NATIONAL ASSOCIATION OF
Community Health Centers®

The Board's Role in Evaluating and Implementing Corporate Consolidation Strategies

In recent years, an increasing number of health centers have consolidated operations with other community providers.[1] For example, many health centers have merged with other nonprofit organizations. Health center boards play an important role in evaluating corporate consolidation strategies. As described in the National Association of Community Health Center's (NACHC) **Governance Legal Brief 4: The Board's Role in Evaluating Collaborative Relationships**, health center board members are the "eyes," "ears," and "voice" of the community and the board is responsible for overseeing the health center project. Accordingly, the board is critical in determining whether a corporate consolidation is consistent with the health center's mission and long-term strategic goals.

This brief document:

- Describes common corporate consolidation goals and rationale.
- Explains corporate consolidation models.
- Examines the board's role in evaluating corporate consolidation by assuring:
  - the health center will still operate in accordance with its mission;
  - the corporate consolidation aligns with the health center's long-term strategic plan;
  - the corporate consolidation does not jeopardize the health center's assets; and
  - the transaction complies with federal and state laws, regulations, and guidance. This includes the Health Center Project statute, implementing regulations, and guidance issued by the Health Resources and Services Administration (HRSA) and the Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (the "Health Center Project Requirements").
- Highlights key decisions that must be approved by the board, including "change in scope of project requests" and "Successor-in-Interest requests," as described below.

1 There are various reasons for this trend including rising competition and the growing emphasis on comprehensive and integrated service delivery.

CORPORATE CONSOLIDATION GOALS

A health center's strategic goals set the foundation for the corporate consolidation strategy. Typical examples of corporate consolidation goals include:

- Expand the amount and type of services available, such as specialty services that enhance the continuum of care and reduce service gaps;
- Enlarge patient base and target populations;
- Enhance and improve operations by integrating administrative and management functions;
- Achieve cost savings by consolidating the workforce;
- Maximize and enhance revenue;
- Enhance managed care participation by obtaining entry into health plans and networks; and
- Expand access to important safety net services, such as employment and housing support.

CORPORATE CONSOLIDATION MODELS

There are generally three corporate consolidation models. They are corporate merger, asset acquisition, and the parent-subsidiary relationship. This section describes each model.

State law dictates the process to implement a corporate consolidation strategy. Thus, it is important to consult attorneys at the beginning of the planning process. The attorneys can help the health center identify and assess its specific corporate consolidation options, highlight each option's advantages and disadvantages, and outline the process to achieve implementation.

Merger: Where two corporations combine their operations, with one corporation functioning as the "surviving" corporation. The surviving corporation automatically assumes all of the assets and rights and liabilities of the "merged out" corporation. Post-merger, there is one board of directors that oversees the consolidated entity. Mergers are implemented through a written plan of merger agreement (or similar document, as established by state law).

If the health center would like to merge into another corporation, then HRSA must approve the transfer of the health center's Health Center Program award to the surviving corporation.[2] For more information, see the **HRSA Technical Assistance Resource: Health Center Mergers, Acquisitions and Other Organizational Changes and Related Successor-in-Interest Requests** and the section below entitled **Corporate Consolidation Strategies that Change the Health Center's Organizational or Corporate Status**.

Asset Acquisition: Where one corporation acquires part of another corporation's assets. Assets can be supplies, equipment, property, etc. that are necessary to operate specific lines of business (for example, outpatient primary care). The acquiring corporation is the "transferee" and the corporation that sells or otherwise transfers its assets is the "transferor." The transferor corporation typically does not dissolve. Instead, it retains its other lines of business that are not acquired by the transferee corporation.[3] Similar to a merger, the process to implement an asset acquisition is governed by state law.

2 As an alternative to transferring the Health Center Program award to the surviving corporation, the health center could relinquish its award prior to the end of the project period. See 45 CFR 75.372 for further details regarding relinquishment (also referred to as "voluntary termination" of awards).

3 The parties may seek to establish the transferor as a subsidiary to the transferee, as described below, subject to state law.

It is common for a health center to acquire another corporation's assets because it wants to expand the health center's scope of project. For example, health centers frequently acquire assets to add new behavioral health and/or pediatrics sites. Asset acquisitions often include the transfer of certain staff from the transferor to the transferee.

Asset acquisitions raise unique and significant legal considerations regarding health care fraud and abuse laws. It is very important for the health center to consult with counsel to ensure the transaction is compliant with such laws. For instance, the health center should consult with counsel when identifying the asset purchase price.

Parent-Subsidiary Model: Where one corporation is the "parent" of the other corporation (i.e., the "subsidiary"). The parent corporation retains certain controls over the subsidiary but the subsidiary maintains its own governing board. The specific controls that the parent corporation can retain over the subsidiary are defined by state law. For example, these controls may allow the parent entity to: (1) become the sole voting member of the subsidiary, and/or (2) have the right to appoint the directors of the subsidiary corporation.

A parent-subsidiary relationship can typically be established by amending the subsidiary corporation's articles of incorporation and bylaws. Note that if the health center is the parent entity, then all services rendered by the subsidiary would be **outside** the health center's HRSA-approved scope of project.

Can a health center be a subsidiary to another corporation?

Technically, this is possible. However, it is often very hard for a health center to operate as a subsidiary and still comply with the following HRSA requirements:

(1) The health center's organizational structure and documents must not allow any other individual, entity, or committee (including, but not limited to, an executive committee authorized by the board) to reserve approval authority or have veto power over the health center board with regard to the board's required authorities and functions.

(2) The health center bylaws and other relevant documents must not permit any other entity, committee, or individual (other than the board) to select either the board chair or the majority of health center board members, including a majority of the non-patient board members.

These requirements are described in the below section, **Protecting the Autonomy of the Governing Board**.

BENEFITS AND RISKS

Corporate consolidation can help a health center expand its scope of services, patient base, and penetration in the community. However, it also presents significant and unique legal and financial risks. Furthermore, corporate consolidation strategies are very difficult, if not impossible, to unwind. Consequently, a health center should not implement a corporate consolidation with another health care entity until the opportunity has been thoroughly evaluated. This includes an in-depth assessment of the clinical, operational, financial, and legal implications.

While health center executive management and attorneys coordinate the day-to-day evaluation and planning for a corporate consolidation strategy, the health center board should be updated regarding the transaction's status. Updates should be periodic and upon request.

THE BOARD'S ROLE IN EVALUATING AND APPROVING CORPORATE CONSOLIDATION STRATEGIES

Overseeing the Health Center Program Project and Assuring Compliance

Chapter 19: Board Authority of the **Health Center Program Compliance Manual** (the "Compliance Manual") states that the board must oversee the Health Center Program project. This includes conducting long-range/strategic planning and assuring that the health center is operated in compliance with applicable federal, state, and local laws and regulations. In addition, the board has a fiduciary responsibility to safeguard the health center's assets. For these reasons, it's important for the board to closely review a corporate consolidation opportunity **before** it is implemented.

Board members should ask these 15 questions when reviewing a corporate consolidation opportunity:

1. Do the organizations have aligning missions and long-term strategic plans?
2. Will this enhance patient access, service continuity, and/or freedom of choice?
3. Will this contribute to the health center's survival and growth?
4. Will this impact how the health center defines its service area?
5. Does this present any financial risk to the health center?
6. If we are considering an asset acquisition, is there a fee?
7. Will this mean the health center assumes the other entity's liabilities? If so, what are those liabilities?
8. Will this mean the health center assumes the other entity's assets? If so, what are those assets?
9. Will the health center need to take on any grants (local, state, and/or federal) from the other entity? If so, what is the process to transfer such grant(s) to the health center?
10. How will this impact the health center's scope of project? Will we need to get prior approval from HRSA for a "change in scope of project"?
11. Will this impact the health center's articles of incorporation and/or bylaws? If so, how?
12. Will this impact any of the health center's board-approved policies and procedures? If so, how?
13. Will this impact the health center board's composition and/or authorities? If so, how?
14. Is this consistent with federal, state, and local laws, regulations, and policies, including but not limited to the Health Center Project requirements?
15. Has this strategy been assessed by qualified counsel? Is the counsel submitting the necessary forms to the applicable state agency? Do we also need accountants to assess this strategy? If so, has that happened yet?

Assessing Alignment of Mission and Vision through Cross Board Collaboration

Assessing whether the health center and the other corporation have aligning missions, cultures, and long-term strategic plans can be challenging. Cross-board collaboration can be an effective way to overcome such challenges. Specifically, consider the following:

- Coordinate a meet-and-greet event for board members from both corporations. One board member from each corporation provides a brief presentation that highlights their corporation's history, mission, scope of services, and long-term strategic plan.
- Establish a joint ad hoc committee composed of board members from both corporations. This committee meets periodically to discuss the status of the corporate consolidation planning process. Committee members also provide input to their respective boards and management teams about the planning process, as applicable.

PROTECTING THE AUTONOMY OF THE GOVERNING BOARD

Chapter 19: Board Authority and **Chapter 20: Board Composition** of the **Compliance Manual** include specific requirements that ensure collaborative relationships (including corporate consolidation strategies) do not undermine the autonomy and integrity of the health center and its independent board. Specifically, the Compliance Manual includes the following requirements:

- **Board Authority**:[4] The health center's governing board must maintain the authority to oversee of the Health Center Program project. Specifically:

  - The health center's organizational structure and documents must not allow any other individual, entity, or committee (including, but not limited to, an executive committee authorized by the board) to reserve approval authority or have veto power over the health center board with regard to the board's required authorities and functions.
  - The health center's collaborative relationships and agreements must not restrict or infringe upon the health center board's required authorities and functions.

- **Board Composition:**[5] The health center's bylaws and other relevant documents must not permit any other entity, committee, or individual (other than the health center board) to select either the board chair or the majority of the health center board members, including a majority of the non-patient board members.

Pay special attention to these requirements if the other corporation wishes to appoint health center board members and/or maintain certain controls over the health center's operations.

The **HRSA Technical Assistance Resource: Health Center Mergers, Acquisitions and Other Organizational Changes and Related Successor-in-Interest Requests** includes the following:

Decisions regarding changes to a health center's organizational or corporate status are the sole responsibility of the health center's governing board. In making these decisions, the board should carefully consider the impact of the changes on potential eligibility for continued Health Center Program funding.

ELEMENTS OF CORPORATE CONSOLIDATION THAT REQUIRE THE BOARD'S APPROVAL

Most of the time, whether and how the health center board must formally approve a corporate consolidation is defined by state law. It is also defined by the health center's articles of incorporation, bylaws, and internal policies and procedures.

4 Excerpt is from Compliance Manua, **Chapter 19: Board Authority,** Demonstrating Compliance, a.
5 Excerpt is from Compliance Manual, **Chapter 20: Board Comosition,** Demonstrating Compliance, a.

There are a few scenarios where HRSA requires the health center board to formally approve a corporate consolidation **before** implementation. The scenarios generally include:

Changes in Scope of Project

Corporate consolidation strategies often impact the health center's scope of project. For example, a corporate consolidation might add a new service and/or a new site to the health center's scope. In this scenario, the health center must submit a Change in Scope (CIS) request to HRSA and obtain HRSA's approval **before** implementing such change(s). Prior to submitting the request, the board must:

- Review the CIS application and the **HRSA Change in Scope Assurances**; and
- Formally approve the CIS request **and** document this approval in board minutes.

Corporate Consolidation Strategies that Change the Health Center's Organizational or Corporate Status

Certain corporate consolidation strategies change the identity of the HRSA Health Center Program award recipient. This change occurs if: (1) a health center mergers into another corporation or (2) a health center transfers its assets which are involved in the performance of the Health Center Program award to another corporation.

HRSA will not transfer a grant to the other corporation unless and until HRSA approves of the new Health Center Program award recipient, which is referred to as the "Successor-in-Interest" (or SII).[6] Accordingly, HRSA approval must be obtained before the corporate consolidation is implemented if the corporate consolidation changes the identity of the HRSA Health Center Program award recipient.

The **HRSA Technical Assistance Resource: Health Center Mergers, Acquisitions and Other Organizational Changes and Related Successor-in-Interest Requests** has detailed application instructions for requesting a Health Center Project grant transfer to a SII. A key step to the application process includes that the health center board must approve of the consolidation and the change in the Health Center Program award recipient.

The SII process requires frequent communication with HRSA Project Officer(s) and Grants Management Specialist(s). It is significantly more time consuming than the CIS request process described above. Both corporations must submit a complete application to HRSA **at least six months before** the p roposed transfer of the Health Center Program award.[7]

CONCLUSION

The health center board plays an important role in corporate consolidation.

Corporate consolidation with another community provider often expands the health center's scope of project, modifies the health center's long-term strategic plan, and impacts the health center's finances and assets. The board should assure that corporate consolidation strategies are: (1) evaluated extensively, (2) well-coordinated, and (3) implemented in a manner consistent with federal and state laws, regulations, and guidance, including but not limited to the Health Center Project Requirements, HRSA Section 330-Related Requirements, and other applicable laws. Importantly, the board's formal approval is required by HRSA if the corporate consolidation triggers the need for a CIS or the transfer of a Health Center Program award.

6 This section does not apply to health center look-alikes.

7 Please refer to the **HRSA Technical Assistance Resource: Health Center Mergers, Acquisitions and Other Organizational Changes and Related Successor-in-Interest Requests** for details.

Health centers should seek the assistance of qualified legal counsel and other appropriate professional advisors when developing, evaluating, and implementing corporate consolidation strategies. Corporate consolidation strategies can yield great results for a health center. However, the board must exercise appropriate direction and oversight for a corporate consolidation to be successful.[8]

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8 Boards may also find the resource **Mergers and Acquisitions: A Practical Guide for Community Health Centers by the California Health Care Foundation to be helpful in thinking through board dynamics post corporate consolidation, stakeholder communication, among other issues.**