

QUESTIONS TO ASK WHEN EVALUATING CONVERSION LEGISLATION

An increasing number of states have proposed or enacted legislation governing conversions. Some legislative proposals are comprehensive and provide for significant oversight and public participation in the regulatory process. Other bills are not as extensive, and lack important consumer protections. Below we have outlined key questions communities should ask when analyzing conversion legislation. In states where conversion legislation has already been passed, the following questions can be used to determine whether laws need to be amended.

WHAT STATE AGENCY IS RESPONSIBLE FOR REVIEWING PROPOSED CONVERSIONS?

- The Attorney General's office? The Department of Health? The Department of Insurance?
- If more than one agency has oversight, how do responsibilities differ or coincide?

Given that the Attorney General has oversight of charitable corporations, that office should have a role in the regulation of all nonprofit conversions. Involvement of the Department of Health also may be important, especially to assess the effect the conversion may have on the provision of health services. Because the Department of Insurance usually has oversight of some health care entities and all insurance companies, it might also be involved in reviewing transactions.

WHAT TRANSACTIONS ARE COVERED?

- Does the legislation cover a wide range of transactions, including acquisitions, joint ventures, sales and mergers, and long term leases?
- Is the creation of for-profit subsidiaries covered? If so, how is it treated?
- Are nonprofit/nonprofit transactions covered?
- What entities are included? Hospitals? HMOs? Insurers? Psychiatric facilities? Others?
- What is the threshold that triggers conversion review? A transfer of 20% of the nonprofit's assets? 50%? A "material amount"? Are there exemptions or exceptions?
- Is there a "lookback" provision to allow regulators to analyze a series of transactions that transfer small amounts of assets over a period of years?
- Is there a prohibition on nonprofit insurance companies converting to mutual companies? Is the nonprofit required to satisfy its charitable obligations if mutualization is allowed?

Legislation that covers a broad variety of transactions and entities offers the best protections for consumers. A relatively low threshold, such as 20%, also ensures that more, rather than fewer transactions will be subject to review. Further, a lookback provision is important to prevent "creeping" conversions that occur over a period of years and might go undetected.

Coverage of nonprofit/nonprofit transactions also is important. While nonprofit/nonprofit transactions differ in a significant fashion from nonprofit/for-profit transactions, health services can nevertheless be adversely affected. The bill should also prohibit nonprofit insurance companies from converting to mutual companies since a number of entities that have converted to mutual companies have later attempted to convert to stock corporations without preserving charitable assets.

HOW WILL THE PUBLIC BE INVOLVED IN THE REVIEW OF THE TRANSACTION?

- What is the procedure for notifying the public about a proposed transaction?
- Is a public hearing or information session mandatory or is it left to the regulator's discretion?
- How will the public be notified of the meeting? How much advance notice is given?
- Will members of the community be allowed to provide both written and oral testimony and ask questions?
- Is there an opportunity for additional hearings at various points during the review process?
- If the transaction has statewide implications, will hearings be held in different geographic locations?
- Are there other roles for the community to play in the regulatory review? Can groups or individuals act as intervenors in administrative or court proceedings? Do they have standing to appeal to the courts?
- Are all of the records related to the transaction public documents or does the legislation limit documents which will be available to the public?

Public participation in the review of proposed conversion transactions is critical. The more opportunity for public participation, the better. Public hearings or meetings should be mandatory, not discretionary. Regulators should hold these meetings early in the transaction review process. Further, members of the public should be able to intervene in administrative or court proceedings.

Also, community groups should advocate for full access to all documents related to the conversion. Communities need this information to thoroughly evaluate the transaction. Further, the state should maintain a registry for citizens and groups who want to be notified about pending conversions.

HOW WILL THE TRANSACTION AFFECT THE COMMUNITY'S HEALTH CARE?

- Is the converting entity required to submit a plan showing the health impact a transaction will have on the community?
- Is the regulator required to conduct a health impact survey to assess the potential health impact the transaction will have on health care access and coverage?
- Can the regulator hire an independent expert to conduct a health impact assessment?
- Will the converting entity be required to maintain or exceed levels of free care?

- What, if any, systems are in place to enforce or monitor the commitments made by the for-profit as a condition of regulatory approval?

It's crucial that regulators evaluate the impact a proposed conversion may have on access to care and the quality of local health systems. The bill should enable regulators to retain ongoing oversight of the for-profit to ensure that it meets its any commitments it made to the community as a condition of approval. At a minimum, the new for-profit should commit to maintain existing levels of free care.

WHAT ARE THE STANDARDS FOR REVIEWING AND APPROVING THE TRANSACTION?

- What information and materials are required to be submitted by the nonprofit to the regulator? Does the regulator have authority to request additional documents?
- If there are standards for transactions outlined in the legislation, are they mandatory or permissive? Does the language say the regulator “*shall consider* the following standards”? Or does the legislation require that the transaction actually meet the standards before being approved?
- What standards are outlined in the legislation? At least the following should be included:
 - Whether access to and quality of health care services will be affected by the transaction;
 - Whether there is a breach of fiduciary duty by the converting entity's directors;
 - Issues concerning private inurement and conflict of interest;
 - Full and fair market value of charitable assets;
 - Protection of charitable assets;
 - Whether the converting entity has exercised due diligence in accepting the deal.

The legislation should outline specific standards for review to ensure regulators analyze every aspect of the proposed transaction. Ideally, the standards should be mandatory – the converting entity has to meet them in order to gain approval for the transaction.

HOW ARE VALUATION AND OTHER FINANCIAL ISSUES HANDLED?

- Does the bill require an independent valuation? By whom? The regulator or the converting entity? Who is responsible for the cost?
- If the converting entity is responsible for the valuation, can the regulator review the valuation and hire an independent expert to review the financial aspects of the deal?

Valuation of the converting entity and the financial structure of the deal is an important component of any transaction. Many entities have been undervalued, at a great loss to the affected community. The ability of regulators to hire independent financial advisors is critical. Further, the converting entity should be required to pay the costs of such advisors.

ARE CHARITABLE ASSETS ADEQUATELY PROTECTED?

- Does the legislation explicitly require that the full fair market value of the nonprofit be preserved

and transferred to an independent charitable entity?

- Are there any provisions regulating the foundation that would result from the conversion?
- Is the foundation required to have a health-related mission?
- How will the community be involved in the process of setting up and running the foundation?
- Does the legislation include requirements concerning the governance and structure of the foundation receiving the charitable assets?
- Is the foundation required to be a 501(c)3 or a 501(c)4 tax-exempt organization?
- Is the foundation required to be completely independent of the former nonprofit and the new for-profit?
- Are there conflict of interest protections for future use of charitable assets?
- Are there any provisions for ongoing monitoring of the foundation once it is established?

The foundation should be broadly based in the community, independent from both buyer and seller, and organized as a private foundation under section 501(c)3 of the Internal Revenue Code or be subject to the consumer protection provisions of the IRS' rules governing private foundations.

DOES THE LEGISLATION PROHIBIT CONFLICT OF INTERESTS AND PRIVATE INUREMENT?

- Does the legislation require that the regulator analyze whether there are conflicts of interest or whether insiders will benefit financially from the deal?
- Does the legislation prohibit board members and executives of the converting entity from gaining financial windfalls as a result of the conversion?
- Does it prohibit executives and board members from receiving stock options in the new for-profit?

As a result of some conversions, directors and executives have received huge financial windfalls in stock options and increased salaries. Regulators should ensure that personal financial gain is not the motivation behind the proposed conversion.

DO REGULATORS HAVE SIGNIFICANT POWERS OF ENFORCEMENT AND THE ABILITY TO MONITOR THE CONVERSION AFTER IT HAS BEEN APPROVED?

- Is regulatory approval required for the deal to go forward? Or is the regulator just required to be notified?
- What options does the regulator have regarding approval or disapproval? Can the regulator provide conditional approval?
- Is court approval necessary?
- Is the converted entity required to report to regulators after the conversion has been approved?
- Does the legislation give the regulator the option of hiring a health access consultant to monitor

whether the new for-profit is fulfilling its commitment to maintain free care and other essential services once the conversion has occurred?

- Are there criminal or civil penalties if an entity fails to meet certain commitments? Can its license be revoked or denied?

Enforcement and ongoing monitoring are important to ensure that promises and commitments made during the conversion review process are kept, especially regarding the provision of health services and community benefits.

CAN A COURT REVIEW A REGULATOR'S DECISION? WHO CAN BRING A LAWSUIT?

- Who has standing to protest the conversion in court? Only the Attorney General? What about members of the public? Can consumers appeal the regulator's decision?

The public should have standing to appeal in both administrative and court proceedings.

OTHER IMPORTANT QUESTIONS

- Are there time frames for the review? Do they allow adequate time for review by and input from the community? Can regulators extend the review period?

The community needs adequate time to respond to any conversion proposal. The initial review period should be at least 90 days, with a permitted extension of at least 90 days. The community must have adequate time to review and respond to all documents submitted by the converting entity. Permitting regulators to extend the review period may allow for a more thorough review when issues are complicated and can give community members necessary time to review any new documents submitted to regulators

- Is the converting entity responsible for paying the costs of any expert assistance received by regulators?

The regulator should be able to hire independent assistance and the converting entity should be responsible for those and other costs associated with the review of the transaction.

- If the converted entity is subsequently put up for sale, does the legislation require that a nonprofit should have the option of purchasing it, before any for-profit buyers are considered?

If the converted entity is sold, nonprofits should have a right of first refusal.

- Does the legislation give rulemaking authority to regulators?

If regulators have rulemaking authority, the community should ensure they will be involved in the rulemaking process.