IMAGINGBIZ NEWSLETTER

Joint Adventure: A Case Study in Hospital–Practice Integration

BY GEORGE WILEY ON JULY 16, 2011

This article is the second in a four-part series on options for hospital–practice integration. To read the first article, click here.

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Of one of the largest joint-venture integrations ever completed between a hospital and a radiology group, Robert Maier, CPA, CEO of Regents Health Resources, Inc, a consultancy headquartered in Franklin, Tennessee, notes, "It's not often that you get to the end of a transaction and both parties feel really good, but here, the benefits and contributions have all worked to success, and both parties are pleased." The transaction to which Maier refers wasn't completed overnight. It took two years—but when it was completed, and the finished entity began operation on April 1, 2011, a $100 million joint venture between a Nashville hospital system and a prominent Nashville radiology practice stood as a monument to perseverance.

From the beginning, there was an attitude of cooperation between the venture partners. Sheila M. Sferrella, MAS, RT(R), CRA, FAHRA, is vice president of nonacute-care operations for Saint Thomas Health (Nashville), the hospital entity involved. She recalls, "From the beginning, we just decided to have fun with this."

It was fun mixed with a lot of work. Both Saint Thomas Health and Premier Radiology (Nashville), the 30-member radiology practice that agreed to the joint venture, assembled advisory teams consisting of lawyers and valuation experts. Without these consultants, the deal would never have been completed, both sides now say.

The Saint Thomas Health–Premier Radiology joint venture was another prominent example of health-care entities seeking synergy by combining interests. Consolidation, in one form or another, is occurring all across the health-care landscape. Hardly a day goes by without a cardiology practice or a radiology group being purchased by a hospital somewhere, with the physicians becoming hospital employees.

Insurance companies are purchasing physician practices, too, and are transforming the physicians into employees to serve the insurers' enrollees. The physician-as-employee model is a favored one, when the objective is to ensure revenues and control expenses as reimbursements decline.

Physicians at Premier Radiology didn't want to become hospital employees, however, according to Chad L. Calendine, MD, the group's president. Premier Radiology's physicians wanted to remain independent, but the group was looking for an alliance with hospitals or health networks in some form.

"We were keenly aware that a stand-alone imaging provider was going to need to align with a health system in order to be flexible enough to withstand the changes taking place in health care," Calendine says. "We knew that something would have to be done in the next couple of years."

Thus, Premier Radiology was receptive, Calendine says, when Saint Thomas Health approached it about forming a joint venture to operate a network of outpatient imaging centers in the Nashville service area and in an adjoining county.

The hospital system had reason to view a joint venture as an opportunity. On the outpatient-imaging side, Saint Thomas Health had been losing market share. Tom Blankenship, vice president of network and business development for Saint Thomas Health, says, "Except for our two existing imaging centers, all our outpatient imaging business was in our hospitals. We were losing business, and the key factors were that we were competing with freestanding, drive-up-to-the-door, quick-turnaround outpatient centers."

Through an aggressive business strategy, Premier Radiology had been taking advantage of its accessibility and quick turnaround to gain market share, Calendine says, yet outpatient market share was not enough for Premier Radiology to feel secure. New health-care entities such as accountable-care organizations (ACOs), which can contract to provide the full continuum of care for patients, are giving hospitals and health networks clout. These new health-care entities favored hospitals, which could act as hubs of care in ways that imaging centers could not.

Premier Radiology was also attracted by the larger geographic footprint that an alliance with Saint Thomas Health would create, Calendine says. A joint venture in which both sides co-owned the freestanding imaging centers would expand outpatient market share for both parties and create that larger geographic footprint.

For its part, Calendine says, Premier Radiology now stands to gain 200,000 imaging studies per year as a result of business brought to the joint venture through Saint Thomas Health's five-hospital network. Saint Thomas Health will also gain outpatient volume through Premier Radiology's imaging-center network. Moreover, the hospital will be able to route its outpatients to locations that are easier to access than a hospital, Sferrella says. Calendine adds, "The idea of a joint venture dovetailed for them and for us. It was a win–win."

Complicating Relationships

Agreeing to pursue a joint venture was the easy part, as it turned out; the next step—determining all the players and evaluating what each party brought to the table—was difficult and time consuming. Premier Radiology had seven freestanding imaging centers to include in the deal. Saint Thomas Health had the outpatient facilities in each radiology department at the five hospitals in its system.

Saint Thomas Health also had two freestanding outpatient centers in an adjoining county, where it was already involved in a joint venture with a second radiology group, MidState Radiology (Murfreesboro), which staffed the Saint Thomas Hospital in its county. Saint Thomas Health wanted those imaging centers to be included in the new joint venture. MidState Radiology, though small, would have to become a third party to the joint venture with Premier Radiology.

Making the joint venture even more complicated were several other factors. Premier Radiology did not interpret inpatient or emergency-department exams for any of the five Saint Thomas Health hospitals. Those hospital contracts were held by a third radiology group, Radiology Alliance; because Radiology Alliance provided coverage for the two large hospitals in Nashville, Saint Thomas Health began discussions with the group, but more than a year into the process, Radiology Alliance backed out and did not sign the letter of intent. Calendine says Radiology Alliance retained its existing contracts for inpatient and emergency-department interpretations at the Saint Thomas Health hospitals. For that reason, the Saint Thomas Health–Premier Radiology joint venture had to avoid impinging on those existing contracts, among many other challenges.

Premier Radiology also had a parent company, Advanced Diagnostic Imaging (ADI), Nashville, through which Premier Radiology's radiologists (as a separate business) provided teleradiology services to dozens of clients in several states. Premier Radiology didn't want ADI to be part of the new joint venture; it wanted to continue the teleradiology business as a separate entity. Furthermore, Saint Thomas Health is part of a larger entity, Ascension Health (St Louis, Missouri), the largest not-for-profit Catholic health system in the country. Ascension Health, too, would have to sign off on the Saint Thomas Health–Premier Radiology joint venture.

As talks progressed between Premier Radiology and Saint Thomas Health, it was clear that valuation consultants and attorneys would be needed. Premier Radiology turned to Maier; Saint Thomas Health brought in Todd J. Sorensen, AVA, an accredited valuation analyst at VMG Health (Dallas, Texas). To assist him, Maier brought in Raif Erim, the senior vice president of Regents Health Resources.

These consultants, along with attorneys for both sides and the administrative representatives of Saint Thomas Health and Premier Radiology, sat down to hammer out the joint venture that all parties sought. "The intent was to drive the hospital outpatient volume to the outside facilities," Erim says, "and they will become part of the joint venture."

At the Table

On its side, Erim says, Premier Radiology brought its network of imaging centers and the associated cash flows. Saint Thomas Health brought its imaging departments' outpatient business and the two imaging centers that it owned in its joint venture with MidState Radiology. The centers, including the imaging equipment and IT infrastructure that each contained, were the hard assets on which the three parties and the consultants needed to put price tags to which they could all agree.

There was a reimbursement reduction that would have to be absorbed that gave both sides pause, though. One traditional incentive to transform freestanding imaging centers into hospital-based outpatient imaging centers is based on an anomaly that has developed between the rates at which Medicare pays hospitals and freestanding centers for the technical components of the same imaging procedures. Hospitals are paid more (under the Hospital Outpatient Prospective Payment System) than imaging centers are paid under IDTF rates, in most cases—and sometimes, much more, Maier notes.

Many private insurance carriers have copied Medicare in paying more to hospitals than to imaging centers for outpatient imaging. The advantage for hospitals on the technical-component side is considerable, so freestanding imaging centers that partner with hospitals often do so with the motive of capturing a piece of the larger hospital reimbursements.

In the joint venture between Saint Thomas Health and Premier Radiology, capturing the higher rates was not possible, nor was it the objective of the venture partners. The hospital system would have to own 100% of the off-campus centers to get the higher reimbursement. If it had purchased Premier Radiology's centers outright, it could have captured the higher fees, but it could not do so through a joint venture in which there was co-ownership, Maier explains.

The joint venture between Saint Thomas Health and Premier Radiology had to be attractive enough that the loss of hospital-based fees would be offset by increased market share, improved efficiencies, and other strategic advantages. Both sides reasoned that the venture could realize these gains.

Michael Moreland, CEO of Premier Radiology and its parent, ADI, gives an example of how reimbursements under the joint venture are projected as stacking up, comparatively. He says, "If we get $500 for an MRI and the hospital gets $1,000, then the private payors now will negotiate in the $750 range, since they will get imaging through the hospital, but will save on managed-care dollars. We will benefit because the rates will go up, and the hospital will benefit because it has many more access points. Insurers don't want to go through the hospitals and pay those high hospital rates."

There was another reason that Saint Thomas Health was willing to let go of hospital-based incentives in favor of added leverage through a joint venture. The higher rates paid to hospitals have come under scrutiny and aren't expected to last. "We felt that was short-lived," Sferrella says. "We think the longer term favorable position is to provide our high-quality service in the less expensive setting of freestanding centers, thereby providing a value to patients and insurers."

Sorenson adds, "That's a bit countercultural, since one of the largest incentives we see is for hospitals to try to take advantage of the price differential by buying imaging centers."

Who Got What

When the valuation dust had settled, each party in the joint venture was assigned a percentage of ownership based on those valuations, to which all parties agreed. "Did we get what we paid for?" Calendine asks. "The valuation methodologies were aligned. Everything was contributed at fair market value; the absolute value was not as important as the relative value. We haven't lost anything. Our assets were worth about $40 million. The joint venture is worth $100 million, and we have 40% of the joint venture." In addition, Premier Radiology kept its teleradiology business completely out of the joint venture and will proceed with that business on its own, under ADI, Calendine says.

Sferrella suggests that with the teleradiology going forward, there might be synergy with ADI, as opportunities are studied for teleradiology service at smaller hospitals in the Saint Thomas Health service area. "For one of the Saint Thomas hospitals in Nashville, three-fourths of the patients come from outside our county, and we work at maintaining good relationships with the smaller community hospitals. To the extent we maintain and support those small hospitals, we can earn preferred spots to take those patients when they can't get treatment at home," Sferrella says. "It's hard for the small hospitals to fund radiology, but it's an important service. They could use our protocols, and their patients could stay local." Sferrella suggests that other Ascension Health hospitals also might use ADI teleradiology services in the future.

Saint Thomas Health is also developing an ACO, Blankenship says. He suggests that the joint venture with Premier Radiology and MidState will fit in well. "We will assemble a network of health-care providers high in quality and high in value, and we believe our imaging joint venture will meet those two important standards," he says.

An important change for everyone in the joint venture is that all insurance carriers (or their covered patients) examined at joint-venture clinics or in hospital outpatient settings will receive a global bill for both the technical and the professional components of imaging services. "Part of the whole notion was the convenience to the patient of getting one bill," Blankenship says.

The technical-reimbursement segment of the global bill will be split between the joint-venture partners. The radiologists will receive all professional fees for doing the interpretations. Thus, Calendine says, Saint Thomas Health, Premier and MidState will share the technical portion of the global fee as venture partners. Calendine explains that technical fees on average will make up 80% of the global bill, leaving 20% to be paid as professional fees.

The joint venture, Calendine adds, should be able to respond more effectively to the changing relationships in health care than the previous entities would have been able to do on their own. "If Medicare goes to requiring prior authorization, that's not a big deal," he says. "We've been dealing with prior authorization for years. We fully expect reimbursement to continue to decline and for there to be an increased burden for obtaining imaging. The joint venture is certainly going to be quicker to respond—and be more flexible than most health systems."

Governance

The joint venture does have an unwind clause (in case the parties want to back out of the agreement), but it is designed to be hard to implement. "To unravel this would be extremely difficult, and it's that way on purpose," Calendine says. "It's a big move, and everybody is dedicated. We didn't want to do this with one foot out the door."

To make decisions, the joint venture created a governing board with membership based on ownership shares. Saint Thomas Health has a majority of the board members, but it can't make decisions unilaterally. "Most decisions require a two-thirds majority," Calendine says. "That was important to us because nothing can happen without our consent."

Maier says that the Saint Thomas Health/Premier Radiology/MidState joint venture can serve as a model for other entities hoping to combine resources. "The opportunity is here to take this model and offer it as a lesson to other hospitals and radiology groups that want to achieve a solution greater than the sum of the parts," Maier says. "My belief is that radiologists and hospitals have to figure out better ways to work together. An adversarial relationship, in the long run, will be detrimental to both."

Calendine adds, "It's a huge joint venture and a great model. We feel fortunate to have the right partner to be able to do it. It's a way for radiology groups to have a bigger stake and more say in the future—and to have a better say. We're big believers."

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