

## PE Investment In NY Hospitals — The Pilot And Politics

*Law360, New York (March 27, 2014, 1:45 PM ET)* -- Should private equity play a bigger role in New York state health care facilities? This is the question facing New York state legislators for the second year in a row.

Historically, investor-owned corporations have been essentially prohibited from owning and operating health care facilities in the state. Gov. Andrew Cuomo's proposed 2014-2015 budget and associated legislation would authorize a two-year private equity pilot program.[1]

Under the governor's proposal, up to five for-profit corporations, subject to approval by the Public Health and Health Planning Council, would be able to participate in the pilot. Eligible corporations are ones affiliated with an academic medical center or teaching hospital.

Publicly traded entities and private corporations with more than 35 stockholders would be prohibited from participating. Participating corporations would be eligible for debt financing from the Dormitory Authority of the State of New York and development corporations.

Ultimately, the pilot seeks to support a restructuring of health care delivery systems by allowing for increased capital investment in facilities. It is also a response to the troubling fiscal environment hospitals and other health care facilities are facing in New York: According to the Healthcare Association of New York State, the average operating margin for New York hospitals is 0.89 percent. Since 2000, 35 hospitals have closed and the pace of closure is accelerating.[2]

While it will not be the state's first venture into expanded private ownership of health care facilities — an exception was granted, in recent years, to certain centers for dialysis services — authorization for the new pilot is far from guaranteed. A similar program appearing in the 2013-2014 budget legislation proposal was steadfastly rejected by some legislators, particularly in the Assembly, and dropped from the final budget plan. That pilot would have allowed for ownership of up to two hospitals, one of which had to be located in King's County (Brooklyn), by up to two for-profit corporations (private or publicly traded).[3]

This year, the Senate has once again included a private equity pilot in its one-house budget bill. The Senate proposal moves beyond the governor's proposal and expands the number of corporations that may participate in the program from five to 10, as well as increasing the demonstration time frame from two years to five years.

The Assembly has once again excised the pilot program from its version of the bill. All three bills incorporate a secondary proposal to establish a \$1.2 billion capital access pool over seven years, albeit with varying provisions regarding process and the types of facilities eligible for participation.

Is it possible that changes from last year's legislative approach will garner greater acceptance from New York lawmakers? The main departures from the 2013-2014 proposal are the increase in the number of pilot projects, the exclusion of publicly traded entities, and the inclusion of a 35-stockholder limit.

Last year's Senate bill, while similarly authorizing up to 10 demonstrations, actually proposed two approaches, one of which included a ban on participation by publicly traded corporations. Moreover, many features of the pilot intended to address concerns about for-profit investment are simply carried over from last year's proposal. This includes provisions such as the academic center affiliation and a requirement that directors and officers of participating corporations consider the effects of "any action" on aspects such as the interests of patients and employees, and "community and societal considerations," in addition to the interests of shareholders.

Despite these potential safeguards, last year's effort foundered after a prominent Manhattan Assemblyman opposed the program, aligning with the position taken by the New York nurses' union on the prior pilot program. At the same time, however, this new legislative proposal follows another year of continued problems for New York hospitals — problems for which a \$1.2 billion capital pool may provide an incomplete solution.

The state's final budget is due April 1. If an agreement is reached over the course of negotiations and a version of the pilot is ultimately included, Public Health Law § 2801 will be amended so as to relax ownership and operation restrictions for program participants.

Public Authorities Law §§ 1676 and 1680, on DASNY, will also be amended. Significant authority over the program will rest with the commissioner of health. The commissioner will be the one to establish the program and its associated regulatory framework, such as the extent of required affiliation with academic medical centers or teaching hospitals.

For participating corporations, any transaction involving all or substantially all of its assets will be subject to the commissioner's approval. The commissioner will also be responsible for providing the New York Senate and Assembly with a final evaluation that assesses the pilot's effectiveness in increasing access to capital investment and its impact on the quality of care provided by facilities.

How will private equity firms react to this potential opportunity? This clearly is an opportunity for distressed-situation health care investors to apply the lessons we have seen put into good effect in other states recently — redesign care systems, apply financial discipline, improve hospital performance metrics and start building toward value-based reimbursement incentives that health care reform embraces.

Possible models exist as nearby as the state next door. In 2012, Texas-based LHP Hospital Group Inc. and Hackensack University Medical Center partnered to purchase and operate two struggling community hospitals in New Jersey (HackensackUMC Mountainside and HackensackUMC at Pascack Valley).

As previously mentioned, approval of corporations to participate in the pilot would rest with the Public Health and Health Planning Council, an entity tasked with advising the commissioner, as well as a broad array of decision-making responsibilities in relation to the health care delivery system.

If New York moves forward with the program, how closely will the council and interested for-profit corporations align on pilot facilities? While the current proposal does not expressly identify specific sites, it is anticipated that Brooklyn will continue to be a priority target for the council given the large number of struggling hospitals there. In recent years, however, a series of efforts to restructure health care services in the borough have been met with resistance, stalled discussions and legal battles. Will this history deter private equity investors?

For private equity funds considering this investment opportunity but that have not been health care services industry investors previously, the general uncertainty of investment during health care reform is heightened by the New York political considerations surrounding this private equity pilot program. This is a very limited pilot program, and the terms and potential exit opportunities remain unclear at this time.

Can a private equity fund have enough certainty of sufficient return being generated to fund a buy-back to occur in a reasonable investment time frame? Will the pilot program rules allow a sale by a participating private equity fund to a subsequent for-profit investor? Also, will the pilot program be subject to lawsuits due to only allowing investors that are not public companies or broadly-owned private companies — what is the difference from a legal point of view between a publicly traded hospital company and a private equity fund as an investor? A dollar of investment is a dollar, after all, and it may be difficult to argue that private equity funds are inherently better stewards or operators than some of the publicly traded or larger privately held hospital companies.

Given the size of the New York health care market and its high barriers to entry to date, these developments are well worth watching closely.

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[1] §§ 12-14 of the Health and Mental Hygiene chapter relate to the private equity pilot. The full Health and Mental Hygiene text is available [here](#).

[2] HANYS testimony before a joint legislative hearing on the 2014-2015 Budget (and the source of these figures) is available [here](#).

[3] For coverage on the 2013-2014 pilot and politics, the New York Times has a good article.