

## PHYSICIAN-HOSPITAL JOINT VENTURES: A STRATEGIC ALTERNATIVE

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Since the first ambulatory surgery center was developed in Phoenix, Arizona in 1970, ambulatory surgery centers (ASCs) have provided an alternative to hospital based inpatient surgery for providers, payors and patients. It is generally recognized that ASCs are low cost, high quality providers of surgical services. During the 1970's and 1980s numerous ASCs were developed primarily by physicians seeking an alternative to hospital based surgery. In the early 1980's, the Medicare program recognized ASCs as a low cost effective delivery system and reimbursement was granted to ASCs. This fostered dramatic growth in ASCs which has continued unfettered into the 1990s with an increased awareness by physicians and hospitals to find ways in which they may work together to meet their strategic, financial and clinical goals.

### I. Factors Contributing to the Development of ASC's

The critical factors that have contributed to the development of ASCs for physicians include:

Control over the clinical operations including, among other things, hiring of staff, greater efficiencies in the operating rooms, and ease of scheduling.

Financial Participation in the project and the ability to garner a portion of the facility fee based upon the success of the surgery center.

Autonomy from the hospital and the ability to control the business affairs and the delivery of care to patients in a safe and efficient manner, negating bureaucracy typically associated with hospital based surgical units.

Lower Cost health care to patients and the community due to the fact that ASC's, by their very nature, are lower cost deliverers of surgical care.

Some hospitals have followed suit by developing their own ASCs. Critical factors contributing to hospital based facilities include:

- **Medical Staff Desire** to operate in a separate facility in order to achieve the efficiencies associated with ASCs as well as the ability to financially participate.
- **Competition** with other hospitals to deliver **lower cost health care** for third party payors in order to establish a **competitive advantage**.
- **Capacity** requirements in current facility lending itself to the development of an ASC.

## II. Factors Contributing to Increased Activity for Physician-Hospital Joint Ventures

Since the 1992 election whereby Bill Clinton proposed a restructuring of health care delivery systems based on provider networks, strategy for the development of ASCs and hospital based strategies have changed. While it is clear that the 1992 election and subsequent defeat of the Clinton legislation did not succeed in a mass overhaul of the health care industry, market forces moved toward an acceleration in ways in which health care services are delivered. One of the outgrowths has been a move by physicians and hospitals to align their interests and has resulted in a flux of activity toward physician-hospital joint ventures of ASCs.

### Hospital Incentives to Joint Venture ASCs

Hospitals have traditionally not entered into joint ownership arrangements with physicians because of the dilution of profit that would result in a jointly owned ASC as well as other miscellaneous factors unique to each hospital. However, many hospitals, especially not-for-profit facilities, recognize that in order to keep a competitive advantage, alignment with physicians is critical to ongoing success. Some of the key considerations accelerating hospitals' willingness to explore joint venture opportunities include:

- The federal government has been regularly increasing reimbursement to ASCs while at the same time, decreasing reimbursement to hospital based surgical units.
- Third party payors are demanding greater efficiencies and are showing greater willingness to contract with freestanding ASCs at prices below those of the hospital.
- Competitors, including hospital and health care conglomerates, are buying ASC companies and developing ASCs to augment their competitive advantage in markets.
- Hospital recognize that physicians will continue to develop ASCs without them and take profitable cases away from the hospital.
- Hospital recognize that partnering with physicians gives them a competitive advantage with third party payors and stops the development of freestanding, physician/ASC company owned facilities.
- Hospitals recognize that there are greater efficiencies achieved with an ASC; thus, the dilution of ownership interest can be negated with the efficiencies of the ASC, and the ability for the hospital to develop new outpatient programs to offset and augment the loss of revenue from the joint venture arrangement.

### Physician Incentives to Joint Venture ASCs

As discussed earlier, physicians have traditionally developed ASCs as an extension of their practice, or entered into partnerships with other partners to own and operate an ASC. However, third party payors desires to enter into global contracts with hospitals for delivery of care as well as their desire to contract with health systems to reach the metropolitan population of their market, have adversely effected the ability for single, freestanding facilities to compete. In addition, many primary care specialists who refer to the surgeons owners of the ASCs have aligned themselves with hospitals through the development of PHO type arrangements which has put increased pressure on surgeon owned ASC's to compete. Thus, the factors that contribute to the physicians desire to enter into a relationship with a hospital to develop a new ASC, or enter into an arrangement to joint venture an existing ASC include:

- Access to managed care contracts and the ability to strike a relationship with a strategic partner to capture greater market share through the use of the ASC as a vehicle for the hospital and participating surgeons to deliver lower cost, high quality care.
- The desire by physicians to keep a positive relationship with the local hospital.
- The addition of a strategic partner which can bring greater access to capital and increased awareness in the community.

### **III. SAMPLE STRUCTURES TO CONSUMMATE PHYSICIAN/HOSPITAL JOINT OWNERSHIP ARRANGEMENTS.**

Based upon the factors set forth above, the key points for physicians and hospitals are control over operations of the surgery center and the amount of ownership in the surgery center. It is imperative to distinguish between control and ownership because an arrangement can be structured whereby one party to the transaction owns a majority interest in the ASC while the minority owner has significant control over day to day operations and governance.

For illustrative purposes only, the following is an example of a way to structure a successful joint venture which attempts to address the fundamental issues which are key elements for the physicians and the hospital:

<b>Operating Entity</b>	Limited Liability Company
<b>Ownership</b>	Physician Group 50% Hospital 50%
<b>Governance</b>	Board of Managers comprised of 3 physicians and 2 hospital representatives.
<b>Management</b>	Professional management company jointly selected by both parties.
<b>Special Rights and Provisions</b>	Supermajority of Board of Managers (4 of 5) votes for certain fundamental decisions.
<b>Physician Clinical</b>	Medicare Advisory Committee comprised entirely of physicians which reports to the Board of Managers and addresses credentialing, quality assurance, quality improvement and other clinical matters. This committee is key because its interfaces with the board and the management company regarding physician issues and serves as a conduit of information and representation for the physicians who do not participate on the board.

This example addresses many of the issues which are key for hospitals and physicians. Specifically, the example contemplates equal ownership between the two parties which addresses the desire of both parties to own a significant interest in the project. Secondly, the example set forth above contemplates physicians having control over the operations and governance of the facility while at the same time delegating day-to-day management to a professional firm specializing in successfully operating ambulatory care facilities. This provision addresses the physician concerns over how the facility will operate, the desire to eliminate bureaucracy, and the desire for significant input regarding the business of the facility. The example also attempts to address the hospital concerns by requiring hospital consent for substantive issues which could adversely effect the hospital. Since many administrators do not have time to develop and operate freestanding ambulatory facilities, the role of professional management ensures the requisite expertise required to make the center a success is in place to ensure the delivery of high quality, low cost care.

It should be noted that each respective situation requires its own unique structure tailored for each transaction. However, examples, such as the one set forth above, attempts to address the fact that there are fundamental market forces moving physicians and hospitals together to develop ambulatory care centers.

Finally, due to the need for both parties to reposition services to better respond to third party payor incentive arrangements, alternative delivery systems, and increased competition, physicians and hospitals recognize the



advantages afforded by the development and joint ownership inherent in ambulatory care facilities because it allows both physicians and hospitals to consummate strategic partnerships in order to enable them to meet their goals and long range objectives for the future.

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