



Case Law

Striking the Deal: Legal Considerations on Structuring Shared-Service Arrangements

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ospitals, by reason of either provincial direction or fiscal necessity, are increasingly interested in exploring new means of pooling their collective resources.

FIRST STEPS

1. DEFINE OBJECTIVES

Where does a hospital start when it wants to rationalize services or “partner” with one or more service providers? The first step for a hospital is to clearly define its objectives and its “non-negotiables.” What is the goal? It may be to achieve cost savings, improve service standards or obtain access to previously unavailable resources. In the twists and turns of negotiating a partnership or joint-service arrangement, it is easy to lose sight of the original objectives. It is extremely helpful to have all the players involved on behalf of the hospital- (i.e. staff, legal council and financial advisors) understand the goal to ensure that whatever structure is selected, the goal is achieved.

2. COMMUNICATE THE “DEAL BREAKERS”

It is equally important to define the “non-negotiables.” These are the elements of the deal that cannot be compromised or sacrificed. In legal jargon, these are often referred to as the “deal breakers.” For example, if the service must be on site, have certain management controls or involve a minimum time commitment, then these principles need to be communicated to the other players early in the negotiations.

3. ENSURE THERE IS A “MEETING OF THE MINDS”

Successful business deals begin with what is referred to as a “true meeting of the minds.” This means that all parties to the deal understand and share a common objective and are prepared to achieve that objective in a way that accommodates the other parties’ “non-negotiables.” At this stage - and assum-

ing that the business case is met and can continue to be met - the parties are ready to select a structure to implement their deal. The parties are now able to begin to contemplate which structure will best meet their needs.

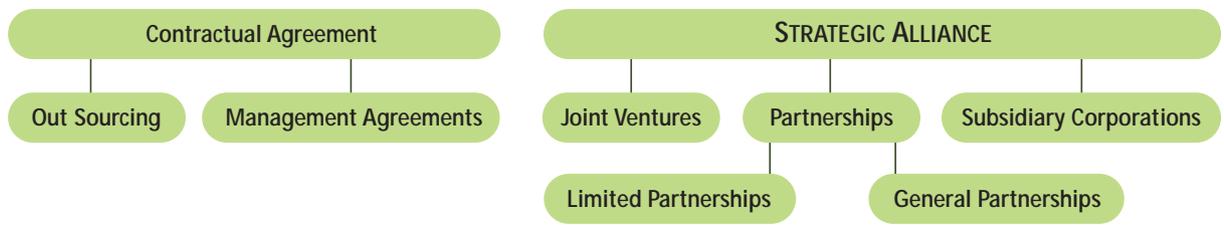
FACTORS TO CONSIDER IN SELECTING THE OPTIMAL RELATIONSHIP

There are a number of factors that a hospital will take into account in determining which structure is best suited to its objectives. Depending upon the specific business activity that is proposed, a hospital may give a lesser or greater weight to these factors. Selecting the most appropriate structure often involves trading off various advantages and disadvantages of each of the structures. Factors that are commonly taken into account include the following:

1. THE RISK FACTOR

If the activities of the joint venture or strategic alliance are likely to expose the hospital to increased risk of liability either because the hospital no longer has complete control over the quality of the activities undertaken or because there will be an increased volume of activity, then the hospital may be more inclined to choose a structure that will limit its liability. A hospital which wishes to minimize its liability risks may prefer to structure its strategic alliance through a subsidiary corporation. The liability of a subsidiary corporation that undertakes an activity is limited to the assets of that subsidiary corporation. All of the risks of the strategic alliance are confined to the assets of the subsidiary corporation. The “owners/shareholders” do not have any liability for the activity of the corporation. In this way, the hospital can “insulate” hospital assets from the activities of the subsidiary corporation.

Partners are, however, liable for the activities of a general partnership. The liability of participants in a strategic alliance or joint-venture contract would also be unlimited. Liabilities



The spectrum above illustrates the primary options available to a hospital which desires to enter into a shared-service or joint-venture arrangement in order to rationalize its activities and become a more efficient service provider.

under contractual arrangements would depend on the terms of the contract and what has been agreed to be contributed.

Selecting a subsidiary corporation does, however, have its own disadvantages, as in most cases the subsidiary corporation would be a tax-paying entity. Hospitals, as charitable organizations, are exempt from taxation. A new venture held directly by the hospital (as is the case with most general partnerships) would allow the corporation to maximize the financial return from the strategic alliance.

2. CHARITABLE STATUS

Hospitals are registered charities under the Income Tax Act. Accordingly, a hospital will wish to ensure that the nature of the new activity and its scope does not jeopardize the hospital's status as a charity.

3. MANAGEMENT DECISION MAKING

If the hospital should decide it wishes to enter into a form of strategic alliance, the parties should clearly define in writing their respective rights and obligations with respect to the management of the proposed venture. Each structure will involve some type of contract or agreement which will allow the hospital to ensure that it has an appropriate voice in management decisions. For example, a management contract or outsourcing arrangement would have certain limits or parameters on the authority of the other party to make decisions which have an impact on the affairs of the hospital. In some cases, decisions may only be made with the consent of certain corporate officers of the hospital.

The management decision-making authority of a joint venture or strategic alliance would also be documented by an agreement. There may be a management committee set up to run the affairs of the joint-venture and, through the joint venture agreement, the hospital could ensure that it had appropriate representation on that management committee or that certain decisions of the management committee could only be made with the consent of the hospital.

Similarly, both a partnership and a limited partnership would be documented by a partnership agreement. Often the

partnership agreement will call for the creation of a management committee with decision-making authority that is substantially similar to the decision-making authority of a board of directors. The hospital may have representation on this decision-making body or may simply have the ability to consent to certain types of decisions that are made.

Lastly, a shareholders' agreement is often entered into to govern the decision making of a subsidiary corporation. Once again the hospital may choose to have representation on the board of directors of the subsidiary corporation, thereby ensuring that it has a voice in all key decisions, or it may require that certain decisions can only be entered into with the consent of the shareholders or with a specified majority vote of the shareholders.

In summary, no matter what structure is chosen, all structures have sufficient flexibility to allow the hospital to ensure that it exerts the degree of authority and influence in the decision making and management of the affairs of the joint venture/strategic alliance that it feels is necessary and appropriate in the circumstances.

4. REPUTATION

All hospitals are concerned about their reputations. When a hospital proposes to get into a venture with a new partner it will wish to be assured that there will be no risk to the hospital's reputation. Accordingly, hospitals usually conduct thorough investigations into the background, financial stability and reputation of their proposed new "partner." In a legal sense this investigation is often referred to as "due diligence." Hospitals usually engage in a review of both the validity of the business case for the new venture and the stability and reputation of the other parties to the venture in order to be assured that the venture will be a success. It is best to begin this investigation as early in the process as possible.

The boards of directors of hospitals take a very keen interest in ensuring that they preserve the reputation and confidence of the hospital in the eyes of the community and should be very rigorous in the standards that they apply to their proposed new partners.

5. IMPACT ON EMPLOYEES

Hospitals are also very concerned to ensure that their staff are treated appropriately. Accordingly, if the proposed venture will involve a transfer of employees to a new employer (even if that employer is a subsidiary corporation of the hospital) or any terminations or layoffs, careful planning must be done to ensure that the treatment of all staff is consistent with the hospital's general employment policies and practices. It is also important to make sure that the new structure will allow for staff who are transferred to a new employer to continue to be treated in a manner that is satisfactory to the hospital. Once again, early planning around human-resource issues will save time and trouble when the proposed venture is brought to the board for approval.

6. BOARD APPROVALS

The board members of not-for-profit corporations like hospitals are subject to certain fiduciary duties in making decisions with respect to the affairs of the institution. Board members are required to act honestly, in good faith and in the best interests of the hospital. Because hospitals are publicly funded and provide an essential service to their communities, boards of public hospitals often consider the "public interest" in their decision making. Accordingly, it is not uncommon to see hospital boards apply a very high and rigorous standard to business proposals that are brought before them. It is important that this high standard of decision making be communicated to the other parties to the venture at an early stage. Board members of public hospitals are often not prepared to allow the hospital to take risks with the affairs of the hospital, even though they might consider the risks to be prudent and reasonable if they were to be considered by a business corporation. Early education of the private-sector partners on the decision-making process of a public hospital board can be very helpful in ensuring that the protections which the hospital seeks to include in the agreement are given serious consideration by the private-sector partner.

CONCLUSION

Joint-venture and "partnering" arrangements whether they be with other hospitals or the private sector, provide opportunities for hospitals to decrease costs, thereby making more of their resources available for their "core business," which is patient care. In today's fiscal climate, it is inevitable that hospitals will seek to enter into such arrangements. Because strategic alliances and partnering arrangements are outside the "core business" of a hospital, hospital management often lacks the resources and skills to quickly and efficiently implement such arrangements. Particularly where hospitals are partnering with the private sector, hospital management may find that it is outmatched by the proposed new partners, who come to the deal from a corporate business sector where deal making is

part of the core business. Hospital management need not be disadvantaged in these arrangements. It is important that the "deal" not be driven by the structure, but rather by the objectives, of the parties. All workable structures should provide for sufficient flexibility to allow the hospitals to ensure that their objectives are met without compromising their non-negotiables. Provided that a hospital clearly understands its objectives, its non-negotiables and the advantages and disadvantages of the various structures that are available, hospital management will be well positioned to implement successful joint-venture and partnering arrangements. 



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