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Management Agreements for Surgery Centers

In this article, I outline for you the key provisions of a Management Agreement for an ambulatory surgery center. Most surgery centers have a manager. Sometimes the manager is an outside management service organization (MSO) that specializes in surgery centers, and sometimes the manager is an insider entity owned by the founder / physicians of the surgery center. Whatever the nature of the manager, it and the surgery center will enter into a Management Agreement. Without further ado, the key provisions of a Management Agreement:

Services and Compensation

First and foremost, in the Management Agreement you must define the manager's services and the compensation for those exact services, plus any ancillary services that the manager will perform for an additional fee. The manager's compensation can be a percentage (often 4% to 6% of collections or accrued revenues) or a flat fee. Manager's compensation usually comes with performance milestones or thresholds, caps, or a decreasing percentage after the surgery center meets a specified threshold of collections. From a regulatory perspective (next), fixed fee is safer than percentage compensation.

Make sure that the Management Agreement fits within the applicable referrals laws (most likely the Kickback statute). The usual requirements apply: the management fee must be set in advance, consistent with fair market value, be commercially reasonable, and may not take into consideration the volume or value of referrals.

The interesting issue is percentage compensation. Most management fees are a percentage of the surgery's center's revenues or net collections. The Kickback safe harbor does not permit percentage compensation, however. If you want percentage compensation, then you don't get the benefit of the safe harbor, which means you default to the general Kickback requirements. This shouldn't be a problem so long as the manager is not a source of referrals. In contrast, you might have a problem if the manager engages in marketing activities designed to generate patients for the ASC, or if the manager is owned by physicians who might give or receive referrals (e.g. anesthesiologists).

Term & Termination

These provisions consist of (1) the initial term (often 10 years) plus the option / renewal terms; (2) the physicians' right to terminate the contract either with or without cause; and (3) the manager's right to suspend services or quit. Together, these provisions tell you how long the two sides are locked together, and the ease and cost of any forced separation.

Liabilities

The parties will negotiate the levels of indemnity between them, if only because indemnification is a sufficiently arcane topic to let us lawyers show off. Keep your eyes on the liabilities and debts of the surgery center for which the manager will be responsible. The manager's goal is to avoid any responsibility for the operation of the surgery center. This includes lease liability, and most important, third-party reimbursement liabilities. The reconciliation process for reimbursements isn't clean as of month end. If the physicians retain liabilities, consider retaining accounts receivable to cover the liability.

Hidden Control

Beware a Management Agreement if the manager is the controlling owner of the surgery center. In this case, the manager controls both sides of the contract, that is, it controls both the surgery center and itself, the manager. If the manager wants to change or terminate the contract, it can do so at any time by agreement with itself. For example, the manager can raise its own management fees – all it needs to do is agree with itself regarding the raise, after due discussion and negotiation with itself.

The real consequence of such a contract is to lock in the manager only for so long as the manager wants to stay in, which is as long as the manager is making good money. If the minority physicians don't like the manager or its compensation, they are stuck for the term of the contract (likely 10 years with successive 5 year terms automatically tacking on thereafter). Because the minority physicians don't control the surgery center, they cannot exercise any of the surgery center's rights under the contract to remove the manager.

The physicians must cover this risk in the Operating Agreement for the surgery center. Minority owners cover the risk through veto votes over the identity of the manager, management compensation, and the payment of fees to affiliates of management. Further, if the minority owners' veto rights are to have any teeth, then the physicians' exercise of the veto right must permit them to change or terminate the Management Agreement. It would be senseless to have the minority owners exercise their veto rights within the surgery center's LLC, but then be bound by the Management Agreement.

And there you have it.

Lying

- It is not only by dint of lying to others, but also of lying to ourselves, that we cease to notice that we are lying. -- *Proust*
- Of all the liars in the world, sometimes the worst are our own fears. -- *Rudyard Kipling*
- Above all, don't lie to yourself. The man who lies to himself and listens to his own lie comes to a point that he cannot distinguish the truth within him, or around him, and so loses all respect for himself and for others. -- *Fyodor Dostoyevsky*
- It's not a lie if you believe it. -- *George Costanza*

"He looks so natural."