The World of Health Care System Joint Ventures
A NOT-FOR-PROFIT/ FOR-PROFIT MODEL

Market Indicators: One party in a particular market anticipates that it can achieve increased efficiencies, economies of scale and other benefits by joining together with another party in the market. For example, perhaps one of the parties is considering selling its holdings if it were to otherwise remain on its own. Another rationale may be that one of the parties is having difficulties gaining access to needed capital. The parties may have other business or legal rationale for joining together with another party.

STRUCTURE

Two parties in a market contribute their assets in that market to a limited liability company (JV, or Newco per the below chart) that is owned by both parties, or to wholly-owned subsidiaries of JV. For purposes of this example, we assume that one party is a not-for-profit/tax-exempt entity (NFP) and the other party is a for-profit entity (For-Profit). NFP takes a simultaneous cash distribution from JV at closing in order to defease any debt associated with any assets contributed to JV (or to create or enhance a community foundation). Upon initial capitalization of JV, it is debt-free with sufficient cash on hand or otherwise available to complete strategic projects or acquisitions. JV profits, losses and cash distributions are shared between NFP and For-Profit based upon their respective ownership interests in JV. JV pays local sales and real estate taxes but is considered a “flow-through” entity for federal income tax purposes, i.e., profits are taxed at the partner level rather than at the JV level based upon each partner’s individual tax status. It would be typical for JV to enter into a Management Services Agreement pursuant to which For-Profit provides comprehensive management services to JV for a fee. As needed, For-Profit may make available to JV a working capital line of credit.
MANAGEMENT

All management authority for JV rests with JV’s Board of Managers (Board). The Board utilizes “block voting” - i.e., it can only approve an action if such action obtains the approval of a majority of the managers appointed by both NFP and For-Profit. So long as NFP retains at least an X percent interest in JV, NFP appoints one-half of the Board. The model is intended to closely track many of the requirements of the IRS as expressed in Revenue Ruling 98-15, which provides guidance as to how a non-profit organization’s tax-exempt status can be maintained in a “whole hospital” joint venture with a For-Profit partner. Each NFP and For-Profit would have certain reserved powers. Sample NFP reserved powers include: (i) the right to name JV’s Board Chairman, (ii) approve closure of any hospital; (iii) rights if JV’s activities could jeopardize NFP’s tax-exempt status; (iv) causing JV to not renew the Management Services Agreement; and (v) right to approve certain Board of Manager actions. Sample For-Profit reserved powers include: (i) rights associated with consolidated financial reporting and (ii) right to approve certain Board of Manager actions.

TAX-EXEMPTION CONSIDERATIONS

The purpose of JV is to operate the system in accordance with the Internal Revenue Code and specifically its Community Benefit Standards for Section 501(c)(3) non-profit corporations. Among other things, these standards require JV to: (i) accept Medicare/Medicaid patients; (ii) accept all emergency patients without regard to ability to pay; (iii) maintain an open medical staff; (iv) provide public health programs of educational benefit to community; and (v) generally promote public health, wellness and welfare to the community by providing health care at a reasonable cost. JV would also comply with IRC Section 501(r) requirements. If there is a conflict between all such standards and the goal to maximize profits, such standards would be satisfied without regard to maximizing profitability of JV. As set forth in the Management section above, sample NFP reserved powers could include rights if JV’s activities could jeopardize NFP’s tax-exempt status.

GOVERNANCE CONSIDERATIONS

The JV’s governance structure would be consistent with applicable state limited liability company law and applicable law pertaining to the fiduciary obligations of the individuals on the Board. The JV would also be structured in a manner to address potential conflicts that may arise in connection with potentially divergent interests of For-Profit, NFP and/or individuals on the Board.

OTHER KEY FEATURES AND RIGHTS

Other key features/rights typically include provisions governing: Noncompetition and Nonsolicitation of Employees; New Business Opportunities; Rights of First Refusal; Put/Call Rights; Conflicts of Interest/Related Party Transactions; Rights upon Dissolution; Dispute Resolution & Deadlocks.

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