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Happily Ever After: Strategies to Create Lasting Relationships and Avoid Heartbreak in Your M&A Deals

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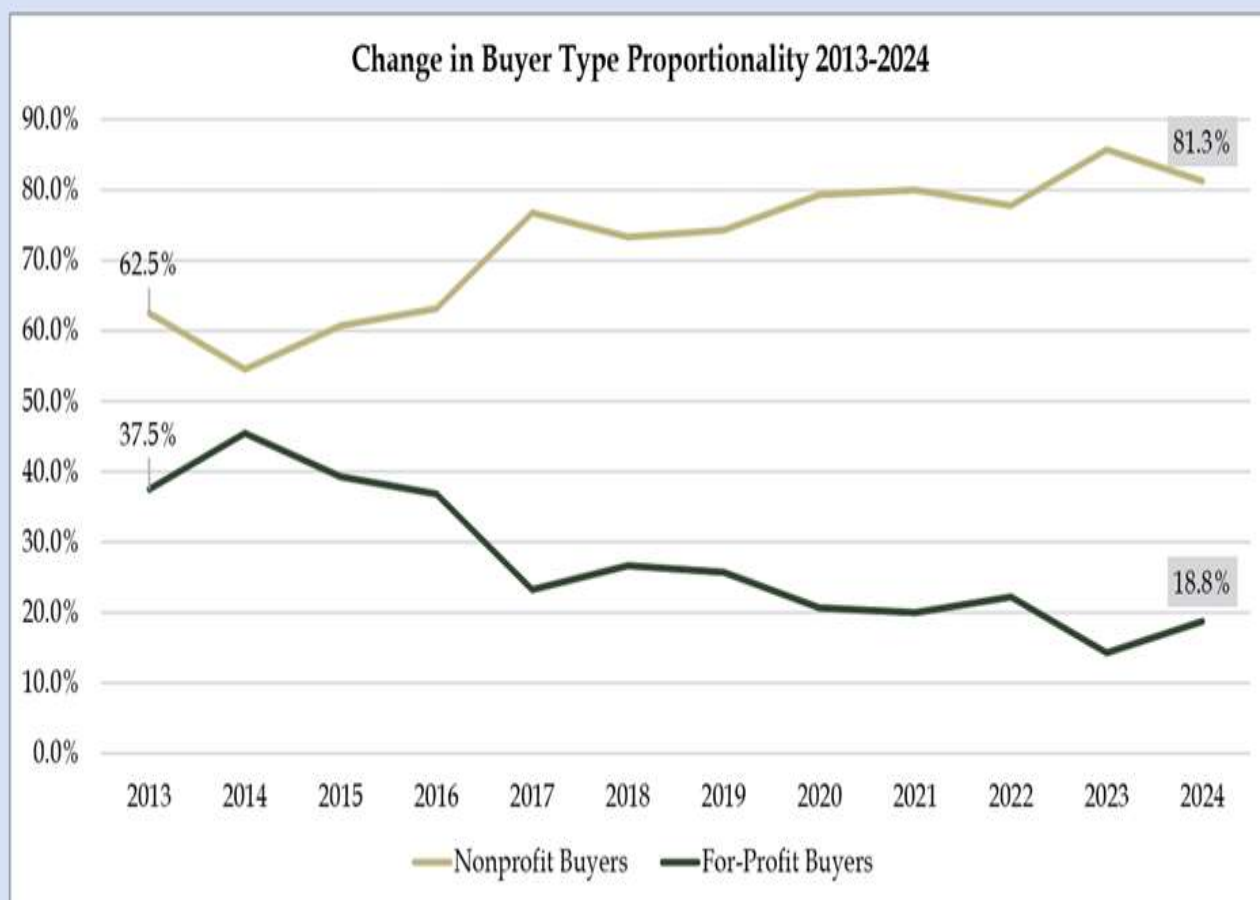
The health care landscape is currently under significant pressure due to various macroeconomic factors, including inflation, the lingering implications of the COVID-19 pandemic, and unfavorable credit markets.¹ As the shift from commercial to Medicare reimbursement continues, providers are

compelled to increase efficiency.² Simultaneously, the health system and hospital industry require substantial investments in infrastructure, equipment, integrated technology, and other areas to meet the needs and expectations of tech-savvy, mobile, and demanding patients.³

As a result, more health systems and their boards of trustees are exploring whether mergers, acquisitions, and partnerships (MAPs) can ensure their organizations' long-term sustainability. This expansion can be crucial for systems to meet community needs and fulfill their overall mission in the future. This trend is evidenced by the rising number of provider MAP transactions, with the majority of announced hospital and health system deals involving a not-for-profit organization acquiring another entity.⁴

NONPROFITS' SHARE OF ACQUISITIONS *trends over time*

- Widening difference in acquisition success
- As for-profits have exited the sector, nonprofits have become a larger proportion of the buyer pool and have become increasingly commercially oriented



Source: Juniper Advisory, Scope Research, transactions with reported consideration

This article delves into the optimization, design, and leadership of the MAP process to ensure that rational partnerships and mergers are executed in a way that bolsters an organization's long-term sustainability. It emphasizes the importance of fostering and enabling key relationships among primary stakeholders to flourish. It also explores strategies for maneuvering through the enhanced federal and state regulatory frameworks that health systems must navigate to successfully implement a MAP. Our focus is on the “art of the deal” and tips for avoiding pitfalls that can derail even the most well-intentioned, mission-critical strategic transactions.

Fundamentals of Strategic Transactions

Anatomy of a Deal: Tips for Deal Success

As experienced health care legal and financial advisors to hospitals and health systems seeking to structure and complete mergers, affiliations, and system consolidations, the authors have developed valuable insights and best practices. These practices ensure that the parties involved in a transaction can create a durable, yet appropriately flexible, framework to achieve their strategic goals and establish a successful, long-lasting relationship. Key areas include a structured process to identify and achieve milestones within an agreed timeline, alignment on the culture and vision for the combined enterprise, and effective, transparent communication and collaboration.

Parties should have a genuine “meeting of the minds” regarding the deal terms and a realistic strategy for the ultimate implementation of the relationship. Knowledgeable advisors should lead and guide the structuring and documentation of definitive agreements. They should also conduct due diligence, navigate the regulatory process, fulfill closing conditions, and maintain comprehensive transaction records.

This article provides recommendations for establishing a solid foundation for alignment on transaction structure, terms, and vision. It also promotes a productive and collaborative relationship among principals and deal team members, facilitating the management and finalization of transformative health care partnerships and consolidations.

Vision/Common Ground/Mutual Goals

There is no question that consolidation and partnerships in health care are driven by external and industry pressures on providers. These pressures compel providers to maintain and improve quality, access, and innovation for patients. At the same time, they must manage and control costs while adhering to a stringent regulatory framework. That's why it is essential for the parties involved in a MAP to first take a step back and build a common vision with guiding principles that support the intrinsic rationale for the proposed transaction.

It is crucial to quickly build immediate consensus to focus the deal team on the relationship's purpose and significance. Beyond that, it is important to develop the narrative for the deal rationale and procompetitive benefits that will be shared with communities, patients, employees, regulators, and other stakeholders. Growth for the sake of growth is generally not a sufficient basis to build the

consensus and support necessary to drive deals to completion or overcome regulatory scrutiny. A meaningful and compelling basis for the transaction should be established at the outset and should remain the guiding star through the closing of the deal and beyond.

Build Relationships: Create Alignment, Cultural Compatibility

Like most relationships, chemistry and compatibility are crucial to the success of a consolidation transaction. This cultural alignment often forms the initial foundation for entering the relationship and continues to be tested and challenged throughout the negotiation, diligence, and closing process. Transparency and effective communication can help the parties build consensus, reinforce their mutual goals and perspectives, and familiarize each other with their respective cultures and leadership styles. Practical steps to achieve alignment and cultural compatibility include forming deal teams that are aligned with the goals of the parties, preparing guardrails for potential conflicts, and maintaining a collaborative tone throughout the process.

Close collaboration and a positive working relationship between parties and their advisors are essential for transactions to proceed efficiently and effectively. It is strongly recommended that health systems seek knowledgeable and experienced support for these complex and highly regulated transactions. The deal team should include participants dedicated to the deal's success and achieving the parties' joint objectives. Turf wars between or among law firms and consultants, or aggressive posturing among deal team members, can destabilize a deal and undermine the broader relationship. While zealous representation and protection of client interests are encouraged, the focus should be on solutions and resolving issues to align with mutual goals. Successful transactions involve collaborative internal legal and business teams, a supportive relationship among deal team members, and respect for the roles and perspectives of all participants.

Parties should anticipate and prepare for tensions during major strategic negotiations by implementing mechanisms to detect and de-escalate conflicts. These mechanisms can include routine and periodic face-to-face meetings, social interactions, and encouragement of socialization and visualization of potential benefits. Fostering relationships between key decision makers in less structured environments can be beneficial, though such interactions should be managed with appropriate guardrails and include a process to document and formalize any resulting understandings or agreements.

In health care MAPs, maintaining a collaborative and civilized tone is crucial, as these transactions often involve charitable or community-based assets, leading to passionate discussions about an organization's future or legacy. Organization leadership should foster open communication, explore win-win outcomes, acknowledge shortcomings, and listen with humility to enhance relationships and create long-term goodwill. Avoiding a toxic negotiating approach is essential, as behaviors like bullying, impatience, and passive-aggressiveness can damage key relationships. Instead, emphasize the mission, benefits, aspirations and value of the MAP, conduct routine check-ins with key leaders, provide timely updates of developments and issues as they arise, and ensure respect and collaboration among all members of the deal team.

Permanence

At the beginning of transaction discussions, the parties' goal is almost always to create a durable and lasting relationship. Completing complex health care transactions requires a significant investment of time and resources. These deals are generally approached with the expectation of forming a solid and incrementally beneficial relationship that ensures the parties are committed to each other and their mutual success.

Notwithstanding these shared goals, priorities can sometimes clash, requiring advisors to balance interests and strike the right chord in discussions. In some cases, a party may need assurances of success and walkaway rights if objectives are not achieved, or if commitments are breached. Conversely, another party may demand unwavering stability and durability, with minimal or no ability to unwind the deal. Some parties have a preferred structure in mind that they believe is more supportive of their approach, leading to potential conflict if the other party's desired structure does not align with that preference. Effective advisors can assist by recommending options and alternatives to resolve these tensions and develop terms that balance the parties' views on permanence and protections.

Identify Key Boulders and Process Issues

It is not uncommon for system leaders to approach transactions with optimism and energy. Deal teams and advisors often face significant pressure to quickly announce and close a deal. Despite this urgency, it is crucial for parties to work with counsel and other advisors to conduct an initial assessment of key issues, challenges, and requirements that could impact the deal's structure and completion and to develop regulatory and communications plans.

These considerations can include legal or statutory limitations that may affect a party's ability to enter a deal, or the type of structure selected. Other examples include the need for approvals from key stakeholders, multiple governing bodies, health care authorities or districts, foundations, lenders, landlords or property owners, and other third parties. Some transactions even require legislative actions, statutory amendments, or other government or voter actions.

Debt commitments and bondholder consents, insolvency or bankruptcy issues, tax considerations, antitrust concerns, and political dynamics can also impact the feasibility and execution of transactions between health systems. Identifying these factors early in the process is essential, as they can cause delays or even derail a transaction if restructuring is required or if critical regulatory approvals cannot be obtained.

Diligence and Disclosure

In most health care M&A transactions, robust due diligence is essential. Given the regulatory implications of a change of control, potential penalties for legal non-compliance, and the financial impact of cybersecurity breaches, malpractice exposure, and labor issues, due diligence is key to managing the risks and costs of consolidation. To build and maintain credibility, parties should be candid about known risks, historical problems, and pending or threatened enforcement, investigations,

and litigation. If available, a party should provide information about the status and management of risks and liabilities, and any solutions developed to address issues. A diligence blow-up late in the transaction process can undermine trust and result in the renegotiation of terms.

In extreme cases, significant diligence issues can lead a party to terminate discussions or withdraw from a transaction. In mega-merger transactions, the scope of due diligence is often managed by focusing on key areas, setting materiality thresholds, or addressing specific concerns. Some deals adopt a phased approach to due diligence, where key legal and financial items are reviewed first, followed by more operational items. Antitrust protocols must be adhered to, ensuring that competitively sensitive information is not shared inappropriately and preventing premature integration activities. Specialized consultants may be engaged and overseen by legal counsel to maintain privilege and ensure compliance in areas such as environmental issues, fair market value analyses, and other specific concerns.

Prioritize/Organize/Implement

Health care transactions are resource-intensive and time-consuming, necessitating numerous regulatory and other essential approvals. Realistically, a hospital merger or other significant consolidation or affiliation transaction can take a year or longer to complete. For nonprofit transactions in some states, the attorney general review process alone has taken up to ten months or more from the original date of submission. Transactions can be conditioned or even blocked by federal and state regulators for antitrust or other reasons related to an agency's specific or general authorities.

Legal and financial advisors well-versed in the deal process, timelines, and key milestones can be invaluable in motivating stakeholders and managing due diligence processes. They also play a crucial role in obtaining input from the parties on key terms, structuring and leading negotiations, creating consensus, and driving the deal process forward. Missing even a single regulatory approval can result in delays, an inability to close, or major operational obstacles at Day 1 implementation. The importance of coordinated organization and impeccable deal management cannot be overstated.

Post-Transaction Tension: Avoid Unwind

Depending on the structure of the underlying transaction—whether it is a member-substitution, lease, joint venture, or a “virtual merger” (such as a joint operating agreement or other synthetic joint venture arrangements)—some transactions face pressure to unwind. The reasons for this can vary, ranging from the retirement of key leadership who originally sponsored the arrangement to the post-combination organization's failure to meet real or perceived commitments to stakeholders.

The durability of transactions significantly relies on the original contractual terms but can also be influenced by social or communication best practices. A key factor for durability is ensuring that the community and key stakeholders remain focused on the vision and mission imperative of the underlying transaction. Often, parties fail to take time to celebrate successes or use annual reporting mechanisms to reinforce the positive benefits of a transaction. This is key, annual reporting may include data about:

- Reduction of health care inequities
- Capital investment
- Indigent and charity care

- New/enhanced service lines
- Medical staff growth
- Economic impact of the transaction on the region.

Strategic Transactions Require Prophylactic Measures

Ensure Proper Deal Ambassadors

A hallmark of successful transactions is the identification of key leadership at the board and executive levels who possess both the gravitas and emotional intelligence necessary to skillfully achieve consensus, both internally and with the potential partner. These individuals generally have institutional credibility gained through tenure and competent service. Optimal deal ambassadors understand the “why” and do not let legacy considerations or ego override important future mission imperatives. Typically possessing high emotional intelligence, these ambassadors can adeptly navigate issues and disputes, preventing escalation and reinforcing the foundation of the transaction.

Mutual Plan as to Public Disclosure/ Communications

Communications planning and timing are critical components of the transaction process. It is key to not let leaks, rumor or innuendo hijack the disciplined rollout of the MAP’s goals and objectives. The cadence of communications and buy-in of key stakeholders who may require special treatment must be strategically planned. Some parties engage an experienced strategic communications firm to develop messaging to political figures, medical staff, and other key constituencies. Our strong recommendation is that all written and verbal communications regarding a transaction be reviewed by counsel prior to dissemination. Poorly planned or inaccurate communications can jeopardize the reception and support by stakeholders, the regulatory process, and potentially the success of a transaction.

Learn from Lean Quality Manufacturing: Empower Deal Teams

Borrowing from lean manufacturing concepts attributed to W. Edward Deming and others, key deal leadership from management and outside advisors must be empowered to pull the metaphorical ‘Andon cord.’ ⁵ The Andon cord, both a real and metaphorical concept in a Japanese production line, allows any employee to pull the cord without fear of reprisal in order to highlight and address a perceived quality issue. ⁶ Without such empowerment, traditional obstacles to a quality deal process may arise due to inertia. Potential obstacles in a health care MAP process include impatience, procrastination, lack of discipline in the negotiation process, isolating the legal team, inflexibility in solutions, and delegating key communications or negotiations to inexperienced individuals.

Trusted Advisors Should Not Be Placeholders

Trusted advisors, both internal and external, should always keep in mind and protect the long-term goals and mission imperatives that originally motivated the transaction. Tone-deaf negotiations, incivility, breaking commitments, and an irrational focus on legacy or one-sided outcomes should not

derail a mission-critical and mutually beneficial transaction. Experienced transaction leaders should be attuned to and identify situations that may cause discontent or disputes and be prepared to provide proactive solutions.

Build Time to Ensure Key Term Documentation Is Thoughtful

Deal team leads and outside advisors should carefully consider how a documented issue will be perceived by the opposing side's counsel and deal team, especially concerning sensitive or "third-rail" issues. In such cases, it may be more effective to raise the issue with a straightforward statement identifying a high-level point that needs focused discussion and decision making, rather than drafting a complex solution and generating additional antagonistic negotiations.

Organized and timely negotiation and documentation of key deal terms and exchanging of drafts, issued lists, and revised agreements are key to maintaining momentum and avoiding deal fatigue. Deal documents and call agendas should not be distributed last minute, late, or without time for proper vetting of key issues by all deal participants and their advisors. On the flip side, returning negotiating points in a hurried and unthoughtful manner, without adequate legal, financial, and operational input, may lead to backtracking on points that can undermine credibility and damage the relationship and deal process. Finally, it is prudent to ensure your drafting team has a quality control process in place. Key documentation of deal points should be managed by experienced attorneys and advisors who have the bandwidth and authorization to be thoughtful and act in the best interests of their client and the overall transaction.

Conclusion

Deal success depends on various factors, including macroeconomic pressures, strategic fit, leadership, integration, and the financial performance of the consolidated health care businesses. However, it is unfortunate for a mission-critical and transformational transaction in health care to be diluted or fail due to process errors such as lack of organization. The success of a transaction that can bring tremendous value to the communities served should not be derailed by a poorly designed process, improper or toxic attitudes of negotiators, unthoughtful and haphazardly determined responses or deal term positions, failure to anticipate and address key structural and regulatory issues, fragmented deal team leadership, or lack of communication or alignment among parties and their advisors. Such missteps can prevent the realization of mission imperatives such as quality improvement, new or enhanced service lines, key investments in technology, infrastructure upgrades, and opportunities to increase access and address health care inequities.

The solution lies in a well-designed process that maintains a disciplined focus on the goals, objectives, and intrinsic value of the MAP. This process should involve the selection of the right combination of deal leads and ambassadors, empowering the deal team to identify and address issues, and considering the legitimate concerns and positions of the future partner. The authors challenge you to be present and allow the relationships of the respective parties to flourish. Use your emotional intelligence, integrity, and good judgment to avoid unnecessary escalations, and instead act constructively to propose options

and resolutions to efficiently bring a deal to completion. Leave ample time for thoughtful consideration, respect the other party and members of the deal team, communicate with honesty and transparency, and set up the parties for success to achieve their transformational health care purposes.

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- ¹ See *Hospitals Face Financial Pressures as Costs of Caring Continue to Surge*, Am. Hosp. Ass'n (May 10, 2024), <https://www.aha.org/news/perspective/2024-05-10-hospitals-face-financial-pressures-costs-caring-continue-surge#:~:text=Hospitals%27%20labor%20costs%2C%20which%20on,cash%20reserves%20to%20maintain%20operations.>
- ² See *The Baby Boomer Effect and Controlling Healthcare Costs*, Univ. of S. Cal. Sol Price Sch. of Pub. Pol'y (Nov. 17, 2023), <https://healthadministrationdegree.usc.edu/blog/the-baby-boomer-effect-and-controlling-health-care-costs.>
- ³ See Am. Hosp. Ass'n, *New AHA Report: Hospitals and Health Systems Continue to Face Rising Costs and Economic Pressures* (May 2, 2024), [https://www.aha.org/press-releases/2024-05-02-new-aha-report-hospitals-and-health-systems-continue-face-rising-costs-economic-pressures#:~:text=WASHINGTON%20\(May%202%2C%202024\),patients%20and%20communities%20they%20serve.](https://www.aha.org/press-releases/2024-05-02-new-aha-report-hospitals-and-health-systems-continue-face-rising-costs-economic-pressures#:~:text=WASHINGTON%20(May%202%2C%202024),patients%20and%20communities%20they%20serve.)
- ⁴ See *Hospital M&A Surges in Q3, Up 79% from Q2: Report*, BECKER'S HOSP. REV., <https://www.beckershospitalreview.com/hospital-transactions-and-valuation/hospital-m-a-surges-in-q3-up-79-from-q2-report.html>.
- ⁵ See *Originating within Japanese manufacturing and, intervene on the problem*, PMC, [https://pmc.ncbi.nlm.nih.gov/articles/PMC5180539/#:~:text=Originating%20within%20Japanese%20manufacturing%20and,intervene%20on%20the%20problem%2C%20and;see%20also%20The%20Andon%20Cord%20Pulling%20the%20Rope%20on%20Quality,BUS.&FIN.TIMES%20\(Oct.%2030,%202020\),thebftonline.com/2020/10/31/the-andon-cord-pulling-the-rope-on-quality/](https://pmc.ncbi.nlm.nih.gov/articles/PMC5180539/#:~:text=Originating%20within%20Japanese%20manufacturing%20and,intervene%20on%20the%20problem%2C%20and;see%20also%20The%20Andon%20Cord%20Pulling%20the%20Rope%20on%20Quality,BUS.&FIN.TIMES%20(Oct.%2030,%202020),thebftonline.com/2020/10/31/the-andon-cord-pulling-the-rope-on-quality/); see also *The Andon Cord: Pulling the Rope on Quality*, BUS. & FIN. TIMES (Oct. 30, 2020), <https://thebftonline.com/2020/10/31/the-andon-cord-pulling-the-rope-on-quality/>.

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