Governance Lessons from the Field

Strategic Affiliations & Joint Ventures

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Agenda

- Strategy & Governance
- Regulatory Considerations & Leadership Engagement
- Hypothetical Examples
- Risk Mitigation Strategies
- Exit Planning
- Hypothetical Examples

Strategy & Governance

- Strategy Examples
  - Market Expansion
  - Access to Clinical Expertise or Capabilities
  - Physician Alignment
  - Risk Sharing/Value-Based Care
  - Service Line Development
- Governance Frameworks
  - Promote collaboration and shared ownership
  - Emphasize speed, efficiency, and delegated authority

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Regulatory & Leadership Considerations

- Regulatory Considerations
  - Antitrust
  - 36 Month Rule & Moratorium on Home Health Licenses
  - Stark Law
  - Anti-kickback Statute & Safe Harbors
  - Tax and tax-exemption
  - Licenses/permits
- Leadership Engagement
  - Leadership alignment before formation
  - Regular touchpoints among leaders from both sides
  - Clear authority delegated to team members

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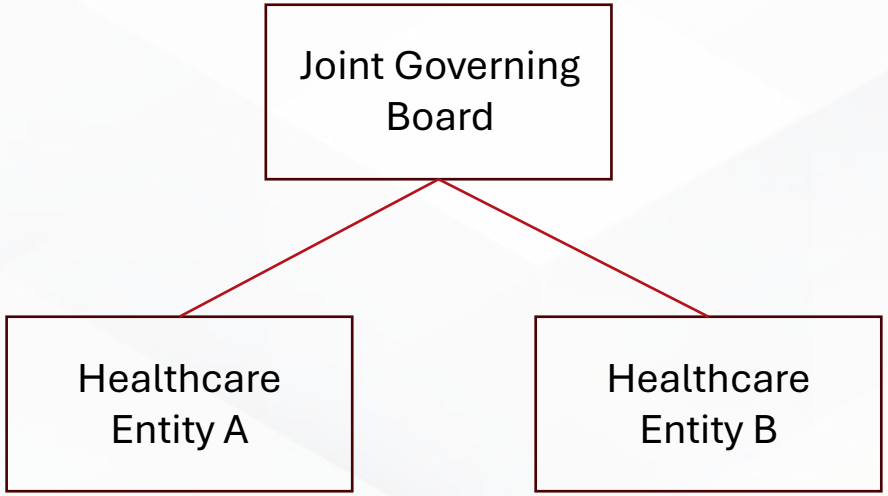
Hypothetical #1 – Joint Governance Model

- **Fact Pattern:**
  - Entity A has strong physician relationships and engagement
  - Entity B has leveraged technology to optimize delivery of care
- **Strategic Rationale**
  - Desire to share and exchange certain strengths
- **Governance**
  - Role of joint governing board is most crucial element
  - How much authority will individual entities have?
- **Regulatory Considerations**
  - State antitrust notices, tax implications, etc.
- **Leadership Engagement**
  - More engagement needed here because certain authority will be taken away from current leadership



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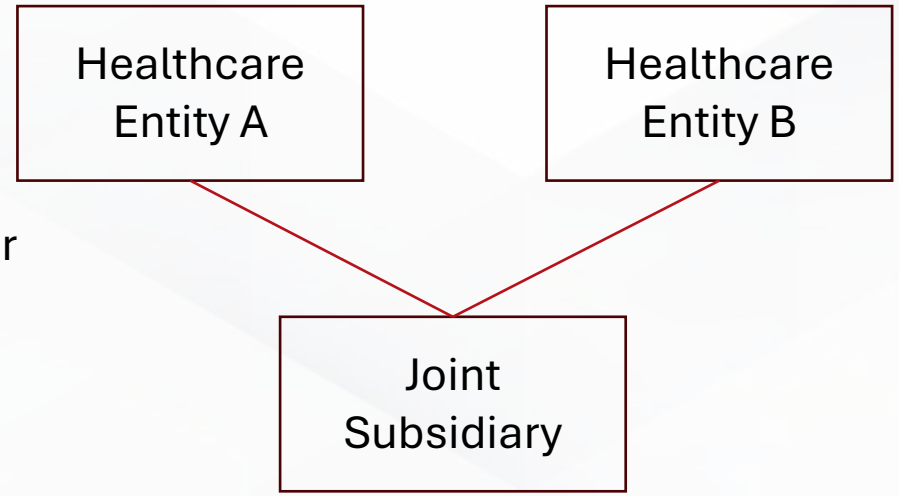
Hypothetical #2 – Joint Operating Model

- **Fact Pattern:**
  - Entity A and B use similar administrative and back-office services, but costs are high
- **Strategic Rationale**
  - Create efficiencies by pooling those services into one subsidiary entity which provides services to both
- **Governance**
  - Outlining ownership rights, decision-making authority, possibility for adding new owners, and exit strategies are critical
- **Regulatory Considerations**
  - Tax exemption may or may not be feasible
  - Be mindful of Stark and AKS
- **Leadership Engagement**
  - Less engagement needed than previous model once the goals are set



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Risk Mitigation Strategies

- **Brand Protection & Reputational Risks**
  - Require approval rights over marketing materials, public announcements and community-facing communications and Identify circumstances under which a party may require removal of its branding from JV operations.
- **Financial & Operational Risk Management**
  - Establish measurable operating and financial performance benchmarks.
  - Clarify responsibility for losses, liabilities and indemnification obligations.
- **Compliance & Regulatory Safeguards**
  - Defined responsibility for regulatory investigations and corrective actions.
  - Quality and patient safety oversight mechanisms.
- **Unexpected or Underestimated Risks**
  - Management resource commitments.
  - Technology and data integration
  - Physician alignment expectations.
  - Capital expenditure requirements.

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Exit Planning

- Define buy-sell rights, put/call rights and valuation methodologies.
- Establish procedures for transition of patients, employees, contracts and licenses.
- Determine ownership and disposition of records and data.
- Removal of trademarks, branding and public affiliation references upon separation.
- Determine resolution waterfall:
  - Escalate to key executives
  - Escalate to the owners' CEOs
  - Mediation
  - Arbitration
  - Buy / Sell
  - Budget Deadlock – Prior year's budget plus % increase
- Exit may be permitted contractually in certain limited scenarios:
  - Right of first refusal (ROFR)
  - Right of first offer (ROFO)
  - Put / Call (also referred to as a buy/sell)
  - Tag-along / Drag-along rights

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Hypothetical #3- Service Line-specific JOA

- **Fact Pattern:**
  - Entity A – Nonprofit single-specialty hospital
  - Entity B – Nonprofit statewide, full-service health system
  - Parties enter into joint operating agreement for the development of a single service line in a specified region
- **Strategic Rationale:**
  - Entity A – Expand footprint in new geography
  - Entity B – Develop improved service line in cooperation with highly rated specialists
- **Governance Considerations:**
  - Joint operating committee serves as "board," with functions delegated to advisory boards and appointed officers
- **Takeaways:**
  - JOA defines scope of service line development with high degree of specificity
  - Entity B required to "wall off" the JOA service line from its other services
  - Subsequent acquisitions subject to a reconciliation process to determine whether the same may be added to the JOA

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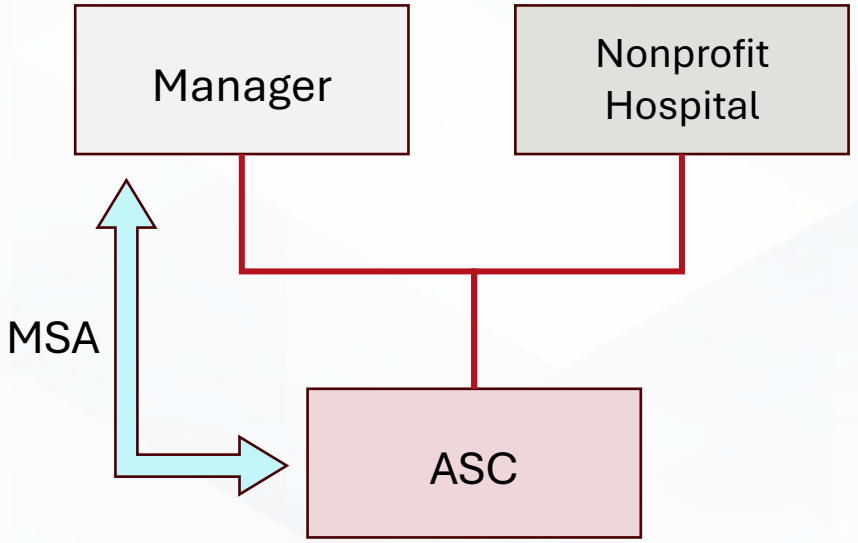
Hypothetical #4 – Nonprofit-PE ASC Joint Venture

- **Fact Pattern**
  - Nonprofit hospital owns majority interest in ASC entity
  - PE-backed management company acquires minority interest in ASC and enters into MSA with ASC
  - Declining financial performance leads ASC to seek alternative arrangement, but management entity has strong minority protections
- **Key Governance Considerations**
  - Strong reserved powers in favor of manager with respect to management arrangement
- **Regulatory Considerations**
  - CON
  - Stark (in scenarios where physician ownership is also implicated)
- **Takeaways**
  - "Culture fit" becomes serious consideration
  - More clearly defined performance metrics would provide hospital with an unwind pathway



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Questions?

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