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# Hospital Joint Ventures (JVs): Trends and Post-Transaction Contractual Considerations

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Colin McDermott, CFA, CPA /ABV, Managing Director

Alex Higgins, Manager



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# AGENDA

I.

Overview of Joint Venture Trends

II.

Post-Transaction Contractual Trends

III.

Regulatory and Valuation Considerations for JVs

IV.

Regulatory and Valuation Considerations for Post-Transaction Contractual Arrangements

# Overview of Joint Venture Trends

# OVERVIEW OF JOINT VENTURE TRENDS



## Joint Venture Background

### What is a Joint Venture?

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- The cooperation of two or more businesses in which each agrees to share profit, loss, and control in a specific enterprise
- Typically formed to undertake a particular business transaction or project

### What is not a Joint Venture?

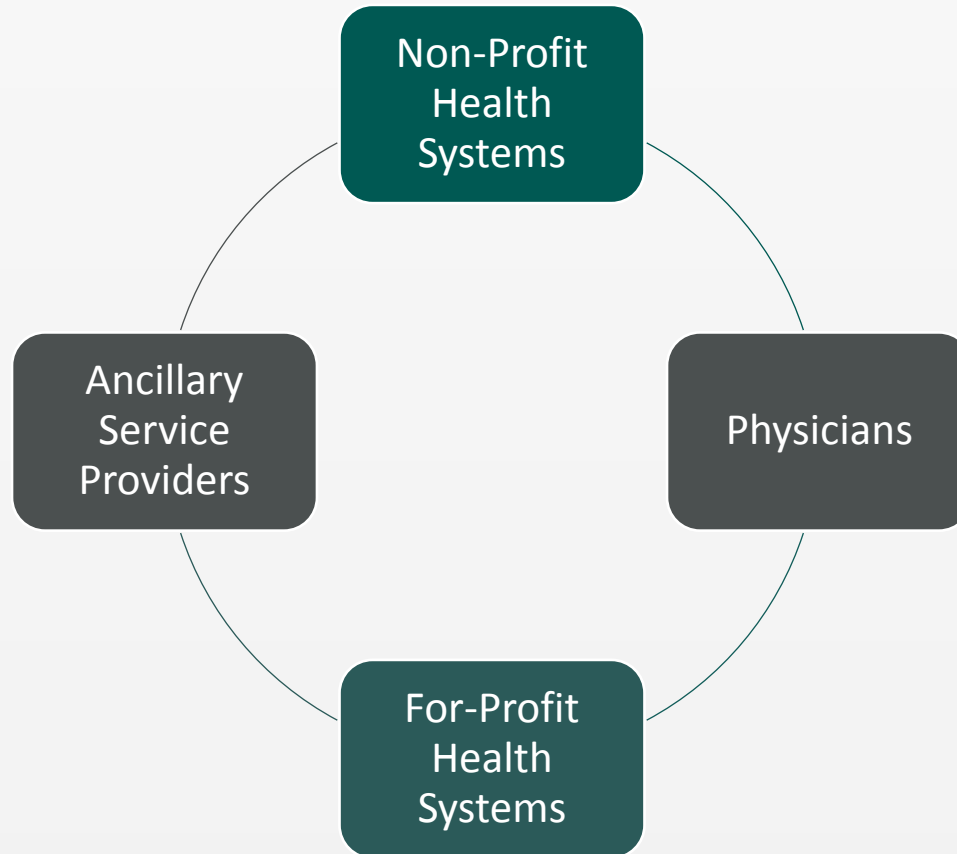
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- Affiliation agreements
- Management agreements
- Joint operating agreements or other contractual (non-ownership) arrangements

# OVERVIEW OF JOINT VENTURE TRENDS



## Joint Venture Participants



# OVERVIEW OF JOINT VENTURE TRENDS



## Joint Venture Transaction Drivers

### Historical Drivers

Reimbursement and Payor Networks

Access to Capital

Management Expertise

Cost Efficiencies

Declining inpatient stays and shift to outpatient care

### Emerging Drivers

Changing reimbursement models

Access to Network and Infrastructure

Retail Health Evolution

# OVERVIEW OF JOINT VENTURE TRENDS



## Ancillary Provider JVs - Participants

### ASC's

- Most long-standing and prevalent
- Significant number of top health systems have ASC JV partners
- USPI and SCA are largest players

### Rehab / Post Acute

- Select Medical – JVs with Penn State Hershey, Baylor Scott & White, Emory and others
- HealthSouth – JVs with Vanderbilt, University of Virginia, and others

### Imaging

- Envision – Texas Health Resources
- SimonMed – Dignity Health
- Touchstone – Baylor Scott & White

### Oncology

- McKesson / US Oncology JVs with Memorial Hermann, Methodist Health (Dallas)

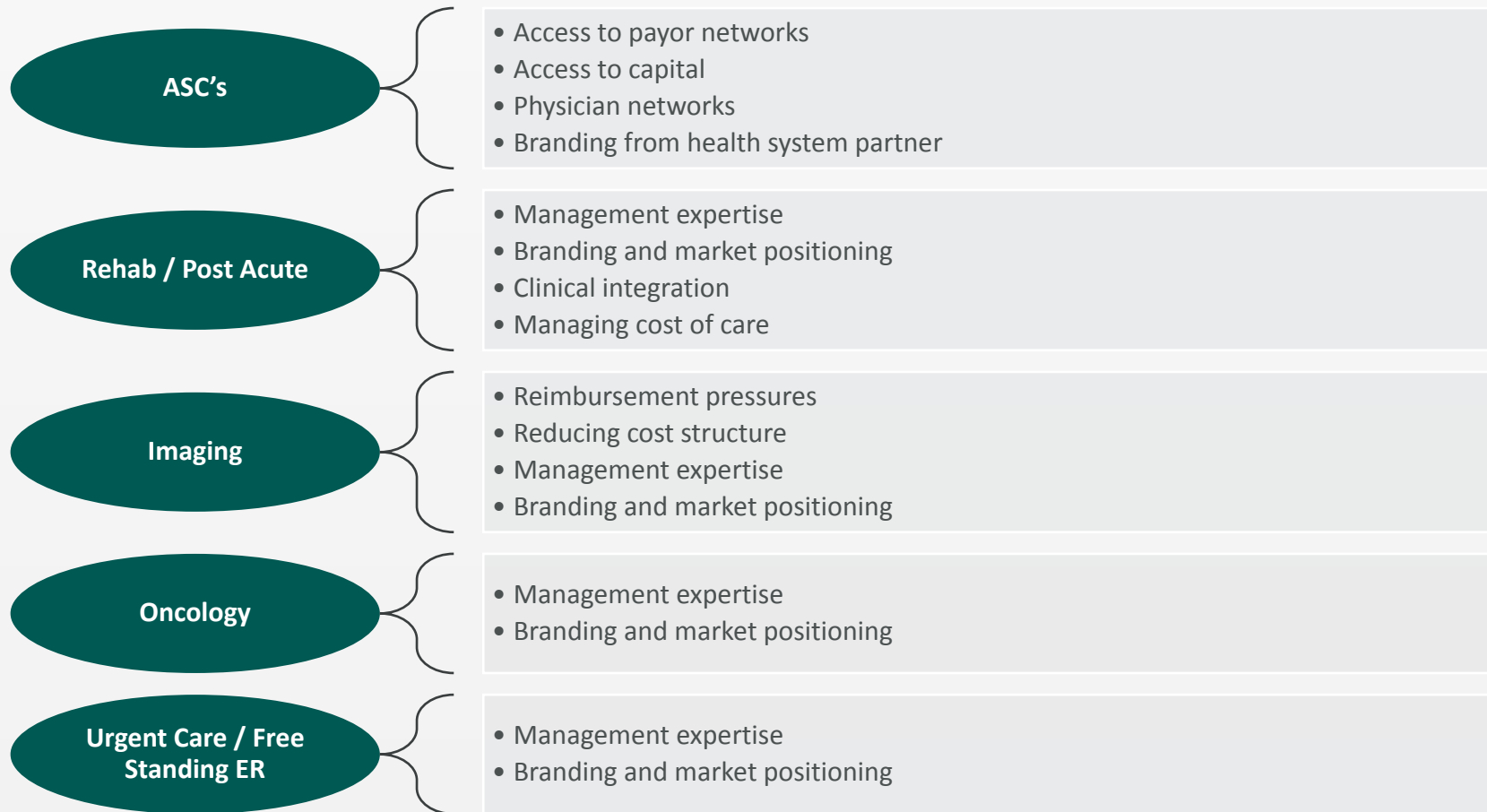
### Urgent Care/ Free-Standing ER

- Premier Health
- NextCare
- Walgreens
- UC Health / Adeptus

# OVERVIEW OF JOINT VENTURE TRENDS



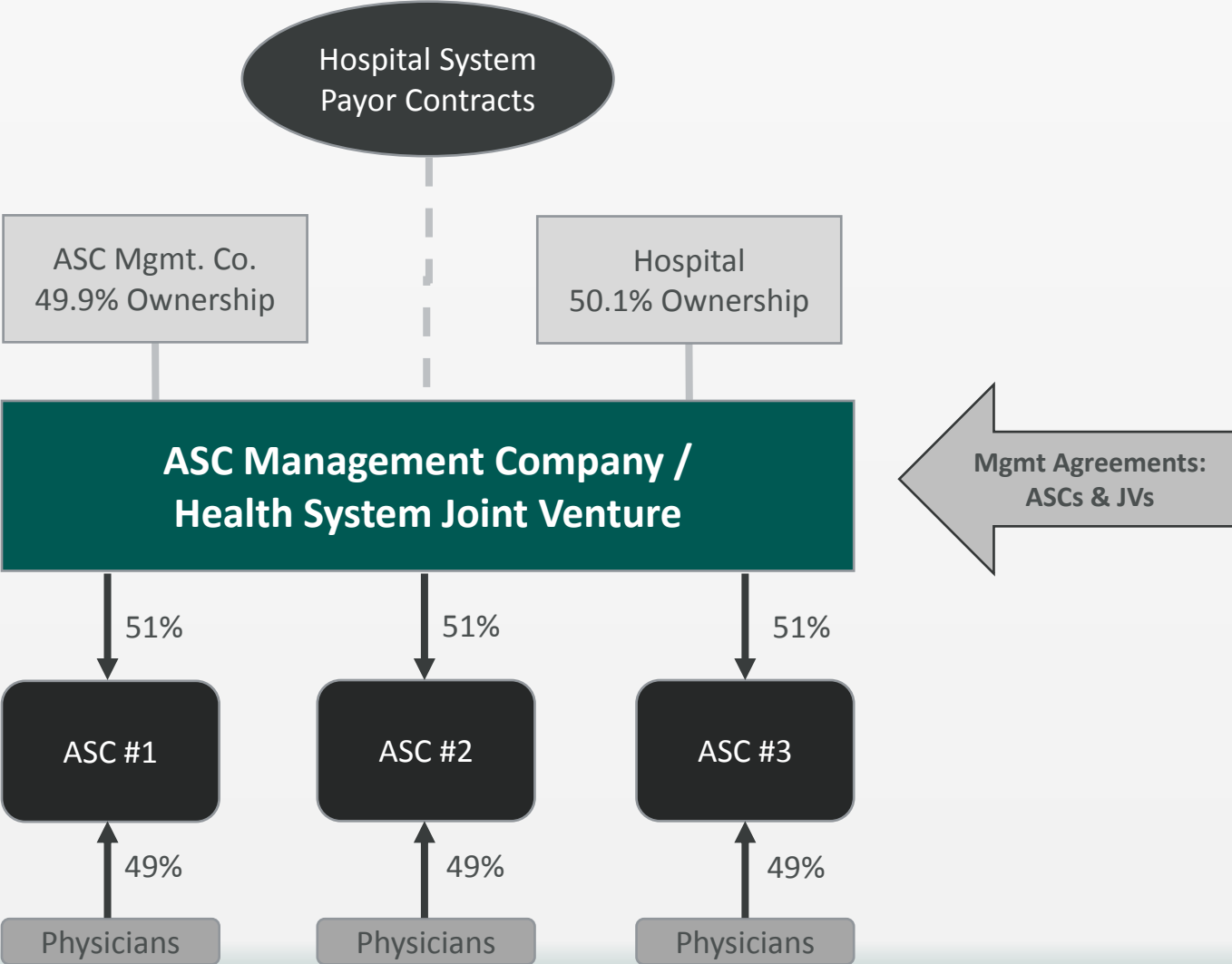
## Ancillary Provider JVs – Key Drivers





# OVERVIEW OF JOINT VENTURE TRENDS

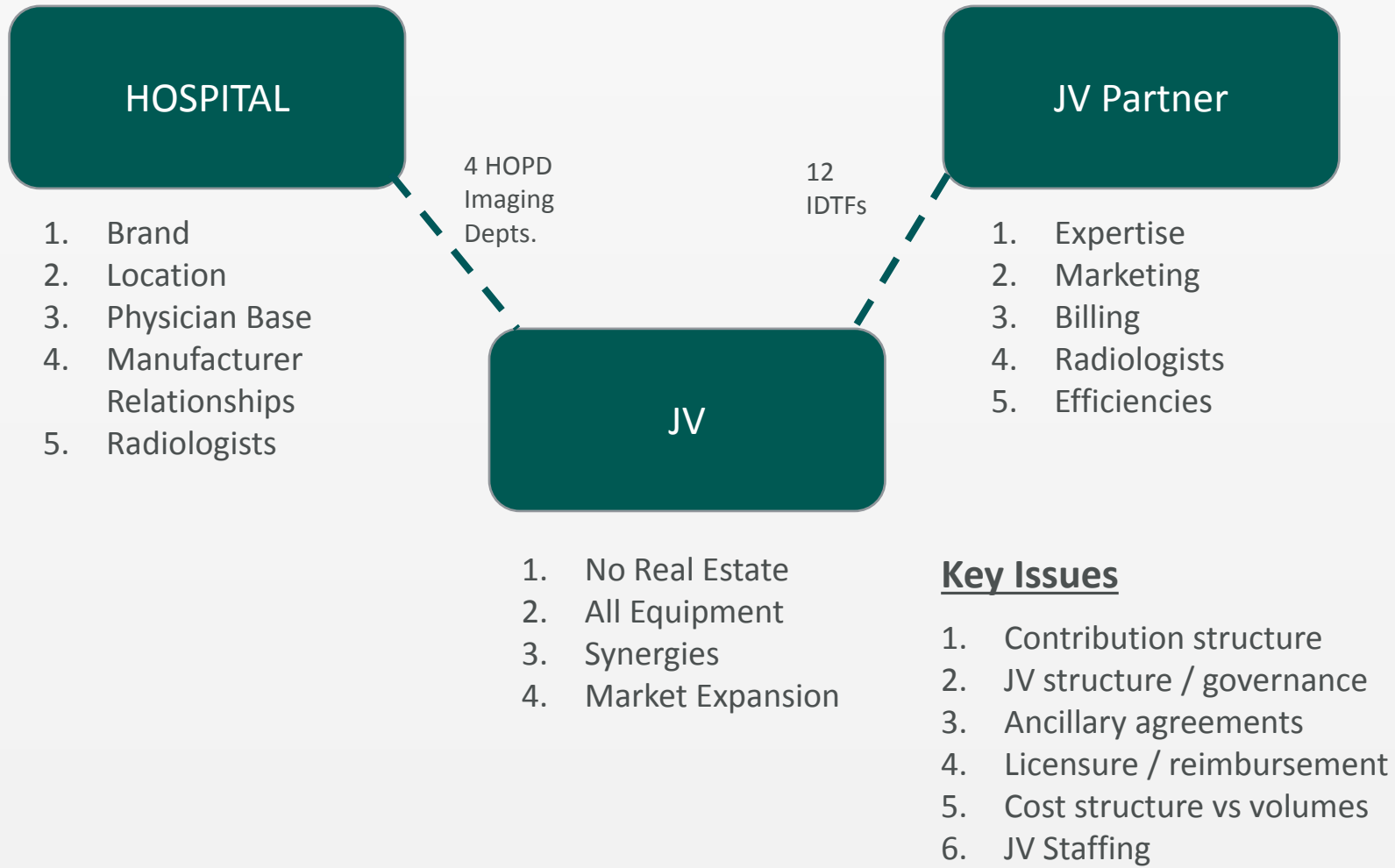
## Typical ASC JV Structure



# REGULATORY AND VALUATION CONSIDERATIONS FOR JV



## Hypothetical – Imaging JV



# OVERVIEW OF JOINT VENTURE TRENDS



## Whole Hospital JVs

### Participants

- HCA - St. David's (Austin), HealthOne (Denver), Methodist Healthcare (San Antonio)
- Duke LifePoint – majority owned JVs
- Tenet – majority owned JVs with John Muir Health (CA), Carondelet Health (AZ), Baptist Health (AL)
- LHP Hospital Group – five hospital JVs with non-profits in TX, NJ, FL and ID
- Baylor Scott and White – Tenet



### Key Drivers

- Significant capital needs for aging facilities and IT upgrades
- Need to be part of larger network to participate in risk-based models
- Economies of scale and management infrastructure
- Access to new markets
- Established brand
- Existing physician networks

# OVERVIEW OF JOINT VENTURE TRENDS



## Pros vs. Cons

### PROS

Market Share

Network Integration

Management Expertise

Capacity / Access

Geographic Penetration

Branding

Reimbursement

### CONS

Lower Ownership

Regulatory Issues

Slow Development Process

Multi-Party Decision-Making

Loss of Control

Greater Complexity

# Post-Transaction Contractual Trends

# POST-TRANSACTION CONTRACTUAL TRENDS



## Common Post-Transaction Contractual Arrangements



# POST-TRANSACTION CONTRACTUAL TRENDS



## Tradename / Brand License

Who provides the tradename / brand?

- Typically health system or hospital

What does the license include?

- Tradename
- Trademarks
- Collectively referred to as the “brand”

How is the fee structured?

- Royalty or license fee as a percent of JV revenue (most common)
- Monthly or annual fixed fee

# POST-TRANSACTION CONTRACTUAL TRENDS



## Management / Administrative Services

**Who provides the services?**

- One of the JV parties
- Healthcare system / hospital
- Physician-owned management company or physician practice
- Third party management company or ancillary service provider

**What are the services?**

- Management or administrative services
- Services may vary based on JV facility need or capabilities of the manager
- Managed care contracting services often retained by health system

**How is the fee structured?**

- Percent of JV facility revenue (most common)
- Monthly or annual fixed fee
- Fee structure may be determined based on which party provides services or state regulations



# POST-TRANSACTION CONTRACTUAL TRENDS



## Billing and Collection Services

**Who provides the services?**

- One of the JV parties
- Healthcare system / hospital
- Physician-owned billing and collection company or physician practice
- Third party management/billing company or ancillary service provider

**What are the services?**

- Billing and collection services
- Little variation in services provided in the market

**How is the fee structured?**

- Percent of JV facility revenue (most common)
- Monthly or annual fixed fee
- Fixed fee per bill
- Fee structure may be determined based on which party provides services

# POST-TRANSACTION CONTRACTUAL TRENDS



## Employee Staff Lease

**Why would there be a staff lease?**

- Best fiscal option
- Trained staff with necessary credentials and expertise

**Who are the leased staff?**

- Most commonly:
  - Nurses
  - Technicians
  - Front office staff

**How are the services provided?**

- Part-time, scheduled leased staff
- Part-time, as-needed leased staff
- Full-time leased staff

**How is the fee structured?**

- Cost (salary and benefits)
- Plus an appropriate mark-up

# POST-TRANSACTION CONTRACTUAL TRENDS



## Physician Compensation

**What are the services?**

- Professional / clinical services
- Medical directorship
- Other physician-required administrative services
- Pay-for-performance

**How is the compensation structured?**

- Depends on the services provided
- Caution against fees stated as a percent of revenue

# Regulatory and Valuation Considerations for JVs

# REGULATORY AND VALUATION CONSIDERATIONS FOR JV



## Stark Law and Anti-Kickback Statute

### Stark Law

#### Overview

- Financial relationship with physician results in prohibition on referral and billing of designated health services to Medicare and Medicaid patients under Stark Law unless financial relationship meets an exception

#### Requirements for exceptions

- Written agreement specifying terms
- Fair market value consideration set in advance that does not vary based on referrals
- Commercially reasonable

### Anti-Kickback Statute

#### Overview

- Prohibits knowing and willful offer, payment, solicitation or receipt of remuneration to induce or reward referrals of services reimbursable by a federal health care program

#### Important considerations

- Commercial reasonableness
- Documentation of fair market value
- No special treatment related to volume or value of referrals

# REGULATORY AND VALUATION CONSIDERATIONS FOR JV



## Tax Exempt Issues

### Requirement to maintain tax exempt status

- Non-Profit must be and remain organized and operated exclusively for charitable purposes

#### Contribution of charitable assets

- Must be fair market value
- May require Attorney General approval under state law

#### Remuneration paid by non-profit partner

- Purchase price, management fee, etc.
- Must be fair market value

#### Activities of JV attributed to non-profit partner

- Income treated as taxable unrelated business income unless activities are substantially related to charitable purposes
- If JV is substantial part of non-profit partner's activities, it could also impact overall tax exempt status

# REGULATORY AND VALUATION CONSIDERATIONS FOR JV



## Tax Exempt Issues

Are JV activities substantially related to charitable purposes of non-profit partner?

- Nature of activities – are they consistent with charitable activities contemplated by IRS (e.g. direct patient care)?
- Governance control – can non-profit partner ensure that activities will be solely in furtherance of charitable purposes?

Key governance considerations and Revenue Rulings 98-15 and 2004-51

- Board control
- Reserved powers
- Term of management agreement
- Charity care policies

# REGULATORY AND VALUATION CONSIDERATIONS FOR JV



## Antitrust Issues

- Analysis of JV formation
  - Are JV partners currently competitors?
  - How is competitively sensitive information treated during transaction – limitations on sharing of information, third-party analysis of sensitive information?
  - Does JV result in concentration of market power that may be subject to challenge?
  - Does JV transaction require Hart-Scott-Rodino filing?
  - Will FTC / DOJ require any divestiture of facilities?



# REGULATORY AND VALUATION CONSIDERATIONS FOR JV



## Unique Issues in JV Transactions

### Fair Market Value

No buyer synergies

Expenses to account for all expenses to operate as a freestanding business

Revenue/reimbursement changes to reflect “market” and not particular buyer

### Strategic Value

Incorporates synergies to specific buyer

Unique hospital based reimbursement

Paying greater than the market could be deemed “paying for referral”

# REGULATORY AND VALUATION CONSIDERATIONS FOR JV



## Common Questions about Accounting for Post-Transaction Structure in Valuation

Adjustments for changes in reimbursement

- Do health system facility contributions get lower valuation due to change in reimbursement model (hypothetical buyer)?

Adjustments for management, royalty or other fees in lieu of historical corporate overhead allocations

- Do health system facility contributions get benefit of reduced overhead costs in valuation?
- Do royalty fees get applied to for-profit facility contributions?

# REGULATORY AND VALUATION CONSIDERATIONS FOR JV



## Benefits of Receiving a FMV

### Compliance

- Stark
- Anti-Kickback

### Knowledge

- What the target is worth?

### Credibility

- Thousands of valuations
- Both sides of the table

### Independence

- No emotional involvement
- Just the facts

# Regulatory and Valuation Considerations for Post-Transaction Contractual Arrangements

# VALUATION & COMPLIANCE CONSIDERATIONS FOR POST-TRANSACTION CONTRACTUAL ARRANGEMENTS

## Trade Name / Brand License

Future economic benefit and incremental benefit to JV

Consider market comparables for similar licenses

Cost to recreate intangible asset

# VALUATION & COMPLIANCE CONSIDERATIONS FOR POST-TRANSACTION CONTRACTUAL ARRANGEMENTS

## Management / Administrative / Billing & Collection Services

Cost to provide services

Reasonable rate of return on services

Market range for similar services

Check for comparability of services to market

Consider other value drivers in the market

Check for overlap of services

Who provides the managed care contracting?

# VALUATION & COMPLIANCE CONSIDERATIONS FOR POST-TRANSACTION CONTRACTUAL ARRANGEMENTS

## Employee Staff Lease

Cost of salary and benefits

Reasonableness of salaries

Consider part-time versus full-time nature of leased staff services

Consider personnel type(s) and experience

Reasonable rate of return on services

# VALUATION & COMPLIANCE CONSIDERATIONS FOR POST-TRANSACTION CONTRACTUAL ARRANGEMENTS

## Physician Compensation

Consider specialty, services provided, and relevant market data

Do the services require a physician?

Are the services required for the operation of the facility and/or to benefit the facility's patients?

Log hours if hourly-based services

Check for overlap of services

Services are actually provided and consistent with agreement terms

Physician compensation must be set in advance at FMV



## ● ● ● BIOGRAPHIES



Colin McDermott, CFA, CPA/ABV is a managing director with VMG Health. He specializes in providing financial, valuation, and transaction advisory services to clients in the health care industry. His clients have included hospitals, hospital systems, health plans, ambulatory surgery centers, imaging centers, laboratories, physician groups, and other healthcare entities.

Mr. McDermott received a Bachelor of Business Administration in Accounting and a Master of Science in Finance from Texas A&M University. Mr. McDermott is a licensed Certified Public Accountant (CPA) in the state of Texas and holds the Chartered Financial Analyst (CFA) designation.

## ● ● ● BIOGRAPHIES



**Alexandra Higgins** is a manager in the Professional Services Agreement Division of VMG Health. She specializes in the valuation of a wide variety of agreements and agreement structures, including: management fees, billing and collection fees, physician and non-physician executive compensation, co-management compensation, and shared savings arrangements.

Ms. Higgins graduated Magna Cum Laude from Texas Christian University with a Bachelor of Science in International Economics. She has recently been published in *HFM Magazine*, *Health Care Compliance Today*, *Becker's Hospital Review*, and *ImagingBiz* and has recently presented at national healthcare conferences including AICPA Healthcare Industry Conference, HFMA National Payment Innovation Summit, and Becker's ASC Annual Meeting.

**QUESTIONS?**

