Fair Market Value

Implications for Sleep Transactions

National Sleep Foundation

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HealthCare Appraisers
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Discussion Topics

1. Introduction to fair market value (FMV)
2. Two recent OIG Opinions pertaining to sleep services arrangements
3. Valuation approaches and their application to Service Arrangements
4. Valuation approaches and their application to Business Entities

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Introduction to Fair Market Value (FMV)

“Person on the Street” Perspective

- “What everyone is getting paid in the market”
- “What the hospital down the street is paying”
- “Incremental cost plus a profit margin”
- “What’s in a survey book”
- “What it’s worth to one party to the transaction”

Legal / Regulatory Perspective

- Stark Law
- Anti-kickback Statute

Stark Law

Stark Definition of FMV:

FMV is defined as the value in arm's-length transactions, consistent with the general market value. General market value means the compensation that would be included in a service agreement as the result of bona fide bargaining between well informed parties to the agreement who are not otherwise in a position to generate business for the other party.

Can't consider the "value or volume of referrals"

Anti-Kickback Statute

- Broader than Stark
- A brief comparison:

Stark	Anti-Kickback
Physician referrals under Medicare and Medicaid	Anyone engaging in business with Medicare or Medicaid. (Some State statutes may be broader.)
Does not require bad intent	Requires intent
Violations may result in: •Civil penalties •Denial of Payments •Exclusion from federal healthcare programs	Violations may result in criminal action against payor or payee

Professional Appraiser

Valuation Industry Definition of FMV:

"The price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arm's length in an open and unrestricted market, when neither is under a compulsion to buy or sell and when both have reasonable knowledge of the relevant facts."

(International Glossary of Business Valuation Terms)

Determining FMV

- Based on the “hypothetical-typical” buyer concept
- FMV contrasts with investment value or strategic value
- Determination of FMV based on 3 approaches to value:
  - Market
  - Income
  - Cost
- Formal body of knowledge and professional standards governing the appraisal practice

Three perspectives on healthcare FMV

1. "Person on the street" perspective
2. Legal/regulatory perspective
3. Professional appraisal perspective

Frequently conflict with each other and confuse parties to healthcare transactions.

FMV in Healthcare

- Stark regulations state that the definition of FMV "is qualified in ways that do not necessarily comport with the usage of the term in standard valuation techniques and methodologies."
- Stark examples:
  - Exclusion of market comparables between parties in position to refer
  - FMV can be established by "any method that is commercially reasonable."

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Two recent OIG Opinions

Perspectives on Service Arrangements

- They are not joint ventures
- Payment should be made based on the value of the services provided

Parties to a Typical Sleep Services Arrangement

- Between a Sleep Services Provider (a "Services Provider") and a sleep center (a "Center").
- Typical Services Provider Ownership:
  - Independent
  - Physician owned in whole or in part
- Typical Center Ownership:
  - Wholly owned by Hospital
  - Joint venture between Hospital and another entity (which may be the Services Provider and/or physicians)

Resources Required to Deliver Quality Sleep Services

- Space
- Clinical Staff
- Administrative Staff
- Centralized/Remote Scheduling
- Equipment and Furniture
- Scoring
- Supplies
- Medical Director
- Management Services
- Other Support

Resources Provided as Identified in the OIG Opinion 10-14

Services	Opinion 10-14
Space	
Clinical Staff	X
Administrative Staff	X
Centralized/Remote Scheduling	
Equipment and Furniture	X
Scoring	X
Supplies	X
Medical Director	
Management Services	
Marketing/Training/Education	
Other Support	

Summary of OIG Opinion 10-14

- The arrangement presents a low risk of fraud and abuse
- Critical Facts
  - Referring physicians don’t have a financial interest
  - Payment at FMV
  - No ancillary services or DME
  - Payment for services delivered and not based on collections
  - Not a turn-key arrangement

OIG Opinion 10-23 Compared with OIG Opinion 10-14

Services	Opinion 10-14	Opinion 10-23
Space		
Clinical Staff	X	X
Administrative Staff	X	x
Centralized/Remote Scheduling		
Equipment and Furniture	X	X
Scoring	X	X
Supplies	X	X
Medical Director		
Management Services		
Marketing/Training/Education		X
Other Support		

Summary of OIG Opinion 10-23

- The arrangement should not be protected
- Marketing Changed the Outcome. The OIG notes that:
  - Marketing fees paid on the basis of successful orders for items or services are subject to abuse because they are linked to the generation of business.
  - As a part of the “per-click” fee, the provider is compensated each time its marketing efforts are successful. The provider’s financial incentive to arrange for or recommend the hospital’s sleep testing facility is heightened.
  - Compensation for the part-time and variable marketing services is incorporated into the per-test fee for the sleep testing services.

Different circumstances could have yielded a different opinion

- Compensation is not FMV (*i.e.*, it is either above or below an established range)
- Under-arrangement entity is in a position to induce referrals
  - Owned by the Hospital
  - Owned by Physicians
  - Marketing
- Other *ancillary* services (such as DME or marketing)
- A "joint venture"

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Valuation Approaches and their Application to Services Arrangements

Valuation Approaches

- Market Approach
- Income Approach
- Cost Approach

Market Approach

Market Approach as defined by the International Glossary of Business Valuation Terms:

> *A general way of determining a value indication of a business, business ownership interest, security or intangible asset by using one or more methods that compare the subject to similar businesses, business ownership interests, securities or intangible assets that have been sold.*

Challenges (and potential pitfalls) in Applying the Market Approach

- Obtaining reliable pricing information
- Assuring that the market data isn't "tainted"
- Apples to Apples Comparison
  - Are the services the same?
  - Are required staffing ratios and credentials the same?
  - Are the markets comparable?
  - Are the equipment and furnishings comparable?
- However, components of a Services Agreement may be based on a Market Approach

Income Approach

Glossary Definition: *a general way of determining a value indication of a business, business ownership interest, security, or intangible asset using one or more methods that convert anticipated economic benefits into a present single amount*.

Challenges (and potential pitfalls) in Applying the Income Approach

- By definition, this Approach incorporates the volume and value of the referrals.
- Generally not applicable to service arrangements
- Therefore, average reimbursement, payor mix, and collections are generally not factored into a services arrangement valuation.

Cost Approach

The Glossary definition – *A general way of determining a value indication of an individual asset by quantifying the amount of money required to replace the future service capability of that asset.*

In general valuation terms, the Cost Approach looks to the cost to replace or recreate the asset.

Challenges (and potential pitfalls) in Applying the Cost Approach

- Cost Approach becomes the most applicable

- However, the following challenges still apply:
  - Costs must be normalized
  - Selection of comparable margins
  - Identify contract provisions that add “false” risk (*e.g.*, leaseback arrangements for space or personnel)

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Valuation Approaches and their Application to the Valuation of Business Entities

Valuation Approaches

- Market Approach
- Income Approach
- Cost Approach

Differentiation

- Financial performance
- Referral base
- Payor mix
- Contracts
- Assets
- Liquidity
- Borrowing capacity
- Technology
- Risk in the projections
- Regulatory environment
- Competition
- Local demographics
- Facility location
- Facility condition
- Ability to attract physicians

Valuation Approaches

- Market Approach
  - Comparable Multiples
  - Placement in range based on the specific center attributes
- Income Approach
  - Discounted Projected Cash Flows
  - Establishing the Discount Rate
- Cost Approach
  - Value of (Cost to recreate) the Assets

Conclusions

Conclusions

- Fair Market Value is a term of art. There are defined standards governing appraisal practice. In healthcare, those standards must also incorporate the legal/regulatory environment
- Two recent OIG opinions are helpful in gaining some insight into the legal construct. However, caution must be taken to assure comparability of background facts.
- There are three distinct approaches to determining fair market value each with its own challenges and potential pitfalls.

Discussion and Questions