New Jersey Continueing Legal Education (NJICLE)
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Issues & Cautions Associated with Medical Practice Affiliations with Hospitals & Alternatives

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Overview of Presentation

General Trends

- Continued Erosion of "Traditional" Medical Staff-Hospital Dynamics
- Mega Trends

Overview of Affiliation Models

- Direct Employment
- Professional Services Agreement Model
  - Management Services Agreement
  - Asset Purchase Agreement

Continued Erosion of "Traditional" Medical Staff—Hospital Dynamics

Overview of Traditional Medical Staff Structures & Relationships

Approval of MS Bylaws & Regulations

Pressures to Integrate

- Hospital Board
- CEO & Executive Leadership Team
- SL Admin./Mgr. PT Med. Directors
- Other S.L./Dept. Admin./Managers
- All Other Support Members/Units

Medical Staff/Hospital Interaction & Support for Shared Mission & Vision

The Medical Staff

Elected Officers & Committees

- President
- Vice President
- Secretary/Treasurer
- Dept. Chairs & Section Chiefs
- Other Elected MS Reps.
- Medical Staff Committees

Individual Members of the Medical Staff

Pressures to Integrate

Patients/Payers

Mega Trends Affecting Physician-Hospital Relationships

1. **Increasing, Shared Economic Pressures from "Eroding" Payer Mix**
   - Declining income
   - Accountable Care
   - Pressures/insecurity resulting from "reform" driven by CMS for cost control, efficiency and "quality"
   - Continuing pressures from payers for P4P, "full networks" and clinical efficiencies

Mega Trends Affecting Physician-Hospital Relationships

1. **Increasing, Shared Economic Pressures from "Eroding" Payer Mix** *(continued)*:
   - Increasing needs/demands from physicians/practices for income support (e.g., joint ventures regarding ancillary services, requests/demands for "call coverage" payments, Medical Directorship stipends, etc.)
   - Competition between physicians and hospitals for ancillary revenue streams
   - Misalignment of physician and hospital reimbursement methodologies, e.g., physician fee-for-service versus hospital-per-case

Mega Trends Affecting Physician-Hospital Relationships

2. **Increasing Operational / Infrastructure Expenses further eroding "bottom line" margins**
    - High capital costs
    - Shared disappointments regarding initial EMR and related IT integration initiatives
    - Reimbursement reductions for failure to implement EHR in hospitals

Mega Trends Affecting Physician-Hospital Relationships

3. **The Changing Profile of "New" Physicians & Allied Health Providers**

- Aging medical staffs
- Risk-adverse residents/fellows and new practitioners
- Increasing competition for physician talent – particularly for hospital-based specialties
- Economics and lifestyle issues
- Erosion of medical staff allegiance - particularly among PCPs
- Limitations of compensation plans to drive desired behaviors
- Emergence of the physician generation gap
- Existing and impending physician shortages

Affiliation Models

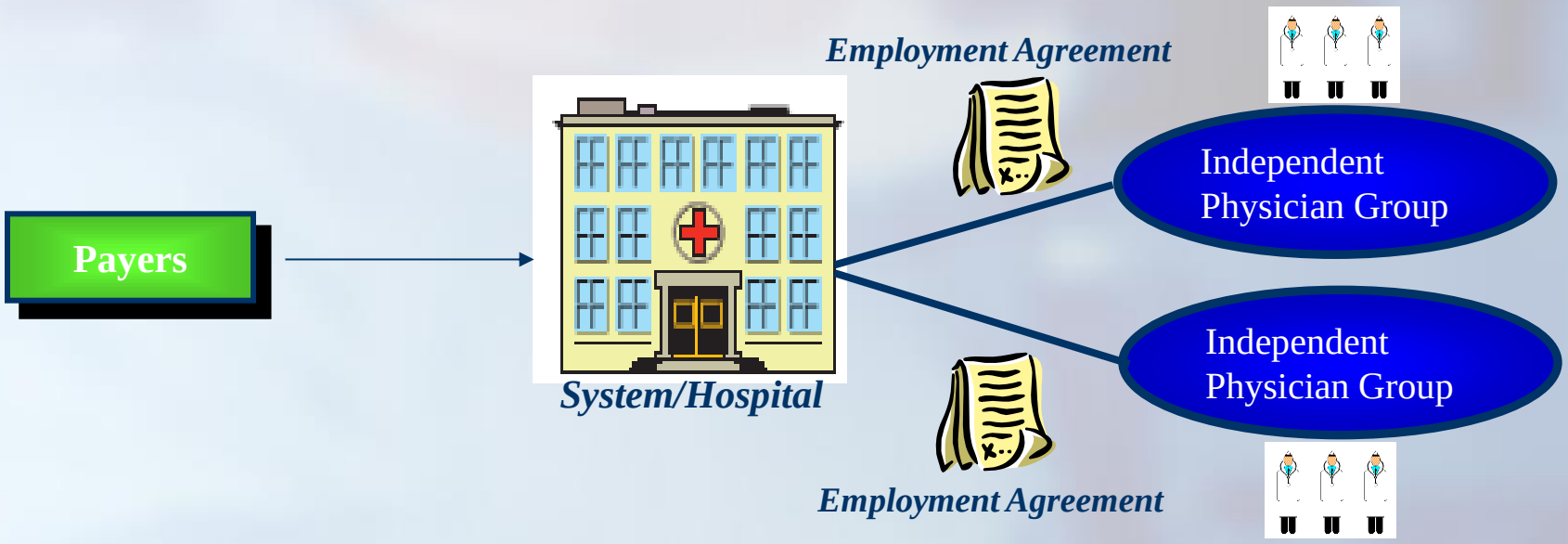
Hospitals/Systems Continue to Re-assess the Necessity of Utilizing a Broad Range of Affiliation Options with Physicians to Advance Their Shared Missions/Visions

Prediction: Increasing Utilization, Sophistication & Complexity of Affiliation Models/Relationships

	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7	Model 8	Model 9
Range of Affiliation Models	Traditional	Physician Recruitment	Medical Directors & Personal Service Agreements	Management Service Organization	Center of Excellence	Joint Payer Contracting	Joint Ventures	Co-Management Agreement	Physician Employment
Projected Utilization Next 24-36 Months	No Growth	Slight Growth	No Growth	Decrease	Slight Increase	Decrease	Steady Growth	Steady Growth	High Growth
Additional Comments & Rationale	Increasing recognition of need to rebuild physician relations programs	Limited per Stark and other regulations	Slight decrease in number of physicians, increase in pay, and accountability	Practices will continue to evaluate whether to seek practice support due to financial pressures	Typically focused upon favored margin services	Dependent upon extent of clinical integration	Continues to increase despite initial resistance from hospitals and systems	Continued increase due to focus on quality and efficiency	Increasing physician employment integration in multiple forms

Integration and Complexity Increases →

Model 9A: **Direct Employment**



Physician Alignment Model with Hospital, or Hospital Affiliate ~ *Full Integration*

- **Hospital Affiliate ~ Purchase**
  - **Furniture fixtures, equipment (Fair Market Value)**
  - **Medical Practice Goodwill ~ No Value**
- **Physician Employed by Hospital Affiliate**
  - **Base salary – (Fair Market Value)**
  - **Incentive based on wRVU's / Quality Metrics**
  - **3 – 5 year contract**
  - **Medical Practice Employees are rehired by Hospital Affiliate**
  - **Hospital Affiliate manages Medical Practice**
  - **Physician continues to practice in their current office location**

Model 9A: **Direct Employment**

Key Provisions:

- Physicians employed directly through the Hospital via a formal individual employment agreement.
- The Hospital, as employer, is responsible for the physician's practice requirements including operations, finances and governance.
- A standard employment agreement exists establishing compensation, benefits and services to be provided by the physician.

Model 9A: **Direct Employment**

Key Provisions *(continued)*:

- Physician salary must be based on Fair Market Value (FMV) compensation, often calculated on a productivity basis such as work RVU, percentage of collections or net revenue basis.
- The physician assigns his or her professional fees to the Hospital.

Level of Integration ◆◆◆◆◆

Model 9D: **Professional Services Agreement Model** (PSA)

Hospital

Asset Purchase Agreement/Lease Agreement

Independent Physician Group

Formal Professional Services Agreement and Management Services Agreement

Partial Integration

- **Alignment – Legal Agreements**
  - **Hospital Affiliate and Medical Practice will enter into the following agreements:**
    - **Asset Purchase or Lease Agreement (APA)**
    - **Professional Services Agreement (PSA)**
    - **Management Services Agreement (MSA)**

Partial Integration - Professional Service Agreement (PSA)

- **Physicians will retain Ownership in their Medical Practice**
- **Physicians Remain Employed by their Medical Practice**
- **Physicians Continue to practice medicine in their current office site**
- **The hospital affiliate purchases / leases physician professional services from their Medical Practice through a Professional Service Agreement and pays the Medical Group based upon Physician wRVUs and a Fair Market Value Conversion Factor**

Partial Integration - Professional Service Agreement (PSA)

- **The Leased Physicians will reassign their Medicare NPI Number (Reassignment of Medicare Benefits Form CMS-855R) to the Hospital Affiliate**
- **Hospital Affiliate will bill exclusively under their own EIN, NPI Number**
- **Hospital Affiliate will submit claims to Third Party Payor's and receive payments based on their negotiated contract rates and their fee schedule**

Professional Service Agreement (PSA) -Fee/Lease Payment

- **Estimated Annual Fees payable to the Medical Practice is based upon the following two components:**
  - **Total of Physician's Historical wRVUs for the prior calendar year**
  - **Multiplied by the Conversion Factor**
    - **Example: 20,000 prior year wRVUs multiplied by the $60 Conversion Factor equals $1,200,000 Estimated Annual Payment**
- **Hospital Affiliate will Pay the Medical Practice monthly 1/12th of the Estimated wRVUs Leasing Fee on the first day of each month**
  - **Example: $1,200,000 divided by 12 equals $100,000 per month**

Professional Service Agreement (PSA) -Fee/Lease Payment

- **Within 30 days after the end of the Calendar Quarter , the Actual wRVUs rendered by Date Of Service will be Multiplied by the Fair Market Value Contracted Conversion Factor pursuant to the Professional Service Agreement. The result will be reconciled to the Estimated Monthly Payments that were paid to the Medical Practice from the Hospital Affiliate.**

Professional Service Agreement (PSA)

Hospital Affiliate:

- **Reimburses the Medical Practice for the following Physician's Fringe Benefits:**

  Health Insurance
  Pension Contribution
  Payroll Taxes

- **Physicians will divide their Professional Service Income based upon their own internal "Practice Income Distribution Formula"**

- **Hospital affiliate usually reserves the right to review the wRVU Conversion Factor at the end of the third year of the five year Professional Service Agreement**

Partial Integration Summary

- **The Medical Practice will remain as an Independent Medical Practice**
- **The Medical Practice will continue to have control over the following:**
  - **Medical Practice Governance**
  - ***Income Distribution Formula***
  - **Benefits Plan (health insurance, retirement plans)**
  - **Malpractice Insurance**
  - **Staff**
  - **Manage the Medical Practice Day-to-Day Operations**

Clinical Compensation Comparison

Assumptions:

- **2 Physicians (Cardiology)**
- **wRVUs annually (20,000)**
- **Fringe benefits**
  - **Health insurance $20,000**
  - **Pension $30,000**
  - **Payroll tax $15,000**

	Historical Practice	Alignment Proposal	△
wRVUs	20,000	20,000	N/A
Conversion Factor	$46.00	$58.00	$12.00
Compensation	$920,000	$1,160,000	$240,000
Management Fee	-0-	$12,500	$12,500
Fringe Benefits	$65,000	$65,000	-0-
Total	$985,000	$1,237,500	$252,500

Overall Percentage Increase 25.6%

MGMA DataDive ~ Cardiology: Noninvasive

Physician Compensation and Production: 2013 Report Based on 2012 Data

Physician Work RVUs, NPP Excl

Overall	Phys	Med Pracs	Mean	Std Dev	10th %tile	25th %tile	Median	75th %tile	90th %tile
	543	136	7,759	3,526	3,786	5,230	7,206	10,069	12,382

Metric	Phys	MedPracs	Mean	Std Dev	10th %tile	25th %tile	Median	75th %tile	90th %tile
Eastern	178	39	7,135	3,369	3,201	4,478	6,561	9,695	11,872
Midwest	109	24	7,706	3,505	4,177	5,487	7,038	9,389	11,484
Southern	193	53	8,439	3,695	4,074	5,640	8,080	10,829	13,337
Western	63	20	7,532	3,160	3,592	4,892	7,015	9,767	12,060

Compensation to Physician Work RVUs Ratio, NPP Excl

Overall	Phys	Med Pracs	Mean	Std Dev	10th %tile	25th %tile	Median	75th %tile	90th %tile
	533	133	$64.81	$28.55	$37.78	$45.72	$57.36	$78.30	$102.42

Metric	Phys	MedPracs	Mean	Std Dev	10th %tile	25th %tile	Median	75th %tile	90th %tile
Eastern	173	38	$64.67	$34.49	$35.51	$41.24	$52.96	$77.03	$109.41
Midwest	109	24	$68.39	$25.82	$43.19	$49.30	$59.40	$89.03	$100.40
Southern	189	51	$64.12	$24.67	$38.79	$46.64	$56.03	$76.84	$101.80
Western	62	20	$61.00	$25.68	$34.14	$43.22	$59.90	$71.17	$92.97

Partial Integration - Management Services Agreement (MSA)

- **Medical Practice will have the responsibility to manage and administer the day-to-day operations:**
  - **Medical Practice will develop an estimated annual operating budget based upon the Medical Practices historical and anticipated increased expenses**
    - **Consists of all Overhead Expenses including:**
      - **Rent, Staff Salaries, Office and Medical Supplies, Utilities, Malpractice Insurance, Accounting Fees and Legal Fees**
      - **The Operating Budget attached to the Management Services Agreement will be mutually agreed to by the Medical Practice and Hospital Affiliate**

Partial Integration - Management Services Agreement (MSA) *Continuation*

- **Hospital Affiliate shall:**
  - **Pay the Medical Practice on the 1st day of Each Calendar Month (1/12) of the Estimated Annual Operating Budget.**
  - **Within 30 days after the end of a Calendar Quarter, the Actual Medical Practice Expenses will be reconciled to the Estimated Monthly Payments paid to the Medical Practice by the Hospital Affiliate**
- **Management**
  - **Hospital Affiliate will pay the Medical Practice a Management Fee for their management of the day-to-day operations**

Sample Medical Practice

DRAFT FOR DISCUSSION PURPOSES ONLY

Operating Expenses - Summary

1/1-12/31/14

	2010	3/M/E 3/31/2011	3/M/E 3/31/2010	Jan-14	Feb-14	Mar-14	Apr-14	May-14	Jun-14	Jul-14	Aug-14	Sep-14	Oct-14	Nov-14	Dec-14	2014
Staff salaries and O/S labor	329,240	78,452	74,330	27,840	18,560	18,560	20,300	20,300	30,450	22,650	22,650	22,650	21,490	21,490	21,491	**268,433**
Staff fringes	90,492	24,609	23,099	12,147	8,491	8,308	8,120	8,150	9,815	8,301	8,286	8,145	11,096	13,990	12,200	**117,046**
Equipment costs	71,444	4,402	16,585	1,273	1,273	1,273	764	764	764	1,398	1,398	1,398	964	964	964	**13,193**
Malpractice insurance	25,430	4,593	2,777	1,988	1,988	1,988	1,854	1,854	1,854	3,708	3,708	3,708	1,531	1,531	1,531	**27,246**
Marketing expense	7,952	7,422	3,887	1,250	1,250	1,250	1,250	1,250	1,250	1,250	1,250	1,250	1,250	1,250	1,250	**15,000**
Medical supplies	258,612	66,455	55,664	10,900	10,900	10,900	9,419	9,419	9,419	8,140	8,140	8,140	12,352	12,352	12,352	**122,432**
Occupancy costs	93,602	29,403	22,444	7,540	7,540	7,540	5,321	5,321	5,321	5,555	5,555	5,555	5,479	5,479	5,479	**71,684**
Office expenses	74,354	24,194	14,760	4,607	4,607	4,607	3,504	3,504	3,504	5,953	5,953	5,953	5,978	5,978	5,978	**60,126**
Purchased services	205,372	52,912	25,000	3,996	3,996	3,996	2,831	2,831	2,831	3,452	3,452	3,452	3,491	3,491	3,491	**41,311**
Physician expenses	205,372	52,912	25,000	375	375	375	375	375	375	375	375	375	375	375	375	**4,500**
Total operating expenses	**1,156,498**	**292,442**	**238,546**	**71,915**	**58,979**	**58,796**	**53,738**	**53,768**	**65,583**	**60,782**	**60,767**	**60,626**	**64,006**	**66,900**	**65,111**	**740,971**

Sample Medical Practice
Salaries and fringe benefits
1/1-12/31/14

Salaries		**Jan-14**	**Feb-14**	**Mar-14**	**Apr-14**	**May-14**	**Jun-14**	**Jul-14**	**Aug-14**	**Sep-14**	**Oct-14**	**Nov-14**	**Dec-14**	**2014**
Office Staff														
Employee #1	Off Mgr/Med Asst.	6,635	4,423	4,423	4,423	4,423	6,635	5,045	5,045	5,045	4,515	4,515	4,515	**59,642**
Employee #2	Receptionist	4,296	2,864	2,864	2,874	2,874	4,311	2,989	2,989	2,989	2,884	2,884	2,884	**37,698**
Employee #3	Receptionist	4,681	3,121	3,121	2,974	2,974	4,461	3,219	3,219	3,219	3,041	3,041	3,041	**40,113**
Employee #4	File Clerk	-	-	-	-	-	-	479	479	479	795	795	795	**3,821**
		15,611	10,407	10,407	10,271	10,271	15,407	11,731	11,731	11,731	11,235	11,235	11,235	**141,274**
Clinical														
Employee #5	Medical Assistant	-	-	-	1,874	1,874	2,811	1,990	1,990	1,990	1,877	1,877	1,877	**18,157**
Employee #6	Medical Assistant	5,250	3,500	3,500	3,483	3,483	5,224	3,633	3,633	3,633	3,668	3,668	3,668	**46,345**
Employee #7	Medical Assistant	6,979	4,653	4,653	4,673	4,673	7,009	5,296	5,296	5,296	4,710	4,710	4,710	**62,657**
		12,229	8,153	8,153	10,029	10,029	15,044	10,919	10,919	10,919	10,255	10,255	10,255	**127,159**
Total salaries		27,840	18,560	18,560	20,300	20,300	30,450	22,650	22,650	22,650	21,490	21,490	21,491	268,433
Outside Labor														-
Total Outside Contractors		-	-	-	-	-	-	-	-	-	-	-	-	-
Total Salaries and Outside Labor		27,840	18,560	18,560	20,300	20,300	30,450	22,650	22,650	22,650	21,490	21,490	21,491	**268,433**
Fringe Benefits														
Payroll taxes - staff		3,558	2,372	2,372	2,234	2,234	3,351	2,310	2,310	2,310	2,941	2,941	2,941	**31,876**
Payroll taxes - providers		3,666	1,196	1,013	1,067	1,097	1,645	1,112	1,097	956	2,893	5,787	3,997	**25,526**
		7,224	3,568	3,385	3,301	3,331	4,996	3,422	3,407	3,266	5,834	8,728	6,938	57,402
Health Insurance														
Employee #1		347	347	347	322	322	322	413	413	413	390	390	390	**4,415**
Employee #3		347	347	347	322	322	322	413	413	413	390	390	390	**4,415**
Employee #4		347	347	347	322	322	322	413	413	413	390	390	390	**4,415**
Employee #6		405	405	405	375	375	375	482	482	482	455	455	455	**5,151**
		1,445	1,445	1,445	1,341	1,341	1,341	1,722	1,722	1,722	1,624	1,624	1,624	**18,396**
Workers comp & Bsn liability		598	598	598	970	970	970	661	661	661	685	685	685	**8,742**
Pension		1,867	1,867	1,867	1,867	1,867	1,867	1,863	1,863	1,863	1,867	1,867	1,867	**22,389**
Laundry & uniforms		808	808	808	585	585	585	560	560	560	642	642	642	**7,787**
Dues and other		205	205	205	56	56	56	72	72	72	443	443	443	**2,330**
Total Fringe Benefits		12,147	8,491	8,308	8,120	8,150	9,815	8,301	8,286	8,145	11,096	13,990	12,200	117,046

Term and Termination

Term

- Term is typically three to five years
- What is the renewal process
  - Evergreen or automatic termination
  - Should have specified period prior to expiration to discuss renewal

Termination

- Typical Hospital-side triggers include:
  - Group default (notice and cure period)
  - Loss of physician's license, exclusion from payors, failure to qualify for malpractice
    - Should be a reasonable number of physicians before termination
  - Group bankruptcy

Termination

- Typical Group-side triggers include:
  - Hospital default
  - Loss of Hospital's license and exclusion from payors
  - Hospital bankruptcy
  - Change in wRVU factor
- If agreements are with a Hospital subsidiary, triggers must extend to Hospital

Term and Termination

Termination

- Without Cause
  - Is this acceptable to Group
  - Consider prohibition in early years
  - Consider termination payment
- Mutual Triggers
  - Change of Hospital structure/control
  - Regulatory issues
  - Hospital tax-exempt issues

Unwinding

Group to "reacquire" the practice on unwinding

- Ability to purchase hard assets and patient charts
  - All or select assets and charts
  - Newly acquired assets which are used at office
- What is the price
  - Hard assets are typically at the Fair Market Value
  - Charts are typically at the initially agreed-upon price

Unwinding

- Re-assignment of office lease and applicable equipment leases
- Transition of information technology systems (including billing, collecting and EMR systems)
  - Will an EMR license be necessary
  - Electronic data to be transferred to Group
- Development of transition plan so minimal disruption

Unwinding

- De Minimus Billing during affiliation
  - In a minimum amount necessary to remain credentialed in each third party payor program
  - Any amounts collected would be remitted to Hospital
  - Allows Group to remain credentialed and thus immediately bill on unwinding

Restrictive Covenant

- Prohibits affiliation with another Hospital system
  - Typically one to two years
  - Typically does not restrict re-engagement of private practice
  - Should not apply on certain termination triggers, including by Hospital without cause, by Group for cause, regulatory issues and Hospital tax-exempt issues
  - Should not apply if Hospital does not give a fair renewal offer
  - Carve out larger medical groups and specific systems, if applicable

Restrictive Covenant

- Mutual non-solicitation of employees
  - Carve-out pre-affiliation employees that were moved to Hospital payroll
- Restrictive Covenant should only apply to Owners (not to associates and other clinical personnel)

Additional Options Physicians are Exploring

- Join existing single specialty group
- Join existing multiple specialty group
- Start a new single specialty group
  - *Gastroenterology*
  - *Orthopedic*
  - *Ophthalmology*
- Become a Retainer or Concierge Practice
- Sell Medical Entity to a Public / Private Equity Company
  - Anesthesia
  - Pain

Strategic Outlook

- Develop a strategic plan
- Outline your goals and objectives
- Develop a vision as well as a mission statement
- Develop an action plan
- Invest in your staff
- Develop an organizational chart
- Invest in informational technology; **Data, Data, Data!**
- Watchful waiting is not an option

Questions and Answers

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February 27, 2014

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