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This newsletter is designed to inform you about new research and expert opinions in the area of hospital and health system governance, as well as to update you on services and events at The Governance Institute. Please note that you are receiving this newsletter because you are a Governance Institute member or expressed interest at one of our conferences.

New Frontiers in Hospital Joint Ventures

By Barry Sagraves, Juniper Advisory, and Ken Marlow, Waller

This article is the second in a series examining the uses of joint ventures, the process of developing a joint venture, and expected trends related to these transactions.

In our first article, we examined the history of joint ventures (JVs) and summarized some of the potential benefits to a non-profit hospital or health system considering a JV.[1]

In this article, we will speculate as to the directions this flexible yet complex organization structure may take in the future and solutions it may provide to the healthcare industry. We will also cite some recent examples of joint ventures and other affiliations and assess the circumstances under which success is more likely than not.

Seller and Buyer Joint Ventures

There are many examples of hospital joint ventures. These are often referred to as "seller JVs," where a hospital that otherwise would have been sold retains a minority stake in a new company. These JVs usually involve a non-profit as the minority partner and an investor-owned company as the majority and managing partner. The benefit to the "seller" is that it remains involved in the governance of the JV and has an ongoing financial stake and potential return, as well as receiving a cash payment for value of the assets contributed to the JV.

A more recent phenomenon is the "buyer joint venture," in which two parties team up to acquire a hospital. The most prominent of these has been Duke LifePoint (DLP), the joint venture between Duke Quality Network, a North Carolina non-profit corporation, and LifePoint Hospitals, a publicly traded hospital company. DLP has acquired through acquisitions or joint ventures a total of 11 hospitals since its inception in 2010.

These arrangements are becoming more mainstream, as is demonstrated by Watertown Regional Medical Center's recent decision to create a seller JV as the first for-profit conversion in the state of Wisconsin.

The Next Big Thing

More recently, a number of creative JVs have been announced that are structured to enable hospitals and health systems to manage populations, collaborate more effectively with managed care providers, and better respond to the compliance demands and reward structures placed upon health systems by the ACA. These structures, five of which are described below, could be precursors to fully integrated health systems, which many believe will be the dominant financing and delivery model of the future.

We've witnessed an increase in the number of multi-party JVs, which adds significantly (some might say exponentially) to the complexity of both negotiating and operating the resulting organization.

The transactions listed below range in their complexity from true joint ventures to more of the

[1] Barry Sagraves and Ken Marlow, "The Rise of the Hospital Joint Venture," E-Briefings, The Governance Institute, Vol. 11, No. 5, September 2014.

"vertical" joint ventures that involve payers and large employers:

- **Tenet, Ascension, and Dignity Health**: The three-way JV between Tenet, Ascension, and Dignity Health in the Tucson, Arizona, area is an example of parties with different strengths, expertise, and resources joining forces to become a more efficient and effective provider. Dignity Health will invest $30 million in cash and hold a minority interest in a proposed joint venture with Tenet Healthcare Corporation and Ascension Health. Tenet will hold a 60 percent ownership interest in the venture, which will operate Carondelet Health Network, a subsidiary of Ascension Health. Dignity Health and Ascension will each hold a 20 percent ownership interest. Carondelet Health Network includes three hospitals, two medical groups, and other assets. While creating a JV with three partners is usually significantly more complex than it is with two partners, the logic in this example is that all partners get to spread their risk while also having the opportunity to pursue additional new business opportunities. Such arrangements usually work best when the parties are reasonably comparable in size, sophistication, and financial strength, and when all benefit to a similar degree from the JV.
- **Stratus Health**: Possibly the largest recent multi-party arrangement is Stratus Health, a 14-system (which owns and operates 29 hospitals) JV in Georgia that formed in order to pool resources, coordinate information, and manage population health in the region. The new organization is a not-for-profit limited liability company and was conceived as a way for providers to collaborate while remaining independent. As with most such organizations, two of the Stratus members took the lead in its formation in 2012, and then brought the others along a year later. The leap to a change of ownership or full integration is too large for many organizations to make in one step, particularly those that are doing reasonably well financially. "Testing the waters" in this way while gaining some benefits of scale works for both the smaller hospitals and the larger ones leading the charge—that tend to prefer to get to an ownership stake sooner rather than later.
- **Vivity**: Anthem Blue Cross and seven health systems in Los Angeles and Orange County have created a joint venture to offer a narrow-network product in that region—Anthem Blue Cross Vivity (Vivity). The partners plan to share data and seek economies of scale to offer higher-quality, lower-cost products than their competitors. Profits and losses are to be shared equally among the partners. Vivity will initially target large employers in the Los Angeles market, and the "narrow network" Vivity plan is designed to align the financial risks and rewards of providers and payers through population health management in a manner that will (hopefully) be an appealing alternative to the high-deductible plans many large employers offer their employees. On its face, Vivity appears to be well positioned to facilitate Anthem's and its hospital affiliates' ability to provide an alternative to payers such as Kaiser and providers of healthcare services in the Los Angeles area. There are still many questions to consider as we evaluate partnerships like Vivity. For instance**,** will the hospital systems be both willing and able to share information and expertise with one another while implementing the population health management tools? How will the Federal Trade Commission and state agencies react to hospital systems potentially sharing competitive information outside the admittedly murky framework of clinically integrated organizations?
- **Puget Sound High-Value Network**: This network of eight hospitals (including those of CHI Franciscan Health and Virginia Mason), more than 160 clinics, and almost 3,000 specialty and primary care providers will contract directly with employers in an effort to offer higher-quality, lower-cost benefits to the self-insured market. Marketed specifically to self-insured employers with 50 employees or more, the network offers competitive rates by selecting network providers that are committed to services at reduced unit costs, while still maintaining a focus on quality through the development of ongoing clinical initiatives. Similar to Vivity in its goal of providing a narrow(ish) network model to the market, this is quite distinct in that the network is a direct-contracting model without a health plan. As such, it may be a more applicable model for providers in other markets that do not have a health plan market but do have the data and care-management skills to successfully take on capitation-like risk.
- **Advocate Health Care**: Based in Chicago, this system has developed an innovative model, not dissimilar to its clinical integration program, for use in aligning with non-owned hospitals. The strategy is to use Advocate's know-how to improve quality, lower costs, and increase efficiency, and potentially allowing affiliated hospitals to be included in Advocate's managed care contracts. Blue Cross Blue

Shield of Illinois has recently decided not to extend its contract with Advocate to hospitals that are part of this affiliation, so the contracting advantages of the structure may not be as strong as hoped. Nonetheless, the quality and cost benefits to the affiliate would remain in any case.

We expect to see an increasing number of these "vertical" joint ventures in coming years as trying to balance quality, access, and cost control becomes ever more central to hospitals' success. The "glue" provided by a corporate structure like the joint venture will be important as employers and government programs seek stable partners to minimize their healthcare costs over time.

When to Consider a Joint Venture

Whether a joint venture is the appropriate corporate structure for a given activity is a matter of the facts and circumstances in each particular situation (see **Table 1**). Form should follow function.

Table 1: A Joint Venture May Be the Most Appropriate Structure If…

Circumstance	How to Address
• Your organization lacks the skills or resources to undertake the activity on its own.	• Be sure your partner actually has the skills/resources, and has deployed them in a similar situation in the past.
• Speed to market considerations preclude you from "growing" the service or activity.	• Do a classic buy vs. build assessment; do not underestimate the complexity of either approach.
• The proposed venture is outside your organization's risk tolerance, and so you wish to spread the risks in exchange for sharing the potential rewards.	• Losing half as much as you otherwise would, with the same probability of doing so, is not much of an improvement; you should be convinced that the odds of failure are significantly lower with your partner than without.

Conclusion

JVs have progressed significantly over the past several years, to where they are a viable option to help organizations provide services or enter markets they would otherwise be unable to access. They have progressed from a way to align with physicians, to a means for building hospital systems, and now to a potentially revolutionary approach to population health.

In our final article of the series, we will outline the process through which hospital directors would seek a joint venture partner, the many steps to consider in structuring a joint venture, and the challenges that may arise in doing so.

The Governance Institute thanks Barry Sagraves, Managing Director at Juniper Advisory, and Ken Marlow, Partner at Waller, for contributing this article. They can be reached at bsagraves@juniperadvisory.com and ken.marlow@wallerlaw.com. Juniper Advisory is an independent investment banking firm dedicated to providing its hospital industry clients with M&A and other strategic financial advice. Waller is a law firm specializing in healthcare transactions and regulations.