

Hospital and Health Plan Conversions

BACKGROUND

In recent years, government and business pressures to contain health care costs have resulted in many instances of consolidation in the health care delivery and insurance system. To maintain or strengthen their competitive posture, a growing number of hospitals, managed-care health plans, and health insurers have been forming partnerships, merging, or converting from nonprofit to for-profit operation. Because of this trend, the conversion of hospitals and health plans from nonprofit to for-profit status is coming under increasing public and government scrutiny. The central concern about hospital conversions is that the nonprofit hospital's assets, held for charitable use in the community, will be lost to large national for-profit corporations (such as the nation's largest hospital chain, Columbia/HCA), which must answer to stockholders rather than the health care needs of the community in which the hospital is located.

GLOSSARY

Charitable-trust doctrine

Legal doctrine that requires charitable assets held in public trust to remain committed to the purposes and uses of the trust.

Conversion

Any transaction in which all or a substantial portion of a nonprofit health care organization's assets are shifted to for-profit ownership. More broadly, any merger or consolidation of health care organizations, regardless of whether the parties are nonprofit or for-profit.

General hospital

A hospital offering a broad range of services to patients, as opposed to one offering only specialty services (e.g., a psychiatric hospital).

While *conversion* undoubtedly applies to the transfer of assets from a nonprofit to a for-profit health care organization, some also use the term more broadly, including any merger or consolidation of health care organizations, regardless of whether the parties are nonprofit or for-profit. Under this broad definition, the merger of two nonprofit hospitals or a nonprofit hospital's purchase of another nonprofit would be considered a conversion. These two definitions are at the heart of one debate over the Michigan conversion legislation (see "Discussion," below). In this piece, however, conversion refers only to *nonprofit to for-profit* transactions, and the focus is on *hospital* conversion. While health-plan conversion has been prominent in California, Ohio, and other states, hospital conversions from nonprofit to for-profit status are garnering most public and legislative attention in Michigan.

First, however, national and Michigan data on hospital conversions deserve mention. Nationally, in 1995, 48 nonprofit hospitals converted to for-profit status. In 1996, the latest year for which data are available, the number rose to 63. All indications suggest that the legal troubles and reorganization of Columbia/HCA (headquartered in Nashville, Tennessee), the nation's largest hospital chain and most aggressive purchaser of hospitals, mean that the number will have declined in 1997. With these conversions, approximately 15 percent of the nation's general hospitals have for-profit status. Conversions and for-profit hospitals are concentrated in eight states: Alabama, California, Florida, Georgia, Missouri, Oklahoma, Tennessee, and Texas.

At present, Michigan has no for-profit general hospitals. (For-profit companies have purchased the assets of two southeast Michigan facilities that already had

closed, but there is no indication that they will be reopened.) The hospital-conversion controversy in Michigan can be traced to a single event: the announcement in 1996 that Columbia/HCA would begin partnership negotiations with Lansing's Michigan Capital Medical Center (now Ingham Regional Medical Center). These negotiations received intense public and government attention. Public hearings were held in Lansing and around the state by the state attorney general (AG) and the state legislative health committees. The AG filed suit to stop the partnership, and the Ingham County circuit court ultimately ruled to prohibit it, stating that a for-profit company is not permitted to use nonprofit assets to make money. The court did not rule out conversion entirely, just joint ventures in which charitable and for-profit assets would be mingled. The Lansing hospital appealed the ruling but later, when some Columbia/HCA hospitals were accused by the federal government of defrauding Medicare, dropped both the appeal and partnership discussions.

In 1997 state legislation was introduced to oversee conversions. Senate Bills 743-46, introduced in October, are the most recent attempt to forge common ground among interested parties. House Bill 4500 also addresses hospital sales and conversions. At this writing, none of these bills has been reported out of committee. The urgency to address conversion issues may have subsided with the discontinuation of negotiations between Michigan Capital and Columbia/HCA in mid-1997.

Senate Bills 743-46 require conversion of nonprofit hospitals to for-profit status to obtain prior approval from both the Michigan AG and Michigan Department of Community Health (MDCH). In general, the bills' two major objectives are to

- preserve charitable assets in the community, and
- protect community members' access to quality health care.

To accomplish these objectives, the bills require

- mandatory public hearings on proposed sales;

- government review of the transaction, to ensure, among other matters, that fair market value is being obtained for the sale of the nonprofit hospital;
- that no private citizen will benefit from the sale;
- all proceeds from the sale (minus debt) to be deposited into a community foundation that will use them to continue the charitable purposes of the nonprofit hospital; and
- assurances that under for-profit ownership, the community's health care needs will continue to be met.

These bills reflect legislation introduced and passed in many other states. Community Catalyst, a Boston health-care advocacy organization, reports that as of September 1997, 35 state legislatures have introduced conversion legislation, and 19 have passed laws overseeing conversions, mergers, and acquisitions. Using 22 criteria, Community Catalyst has evaluated these laws by the extent to which they protect community charitable assets and health care access and quality. The range of scores is wide.

DISCUSSION

Debate on conversions centers on

- how to adequately preserve a nonprofit's charitable assets and purposes;
- how to maintain or improve people's access to care and the quality of care they receive; and
- whether conversion legislation should include nonprofit-to-nonprofit ownership changes.

The legal doctrine of charitable trust holds that charitable assets held in public trust—such as those of a nonprofit hospital—remain committed to the trust's purposes and uses. When a charitable corporation is dissolved, its assets must be transferred to one or more nonprofit organizations—often foundations—engaged in substantially similar activities.

The flurry of nationwide legislation on conversions stemmed from the fact that nonprofit hospitals and health plans in several states were negotiating sales,

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with little or no public scrutiny, to for-profit corporations. In some instances, board members and administrators of the converting nonprofits were receiving sizable financial benefit (private inurement) from the for-profit buyer, and in many, secret transactions were resulting in the nonprofit's charitable assets being diminished considerably. In some cases, nonprofit hospital sale proceeds were deposited in a foundation not always used for, as the legal doctrine of charitable trust holds, "substantially similar activities" to those carried out previously by the hospital. Often, the public and state government regulators were unaware that negotiations were occurring until a deal was completed.

Advocates for comprehensive conversion legislation argue that it is needed to protect the public's right to the nonprofit hospital's charitable assets. They call for the measures in the Michigan legislation—sale at fair-market value, public hearings, no private inurement, deposit of the proceeds into a foundation committed to carrying on the charitable purposes of the nonprofit hospital—and more. For example, they want to see strong *enforcement* of (1) the acquiring corporation's commitment that it will continue to deliver high-quality care to all members of the community and (2) the new foundation's commitment that it will carry out the former nonprofit hospital's mission.

Much of the concern about conversion stems from the belief that for-profit hospital chains are more beholden to their stockholders than to the communities in which they acquire nonprofit hospitals. Advocates for strict conversion laws contend that staffing cuts, discontinuation of necessary services, and even hospital closure frequently follow a for-profit's purchase of a nonprofit hospital. They argue that nonprofit hospitals are much more likely than for-profits to be committed to caring for the disadvantaged and improving the general health of the community—thus, strict laws are needed to protect the community's access to health care and the quality of the health care it receives.

While few opponents of conversion legislation are speaking out, some observers assert that worry about

for-profit hospitals is misplaced. For-profit hospital advocates contend that many times, a conversion will enhance the community's health. They argue that cutting staff and discontinuing certain services sometimes are necessary to increase efficiency and maintain a hospital's financial well-being. They believe that such steps can be taken without jeopardizing access to or quality of care, because the services that have been discontinued usually are available in another location nearby. They further contend that for-profits offer access to capital needed to modernize facilities that have become obsolete, and obsolete technology compromises care.

Some advocates for strong conversion oversight call for the buyers to submit to regulators a detailed community-benefits plan that spells out clearly how the buyer will maintain or enhance existing services—free care to those without health insurance, AIDS care, burn care, Medicaid, and others—necessary to meet the community's health needs, even if the services in question do not make a profit for the hospital. Such services are at the heart of what many believe is a nonprofit hospital's charitable mission.

Defenders of for-profit hospital practices respond that policymakers must not overlook the fact that for-profit entities pay taxes, and when taxes paid are counted as a community benefit, for-profit hospitals often in fact offer *more* community benefit than do nonprofit hospitals. In fact, some for-profit hospital executives—arguing that many nonprofit hospitals overstate their commitment to the community—believe that *all* hospitals should be required to publish a community-benefits plan. They point out that standardized community-benefit calculations will allow the public to properly compare hospitals; in this they are joined by many opponents of for-profit hospitals, who agree that public accountability for *all* hospitals is in a community's interest.

In Michigan, there is considerable debate over whether nonprofit-to-nonprofit hospital sales should be treated the same as nonprofit to for-profit conversions. Those who answer in the affirmative argue that—regardless of the tax status of the purchaser, which may not be

from the same community anyway—accountability for a community’s charitable assets demands that the transaction’s details be public and that a commitment to maintaining and enhancing access to and quality of care should be required. Otherwise, they say, there is nothing to prevent a nonprofit hospital from making a deal that is not in the best interest of the community it serves.

Opponents of such oversight for nonprofit to nonprofit purchases reply that they are unnecessary because nonprofit hospitals, whatever their differences, share a charitable mission to serve their community’s health needs. They add that nonprofit hospitals currently are governed by myriad state and federal statutes that regulate mergers and acquisitions.

Senate Bills 743–46 do not cover nonprofit-to-nonprofit conversions, but there has been considerable discussion about introducing a separate package of bills that does. Earlier in the session, some bills had been introduced that did not distinguish between types of conversion, but they were superseded by SBs 743–46.

A more general question concerns the extent to which government should oversee conversion transactions. Among states there is a wide range in oversight and monitoring. Some require only that the seller and buyer notify the state regulator of the proposed transaction; public comment and government approval are not mandated. Other states have proposed or passed much more comprehensive legislation, believing that only by doing so can the public be protected.

See also Health Care Costs and Managed Care; State Government Debt.

FOR ADDITIONAL INFORMATION

Community Catalyst
30 Winter Street
Boston, MA 02108
(617) 338-6035
(617) 451-5838 FAX

Committee on Health Policy and Senior Citizens
Michigan Senate
P.O. Box 30036
Lansing, MI 48909-7536
(517) 373-0793
(517) 373-5607 FAX

Federation of American Health Systems
1111 19th Street, N.W.
Washington, DC 20036
(202) 833-3090
www.fahs.com

Metro Health Foundation
333 West Fort Street, Suite 1370
Detroit, MI 48226-3134
(313) 965-4220
(313) 965-3626 FAX

Michigan Department of Attorney General
Law Building, 7th Floor
P.O. Box 30212
Lansing, MI 48909
(517) 373-1110
(517) 373-3042 FAX
www.ag.state.mi.us

Michigan Health & Hospital Association
6215 West St. Joseph Highway
Lansing, MI 48917
(517) 323-3443
(517) 323-0946 FAX
www.mha.com