

Demonstrating Fairness in a Market Approach to Hospital M&A

By Rex Burgdorfer, Vice President, Juniper Advisory, and
Ken Marlow, Healthcare Department Chair, Waller Lansden Dortch & Davis

This is the third article in a series that Juniper Advisory is publishing with The Governance Institute to outline key topics related to hospital mergers and acquisitions. In each article, we define the issue, detail the role it has played in real-life transactions, and provide important context to help guide hospital leaders as they examine their organization's strategic positioning.

Last year, we noted that the majority of hospitals and health systems are exploring their options when it comes to potential partnerships.¹ We are starting to see more multi-state transactions that join non-profit health systems across state borders. This comes as organizations look to achieve the scale and geographic reach necessary to make a meaningful impact on population health and operational efficiencies.²

As transactions between large systems become more common, and more strategically focused on patient concentration and needs

1 Rex Burgdorfer, "A Year of Change for Community Hospitals," Hospital Focus, The Governance Institute, December 2017.

2 Barry Sagraves, "Multi-State Health Systems: On Their Way at Last," BoardRoom Press, The Governance Institute, June 2018.

Key Board Takeaways

In considering a business combination, a hospital board must be sure to:

- Set goals to guide process decision making.
- Leverage a controlled competitive process to elicit the market's most optimal outcomes.
- Demonstrate that proposals were objectively assessed based on how the terms met process goals.
- Be prepared to illustrate to stakeholders, including regulators, that the process was robust and the resulting terms were fair and beneficial to the hospital and its community.

rather than geographic boundaries, we are unsurprised to see state regulators taking closer examination of hospital transactions than has been the case in the past.

From California to Illinois to Florida, state attorney generals have applied increased scrutiny to recent hospital transactions, regardless of tax status or ownership type. With healthcare expenditures increasing, consumers assuming a larger burden of the cost of care, and competition between systems heating up, regulators will continue to have a watchful eye on healthcare M&A activity.

A Structured, Competitive Partnership Process

A hospital board should take thorough, prescriptive action as it moves through a partnership process. This means designing and implementing a highly

structured program to position the hospital competitively in order to realize optimal terms. The controlled competitive process Juniper generally enlists allows the market to determine a hospital's value, underscoring the hospital's commitment to fairness and objectivity. A hospital must be prepared to demonstrate to regulators that a transaction is "fair" and will preserve its mission and value to the community. The more deliberate the process, the better it will be able to withstand even the most pointed examination. This includes having the board:

- **Develop a set of process goals that are aligned with the mission of the hospital.** Convene a group dedicated to moving the process forward. This should not only include the hospital board, but also select administrative and clinical leaders and a transaction

A hospital board should take thorough, prescriptive action as it moves through a partnership process.

advisor. It is important to select different constituents within the hospital community. The group must be well-informed and committed to investing time and energy into ensuring a comprehensive process. You want to have buy-in from the different constituents.

- **When approaching the market, set sights broadly.** Allow the market to work freely in defining the hospital's value. Do not limit the universe of potential respondents.

- **Judiciously narrow the participants through detailed evaluation and discussion.**

Show that all proposals were measured based on how well they would achieve the goals agreed upon at the outset of the process.

- **Understand how the financial and non-financial measures of the transaction fall within the range of industry standards.** Be ready to demonstrate that the terms are fair and in the best interest of the hospital and those it serves.

Meeting Regulatory Expectations

It is important to have an understanding of what expectations regulators may have with respect to a transaction well in advance of closing, and set timing expectations for closing in line with the demands of the regulatory approval process. For example, there are some states in which attorneys general require a "fairness opinion" by a third-party valuation firm, investment banking firm, or other approved provider of similar services. In connection with an acquisition, merger, membership

substitution, or other combination, a "fairness opinion" is an opinion by a reputable third-party firm that the proposed consideration in connection with the transaction constitutes fair value. The parties should understand two important points:

1. Preparation of a fairness opinion generally takes a number of weeks, and oftentimes the fairness opinion must be submitted at the time of the initial regulatory filings.
2. The fees in connection with a fairness opinion can be extensive.

It is important to have good strategic and legal advisors on the front end because they not only can give you guidance on the process, they may be aware of workarounds to avoid submission of a fairness opinion and transparency. For example, with strategic advising, the seller may be able to demonstrate the thoroughness of the process and that fair value of the consideration is evident by such a competitive process without engaging a third party to undertake a fairness opinion.

The importance of a robust process is highlighted in the State of Michigan's approval of the partnership between Marquette General Hospital and Duke LifePoint.³ In its final report,

3 See Bill Schuette, Attorney General, *Report on the Proposed Sale of Marquette General Hospital to Duke LifePoint, LLC*, August 29, 2012 (available at www.michigan.gov/documents/ag/AG.report.8.29.12.Final.signature_396616_7.pdf).

the Michigan Attorney General reflected on the comprehensive steps Marquette took to obtain the services of an expert advisor, identify viable suitors, as well as the rigor of the evaluation process noting, "A fair market process is the best way to obtain value." Along with the quantitative analysis of the transaction terms was an analysis of the non-financial terms that ensured the sale "properly protects the public interest." Importantly, the Attorney General noted that Duke LifePoint was not the highest bidder, but that its proposal "surpassed the field" when it came to non-financial considerations, including quality, local governance, and long-term financial sustainability.

The proposal with the highest cash value is not a fait accompli. As we discussed in the last article, regulators, like non-profit hospitals, understand the value of non-financial terms, such as capital and service line commitments, local governance provisions, and the assumption of debt.⁴ While an industrial company's board of directors has a fiduciary responsibility to select the proposal with the highest financial terms (the Revlon standard),⁵ a non-profit hospital board is also beholden to its duty to uphold the hospital's mission. Ultimately, board members must exercise their best judgement in structuring fair terms that satisfy the fiscal needs of the hospital (as well as market/regulatory expectations) and support the

4 Rex Burgdorfer, "Acquisition Currencies in Non-Profit Hospital M&A," Hospital Focus, The Governance Institute, March 2018.

5 *Revlon, Inc. v. Macandrews & Forbes Holdings, Inc.*, 506 A.2d 173, 1986 Del. LEXIS 1053, 66 A.L.R.4th 157, Fed. Sec. L. Rep. (CCH) P92,525 (Del. March 13, 1986).

hospital's role as a provider of care, charitable organization, and employer.

A controlled competitive partnership process provides the framework through which to solicit and

objectively evaluate proposals in a reasonable free-market environment, eliciting high value and fair terms that are agreeable to external stakeholders, including the state attorney general, and optimal for the hospital and its community. Unlike

the corporate world, where fairness opinions are often commissioned to satisfy institutional shareholders, rarely are they necessary in a non-profit hospital transaction.

The Governance Institute thanks Rex Burgdorfer, Vice President, Juniper Advisory, and Ken Marlow, Healthcare Department Chair, Waller Lansden Dortch & Davis, for contributing this article. They can be reached at rburgdorfer@juniperadvisory.com and ken.marlow@wallerlaw.com.

