THOMPSON COBURN LLP

insights

Top considerations for structuring health care mergers and acquisitions

As a new year starts, health care organizations looking to grow or sell their businesses in the upcoming months will need to tackle the key question of which transaction structure is the best fit in light of the competing considerations.

To sort through this question, we will first cover the main types of transaction structures. Then, we will examine the major financial, business and operational considerations that factor into identifying the optimal structure for the contemplated transaction.

Types of transactions

There are three primary means to acquire or sell a business: an asset purchase, a merger or a stock sale (or member substitution in the case of a not-for-profit entity).

Asset purchase: The buyer acquires some or all of the assets of the target entity. In many cases, asset purchase agreements are “cash out” deals that permit the target entity to distribute cash to its owners, and to eventually wind-up operations and dissolve.

- **Pros**: The buyer is able to acquire specific assets and often times assume only selected liabilities.

- **Cons**: CMS regulations may effectively force the buyer to assume responsibility for previously existing regulatory liabilities; the parties may incur additional costs related to taxes; asset purchases may be more labor-intensive than other structures due to the need to obtain consents and create asset schedules.

Merger: Two entities legally combine into a single surviving business that owns the assets, and is responsible for both the pre- and post-transaction liabilities of both entities.

- **Pros**: Because all assets and liabilities of both entities are involved, a merger may be more straightforward to execute.

- **Cons**: Liability considerations may require significant due diligence; the combined entity theoretically has unlimited exposure for pre-transaction liabilities.

Stock sale: A stock sale does not involve the direct transfer of assets. Rather, the shares of the target entity are transferred to the buyer.

- **Pros**: Stock purchases can minimize tax consequences, particularly to the target entity’s shareholders, and they often require less documentation and fewer contractual consents.

- **Cons**: Stock sales can also be significantly complicated by the presence of dissenting shareholders.

Member substitution transaction: The buyer normally becomes the sole member of the target entity, with the power to appoint some or all members to the target entity’s board of directors.

- **Pros**: Member substitutions may minimize the number of approvals needed, as well as the need to create asset and liability schedules.

- **Cons**: Unless there is a surviving community foundation of the target entity, there may be little recourse available to the buyer for exposure to pre-transaction liabilities.

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Determining of the most beneficial transaction structure requires a careful analysis of a number of factors, including the risk tolerance of the parties. There is no "one size fits all" model, particularly in health care. The choice of which transaction structure is desirable may be determined based on some or all of the following factors:

- **The ability to limit exposure for liability for pre-transaction activities of the target entity**. In some instances, exposure to pre-transaction liabilities may be mitigated by indemnification provisions or adjustments to the purchase price.

- **Certificate of need ("CON") and licensure laws**. Many, but not all, states require that certain types of entities obtain a CON in order to operate health care facilities, and states have numerous laws regulating the operation of health care facilities. These laws vary greatly from state-to-state, but they often require either notice or regulatory approval for an acquisition, change of control or a change of ownership. The transaction structure may mean that a CON is not required or that a new license may not need to be issued. Some transaction structures may result in a more involved, time-consuming CON and licensure process than other structures.

- **Payor issues**. Payor matters are of critical importance in most health care transactions, and must be handled very carefully. The choice of structure may impact whether payor consent is necessary under the terms of a payor contract and significant payor contracts should be reviewed carefully as a result. Failure to plan accordingly with respect to payor contracts may result in the buyer having to obtain a new payor contract, lost reimbursement and/or delayed reimbursement. In some instances, payors may refuse to recognize provider-based or other special status, or they may have other arrangements that preclude recognition of the target entity once affiliated with the buyer.

- **The necessity of obtaining third-party consents**. In most instances, the buyer will want to retain certain key contracts (e.g., professional services agreements, leases for significant properties and clinical arrangements with other health care providers) which may require consent to assign in an asset purchase or include change of control provisions requiring consent for mergers and stock/member substitution transactions. In some cases, the key contracts may contain an exclusivity or non-competition provision which, if enforced, could affect the structure of the transaction.

- **Tax considerations**. Tax considerations can significantly affect many transactions. For example, a stock sale may be advantageous to a target entity's shareholders, but disadvantageous to a buyer. Similarly, a not-for-profit entity may readily acquire a taxable entity, but when a for-profit entity acquires a not-for-profit organization, it must assess a number of complicating factors.

- **Debt considerations**. A buyer must examine any restrictive covenants, any ability to refinance on a tax-exempt basis, and whether acquisition financing is available.

- **Human resources considerations**. It's worthwhile for a buyer to minimize workforce disruptions as much as possible. In addition, many health care organizations may have collective bargaining agreements that could be affected by the transaction structure. Employee benefits, seniority, and pension funding can all be affected. Transactions that will result in the non-retention of employees may trigger requirements under the Worker Adjustment and Retraining Notification ("Warn") Act. Even an asset purchase wherein the buyer plans to terminate and re-hire employees could trigger notice requirements under the Warn Act.

- **Special considerations for not-for-profit entities**. Not-for-profit entities may need to closely examine their donor-restricted funds and other assets to ensure that they comply with applicable charitable trust laws. In some states, approval for any transaction involving the sale of all or substantially all of the assets of a charitable organization may require approval from the attorney general of that state.

The factors listed above are just a sampling of considerations in structuring a health care transaction. There are obviously other considerations that can affect structure, as can the weighting among these factors from deal to deal depending on the parties' business objectives. An experienced legal advisor can help you sort through these factors and use your specific goals for the deal to structure the best possible transaction.

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