to do so with respect to system operations. In a JV, a negotiating starting point would be to control over half of the board seats in order to protect against an outside party immediately making decisions potentially adverse to Beazleyville residents. In the likelihood that the JV partner demands equal board representation, a further negotiating point would be that the Beazleyville City Council votes as the tie breaker.

With respect to all transactions where there is a change of ownership of the hospital facilities, Beazleyville should request that any outstanding liabilities become the responsibility of the new owner, partner, or lessee. In the event that People’s unable to acquire this level of indemnification, People’s should
follow up with a request to have the new owner, partner, or lessee pay for tail insurance that would cover any potential outstanding liabilities.

V. COMPLIANCE CONCERNS

Before commencing any of the transactions discussed above, People's should evaluate any outstanding liabilities, which could include liabilities incurred as a result of compliance violations. Such liabilities, if they exist, need to be taken into account for purposes of determining which party will be responsible for them after a transaction is completed. A series of potential compliance issues that could possibly affect People's are analyzed below.

A. Joint Venture Issues

1. Payment Arrangement Analysis

The first compliance issue regarding the Tri-City JV is whether the billing arrangement is appropriate. In the arrangement, the Tri-City physicians’ benefits are reassigned to People’s so that People’s can bill the Tri-City physician professional fees. People’s claims the JV as an outpatient department of the hospital and bills the Tri-City specialist physicians as provider-based practitioners. People’s subsequently reimburses Tri-City at 110% of the Medicare physician fee schedule for the Tri-City physicians' services.

The relationship between People’s and Tri-City likely qualifies as an under arrangement agreement, and therefore this billing arrangement is permissible. In an under arrangements relationship, a hospital contracts with another entity to provide services to the hospital’s patients. Although the contracted entity provides the service, the service is treated as a hospital service and thus the hospital bills for it—in return, the hospital pays a reimbursement fee to physicians from the contracted entity. CMS has explained that these arrangements are intended only for circumstances in which a provider obtains “specialized health care services that it does not itself offer, and that are needed to supplement the range of services that the provider offers to its
patients.”¹⁷ People’s and Tri-City’s JV appears to be appropriately structured as an under arrangement agreement. Tri-City’s physicians offer certain tertiary outpatient services that People’s CAH is unable to offer on its own. People’s charges for Tri-City’s services and reimburses them their fees based on the Medicare physician fee schedule that they are able to charge for outpatient services under CAH payment guidelines.

In order to assure compliance, however, People’s should first confirm that the patients who receive services at the clinic are registered as People’s outpatients—the hospital is required to treat the patients as if they are patients at their own entity. Second, People’s should ensure that it applies appropriate supervision over the JV. CMS stipulates that the hospital cannot serve simply as a billing mechanism for the contracted entity but rather must exercise a level of professional responsibility over the arranged for services. A few examples of ways in which People’s could accomplish this is by ensuring that the quality standards of the facilities at the JV clinic are similar or the same as those at the hospital and by ensuring that the individual patient receives the same notices and signs the same forms as they would at the hospital.

2. Anti-Kickback Statute Analysis

While the general payment arrangement set up by the JV is likely legal, AKS concerns could potentially come into play in regards to other aspects of the JV. One potential violation could arise regarding the amount that the Tri-City physicians are reimbursed for their services. Under CAH outpatient reimbursement rules, the fee schedule for professional services is “115 percent of such amounts as would otherwise be paid under this part if such services were not included in outpatient critical access hospital services.”¹⁸ Under the JV agreement, however, People’s only

¹⁸ 42 U.S.C. 1395(g)(2)(B). Note: A new rule effective November 2015 changes the Medicare hospital restriction payment system (OPPS) for off-campus outpatient departments. See Reminder: New Billing Requirements for Off-Campus Provider-Based Departments Effective January 1, 2016, HALL RENDER BLOG, (Dec. 21, 2015)
pays Tri-City’s physicians 110% of the Medicare physician fee schedule. While this reimbursement is not the normal excess monetary inducement that usually triggers an AKS violation, Tri-City accepting less than the amount that People’s collects for the Tri-City physicians’ services could potentially qualify as an illegal inducement. Tri-City accepting a slightly discounted amount could be interpreted as an inducement in exchange for People’s continuing the JV relationship, which in practice provides Tri-City with an influx of referrals of People’s patients for tertiary services. A cautious approach would be to pay the full 115% of the physician fee schedule for Tri-City physicians’ services; however, based on the information available there is no direct evidence of intent of inducement from either party in the JV.

Finally, People’s paying the entire rent expense associated with the JV could potentially be construed as an AKS violation—the use of the space by Tri-City physicians essentially for free could be considered an illegal inducement. This is unlikely, however, because People's supposed inducement in this case would not lead to any referrals from Tri-City to People's. Pursuant to the under arrangement set up, all patients at the JV clinic would already be considered People's patients. Since there is no referral given in exchange for the so-called inducement, the rental space arrangement likely does not violate the AKS.

**B. Physician On-Call Arrangement Issue**

**1. Anti-Kickback Statute Analysis**

The first major compliance issue in regards to the physician on-call arrangement is whether a per diem payment for on-call coverage constitutes remuneration under the AKS. The Office of Inspector General (“OIG”) has analyzed this issue in two separate Advisory Opinions (07-10 and

http://blogs.hallrender.com/blog/reminder-new-billing-requirements-for-off-campus-provider-based-departments-effective-january-1-2016/ (last accessed Feb. 19, 2016). However, since CAH’s are not reimbursement under OPPS, the regulation change does not apply in this instance.
12-15) where the OIG concluded that a per diem payment structure between a non-profit hospital and specialty physicians would not result in administrative sanctions under the OIG's civil monetary penalty law that relates to prohibited remuneration under the AKS.

The OIG issued the September 2007 Advisory Opinion in response to a medical center arrangement structured to pay physicians in certain specialties a per diem rate for each day spent on-call for the emergency department. The OIG found that the per diem payments in the advisory opinion were consistent with FMV and did not take into account referrals; the medical center had a legitimate, unmet need for on-call coverage; the safeguards reduced the risk of fraud and abuse; and there were substantial public health benefits and financial advantages for the government.

In October 2012, the OIG reviewed an arrangement where a non-profit hospital paid a per diem fee to specialists providing unrestricted on-call coverage for the hospital's emergency department. The arrangement included one-year contracts requiring that physicians be available to respond within specified response times and provide appropriate inpatient and follow-up care to admitted patients. Upon review, the OIG concluded that it would not impose administrative sanctions on the hospital in conjunction with the arrangement described in the opinion. To reach its opinion, the OIG looked to whether: the hospital administers a per diem fee, calculated annually in advance, to a specialist physician to provide unrestricted on-call coverage for the emergency department; all specialists on the hospital's medical staff are offered the opportunity to participate in the call arrangement; physicians agree to provide inpatient care required by any patient admitted by the physician as well as outpatient follow-up care following discharge, without additional

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People’s lack of a written on-call agreement distinguishes its arrangement from those in the advisory opinions. While OIG advisory opinions are only binding for the individual or entity that requested the opinion, they establish a guideline for what the OIG will and will not enforce. The information provided indicates that People’s on-call arrangements seem to be closely aligned with these advisory opinions with one major exception: they lack a written contract. People’s could overcome its lack of a writing by presenting evidence that an unwritten agreement existed and that it comported with the other criteria established by the advisory opinions. This evidence includes meeting notes from the 2002 meeting with People’s CEO and representatives of the physician groups where they established the arrangement for a duration clearly lasting for a period of over one year. Additionally, the agreements have regularly been approved by the City Council as a line item on People’s budget. While there is insufficient information to determine if People’s complied with all of the requirements set forth in the advisory opinions, if the arrangement does comply with these criteria, then even without a written agreement, it is unlikely that People’s will be held liable for any AKS violations.

2. Stark Law Analysis

Additionally, there is also a question as to whether the absence of written contracts with the specialty physician groups creates a technical Stark violation. Because the Stark Law is a strict liability statute, technical violations arise when a party does not completely comply with the statute. These violations often have occurred when a required written agreement is missing or has expired, even though the underlying conduct or arrangement complies with the remainder of the exception required by the statute. As such, historically, People’s lack of a written agreement
governing the on-call arrangements would have resulted in a technical Stark violation. However, in November of 2015, CMS announced that arrangements need not be set forth in a single, formal contract to comply with the requirement that the arrangement be “in writing.”

CMS declined to give specific examples of documents that would, taken as a whole, satisfy the writing requirement, but it did provide several examples of documents a party could consider as part of a collection to determine whether the writing requirement was satisfied. These include: board meeting minutes or other documents authorizing payments for services; written communications between the parties; fee schedules for specific services; check requests or invoices identifying items or services provided, relevant dates, and/or rate of compensation; time sheets documenting services performed; call coverage schedules or similar documents providing the dates of services to be provided; accounts payable or receivable records documenting dates and rates of payment; and checks issued for items, services, or rent.

To determine whether these documents could establish an informal “writing,” CMS states that the relevant inquiry should be whether the contemporaneous documents would permit a reasonable person to verify compliance with the applicable exception, which in this case would be the personal services arrangement exception. It is important to note that CMS has declined to allow a grace period for this requirement. Therefore, if any on-call services occurred before the 2002 meeting, there would be a technical Stark violation.

To establish that an informal writing existed between the parties, People’s must produce documents that demonstrate: terms of the agreement and establish that the services are reasonable and necessary to accomplish their business purpose; the schedule of the services; that the agreement was for not less than one year; and that compensation was set in advance, consistent

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with FMV, and did not take into account any business generated between the parties, i.e. referrals. Since it is likely that People’s can produce the necessary documents to demonstrate an informal writing, it is unlikely that there will be any Stark liability associated with the on-call arrangements.

VI. CONCLUSION

Due to the rapidly changing health care environment within Beazleyville, People’s health system will struggle to maintain market share in the community. If People’s acts assertively, it can execute certain transactions with other health care entities that would result in providing a stronger and higher quality health care product for Beazleyville residents. A sale is the clearest path to the achieving these benefits. Please consider these recommendations as you make your decision.