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

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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

Joint Venture Background

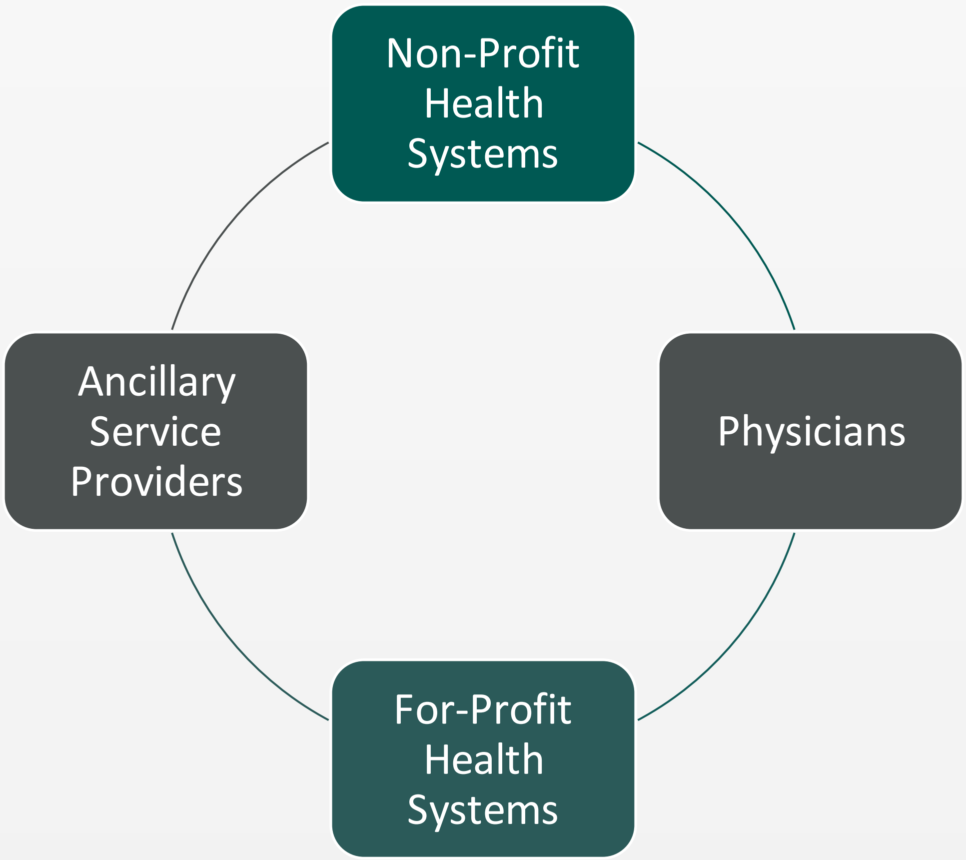
What is a Joint Venture?

- 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?

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

Joint Venture Participants



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	Rehab / Post Acute	Imaging	Oncology	Urgent Care/ Free-Standing ER
• Most long-standing and prevalent • Significant number of top health systems have ASC JV partners • USPI and SCA are largest players	• Select Medical – JVs with Penn State Hershey, Baylor Scott & White, Emory and others • HealthSouth – JVs with Vanderbilt, University of Virginia, and others	• Envision – Texas Health Resources • SimonMed – Dignity Health • Touchstone – Baylor Scott & White	• McKesson / US Oncology JVs with Memorial Hermann, Methodist Health (Dallas)	• Premier Health • NextCare • Walgreens • UC Health / Adeptus

Ancillary Provider JVs – Key Drivers

ASC's

- Access to payor networks
- Access to capital
- Physician networks
- Branding from health system partner

Rehab / Post Acute

- Management expertise
- Branding and market positioning
- Clinical integration
- Managing cost of care

Imaging

- Reimbursement pressures
- Reducing cost structure
- Management expertise
- Branding and market positioning

Oncology

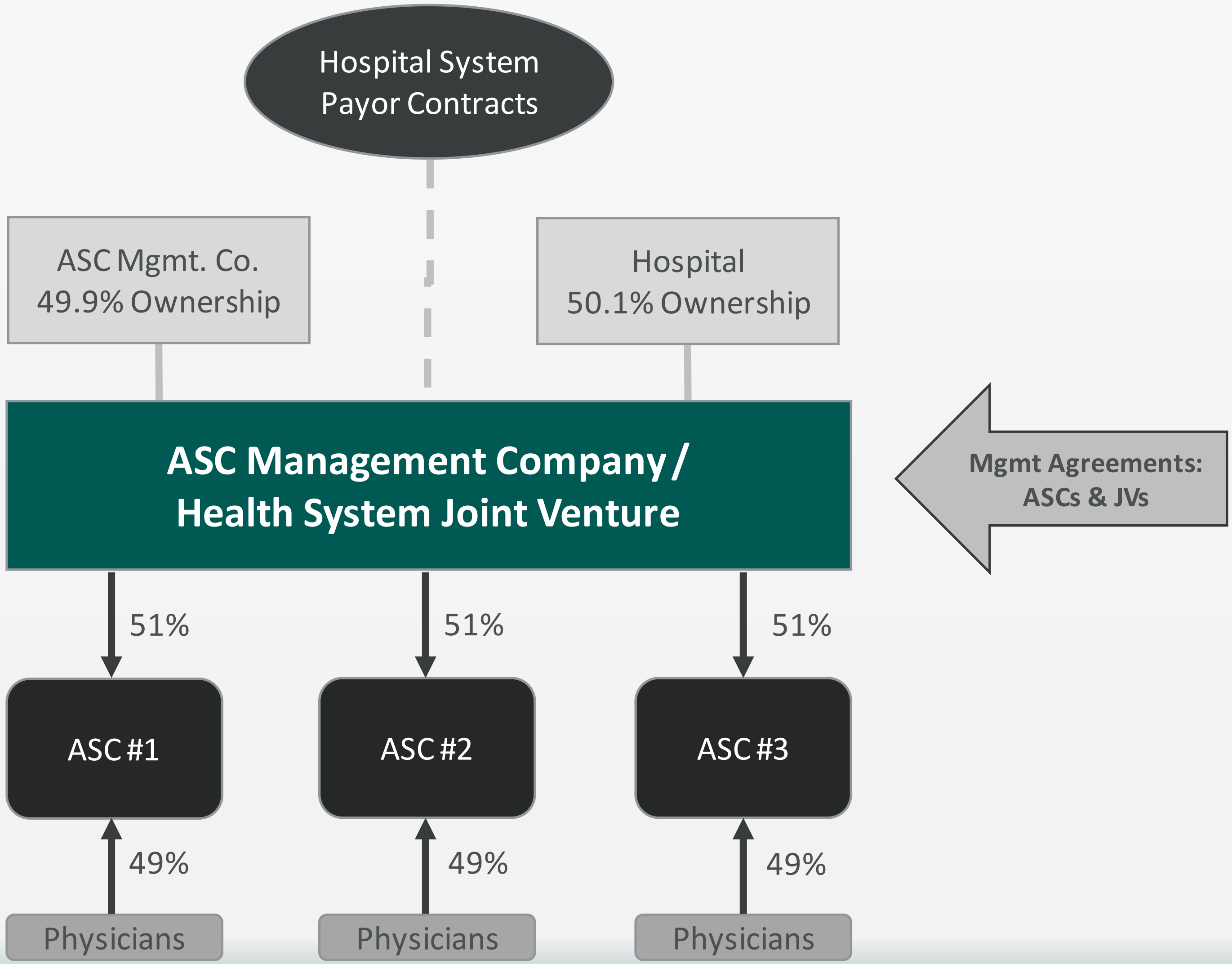
- Management expertise
- Branding and market positioning

Urgent Care / Free Standing ER

- Management expertise
- Branding and market positioning

OVERVIEW OF JOINT VENTURE TRENDS

Typical ASC JV Structure



REGULATORY AND VALUATION CONSIDERATIONS FOR JV

Hypothetical – Imaging JV

HOSPITAL

1. Brand
2. Location
3. Physician Base
4. Manufacturer Relationships
5. Radiologists

4 HOPD Imaging Depts.

JV Partner

1. Expertise
2. Marketing
3. Billing
4. Radiologists
5. Efficiencies

12 IDTFs

JV

1. No Real Estate
2. All Equipment
3. Synergies
4. Market Expansion

Key Issues

1. Contribution structure
2. JV structure / governance
3. Ancillary agreements
4. Licensure / reimbursement
5. Cost structure vs volumes
6. JV Staffing

10

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

Pros vs. Cons

PROS	CONS
Market Share	Lower Ownership
Network Integration	Regulatory Issues
Management Expertise	Slow Development Process
Capacity / Access	Multi-Party Decision-Making
Geographic Penetration	Loss of Control
Branding	Greater Complexity
Reimbursement	

Post-Transaction Contractual Trends

Common Post-Transaction Contractual Arrangements

- Tradename / Brand License
- Management / Administrative Services
- Billing & Collection Services
- Employee Staff Lease
- Physician Compensation

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

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

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

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

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

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

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

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

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?

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”

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?

Benefits of Receiving a FMV

Compliance	Knowledge	Credibility	Independence
• Stark • Anti-Kickback	• What the target is worth?	• Thousands of valuations • Both sides of the table	• No emotional involvement • Just the facts

Regulatory and Valuation 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

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

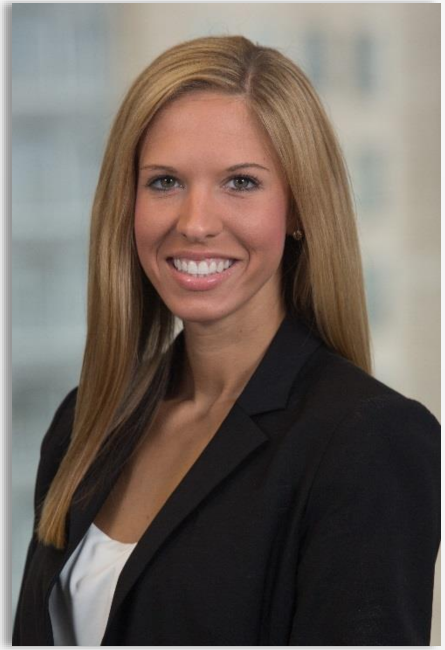
- Consider specialty, services provided, and relevant market data
- Do the services require a physician?
- Are the services required for the operation of the facility and/or to benefit the facility's patients?
- Log hours if hourly-based services
- Check for overlap of services
- Services are actually 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?

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