

HEALTH LAW CONNECTIONS

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TOP TEN ISSUES IN HEALTH LAW: #6 Resilience and Reinvention: Partnering in a Pandemic

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The COVID-19 pandemic created a tumultuous and unprecedented environment for health care transactions over the past year, including a near cessation in hospital M&A activity during the second quarter of 2020. However, as hospital operations began to stabilize in mid-2020, and deals that commenced pre-pandemic were consummated, deal volume increased in the second half of 2020 to near pre-pandemic levels.¹ As health systems shift from emergency pandemic preparation and treatment to forward-looking strategic planning, we expect to see the trend in increased deal activity continue in this sector for 2021. We believe that transformations in the delivery of health care will influence M&A activity in 2021 as health care organizations more proactively address the pandemic's challenges, leverage opportunities for innovative partnerships, and prepare for long-term strategic growth and success.

Mega Deals. Significant combinations involving large health systems attract attention for their scale, strategic importance, and market impact. In Q3 2020, four transformational transactions were announced, the highest number of such deals ever announced in a single calendar quarter.² Notwithstanding the pandemic, these mega deals continue to be pursued and closed as health systems aspire to grow into new markets, leverage economies of scale, spread risk, encourage innovation, and manage large patient populations.³ It is worth noting, however, that several announced transactions were abandoned in 2020.⁴ While we can speculate as to whether pandemic-related financial distress and reallocation of priorities contributed to these deal terminations, it is also possible that typical deal challenges, such as lack of cultural fit or inability to reach agreement on key financial and governance terms, may have played a role in causing parties to walk away from certain combinations. We predict that in 2021, large system partners will continue to explore transformational transactions consistent with historical deal-making activity in the sector.

Deal Resurrection. As the pandemic set in during Q2 2020, many hospitals paused transaction discussions to focus available resources on planning for patient care and ensuring community and workforce protection. However, some hospitals experienced immediate and drastic financial decline due to mandated cessation of elective procedures, increased expenses, and other pandemic challenges, creating pressure on the transaction parties to resume paused deals in order to save hospital operations and maintain critical community health care services.⁵ A number of pending transactions have remained in a holding pattern through 2020, or have been progressing on a slower

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or delayed timeline, as the parties reevaluate deal terms and modify projections to reflect pandemic realities. While many such paused or delayed discussions will be resurrected in 2021, it is possible that the recent pandemic surge may cause additional disruption and restrict deal flow. However, we anticipate transaction volume in the sector will ultimately recover from its 2020 low point as vaccine rollouts, reductions in transmission, and eventual herd immunity are achieved.

Deal Drivers. The pandemic may contribute to increased deal flow in 2021 as financial distress creates additional incentives for partnership and drives transaction discussions. Distressed health care facilities may have no choice but to partner with larger and more financially stable health systems to provide capital and financial stability and absorb future operational risk. Systems with strong margins and good market positions will continue to think strategically about growth and search for the right opportunities and relationships to achieve their objectives, and distressed partners may now be more interested in engaging in those conversations if they are unsure about their viability as an independent enterprise. In addition, some systems may continue to execute on their divestiture strategies, including publicly traded companies such as HCA Healthcare, Quorum Health, and Community Health Systems,⁶ further contributing to potential increases in health care transaction volume.

Deal Trends. In 2021, we expect that a variety of providers, including for-profit and nonprofit health systems, academic medical centers, and independent hospitals, will pursue joint ventures or affiliations with partners to strengthen core offerings and bolster the continuum of care. There will likely be increasing focus on health care operations buoyed by pandemic-related changes to government and private reimbursement, such as telehealth, home health, and ambulatory care services. Providers also may accelerate their transition to value-based care arrangements to protect against reimbursement fluctuations. Health systems, insurance companies, and private equity firms will likely continue to seek opportunities to align with or acquire physician groups, who may be more open to such relationships due to pandemic-related financial distress.⁷ Some systems may be in a position to monetize non-core assets, such as by spinning off real estate or activities in non-performing or distant markets.⁸ We expect to see relationships that are tailored to specific service lines, partners, and markets continue to drive transactions in the health care sector in 2021.

If 2020 has taught us anything, it is that it is impossible to predict the future with any certainty and that we must expect the unexpected. Despite this, subject to every qualifier and caveat imaginable, we predict that 2021 will be a robust year for health care transactions, as hospitals and health systems continue to pursue collaborations and innovative partnership strategies to survive, compete, and thrive.

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¹ At the time of this writing, Q4 transaction numbers were not available, however, industry financial advisory firm KaufmanHall noted that the number of announced Q3 transactions was “significantly above the 14 transactions announced in Q2.” Anu Singh, *Healthcare Mergers & Acquisitions Activity Report: Q3 2020*, <https://www.kaufmanhall.com/ideas-resources/article/healthcare-mergers-acquisitions-activity-report-q3-2020>.

² *Id.* Four transformational transactions were announced, including the combinations of Cone Health and Sentara Healthcare in the Southeast, Lifespan and Care New England in Rhode Island, CHI Franciscan (CommonSpirit) and Virginia Mason in the Pacific Northwest, and Novant Health, UNC Health, and New Hanover Regional Medical Center in North Carolina.

³ See, e.g., the combination of Atrium Health and Wake Forest Baptist Medical Center, which will create a new medical school in Charlotte, NC, and which parties cite as their rationale for the deal to “build a ‘Silicon Valley’ for healthcare innovation.” Atrium Health, Press Release, *Atrium Health and Wake Forest Baptist Health Combine, Create Next-Generation Academic Health System* (Oct. 9, 2020), <https://atriumhealth.org/about-us/newsroom/news/2020/10/atrium-health-and-wake-forest-baptist-health-combine-create-next-generation-academic-health-system>.

⁴ See, e.g., the termination of the proposed merger of Beaumont Health and Summa Health in May 2020, *Beaumont, Summa Health cancel \$6.1B merger plan*, *Becker's Hosp. Rev.* (May 29, 2020), <https://www.beckershospitalreview.com/hospital-transactions-and-valuation/beaumont-summa-health-cancel-6-1b-merger-plan.html>; the termination of the proposed combination of Advocate Aurora and Beaumont in October, Guy Boulton, *Advocate Aurora Health and Beaumont Health in Michigan end merger talks* (Oct. 2, 2020), <https://www.jsonline.com/story/money/business/health-care/2020/10/02/advocate-aurora-health-and-beaumont-health-end-merger-talks/3593573001/>.

⁵ See, e.g., St. Luke's University Health Network's acquisition of Easton Hospital from Steward Health Care, which closed July 1, 2020. *St. Luke's University Health Network to Acquire Easton Hospital* (June 7, 2020), <https://sauconsorce.com/2020/06/07/st-lukes-university-health-network-to-acquire-easton-hospital/>.

⁶ CHS recently sold facilities to Allegiance Health Management and Orlando Health. Tara Bannow, *CHS plans to sell Florida hospital to Orlando Health*, *Modern Healthcare* (June 26, 2020), <https://www.modernhealthcare.com/providers/chs-plans-sell-florida-hospital-orlando-health>.

⁷ Bob Herman, *The coronavirus could force more doctors to sell—or shutter* (Apr. 20, 2020), <https://www.axios.com/coronavirus-doctors-practices-sell-close-d59aa9f0-1e01-4a90-82f7-d4ebab26e355.html>.

⁸ Sydney Halleman, Mergermarket, *Struggling hospital systems pursue more JVs to bolster care offerings, experts say*, (October 7, 2020).