Oregon HFMA Spring Meeting

Health System / Community Hospital

Integration Models in the New Environment

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Discussion Outline

- The Environment – Today's Drivers of Integration
- Community Hospital – Health System Integration Models
- Case Study: CentraCare Health System and Critical Access Hospitals

Drivers of Integration

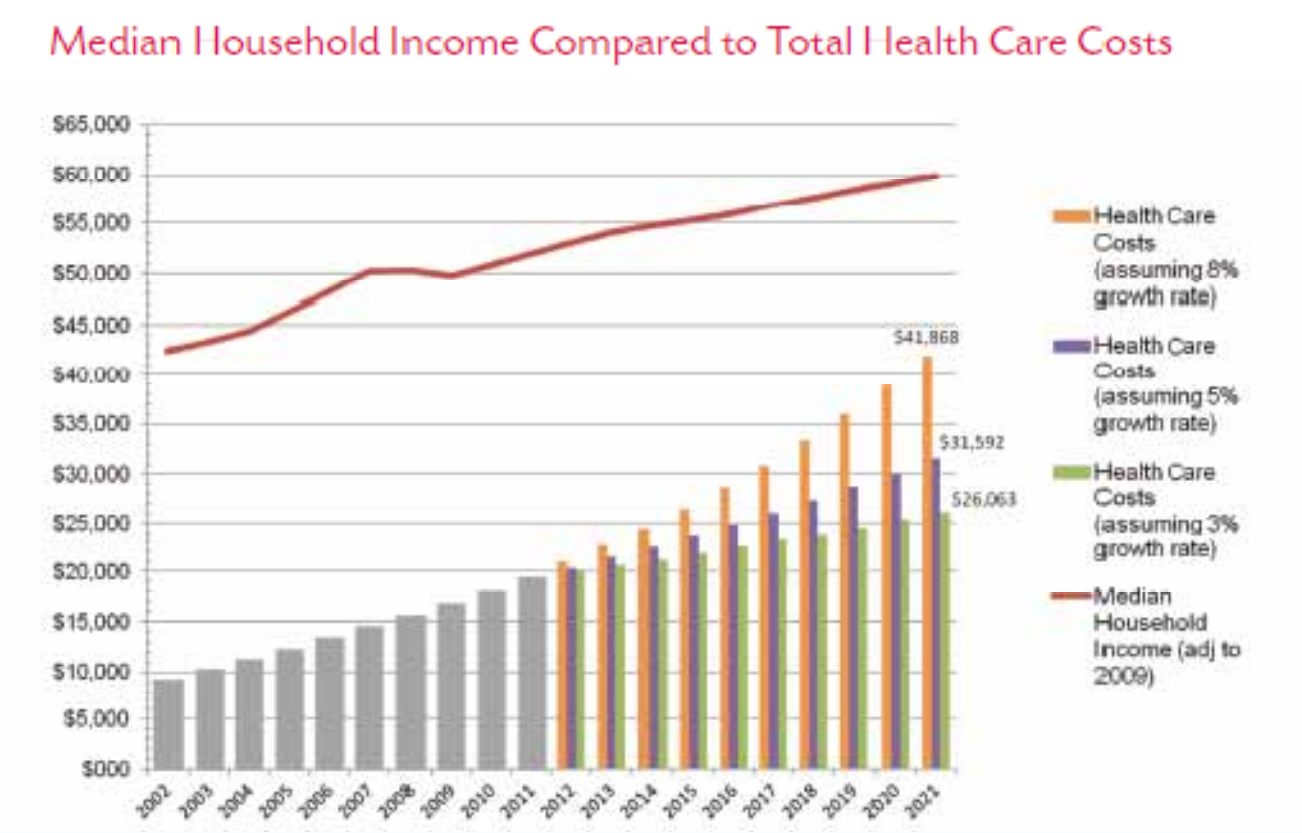
- Historical
  - Access to capital
  - Physician recruitment/retention
  - Market position
  - Management services depth
  - An uncertain future
- Today . . . all of the above, plus
  - The Triple Aim mandate
  - Value Based Purchasing – new payment models
  - Population health management
  - Physician shortages, compensation, and changing expectations
  - Don’t be left out of the game
  - Fear of the unknown future

Why is Reform Needed?

"Health care in America is badly organized, highly inconsistent, internally dysfunctional, sometimes brilliant, almost always compassionate, close to data free, amazingly unaccountable in key areas, too often wasteful, too often dangerous, and extremely expensive. Care costs more in America than it does anywhere else in the world—by every measure. Care costs more per person, more by the unit, more by the dose, more by the disease, and more in the aggregate. We spend far more than anyone else in the world on care, and we are alone among the industrialized countries in not covering all of our people. We need to do a lot better."

George Halvorson, Health Care Will Not Reform Itself.

Bend the Cost Curve?



Source: 2011 Milliman Index

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COMMUNITY HOSPITAL – SYSTEM INTEGRATION

The Core Questions

- Are we more likely to be who and what we want to be by remaining independent or by aligning with a larger system in some way?

- If we consider affiliation with a larger system, how do we protect what is important to us and get what we want out of the relationship?

Why Do Community Hospitals Consider System Affiliations?

- To facilitate access to capital, typically for a major project
- To enhance the scope of services offered to the community
- To facilitate physician recruitment and retention
- To avoid unhealthy competition with the system physicians and the large system regarding ancillary services
- To access key management services; reduce costs
- To achieve clinical integration and financial alignment
- To protect market position in a reformed health care environment – be in the game

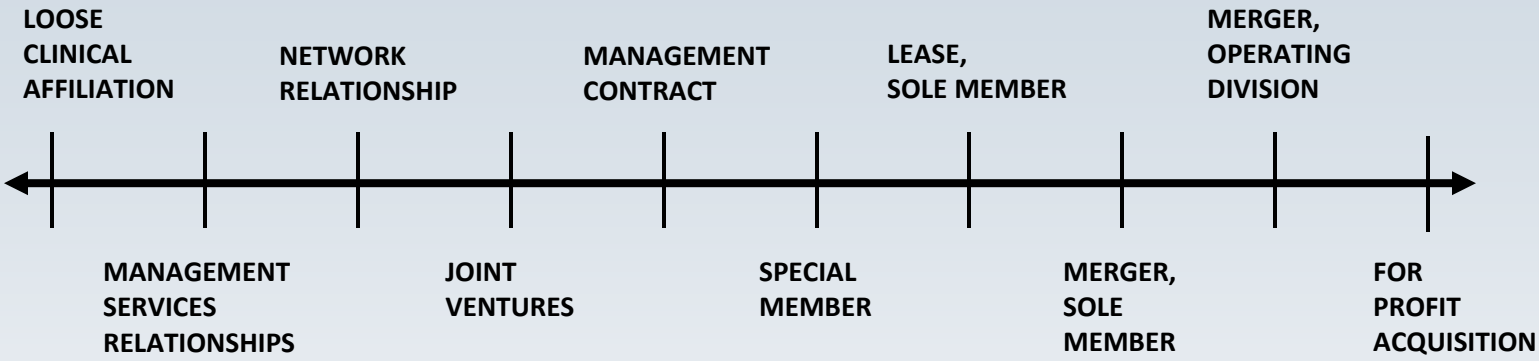
The Key Trade-Off

The key trade-off for many community hospital Boards is that of benefit of the relationship versus loss of local governance control.

Boards should recognize, however, that there is not just one model of affiliation, and that retention of a degree of local control is possible based upon the models under consideration.

Health Care System – Community Hospital

Potential Affiliation Relationship Paradigm



Degree of Economic Alignment/Commitment

Potential Loss of Local Control

- **What are the strategic objectives of the parties?**
- **What degrees of independence / control are we willing to explore?**
- **What form of relationship will best allow us to achieve our objectives?**
- **What barriers need to be considered, and how will they be addressed?**

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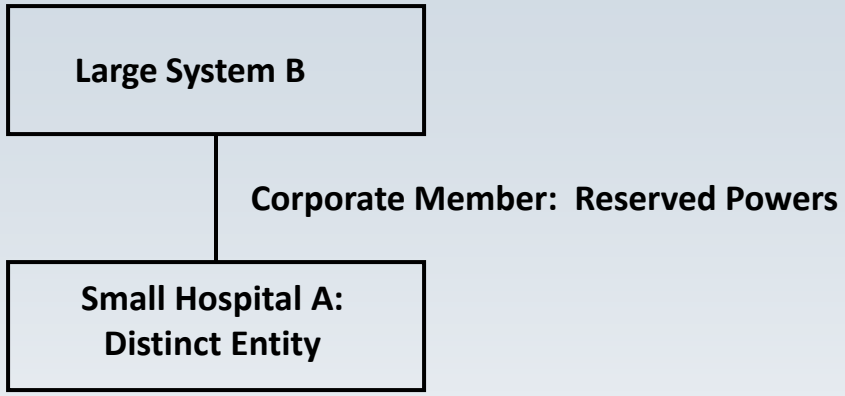
Network Relationships

- Examples: Iowa, New Jersey, New Hampshire
- Focus is on clinical integration and Triple Aim, potentially to enable joint contracting at some point

Special Member

- Analogous to minority ownership in a for profit situation
- Large system makes investment in small hospital
- Large system treats as equity investment (not a gift or loan) → creates alignment of interests
- Large system may treat as "Beneficial Interest" (x% ownership position)
- Large system receives consideration for investment
  - Board seats
  - First right of refusal: clinical relationships, administrative services, conversion to Sole Member
  - Reserved Powers, e.g. issuance of debt, to protect value of investment
- Large system and small hospital able to a) enter into risk contracts together, and b) enter into other contracts together after clinical integration

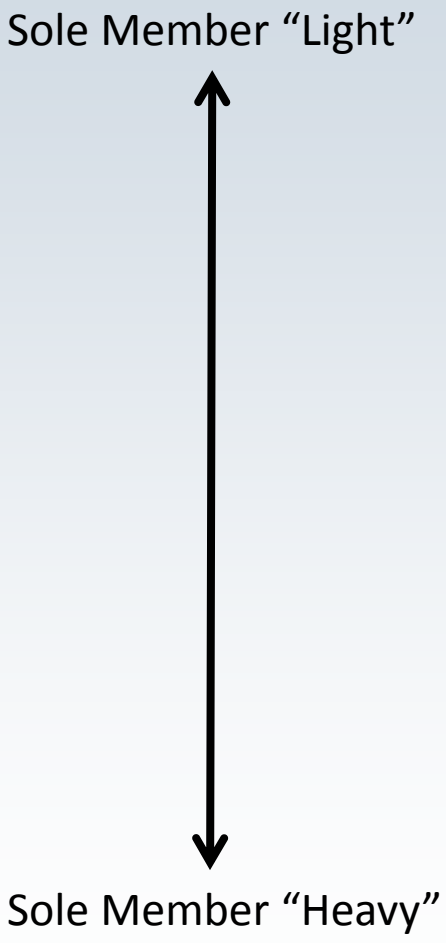
Sole Corporate Member: Distinct Entity



- Role/Control of Corporate Member defined by "reserved powers"
  - May be extensive or limited (Sole Member "Heavy" or "Light")
  - Creates ability to consolidate financial reporting = financial alignment
- Interests are aligned: economic, quality, strategic
- Managed care contracting can be fully integrated
- Distinct Entity status = potential separate employer, limits impact on employees

Illustrative Reserved Powers (System Approval Required)

- Issuance of Debt through System
- Changes in Articles/Bylaws which dilute System rights
- Sale of significant assets
- Final appointment of Board members
- Compliance and Audit
- Change in Corporate Members
- Selection/Termination of CEO
- Approval of other affiliations
- Budgetary approval
- Approval of Strategic Plan
- Employment as system, employment policies
- Marketing initiatives



Illustrative Examples

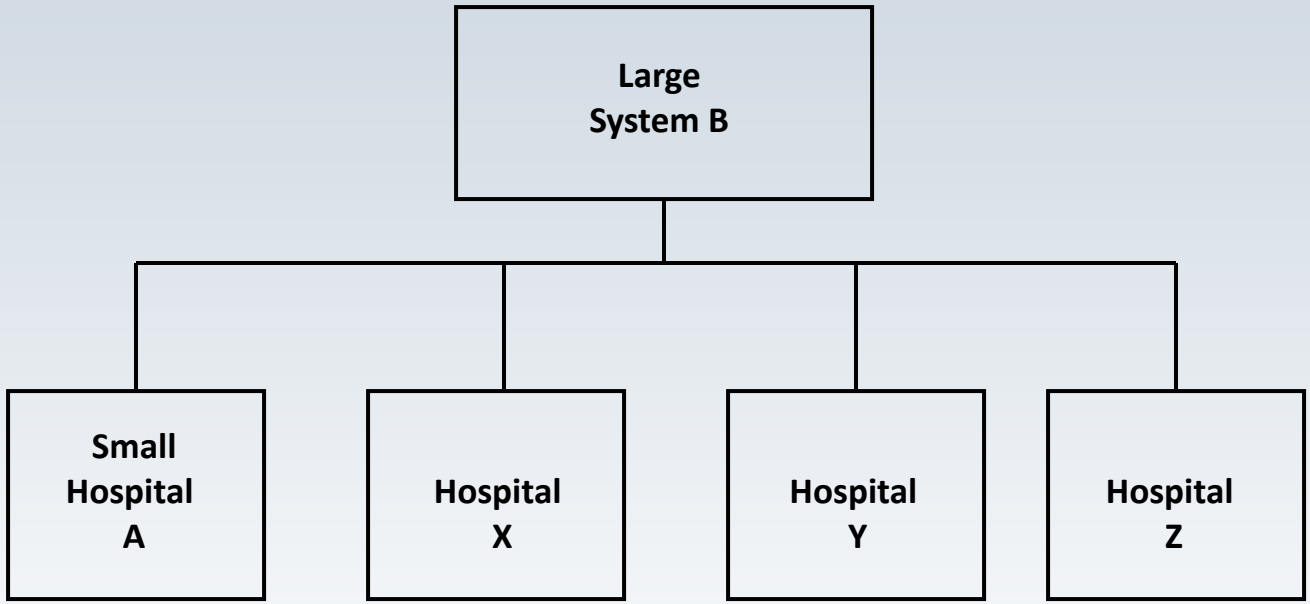
West Hospital: Sole Member "Light"

- Remains distinct corporate entity
- Remains distinct employer
- Remains distinct medical staff
- Retains local Board, with 2 system Board seats
- Board appointments follow local nomination process
- Budget approvals follow local budget formulation, approved or consolidated basis only
- Strategic plan approval follows local process
- CEO appointment: two to hire, one to fire
- Local patient satisfaction and quality management, with System support where requested
- Purposeful retention of local culture
- Local operations retained; system support where requested

East Hospital: Sole Member "Heavy"

- Remains distinct corporate entity
- Employees become system employees
- One medical staff for system
- One System Board serves as Board for all entities
- System Board members are local Board
- Top down budget, line item approval
- Top down strategic plan
- CEO appointment: System based
- System functions same at all entities
- Purposeful application of system culture
- Operations system/corporate based

Full Asset Merger: Operating Division



- Full asset merger
- No real governing board retained; full control by Large System B
- No distinct entity; employees become employed by Large System B

For-Profit Acquisition

- Small hospital is purchased by national/regional for-profit system.
- Transaction typically involves a combination of cash paid to a local entity (such as a Foundation) and agreement to invest capital in local facilities.
- A local advisory Board, with very limited role, may be retained.
- Operating models (financial, staffing, patient satisfaction, quality, employee relations, etc.) are typically those of the for-profit corporation, with limited latitude for variance locally.

Typical Process

- Be clear about . . .
  - Why
  - What is sacred
  - What we want
  - Range of acceptable structural outcomes
- Appoint Steering Group
- Reach out to potential affiliate systems: preliminary interest?
- Decide who to continue with (if any, preferably at least two)
- Negotiate to non-binding Term Sheet/MOU
- Board authorization of Term Sheet
- Negotiation of Definitive Agreements (binding)
- Final Due diligence/Regulatory Approvals
- Closing on Affiliation/Transaction