

## **Can Participation by a Nonprofit Hospital in an ACO Trigger Unexpected Bond Consequences?**

*Can participation in an Accountable Care Organization (ACO) cause a nonprofit hospital's bonds to become taxable?* A quick inquiry to bond counsel would probably yield an answer of “it shouldn't” in many cases. While this response would be legally sound in most instances, it is worth analyzing current bond law to make sure that the private activity bond rules are not inadvertently triggered when a nonprofit hospital (such as a governmental, public or private nonprofit hospital) and certain primary care physicians choose to participate in an ACO.

### Private Business Use

Generally speaking, tax-exempt bonds are permitted to be used to finance hospital facilities owned and operated by governmental units and 501(c)(3) organizations as long as the facilities do not have too much private business use taking place at the financed facility. Private business use arises through ownership or some interest that gives a private person the right to use the tax-exempt bond financed facility on a basis other than as a member of the general public. This means that an ownership interest in or lease with respect to the financed facility or a management contract relating to the facility may give rise to private business use. If there are changes with use at a bond financed facility that occur after bond issuance and result in private business use in excess of the permitted limits (10% for governmental facilities, 5% for 501(c)(3) organizations), the bonds financing the facility in question will become “private activity bonds.” If this type of post-closing event takes place and increases the private business use above the permitted limits at the facility, the outstanding bonds in most instances will be required to be redeemed or will run the risk of being declared taxable.

### Nonexclusive Provider Arrangements

Against this background and with the aid of the regulatory guidance provided to date, a number of nonprofit hospitals are considering participation in ACOs

under the Patient Protection and Affordable Care Act (PPACA). Under many models where a hospital is a participant, the hospital itself will be a non-exclusive provider. Being a non-exclusive provider is designed to ensure that the ACO does not run afoul of any antitrust laws. This means that a hospital participant in an ACO must be allowed to contract or affiliate with other ACOs or commercial payors. The typical non-exclusivity of the hospital member in an ACO contrasts with the relationship between the primary care physician and the ACO. Except for a limited exception, primary care physicians will be exclusive to the ACO with which they are affiliated. In instances where a nonprofit hospital with outstanding tax-exempt bonds is providing service on a non-exclusive basis, participation in the ACO should not give rise to any private activity bond concern on the part of the hospital. Since beneficiaries are free to choose their providers and the hospital itself is free to participate in or affiliate with other ACOs of their choice, the ACO should not be viewed as creating any special legal entitlements at the hospital that could give rise to private business use even though the primary care physicians who are members of the ACO may have an exclusive arrangement with the ACO.

### Exclusive Provider Arrangements

Hospitals, including nonprofit hospitals, are also permitted under PPACA to participate in an ACO on an exclusive basis. This type of arrangement simply means that the ACO won't fall within the safety zone entitling the ACO to the comfort that its structure should be free from antitrust challenge. With respect to a private activity bond analysis, the ramification of an exclusive relationship requires further review to determine if there are any adverse bond consequences for a nonprofit hospital that participates in an ACO on an exclusive basis and that financed its hospital with tax-exempt bonds. For instance, could the ACO operating agreement be deemed to be a management contract with respect to the hospital facilities, giving rise to private business use?

Under the applicable U.S. Treasury Regulations, a "management contract" is defined under Treas. Reg. §1.141-3(b)(7) as "[a]ny other arrangement that conveys

special legal entitlements for beneficial use of bond proceeds or of financed property that are comparable to special legal entitlements described [above]. . . .”

Because “management contract” under Treas. Reg. §1.141-3(b) is broadly defined and could technically capture an ACO with an exclusive arrangement with a hospital, a full facts and circumstance analysis of any ACO’s operation will need to be performed to be certain that private business use rules are not inadvertently tripped. An ACO that permits its beneficiaries to choose their providers and does not otherwise tie its other participant providers exclusively to the hospital facilities would have a strong argument against a determination of private business use. An ACO that contemplates stretching its business model further, however, may well cross the line and cause adverse bond consequences if the operating agreement of the ACO calls for the primary care physicians and the hospital to have an exclusive arrangement with the ACO. In addition, tying arrangements with other participants that create additional rights at the hospital or additional compensation flowing to the ACO or its participants could also be problematic. Relationships underlying the ACO that are a mask for the sharing in the net profits of the hospital’s operations with the physicians or other participants in the ACO could well be found to give rise to private business use. In these cases remedial action would be required or the hospital would run the risk of its tax-exempt bonds being declared taxable. Given these risks, prudence dictates treating the issue as a potentially significant one before committing to this type of ACO structure.

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