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How Health Cos. Can Minimize Consolidation Risk

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Consolidation among health care providers has long been a contentious regulatory issue. Providers argue that they are squeezed between two forces that make economies of scale and partnerships essential.

On the one hand, there are the ever-increasing costs of providing high-quality care, including technology, equipment, drugs, compliance costs, and salaries of physicians, nurses, and professional staff.

On the other, there is continued downward pressure on payments from Medicare, Medicaid, and private insurance. Legislators and regulators, however, counter that consolidation increases patient costs without materially improving patient care.

The combination of the pandemic and the policy priorities of the Biden administration has only served to intensify this conflict. The pandemic overwhelmed hospitals with medical emergencies while depriving them of revenue from standard patient care and elective procedures.

Physician practice groups were hit even harder, as patients stayed home for all but the most essential visits. Shortages of nurses and other personnel are forcing providers to rely on temporary workers, driving up labor costs.

While things may be slowly returning to normal, the damage has been done, with strong providers weakened and weaker ones pushed onto even more precarious ground.

Every CEO has their team developing strategies to both survive an extended recovery period and prepare for the next storm. At many institutions, those strategies will include the possibility of consolidating with other entities. This is particularly the case for rural hospitals, which are far more isolated, have fewer resources, and face a particularly long road to recovery.

Consolidation in the Crosshairs

But while providers are approaching consolidation with new urgency, both Congress and the Biden administration have made it a priority to challenge consolidation, with the aim of increasing competition among health care providers.

In May 2021, the U.S. Senate Subcommittee on Competition Policy, Antitrust, and Consumer Rights convened a hearing devoted entirely to hospital consolidation, with the clear takeaway that consolidation will be the focus of continued legislative scrutiny.

President Joe Biden’s July executive order on promoting competition takes a skeptical view of hospital mergers and encourages the U.S. Department of Justice and the Federal Trade Commission to revise their merger guidelines and to challenge more anti-competitive combinations.

Recent developments at the Federal Trade Commission provide a vivid illustration of how tougher policy pronouncements are being converted to action. The FTC’s Bureau of Competition has indicated its merger reviews may now include a scope of factors that extend significantly beyond the traditional measures of higher prices or reduced output or quality to include considerations such as the proposed merger’s cross-market effects and its potential impact on labor markets.

Further, if the bureau is unable to conduct a preliminary investigation into a proposed merger within the 30-day window, the bureau has begun to warn companies the agency reserves the right to subsequently determine that the deal is unlawful at some unspecified future time.

New Strategies for a Tougher Terrain

Potential mergers among providers today face substantially higher regulatory risk at exactly the same time that the impetus to consolidate is greater than ever. As the organization’s chief legal adviser, it falls to the general counsel to navigate those risks. Two strategies can be particularly helpful in doing so.

First, general counsel needs to rethink their presentation to regulators in light of regulators’ new perspectives. FTC Chair Lina Khan’s recent priorities memo calls for the agency to take a “more holistic approach to identifying harms” to include effects on workers and competitors and to “democratize the agency” by ensuring that “the Commission is in tune with the real problems that Americans are facing in their daily lives.”

Health care providers may be in a stronger position than other industries to respond to this wider-angle view, given that it is usually structural issues, rather than the opportunity to dominate a market, that prompts a health care merger in the first place.

If the reality is that rural patients are already traveling to get specialty care at better-equipped urban facilities, an urban-rural hospital system merger that provides needed financial stability to the rural partner and keeps its doors open to serve patients is fundamentally pro-competitive and in the interest of the people in those communities. That makes for a fairly compelling argument from a systems perspective.

But given the solidifying regulatory skepticism toward consolidation, general counsel should also consider how they might be able to achieve many of the same goals as a merger through different means, such as joint ventures, clinical integration agreements, and other types of collaborations.

These arrangements are generally not subject to anywhere near the level of scrutiny that full-on combinations receive, and yet can offer many of the same benefits in terms of shared resources, economies of scale, and expanded reach.

Managing Collaboration Risk

If collaboration brings less regulatory risk than consolidation, it can bring risk of another sort: that the two parties fail to achieve the strategic goals driving the partnership.

The greatest threat to informal partnerships is entropy and the loss of focus that comes in the face of the demands of day-to-day operations; the energy needed to maintain an unproductive partnership increases over time even as the expenditure of that energy becomes harder to justify.

By the same token, if both sides are providing patients with better care through increased or enhanced services, or attracting more patients to their core services, the necessary commitment is much easier to sustain.

There are several strategies health care entities can employ to help minimize that risk.

First, responsibility for the success of the venture should rest with a joint management team comprised of employees who are primarily dedicated to managing the joint venture; simply making the collaboration one more thing for a group of overworked, pandemic-exhausted managers to worry about is a recipe for failure. The management team should report directly to both boards, who should provide the collaboration with a recurring place on their agendas.

The agreement should reflect the business rationale driving the collaboration and align with the plans and frameworks used by both management teams. This means going beyond economic terms to anticipate operational issues that may arise as the partnership unfolds.

The agreement should also include benchmarks and incentives so that everyone is held accountable and has skin in the game. For example, a given increase in growth for either side could trigger bonus payments for the joint venture management team.

The term length of the agreement can seem like a relatively minor logistical detail, but it can play an outsized role in the venture's success. Too often, parties default to a short trial period such as a one-year term. But doing so undermines the partnership's chance of success; in practice, a year is often only enough time to form the necessary working relationships and to smooth out the mechanics of the collaboration.

A one-year term also sends an unavoidable, subconscious message from the start that the venture only warrants a temporary commitment. And precisely because a longer agreement represents a bigger commitment, it forces both the legal and management teams to think through in greater detail the mechanics and goals of the agreement, as well as the problems that might occur and how they will be handled.

Neither the Biden administration's increased scrutiny of consolidations nor the forces pushing health care providers to consolidate are likely to abate anytime soon. In this environment, when going it alone is no longer viable, and the ground beneath them shifts on a seemingly daily basis, health care providers will need to turn to new strategies to find stable footing.

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