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L. EDWARD BRYANT, JR.
NATIONAL HEALTH LAW
TRANSACTIONAL COMPETITION

OFFICIAL PROBLEM

Hosted by:

**Beazley Institute for Health Law and Policy
Loyola University Chicago School of Law**

Your firm is outside general counsel for Beazley Health System (the “System”), headquartered in the city of Pearson, State of Loyola. Recently, the System has been exploring strategic options, as set forth below, and is seeking your counsel on the corporate, transactional, and regulatory issues associated with two options under consideration.

Beazley Health System Background

Beazley Health System, with two hospitals and two affiliated skilled nursing facilities, is one of four health systems in the greater Pearson metropolitan area. Beazley Memorial Hospital, a 250-bed general hospital, is located in Pearson just west of the city center, while Beazley West Medical Center, a 275-bed general hospital, is located in the western suburbs of Pearson. A not-for-profit tax-exempt corporation, Beazley Health System is governed by a fifteen-person Board of Directors. The System hospitals are separately incorporated, each with its own board and separate medical staff, with the System holding the customary reserved powers over the hospitals and all other subsidiaries. The System corporate office coordinates capital finance with a master indenture (with over \$400 million in tax-exempt bond debt), budgeting, treasury operations, and benefit plans, although other human resource functions have not yet been centralized.

Beazley Memorial Hospital

Beazley Memorial Hospital has a storied history. One of the first hospitals in Pearson, its founding was spearheaded by prominent physicians and philanthropists. Once considered Pearson’s most prestigious institution, and the site of a number of medical advances, Beazley Memorial, like other inner-city hospitals, has struggled with changing demographics and payer mix. However, it still maintains an active obstetrics unit and a focus on maternal and child health needed in the community and is served by a dedicated but aging medical staff. Although Beazley Memorial maintains a teaching affiliation with Pearson University School of Medicine, increasingly the specialists and patients they serve are migrating elsewhere.

The Beazley Memorial facilities are aging, but well-maintained. Management has developed plans for a new bed tower which would provide for more efficient staffing, however; major capital expansion projects have been put on hold. Although the hospital was generating a small excess of operational revenue over expenses, the effect of the pandemic has been devastating. Its facilities could not be easily converted to the type of critical care beds required for effective treatment of Covid-19. The emergency department, chaotic in usual times, was hard-pressed to meet the demand. The community served by Beazley Memorial was especially hard-hit by the pandemic, and the loss of elective procedures, together with the inadequate reimbursement for specialized procedures, have caused a massive deficit in 2020. With a continuing pandemic surge, the anticipated fiscal year-end loss from operations would threaten the system debt covenants under the master indenture.

Beazley West Medical Center

Beazley West Medical Center has a favorable location, with ready access to highways and an enviable payer mix. It has an extensive campus in a fashionable suburb of Pearson, with attractive medical office buildings, a surgery center, and a comprehensive cancer center. Although late in implementing physician integration, Beazley West is engaged in aggressively forming its own medical group and an accountable care organization. Attracted by the area's lucrative payer mix, Beazley West has strong representation of physicians in all specialties, and its medical staff has grown significantly in recent years. The facilities at Beazley West are beautiful, but not ostentatious (unlike some other hospitals in Pearson) as the System board and management, conscious of the differences between Beazley Memorial and Beazley West, have been targeted in their facility investment decisions.

The financial performance of Beazley West reflects its advantages, particularly compared to Beazley Memorial. Its operating revenue has been strong, and although all hospitals are challenged, it has begun to focus on transforming the hospital to thrive in a pay for value reimbursement system. Over the years, Beazley West has been able to fund significant reserves for the System. The loss of elective procedures during the first surge of the pandemic was difficult for Beazley West but it did react quickly to reinstate procedure times when it was clear that the initial surge would not affect it as much as Beazley Memorial. Still, these have been challenging times with staff costs and extra expenses for PPE, conversion of specialty units and the hasty construction of a dedicated Covid-19 emergency portal.

The Pearson Health Care Environment

Almost all of the hospitals in the greater Pearson area are affiliated with one of four systems. A market leader is NorthHealth, with five hospitals situated throughout Pearson and the nearby area. NorthHealth is a not-for-profit, tax-exempt organization. Beginning with two hospitals, it has grown with the merger of additional hospitals, many of them leaders in their respective markets. NorthHealth is known for its strong physician integration, a large cohort of employed physicians, and an even larger group of affiliated physicians. With these strengths, its attractive hospitals, and the affiliated primary care physicians, it is in the position to attract favorable managed-care agreements.

NorthHealth has announced a strategy of continued growth, recently merging with a large system in an adjoining state to form a 15 hospital system. Known for its centralized governance and management structure, NorthHealth has also enjoyed a reputation for quality and patient centered care.

With four hospitals in Pearson, St. Luke's Health System ("SLHS") a not-for-profit tax-exempt organization, is also a major player. It is a Catholic system, growing from a core of two hospitals operated by a Franciscan order of religious sisters, and assuming sponsorship

of two additional Catholic facilities. Generally, the SLHS hospitals do not enjoy the same favorable demographics as NorthHealth. However, the hospitals are seen as strongly responsive to their communities and enjoy a positive reputation within them. The SLHS strategy is to have multiple entry points into their system, with urgent care centers, small physician offices, and other facilities in its neighborhoods.

SLHS hospitals in Pearson are strong in cardiology and orthopedics. Through an affiliation with St. Ignatius Medical School, SLHS hospitals are teaching sites for medical residents. Although the cost of the medical education program is significant, the availability of clinical specialists and super-specialists is seen to enhance the reputation of the SLHS hospitals for quality.

SLHS has recently joined a national Catholic healthcare system, which gives it greater access to capital, even if it must be allocated from the national system. The SLHS strategy is to continue to grow in Pearson and throughout the region. The national system does have a strategy of physician integration, although most of the efforts are focused on operational effectiveness through national system programs, such as central call centers, revenue cycle optimization, purchasing, and development of centers of excellence

CareWell Health is a for-profit system which operates two hospitals, one in a northwest and one in a southwest suburb of Pearson. With more than fifty hospitals nationally, the strategy of CareWell is to locate in smaller metropolitan areas or growing suburbs. CareWell built one of its Pearson hospitals, and acquired the other from a different for-profit system which exited the market. At one time the hospital sites were exurban, but with Pearson growing westward, both hospitals now enjoy strong financial demographics (young families, with a high percentage of commercial insurance) and good payer rates. Generally, CareWell hospitals tend to be smaller (here, both are 150 beds) with medical staffs mostly of independent physicians and small groups. Employment of physicians is on the back burner as being seen as inconsistent with the CareWell physician-friendly operating philosophy. With tight operational control from its national system, and with good locations, the CareWell hospitals in Pearson have been consistently profitable. As a part of a national for-profit system, CareWell has access to capital for strategic investments. Its portfolio strategy is to invest in areas where its hospitals can maintain a leading market position, and to divest underperforming hospitals or those in areas where it cannot attain that leading position.

Beazley Health System Transaction Strategy

Although the effects of the Covid-19 pandemic have affected all hospitals, Beazley Memorial is particularly stressed given the disproportionate effect on the populations it serves. The System Board of Directors has created a Strategic Transaction Committee to identify and evaluate possible transactions available to the System. Confidential high level discussions have focused on two: 1) affiliation with SLHS (and its national system), and 2) sale to CareWell Health. Your firm has been asked to guide Beazley Health System as it considers its options. The Committee has reached out to SLHS and CareWell management

for preliminary discussions. Each group has executed a Confidentiality and Non-Disclosure Agreement your firm has drafted, and each system understands that Beazley Health System is evaluating all options and has not disclosed the identity of other parties with which it may be having discussions. There has been no formal due diligence process at this preliminary stage, but conversations at the executive management level have revealed the parties' interest in pursuing further discussions.

Affiliation with SLHS

SLHS has indicated its interest in Beazley Health System joining the system. The proposed transaction would include both Beazley Memorial and Beazley West. SLHS has indicated that these transactions could involve a commitment to further investment in Beazley Memorial and the pledge to continue to operate the hospital for a specified number of years. The Beazley Health System institutions would become Catholic facilities following the transaction. SLHS representatives have suggested that the mission and values of SLHS are consistent with the commitment of Beazley Memorial to its underserved community.

CareWell Health

CareWell has indicated its strong interest in Beazley West as adding it to the two existing CareWell hospitals would give it a premier market position in the desirable west suburbs of Pearson and the system would become a "must-have" system for commercial payers. CareWell has let it be known, however, that Beazley Memorial does not fit into its plans. If forced to include it in the transaction, CareWell would not commit to operate the hospital for any length of time, and probably would seek to divest it as soon as possible. Given this, any transaction with CareWell would focus on an acquisition of Beazley West, with the System Board needing to find an alternative transaction/operating strategy for Beazley Memorial.

Transaction Preparation

To prepare Beazley Health System for considering any transaction a preliminary due diligence process on the System facilities is being performed under your firm's direction. Several potential issues have been identified:

1. In a routine audit of outpatient billing practices, Beazley West identified codes that were inappropriately billed for certain radiation therapy services. Beazley West was able to repay federal healthcare payers for the overpayments. You have now learned that the same billing process was in place at Beazley Memorial. (Both facilities were following the recommendations of the equipment supplier.) No formal investigation was initiated at Beazley Memorial, but it appears that the department manager did perform a quick review which would show in excess of \$1.5 million in inappropriate billings. Because the compliance function did not pursue the issue at Beazley Memorial, and because the budget projections were not being met, the department manager did not raise the issue further than his own boss, the assistant administrator. As part of a pandemic-related reduction in force, the department manager's position was recently eliminated.

2. There is reporting in the trade press of a national False Claims Act case against CareWell. The Pearson facilities appear to be among the CareWell hospitals involved in the case.

Strategic Transaction Committee Deliberations

The Committee has met to consider the competing alternatives. It seeks clarity on the legal, strategic and business issues involved in these two options, as it begins consideration of its recommendation to the System Board. Specific issues to be addressed are as follows:

1. The potential forms of the transactions, and your firm's recommendation as to the transaction structure most favorable to the System for each of the options. The Committee has requested options for the continuing input into the governance of the hospitals.

2. A discussion of associated corporate/nonprofit/tax-exemption law issues raised with these two options, any impediments to negotiating or closing the transaction raised by these issues and your recommendations regarding issue resolution.

3. A discussion of associated regulatory issues raised with these two options, any impediments to negotiating or closing the transaction raised by these issues, and your recommendations regarding issue resolution.

4. A discussion of business/strategic and related issues that the Strategic Transaction Committee and the Board should consider when making their recommendation/decision. If additional information is needed, please specifically discuss the type of information and its import to the recommendation/decision making process.

Your firm has been invited to present your analysis of the pertinent issues, proposed legal strategies and associated business options to the System Board on March 26, 2021.

Your firm has also been asked to prepare a memorandum addressing the relevant issues. Please limit your written response to 25 pages double-spaced.



Beazley Health System

Always Caring. Always Pearson.

Transactional Memorandum

Team 11, LLC

111 Chicago Drive

Pearson, Loyola 28510

(555) 123-4567

team11@gmail.com

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I. Executive Summary

Our firm recommends an affiliation with St. Luke's Health System (SLHS). SLHS and the Beazley Health System (the System) have the best synergy out of the proposed partners. SLHS is also a nonprofit system similarly devoted to patient care, making it the preferable partner as compared to CareWell Health (CareWell).

Specifically, our firm proposes two options. Both options potentially allow the Board to retain some level of governance, which is another benefit of affiliating with SLHS. First, the System could sell Beazley Memorial (Memorial) to SLHS or another interested buyer and use the proceeds to pay down its debts. Selling Memorial would also allow the System to divest the hospital contributing to its growing deficit. It would then enter Beazley West (West) into a whole hospital joint venture with SLHS. A whole hospital joint venture would allow West to benefit from a continued investment from SLHS. West would also have access to other SLHS resources, such as its physician recruitment program. Even though West does not currently have a recruitment issue like Memorial, access to these resources could lower West's operating costs or improve its market position given that the System would only have one remaining hospital.

Second, the System could enter a membership substitution with SLHS, which would involve both West and Memorial. This transaction is preferable if the System is unable or unwilling to sell Memorial. This structure would allow the System to access much needed capital. Additionally, this structure will allow the System to remain intact and benefit financially and reputationally from an association with a national nonprofit health care system.

II. Pre-Transaction Considerations

This Section proposes three considerations that the Board of Directors (the Board) should address at the outset as it continues to evaluate potential transactions with another system. These

considerations are important both for selecting the best transactional structure for the System as well as improving its bargaining power in any transaction. Additionally, throughout this process, the Board must keep in mind the fiduciary duties owed to the System. The duty of care requires the directors to act in good faith and in the reasonable belief that the actions are in the corporation's best interests.¹ The duty of obedience requires the directors to adhere to the mission and purpose enumerated in the corporation's charter.² Finally, the duty of loyalty requires the directors to make decisions in the corporation's best interest without conflicts of interest.³

First, our firm requests a copy of the System's master indenture, so the Board's preferred transaction can be structured in a way that considers the language of the System's bond covenants. The language of the bond covenants can determine what types of transactions or changes in ownership would call or otherwise jeopardize its bonds.

Second, the System should conduct an in-depth internal investigation of Memorial's False Claims Act (FCA) liability. Assuming that the investigation uncovers similar violations as those previously settled with West, the System should strongly consider self-disclosing.

Third, the Board should consider applying for funding under the Coronavirus Aid, Relief, and Economic Security (CARES) Act given that some of its recent financial struggles have been

¹ Naomi Ono, *Board of Directors Under Fire: An Examination of Nonprofit Board Duties in the Health Care Environment*, 7 ANNALS HEALTH L. 107, 111 (1998). To fulfill the duty of care, the directors must act "with the care that an ordinarily prudent person in a like position would reasonably be expected to exercise under similar circumstances." *Id.* This inquiry focuses on the Board's decision-making process, not the ultimate decision. *Id.* at 114. Under the business judgment rule, courts defer to the directors' business decisions as long as the directors were well-informed. *Id.* at 111-12.

² Thomas Lee Hazen & Liza Love Hazen, *Punctilios and Nonprofit Corporate Governance—A Comprehensive Look at Nonprofit Directors' Fiduciary Duties*, 14 U. PA. J. BUS. L. 347, 386-87. (2012). However, if running the nonprofit is no longer practical and the nonprofit has a general charitable intent, then the directors may use the nonprofit's funds for a purpose as near as possible to the original. 88 AM. JUR. PROOF OF FACTS *Circumstances Warranting Application of Cy Pres Doctrine to Modify Terms of Charitable Trust* 3d § 469 (2006).

³ *Id.* at 380-82. This duty includes a requirement to keep all board discussions confidential. Jerry A. Bell, *Conflicts of Interest: Ethical and Legal Issues Seminar at the American Health Lawyers Association* (Dec. 8, 1997) (transcript available on Westlaw).

directly related to the impacts of COVID-19. Regardless of the transaction that the Board ultimately chooses, this funding could help mitigate ongoing loss of revenue. These latter two considerations are discussed in greater detail below.

A. False Claims Act Liability

A significant threat to the System and any potential transaction is Memorial's potential FCA liability caused by the overpayments on radiation therapy services. The FCA prohibits a person from knowingly presenting a false claim to Medicare for payment,⁴ and it can be used to enforce the Stark Law and the Anti-Kickback Statute.^{5,6} The penalties for violating the FCA are severe and can result in repayment of the fraudulent claims and treble damages.^{7,8} The best solution to the System's FCA liability is self-disclosure of its violations if an internal investigation confirms the former supervisor's findings of similar violations as those previously settled in West.⁹

While self-disclosing is a multi-step process, there are two requirements that will require special attention. First, the System will need to estimate the amount paid through false billing and

⁴ 31 U.S.C. § 3729(a)(1)(A) (West 2021); *see also id.* § 3729(b)(1)(A)(i)–(iii) (defining “knowingly” as a person having “actual knowledge of the information,” “acts in deliberate ignorance of the truth or falsity of the information,” or “acts in reckless disregard of the truth or falsity of the information”).

⁵ *The Intersection Between the False Claims Act and the Federal Stark Law, Part I*, BERGER MONTAGUE, <https://bergermontague.com/understanding-the-intersection-between-the-false-claims-act-and-the-federal-stark-law-part-one/> (last visited Feb. 7, 2021).

⁶ If upon further investigation it is found that the System has violated only the Stark Law, the self-disclosure process must be done through the Centers for Medicare and Medicaid Services' (CMS) Self-Referral Disclosure Protocol. *See generally Physician Self Referral*, CTRS. FOR MEDICARE AND MEDICAID SERVS., <https://www.cms.gov/Medicare/Fraud-and-Abuse/PhysicianSelfReferral/index?redirect=/PhysicianSelfReferral/> (Jan. 5, 2015).

⁷ 31 U.S.C. § 3729(a)(1)(G). Assuming that actual damages were calculated to total \$1.5 million, the System would have to pay \$4.5 million in treble damages in addition to a penalty for each individual claim in violation of the FCA. Kathleen McDermott & Holly C. Barker, *Calculating Damages Under the False Claims Act: Basic Considerations to Review* HEALTH L. RES. CTR. 1 (2014), https://www.morganlewis.com/-/media/files/publication/outside-publication/article/bna_calculatingdamagesunderfalseclaimsact_may2013.pdf.

⁸ Adding to the potential costs, if the government takes civil action against the System, the System would also have to pay the cost of the civil action. 31 U.S.C. § 3729(a)(3).

⁹ To self-disclose, the System will report its overpayments and provide evidence of the overpayments to the Office of Inspector General (OIG). OFF. OF INSPECTOR GEN., PROVIDER SELF-DISCLOSURE PROTOCOL (2013), <https://oig.hhs.gov/compliance/self-disclosure-info/protocol.asp>.

provide a report with its findings.¹⁰ Second, the System will have to describe the corrective action it has taken,¹¹ so the Board needs to ensure that the System’s compliance department is taking action to find the root cause of the issue and implement a corrective action plan. After self-disclosing, the System would engage in a resolution process with the Office of the Inspector General (OIG).¹²

Nonetheless, self-disclosure will yield much more favorable results than waiting until CMS and OIG discover the overpayments.¹³ First, a benefit of self-disclosure is that Memorial can avoid government investigation and litigation, both being expensive and time-consuming.¹⁴ Second, as parties conduct a formal due diligence in advance of a transaction, potential FCA will be discovered by the transactional partner. Third, and most importantly, self-disclosing could reduce the civil monetary penalties assessed against the System. OIG stated in its Self-Disclosure Protocol (SDP) that “individuals or entities that use the SDP and cooperate with OIG during the SDP process deserve to pay a lower multiplier on single damages than would normally be required in resolving a Government-initiated investigation.”¹⁵ However, a crucial element of the self-disclosure process is cooperation with the government.¹⁶ The Board should do all it can to orchestrate useful cooperation, thus casting the System in a favorable light as a good faith participant in the self-disclosure process. OIG usually multiplies the damages by 1.5 instead of the

¹⁰ *Id.* at 7.

¹¹ *Id.* at 6.

¹² *Id.* at 1–2.

¹³ If self-disclosure occurs within 60 days of identification of the overpayment, OIG “believe[s] that using the SDP may mitigate potential exposure. . . . Section 1128J(d)(2) of the [Social Security] Act requires that a Medicare or Medicaid overpayment be reported and returned by the later of (1) the date that is 60 days after the date on which the overpayment was identified or (2) the date any corresponding cost report is due, if applicable.” *Id.* at 2.

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ 31 U.S.C. § 3729(a)(2)(B).

usual treble damages, meaning that the System could owe \$2.25 million instead of \$4.5 million in damages.¹⁷

The Board should consider immediately investigating and self-disclosing for two reasons. First, by self-disclosing and addressing the unresolved liability, the System can improve its bargaining power in the proposed transactions or avoid jeopardizing a potential transaction. Secondly, the Board should be concerned that the supervisor who was fired after discovering FCA liability will bring a *qui tam* suit before the System has the opportunity to self-disclose.¹⁸ While the System fired the supervisor due to necessary pandemic-induced cuts, the former employee might allege that the firing was a result of uncovering Memorial's potential FCA liability. The former employee has a strong financial incentive to file a *qui tam* suit, as the whistleblower is entitled to a portion of any money the government recovers as a result of the suit.¹⁹ Not only are these potential damages appealing to a disgruntled former employee, but the former employee is most likely aware that the same problem occurred at West, resulting in a large repayment to the government.

B. Coronavirus Aid, Relief, and Economic Security Act

Because COVID-19 has created financial and operational challenges for the System, our firm explored governmental relief programs that may allow the System to mitigate its loss of revenue as it continues to evaluate potential transactions.

¹⁷ These calculations were made based on the assumption that the \$1.5 million in false billings accurately reflected Memorial's FCA liability.

¹⁸ Under the FCA, a private citizen (i.e., the whistleblower) can file a suit against the System for FCA violations on behalf of the government (i.e., a *qui tam* suit). *The False Claims Act*, DEP'T OF JUST., <https://www.justice.gov/civil/false-claims-act> (Jan. 14, 2021).

¹⁹ *False Claims Act: What Potential Whistleblowers Need to Know About Bringing a Qui Tam Lawsuit Under the Federal False Claims Act*, CONSTANTINE CANNON, <https://constantinecannon.com/practice/whistleblower/whistleblower-types/whistleblower-reward-laws/fca/> (last visited Feb. 9, 2021). Whistleblowers can typically expect 15 to 25% of the amount recovered by the government. *Id.*

The CARES Act allows healthcare providers to apply for reimbursement “for health care related expenses or lost revenues” due to the pandemic.²⁰ Previous phases of the Provider Relief Fund allowed for reimbursement for lost elective procedures.²¹ Thus, Memorial could potentially be reimbursed for its lost revenue due to the necessary cancellation of elective procedures. These funds can also improve Memorial’s surge capacity by providing capital to hire new employees and build temporary structures, which was one of West’s financial concerns.²² Additionally, under the COVID-19 Uninsured Program, the System can seek reimbursement on a rolling basis for testing and treating uninsured patients with a primary COVID-19 diagnosis.²³ If the System decides to apply for funding, it should designate individuals in the financial department to focus on submitting uninsured claims, satisfying the PRF’s deadlines, and meeting reporting requirements.

The next two Sections will explore potential transactions with the Board’s proposed partners: CareWell and SLHS. It will also address business, strategic, and legal considerations related to working with either partner.

III. Transaction with CareWell

Based on its strategy and past acquisitions, a transaction with CareWell would likely involve a merger.²⁴ However, the System’s bond debt is a liability. Under the master indenture,

²⁰ H.R. 133–739, 116th Cong. (2d Sess. 2020); *see also* Coronavirus Aid, Relief, and Economic Security Act (CARES Act), Pub. L. No. 116-127, 134 Stat. 178 (noting a previously passed version of the Act).

²¹ In June 2020, Health and Human Services (HHS) released FAQs that included “canceled elective procedures or services” in its definition of “lost revenues that are attributable to coronavirus. Nicole Fallon, *Congress Adds to Provider Relief and Clarifies Lost Revenues*, LEADINGAGE (Dec. 22, 2020), <https://leadingage.org/legislation/congress-adds-provider-relief-and-clarifies-lost-revenues>. However, HHS has not released FAQs regarding the new Provider Relief Fund.

²² H.R. 133–739, 116th Cong. (2d Sess. 2020); *see also* Coronavirus Aid, Relief, and Economic Security Act (CARES Act), Pub. L. No. 116-127, 134 Stat. 178 (noting a previously passed version of the Act).

²³ *COVID-19 Claims Reimbursement to Health Care Providers and Facilities for Testing, Treatment, and Vaccine Administration for the Uninsured*, HEALTH RES. & SERVS. ADMIN., <https://www.hrsa.gov/CovidUninsuredClaim> (Jan. 2021).

²⁴ In a traditional merger, the System would combine with CareWell, who would then own all of the System’s assets and liabilities; the Beazley entity would subsequently cease to exist. Therefore, any claims that could have been brought against the System could then be brought against CareWell. *See* MARK A. HALL & WILLIAM S. BREWBAKER

each System hospital owes a portion of the debt pro rata. While a for-profit entity cannot assume tax-exempt debt,²⁵ the System could use the proceeds of the sale to pay down its bond debt. To address its concerns about the System's liability, CareWell would likely propose a reverse triangular merger, which has additional benefits to the buyer aside from some level of insulation of liability.

In a reverse triangular merger, CareWell would form a new subsidiary, which would merge with a System hospital, with the System hospital surviving as a wholly-owned subsidiary of CareWell.²⁶ Because the target, the System hospital, is the surviving entity, this transaction will not trigger anti-assignment provisions,²⁷ so CareWell would be able to avoid having to obtain new licenses or contracts.²⁸ Furthermore, assets and liabilities remain in the entity, insulating the CareWell system somewhat from the debts and liabilities of its subsidiary.²⁹ Nonetheless, for the business and strategic reasons discussed below, our firm ultimately does not recommend a transaction with CareWell.

A. Business and Strategic Considerations

While a transaction with CareWell would allow the hospital to access capital and other resources from its national system, there are several cons to a transaction with CareWell. First,

III, HEALTH CARE CORPORATE LAW: FACILITIES AND TRANSACTIONS 5-8-5-9 (1999). FCA liability could transfer if CareWell is able to use the same Medicare Provider Number. *See* 42 C.F.R. § 489.18. Thus, Beazley has the best bargaining power in a transaction in which it has already settled its FCA liability. To avoid assuming liabilities, CareWell could also consider an asset purchase in which it would purchase all of the assets of the Beazley hospitals. It could exclude liabilities from the transaction. HALL & BREWBAKER, *supra*, at 5-14. However, the drawbacks of this structure are that an asset purchase is time-consuming and more complex than the other options because they require a complete detailing and negotiation of the assets subject to the sale, making it an unlikely option. *Id.* at 5-15.

²⁵ IRS, TAX-EXEMPT GOVERNMENTAL BONDS 4 (2019), <https://www.irs.gov/pub/irs-pdf/p4079.pdf>.

²⁶ Andrew L. Bab & Dmitriy A. Tartakovskiy, *Basic Transaction Structures in Health Care M&A*, in HEALTH CARE MERGERS & ACQUISITIONS 1, 4 (2015).

²⁷ *See id.* at 22.

²⁸ *Id.*

²⁹ *Id.*

based on its past acquisitions, CareWell seems to only be interested in a traditional merger and acquisition. It has “tight operational control from its national system.” Thus, the possibility of the System maintaining any governance or continuing the same level of charitable care is quite slim.

Second, CareWell is only interested in acquiring West given its strategy of acquiring suburban hospitals, which is the System’s financially healthy hospital. CareWell is not interested in Memorial due to its payer mix and location, which is a huge concern. Even if the System could convince CareWell to also acquire Memorial, it would likely divest it very quickly given its refusal to commit to operate the hospital for any length of time.

If the System only sells West and cannot find another transactional partner for Memorial, then the System’s financial situation could worsen because it would no longer have the reserves from West to subsidize the debts of Memorial. At the very least, the System should refuse to work with CareWell unless it agrees to acquire both West and Memorial. Aside from the fact that West is a great asset that gives the System a lot of bargaining power in a transaction with CareWell, the System should also raise CareWell’s FCA liability in its negotiations to get greater value out of the transaction. However, while the System could potentially convince CareWell to include both hospitals in the deal, it is still unlikely that CareWell will agree to any amount of control by the System despite its lower bargaining position. Additionally, CareWell’s liability raises concerns about its suitability as a partner in general.

Third, its for-profit status and strategy of divesting underperforming hospitals in urban or underserved areas would likely create reputational concerns among the community. If CareWell acquires one or both of the System’s hospitals, the System’s reputation could suffer as the community could view the transaction as the System "selling out" to a for-profit entity. Additionally, CareWell’s liability under the FCA, especially given the fact that the case involves

the Pearson area hospitals, creates further reputational concerns. The community may view this case as a result of gross mismanagement by the for-profit system, and given CareWell's insistence on governance of its hospitals, the liability could negatively impact the System's reputation as well.

Fourth, it is unclear whether CareWell and the System's strategies align. Aside from its for-profit status, CareWell seems to be profit-driven based on its ruthless divestiture of underperforming hospitals and insistence on only locating in areas with profitable payer mixes. In other words, CareWell does not seem interested in providing care to the community or to uninsured patients. Additionally, CareWell's long-term strategy depends on its ability to locate in suburban areas with a favorable payer mix. Unlike other systems in the area, it is unlikely that CareWell will explore integration options in the near future. It is possible that if healthcare does not change substantially in the coming years, that physicians could be attracted to CareWell's independent staffing model and positive payer mix, which would be a benefit of this strategy. However, if healthcare continues to evolve over time in response to increased public healthcare costs, CareWell may have a more difficult time adapting to these changes. Therefore, for these business and strategic reasons, our firm does not recommend any transaction with CareWell.

B. Legal Considerations

Nevertheless, should the Board choose to continue with a merger of the System's hospitals with CareWell, our firm concludes that a merger with CareWell does not raise substantial antitrust law concerns. However, the System should be careful to construct the transaction in a way that would not threaten its tax-exemption status.

1. Antitrust Law Considerations

Because of the value of the transaction, this merger would likely require the transactional parties to file a pre-merger notification to the Federal Trade Commission (FTC) under the Hart-Scott-Rodino Act.³⁰ This notification can be time-consuming and expensive due to the required documentation, but if the FTC does not request a second filing or prohibit the transaction, then it is unlikely to be subject to an antitrust challenge.³¹

The FTC has been more active in enforcing antitrust law for healthcare transactions over the last several years, and the FTC and Department of Justice (DOJ) have emphasized that this scrutiny will continue despite challenges created by the pandemic.³² Regardless, a merger with CareWell will likely not raise many antitrust concerns.³³ CareWell currently operates two 150-bed hospitals in the greater Pearson area, which is the smallest system in the area. If West is the only hospital included in the transaction, then the transaction would not eliminate a competing system. Furthermore, CareWell would likely still remain less concentrated than other systems in the area with more hospitals.

Alternatively, if Memorial and West are both included in the transaction, then the number of competing hospital systems would decrease to three: CareWell, SLHS, and NorthHealth. The

³⁰ 15 U.S.C. § 18a.

³¹ *Id.*

³² See Martin Gaynor, *Competition Policy in Healthcare Markets: Navigating The Enforcement And Policy Maze*, 33:6 HEALTH AFFS. 1088, 1089 (2014), <https://www.healthaffairs.org/doi/pdf/10.1377/hlthaff.2014.0333>; Alexis J. Gilman & Alexis V. DeBernardis, *Antitrust for Collaborations and Transactions in the Time of COVID-19*, AM. HEALTH L. ASS'N 1, 2 (May 8, 2020), <https://www.americanhealthlaw.org/content-library/health-law-weekly/article/431ede11-83ad-43b8-a0f8-054aeb597eed/antitrust-for-collaborations-and-transactions-in-t>.

³³ The relevant potential challenge arises under Section 7 of the Clayton Act. 15 U.S.C. § 18. When assessing whether it should challenge a merger, the FTC will look at the concentration in the relevant market before and after the transaction to determine whether the merger will lead to anticompetitive effects such as an increase in price for the services. See FED. TRADE COMM'N & DEP'T OF JUST., HORIZONTAL MERGER GUIDELINES §§ 5–7 (Aug. 2010), <https://www.justice.gov/atr/horizontal-merger-guidelines-08192010#5b>. The relevant market appears to be the greater Pearson area because in response to a small but significant price increase, patients would likely respond by driving to another hospital in Pearson or the surrounding suburbs. See *id.* § 4.

latter option raises slightly more antitrust scrutiny because one system is eliminated, thus decreasing competition in the Pearson area. Nevertheless, this transaction would likely not be challenged by the FTC because even after the transaction, CareWell would not be more concentrated as compared to the other systems.³⁴ Thus, substantial competition would likely still remain in the remaining systems to prevent CareWell from raising its prices.³⁵

2. Tax Law Considerations

A transaction with a for-profit entity creates tax issues at both the federal and the state level. Because CareWell is a for-profit entity, the System must ensure that a merger with CareWell will not jeopardize its tax-exempt status. First, the System may need to seek approval from the state of Loyola's Attorney General before transacting with a for-profit entity.

Next, the System must ensure that it does not provide a private benefit to CareWell. In this case, a private benefit would be a situation in which CareWell receives a benefit, whether financial or non-financial, that is not related to furthering the System's charitable mission.³⁶ To avoid a private benefit issue, CareWell must pay at least fair market value for the transaction,³⁷ so the System should obtain an independent valuation of West. It should also obtain an independent valuation of Memorial should the transaction include both hospitals. CareWell will then own and run the hospital or hospitals as for-profit entities.

If the System only sells West and retains Memorial, it would continue to run Memorial as a nonprofit entity. Charitable trust law in the state of Loyola requires that the System use the proceeds of the sale of West to further its charitable purpose. Thus, the System could use the

³⁴ *See id.* §§ 5–7.

³⁵ *See id.* §§ 5–10.

³⁶ Thus, to avoid a tax-exemption issue, any private benefit from the activity must be insubstantial when viewed against the public benefit of the activity. Furthermore, any benefit to the public could not have been achieved without also benefiting the private entity. 26 U.S.C. § 501(c)(3).

³⁷ *See id.*

proceeds from the sale of West to pay down its bond debt and then use any excess to further support its charitable mission.

Alternatively, if the System sells both hospitals to CareWell, it will need to jump through additional hoops to prevent a tax law violation.³⁸ Our firm wants the Board to bear in mind that while the sale of both hospitals is more legally complex, it is still the preferred option from a business and strategic standpoint if the Board chooses to transact with CareWell.

Because the System would no longer operate a hospital if it sells both hospitals to CareWell, it could potentially continue its charitable purpose through a nonprofit hospital foundation.³⁹ However, the System should refer to its charter to determine whether its charitable mission could still be met even though it no longer runs a hospital.⁴⁰ If the System's charter specifically requires the operation of a hospital, the cy pres doctrine could potentially serve as a safety valve preventing a strict reading of the charter, allowing it to continue its charitable purpose through a hospital foundation.⁴¹

³⁸ For example, if the System's two affiliated skilled nursing facilities are for-profit entities, the revenue generated from the facilities would be considered unrelated business income. These activities could threaten the System's tax-exempt status if they represent a substantial portion of the System's total operations. 26 U.S.C. § 512.

³⁹ Importantly, foundations are usually subject to a 1 or 2% excise tax on investment income. However, our firm could potentially structure a foundation in a way to lower the tax to 1% or to meet the exception to the excise tax. 26 U.S.C. § 4940.

⁴⁰ If the System's charter does not include broad language for its charitable mission, it may need to amend its charter before selling both hospitals to CareWell. Alternatively, Loyola may require the Attorney General to approve charter amendments. *Staying True to Your Mission: The Duty of Obedience*, WAGENMAKER & OBERLY BLOG (Oct. 17, 2017), <https://wagenmakerlaw.com/blog/staying-true-your-mission-duty-obedience>; *Nonprofit Organizational Changes & State Amendment Filings*, WOLTERS KLUWER, <https://www.bizfilings.com/toolkit/research-topics/staying-compliant/nonprofit-organizational-changes-state-amendment-filings> (last visited Feb. 10, 2021).

⁴¹ *Q&A: Restricted Funds*, HURWIT & ASSOCIATES, <https://www.hurwitassociates.com/major-gifts-grants-restricted-funds/q-amp-a-restricted-funds> (last visited Feb. 6, 2021).

IV. Affiliation with SLHS

Because there are many forms of affiliations,⁴² the Board has more leeway to address its competing goals. Thus, an affiliation with SLHS will best address the Board's competing concerns about gaining access to capital, maintaining some level of governance, and attracting physicians. This Section will first discuss the business and strategic implications involved in partnering with SLHS for any affiliation type. It will then propose three affiliations that balance the Board's competing goals differently. Finally, it will provide an overview of the relevant legal considerations involved in these potential affiliations.

Specifically, our firm proposes three options for an affiliation with SLHS: a joint operating agreement (JOA), a whole hospital joint venture, or a membership substitution. For a JOA or a whole hospital joint venture, it will be necessary for the System to sell Memorial to an interested buyer in order to pay down its bond debt and rid itself of its financial drain. By divesting Memorial, West's stable revenue stream will no longer be subsidizing Memorial's losses. Moreover, an affiliation with SLHS may allow the System to further improve West's financial stability, and despite losing one hospital, increase its market power. A membership substitution would involve both Memorial and West in the affiliation. Each of these affiliation structures proposed could address the Board's concerns depending on how it weighs each of the concerns related to capital, governance, and physician recruitment.

A. Business and Strategic Considerations

Affiliating with a nonprofit organization is a preferable strategic move to merging with a for-profit hospital system for three reasons. First, affiliating with a nonprofit organization will

⁴² Onyinye Oyeka et al., *The Rural Hospital and Health System Affiliation Landscape—A Brief Review*, RURAL HEALTH RSCH. & POL'Y CTRS. & RURAL POL'Y RSCH. INST. 1, 6 (Nov. 2018), <https://rupri.public-health.uiowa.edu/publications/policypapers/Rural%20Hospital%20and%20Health%20System%20Affiliation.pdf>.

generate less tax-exemption issues.⁴³ Second, affiliating with a nonprofit organization that prioritizes charitable care over profits will allow the System to continue its charitable mission without disruption.⁴⁴ Third, affiliating with a nonprofit organization with a good reputation in the community is a better option than risking the potential reputational damage that might arise from “selling out” to a for-profit organization.⁴⁵ Additionally, with a strong presence in the community and on a national scale, the System could rename itself “Beazley Health System: An Affiliate of St. Luke’s Health System,” reaping the rewards of SLHS’s strong reputation while keeping its own name and renowned reputation.

Before considering the specific strategic and business benefits associated with an affiliation with SLHS, the Board should first consider two potential strategic and business concerns. At the outset, the Board should consider whether SLHS and Beazley’s charitable missions are sufficiently compatible considering SLHS’s religious ties. SLHS’s religious directives and faith-based mission do not necessarily make SLHS and the System incompatible given that both systems prioritize charitable care. However, the religious directives could potentially conflict with certain services provided by the System’s strong OB-GYN service line. Thus, the Board should carefully consider whether it is willing to abide by SLHS’s religious directives. This potential downside might be offset by gaining community respect by affiliating with another highly respected charitable organization as compared to transacting with a for-profit entity. However, if the Board is unwilling to follow SLHS’s religious directives, a JOA is a potential structure in which the System can remain secular and continue to provide all of its existing OB-GYN services.

⁴³ Cf. discussion *supra* Section III.B.2.

⁴⁴ Cf. discussion *supra* Section III.A.

⁴⁵ *Id.*

Additionally, the Board should acknowledge that SLHS's payer mix is not as strong as other hospital systems in the Pearson community. Given that hospitals rely on private payers to maintain a sufficient revenue stream, the Board should keep in mind that, if the pandemic continues to worsen, the System may find itself affiliated to a struggling organization. However, this potential risk is largely mitigated by the fact that SLHS is connected to a large national system.

Nonetheless, there are several benefits to transacting with SLHS. First, SLHS has an excellent reputation for serving the Pearson community.

Next, by virtue of being a part of a national system, SLHS has access to consistent capital. Continued access to capital through a transaction with SLHS will help the System continue to pay down its bond debt. Furthermore, SLHS's connection to a national system could also give the System strong market power and purchasing power. Third, access to capital would provide the resources the System needs to improve quality of care and clinical outcomes, which could yield financial rewards in the form of increased reimbursement through the Value-Based Purchasing Program.⁴⁶ Additionally, SLHS has ties to a medical education program and thus a consistent means of physician recruitment. Because SLHS has funding from the national system to continue its medical school education program, the System can anticipate that this program will continue.

SLHS is also setting itself up for long-term success as healthcare continues to evolve. In response to Medicare looking for ways to cut costs and decrease reimbursement, SLHS's long-term strategy focuses on establishing integration models.

⁴⁶ The Hospital Value-Based Purchasing program is a program that rewards Medicare providers for excellence in four areas: clinical outcomes, person and community engagement, safety, and efficiency and cost reduction. *Hospital Value-Based Purchasing*, CTRS. FOR MEDICARE & MEDICAID SERVS., <https://www.cms.gov/Medicare/Quality-Initiatives-Patient-Assessment-Instruments/HospitalQualityInits/Hospital-Value-Based-Purchasing-> (last visited Feb. 6, 2021). To reward hospitals, CMS first reduced all reimbursements by 2%. *Hospital Value-Based Purchasing*, AM. HOSP. ASS'N, <https://www.aha.org/hospital-value-based-purchasing/home> (last visited Feb. 6, 2021). The money from the 2% reductions is pooled and distributed to hospitals who exhibit excellence in the four aforementioned areas. *Id.*

Finally, as the Board considers whether to affiliate with SLHS or merge with CareWell, it should acknowledge that SLHS has expressed enthusiasm about both of the System’s hospitals. The System should also note that SLHS is willing to affiliate rather than execute a traditional merger and acquisition. While SLHS may not be willing to let the System maintain majority control or management, the current Board could still negotiate to maintain a role in the affiliation. In contrast, CareWell does not seem amenable to any form of governance from representatives of the System, which creates major problems as CareWell’s governance priorities will place profit over the provision of charitable care.

B. Potential Transactional Structures

This Section will discuss three potential affiliations with SLHS—a JOA, a whole hospital joint venture, and a membership substitution—and the competing considerations implicated by each option.

1. Joint Operating Agreement

As previously mentioned, this first option would involve the sale of Memorial to an interested buyer so that the System could use the proceeds to pay down its bond debts.⁴⁷ There are two systems that may be interested in purchasing Memorial. First, the System could explore this option with SLHS. While the System did not explore the sale of Memorial in its initial negotiations with SLHS, SLHS has already expressed an interest in Memorial joining its system. Acquiring Memorial would allow SLHS to further its strategy of having “multiple entry points into their system” and gaining a stronger foothold in the Pearson area. Further, SLHS likely has access to the capital needed to purchase Memorial through its national system. Second, the System

⁴⁷ A sale could involve an asset sale or merger. *See* discussion *supra* note 24.

could reach out to NorthHealth, who has actively been growing its system, to see if it would be interested in purchasing Memorial.

While selling Memorial would cause the System to lose some market power, this loss can be offset to some extent by entering a joint operating agreement between West and SLHS. A JOA is a contract between two entities who agree to jointly operate without transferring ownership or assets.⁴⁸ In the JOA, the System and an affiliate would form a tax-exempt joint operating company (JOC), which is a jointly owned subsidiary that financially integrates the entities and manages the day-to-day operations of the healthcare providers that the parent entities designate in the JOA.⁴⁹ Through unifying operations, the JOC promotes cost savings by utilizing fewer employees, avoiding duplicate equipment or facilities, and purchasing supplies in bulk.⁵⁰ In this structure, the System would retain ownership over West. While JOAs do not always require immediate capital investment,⁵¹ the System and its affiliate could agree to input capital into the JOC or split future capital expenditures.⁵² Thus, despite selling Memorial, the System could compete more efficiently in the Pearson market, which is dominated by multi-hospital systems, by affiliating West with SLHS who has greater market power and access to capital and other resources from a national system.⁵³

⁴⁸ Derek F. Covert, Tax Issues for Healthcare Organizations Seminar at the American Health Law Association (Oct. 28, 1999) (transcript available on Westlaw).

⁴⁹ Robert N. H. Christmas et al., *Alignments and Joint Ventures Offer Alternatives for Health Care Providers*, NIXON PEABODY, (Oct. 7, 2015) <https://www.nixonpeabody.com/en/ideas/articles/2015/10/07/alignments-and-joint-ventures-offer-alternatives-for-health-care-providers>.

⁵⁰ *Joint Operating Agreement*, REFERENCE FOR BUS., <https://www.referenceforbusiness.com/encyclopedia/Int-Jun/Joint-Operating-Agreement-JOA.html> (last visited Jan. 30, 2021).

⁵¹ David T. Lewis & Elizabeth M. Mills, *Joint Operating Agreements in Healthcare* 1, 16 (Aug. 23, 2017), <http://media.straffordpub.com/products/joint-operating-agreements-in-healthcare-2017-08-23/presentation.pdf>.

⁵² Christmas, *supra* note 49; *Joint Operating Agreement*, *supra* note 50.

⁵³ See Covert, *supra* note 48.

There are several benefits to this structure. First, it would allow the Board to maintain complete governance over West.⁵⁴

Second, if the Board is interested in transacting with SLHS but is concerned about the compatibility of their missions, then a JOA would offer a less permanent trial period.⁵⁵ For example, if the System entered a JOA with SLHS, it can remain secular⁵⁶ while gaining SLHS's access to resources like its physician recruitment program. Because SLHS already has established operations with its national system programs, the System could contract to utilize these programs to decrease West's operational costs and increase revenues. The Board could later explore a more permanent option, such as the whole hospital joint venture between West and SLHS, that provides a heightened financial benefit.

Third, because the entities would not merge, the System would retain its board of directors, and its reputation in the community would not be affected by the transaction.⁵⁷ However, our firm does not prefer this structure as compared to the other affiliation options. While a JOA would allow the System to maintain complete governance, it fails to provide the System an ongoing influx of capital as compared to the latter structures.

2. Whole Hospital Joint Venture

Alternatively, if the System first divests Memorial, it could enter West into a whole hospital joint venture with SLHS. Unlike a membership substitution,⁵⁸ another promising structure that

⁵⁴ Christmas et al., *supra* note 51.

⁵⁵ Joint operating agreements generally last between three to five years. Keith Anderson et al., *Healthcare Provider Transactions: Trends and Issues*, JDSUPRA (May 24, 2019), <https://www.jdsupra.com/legalnews/healthcare-provider-transactions-trends-61871/#:~:text=In%20a%20joint%20operating%20agreement,tend%20to%20be%20less%20durable>.

⁵⁶ See Christmas et al., *supra* note 49.

⁵⁷ Roderick Darling & Marvin Friedlander, *Virtual Mergers Hospital Joint Operating Agreement Affiliations*, IRS 131, 132 (1997), <https://www.irs.gov/pub/irs-tege/eotopicj97.pdf>; Lewis & Mills, *supra* note 53, at 54.

⁵⁸ See discussion *infra* Section IV.B.3.

which will be discussed below, a whole hospital joint venture will not result in an initial influx of capital.⁵⁹ Thus, for this transaction to be successful, it is critical for the Board divest itself of Memorial so that the Board can obtain an initial influx of capital from the proceeds to pay down its bond debt.

A whole hospital joint venture requires a hospital to transfer its all of its assets and liabilities to a new entity that will be jointly owned and operated.⁶⁰ Thus, the System would transfer all of West's assets into the joint venture, and, in return, SLHS would invest capital and resources.⁶¹ The System's corporate existence would remain intact, but West would be operated through the jointly owned entity.⁶² SLHS and the System would receive distributions in proportion to the value of the capital and assets put into the jointly owned entity.⁶³ While the Board could negotiate for equal representation on the joint venture's board,⁶⁴ SLHS will likely seek majority control due to its investment and the System's current liabilities. Nonetheless, the Board could still retain some level of control. Generally, daily operations are conducted by an outside management company in this type of joint venture, but it is possible that SLHS would prefer to conduct daily operations itself.^{65, 66}

⁵⁹James E. Burgdorf, *Whole-Hospital Joint Ventures between Non-Profit and For-Profit Companies* 1 (March 2010), <http://www.juniperadvisory.com/wp-content/uploads/2014/01/WHJV-Between-Non-profit-and-For-profit-Companies-March-2010.pdf>.

⁶⁰ *Id.*

⁶¹ *Id.*

⁶² Mary Jo Salins et al., *Whole Hospital Joint Ventures*, IRS 1, 4–5 (1999), <https://www.irs.gov/pub/irs-tege/eotopica99.pdf>.

⁶³ *Id.* at 5.

⁶⁴ *Id.* at 6.

⁶⁵ *Id.*

⁶⁶ The Board must be careful in choosing a management company because granting the management company too much authority could lead to intermediate sanctions, or even threaten tax-exempt status. According to the IRS, a nonprofit who hires a for-profit management company must ensure that the management company cannot make decisions on behalf of the nonprofit, unilaterally use the nonprofit's assets, or otherwise control the activities of the nonprofit. Rev. Rul. 98-15, 1998-12 I.R.B. Therefore, the Board must ensure that the contractual agreement between the System and the management company reflects the IRS rule.

A whole hospital joint venture offers the potential of the Board either retaining minority control of the joint venture's Board or serving as an advisory Board. However, it does not offer the Board complete governance, though the Board should keep in mind that loss of governance is the price of an increased investment from its transactional partner.

A whole hospital joint venture is also a more permanent option than a JOA, meaning that the Board should factor how it believes SLHS would be as a partner into its decision, considering SLHS's culture, charitable mission, and synergy. Most importantly, a whole hospital joint venture would allow the System to access an investment and resources from SLHS into the venture. It would also grant the System access to other SLHS resources, such as its medical education program.

3. Membership Substitution

A membership substitution is an excellent option if the Board decides to keep both hospitals or if the Board has a difficult time divesting itself of Memorial. For reasons explained below, a membership substitution yields similar results to a purchase of the System, so an influx of capital can still be achieved to help the System pay down its bond debt.⁶⁷ With a membership substitution, SLHS will have complete ownership and control over the System.⁶⁸ As the sole member of the System, SLHS may elect directors and vote on any matters in which the constitutive documents allow.⁶⁹ It is not uncommon, however, for nonprofits like the System to negotiate with

⁶⁷ It may be possible to structure the transaction to keep the bonds of both the acquirer and the target in place. William B. Eck, *Nonprofit Hospital Acquisitions: Structuring and Regulatory Considerations*, SEYFARTH SHAW 1, 4, https://www.seyfarth.com/images/content/7/1/v1/7122/Nonprofit_Hospital_Acquisitions_Structuring_Regulatory_Considerations.pdf (last visited Feb. 9, 2021).

⁶⁸ Ken Marlow et al., *Membership Substitution Transactions—Why Are They So Misunderstood?*, THE BOND BUYER 1, 2 (Feb. 15, 2017, 10:42 AM), http://www.juniperadvisory.com/wp-content/uploads/2017/02/Membership-Substitution-Transactions_Why-Are-They-So-Misunderstood-February-2017.pdf.

⁶⁹ BARRY R. FURROW ET AL., HEALTH LAW 554 (3d Ed. 2015).

the sole member for a small minority of board seats on the sole member's board.⁷⁰ Additionally, to mitigate the potential concerns associated with losing governance, the Board could negotiate for the creation of an advisory committee to further ensure that the System continues to advance its charitable mission.⁷¹ In other words, this structure still provides an opportunity for the Board to have some level of control. However, the System will need to update its governing documents to reflect its Catholic ties.⁷²

A membership substitution creates a corporate structure that strongly resembles a parent-subsidary structure,⁷³ but when SLHS assumes sole membership of the System, the System's corporate existence remains.^{74, 75} Because the System remains intact, the System can maintain its identity and continue to benefit from its reputation in the community. Once the membership substitution is executed, SLHS will either assume or guarantee all the System's liabilities.⁷⁶ One reason that SLHS might be hesitant to execute a membership substitution is due to the amount of liability that it will have to assume.⁷⁷ Thus, self-disclosure of potential FCA liability and settling the matter before the execution of this transaction may be critical to this transaction's success because it will lower the liabilities SLHS will assume.

⁷⁰ Marlow, *supra* note 68, at 2.

⁷¹ Eck, *supra* note 67, at 5.

⁷² See *supra* text accompanying note 40; see also discussion *supra* Section IV.A.

⁷³ Marlow, *supra* note 68, at 2.

⁷⁴ *Id.*

⁷⁵ From an operational standpoint, transactions of this magnitude can be disruptive, but membership substitutions provide some ease of transition. A membership substitution "creates successorship" for contracts, leaves contractual agreements intact. *Id.* at 1. Payer agreements and physician agreements likely do not need to be reassigned or re-consented to. Eck, *supra* note 67, at 4. Moreover, this affiliation model will not disrupt leases, licensures, working capital, or other business operations. Marlow, *supra* note 68, at 1.

⁷⁶ Marlow, *supra* note 68, at 2.

⁷⁷ Eric Tower, *Top Considerations for Structuring Health Care Mergers and Acquisitions*, THOMPSON COBURN (Jan. 7, 2020),

<https://www.thompsoncoburn.com/insights/blogs/health-law-checkup/post/2020-01-07/top-considerations-for-structuring-health-care-mergers-and-acquisitions>.

SLHS can pay for sole membership of the System using some combination of three forms of payment that can be tailored to the goals and resources of the respective parties.⁷⁸ First, SLHS can pay a purchase price.⁷⁹ Second, SLHS will assume the System's liabilities.⁸⁰ Third, SLHS can commit to granting the System access to capital.⁸¹ The sum total of the payment must be fair market value.⁸² SLHS has expressed its intention to provide the System access to capital, which benefits both parties; SLHS benefits from the System's growth as an affiliate, and the System benefits from the access to capital. It is unlikely that SLHS will want to pay a purchase price as one of the forms of payment because of the substantial amount of liabilities it may have to take on from the System. It is more likely that SLHS will assume the System's liabilities and potentially provide a future capital commitment.⁸³

C. Legal Considerations

An affiliation with SLHS raises slightly more antitrust concerns than a transaction with CareWell. However, there are less tax issues implicated by an affiliation with SLHS.

1. Antitrust Considerations for a Joint Operating Agreement

A JOA with SLHS would likely be analyzed under the Competitor Collaboration Guidelines.⁸⁴ These agreements do not require advance notification to the FTC under the Hart-Scott-Rodino Act, and they are unlikely to be challenged given how commonplace these

⁷⁸ Marlow, *supra* note 68, at 2.

⁷⁹ *Id.* at 1–2.

⁸⁰ *Id.* at 2.

⁸¹ *Id.*

⁸² *Id.*

⁸³ The amount of the payment for the membership substitution in the form of assumption of liabilities will depend on what the System will owe in FCA liability and highly dependent on the specific requirements of the bond covenants. See Eck, *supra* note 67, at 4.

⁸⁴ FED. TRADE COMM'N & DEP'T OF JUST., ANTITRUST GUIDELINES FOR COLLABORATIONS AMONG COMPETITORS (Apr. 2000), https://www.ftc.gov/sites/default/files/documents/public_events/joint-venture-hearings-antitrust-guidelines-collaboration-among-competitors/ftcdojguidelines-2.pdf.

agreements are and their potential procompetitive efficiencies, such as improving struggling hospitals' purchasing power or achieving other types of economies of scale.⁸⁵ Therefore, this option is unlikely to raise significant antitrust concerns.

2. Antitrust Considerations for Whole Hospital Joint Venture or Membership Substitution

The whole hospital joint venture or membership substitution options raise slightly more antitrust concerns. Other than NorthHealth, SLHS is one of the largest systems in the Pearson area, with four hospitals in Pearson. Depending on whether one or both of the System's hospitals are included in the specific transactional structure chosen by the Board, SLHS could potentially grow to a five or six hospital system. This result would potentially cause SLHS to be the largest system in Pearson, and it could eliminate competition from the System. In other words, in effect, the transaction could result in competition decreasing to only three systems in Pearson. Nevertheless, while these affiliations with SLHS create more antitrust risk as compared to a merger with CareWell, our firm does not believe that the FTC will prevent an affiliation with SLHS because meaningful competition would still exist in Pearson after the transaction.⁸⁶

While these affiliation models between SLHS and the System could result in a substantial increase in SLHS's market concentration,⁸⁷ market concentration is not an end in and of itself; rather, it is used to assess anticompetitive effects of the transaction.⁸⁸ The potential anticompetitive

⁸⁵ *Id.* at 6. These agreements currently fall under rule of reason analysis. *Id.* at 4.

⁸⁶ Because a whole hospital joint venture or a membership substitution with SLHS will have similar effects to those that would arise under a merger, the FTC would use its Horizontal Merger Guidelines as opposed to their Competitor Collaboration Guidelines to analyze the competitive effects of these models. FED. TRADE COMM'N & DEP'T OF JUST., ANTITRUST GUIDELINES FOR COLLABORATIONS AMONG COMPETITORS 5 (Apr. 2000), https://www.ftc.gov/sites/default/files/documents/public_events/joint-venture-hearings-antitrust-guidelines-collaboration-among-competitors/ftcdojguidelines-2.pdf.

⁸⁷ See FED. TRADE COMM'N & DEP'T OF JUST., HORIZONTAL MERGER GUIDELINES § 5 (Aug. 2010), <https://www.justice.gov/atr/horizontal-merger-guidelines-08192010#5b>.

⁸⁸ See *id.* § 6–7.

effect arises from the fact that an affiliation could decrease competition to only three systems: SLHS, NorthHealth, and CareWell.⁸⁹ At the same time, the FTC may not be concerned with this decrease in competition if the remaining systems provide sufficient competition to prevent the affiliation from increasing its prices or decreasing its output.⁹⁰ There has been significant expansion among the other hospital systems in Pearson over the past several years, indicating that entry is possible to deter anticompetitive effects.⁹¹ Furthermore, even if there is no entry, the remaining systems would likely prevent a substantial increase in price by the affiliation because consumers could simply go to another hospital in the Pearson area. Therefore, our firm does not think these transactions pose significant antitrust challenges.⁹²

Additionally, the whole hospital joint venture or the membership substitution could require advance notification to the FTC under the Hart-Scott-Rodino Act due to the value of the transaction and the ownership, control, and size of the transactional partners.⁹³ One benefit of the notification requirement is that the parties will know before completing the transaction whether or not the FTC will challenge it.

3. Tax Law Considerations

A situation that ordinarily threatens tax-exempt status in a whole hospital joint venture involves a venture between a nonprofit and a for-profit hospital,⁹⁴ which is not implicated when two nonprofits engage in a whole hospital joint venture. Because these transaction options involve

⁸⁹ *See id.* § 6.

⁹⁰ *See id.* § 9–10.

⁹¹ *See id.* § 9.

⁹² *Id.* Our firm believes the procompetitive effects of a joint venture outweigh the potential anticompetitive effects. And we think the presence of the other systems provide sufficient substitutions under our definition of the market to prevent a challenge. *Id.* § 10–11.

⁹³ 16 C.F.R. § 801.40.

⁹⁴ Rev. Rul. 98-15, 1998-12 I.R.B.

a nonprofit partner, it is additionally bound by tax law requirements to maintain its nonprofit status. Thus, a transaction with SLHS is unlikely to raise significant tax law concerns.

D. Alternate Proposal

Alternatively, if the Board is concerned about the compatibility between its charitable mission and that of SLHS, it could potentially explore a whole hospital joint venture or a membership substitution with NorthHealth, which is also nonprofit but has a preferable payer mix as compared to SLHS. NorthHealth also has access to capital through its ties with a larger interstate health system. The benefits of the structures our firm has proposed would equally apply in a transaction with NorthHealth. However, our firm has not greatly explored these options given that Beazley has not gauged NorthHealth's interest in affiliating. If the Board is dissatisfied with its current transactional options, our firm would recommend starting a dialogue with NorthHealth.⁹⁵

V. Final Recommendation

Out of the proposed options, our firm therefore recommends an affiliation with SLHS. Specifically, our firm prefers either (1) selling Memorial to an interested buyer then entering West into a whole hospital joint venture with SLHS or (2) entering a membership substitution with SLHS, which would involve both West and Memorial.

⁹⁵ If the System considers NorthHealth as a potential transactional partner, then the FTC would subject the transaction to greater antitrust scrutiny because it is the largest system in the market. Even if it acquired only one additional hospital, this result would substantially increase its market share and concentration. Thus, if the Board decides to explore this option, we will need to explore potential antitrust law implications.