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SELECTING A JOINT VENTURE PARTNER FOR YOUR ASC

The success of a surgery center will often depend upon an alliance with an appropriate party. This party can be a national management company, a hospital or other local physicians. This article explores considerations and issues to review in connection with the selection of each type of partner.

1. <u>National Management Company</u>.

A national management company can bring specific expertise to a joint venture. This may be with respect to cost management, site selection, partnership, and operational efforts, manage physician partners, collection of account receivables, information technology, or other expertise. A national management company may also bring substantial cash to the venture, which may be needed for purposes of buying out or down investors, reducing debt for the center or acquiring needed equipment for the center. Further, a national management company may bring needed management expertise to the center.

The selection of the management company generally focuses on both financial and political issues. From a financial standpoint, issues that often require negotiation include:

A. What percentage will the national company buy?

B. What price will they pay?

C. What management fees will they charge?

D. What services are included in the management fee?

From a political standpoint, issues to resolve with a national management partner include:

A. How much do you like the national partner?

B. How strong are the references (including specified references as well as third party centers who have worked with them, but who are not listed as referrals)?

C. Who will control the partnership after they become a partner?

Many of the national management companies focus solely on multi-specialty or single-specialty centers. Of course, many are focused on centers that include orthopedic physicians or podiatrists. Others focus specifically on ENT, ophthalmology, gastroenterology, or other types of services.

Further, many national management companies will only become partners if they can own controlling interests in the venture.

2. <u>Hospital as Partner</u>.

Surgery centers often look to local hospitals as potential partners. The core reasons why a hospital may make a good partner for a surgery center tend to include:

A. The hospital partner brings capital to the venture, which can greatly assist to pay down debt, to acquire equipment or to liquidate interests.

B. The local hospital may control primary care physicians.

C. The hospital partner may be needed for a certificate of need or other efforts.

D. The local hospital may control managed care.

E. The local hospital may be able to otherwise harm the physician practices.

For several years, many surgery centers have looked toward hospitals as partners for a variety of the aforementioned reasons. In many situations, a surgery center cannot access managed care contracts or has been refused the ability to obtain business from primary care physicians because the managed care company or the primary care physicians have hospital connections.

Critical issues to discuss in developing a partnership with a hospital investor include:

A. The amount of control the hospital wants to have. Many hospitals, due to tax exempt or other concerns, desire substantial control over the venture.

B. The amount of impact that providing significant indigent care will have on the venture. In most situations, the determination to provide or expand indigent, Medicaid and Medicare care at a surgery center will have little overall impact on the surgery center.

C. The split of ownership of the venture.

D. The control of the board after the transaction. Will it be physician-controlled or hospital-dominated?

E. The price the hospital will pay for its interests in the venture.

F. Whether or not the hospital will manage the venture.

The ability and strength of many physician-hospital ventures often rests on the "attitude and tone" set by the hospital's chief executive officer and/or the hospital board. In certain situations, the hospital CEO and the board are intent on a method of doing business that is reliant upon physician alliances and relationships. This type of administrator can provide stability for a venture. Unfortunately, there are still many hospital administrators that believe in a partnership where the hospital dictates and the physicians listen. This type of administrator or board, notwithstanding fine legal documents, can lead to a poor joint venture.

3. <u>Physician Joint Venture Partners</u>.

Physicians can make good venture partners for surgery centers for a number of reasons. These include the following:

A. Physicians may bring needed cash to the joint venture.

B. Physicians may use the center as an extension of their practice.

C. Physicians often have the same focus on quality of care and economic goals that their other partners may have.

For these reasons, physicians may often make helpful partners for ventures. The key issues that often need to be discussed with respect to physician partners include:

A. The amount they will pay for the venture interests.

B. The amount of the interests they will be offered in the center.

C. The physician commitment to the center in terms of time and effort related to the center, including board activities, medical staff matters, and other issues.

D. The political and personal comfort with the physicians brought into the partnership.

Due to legal concerns, all physicians are generally offered the same amount of shares as are being offered to other physicians in the center at the same time. Further, the price paid by each physician per share should essentially be the same. In short, a physician that can bring in a lot of cases should not be offered more shares or a lower price.

Like any other sort of partner, there is almost no criteria that is more important than developing relationships with the type of physician partners that one likes to work with. In short, it is almost always a mistake to enter into a partnership with very high volume surgeons that one strongly dislikes.

4. Tips for Completing a Joint Venture.

There are a number of critical tactics that can be used to help effectively complete a joint venture. These include the following:

A. Engage in negotiations with at least two to three parties when planning to enter into a joint venture. This provides the center a clear idea as to the value of their enterprise. It also helps to diminish the opportunity for any party to hold the center "hostage" or vulnerable in negotiations.

B. Develop a consensus early on among the partners as to the type of realistic terms that partners are looking for in a transaction.

C. Allow for principal-to-principal discussions throughout the development of the joint venture. This should be handled in a professional way. It usually is a mistake to avoid any contact whatsoever between the principals and to allow just the lawyers or consultants to interact.

D. Keep a clear timetable as to the milestones that need to be met to complete the venture.

E. Sign a non-binding letter of intent with a short window for completion of the transaction. This provides a focus for the deal and helps cause early agreement as to principal terms.

F. Do not allow deals to be "cratered" based upon points that are not very critical to your party.

* * *

This is intended to provide a short overview of issues to consider in structuring joint ventures. Should you have any questions, please contact Scott Becker at (312) 750-6016 or John Vick at (760) 751-0250.

ASCs - CORE RISKS

1. <u>Cases.</u>

A failure by the venture to generate the amount of cases expected will have a very negative effect on the venture. There is often no requirement in the documents or otherwise that people bring cases to the venture. In an ambulatory surgery center, the structure can, in a multi-specialty venture, provide a clear compliance reason to require meeting so called "one-third/one-third" practice tests.

2. <u>Hospital Competition</u>.

Local hospitals may compete in a variety of ways. These include attempting to develop exclusive relationships with managed care plans, and developing exclusive relationships with other physicians so as to preclude physicians in the group from operating at the hospital. The hospital may also steer emergency, primary care, urgent care, and other cases away from the group. Surgery centers throughout the country have been harmed in part by a number of these actions.

3. <u>Fraud Abuse Statute; Stark Act; Similar State Laws</u>.

Currently, the Stark Act permits physicians to own interests in ASCs and in specialty hospitals. It is possible that the Stark Act exception would be later interpreted so as to apply to larger and more full-scale hospitals and not to small hospitals, which the government might characterize as an ambulatory surgery center that has MRI capacity. The government might also attack ownership of an ambulatory surgery center. There is not a specific "safe harbor" for ownership in a specialty hospital joint venture. Also, many ASCs do not meet a safe harbor. Thus, centers should take a number of steps to help lessen the potential for a negative investigation or prosecution. For example, it is critical that the venture adopt and comply with a strong legal compliance plan. Further, state and federal laws may be enacted or amended to prevent physician ownership.

4. <u>Overbuilding</u>.

Many surgery centers fail due to overbuilding (i.e., building a surgery center that is larger than necessary).

5. <u>Limited Liquidity</u>.

Anyone who invests should recognize that there is an extremely low level of liquidity of units. There is usually not a short-term right to cause the venture to buy a doctor out. Further, there is an extremely limited number of eligible physicians who could possibly buy one out.

6. <u>Reimbursement and Managed Care Exclusions</u>.

Reimbursement can be reduced from a Medicare perspective or from a commercial payer perspective. This can have a substantial negative impact on ventures.

7. <u>Limited Anesthesiologists, Radiologists and Nurses</u>.

In many communities, there are extensive shortages of Radiologists, Anesthesiologists and Nurses. Because the existing hospital greatly control the volume of patients, they can often influence people to not provide services at a competitive ASC or specialty hospital.

8. <u>Financing on a Non-Recourse Basis</u>.

Financing for ASCs and specialty hospitals on a non-recourse basis is increasingly difficult to obtain.

9. <u>Loss Of Any Key Physician</u>.

The loss of one or two or three key physicians can have an extremely negative impact on the venture.

10. Non-Competition Covenants.

In many states, a possibility exists that covenants against competition will not be enforceable.

CENTER FOR SURGERY, NAPERVILLE, ILLINOIS -- A SHINING SUCCESS STORY

The Center for Surgery was founded in 1994. At that point, it did no cases. Today, the Center provides services to 12,000 patients per year (this number reflects actual patients, not procedures).

The Center includes physician partners and two hospital partners. Each hospital partner owns approximately ⅓ of the venture, while approximately 80 physicians own the other ⅓ of the venture. Physician ownership is limited to surgeons and anesthesiologists. While 80 physicians own interests in the Center, more than 320 physicians are credentialed to utilize the Center. The Center has six full operating rooms. It also includes a significant number of procedural rooms used for specialities such as gastroenterology, lasik procedures, and pain procedures.

The Center attributes its success to two key factors. First, the phenomenal focus on patient and physician needs. Second, its efforts to ensure that all physicians are treated equally and have equal opportunities to own interests in the Center.

The Center believes strongly in a mentality of not allowing any one surgeon or group of surgeons to be dominant over other surgeons in the venture. For example, no surgeon is allowed to own more shares than any other surgeon in the venture and no more than 1% of the total venture. The Center believes this atmosphere has avoided situations where surgeons are uncomfortable using the Center for concern that they are feathering the nests of other surgeons.

Although the Center's administrator believes that the biggest competitor of the Center over the last couple of years has been the local hospitals, he has worked hard to maintain positive relationships among all of the parties.

The Center perceives its biggest threat as continued reduction in reimbursement. Continued escalation in cost and staffing, and consolidation of managed care payors, reduced reimbursement or exclusion from managed care plans, and Medicare reductions are of concern. Of necessity, the Center had to drop several managed care plans because the prices offered for services were considered below fair market value and insulting.

For more information regarding this shining success story and for tips that can be useful to your Center, please contact Rick Myers. Rick Myers is the Administrator of the Center and can be reached at (630) 505-7733.

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