Brief Description of Possible Organizational Operating Models

1. ***Type of Relationship:*** Sole Member Direct System Affiliation

Ownership Model, Capital Structure and Capital Commitments: Maui Memorial Medical Center (MMMC) becomes a corporate member of a large multi-hospital system, tertiary hospital, or academic medical center. Current MMMC debt would likely be refinanced or assumed as part of the parent entity's obligated group. Arrangements such as this usually include a commitment of capital for the member to invest in a strategic and master facility plan.

Governance: MMMC would generally retain its local governing board subject to the reserved powers of the parent. The MMMC Board Chair, President and CEO and Chief of the Medical Staff are often invited as guests to parent board meetings. The President and CEO of the parent generally become an ex officio member of the member's (i.e. MMMC's) board.

> **Delegated powers** to the local MMMC board might typically include: Approval and recommendation of strategic plans, appointing and evaluating the MMMC Chief Executive Officer, recommending to the parent board appointment of MMMC board members, setting and monitoring quality plan and targets, granting credentials and privileges to physicians, appointing and reappointing medical staff, approving the annual operating budget and capital and recommending it to the parent, and monitoring financial, operational, and clinical.
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> **Reserved powers** maintained by the parent board: Approval of articles of incorporation and bylaws, appointment of MMMC board members and ratification of the Board Chair, appointment of the MMMC CEO, review and approval of strategic plan and capital and operating budgets, issuance of debt, significant asset or clinical service acquisition/addition or dissolution, appointment of independent auditor and changes that would affect not-for-profit status.

Management: Overall management and operating responsibility would be vested in the parent. There is typically a commitment to maintain selected existing member hospital senior management teams for a specified period.

Management Services: The parent works with the member to assess opportunities to realize operational efficiencies through centralizing transactional systems and processes in administrative and support services (e.g. revenue cycle management, accounting, human resource management and purchasing, IT), as well as clinical, quality, and safety systems.

Organizations with Similar Structures: Catholic Health Initiatives, CHRISTUS Health (with several exceptions), Trinity Health, and Sisters of Charity of Leavenworth Health System.

2. Type of Relationship: 100% Asset Sale

(Note difference in form to above, but similarity in result.)

Overview: Prospective partner will purchase 100% of MMMC assets, not including assets associated with specified non-core businesses as defined by MMMC.

Ownership Model, Capital Structure and Capital Commitments: MMMC assets will transfer to a new owner in exchange for payment of fair market value (which is likely to be impacted by commitments for capital investment in the facility). Transaction proceeds will be paid to a MMMC entity, which will have responsibility for the remaining liabilities other than those specifically assumed in the transaction. The net proceeds can be used to create a charitable foundation to support MMMC's remaining businesses or to provide philanthropic support to other programs that benefit the community.

Governance: The new owner would have the prerogative for how MMMC is governed following the transaction, although this can include a formal legal commitment to offer substantial local participation in governance. Governance could be structured through a subsidiary of the new owners, or subsumed into the existing governance structure of the new owners. The sale documents would define those contractual commitments that would provide MMMC a continuing role in the governance of the hospital.

> **Delegated and reserved powers** will depend upon how the new owners choose to govern the facility. This can be an issue in the negotiation of the transaction.

Management: Overall management and operating responsibility will be vested in the new owners. Retention of the current MMMC senior management team can be a negotiated issue in the transaction.

Management Services: Centralized and value added services available through the new owner will be implemented at the new owner's discretion.

Organizations with Similar Structures: Most of the investor-owned systems, very few not-for-profit systems.

3. Type of Relationship: Joint Venture

Overview: MMMC and its joint venture partner will create a new jointly owned legal entity to which MMMC contributes some or all of its assets. The joint venture partner would pay to MMMC a percentage of the fair market value of those assets for its share of

the ownership of the joint venture entity. It is unlikely that a joint venture partner will enter into such an arrangement for less that 50% ownership and control.

Ownership Model, Capital Structure and Capital Commitments: MMMC and the joint venture partner will be the sole members of the joint venture entity. The joint venture entity would typically be structured as an LLC or 501(c)(3). The joint venture ownership percentage would typically be based on each party's contribution to capitalize the JV (e.g., with MMMC's assets and cash from new partner). Transaction proceeds will be used to pay off liabilities and the organization will emerge debt free from the transaction. Future capital commitments are negotiated as part of the transaction documents.

Governance: Governance and reserved powers will be negotiated based on the ownership percentages of the joint venture entity.

> **Delegated powers** to the joint venture board will include: Approval and recommendation of strategic plans, appointing and evaluating the MMMC Chief Executive Officer, setting and monitoring quality plan and targets, granting credentials and privileges to physicians, appointing and reappointing medical staff, approving the annual operating budget and capital and recommending it to the joint venture members and monitoring financial and operational performance.
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> **Reserved powers** maintained by the members: Approval of articles of incorporation and bylaws, appointment of JV board members and ratification of the JV Board Chair, appointment of the JV CEO, review and approval of strategic plan and capital and operating budgets, issuance of debt, significant asset or clinical service acquisition/addition or dissolution, appointment of independent auditor and changes that would affect not-for-profit status.

Management: Management will be appointed by the JV Board and will report to it. Retention of the current MMMC management team as employees of the joint venture entity can be a negotiated issue in the transaction.

Management Services: Centralized and value added services available through the joint venture partner will be implemented as opportunities to realize operational efficiencies, service improvements and additions are assessed.

Organizations with Similar Structures: Capella Healthcare, CHRISTUS Health, Signature Hospital Corporation, Sisters of Charity of Leavenworth Health System and LifePoint Hospitals, Inc.

4. *Type of Relationship: Lease*

Overview: MMMC leases its property to include, land, improvements, appurtenant rights, fixtures and equipment to a party that will continue to operate the facilities as an

acute care hospital. Post-closing covenants can be written that will contractually commit the lessee to continue or expand certain services that are important to the community.

Ownership Model, Capital Structure and Capital Commitments: Title to MMMC assets are not transferred to the lessee. Rent can be prepaid to the lessor at closing (preferred) or can be paid in periodic lease payments. This prepayment arrangement can be of a scale equivalent to the amount that would be otherwise received as a result of a sale. Requirements for future capital expenditures by the lessee can be incorporated into the lease agreement. The proceeds of the lease to the lessor can be used to pay retained liabilities and create a charitable foundation to support MMMC's remaining businesses or to provide philanthropic support to other programs that benefit the community.

Governance: Lessee will appoint an operating board which will adopt written by-laws for the hospital. Lessor may negotiate role in appointing local operating board members.

Management: Overall management and operating responsibility will be vested in the lessee. Retention of the current MMMC senior management team can be a negotiated issue in the lease agreement.

Management Services: Centralized and value added services available through the lessee will be implemented at the new lessee's discretion or a negotiated in the lease agreement.

Organizations with Similar Structures: City of Las Cruces & Dona Ana County New Mexico (lessors), LifePoint Hospitals (lessee)

5. Mayo Clinic Model

Type of Relationship: Wholly owned

Overview: The Mayo Clinic System has merged a total of 14 hospitals within its Minnesota/Iowa Wisconsin service area. Each hospital merger agreement includes requirements for physician leadership, local economic self-sufficiency, local operational input overshadowed by system reserve powers, and a commitment to quality of care.

Ownership Model, Capital Structure and Capital Commitments: Each subsidiary hospital is owned by the Mayo Clinic System, which in turn is controlled by the Mayo Foundation. Transactions are generally based upon market based reimbursement for tangible assets and for limited infrastructure improvements. Individual hospital subsidiaries are expected to meet their own working capital requirements and generate a 5% operating margin. All investment capital is allocated from the Mayo Foundation to the Mayo Clinic System. The 16 member Mayo Clinic System Board (half Mayo Clinic Rochester representatives, half regional subsidiary representatives) allocates investment capital to the subsidiaries.

Governance: Local subsidiaries have the following delegated and reserve powers:

Delegated powers to subsidiary hospitals are largely advisory, and include recommending a strategic plan, recommending an operating budget, developing capital budget requests, and monitoring financial and operational performance. Physician privileging and credentialing is done locally.

Reserved powers maintained by the Mayo Health System Board and the Mayo Foundation Board include approval of hospital and practice strategy plans, operating and capital budgets, fee schedules, new programs and services, compensation, changes in employee benefits, incurrence of debt, transfer of assets, professional staff requests, bylaw amendments, mergers, or any other fundamental changes.

Management: Administrators are assigned to each subsidiary hospital by the Mayo Foundation.

Management Services: The Mayo Health System provides central support for communications, contracting and payor relations, disease management policies, facilities, finance and accounting, human resources, information technology, leadership education and development, marketing, patient financial services and compliance, physician recruitment, supply expense management, and systems and procedures.

6. *Joint Operating Agreement*

Type of Relationship: Contract based, rather than transfer of ownership.

Overview: The Joint Operating Agreement or JOA model brings together two or more healthcare organizations to create a jointly governed entity to operate affiliates (in this case the affiliate would be CCH). Economic integration is achieved by a contractual agreement to share revenues and future capital expenditures according to predetermined formulas. The operating entity does not own any of the assets of the affiliates, and is not a healthcare services provider.

Ownership Model, Capital Structure and Capital Commitments: The JOA operating entity generally holds no assets other than contracts and working capital. Ownership of the JOA entity can be shared according to the preferences of the parties. An asset transaction could be structured independently of the JOA, but based upon the strategic and capital structure goals defined by the JOA.

Governance: Governance of the new operating entity is shared by the founding parties as agreed upon in the JOA. The Boards of the founding organizations remain intact.

Delegated powers. The JOA agreement delegates management and other specific authorities to the JOA operating entity from the healthcare service provider organizations.

Reserved powers. The JOA has contractual authority to provide services and make decisions based upon the specifics of the JOA contract structure. Healthcare providers cannot delegate authorities to the JOA that are required to remain within the provider entity by licensing, accreditation, or regulatory requirement (e.g. privileging, credentialing, quality oversight).

Management: Management of the JOA affiliate is through the JOA operating entity.

Management Services: Any number of management services can be contracted through the JOA entity from the participants to the affiliate.

Summary

Note that the resulting functionality of the models can be quite similar. The closer you look at alternative structures, the more you realize that each alternative can be customized to meet almost any specific arrangement agreed upon by the parties. Governance agreements, including membership and reserve powers, can be modified in each to follow the objectives of the parties rather than the form of each model. Beyond governance, the post-closing covenants of the transaction agreement can have significant impact on the future operations of the affiliated entity.