

## **Proposed Pilot Program: Business Corporations to Operate New York Hospitals**

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January 2013

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There is a potentially significant development in New York with respect to the ownership and operation of hospitals in the State. On January 25, 2013, Governor Andrew Cuomo proposed comprehensive budget legislation for 2013-2014 that included a pilot program (the “Pilot Program”) that would allow business corporations to own and operate two hospitals located in the State, subject to establishment approval by the Public Health and Health Planning Council (the “PHHPC”). The Pilot Program is intended to “assist in restructuring health care delivery systems by allowing increased capital investment in health care facilities.”

### **History**

New York has strictly regulated the practice of medicine and the delivery of health care within its boundaries. One particular restriction, which has periodically been subject to debate over the years, is the requirement that all owners of a corporation that operates a for-profit hospital be natural persons.<sup>1</sup> The reasons for this policy include the view that the provision of health care is a charitable activity and that there must be transparency and accountability as far as the owners of hospitals are concerned. This prohibition has essentially prevented investor-owned corporations from directly owning and operating hospitals in New York.

In the past few years, there has been a call from some in both the public and private sectors to loosen or eliminate this restriction. One reason for this “call” has been the financial pressures that many hospitals are facing and the potential capital that the for-profit community can provide.

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<sup>1</sup> New York Public Health Law §2801-a(4)(e).

## Overview of the Pilot Program

The Pilot Program, which is found in Section 104 of the Governor’s 2013-14 Executive Budget Article VII Bills, would amend New York Public Health Law §2801-a to authorize the Commissioner of Health (“Commissioner”) to establish the Pilot Program. The PHHPC would be responsible for approving a maximum of two business corporations formed under the New York Business Corporation Law to operate hospitals in New York State. One business corporation would operate a hospital or hospitals in Kings County and the other business corporation could operate one elsewhere in the State. In order to qualify to become an operator, the business corporation must be affiliated with a PHHPC-approved academic medical institution, to the extent satisfactory to the Commissioner.

Structurally, the Pilot Program would suspend the restrictions on owners and operators of the hospitals mentioned above. This modification of New York law would allow investor-owned entities to directly invest in a hospital without the requirement that all shareholders or members of the for-profit operator be natural persons.<sup>2</sup>

The Pilot Program would place restrictions on the two business corporations. First, they would need to limit their corporate purposes and powers to the ownership and operation of the specifically designated hospitals. Second, the boards of directors and officers of the corporations would be required to consider specified public health metrics when taking any actions including: (i) “the interests of patients of the hospital or hospitals”; (ii) “community and societal considerations, including those of any community in which facilities of the corporation are located”; and (iii) “the local and global environment.”<sup>3</sup> The Pilot Program specifically states that accounting for the public health metrics and other considerations listed in the legislation will not constitute a violation of the fiduciary duty or any other duty of loyalty that a director or officer owes to the corporation or its shareholders.<sup>4</sup> The foregoing metrics are intended to address some of the reasons historically advanced by New York State for prohibiting investor-owned hospitals.

The Commissioner must submit a written evaluation of the Pilot Program to the Governor and certain legislators within two years of the establishment of the business corporations. The evaluation must specifically address “the overall effectiveness of the Program in allowing for access to capital investment in health care facilities and the impact such access may have on the quality of care provided by hospitals operated by business corporations established under this subdivision.”<sup>5</sup>

## Unanswered Questions

The Pilot Program leaves several unanswered questions, including the following:

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<sup>2</sup> Proposed — New York Public Health Law §2801-a(18)(c), citing current New York Public Health Law §§2801-a (3)(b), (4)(c), (4)(e) & New York Public Health Law §4004(3)(a).

<sup>3</sup> Proposed – New York Public Health Law §2801-a(18)(e)(1).

<sup>4</sup> Proposed – New York Public Health Law §2801-a(18)(e)(2), citing current New York Business Corporation Law §§ 715 & 717.

<sup>5</sup> Proposed – New York Public Health Law §2801-a(18)(g).

- (i) What does “affiliated” with an academic medical institution mean?
- (ii) Will there be interest in the Pilot Program notwithstanding the numerous restrictions placed on participants?
- (iii) How will the business corporations recoup their investment, and will they be permitted to make profit distributions to their owners?
- (iv) If the proposed Pilot Program is successful, will the restrictions be loosened in the future?
- (v) If the Pilot Program is not successful, what will happen to the business corporations and to the capital that they invested?
- (vi) What effect will the Pilot Program and its possible future expansion have on the existing not-for-profit hospitals in New York?

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*This Client Alert was authored by **Jeffrey H. Becker** and **Vinay Bhupathy**. For additional information, or if you have any questions, about the Pilot Program or its potential impact, please contact one of the authors or the Epstein Becker Green attorney who regularly handles your legal matters.*

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