

Hot Collaboration Considerations: Healthcare Joint Ventures in 2025 and Beyond
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Jennifer C. Hutchens
Thomas Spellman

Introduction

For decades, healthcare companies (from hospitals to providers to ancillary businesses) have been under pressure to control costs and provide competitive services. Joint ventures, or “JVs,” have been popular in healthcare since the 1980s in order to achieve these goals. JVs allow two or more healthcare organizations to pool resources and expertise for a specific purpose, while also allowing those organizations to keep their current organizations distinct.

JVs come in many different forms, and part of their popularity stems from the flexibility and variety that they offer over other types of corporate transactions, like mergers or acquisitions. However, flexibility and variety can be a double-edged sword, and in a heavily-regulated industry like healthcare, lawyers must be mindful of the legal, compliance and operational challenges that JVs bring.

What are JVs?

The most common type of JV is probably the “equity” JV, where the parties will form a new legal entity, fund it with cash, and each party provides some form of services to the new entity. The “Newco” will operate as a separate and distinct entity from the contributing parties. An equity JV is especially popular and useful for when the parties are looking to establish a new and/or separate business line. For example, a hospital and a cardiology group may form a joint venture to develop, own and operate an ambulatory surgery center, or ASC. By having the ASC JV exist in its own legal framework, the parties can simplify accounting and operations, without worrying as much about liabilities tracking back to their respective “primary” legal entities.

Another common type of JV is the “contractual” JV. In a contractual JV, the parties do not form a new entity. Instead, the relationship is governed by a contract, or series of contracts, that dictate the JV relationship. A contractual JV might come in a variety of different names, like an affiliation arrangement, or a collaboration agreement.

A third type of JV is the “management” JV. In a management JV, one party will provide “management services” to another party. Management services can have a varied meaning, but it includes a scope of services including billing and collections, compliance and legal support, tax and accounting services, employee staffing and employee benefits. Many healthcare providers secure these services in the ordinary course. For such an arrangement to rise to the level of a JV, typically the parties will structure compensation for those management services as something other than “fee for service.” So the parties may share the profits of the business, or have some other sort of risk-reward sharing arrangement.

What Additional Legal Considerations Do JVs Bring?

For providers in healthcare, the industry is already full of complex rules and regulations governing the provision of services, interactions with referral sources, seeking reimbursement, among a host of other concerns. Unfortunately, JVs often bring an additional layer of legal and compliance concerns.

The first pair of considerations that lawyers forming a JV should consider are the Anti-Kickback Statute (“AKS”) and Stark Law (“Stark”) (and if applicable, their state law counterparts). AKS exists to ensure that referral sources are not induced by financial incentives to provide referrals to a particular provider. Stark exists to prevent referring physicians from referring Medicare beneficiaries to a business that such physician has a financial interest in. There are a variety of exceptions under Stark, and the OIG has given broad guidance regarding safe harbors available for JVs that might otherwise have issues under Stark and AKS.

The second consideration, which is tied to Stark and AKS, is the concept of fair market value and commercial reasonableness. This analysis must occur at the formation, operation and wind-down of a JV, as well as if there are any exit events, whereby a member is bought out of or redeemed from the JV.

The third consideration is licensure. Assuming the JV in question will operate in an industry where licensure is required (which is true for most healthcare operations), the parties will need to analyze how the structure of the JV (including the identity of the owners, if an equity JV) will impact licensure.

One important caveat overlaying all of these considerations: the facts and circumstances of a JV matter. For JVs involving referring physicians as investors, with government reimbursement as a main source of revenue, these considerations are going to be crucial to the analysis. For a JV involving the provision of services ancillary to a healthcare provider (like creating software to assist in medical record keeping), and there is no participation in government or third-party reimbursement programs, the fraud and abuse analysis would potentially be secondary to other regulatory concerns.

Pre-Formation Analysis

Generally, parties are not, from the outset, saying “let’s form a joint venture.” Instead, most JVs arise from much more abstract discussions, where two or more parties express interest in working together, or one party has a concept for a business and wants to bring in other investors. Therefore, the fundamental business needs and goals will dictate whether a JV makes sense, and what other legal structures might be appropriate. Therefore, when a lawyer is tasked with considering whether a JV is appropriate, the lawyer needs to have knowledge and experience generally about corporate structures and corporate forms. This whitepaper outlines below some different legal structures and transaction types, but please note that these are high-level summaries. Ideally, the lawyers with primary responsibility for structuring and consummating a JV have significant experience in corporate and transactional law, and will be well-versed beyond these summaries.

Types of Entities

Corporations – Corporations are very common entity structures and can be beneficial for both small business owners and Fortune 500 companies. Choosing a corporation can be very beneficial because of the expansive case law and regulations that govern corporations, especially regarding the protection of minority shareholders. However, in healthcare, parties utilize corporations far less frequently for JVs, for two main reasons. First, as is often the case in corporate law, a corporation can be far less tax efficient when the shareholders of a JV are legal entities themselves (by using a corporation, the shareholders run the risk of triggering “double taxation,” where the corporation is taxed on its income, and then the shareholders are again taxed on their dividends or other earnings). Second, the protections that corporate law provides shareholders of a corporation can often be unnecessary or unwieldy (especially if a JV is a startup business, and may need flexibility in decision-making). Third, other corporate forms can provide for limited liability for shareholders, and offer more protections for the directors and officers of the JV (mainly protections against claims of breach of fiduciary duties).

When discussing healthcare JVs, the assumption is that the parties are usually sophisticated, are represented by legal counsel, and are entering into a JV with only a few other parties. Therefore, while there are still concerns about self-dealing, or interested board members (topics that regulations governing corporations often touch upon), the parties can usually resolve those issues by negotiating appropriate protections into the entity’s governing documents.

Limited Partnership – Limited partnerships are somewhat more common for JVs, because limited partnerships allow for pass-through tax treatment, and because the partners can enjoy limited liability. However, a limited partnership can create challenges for certain JV relationships, due to the need of a general partner (and the obligations that a general partner may have as required by statute or caselaw). Some JVs have a clear “primary” partner – this person or entity may be investing the majority of the cash to start the business, or may have the expertise or assets necessary to run the business. In these sorts of cases, where the other JV partners are closer to passive investors, or are otherwise ancillary to the business, it is clear that the “primary” partner should serve as the general partner, and have outsized control over the JV’s operations. Other times, though, the expected ownership of a JV will have two or three more equal (and equally important) partners, or will have a diffuse ownership structure (imagine 20 physicians all with an equal ownership stake). In these cases, it is unlikely that there will be a clear “leader” to serve as general partner.

While a limited partnership can mitigate some of these governance concerns in its partnership agreement, there is always a constant push-and-pull between the risks borne by general partner (which will by statute have more liability than the limited partners) and the benefits received by that general partner. For lawyers structuring a JV as a limited partnership, they must be aware of this tension.

Limited Liability Companies (LLCs) – LLCs are probably the most common entity used for JVs, as they provide tax efficiency through their pass-through status (if elected), and they provide significant flexibility in operations while maintaining limited liability for the members. LLCs have very little in the way of statutory requirements or caselaw, in terms of how

they must operate, or in terms of protections that must be provided to minority members. On the contrary, in some jurisdictions (including Delaware, which is the most common state of incorporation for JVs), members of an LLC can affirmatively waive fiduciary duties for its members.

The flexibility offered by LLCs is prized especially in JVs, because they almost always have some known and expected self-dealing between members and their affiliates. Consider a JV between a hospital and a physician group: one of the driving factors of forming this JV is that the new relationship can leverage some of the hospital's infrastructure (e.g., the billing and coding team), and some of the practice's employees. LLCs arguably make it easiest for the JV to utilize some of the affiliated services.

LLCs are not without downsides, especially for minority members. Because the parties have so much flexibility in determining the governance and operation of an LLC JV, a member runs the risk of giving "too much" freedom to its fellow members, or the board of managers. Accordingly, it is crucial that each party have competent legal or other advisory representation to ensure fair treatment. It is also important for all the lawyers responsible for the JV to fully flesh out a variety of issues (covered in more depth below), so that there are some guiding principles in place when a dispute arises in the distant future.

State Selection – In addition to determining which type of entity the JV will exist as, the parties also need to decide which state to incorporate the JV entity. While each transaction will have its own considerations, generally the parties will have two competing options when choosing a state of incorporation.

One set of possibilities is to choose "major" states that, for one reason or another, are popular states for incorporation. Those states usually include Delaware, New York and California. Delaware is a popular choice, for its focus and attention on corporate law issues. Parties appreciate knowing that, in a dispute, or in the event of new regulations, Delaware's bar will review and understand issues with a high level of sophistication. New York is similarly well-regarded for its jurisprudence, with the added advantage of being a central hub for a global workforce. Lastly, California is similarly sophisticated, but has a reputation for being more favorable and protective of minority shareholders and employees.

The other set of possibilities is to choose the state where all, or most, of the JV's business will occur. While choosing a "non-major" state can result in operating under a less fulsome statutory framework and caselaw, there can nonetheless be significant benefits. Choosing the state of operation may provide the JV an opportunity to take advantage of certain tax credits or other subsidies. It may be the state that the lawyers representing the members are most familiar with, and therefore the lawyers will have a better understanding, and be better suited to address the intricacies of that state's laws and regulations. It may also make the permitting and licensure application smoother with the applicable state agencies.

Transaction Structures

Transaction structures are going to be dictated by the circumstances of a JV, and the needs of the business. So oftentimes, a lawyer will have no choice, or minimal choice, about

how to form a JV. For instance, if two parties both have operating businesses to be combined, a variety of factors (assignability of contracts and permits, change of control provisions, tax efficiencies, etc.) would determine whether a merger, stock purchase, or asset purchase makes the most sense. On the other hand, if the parties are planning to build a new business funded entirely through cash, a merger would not be an expected option, because there are no businesses in place to merge together. Below is a short summary of the different transaction types commonly seen in the formation of a JV. One thing for lawyers to keep in mind is how the “formation transaction” (i.e., the transaction that birthed the JV) can impact the JV (discussed more below).

Asset Purchase / Asset Transfer – Asset sales are often considered the simplest way to form a new business. For a standard JV transaction, two or more parties may form a new company (called “NewCo” hereafter), and each party transfers necessary assets to NewCo so that NewCo can function. These assets might be real estate, required licensure, medical technology or machinery, office supplies, etc. Asset sales bring a certain level of simplicity, in that only enumerated assets are moved into NewCo, and typically the historical liabilities of the contributing members do not become NewCo’s responsibility. Said another way, NewCo starts with a clean slate and a clear list of assets and liabilities.

The downsides of an asset sale are two-fold: First, NewCo only has the enumerated assets, and so therefore, it requires significant up-front diligence of the parties to ensure that NewCo has all of its required assets, and that if any assets are missed or forgotten, then NewCo will not have those assets. Second, transferring these assets requires assignment, and sometimes assignment either requires counterparty consent (common in most service and vendor contracts) or government approval (almost always the case for required permitting and licensure). So for large or complex on-going businesses to be contributed to NewCo, the parties may need to engage in significant pre-transaction legwork to get requisite consents. Oftentimes, this legwork is not feasible or brings too much risk that the transaction cannot close in a timely manner.

Stock Purchase / Merger – These two transaction types, while very different operationally, are lumped together because they bring similar operational efficiencies and legal challenges. In a stock purchase transaction, NewCo may purchase the stock of one or more subsidiaries of a member, as a means of moving a contributed business to NewCo. Similarly, for a merger, the members may merge one or more subsidiaries into NewCo.

The stock purchase or merger option mitigates the concerns from asset sales outlined above: typically contracts and permits will automatically be moved to NewCo, and the parties avoid extensive diligence about enumerating assets necessary for NewCo. However, these transaction structures also bring downsides. First, just as asset sales allow the parties to exclude or “leave behind” the historical liabilities of a contributed business, a stock purchase or merger does not leave behind these liabilities. While the parties can account for these liabilities through indemnification, indemnification and corresponding valuations (outlined more below) can be a challenging and contentious legal negotiation. Further, even when the parties can agree on the economics of indemnification, there can still be significant operational issues impacting the members (e.g., who controls a litigation; what happens if an indemnity claim impacts a contributed business and a retained business).

Second, while in theory, a stock purchase or merger feels cleaner because parties just move a subsidiary to NewCo, for larger companies or more complex healthcare providers, it can be rare that a contributed business sits alone in a subsidiary. Oftentimes, companies will have a variety of asset types in one subsidiary (e.g., all owned real estate sits in one subsidiary), or a large business sits in one subsidiary, and the parties only want a slice of a business (e.g., national lab testing business sits in one subsidiary, but the JV only wants the lab testing business for a particular state). Therefore, for lawyers at large companies, there needs to be a clear understanding and documentation of what aspects of a business (i.e., assets, contracts, permits, employees) sit in which subsidiaries in the corporate organizational chart, and how easily these businesses can be legally partitioned, if necessary.

Management Services Organizations (MSOs) – MSOs are common JV structures utilized when corporate practice of medicine (CPOM) statutes raise issues (though MSOs may be used in other situations as well). While most readers are probably familiar with CPOM statutes, at a high level, certain states have statutes that prohibit the ownership of certain physician practices by non-physicians. Therefore, the MSO structure is utilized when non-physician individuals or entities want to invest or JV into a business impacted by CPOM statutes.

The MSO structure, on a basic level, provide that NewCo (the operating company) will operate the JV business, and hold most relevant contracts, permits and assets. Further, if CPOM is applicable, NewCo will be owned by the appropriate individuals (either physicians associated with the JV, or a “friendly physician” in a captive practice. Then, the parties form a management company (hereafter called ManagementCo), which will have a management services agreement (or MSA) with NewCo. The JV partners will own ManagementCo, and the MSA will allow ManagementCo to exert control and decision-making authority over NewCo.

The economics of this MSA can vary: on one extreme, the MSA can entail the provision of all services necessary for the operation of NewCo, and can pull out all revenue (and therefore profit) from NewCo, and NewCo simply functions as a pass-through entity; on the other extreme, the MSA (and the applicable services) only cover certain functions of NewCo (such as coding, billing and collecting), and only a portion of NewCo’s earnings flow to ManagementCo.

The MSO structure can raise some complications, and must be formed to deal with the applicable CPOM statute. Therefore, the lawyers responsible for such a transaction structure need to have a strong understanding of the specifics of a CPOM statute, as well as any state regulations or caselaw that offer guidance or interpretations. Additionally, the MSO structure by its nature has several interlocking documents: the organizational documents of NewCo, the organizational documents of ManagementCo, and the MSA itself. Therefore, the parties to the transaction will need to understand how these documents interact, and will need to make sure that there are no “gaps” (where a business issue or topic is not covered by any of the documents), or perhaps more importantly, that any “overlap” is not contradictory.

Valuation – In addition to choosing a transaction structure, the parties need to be mindful of valuation, in several different contexts. First, depending on the healthcare industry and the applicable parties, there may be general requirements about engaging in transactions that

are fair market value and commercially reasonable. In particular, many types of healthcare JVs have specific safe harbors that have valuation methodologies as a particular prong. Second, valuation needs to take into account transaction structure. If a particular transaction structure results in an interruption of billing and collection (through a Change of Ownership filing, for instance), or results in revised reimbursement rates (such as a change in current payor rates compared to NewCo's payor rates), the parties need to take these effects into account to ensure that the transaction is fair market value. Lastly, the parties should make sure that post-transaction expenses and liabilities are reflected in the JV structure. For instance, if a party is contributing a business in exchange for 50% of the JV's equity, and a future indemnity claim for a historical liability of the business results in losses for the JV, the parties should address how the contributing member will make the JV whole (i.e., either through a reduction in equity, or a cash payment).

Joint Venture Formation

The remainder of this whitepaper will cover a variety of topics that parties should consider prior to entering into a JV, and how to memorialize these terms in the governing documents of the JV (broadly referred to as the "operating agreement"). Generally, an operating agreement is going to contain quite a bit of "standard" contractual language. This whitepaper will not cover the various boilerplate decisions (e.g., governing law, venue, amendments, etc.). However, lawyers forming a JV should nonetheless be mindful of these provisions, and understand the impact and importance that these provisions can have on a JV.

Initial and Future Members

Generally, upon formation, the parties of a JV will be well known. However, some transaction types, especially those that involve a delayed signing-then-closing (where the parties sign a binding transaction agreement, then wait for some interim event before the transaction becomes effective), or involve members with diffuse indirect ownership, like a large physician practice, may result in some uncertainty about initial membership. Lawyers forming a JV should have a good understanding of the identity and requirements of initial members, because the identity of the members can have significant consequences for other terms of the operating agreement. For instance, a tax-exempt member might require certain considerations or protections surrounding issues like UBTI generated by the JV. For large and complex entities intending to participate in the JV, it is crucial to ensure that the correct legal entity or subsidiary exists as the member of the JV. For individual owners, the exact identity of the individuals will be critical for things like complying with federal and state securities laws, and ensuring initial compliance with any restrictive covenants.

However, the more challenging negotiation regarding the JV's membership usually stems around the admission of members in the future. Sometimes a deal makes it obvious when additional members will be included in the JV: again, thinking about the physician practice example, when the practice hires new physicians, it is likely expected that the new physicians have a path towards ownership. But, most of the time, when a JV is formed, the general expectation is that the parties to the JV, as the initial members, are entering into the joint venture to do business with each other, not unknown future parties. Therefore, absent general consent or

some triggering event, additional members will not be added at the discretion of just one of the members.

That being said, JV members will often want some level of protection that the JV has some means of bringing in new partners, if necessary. So oftentimes the operating agreement will contain a variety of provisions that permit the transfer of JV equity to a new member. Some of these provisions will include covenants such as the ability of a member to transfer equity to one of its affiliates or a successor-in-interest. Also, the parties may agree that equity may be transferred to a new member if a certain threshold of other members approve the transfer (sometimes referred to as a supermajority threshold). Lastly, some JVs may provide that the JV may issue new shares to a new member or an existing member may sell equity to a new member so long as there is compliance with a right of first refusal or right of first offer.

The general principle for lawyers to keep in mind is to what extent the parties want to give a transferring member some ability to bring in a new member and or exit itself from the JV, while balancing the protection for remaining members having some level of control over the identity of the new member. Said another way, do the parties want to allow the remaining members to use their money to protect against an outcome that they do not desire. One of the general challenges with negotiating these sorts of covenants is that it is difficult, if not impossible, to know which of the members will be the member desiring to transfer equity, and which will desire to remain. In fact, over the life of a JV, a particular member may be on each side of the issue at certain times.

In almost all circumstances, because health care is a regulated space, there will be some restrictions or other covenants regarding these transfer rights that the parties cannot (or should not) negotiate away. Even if the parties comply with a ROFR or ROFO, for instance, most operating agreements would nonetheless block the transfer of equity to a new member that is excluded under government reimbursement programs or would jeopardize a federal securities filing exemption. Similarly, certain members may want to protect against a competitor joining the JV. One could easily imagine a JV involving Health System A having a general prohibition against any sort of transfer that results in Health System B coming into the JV as a member. Through all of these considerations, the lawyers must keep in mind concerns like antitrust and other regulatory considerations when crafting these rules. What may seem like an innocuous provision, such as limiting a physician member from only transferring to another physician, could be interpreted in another light as requiring any future member to be in a position to make referrals. The lawyers negotiating an operating agreement need to pay close attention and keep in mind how a regulating agency might look at what the parties are trying to accomplish.

Initial and Future Cash Contributions

Lawyers familiar with negotiating health care transactions will appreciate that the finances of a transaction often get the most attention from the business partners on the deal. Accordingly, the treatment of cash coming into and exiting the JV is going to be a key focus when negotiating an operating agreement. The initial cash contributions, like initial membership discussed above, are usually fairly straightforward. The parties will know with some certainty how much money is needed to either develop or acquire the JV's business and each party will be responsible for making its in-kind or cash contribution accordingly. This whitepaper assumes

that the parties will be making pro-rata contributions, and receiving pro-rata distributions, as is required by many healthcare provider JV safe harbors. However, the lawyers should understand the circumstances in which non pro-rata transactions are permissible and whether, if permissible, they are appropriate.

Once initial capital has been contributed, many JV partners hope that no further contributions would be required. However, in practice, there can be a variety of reasons as to why a JV would need additional cash. Sometimes, the need for additional cash is for good reasons, such as the expansion of a business (discussed in more detail below). However, sometimes the need for cash is because the business is not performing well, and, in those circumstances, the lawyers should consider the process by which the JV can request additional capital from its members (usually through cash or debt), and, perhaps more importantly, the process by which the JV deals with less than all of the members making their applicable capital contributions.

If the parties decide that a non-contributing member should be punished by dilution of its equity ownership, the parties need to decide how that dilution will be calculated. To calculate dilution, the parties may look at capital accounts, they may determine the fair market value of the JV at the time of the capital call, or they may come up with some other methodology. Some JVs may decide that failure to contribute additional capital warrants the expulsion of a member. Some JVs may decide that any future capital contributions should occur through loans from members that accrue interest and have priority in a liquidation or dissolution scenario. Regardless, it is important that the members decide at the outset of the JV how to address this issue.

Lawyers negotiating and considering how to manage these issues in the operating agreement need to consider several principles. First, it is relevant as to which members or which managers have the authority to call additional capital, and whether there are any limits or guardrails as to how that capital is called. For instance, if all members must consent to a capital contribution, then dilution methodology or imposing severe consequences are probably less important as negotiation points (because any non-contributing member could in theory simply not approve a capital call). Similarly, if the JV can only call a limited amount of capital without further approvals, then most members will be protected, because any dilutive effect might be relatively minor. However, if there is a minority owner with limited restraint on the authority of the majority owner, and that minority owner is an individual without much in the way of liquid reserves, that minority member rightfully will want some protection against draconian dilution. On the other hand, that minority owner should appreciate that presumably the JV needs additional capital to operate, and it is unreasonable that a minority owner could force the JV into bankruptcy if the other members are willing to fund continued operation.

Lawyers should also consider how the overall financials of a JV function in light of capital contributions. If one member is incurring significant costs for the JV, perhaps because it is a key vendor of the JV's business, it may be very reasonable in wanting comfort and certainty that the JV will pay its bills to the vendor as they come due. The vendor/member does not want to be left holding the bag on unpaid invoices for services rendered/products provided, or otherwise acting as a de facto insurer of the JV's business performance.

Throughout all of these considerations, the lawyers should keep in mind fair market value and its importance from a safe harbor perspective. While there is significant leeway in determining dilution methodologies and other rules regarding contributed capital, there is not a carte blanche allowing JVs to do whatever they want. For instance, if the JV is too lenient to a non-contributing member such that it looks like the non-contributing member is getting an unreasonable financial benefit (as a “free rider” problem) and that member is a referral source, it is very easy to see a scenario where the government would have a problem with the structure.

Distributions

For many JVs, negotiating operating agreement provisions regarding the distribution of profits is a very simple and straightforward process. If the business is doing well enough to be profitable, the members will be happy to receive funds, and those funds will be distributed based on equity ownership of the JV. However, many JVs have complicating circumstances that can make the discussion of distributions fraught with potential conflicts. Further, for larger JVs that may have complex equity structures (including preferred equity), the “waterfall” of distributions or dividends may add challenges.

As mentioned, it is very common that one or more members of a JV will also have some other contractual relationship with the JV. There are a litany of possible relationships, from a physician member providing medical director or other physician services, or a hospital member leasing real property and acting as a landlord for the JV’s site of business. The lawyers need to understand the variety of circumstances whereby a member of the JV wants to ensure that the joint JV has sufficient cash to meet its future contractual obligations.

Since it is very difficult to require capital contributions in a limited liability legal entity (whether a partnership or LLC), the members often need to use other means of ensuring that the JV does not distribute too much cash, and then lack the means to meet its current and future liabilities. This can also be a challenging scenario to solve for in negotiations because it is rare that the parties will know and be able to predict the issues at the outset of the JV. Remember, the parties are entering into this relationship assuming a growing and successful business. If the parties were expecting significant and consistent cash shortfalls over time, the JV would never be formed. Also, similar to the capital contributions discussion above, at the outset of a JV, it can be difficult for a member to predict whether it will want a looser distribution threshold, or more protective reserve policies (discussed below).

The main way to protect against this issue of insufficient cash is through a reserve policy. The parties should agree to what are reasonable reserves, and they should have a policy in place to update that reserve policy as the business needs grow and change over time and as the financials of the JV evolve. Typically, the members that have the most to lose will want solid protections and want to limit distributions to cash that exceeds the reasonably foreseeable near-term business expenses. They will also want the ability to deal with unforeseen but known large expenses. Imagine a JV for ambulance services where the members know that the current fleet of vehicles will be obsolete in a few years. Notwithstanding the standard reserve policy, the members will likely want to make sure that reserves can be increased for one-off needs, to make sure that there are not excessive distributions in the near term that prevent the JV from replacing its fleet.

This concern needs to be balanced against the reasonable concerns of a minority partner that does not want to see cash sit on the books of the JV (where presumably it is accruing at best minimal interest). For large organizations that either have healthy cash flows or debt instruments to ensure sufficient cash, they, as members of a JV, are not likely to have this concern. But for a smaller JV partner, or JV partners that are individuals, this access to cash could be a very important business consideration, especially if such partner's investment in the JV was funded through third-party debt that needs to be periodically serviced through loan payments.

Lastly the lawyer should keep in mind the statutory requirements applicable to the JV. Most states have restrictions against distributions that would disproportionately harm a creditor and by making such a distribution, the JV may be subjecting its members to liability for a claw-back by a creditor.

Governance

The governance of a JV can be a particularly challenging negotiation. Oftentimes when companies are structuring an operating agreement, the decision-making analysis is straightforward: the largest investors have the most control. This may still be true in a healthcare JV, but oftentimes, because JV partners may be personally practicing medicine on behalf of the business operations, and because provider independence is so critical to good health care outcomes, a JV's governance structure may not track exactly to what is "market."

When discussing JV governance, there are typically two options and sometimes both of those options can be chosen. Assuming we are in a limited liability company, a JV may be governed by its members (i.e., the equityholders) or its managers (i.e., its directors). The decision between member or manager management can have many operational legal and regulatory impacts. The parties may also decide that some decisions will be member decisions and some decisions will be manager decisions. Overlaying, and also complicating, this analysis is the fact that there is likely some sort of management or services agreement between the JV and one or more of the members, and the terms and control of the business pursuant to such contract also needs to be taken into account.

When deciding between member or manager management, there are a few key areas for lawyers to keep in mind. The first area is the legal analysis of decision making. The courts look differently on decisions made by equity holders compared to directors, and parties should be mindful about fiduciary duties, disclosure of conflicts of interest, etc. In practice, it is often clear in a closely held JV where the parties are familiar with each other where competing incentives might exist, and for better or worse, the parties decide to live with these potential conflicts. However, if structuring a large JV with tens or hundreds of owners, the parties need to take care that future decisions do not draw additional scrutiny as being in some way fundamentally unfair to a subset of the members.

The second issue to keep in mind relates to operations of the business. Having member management may create challenges in having meetings and obtaining requisite approvals. Imagine a JV that involves a large health system with many layers of executives and bureaucracy. If the health system as a member needs to approve a lot of decisions, and that

health system has an onerous approval process, it is easy to imagine a scenario where decision making, and therefore speed of operations, is slowed significantly waiting for health system approval. A board of managers structure where individuals, rather than entities, are making key decisions, may significantly mitigate this concern. There are of course potential operational downsides of a board of managers, or even a single manager, depending on the identity of the membership. Obviously, the members must have significant faith and trust in the managers that they appoint, and they may not have much visibility into their actions. It is not hard to imagine a large physician practice, with lots of physician members and competing interests, having difficulty choosing the correct manager to represent their collective interests, since there may not really even be a collective interest other than successful financial performance.

Lastly, keep in mind how the management and governance structure will be viewed externally, mainly by healthcare regulatory agencies. While JVs are very common in health care, many times the JV structure does not easily fit into how regulatory bodies think about permitting, licensure, and similar issues. Close work with licensure specialists during the formation process for the JV can help ensure that the JV is structured in a way to ensure easy compliance with applicable permitting requirements, and also to ensure ease of things like periodic recertifications. If an annual report requires the signature of president or chief executive officer, the operating agreement should make sure that the JV has such an officer.

This white paper does not go into extensive details or provide a laundry list about every possible decision that the parties should address in voting rights. The appropriate list of voting rights is too specific to every JV. Further, the appropriate thresholds for voting (i.e., majority of members or managers, or some super-majority threshold of the same) will depend heavily on the identity and number of the members (and managers, if applicable) and the applicable investments made in the JV. The lawyers will need to understand the needs and goals of the current and potential future members, and the business of the JV. For instance, if a JV is engaging in new construction overseen by one of the members, voting and approval of future construction expenses will be important to the members from an approval standpoint. However, if the JV is built for the development of a new medical records software platform, the parties likely do not need to focus on approving construction budgets.

Many of the other sections in this white paper identify the key push and pull challenges that a particular topic creates for a JV. Nevertheless there are some common issues that face nearly every JV that should be accounted for in the approval thresholds an operating agreement. These issues include materially changing the JV's line of business, changing the terms and conditions of the operating agreement, and selling all of these stock or equity of the JV. These issues do not automatically need to have full approval of all members and managers. There are obviously times where small minority members do not have sufficient investment to justify control over major decisions like these. However, one thing for lawyers to keep in mind is that many JV safe harbors, when dealing with referral sources, assume some level control and input by the referral source partner. So, the lawyers need to make sure the operating agreement is creating a scenario where a referral source minority partner has effectively no input or control over governance and management decisions.

Transactions with Affiliates

As previewed several times in this white paper, most JVs will have at least one contract or financial transaction with an affiliate of one of the members. While contracts may have varying definitions of what an affiliate is, we generally think of affiliates as being in some way related to or sharing common ownership with a member or a manager of the applicable JV. As an example, an affiliate of a health system member of a JV might be the billing and collecting arm of that health system that provides services.

In normal corporate settings, affiliate transactions raise many red flags and require significant disclosure to the board and the shareholders to ensure compliance with law. While those same laws are applicable to JVs, usually a JV can be structured in such a way that gives some level of protection to JV members while also ensuring that the approval and maintenance of an affiliate transaction is not overly burdensome and negatively impacting operations. This section will focus on how the JV as a corporate entity needs to think about approving, overseeing, and potentially terminating those affiliate transactions.

When factoring in how to address affiliate transactions in an operating agreement, the lawyers need to be mindful of the scope, scale, and duration of known and potential affiliate transactions. An easy scenario would be where a JV is formed by the purchase of real estate from one of the members. If we assume no other affiliate transactions, the parties do not need to be overly concerned with managing conflicts of interest. Since this is a one-time transaction, the parties can evaluate the transaction on its merits, and the decision to enter into the JV can be considered a de facto approval of the terms of the real estate sale.

However, imagine a JV whereby one of the members will provide management services to the JV for the life of the JV. In this scenario, there will be consistent and ongoing affiliate transactions, so the operating agreement will need to take into account, on one hand, protections for the non-affiliated members, and, on the other hand ensure that the service provider has enough flexibility and delegated authority to perform the management services that it is hired and paid to do. This inherent conflict can be somewhat mitigated by a well-drafted management agreement that covers potential misaligned incentives, but also allows the non-affiliated members to take action or control negotiations if there is a fundamental change to the business, or a problem with the services provided.

While every JV is going to have different pressure points regarding affiliate transactions, the operating agreement should generally provide for a clear approval process by at least a majority of the disinterested members or managers. There should also be an approval process for material changes to existing affiliate transactions, as well as a process for terminating affiliate transactions in the event that either the service levels provided are insufficient, or the parties have otherwise found another service provider.

Lawyers should also make sure that wind down or exit provisions take into account potential terminations of affiliate transactions. Often times one of the affiliate services being provided either can only be provided by one of the members, or one of the members would not be comfortable with an unaffiliated service provider. Imagine a JV for cardiology imaging on a hospital campus. The hospital as landlord is in an affiliate transaction. It is likely that the hospital does not want to move its imaging from the campus, so if the other members want to terminate the lease for any reason, it seems likely that the JV will not survive. Similarly, if

physician JV members provide medical director services at this imaging center, it is likely that they would not want some other physician group taking responsibility for those services. So if the medical director agreement terminates, we would expect that the physician partners might want the ability to exit the relationship.

Tax and Accounting

Most JVs are going to need at least some discussion surrounding tax treatment and accounting policies as an initial matter as the members consider their financial investment. Then the operating agreement will also need to take into account the fact that tax and accounting is fluid and changes over time, so the JV needs to be able to adapt accordingly. For the most part, the negotiation and drafting of these provisions will be driven by the business needs of the members and the realities of the JV's operation. Usually the lawyers are not expected to know and dictate the appropriate accounting treatment. However, a lawyer for a member does need to understand the underlying issues, and does need to understand its client's preferences so that, if possible, favorable tax and accounting treatment can be negotiated into the agreements. The lawyer for the deal also will need to understand what, if any, external requirements come into play. For instance, a member with a credit facility on its overall business may need to include covenants about receiving financial statements in strict accordance with GAAP. The lawyers don't need to negotiate whether GAAP or IFRS is the appropriate accounting standard.

When negotiating accounting decisions, JV members should also be mindful of what sort of financial reporting and auditing rights a member or a manager may have. Generally, members of a JV are going to want to receive periodic and annual financial statements, as well as possibly audited financial statements, depending on the size and maturity of the JV. Minority members may also want to ensure some sort of right to audit the JV financials, especially if there are major affiliate transactions that drive the JV's financial performance; the minority members will want some certainty that the business deal negotiated on the affiliate transactions is being followed.

One common key issue for lawyers to think about is deciding which member controls tax filings and disputes with the IRS. It is not always appropriate that the largest member control this decision making, because oftentimes they may not necessarily have the sophistication or the resources to analyze the issue. Further, some members are more impacted by tax and accounting decisions. Imagine a JV where the majority member is a nonprofit. So long as the rules governing tax exempt organizations are met, that nonprofit may not feel strongly about particular tax and accounting decisions. Alternatively, the parties may generally have aligned incentives on resolving disputes or addressing changes in the tax code, but one entity, typically the larger one, may need to exert control because that member may not want or be able to have conflicting tax positions taken on its own tax return and its JV tax return.

Lastly, the parties should be mindful if one or more JV members are a private equity fund, or other financial institution. These sorts of entities are usually very financially sophisticated, and often can derive significant value for their investors through accounting and tax decisions. It is important for all parties to the JV to understand the rationale for certain requests from a PE partner, but also to understand how these decisions may impact the other members of the JV. Fortunately, sometimes the non-PE and PE members will have aligned

incentives, so a particular tax or accounting request by a PE member should not just be assumed to be detrimental to the other members.

Future Growth

While it is important for lawyers to plan for poor business performance when negotiating a JV's operating agreement, it is equally important for the parties to consider how to address the growth of a successful JV. Oftentimes, growth comes at the expense of cash being distributed to the members. Thus, there is an inherent struggle between members that want to keep a small, but successful business that distributes cash as income, against other members that want to re-invest profits (or even invest additional capital in the business) to fuel growth, with the hopes of even greater profits in the future.

Future growth can come in a variety of forms, and will be heavily dependent on the type of business the JV operates. For example, a JV for medical imaging could possibly grow by expanding its existing footprint, but there are fundamental limits to the size of a single imaging center; therefore, it is more likely that growth would come in the form of multiple locations, or additional lines of business at the initial site. However, for a JV for clinical research, growth could come in a variety of different pathways, from expanded research, to device or pharmaceutical development, to clinical site management. Accordingly, the second example would need considerably more flexibility in drafting an operating agreement to account for this growth. Ideally, the business teams negotiating the JV will have some sense of where future avenues of growth could lead, so the lawyers should have some guidance when drafting.

Provisions regarding growth and expansion will need to be carefully connected to any restrictive covenants binding the JV members. Most JVs will have some sort of covenants to protect the business, either limiting members from building competing businesses, or soliciting JV customers, employees, etc. Additionally, as noted above, most JVs have some sort of protection for minority members, such that their consent is required for major transactions (such as expanding to a new line of business, or securing significant amounts of capital). Therefore, the lawyers need to understand (and balance) potential conflicting interests where one or more members want to grow and expand the JV, and other members do not. The growth-focused members will want to make sure that the restrictive covenants do not completely limit their ability to explore new business opportunities (either through the JV or separately), while the growth-resistant members will want to make sure that the current JV business is not cannibalized by a new competitor that has intimate knowledge about the JV's business strategy, or that their currently successful investment is not jeopardized by an expansion that they do not agree with.

This push-and-pull can be further complicated if one of the JV members has a primary line of business the same or similar to the JV. Consider a large-scale dialysis provider, which operates dialysis clinics, decides to form a JV with a physician group to create a JV dialysis clinic. The provider will want to be especially careful that future growth, which is an important part of its overall corporate strategy independent of the JV, is not unreasonably hampered due to its JV relationship. Since most members to a JV typically enter into such an arrangement because they have direct or ancillary knowledge and experience in the proposed JV's business, this is a common issue for lawyers to keep in mind in most JV negotiations.

Assuming that the parties agree on how to handle future growth, there are a variety of other considerations that relate to other topics in this whitepaper. If the growth needs capital outlays (and most growth does), is the funding achieved through capital contributions, bringing in new members, selling additional equity, securing debt, etc.? If the growth opportunity will require additional services of a member or its affiliates, how do the affiliate transaction rules come into play (and do the various affiliate agreements need to be initially drafted assuming some growth of the business)? If the growth opportunity is outside of the JV's current operations, does the management of the opportunity need to change (said another way, does the current board or officer slate have the expertise to manage the new business line, or should a minority member have additional oversight due to its experience)? It can be very difficult to predict which of these issues will arise, or to predict which issues will create deadlocks. Therefore, while it is helpful for lawyers to anticipate potential areas of disagreement with specificity, it is just as important that lawyers draft an operating agreement for a JV that broadly covers potential disagreements and deadlocks (and a path towards resolution).

Restrictive Covenants

As noted above, JVs will often contain several types of restrictive covenants, binding on one or more members, intended at protecting the JV's business operations. The main types of covenants are confidentiality covenants, non-solicitation covenants, and non-competition covenants. These covenants can have significant interplay and can work together to ensure some level of protection of the JV's business. However, while these covenants generally work to protect the JV's business, the members may not necessarily be aligned when forming a JV. So the lawyers need to understand and appreciate the current (and potential future) strategies of each member of a JV, since those strategies are likely to be distinct from the JV's strategy.

Confidentiality covenants require the members to keep JV information confidential, and may possibly limit the use of JV confidential information by the members. Confidentiality covenants are common, but sometimes can be difficult in practice to draft in a way that protects the JV's interest, but does not unreasonably restrict the members. By way of example, consider a hospital-physician JV. Each member comes into the JV with significant knowledge developed internally, and will continue to grow that knowledge during the course of the JV relationship. It would be difficult in many instances to determine whether a member learned confidential information as a result of its involvement in the JV, or developed independently. It may also be difficult to ascertain whether a particular business decision of that member outside of the JV relied on JV information or independently developed information.

Nevertheless, confidentiality provisions are still important and common, because sometimes it is clear that information is derived from JV ownership. Further, confidentiality obligations can provide important protection for JV members from an antitrust perspective. One common concern in JV arrangements is that the members could ostensibly be competitors, either in the JV's business or in their respective non-venture businesses. Again, consider a hospital-physician JV for an ambulatory surgery center. Each party could pursue this opportunity separately, and each member's non-JV business could be competitive with the other member. As a result, taking efforts to limit the use of JV information outside of the JV can protect the members against potential claims of anti-competitive behavior.

JV agreements may also contain provisions regarding the solicitation of customers, employees, vendors, and the like. The rationale should be relatively straightforward here: the JV has invested time and energy to develop its business pipeline, and it probably wants some assurance that the members or their affiliates will not poach key aspects of that pipeline to the detriment of the JV's business performance, or be unduly enriched by JV activities. However, a non-solicitation covenant can be a challenging provision to draft, for a variety of reasons. First, as noted above, there may be antitrust concerns regarding these restrictions. Given that antitrust is a hot topic in government regulations currently, lawyers should be abreast of the latest developments in this area to ensure compliance. Generally though, the parties should be trying to ensure that actual business interests are being protected without creating an undue burden on competition. Members should also be mindful that the covenants that they push for to protect the business may ultimately hinder their own operations and should be sure to not limit themselves unnecessarily.

Non-solicitation covenants may also raise some challenges in connection with affiliate arrangements utilized by the JV. For instance, if one member is providing management services to the JV, those employees may not actually be JV employees, and it may actually be more appropriate for the non-solicitation covenant to be binding on the JV, and not the member. Similarly, in a world where some JV members already have existing business operations in a particular market, it may be impracticable or inappropriate to somehow limit interactions with vendors or customers. Because these customers or vendors have already been solicited, and the proper way to deal with such an issue would be through a non-competition covenant.

Lastly, one key item regarding non-solicitation covenants for lawyers to be mindful of is that business operators usually look to maximize protection for the entirety of their business. In a situation where the JV only consists of a small portion of a member's business, the parties should be careful about how they frame these business protections. By way of example, imagine a JV involving a large health system for the operation of a pharmacy. It would not be appropriate in most cases for the non-solicitation covenant to cover all of the employees of the health system because, to the extent the JV members get any information about the health system employees, that information would almost certainly be limited to those individuals with pharmacy experience. Accordingly, a global non-solicitation could create significant regulatory and compliance issues for the JV and its members.

The final and typically most heavily negotiated restrictive covenants is the non-competition covenant. The non-competition covenant, or noncompete, will typically restrict the members from operating a competing business in a defined territory during the duration of a member's participation in that JV, and potentially after such member leaves the JV (such period is usually called a "tail."). There are many factors that go into what constitutes an appropriate non-competition covenant for a particular JV, and this whitepaper cannot go through every possible factor that might affect this analysis. Fortunately, lawyers can lean on common market terms and can also lean on their business counterparts to determine what would be an appropriate protection.

Before getting into discussions of how the parties may want to consider non-competes, lawyers for the deal should also understand the enforceability of non-competes in their particular industry and in their particular geography. Many states have broad rules applicable to

non-competes, and may have even more specific rules regarding non-competes that restrict or otherwise hinder medical operations or physician activity. The lawyers on a transaction should ensure that whatever business provisions ultimately are negotiated, these provisions are considered enforceable by the relevant court.

The two main items for negotiation in a noncompete are the scope and the territory. The scope will typically include the actual business of the JV as well as businesses that are ancillary to the JV. It can be challenging to identify these ancillary businesses, but it is important for parties to consider these ancillary businesses, especially in light of potential future growth opportunities. For instance, imagine a JV providing behavioral health services to children in a particular region. The parties may want to ensure that the non-competition covenant also covers behavioral health services to teenagers and adults. Depending on the business operations of the members, covering such ancillary businesses in the covenant may be entirely appropriate or may be very detrimental to the non-JV operations of one or more members. The applicability or appropriateness of this covenant will be dictated by the facts and circumstances of the particular transaction.

The territory will also be important for the effectiveness of the covenant, and may also highlight potential concerns or disputes about how the parties view the current business and future growth opportunities. Many healthcare businesses are geographic in nature. An ambulatory surgery center, for better or worse, likely has a limited geography from which it could attract most of its patients. Typically, patients are not going to fly across the country for a simple outpatient service. Accordingly, for these types of JVs, the business has a relatively straightforward starting point for negotiating these covenants. Even when a business has a specific geography, the parties will still need to negotiate the details, and again this territory needs to be considered in light of future growth opportunities. An overly broad restrictive territory can create a future conflict where some members are disappointed that they cannot take advantage of future business opportunities, either through the JV or independently. There are a variety of ways for parties to add some complexity to non-competition covenants, including things like right of first refusal territories, or provision the scope of the covenant for certain business opportunities brought by specific members. But generally, the lawyers for a member need to ensure that the JV does not become restrictive in any way regarding the main business operations of a particular member.

Another factor to consider when structuring a non-competition covenant is whether that covenant will apply to a member after that member exits the JV. This negotiation is often impacted by how a member may elect or be required to exit, and the sale price upon such exit (if any). It is easy to understand the principles driving this sort of discussion and analysis. If a member can be forced out of a JV, and does not receive what it believes fair market value at such exit, it would be difficult to imagine such member agreeing to restrict itself in the future. On the other hand, if the JV is spending what it believes to be significant money to buy out a JV member, it would be disappointed if such member used not only the purchase price but also the knowledge received during its time as a member to then compete with the JV.

The analysis of post-exit tails can also raise significant regulatory concerns regarding fair market value referral inducement depending on the structure of the buyout of a member. Sometimes buyout procedures or requirements can be punitive or beneficial, depending

on the terms and conditions. Attempts at such creativity need to be carefully weighed so that, when these outcomes occur, it does not appear as though a referral source is receiving an undue benefit. While the purpose of a punitive buyout procedure may be intended to punish a bad actor, if it has the unintended consequences of enriching a referral source partner, the JV may nonetheless have a regulatory concern on its hands.

One additional consideration for non-competes comes into play when dealing with JV partners that are entities themselves. Those entities, somewhere up the corporate ladder, will have individual owners. There may be a debate as to whether any non-competes should be binding on those individuals. On one hand, it is easy to see a scenario where a restrictive covenant binding an entity formed just to invest in a JV has very little value. It is easy enough for the owners of the partner entity to form a separate entity or otherwise pursue competitive business opportunities elsewhere. On the other hand, indirect owners may have less control over the approval and negotiation of restricted territories and may not be receiving much if any financial benefit from the investment in the JV. Therefore, it can be hard to create an enforceable covenant to restrict an individual for many years, especially if that individual is a physician or other healthcare employee.

Regulatory Changes

Since this is a JV whitepaper for health care operations, the regulatory landscape of the JV's business (in its current form and any new potential iterations) will have a significant impact on the JV. In almost all instances, the lawyers will have a solid grasp of, and be able to take into account existing regulations. The challenge, though, is making sure that the JV is positioned to take into account future changes to the regulations, or the imposition of new regulatory overlays. This can come in the form not only of the regulations applicable to the JVs business, but can also come in the form of regulations that apply to the members of the JV (for instance, a tax exempt JV partner that must comply with new UBTI rules).

Since it will be nearly impossible to predict specific changes in the future, the JV operating agreement needs to try to walk a fine line between having flexibility, on one hand, to address significant regulatory changes, while also having some level of predictability and certainty regarding current regulations so that JV partners still some level of certainty when entering into the operating agreement. One common strategy to address potential regulatory uncertainty relies on using external expertise to assist in resolving disputes about how the JV structure may need to be revised in light of regulatory change. For example, a possible covenant could provide that the JV will engage an independent law firm with expertise in the industry to propose possible changes to the operating agreement or JV structure, and the parties would agree to negotiate in good faith these revisions. If the parties are unable to come to an agreement, the parties would have an opportunity to either sell equity or otherwise wind down the business. In almost all instances, a sophisticated JV partner is not going to position itself such that a third party, even an independent third party, is making regulatory or compliance decisions for that entity. On the other hand, the lawyers do not want to be crafting a JV that has terms that allow an easy and unintended exit by a particular party.

For regulatory changes that do not affect the JV directly but instead impact one or more members, the solutions can be significantly easier, albeit raised the same concerns about

giving a member an easy opportunity to exit the JV. It can also be difficult for JV partners to reasonably evaluate the claims of a member claiming an issue with regulations, or want to change a fundamental aspect of the business relationship simply because of one member's tax or regulatory status. But perhaps even more challenging is that most sophisticated JV members are not going to leave the decision about regulatory interpretation to the other members or managers of the JV. Revisiting the tax-exempt JV partner, if such tax-exempt partner feels that the change in regulations has made its ownership and participation in a JV problematic (or, in the extreme case, threatens its tax-exempt status), such tax exempt partner is not going to want to lose its tax exemption because of decisions made by the JV. Fortunately, given that these regulatory changes are public and often take months or years of drafting, notice and comment periods, and other delays before becoming law, JV members hopefully will have plenty of time to figure out a mutually agreeable solution.

Winding Down/Going Broke

While generally parties enter into JVs assuming success, profitability and growth, it is important for the lawyers to make sure that the parties discuss and plan for the JV's potential failure. A good operating agreement should have provisions in place to wind down the business when necessary, and also provisions for unwinding if the business consistently loses money. There are a variety of circumstances that can lead to a wind-down scenario, and an operating agreement should have provisions that anticipate both specific concerns knowable at formation (e.g., negative cash flow), as well as flexibility to deal with unanticipated events far in the future (since a JV could exist for decades).

First, the members should consider what events trigger automatic dissolution, and what events do not. Just because an event does not automatically trigger dissolution does not mean that it could not eventually be a dissolution event, but instead the members will assess and make a mutually agreed-upon decision at that point. Automatic triggers should generally be tied to events that mean that the business cannot continue to function. For instance, negative cash flow coupled with a refusal by members to take on debt or fund capital contributions means that eventually the JV cannot pay its bills and will be forced into some sort of bankruptcy or receivership. This sort of event should clearly be contemplated for how the JV dissolves. Similarly, if there is a regulatory change that bans the particular type of JV in question, the dissolution process should be automatic.

However, there are a variety of circumstances that might be grounds for dissolution, but there might be business solutions. Consider an imaging JV on a hospital's campus. If the hospital needs to re-build its campus, and the JV can no longer lease space on the campus, the members may not want to continue at a new site (and may be frustrated that the hospital created this issue). Or consider a surgery center JV where the other members no longer want the physician member to provide medical director oversight. In theory, the JV could continue, but the physician member may not want it to do so. These sorts of possibilities need to be considered in connection with exit rights, and also with a view towards the overall JV relationship. Oftentimes, members enter into a JV assuming that they will bring a certain expertise or set of services to the JV, and that oversight and/or revenue is an important consideration in deciding to be a JV partner. If these assumptions prove false down the line (such

as if a medical director agreement is terminated), a member may not feel that continuing the JV is in its best interest.

Second, a JV agreement should contain specifics for the dissolution process. Standard language usually includes some formulation of, to the extent possible, liquidating assets and applying cash and cash equivalents to pay, in order, secured creditors, unsecured creditors, and then the members. Usually in a dissolution process, the point of conflict arises because the JV lacks sufficient assets to make the members whole (let alone the creditors). Depending on the nature of the JV business, the parties may want to layer on a preliminary step to the wind-down process. Assuming the dissolution is occurring because the JV is insolvent or otherwise incapable of proceeding, but the underlying business still exists and operates, the members may want to require that the JV first be shopped, either to third parties or all of the members (basically an auction process). This sort of provision can financially improve the outcome of a wind-down (because there is potential for a third party to buy the business above the book value of assets), but it can also create some challenges when considering the operating agreement as a whole. If the dissolution process in theory allows a member to buy the business at a discount, the operating agreement should also ensure that the buying member cannot get the JV into the dissolution process unilaterally. Imagine that a single member's declining to contribute capital triggers a dissolution, and that refusing member then tries to buy the business in dissolution. The other members would rightfully be frustrated by such self-dealing.

Dissolution can often be closely tied to affiliate transactions. When affiliate transactions include services or products that only the providing member can reasonably provide, negotiations around amending, renewing, or otherwise addressing vendor performance can require a broader strategic consideration. Consider a surgery center JV in a rural area. If a member physician provides medical director oversight, and the medical director agreement requires a renewal, what happens if the physician and the JV cannot agree on terms? Presumably the surgery center needs medical director oversight, and no one else in the market may be a realistic service provider. The JV still needs to comply with regulatory requirements regarding referral source contract negotiations, and so the JV may have a difficult decision that can only be resolved via dissolution. The lawyers should make sure that, in this case and others like it, the service provider member (or its affiliate) cannot use the affiliate transaction to derive personal benefit at the expense of the overall JV.

Dealing with Bad Behavior

In healthcare perhaps more than most industries, bad behavior or bad actors can have a long-lasting impact on a business venture. In other industries, criminal acts or regulatory violations by shareholders or directors might entail fines and penalties, loss of customers and employees, and brand damage, but typically so long as the business itself was not engaging in the bad acts, the business can survive. In healthcare, actions of a member that result in that member being excluded from participation in federal payor programs (or other federal reimbursement structures) can be a death sentence for a JV (even when the JV did nothing wrong). Accordingly, for most healthcare JVs (and not all, since not all healthcare industries rely on government reimbursement), the JV operating agreement should contemplate what happens if the JV and/or a member engages in bad behavior. Additionally, the lawyers for the JV members should have a

strong understanding about what such investigations and or convictions might entail for the operations of the JV.

First, the JV should, at a minimum, confirm that no members or managers, upon formation, have been convicted or are otherwise under investigation for alleged activities that could result in exclusion. Ideally there would also be a mechanism to require members to make the same representations about its current and future indirect owners as such individuals enter the JV.

Next, the parties should plan for the consequences of investigated bad behavior as well as convictions of bad behavior. There can often be significant disagreement about whether the presence of an investigation alone should trigger any consequences. On one hand an investigation can result in a conclusion of no wrongdoing. So it seems, in those cases, that any sort of negative outcome for the investigated member is unwarranted. Further, sometimes investigations cast a very wide net, and may be done in the ordinary course. On the other hand, certain regulations impose liability on an entity at the start of bad behavior, not at the point such bad behavior has been definitively established. Therefore, the JV may be in a situation where it is aware that liability may be accruing due to a member's bad behavior, but it lacks the ability to mitigate that liability. The parties may try to solve this issue by structuring some sort of indemnity by the misbehaving party, but for a large JV or exceptionally egregious bad behavior, it may not be realistic for any one member to be able to stand behind that indemnity with any certainty (and indemnity only has value if the indemnitor has the resources to satisfy the indemnitee).

Assuming that there are consequences in the operating agreement for bad behavior, the lawyers should understand how, if at all, such bad behavior can be mitigated in the eyes of the regulating agency. For instance, if exiting a bad behaving member solves the issue, the JV operating agreement should contain provisions for such exit. One point to keep in mind when considering exit terms for bad behaving members: if the bad behavior is occurring upstream in the investment entity of one of the members (e.g., the LLC that all the physician JV members invest through), it is important that the upstream investment entity has a mechanism to exit the problematic individual or entity. Otherwise, the only recourse would be that the JV exits the entire member entity, and some individuals of that member entity may be unduly punished for the bad behavior of their partner.

Like most provisions in an operating agreement that deal with regulatory issues, it is important that provisions like these have some flexibility for changes to existing regulations and as well as the creation of new regulations. Similarly, if an existing JV (with a signed operating agreement) is expanding into new lines of business, the lawyer should be mindful of whether any changes to the existing operating agreement are required due to the requirements of the new business line to ensure protection against bad behavior. While no one would enter into a JV with an individual or entity that is expected to engage in bad behavior, it is the job of the lawyers to ensure a good outcome when the unanticipated happens.

Exit Rights/Transfers

Nearly all JVs will be private companies, meaning they are not registered for sale on a stock exchange. Therefore, there will be a limited market for resale, as well as potentially onerous federal and state securities regulations governing such a transfer. Additionally, most operating agreements will limit the ability of members to transfer or sell their equity even when such transfer is permissible under applicable regulations. There is an obvious push-and-pull that the lawyers structuring the JV will need to keep in mind. On one hand, a JV is typically formed by specifically selecting members that have an expertise or knowledge that will drive the financial and operational success of the JV. If such member leaves, or sells its equity to an unknown party, the JV may be worse off. On the other hand, it is difficult for any individual or entity to commit to a perpetual business relationship, and few JVs have a natural “end date” (in a way that other business ventures might).

There are several tools available to lawyers that can help provide some level of flexibility for members that may want to exit the JV in the future, and that also provide some protection for the members remaining in the JV. Below are a list of options, and oftentimes these options work well together; a lawyer should not feel like he or she needs to only pick one of these possibilities. Deciding which options are appropriate, though, will be dictated by the facts and circumstances of the JV. The nature and identity of the members (e.g., entities, or individuals; three or four initial members, or dozens or hundreds), the scope and scale of the JV business, and of course, regulatory concerns will all dictate the rules around transferring equity and exiting the JV.

- **Permitted Transfers** – Some transfers (i.e., sales) of equity are de facto permitted. These usually include transfers by an entity to its affiliate or subsidiary, or by an individual to a trust or other estate planning vehicle; similarly, a transfer between members already part of the JV could be permitted. In each of these cases, these transfers are usually permitted because, while the legal form of the member changes, the member is still effectively “the same.”
- **Right of First Refusal (“ROFR”)** – If a member desires to sell equity to another member or a third party, the existing members have a right of first refusal to purchase the equity at the proposed pricing. The ROFR provides some opportunity for a member to seek an exit, but it also allows the remaining members to have the chance (assuming they have the funds) to control the identity of the JV membership.
- **Tag-Along and Drag-Along Rights** – A tag-along right provides that if one member sells its equity to a third party, the other members have the option to “tag along” in the sale transaction, and sell some or all of their equity to the same third party at the same price. Conversely, a drag-along right provides that if one member sells its equity to a third party, that selling member has the option to “drag along” the other members, and require those members to sell their equity to the third party at the same price. Tag and drag rights usually exist when the JV has a large pool of small equity holders, and one or two majority owners.
- **Put and Call Rights** – A put right provides that a member may “put” its equity to the other members, and the other members must purchase that equity at an agreed-upon

price. Conversely, a call right provides that a member may “call” the equity of another member, and the other member must sell its equity to the calling member. Both of these rights can raise questions of valuation of the equity in question.

- **Buy/Sell Right** – A buy/sell right permits a member to set a price for its equity. Then, the other members have a right to either buy the setting member’s equity at the set price, or sell their equity to the setting member at the set price. These provisions can be particularly effective if no member has a particularly outsized importance to the JV through either expertise or affiliate services.

- **Redemption Rights** – Similar to a put right, a redemption right provides that a member may require that the JV redeem (or buy back) its equity. The opposing right, whereby the JV has the right to redeem a member without such member’s consent, may exist as well. Redemption rights can create some accounting and business planning challenges for JVs, because if a redemption right is exercised, the JV now has a financial liability for the redemption price (whereas a put or call right imposes that liability on the members).

- **Registration Rights** – Some JVs may provide members registration rights. Registration rights, at a high level, give a member the right to force the JV to become a publicly-traded company. Then, once the JV is publicly-traded, a member may sell its equity to the public freely (of course taking into account federal securities and listing exchange regulations).

- **Resignation/Withdrawal** – These rights are rare, but they basically permit a member to resign or withdraw as a member of the JV. Usually this means that the member receives no purchase price or other compensation for its equity, and instead can just walk away. These sorts of rights are rarely exercised.