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Top Five Issues Related to Physician-Hospital ASC Joint Ventures

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The past several years have seen resurging interest in ambulatory surgery center (ASC) transactions. As previously covered in Health Care Law Today, ASCs have made a comeback with involvement of multi-specialty groups. This is the third post in a series regarding the ASC industry. This article highlights the relationships between physicians and hospitals involved in joint ventured ASCs.

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Why Physician-Hospital Joint Venture ASC Deals?

Many of today's ASC deals involve facilities originally developed by physician investors years ago, a number of which stripped surgical volume out of local hospitals. Initially successful, these physician-owned centers have found it increasingly difficult to negotiate favorable rates with payers. Hospitals, meanwhile, still maintain leverage with insurers and a properly structured deal can allow a joint ventured ASC to enjoy better pricing in the insurance market. Moreover, these deals allow hospital partners to regain a fraction of the surgical volume lost when the ASC in question was initially developed, even if at lower profitability.

How Are These Ventures Structured?

As a general proposition, the hospital partner purchases, and owns, at least 51% of the outstanding equity of the ASC and, in some cases, controls the ASC's governing board. This structure is usually necessary to ensure that the hospital's payer contracts cover the ASC as an affiliate, thus allowing the ASC to benefit from the hospital's favorable rates. This deal structure also, generally, can allow for compliance with federal and state antitrust laws.

At What Price?

These deals are generally transacted at fair market value, as they can implicate the federal, as well as certain state, anti-kickback statutes, primarily because the physician partners in the deal may refer non-ASC work to the acquiring hospital partner. Any payment by the acquiring hospital in excess of the fair market value for the acquired equity could be seen as remuneration from the hospital in exchange for physician referrals. In addition, since many acquiring hospitals or health systems are tax-exempt, it is important that this status not be jeopardized by an overpayment for an interest in a physician owned ASC. Hospitals often seek third party valuations in order to set, or support, purchase price as consistent with fair market value. Over the last 12 months we've seen the median purchase price for a controlling interest range from 7-9x trailing twelve months' EBITDA, depending upon whether or not the center is a single specialty or multi-specialty center facility.

What Does Governance Look Like?

Governance of a Physician-Hospital ASC joint venture can vary depending upon the situation. In certain instances the acquiring hospital's managed care contracts might require that the hospital have not only a majority position in the equity of the ASC but also have governance control, at least over certain issues. In addition, and as noted above, the need to avoid certain antitrust concerns may dictate that the acquiring hospital be granted certain

controls. However, in some instances, minority physician owners can be given equal representation on governance boards or, at least, control over the clinical aspects of the ASC's operations. This sort of flexibility is possible since most of these ventures are structured as limited liability companies, which allows for the bifurcation of equity ownership from governance.

Are There Significant Legal Issues Attached to the Structure Given Hospital Ownership?

While a hospital partner increases complexity of an ASC joint venture, it should not necessarily present insurmountable legal issues. As an initial matter, the Department of Health and Human Services promulgated a specific safe harbor regulation under the Federal Anti-Kickback Statute designed to address ASCs owned jointly by physicians and hospitals. Any returns enjoyed by the owners of any ASC venture that precisely meets the requirements of the safe harbor are deemed not to violate the Federal Anti-Kickback Statute. This safe harbor is somewhat complex, however, and doesn't necessarily account for the fact that many hospital partners employ physicians who may refer to the ASC or to the surgeons who work in the ASC. Thus, meeting the requirements of this safe harbor may not be practical. However, the failure to meet a safe harbor doesn't necessarily render the arrangement illegal. In instances where a specific arrangement doesn't meet all of the requirements of the safe harbor a determination of whether or not the joint venture complies with the fraud and abuse laws will require an analysis of the specific facts surrounding the venture. The OIG has issued a number of Advisory Opinions addressing the application of the safe harbor and the Federal Anti-Kickback Statute to these sorts of ventures.

Other possible legal issues to be aware of are those related to the hospital owner's tax exempt status—as many hospital investors are tax exempt—which may require the ASC to conform its operations in order to avoid the returns earned by the hospital being treated as unrelated business taxable income or otherwise jeopardizing the hospital owner's exempt status. Examples may be a requirement that the ASC adopt the hospital's charity care and compliance policies. In addition, antitrust laws can be implicated should the hospital and the ASC be deemed competitors, which is one good reason why these deals are structured so that the hospital owners control the equity and the governance of the ASC.

In summary, ASC ownership by physicians and hospitals is on the rise and there are solid business reasons for these deals. Careful structuring will allow parties to achieve those business objectives while avoiding significant legal issues.