

2016

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

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OFFICIAL PROBLEM

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## **Background: People's Health Care**

People's Health Care is a city-owned (public) health care system located in Beazleyville, Loyola ("People's" or the "System"). People's operates a 25-bed critical access hospital ("People's Hospital" or the "Hospital") and a fifty-bed skilled nursing facility. Through a 50 – 50 joint venture with Tri-City Health, a regional, tertiary health care system about 40 miles away, People's operates, in Beazleyville, a free-standing outpatient surgery and specialty clinic, and also a home health agency serving the Beazleyville community.

Since its founding in 1937, People's has had the Beazleyville market to itself, but over the past few years, this has begun to change. Patient outflows have begun to increase markedly, largely to Tri-City, with Tri-City, Samaritan and Cornish—the three systems within an hour's drive of People's—now holding (in total) about a 30% market share in the Beazleyville market. Further, Beazleyville's population has grown rapidly with the development of the interstate exchange four years ago, and new residents lack the allegiance to People's that prior generations of Beazleyites had. Many of these people are working professionals, a change from Beazleyville's rural roots. While the wealth that the newcomers have brought to the community is good for the local economy, their expectations of service are markedly higher than the traditional Beazleyite. Given the demographic changes in Beazleyville, patient outflows are likely to increase unless People's undertakes significant actions to stem the tide.

Over the years there have been occasional exploratory committees established by the Beazleyville City Council to examine the System and whether the City should continue to own and operate a health care enterprise. This question had always strongly been answered in the affirmative, but there are signs that this position is changing quickly. Beyond people "voting with their feet" by seeking care outside of Beazleyville, People's Hospital has struggled to negotiate effectively with major payors in the area. During the last round of negotiations, the Hospital was essentially handed its rates with no opportunity to challenge them. Further, payors are looking for hospitals to develop shared savings-type arrangements and bundled payment pricing for select services, areas that the Hospital is unable to offer given its small size, "old school" medical staff and relatively unsophisticated EHR system.

The result is that for the first time in its history, the System operated at a loss. Next year's budget is projecting an even wider loss as the System begins to fast track capital improvements and strategic expenditures, such as plant upgrades/expansion and physician recruitment and employment, to potentially increase its attractiveness to the local community. Financial concerns have led to a three-part series in the Beazleyville Herald alerting the community to the possibility that the System may "go under" leaving taxpayers "holding the bag." This fear is gaining particular relevance in that the Hospital has approximately \$55 million in long term debt associated with the emergency room, operating suite and patient room remodel (conversion to private rooms and expansion) undertaken in 2003.

In addition, rumor has it that Cornish has been courting some of the Beazleyville physicians to join with it in opening a medical clinic, which would also offer the full complement of diagnostic testing, including scanning; currently, patients seeking MRIs are referred to Tri-City. The clinic may be the first step in Cornish offering a narrow network insurance option within Beazleyville; Cornish rolled out this insurance product earlier this year in the other markets that it serves. News of these potential moves by Cornish leaked to the local press, causing worry amongst the Beazleyville physicians as to whether they need to align with a health care system, as they have seen their peers in other markets do.

Tri-City has confronted People's administration about the Cornish rumors, hinting that it would adopt a "go it alone" strategy in Beazleyville if Cornish moves into the Beazleyville market. In addition, the market volatility has attracted outside interest. MedCor, a startup investor-owned system, has issued an open proposal to the Beazleyville City Council to purchase the system at a very attractive price. People's administration has rejected such overtures from other systems in the past, but is more open to thinking about the possibility of partnership or sale given the instability in the market and continued pressure from payers.

### **People's Organizational Structure**

As a city-owned health care system, People's Health Care is an unincorporated division within Beazleyville city government. The system is tax-exempt because of its public ownership. Through procedures established in local ordinance, the Beazleyville City Council appoints a seven member Board of Trustees to oversee the governance of the System. Trustees serve for a three-year term; there are no limitations on reappointment. Trustees can be removed by a majority vote of the Beazleyville City Council. As a division of the City, People's is subject to the typical requirements involving public entities, including open meeting laws and government employment and contracting procedures. The City Council must vote to approve People's annual budget and approve any contract that exceeds more than \$100,000 per year. Consequently, the finances of People's is often front and center at Council meetings.

General tax revenues are not used to support People's. There is, however, a dedicated hospital tax levy imposed on Beazleyville property owners, to help pay for the 2003 capital projects, which generates approximately \$1.3 million annually for the Hospital. The levy was a requirement for People's to secure financing for the projects.

### **Assistance Required**

Seeking assistance to wend its way through the strategic, legal and political issues involved in contemplating some sort of "partnership" or transfer of ownership, People's engages your firm as outside counsel, with the following charge:

1. Set forth the process that People's should use to consider its strategic options, including identification of key constituencies and issues that People's should consider in developing this process.
2. Explain the range of "partnership"/transfer of ownership options available to People's, including the pros and cons associated with each option, including attendant legal, business and strategic issues.
3. Develop a first draft of negotiating points for the key issues of concern for People's, explaining why you flagged each issue and the approach/permutations that could be taken to address it.
4. Explain the pros and cons of holding an auction for the System—with proposals solicited from any interested for-profit or not-for-profit system—as opposed to a more directed process, where only select systems (such as Tri-City, and perhaps Samaritan, are approached). As part of your analysis please also address any issues associated with these approaches.
5. Anticipating a potential partnership/change of ownership transaction, Peoples' Compliance Officer, Martha Grady, has stepped up her compliance audits. Two issues have preliminarily been identified as requiring further analysis. As part of your analysis, please address how these compliance issues would be handled in any transaction.

The first instance involves the Tri-City joint venture. The joint venture is structured as an LLC with People's and Tri-City serving as equal members. A significant activity of the joint venture is to operate the Tri-People's Clinic, which is located in leased premises in a strip mall location in the newest part of Beazleyville. Management of the joint venture, and the surgery center and clinic, is vested in Tri-City. Physician coverage is provided by a combination of People's employed primary care physicians and Tri-City's specialists. The Tri-City physicians reassigned benefits to People's so that People's could bill the Tri-City physician professional fees. Depending upon the level of follow up care needed, patients are referred to People's or Tri-City for additional diagnostic or treatment options.

In her review of the arrangement, Ms. Grady found that Tri-City did not share any of the rent expenses associated with the People's joint venture. Instead, only People's paid the rent, with People's in turn placing the lease expense on the People's hospital cost report. Through the hospital cost report, People's claims the joint venture to be an outpatient department of the Hospital. Similarly, because of the outpatient designation, People's billed the Tri-City specialist physicians as provider based practitioners, reimbursing Tri-City at 110% of the Medicare physician fee schedule for the physician services.

In the second instance, Ms. Grady is concerned about call coverage arrangements for People's emergency room. For staffing emergency services, People's has relied on four physician groups. People's has had a long-standing contract with Quick Emergency Physicians, Inc. to provide basic on-site emergency physicians. People's has relied on

three independent specialty physician groups to provide on-call coverage specialty services that Quick does not provide. Ms. Grady can locate no written contracts between People's and the specialty physician groups for the on-call coverage. The specialty physician groups each receive \$500 per day to ensure that one of their specialists is available if needed in the emergency department. This arrangement with the specialty groups has not changed since People's brokered the consistent compensation amount with all of them in 2002. Ms. Grady confirmed that there are automatic monthly payments set up to pay the groups. There have never been any complaints about the specialty groups. Although she cannot locate contracts, she has the minutes of a meeting in 2002 between People's CEO and representatives of the three specialty groups. She also has noted that every year the City Council has approved a budget for People's that includes line items for the on-call coverage amounts and names the practice groups in the budget.

Please limit your written response to no more than thirty pages. The People's Board and Administration has reserved March 18, 2016 for your firm to visit with the Board to present a summary of your conclusions and to answer questions.