Public Focus

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Piloting a Municipal Hospital Transaction: Communication Is Key to a Smooth Landing

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Municipal hospitals, which serve some of the most vulnerable populations in the community, are particularly susceptible to the pressures of decreasing inpatient census, declining revenues, the shift toward value-based reimbursement, and ever-increasing capital demands. This may cause financially stable government-owned hospitals and municipalities to consider whether it is best to transition to private ownership while still in a position of relative strength, and financially distressed government-owned hospitals and municipalities to search for exit options before their communities permanently lose what may be a critical community healthcare resource. Privatizing a municipal hospital, however, brings a host of challenges, which can protract or even prevent efforts if not well planned out and executed.

Key Board Takeaways

Boards and senior leaders of municipal hospitals should:

- Communicate to their transaction counterparty the extent and manner of public accountability required through the transaction process.
- Understand all of the various constituencies, and their goals and fears, and take steps to educate the public so that public expectations do not diverge significantly from what a reasonable transaction might entail.
- Be aware of the unique legal and regulatory challenges and opportunities that come with municipal hospital transactions, and ensure their counterparty is also considering them in the context of the transaction structure and process.

Unique Constituencies

A key feature of municipal hospitals is that their leadership is accountable, in some manner, to the municipality and the voters. Whether direct or indirect, this feature makes the hospital susceptible to considerations beyond what non-government-owned hospitals face. This dynamic is one that a potential partner may have little experience with, and may result in the need to deal with fairly unique issues related to:

- **Voters:** The ultimate voice of control for municipal hospitals, of course, is that of the public. Similar to stockholders of a corporation, voters do not have direct control over operations. Their control takes the form of having the power to elect municipal leaders and perhaps, hospital leaders. In addition, the disposition of municipal assets may require a public referendum. The direct accountability of elected officials to voters can give a public perspective significant weight and can be clouded by inaccurate information or aspirational desires, or by a lack of familiarity with the complicated and confusing operating and regulatory environment in which hospitals operate.
- **Elected officials:** Elected officials may serve a roll similar to voters by having control over specific matters, or they may be directly involved in hospital governance. In either case, the individuals serving can change through election, which can disrupt carefully developed strategic plans, and their perspective may incorporate a broader set of municipal concerns. In addition, they may have little or no experience in the healthcare industry. Finally, elected officials are accountable to the voters. This accountability, of course, includes ensuring that the voters are informed about the challenges and opportunities faced by the municipal facility.
- **Employees and government employee unions:** Often

municipal hospitals are one of the largest employers in the community. As part of a transition from a government-owned facility to a private facility, there will likely be changes to the benefits and general employment terms of the employees. Employees, who may also be voters, might be nervous about what the future holds for them, even more so than in transactions where the nature of the employer is not changing. It's important to understand what the transition will entail so that it can be communicated to the employees and organized labor to increase the likelihood of a smooth transition. Frequent and clear communication on the process and overall job security can go a long way in calming fears and keeping employees focused on daily operations.

The result of this feature of municipal hospitals is that strategic decisions and transactions are more complicated and need to take into consideration a wide array of issues, including tax policy, community employment, and voter sentiment. Elections and referenda can cause significant changes to strategy as well as the transaction process, and sensitivity to employee concerns may be heightened. These types of considerations and issues are ones that may be unfamiliar to a transaction partner, resulting in the need for accommodation and, perhaps, concessions that are otherwise not "commercial" or reflective of a strong hospital-exclusive strategic perspective. Accordingly, municipal hospitals should be scrupulous in their communications with potential partners about the issues that are driving their strategic decision making and the processes that are required to complete a transaction. Further, they must ensure that they and their transaction partners are coordinated in all communications about the transaction to ensure they are considering the many perspectives and issues that the municipal hospital may need to address.

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Transaction Process and Structuring

When developing the process and structure of the transaction, municipal hospital boards will want to consider these legal and regulatory challenges and opportunities:

- **Disposition of public assets:** Most states and many municipalities have specific laws governing the disposition of public assets, generally, or of municipal hospitals, specifically. These laws can take the form of restrictions on the governing body's power to transfer certain assets (e.g., restrictions on the power to approve the sale of real property) or more frequently, take the form of prescriptive processes required prior to a disposition (e.g., public bidding or public referendum). In the case of transferring the ownership of a municipal hospital, it is not uncommon to need the approval of the impacted electorate through a public referendum or input from the public through an open meeting. The public process therefore plays a significant role in transaction structuring, timing, and communication strategies.
- **Long-term leases, management arrangements, and other partnerships:** If approval of a municipal hospital disposition through a public referendum is unlikely due to timing constraints or uncertain public support, then hospital and government leaders may be able to pursue alternative transaction structures, which may not require public approval. These structures could include, among others, a long-term lease of hospital assets (e.g., 100-year lease), long-term management agreements, outsourcing of back-office functions, public-private partnership (e.g., privately constructed and operated hospital wing), or a combination of the foregoing. Although these structures may avoid some of the hurdles that accompany the disposition of a public hospital as a going concern, these structures may require the same or alternative approvals (e.g., Attorney General or Department of Health approval of management agreements) and face other complications (e.g., reimbursement changes). The importance of understanding any sort of approval process cannot be understated, particularly if other complex approvals or processes, such as certificates of need, are required. The sequencing and management of these processes in coordination with each other is essential, especially if public sentiment is either not well known or subject to change during the course of the transaction process.
- **Understanding and communicating value:** Irrespective of the transaction structure, hospital and

government leadership must remain acutely aware of the public perceptions of value. The public often overvalues hospitals and fails to fully understand the condition of assets, needed investment, and ongoing revenue pressures on the facility. This can cause unrealistic expectations for deal terms, including investment commitments, debt pay-off, or even expectations of cash consideration. In addition, the public may not have a realistic sense of the cost and value or a realistic expectation of what services the community could support or which a potential partner may be able to subsidize. This can create its own set of unrealistic, or at least unmet, expectations. Navigating these issues requires existing leadership and partners to have a clear and coordinated communication plan to share both internally within the facility and externally to the general public.

- **Antitrust analysis:** In many markets, a government-owned hospital may be one of only two or three hospitals. If the privatization transaction involves one of these in-market competitors, then federal and state antitrust laws can create considerable barriers to the transaction. Importantly, transactions that do not trigger the pre-merger notification rules are not exempt from these laws, and the privatization of municipal facilities does not warrant favorable treatment by antitrust authorities. Accordingly, hospital and municipal leaders cannot ignore the implications of these laws.
- **Medicare, 340B, Medicaid, and Medicaid Upper Payment Limits (UPL):** Government-owned hospitals and their transaction partners should consider the reimbursement impact and opportunities of the transaction. For example, certain government-owned hospitals may benefit from special reimbursement programs (e.g., UPL), for which they may not be eligible following privatization.
- **Tax-exemption process and additional obligations:** Government-owned facilities enjoy certain tax advantages through their municipal status, including exemptions to income, real property, and personal property taxes, among others. While most private hospitals in the United States are tax-exempt, such exemption results from a different federal and state basis. Accordingly, as part of the transaction process the parties will need to plan and implement the relevant exemption applications.

When preparing for a municipal hospital transaction, hospital boards and senior leaders should be prepared to address the unique legal and regulatory challenges that come with the privatization process, as well as have a strategy on how they will communicate the transaction, challenges, and opportunities to the hospital's various constituencies and transaction partner.

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