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

OFFICIAL PROBLEM

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

You are outside general counsel for Beazley Health System, headquartered in the city of Pearson, state of Loyola (“Beazley”). Beazley has asked you to advise it on a potential transaction with MetroHealth, through which MetroHealth’s operations and assets (except for the MetroHealth Foundation and certain investments) would join Beazley.

1. Background

Beazley is a non-profit, tax-exempt, 25-hospital, regional health system operating in three states. Beazley is the creation of two health systems that came together in 2010. Beazley’s predecessors brought 20 hospitals together to create the system; over the past 8 years an additional 5 hospitals, in five separate transactions, have joined Beazley.

Beazley enjoys a reputation of being the market leader, or close second, in each of its respective markets. It is often thought of as being the “Nordstrom” of hospital and health services: Beautiful facilities; top-line accouterments for patients; high quality, responsive service; all supported by an envious payor mix.

As the consolidation wave has engulfed larger systems, Beazley’s Board has questioned whether its system, too, should seek to join a larger organization. After careful consideration over an 18-month strategic and financial planning process, the Board concluded that Beazley has the financial and strategic wherewithal to go it alone, but that to optimize its future position, it needs to expand significantly. Accordingly, Beazley management has been focused on an aggressive growth strategy examining multiple opportunities.

One opportunity under development involves BHS Longdale, a Beazley hospital located in Pearson. For the past six months Beazley management has been in discussions with MetroHealth, a three-hospital non-profit, tax-exempt health system providing hospital services in communities about 15 miles outside of BHS Longdale’s secondary service area. Beazley management has had its eye on MetroHealth for some time, and has made several important practice acquisitions in MetroHealth’s markets over the past few years. Specifically, in 2016, Beazley acquired Loyola’s second largest cardiology group, which has a strong presence throughout Pearson and into MetroHealth’s service areas as well. Purchased with hopes that the group would be able to direct referrals to Beazley surgeons and facilities, the acquisition has, in fact, resulted in relatively few patients. Beazley has also opened four primary care clinics in MetroHealth’s primary and secondary service areas in an effort to draw patients to BHS Longdale, but this strategy, too, has been relatively unsuccessful in building a presence for Beazley. Beazley sees the opportunity to acquire MetroHealth as an important part of making these strategic forays successful and expanding the reach of its system.

MetroHealth is interested in joining Beazley for several reasons. First, the two service areas served by MetroHealth’s hospitals (one urban, one suburban) are extremely competitive, and MetroHealth’s share of admissions and services provided to patients from these areas is steadily declining as larger, financially stronger organizations continue to move aggressively to employ medical staff who previously had referred to

MetroHealth. This slow and steady erosion of patient base has caused MetroHealth to undertake a system-wide reduction in force in 2016, and to significantly reduce its capital budget for the foreseeable future. Last year, for the first time in its history, MetroHealth had a loss on operations, causing rumors to spread throughout the community, and among the physicians and employees. As a result, MetroHealth's efforts to grow its employed medical staff have been severely hampered, as physicians are loathe to join an organization whose future seems uncertain.

Further creating problems for MetroHealth is that one of its competitors recently opened, to much acclaim, a new facility in MetroHealth's primary service area. In addition, this same competitor—part of a ten-hospital system located throughout Loyola—partnered with Loyola's leading health insurer to create a "super PPO"—a cross between a narrow network and a PPO with significant discounting for patients to remain in network—which is likely to result in a strong swing of patients away from MetroHealth's clinics and hospitals.

In addition, even as a reasonably well rated (A-, although with a negative outlook) organization, MetroHealth does not have the financial heft to access capital at a price point enabling it to invest at the rate it must to thrive in its markets.

2. Preliminary Due Diligence Findings

The parties have engaged in very limited, high level due diligence sharing under the terms of a confidentiality agreement, so that the respective management teams could effectively brief their boards on whether efforts should be expended to develop a letter of intent. As a result of its review of MetroHealth's financial statements, strategic plan, conversations with MetroHealth's management team and a "high level" risk assessment that it conducted, Beazley has concluded the following:

A. Operations/Strategy

1. The desirability of the service areas served by MetroHealth (and by the four primary care Beazley clinics) is affirmed. The areas have a good payor mix and MetroHealth has a solid reputation for quality care. Even though competition is intense, and the recent partnership with the insurance company is problematic, Beazley has the financial wherewithal to effectively compete for patients. Beazley enjoys a respectful relationship with the insurer and believes it can leverage its enhanced scale (with MetroHealth as part of its system) to develop its own "super PPO" option with the insurer as well, perhaps extending throughout the state of Loyola.
2. There is a reasonably good mission and cultural fit between the two systems, although MetroHealth's service to the poor—Medicaid payor mix, charity care commitment—is much higher than that of Beazley hospitals.

3. MetroHealth's facilities are not up to Beazley standards and need a significant, 7-figure commitment of capital improvements to align with the Beazley brand.
4. There is concern about MetroHealth's eroding patient base, and operating loss, but belief that this can be turned around by Beazley through efficiencies gained by MetroHealth being part of the Beazley system, additional reductions in force (through not filling open positions) to align MetroHealth's operating statistics with those more efficiently achieved by Beazley, and growth to be achieved by leveraging Beazley's enhanced size in the market.
5. MetroHealth has been in discussions to purchase the leading cardiology group in its market. Should this occur, and the group ultimately be combined with the Beazley cardiology group when MetroHealth joins Beazley, Beazley would have a significant advantage in the MetroHealth service areas for this essential service.

B. Legal

1. MetroHealth is self-insured for malpractice claims, with a \$25-million retention point. Historically, the most that MetroHealth has paid on a single claim has been \$7M. Unfortunately, MetroHealth has three claims pending that could lead to settlements or verdicts at roughly the same time, within the next year to 18 months. Each claim is estimated to result in a payment of \$11-15M, with the possibility that the amounts could be higher as the same care team was involved in all three claims. MetroHealth's self-insurance trust does not have sufficient reserves to pay these claims if they all hit at or near the same time.
2. MetroHealth has been notified that it is the subject of two qui tam suits. It appears that one of its hospital CEOs routinely provided medical director contracts to medical staff members without documenting the quantity or quality of services provided, and that the payments were not fair market value. In a second suit filed by a different relator alleging behavior by the same CEO, the allegation is that a physician co-management arrangement entered into between the hospital and a leading oncology group resulted in inappropriate referrals and compensation to the group and its individual members.

C. MetroHealth's Negotiating Points

While Beazley has not engaged MetroHealth in extensive conversations on its "must haves" to join Beazley, MetroHealth has been clear about the following:

1. The MetroHealth Foundation, one of whose primary purposes is to support MetroHealth and currently holding assets in excess of \$75M, would not be part of any transaction. In addition, MetroHealth desires to transfer \$25M of investments on its balance sheet to the Foundation and will be seeking a multi-year, multi-million dollar contribution from Beazley to the Foundation in return for MetroHealth surrendering sole control of its system to Beazley.

2. MetroHealth is adamant that one of its hospitals become the center of excellence for cardiology within the Beazley system. This directly contradicts a commitment that Beazley made to Memorial Health System when one of its hospitals, Northwest Community, joined the Beazley system.

3. MetroHealth has an unusual Board structure, with its CEO also serving as Chair of its Board. The CEO has indicated that he is willing to retire if the Beazley transaction comes to fruition, but he wants to be Vice-Chair of the Beazley Board. He also wants at least two additional seats on Beazley's current 15-member Board reserved for appointees nominated by the MetroHealth Foundation.

3. Issues to Be Addressed

Beazley's CEO has asked you to advise on the issues set forth below. Please note that clients expect you to consider business risks as part of your analysis of transaction structure, negotiating points and assessment of the overall transaction.

A. What options are available to structure a transaction with MetroHealth, which approach do you recommend, and why?

B. Explain the material legal risks associated with a potential MetroHealth transaction, identifying each specific risk, the implications to Beazley and how the risk can be ameliorated or contained.

C. Your assessment of the MetroHealth opportunity and key negotiating points for Beazley should the discussions with MetroHealth move forward.