

HCA Hit with \$400 Million Judgment by Missouri Court

A recent Missouri court decision against the largest for-profit hospital chain in the U.S.¹ has brought new attention to the need to abide by post-closing covenants related to the provision of charitable care by acquiring for-profit entities. On December 9, 2015, the state Circuit Court of Jackson County, Missouri at Kansas City, in the case *Health Care Foundation of Greater Kansas City (Foundation) v. Health Corporation of America (HCA)*,² found that HCA did not abide by post-closing covenants requiring HCA to spend funds in furtherance of the charitable mission of Health Midwest, a greater Kansas City non-profit health system acquired by HCA in 2003.³ The ruling, which set forth damages against HCA in the amount of \$433,725,593, highlights the importance of a for-profit company to comply with post-closing covenants related to furthering charitable goals when buying the assets of a non-profit health system.⁴ This Health Capital Topics article will detail the facts and rulings of the case, as well as the potential implications of the ruling on the transactional environment for hospitals.

In *Foundation v. HCA*, the Foundation brought an action against HCA to obtain a declaration from the court interpreting that HCA violated certain post-closing covenants related to the *Asset Purchase Agreement (APA)* as part of the Health Midwest-HCA transaction.⁵ The APA included post-closing covenants “for the benefit of the public,”⁶ which involved certain obligations related to charitable care obligations and capital improvements, to wit:

“Because of the charitable mission previously served by Health Midwest, HCA agreed to spend more than five hundred million dollars (\$500,000,000.00) on charity care in the Kansas City community, and to spend four hundred fifty million dollars (\$450,000,000) to improve the hospitals it purchased.”⁷

The sale also created the Foundation, which was formed “to accept eighty percent (80%) of the net proceeds of Health Midwest’s sale to HCA.”⁸ This case raised three questions: (1) whether HCA’s capital improvement obligations in connection with “existing Facilities” were credited by the construction of “related ‘new’ facilities”; (2) whether the construction of new facilities “materially detracted” from existing Facilities; and, (3) whether HCA provided “reasonable detail” and

properly “committed to spend” capital such that it could take credit for its “commitments” toward its \$450 million obligation.⁹ The court ruled in favor of the Foundation on the first and third issues, and found in favor of HCA on the second issue.¹⁰

The first issue in this case examined whether HCA had satisfied its \$450 million obligation for capital improvements.¹¹ Under the APA, HCA was subject to a post-closing covenant that obligated the health system to spend \$450,000,000 on capital expenditures “within a reasonable period of time after the fifth anniversary of closing.”¹² The Foundation asserted that the APA specified an obligation that HCA make improvements to “existing Facilities;”¹³ in contrast, HCA argued that the construction of “new facilities” should have been credited to the balance of its obligation for “existing Facilities,” as the new construction was for the benefit of the Kansas City community.¹⁴ HCA argued that the \$343 million spent to build two new hospitals should be credited to HCA’s capital improvement obligations, even though HCA closed several hospitals acquired under the APA.¹⁵ According to Health Midwest, at the time of closing in 2003, the now-closed facilities had aged significantly and would have required significant repairs,¹⁶ yet HCA did not have specific plans to build new facilities at the time of the APA.¹⁷

In the months preceding the Health Midwest-HCA transaction, Health Midwest lacked the capital to make the necessary renovations and improvements for its hospitals.¹⁸ Health Midwest could only afford capital expenditures of \$25 million, yet the need for capital by Health Midwest was upwards of \$100 million.¹⁹ Health Midwest offered HCA the opportunity to purchase its assets, but specified that HCA’s commitment would include “...injection of new capital into the healthcare assets that currently comprise the Company.”²⁰ Based on this language, as well as on certain inferences that the court made from the testimony and exhibits at trial, the court determined that the “...central purpose of the sale...” was to “...infuse drastically needed capital into the existing Facilities...” [emphasis added]. The court found that HCA was aware of Health Midwest’s reasons for selling (e.g., the need for capital improvements),²¹ and noted that the condition of the “existing Facilities” was of “paramount importance” to its decision in favor of the Foundation.²² The court also highlighted the significance of the term “Capital Improvements” to its findings concerning the parties’ intent, noting “... it is

axiomatic that one cannot improve that which does not exist. The Court therefore finds that the parties' use of the term is probative to support [...] the parties intended for the \$450 million in capital expenditures to be used solely for 'the existing Facilities.'"²³

The second issue addressed by the court was whether the construction of the "new facilities" materially detracted from the necessary improvements to "existing Facilities" purchased under the APA.²⁴ Here, the court noted that this issue was a question of fact, and weighed the parties' evidence under the "preponderance of the evidence standard."²⁵ The expenditures at issue were driven by a "roughly \$800 million, 5-year capital plan" that did not exist when the APA was signed.²⁶ The court found that the weight of the evidence favored HCA, and held that the capital plan for the construction of the "new facilities" did not detract from "existing Facilities."²⁷

The third issue was whether HCA complied with necessary reporting policies regarding its obligation to provide charity care.²⁸ Here, the court concluded that HCA was a fiduciary to the Foundation—and was accordingly required to maintain "complete and accurate records ... bear[ing] the burden of proving what any absent records would show."²⁹ The court found that HCA did not provide reasonable detail of its claimed compliance with the APA.³⁰ For example, numerous issues existed in HCA's annual reports regarding its charity care, such as defects related to the report's preparation, internal consistency, and failure to provide the court with sufficient evidence to determine whether HCA complied with the post-closing covenants set forth in the APA.³¹ Moreover, there were several unexplained discrepancies in HCA's public comments regarding the amount of charity care provided, compared to HCA's annual reports of expenditures.³² Additionally, the APA required that Health Midwest's previous records of charity care be used to provide the benchmark for HCA's annual charity obligation; however, Health Midwest's charity care records were never utilized, and HCA instead calculated its own annual benchmark.³³ Because of these compounding issues, and HCA's failure to provide adequate information to the court throughout the trial, HCA was subject to court-supervised accounting.³⁴ Although HCA argued that it had not just met, but exceeded its charity obligations, it agreed to settle this issue with the Foundation for \$15 million in February 2015.³⁵

Foundation v. HCA may have far-reaching implications for communities seeking to divest their nonprofit health system holdings.³⁶ As health systems face mounting pressure to contain costs while improving patient outcomes and extending the continuum of care, they are increasingly choosing to consolidate.³⁷ Similar to other regulatory schemes, it may be prudent for health systems engaging in conversions of non-profit hospitals to for-profit hospitals to seek legal advice, or they may pay a greater price later. The damages awarded to the Foundation totaled approximately half of the \$855

million that HCA spent acquiring Health Midwest (not to mention court costs and attorney's fees).³⁸ This ruling underscores the necessity of health systems scrutinizing transactions to fully understand all duties, obligations, and post-closing covenants thereunder—particularly where nonprofit assets are involved.

- 1 "Health Care Foundation of Greater Kansas City v. HM Acquisitions, LLC, & HCA, Inc." Case No. 0916-CV30692, (16th Mo. Cir., December 9, 2015) Judgment, p. 4; "HCA's Q4 puts firm on course for even better 2016" By Meg Bryant, HealthcareDIVE; Top Healthcare Payer News, January 29, 2016, <http://www.healthcarediver.com/news/hcas-q4-puts-firm-on-course-for-even-better-2016/412950/> (Accessed 2/26/2016).
- 2 "Health Care Foundation of Greater Kansas City v. HM Acquisitions, LLC, & HCA, Inc." Judgment, p. 4.
- 3 "Health Care Foundation of Greater Kansas City v. HM Acquisitions, LLC, & HCA, Inc." Case No. 0916-CV30692, (16th Mo. Cir., January 24, 2013) Findings of Fact, Conclusions of Law and Judgment, p. 6-7; "HCA finalizes purchase of Health Midwest" Kansas City Business Journal, April 1, 2003, <http://www.bizjournals.com/kansascity/stories/2003/03/31/daily24.html/> (Accessed 2/26/2016).
- 4 See, "Nonprofit or For-profit? Hospital Conversion Considerations" By Rebecca Bales, et al., The Camden Group, <http://www.thecamdengroup.com/wp-content/uploads/Camden-Nonprofit-or-For-profit-Hospital-Conversion-Considerations.pdf> (Accessed 2/26/2016) p. 18, 20
- 5 "Health Care Foundation of Greater Kansas City v. HM Acquisitions, LLC, & HCA, Inc." Findings of Fact, Conclusions of Law and Judgment, January 24, 2013, p. 8.
- 6 *Ibid*, p. 6.
- 7 *Ibid*.
- 8 *Ibid*, p. 6-7. "KC Health Care Foundation wins legal judgment against HCA" By Alan Bavley & Steve Rosen, Kansas City Star, December 10, 2015, <http://www.kansascity.com/news/government-politics/article48986370.html> (Accessed 2/5/16). "Kansas City health care foundation wins \$434M judgment" News Tribune, December 12, 2015, <http://www.newstribune.com/news/2015/dec/12/kansas-city-health-care-foundation-wins-434m-judgm/> (Accessed 2/5/16); "Judge Orders HCA to Pay \$162 Million to Foundation" By Julie Creswell, January 24, 2013, New York Times, <http://www.nytimes.com/2013/01/25/business/hca-must-pay-kansas-city-foundation-162-million.html/> (Accessed 2/26/2016).
- 9 "Health Care Foundation of Greater Kansas City v. HM Acquisitions, LLC, & HCA, Inc." Findings of Fact, Conclusions of Law and Judgment, January 24, 2013, p. 8-9.
- 10 *Ibid*.
- 11 *Ibid*, p. 8.
- 12 *Ibid*, p. 57.
- 13 *Ibid*, p. 8.
- 14 *Ibid*, p. 8, 127.
- 15 *Ibid*, p. 122; News Tribune, December 12, 2015.
- 16 "Health Care Foundation of Greater Kansas City v. HM Acquisitions, LLC, & HCA, Inc." Findings of Fact, Conclusions of Law and Judgment, January 24, 2013, p. 11.
- 17 *Ibid*, p. 13.
- 18 *Ibid*, p. 10-11.
- 19 *Ibid*.
- 20 *Ibid*, p. 11.
- 21 *Ibid*, p. 12.
- 22 *Ibid*, p. 8, 127.
- 23 *Ibid*, p. 62.
- 24 *Ibid*, p. 9.
- 25 *Ibid*, p. 65, 71-72, 132.
- 26 *Ibid*, p. 62, 64.
- 27 *Ibid*, p. 65, 71-73.
- 28 *Ibid*, p. 9.
- 29 *Ibid*, p. 133.
- 30 *Ibid*, p. 119.
- 31 *Ibid*, p. 115.

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- 32 *Ibid.*
- 33 *Ibid.*, p. 116.
- 34 *Ibid.*, p. 119.
- 35 Alan Bavley & Steve Rosen, December 10, 2015.
- 36 “Judge Orders HCA to Pay \$162 Million to Foundation” By Julie Creswell, January 24, 2013, New York Times, <http://www.nytimes.com/2013/01/25/business/hca-must-pay-kansas-city-foundation-162-million.html/> (Accessed 2/26/2016).
- 37 “3 Reasons Why Not-For Profits Hospitals Are Merging” By James Ellis and Aaron Razavi, Healthcare Finance News, August 16, 2011, <http://www.healthcarefinancenews.com/blog/3-reasons-why-not-profits-hospitals-are-merging.> (Accessed 7/9/2012).
- 38 “Health Care Foundation of Greater Kansas City v. HM Acquisitions, LLC, & HCA, Inc.” Findings of Fact, Conclusions of Law and Judgment, January 24, 2013, p. 6-7. Alan Bavley & Steve Rosen, December 10, 2015. News Tribune, December 12, 2015. Julie Creswell, January 24, 2013.



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