

## Structuring Post-Closing Governance in Today's Merger Environment

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**As the non-profit healthcare merger market changes dramatically, so also must the merger parties' approach to post-closing governance matters.** This is especially as it relates to board culture, decisions concerning corporate purpose, board size and composition, board authority and reserved powers, and committee structures.

There are at least four factors driving this change. This article highlights each of those factors and provides proactive solutions for each.

### 1. Antitrust Enforcement

First, and perhaps most obvious, is the Biden Administration's concentration on enhancing competition in the marketplace, and its implications for Federal Trade Commission (FTC) oversight of corporate mergers, especially in the healthcare industry. As is widely recognized, the FTC has aggressively challenged horizontal mergers of healthcare providers across the country over the last several years. It has prevailed in certain key federal court litigation filed to block other mergers. All this has significantly clouded the climate for mergers of health systems operating in similar or complementary markets.

As a result, health systems are giving greater consideration to merger options involving health systems from geographically disparate regions, in the hope that they will not trigger traditional FTC concerns with concentrated markets. Yet these types of mergers can create unique—but resolvable—governance challenges that must be addressed during the negotiation phase, including:

- Overcoming the cultural and informational barriers associated with widely disparate geographic backgrounds
- Lack of familiarity with the operating history and competitive environment of the respective merger parties
- Possible differences in the parties' respective social, economic, and political environments

These and similar issues raised by disparate geographic markets could render more difficult the post-merger board's oversight and decision-making processes.

The solution lies in part to a more significant commitment to addressing post-merger governance culture in the transaction timetable. In years gone by, merger party boards often became acquainted in abbreviated ways through cocktail parties, dinners, and short retreats—often hamstrung by antitrust protocols that prevented much substantive discussion.

That is unlikely to be sufficient in the new environment—especially where the parties represent disparate geographies. The potential for successful post-merger governance will benefit from much greater emphasis on socialization, cultural alignment, and vigorous joint onboarding activities (still within antitrust protocols). Engagement of a consultant with an industrial psychology background will enhance such efforts.

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### → Key Board Takeaways

- Commit to addressing the post-merger governance culture. Ensure that there are opportunities for socialization, cultural alignment, and joint onboarding activities (within antitrust protocols).
- Educate and train the post-merger board during the transaction process so that directors are prepared to thoughtfully execute their fiduciary duties right away.
- Ensure that, post-closing, the board agenda is committed to exercising oversight of how the organization's activities support the commitments made in the regulatory process regarding the rationale and goals for the transaction.
- Keep the board informed about organizational risks and challenges so that it can effectively work with management to lead the merged company through the initial stages of operation.

## **2. Transaction Magnitude**

Second is the sheer size of many of the transactions in the current merger market. Oftentimes they involve one or both parties of significant economic and operational size (e.g., large regional or statewide health systems). In other situations, they can involve a party with a complex portfolio of subsidiaries and related healthcare investments.

Under either circumstance, the duties of the post-merger governing board will be substantial. It will be assuming fiduciary responsibility for a combined organization with a large operational and financial footprint. This board will be expected to be in a position to thoughtfully exercise those responsibilities on “day one”; for organizations of such size and scope, corporate governance law does not provide any grace period for director preparation.

The solution will be greater focus on the education and training of the post-merger board during the transaction process. This would cover a range of information, from basic organizational structure, to publicly available operational and financial information, to a description of current healthcare delivery challenges in the parties’ respective markets, and other important preparatory information. While any such education and training must proceed within strictly defined antitrust protocols, it should nevertheless be treated as a pre-closing priority and supported (and staffed) by the parties’ respective senior management team members and external advisors.

## **3. State Regulatory Oversight**

Third is the increasing tendency of state charity officials to inquire about the fundamental purposes and goals of mergers involving non-profit healthcare organizations. This inquiry may often extend to questions regarding the rationale of the boards of the respective merger parties for authorizing the transaction.

The public policy behind this tendency is the state’s need to assure that charitable assets are being applied appropriately and that a non-profit health system’s governing board is acting as a good and faithful steward of those charitable assets in authorizing a merger with another non-profit. This state need becomes acute when the merger partner is located in another state and where the post-closing headquarters of the combined organization will be located out-of-state. Of particular, but not the sole, interest of these regulators is how the interests of the healthcare consumers in their state will be impacted by the merger.

The solution will be to ensure that, post-closing, the board agenda is committed to exercising oversight of the ways in which the activities of the merged organization support the commitments made in the regulatory process regarding the rationale for the transaction and the efforts made to achieve its goals. Working with the legal advisors of the merged organization, this oversight activity would become an important post-closing task of the board.

#### **4. Enhanced Oversight Obligations**

Fourth is general governance development that, while not directly related to the merger process, will have a substantial impact on post-merger governance.

One of the most significant, yet discreet, governance developments of the pandemic era has been the expansion of corporate directors' oversight obligations—i.e., the expectation that the risks and challenges of corporate operations require a greater governance commitment to oversight.

This expansion is essentially the byproduct of evolving third-party expectations that directors be attentive to a larger universe of issues than before. The pandemic and the extraordinary business and operational risks it exposed heightened third-party attention to the importance of the board's oversight and decision-making duties.

This shift could affect how directors perform their duty of care in the post-merger environment, which has historically been known for the complexity of its integration issues and challenges.

The solution will be, in part, for the board to “lean in” more fully in this regard, becoming more informed about, and more committed to monitoring the resolution of, these issues and challenges. Rather than being deferential to senior management during the integration phase, the board will be expected to be more of a resource and reference point to management as it leads the merged company through its early stages of operation.

The solution may also include creating a post-merger board that will reflect greater consideration for how board size relates to board effectiveness. The goal would be to create a board that is large enough to address its oversight and decision-making responsibilities, yet small enough to make decisions on a timely basis and hold meetings when necessary without quorum or notice problems.

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## Other Considerations

This new merger environment, and its focus on fiduciary involvement, is likely to prompt the merger parties to consider a variety of other governance measures and duties related to the post-closing board of the combined organization. These include, but are not limited to, the following:

- **Commitment to non-profit purposes:** Post-closing, the board should ensure that the combined organization remains committed to non-profit ownership and to operation consistent with the principles of non-profit corporations, serving the healthcare consumers, the communities in its service areas, its suppliers, and its employees.
- **Mission preservation:** All board members should share a consistent interpretation of the purposes and mission of the combined organization, and the focus of the fiduciary responsibilities they owe.
- **Focus on the combined organization's purpose:** The combined board will be expected to exercise its duties on behalf of the stated purposes of the organization, not the interests, goals, and initiatives of any of the organization's predecessor or legacy organizations.
- **Role of the board:** Post-closing, governance will proceed more smoothly when all board members agree that the board's role is to oversee the combined organization's management and business strategies to ensure long-term sustainability of its mission.
- **Board/management dynamic:** Leadership efforts will be enhanced by an understanding as to the ultimate responsibility of the governing board for the operations of the combined organization, and for the authority it retains with respect to this responsibility.

## Summary

Structuring effective post-closing governance has always been a major feature of the non-profit merger process. However, a variety of recent developments combine to attribute increased importance to this transaction task. While there is no one-size-fits-all or “must have” approach to designing effective post-closing governance, there are a variety of measures available to support efforts toward such a goal.

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