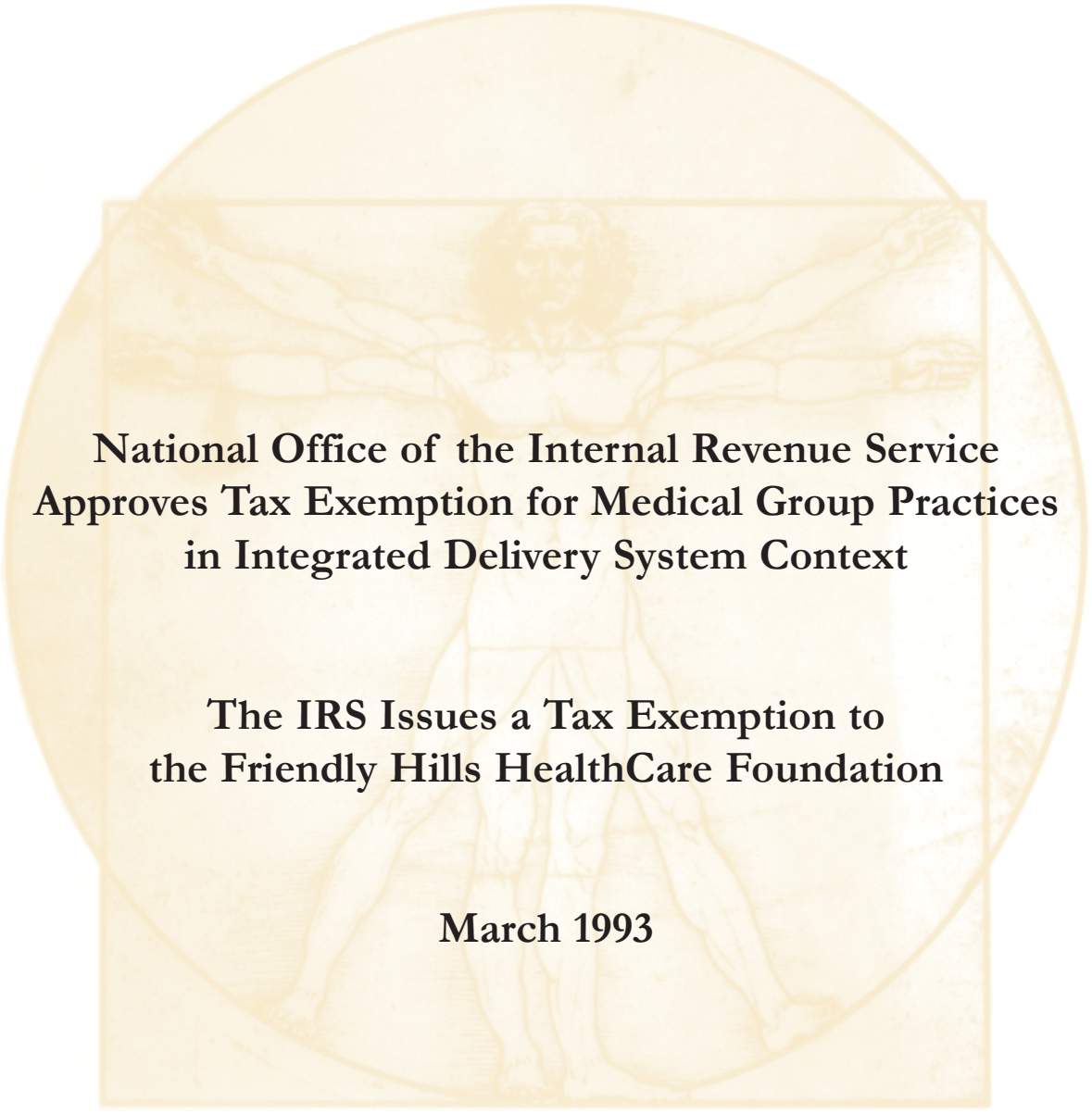


National Office of the Internal Revenue Service Approves Tax Exemption for Medical Group Practices in Integrated Delivery System Context

The IRS Issues a Tax Exemption to the Friendly Hills HealthCare Foundation

March 1993

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-The Wall Street Journal

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–Thomas P. McCabe
Executive Counsel
Friendly Hills HealthCare Foundation

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A dramatic move with profound implications for both existing and proposed tax-exempt medical group practices and merged hospital-medical group health systems nationwide occurred on Friday, January 29, 1993, when the National Office of the Internal Revenue Service (the "IRS") issued a determination letter granting the Friendly Hills HealthCare Foundation (the "Foundation") an exemption from federal income tax under Section 501 (c) (3) of the Internal Revenue Code. For 20 months prior to the issuance of the Friendly Hills exemption, the National Office of the IRS had put a hold on the issuance of all tax exemptions to applicants proposing tax-exempt clinics or integrated delivery systems. This memorandum details the lessons learned from obtaining the new determination.

As defined by the National Office of the IRS, a "tax-exempt" clinic is a free-standing medical group which seeks to convert to tax-exempt status; an "integrated delivery system" or "IDS" involves the affiliation of a medical group with a hospital or health system whereby the newly created coordinated delivery system seeks tax-exempt status. The precise legal structure of such organizations varies with state law requirements.

Historically, many of the nation's most prominent medical clinics have been organized as tax-exempt organizations. Including faculty practice plans, we understand that over 400 medical group practices around the country are tax-exempt. The table below lists 10 of the largest tax-exempt systems.

ORGANIZATION	Total FTE M.D.'s	Year Founded
Mayo Clinic *Rochester, Minnesota*	995	1864
Henry Ford Medical Group *Detroit, Michigan*	800	1914
Cleveland Clinic Foundation *Cleveland, Ohio*	536	1921
Geisinger Medical Center *Danville, Pennsylvania*	360	1916
Marshfield Clinic *Marshfield, Wisconsin*	360	1916
Northwestern Medical Faculty Foundation Inc. *Chicago, Illinois*	350	1980
Oschner Clinic *New Orleans, Louisiana*	350	1941
The Hitchcock Clinic *Lebanon, New Hampshire*	310	1927
Scripps Clinic & Research Foundation *La Jolla, California*	310	1924
Park Nicollet Medical Center *Minneapolis, Minnesota*	303	1983

Source: Healthweek's 1991 Book of Lists, 10/21/91

Recently, however, with the dramatic growth of managed care and the specter of managed competition as a national reform strategy, there has been an explosion of new medical group formation and hospital-medical group affiliation around the country. How will these emerging organizations be structured? By what means will they be capitalized?

These questions are being addressed by a new generation of regulators who have emerged at the National Office of the IRS, many of whom have specific experience and expertise in health care. These regulators have embarked upon a fundamental rethinking of the ways in which the tax laws apply to health care payors and providers. Evidence of this rethinking was most dramatically exemplified by the issuance of General Counsel Memorandum 39862 issued in November of 1991 in which the IRS overruled a number of private letter rulings permitting the formation of hospital/physician partnerships which acquired the future income stream of hospital outpatient departments.

The issuance of GCM 39862 roughly coincided with the filing for a number of new tax-exemption applications for IDSs. Because of the novelty of these IDS proposals and in order to avoid issuing rulings which they might have to later reverse, the IRS National Office delayed acting on all applications until an overall policy review of the matter could be performed. During this delay, many health care consultants and attorneys speculated incorrectly that clinic and IDS applications for tax exemption would be denied. The task of the IRS National Office was to apply the fundamental requirements for tax exemption for health care providers, traditionally hospitals, to the quickly evolving IDS structures around the country. As a test case, the IRS National Office chose the proposal of the Friendly Hills HealthCare Foundation to convert to a tax-exempt IDS. After almost twenty months of deliberation, the IRS National Office has formulated its position with regard to tax-exempt clinics and IDSs. The first action it has taken is the issuance of the tax exemption for the Friendly Hills HealthCare Foundation.

We anticipate that the IRS National Office will take two additional actions to further delineate its position with regard to tax-exempt clinics and IDSs. First, in the next several weeks, it is our understanding that the IRS National Office will publish a position statement with respect to applications by clinics and IDSs for tax-exempt status. This position statement will not deal with faculty practice plans or health maintenance organizations (HMOs) which are subject to separate analyses. The statement will not enjoy the status of law or regulation, but rather will be a simple published policy statement on the matter by the IRS. Thus, while it will hold no legal precedential value, the statement should provide substantial guidance for future clinic and IDS applicants seeking tax-exempt status. The IRS National Office has informed us that it will establish a period for public comment and will consider those comments in a possible revision of its policy statement.

"Many health care consultants and attorneys speculated incorrectly that clinics and IDS applications for tax exemption would be denied."

Second, we anticipate that in the next several months the IRS National Office will issue a general counsel memorandum addressing the issue of tax-exempt clinics, and in particular, tax-exempt clinics which are structured as professional corporations. Such arrangements appear to be more common in the Midwest and on the East Coast. We speculate that the IRS National Office may find that such structure result in inappropriate physician control of the tax-exempt clinic organization, and

that equity holding by participating physicians is inconsistent with the charitable mission of the organization. However, these are matters of speculation and we must await the issuance of the GCM for clarification of the IRS position.

At this time, however, the only resource from which we can glean the position of the IRS National Office with respect to IDSs is the decision made in the matter of the Friendly Hills HealthCare Foundation.

The Friendly Hills HealthCare Foundation

Founded by physicians, the Friendly Hills HealthCare Network (the "Network") is comprised of five separate legal entities: the Friendly Hills Medical Group (the "Medical Group"), an integrated group practice consisting of approximately 160 physicians representing over 30 medical specialties; the Friendly Hills Regional Medical Center (the "Medical Center"), an affiliated 274-bed general acute care hospital; and one corporation and two general partnerships holding the land and certain tangible assets utilized by the Medical Group and Medical Center. At present, the network provides care to over 100,000 pre-paid patients, including 15,000 Medicare senior risk enrollees.

The Network is one of the most advanced integrated managed care organizations in the United States. It is a primary care-based medical organization with a strong family practice contingent. Its business is approximately 96% capitated on both the inpatient and outpatient sides of its operations. The administrative and clinical departments of the Medical Center and the Medical Group are fully merged. It has been a pioneer in HMO full capitation contracting, including serving a substantial Medicare population on a full risk basis. Thus, the Network has developed a cadre of both administrative and clinical staff sophisticated in the delivery of high-quality and cost-efficient managed care services. The Network joined with Loma Linda University Medical Center ("Loma Linda"), a nonprofit, tax-exempt, religious tertiary medical center affiliated with Loma Linda University Medical School, in order to create the proposed Friendly Hills HealthCare Foundation. The vision of Loma Linda and Friendly Hills is to create a new tax-exempt IDS which will offer the full range of health care services, ranging from community-based primary care through inpatient tertiary care, in a manner which benefits all of the members of its community. It is anticipated that the Foundation will coordinate a substantial program of medical education and clinical research with Loma Linda.

"THE NETWORK HAS DEVELOPED A CADRE OF BOTH ADMINISTRATIVE AND CLINICAL STAFF SOPHISTICATED IN THE DELIVERY OF HIGH-QUALITY AND COST-EFFICIENT MANAGED CARE SERVICES."

In brief, the transaction contemplates the formation of a new 501 (c) (3) tax-exempt corporation which, pursuant to a bargain sale partially funded by a tax-exempt bond financing, will acquire all the assets, both tangible and intangible, of the Network. Pursuant to Section 1206 (1) of the California Health and Safety Code, the Foundation will become the provider of care and will contract with the Medical Group to render services to the Foundation's patients.

While this "independent contractor" model of the tax-exempt medical foundation is required under California law, in other states a foundation may employ physicians directly. It is also noteworthy that under the Friendly Hills HealthCare Foundation model, the clinic functions as a division of a tax-exempt corporation which also oper-

ates a hospital. Historically, most tax-exempt foundations affiliated with hospitals have operated as sister subsidiary corporations to a tax-exempt hospital under a common parent corporation.

We believe that the IRS National Office chose the Friendly Hills HealthCare Foundation as a test case for several reasons. First, historically the Network has been a highly successful organization, both clinically and financially. Second, the Network represents an advanced form of capitated IDS toward which the marketplace appears to be evolving. Third, in the approximately 20 months during the pendency of its application for tax exemption, the Network actually outperformed financial pro forma projections set forth in the application. Finally, and importantly, the Foundation's affiliation with Loma Linda University Medical Center facilitated the creation of a substantial program of medical education and clinical research within the facilities of the Foundation.

"WE BELIEVE THAT THE IRS CONCLUDED THAT THE AFFILIATION OF A CAPITATED, PRIMARY CARE-DRIVEN MEDICAL GROUP PRACTICE WITH A COMMUNITY HOSPITAL AND AN ACADEMIC MEDICAL CENTER HELD SUBSTANTIAL POTENTIAL BENEFITS FOR THE COMMUNITY "

The IRS Approves the Concept of Tax Exempt Integrated Delivery Systems

The key question addressed by the IRS National Office in determining whether the Friendly Hills HealthCare Foundation qualified for tax exemption was whether the Foundation would benefit the community. In order to make this determination, the IRS considered the traditional "community benefit standard" originally promulgated in 1969 with regard to hospitals in Rev. Rule 69545. That Revenue Ruling sets forth the following standard for tax exemption:

By operating an emergency room open to all persons and providing hospital care for all those persons in the community able to pay the cost thereof either directly or through third-party reimbursement, [a hospital] is promoting the health of a class of persons that is broad enough to benefit the community.

The challenge for the IRS was to apply this standard, which was developed for application to hospitals, to far more complex IDSs, including not only a hospital but also a large medical group practice.

The IRS is grappling with similar issues in the context of applications by HMOs for tax exemption under Section 501 (c) (3) of the Internal Revenue Code. The IRS recently denied the application of the Geisinger Health Plan for tax-exempt status because, in its view, the Geisinger Health Plan lacked certain "critical community benefit factors." The IRS noted that Geisinger's failure to provide medical services through its own medical staff and hospital, its substantial failure to provide services to non-members or to indigent or Medicaid beneficiaries, and its failure to render emergency care to anyone in need regardless of ability to pay precluded its receipt of a tax exemption.

Geisinger appealed the refusal of the IRS to grant a tax exemption to Tax Court which overturned the action of the IRS. The Tax Court concluded that there was no requirement that tax-exempt HMOs provide health services directly through employed physicians or owned hospitals, or that HMO services be offered to Medicaid recipients. The IRS

appeal of the Tax Court ruling is still pending, and the IRS remains very sensitive regarding these issues.

It was in this context that the IRS National Office considered the baseline issue regarding whether the IDS proposed by the Friendly Hills HealthCare Foundation might hold sufficient benefits for the community. After many months of review, we believe that the IRS concluded that the affiliation of a capitated, primary care-driven medical group practice with a community hospital and an academic medical center held substantial potential benefits for the community. Having made this fundamental decision, the IRS sought to apply the traditional criteria of the community benefit standard to this new and innovative organization.

Criteria for Integrated Delivery System Tax-Exempt Status

Drawing from the lessons learned during the discussions leading to the Friendly Hills HealthCare Foundation tax exemption, we believe that the IRS National Office will consider the following criteria in reviewing the application of an IDS for tax-exempt status. It is important to recognize that each IDS operates in a unique marketplace and that the application of relevant criteria may vary by community.

1. *Open Emergency Room.*
   IDS applications for tax exemption which include a hospital will be required to show that the hospital's emergency room is open to anyone regardless of ability to pay.

2. *Open Medical Staff.*
   A traditional requirement of hospital tax exemption has been that the hospital's medical staff be open to all physicians in the community who can meet the requirements for medical staff membership and clinical privileges. The policy behind this requirement has been to assure the broadest access of community members to the inpatient facilities of the tax-exempt hospital by allowing the greatest number of physicians to practice at those facilities.

   It is the current position of the IRS National Office that an IDS with a hospital should assure that the hospital medical staff is open to all qualified applicants.

   While the Friendly Hills HealthCare Foundation will comply with this requirement, we have raised serious questions with the IRS regarding the appropriateness of an open medical staff for a fully-capitated IDS. A major thrust of managed care developments in the marketplace and in state and national health policy is cost containment through managed competition. Such arrangements contemplate capitated primary care-driven delivery systems which operate at maximum levels of efficiency. We believe that the closed-staff hospital will become an essential element in maximizing the efficiency of capitated IDSs. Accordingly, we question the appropriateness of the open staff requirement to IDSs.

   In the managed care environment, we believe that community access to IDSs will be obtained by enrollment in competing health plans rather than admittance to inpatient facilities by fee-for-service solo or small group practitioners. Thus, showing that the IDS participates in a broad portfolio of health plan arrangements should constitute accessibility to community members.

3. *Governance and Control.*
Because crucial elements in IDS formation and operation include the acquisition of medical group assets and contracting with the medical group to render services to the foundation's patients, the IRS National Office requires that physicians do not control the organization.

In this regard, it should be noted that under the laws of many states no more than 49% of the board of directors of a medical foundation may consist of interested parties, a category which will include all medical group physicians. Additionally, as will be explained in more detail below, independent contractor medical foundations which seek tax-exempt bond financing must be structured such that no more than 20% of the board of directors is made up of interested persons, including medical group physicians. However, except for the terms of the acquisition of medical group assets and payment for professional services, medical group representatives on the board may be accorded greater influence through super majority voting requirements.

> "THE IRS RECOGNIZES THAT THE PHYSICIAN STAFF OF THE IDS IS AN IMPORTANT ASSET OF THE TAX-EXEMPT ENTITY WHICH THE ENTITY MUST PROTECT."

In this context, the IRS will carefully scrutinize the governance provisions of any IDS proposal. It is unlikely that the IRS would accept board domination by physicians affiliated with the IDS. The IRS may also request assurances that any "community" board members not include retired medical group physicians.

4. *Medical Group Covenants Not To Compete.*
One of the major goals of the IRS's community benefit standard is to maximize the accessibility of health care services in a community. With this goal in mind, the IRS National Office has questioned the appropriateness of the imposition on physicians by an IDS of a covenant not to compete within a defined geographic area for a set period of time upon termination of their relationship with the IDS. Such an absolute noncompete covenant, the IRS reasons, might preclude physicians in a needed specialty from practicing in the community.

On the other hand, the IRS recognizes that the physician staff of the IDS is an important asset of the tax-exempt entity which the entity must protect. Accordingly, the IRS National Office finds acceptable noncompete provisions which restrict the ability of physicians to enter into capitated contracts with certain classes of payors with which the IDS currently contracts or has contracted in the prior two years.

5. *Participation in Medicare and Medicaid.*
The current position of the IRS National Office is that an IDS must participate in Medicare and Medicaid in a "nondiscriminatory manner," including the acceptance of elective fee-for-service Medicare and Medicaid beneficiaries in the IRS's clinic facilities. This is a matter of significant sensitivity to the IRS because of its current appeal of the Geisinger case described earlier.

In the context of the current managed care revolution and the managed competition policy debate, we believe that the current position of the IRS with respect to participation in Medicare and Medicaid is somewhat anachronistic. Increasingly, both Medicare and Medicaid

beneficiaries are being enrolled in capitated plans. Thus, a showing by the IDS that it is participating actively in Medicare and Medicaid through managed care contracting should satisfy the community benefit standard requirements.

It is noteworthy that the IRS recognizes that in most geographic areas of California, MediCal inpatient services are delivered under the "selective contracting program." That program allows the State to contract with a limited number of hospitals to render services to Medi-Cal beneficiaries in a defined service area. Because of this, the IRS recognizes that a tax-exempt hospital in California is participating in Medicaid on a nondiscriminatory basis if it has entered into good faith negotiations with the State to obtain a Medi-Cal inpatient contract, whether or not it actually receives one.

6. *Valuation of Tangible and Intangible Assets.* In order to avoid private inurement or private benefit, the tax-exempt IDS must acquire assets only on an arm's length, fair market value basis. The determination of what medical group assets are appropriate for the IDS to acquire and what method of valuation should be used in determining fair market value became the most time consuming and technical matter of discussion in our negotiations with the IRS. Ultimately, several full time appraisal experts from the IRS Office of Appraisal Services were called in to work with the valuation consultant representing the Foundation to resolve these issues.

The following lessons were learned about the standards of due diligence required by the Office of Appraisal Services:

- Although the transaction is essentially structured as an acquisition of assets for cash which for a tax-paying entity may result in substantial post-transaction depreciation and amortization benefits under section 1060 of the Internal Revenue Code, such benefits do not inure to the Foundation due to the IRS approval of tax-exempt status. The values and remaining lives of individual assets to be acquired in this transaction are, therefore, less important than might otherwise be the case to the IRS, and the value of the business enterprise becomes of paramount importance. The value of the business enterprise is the value of the firm's capital structure or, alternatively, the aggregate value of the assembled assets that comprise the entity as a going concern.

"Fair market value within this context must be determined without regard to prospective benefits that may arise as a consequence of the proposed merger or acquisition."

- Value is defined as fair market value, the definition of which is: "the price at which a willing buyer and a willing seller agree, neither being under any compulsion to buy or sell and both having reasonable knowledge of the relevant facts."

- Fair market value is determined within the context of the enterprise's worth to the most likely, hypothetical acquiror which for these purposes is deemed by the IRS to be a commercial buyer – a tax-paying corporation in the health care industry. The proposed tax-exempt status is disregarded as a factor. The conclusion reached by the IRS on this issue is that a tax-exempt entity should pay no more for an asset than would a for-profit corporation. Furthermore, fair market value within this context must be determined without regard to prospective benefits

that may arise as a consequence of the proposed merger or acquisition.

- Because the economic analysis of value is conducted for a determination of tax status, all factors itemized in IRS Rev. Rul. 59-60, 1959-1, C.B. 237 must be considered. Rev. Rul. 59-60, as modified and amplified by later rulings, has "stood the test of time" and adjudication. It is now the generally accepted framework within which valuations of securities and and business enterprises are conducted.

- An appraisal report must be prepared and should conform to standards of Rev. Rul. 59-60, as well as to guidelines established under the Uniform Standards of Professional Appraisal Practice (U.S.PA.P) as mandated under Title XI of FIRREA, and guidelines provided by the American Society of Appraisers.

- A comprehensive analysis of the target's historical financial performance should include a restatement of past financial statements to reflect post-transaction economics, particularly with regard to post-transaction physician compensation. Prospective financial data will then be extrapolated from adjusted historical performance, thereby properly reflecting the net benefits to be available to the acquiring entity going forward.

- A comprehensive analysis of geographically relevant market rates of compensation, by specialty, must be completed to corroborate the propriety of the proposed, post-transaction compensation to the physicians.

- There are numerous techniques and formulae for estimating the value of a going concern. The Office of Appraisal Services expects all recognized approaches to be performed and presented, including income approaches, market approaches and cost approaches. Despite the proclamations of the IRS in Rev. Rul. 68-609, 1968-2, C.B. 327, concerning the inadequacy of the "formula" or "excess earnings" approach, the inclusion of that approach, nonetheless, is mandated in these analyses by Rev. Rul. 76-91.

- The IRS will place greatest reliance on the Discounted Free Cash Flow methodology in reaching their final determination, thereby demanding a particularly rigorous, detailed, and complex presentation of prospective revenues, expenses and costs. However, the IRS will also scrutinize the process by which comparable, publicly traded companies are chosen from the universe of potential comparatives and the thinking process by which applicable market multiples are selected.

7. ***Medical Education, and Clinical Research.***

A key benefit to the community which may be offered by the IDS is a program of medical education and clinical research. The ability of an IDS to support such a program will weigh heavily in its favor in its application for tax-exempt status. Tax-exempt IDSs in the managed care environment might consider establishing primary care residency programs in hospitals and clinic facilities, and programs of research regarding the quality and efficiency of IDS structure and operations.

No single set of criteria met by an applicant guarantees tax-exempt status. Each applicant operates ina unique environment, and a combination of factors may coalesce to tip the community benefit balance in favor of the applicant.

We have suggested that two of the IRS's current criteria for IDS tax-exempt status, the hospital

open staff requirement and participation in fee for-service Medicare and Medicaid programs, may be inconsistent with the fundamental administrative and operational objectives of IDSs in the managed care environment and may detract from their cost effectiveness and efficiency. Accordingly, we have urged the IRS to reconsider these positions as their policies evolve in the future.

Effect of Tax-Exempt Financing on Professional Services Agreement

In our negotiations with the IRS, we obtained an important new ruling applicable only to the "independent contractor" model of a tax-exempt clinic being capitalized by tax-exempt financing. Under the independent contractor model, the clinic contracts with a freestanding, separately incorporated medical group to render services to the clinic's patients. The ruling is not relevant to tax-exempt clinics which employ physicians directly. As explained below, this new ruling will allow the professional service agreement between the tax-exempt clinic and the medical group to have a longer term.

The acquisition of the Network's assets by the Foundation is to be funded, in part, by the issuance of tax-exempt obligations. Federal law generally prohibits the use of the proceeds of tax-exempt obligations for private business uses. Where facilities that were acquired with the proceeds of tax-exempt obligations are used by independent contracting physicians to practice medicine, there is a danger that they may be considered to have been put to a private business use.

In Rev. Rul. 82-15, 1982-1, C.B. 461, the IRS has issued guidelines that provide that this will generally not be the case, as long as the contract under which the physicians practice complies with the following conditions:

- If the physicians' compensation is based on a percentage of fees charged for services rendered, the contract may not have a term exceeding two years, and the contract must be terminable by the exempt organization without penalty or cause by giving the non-exempt person 90 days notice.
- If the physicians' compensation is based on a periodic flat fee, the contract may not have a term exceeding five years, and the exempt organization must be able to cancel the contract without penalty or cause at the end of the third year of the contract term.

"A CONTRACT BETWEEN A TAX-EXEMPT FOUNDATION AND A MEDICAL GROUP CAN HAVE A FIVE-YEAR TERM IF THE MEDICAL GROUP IS CAPITATED."

In its ruling on the Friendly Hills HealthCare Foundation's application, the IRS recognized for the first time that a contract providing for a capitation payment to a medical group (i.e., a fixed amount per enrollee per month) is a flat fee for purposes of these guidelines, so that a contract between a tax-exempt foundation and a medical group can have a five-year term if the medical group is capitated.

Other Considerations Relating to Tax-Exempt Financing for Integrated Delivery Systems

An important aspect of the bargain sale transaction funded with the proceeds of a tax-exempt borrowing centers on the allocation of assets between acquisition and donation. Tax Law constrains the maximum term of a tax-exempt financing by limiting its average life to 120% of the average useful life of the assets financed. Accordingly, it is generally advantageous to allocate the longer-lived tangible assets to the financed portion of the transac-

tion. At the same time, establishing and substantiating a charitable contribution may create a competing need to allocate tangible assets to the donation component of the transaction. (As land is not accorded a useful life for financing purposes, the allocation of land value may comprise a solution in whole or in part to this potential problem.)

A separate issue with respect to financing for IDSs is the $150 million limitation imposed by Tax Law on the use of tax-exempt bond proceeds by a 501 (c) (3) organization to finance non-hospital assets. Recent proposals to eliminate this restriction may succeed under the Clinton administration. In the meantime, larger IDSs approaching or having reached this limitation must resort to the higher cost taxable markets for debt capital. Notably, for purposes of this test, defeased bonds are included in the determination of "bonds outstanding" until those issues are actually redeemed. This provision effectively doubles an organization's debt under the limitation for any bonds refinanced through an advance refunding.

Conclusion

The decision of the IRS to grant tax-exempt status to the Friendly Hills HealthCare Foundation establishes that IDSs may qualify for tax exemption. Admittedly, however, the Friendly Hills HealthCare Foundation is somewhat unusual in its affiliation with Loma Linda University Medical Center and, therefore, has a strong claim to tax exemption because of its potentially substantial programs in medical education and clinic research. Only the IRS's actions in its upcoming IDS and clinic policy statement, in the tax-exempt clinic general counsel memorandum and in its actions with respect to other pending IDS applications, will clarify the extent to which other applicants may qualify for tax-exempt status.

Existing tax-exempt clinics and IDSs should quickly review these IRS policy pronouncements to determine whether they are in compliance with the new rules. The IRS has informed us that it intends to review the operations of existing tax-exempt medical practices and to require compliance with its new policies.

Having established that tax-exempt status may be available for clinics and IDSs, of course, does not mean that the tax-exempt structure is appropriate for every clinic or medical group/hospital combination. A variety of models exist whereby hospitals and medical groups may be brought together and capitalized, including strategies of accessing public equity markets such as those pursued by PhyCor and Pacific Physician Services. We anticipate the creation of medical group-driven, hospital-driven and hybrid IDSs - some tax-exempt, others for-profit. Ultimately, the reorganization strategy adopted with the formation of an IDS will be a result of the unique factors applicable in a local market and the culture of the medical group and health system involved.

Dramatic reform of the health care system is clearly high on the nation's agenda. In both the marketplace for health care services and the centers for health care policy-making, shifting risk to providers is en vogue. In this context, we anticipate that IDS formation will grow even more explosively. The headline in American Medical News on February 1, 1993, perhaps best captures the mood of our nation's health delivery system:

REFORM PANIC

Doctors, hospitals rush to integrated services.

Accordingly, we anticipate that the mid-1990s will be a period of major health delivery system restructuring. The IRS has established that one alternative in this restructuring will be the tax-

FURTHER INFORMATION

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You may also wish to read Ambulatory Care Management and Practice, ed. Albert E. Barnett, M.D., and Gloria Gilbert Mayer, R.N., Ed.D. (Gaithersburg, Maryland: Aspen Publishers, Inc., 1992).

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William B. Hanlon III is a Principal in the San Francisco office of Shattuck Hammond Partners, Inc., a privately owned investment banking and financial advisory firm specializing in health care, education and tax-exempt organizations. Shattuck Hammond's business includes securities underwriting and placements; mergers, acquisitions and other corporate finance activities; and real estate advice, financing and investments. The firm's clients include a cross-section of national organizations, both tax-exempt and investor-owned. As financial advisor to the Friendly Hills Medical Group, Mr. Hanlon assisted in the initial design and structuring of the Friendly Hills HealthCare Foundation and its relationship to Loma Linda University Medical Center. As underwriter for the Friendly Hills HealthCare Foundation, Mr. Hanlon will assist in capitalizing the newly formed organization.

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Houlihan Lokey Howard & Zukin

Selected Health Care Industry Clients

Houlihan Lokey Howard & Zukin is dedicated to serving the health care industry. We are proud to have served as financial advisor to over 50 health care clients, including the following companies.

Allergan, Inc.
American Medical International, Inc.
Care Enterprises, Inc.
Catholic HealthCare West
Cedars-Sinai Medical Center
Charter Medical Corporation
Children's Hospital of Orange County
CIGNA Healthplans of California, Inc.
Holy Cross Medical Center
Hospital Corporation of America
Humana Incorporated
Link Imaging Corporation
Loma Linda University Medical Center
Palomar Pomerado Hospital District
Physicians' Health Network
Qual-Med, Inc.
Ramsay-HMO, Inc.
Saint Joseph Hospital of Orange
Santa Monica Hospital
Unihealth America
The Upjohn Company
Victor Valley Community Hospital
Vista Health Plans
Wellmark, Incorporated

Houlihan Lokey Howard & Zukin provides a wide variety of specialty investment banking services to more than 4,000 clients, including small, closely held businesses, Fortune 100 companies and government agencies. Founded in Los Angeles in 1970, Houlihan Lokey also has offices in New York, Chicago, San Francisco, Minneapolis, Washington, D.C. and Toronto with a staff of over 125 financial professionals.

Financial Advisory Services

Valuation opinions
Tax opinions
Solvency opinions
Fairness opinions
ESOP opinions
Litigation support

Corporate and Public Finance

Mergers & acquisitions
Private placements
Corporate partnering
Strategic planning
Public finance
Leveraged transactions

Financial Restructuring Group

Chapter 11 planning
Retrospective fraudulent conveyance analysis
Debt and equity financing
Plan confirmation determinations

Investment Management Group

Fixed-income asset management
Price and measure credit risk
Portfolio management
Customized research reports and analysis
Corporate credit rankings