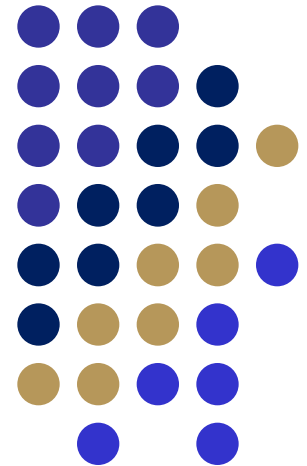


Healthcare Valuation Fundamentals & Common Pitfalls

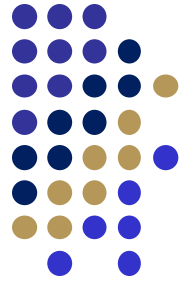
*Philadelphia Bar Association
Health Law Committee*

Presented by:
Fred Lara, CFA, ASA, CVA, Partner
October 10, 2014


HealthCare Appraisers
INCORPORATED

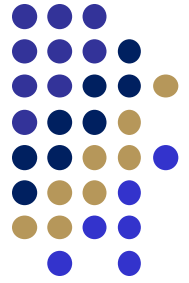


Presentation Summary



- Regulatory Overview – Why FMV matters
- Commercial Reasonableness
- Approaches to Value – Applications
 - Cost/Market/Income
- Pitfalls—
 - Valuation Approach issues distinct to Healthcare
 - Call Coverage and Employment examples
- Q&A

Why FMV Matters - Key Laws



- Anti-Kickback Statute (*Criminal Statute – Felony*)
 - Prohibited – Intentional payment for referrals (past, present or future)
 - 25 Safe Harbors offer protection - Key ones require FMV
 - OIG Advisory Opinions – frequently require FMV
- Stark Statute (*Civil Law - not criminal*)
 - Prohibited – Financial relationships between physicians and “DHS” entities to which they refer UNLESS the arrangement fits into a Stark exception.
 - Most exceptions require transactions to be: consistent with FMV and “commercially reasonable”
 - Commercial Reasonableness – different from FMV
 - How to determine FMV? Government commentary limited
- IRS Private Inurement Guidance (*for non-profit entities*)
 - Prohibited - Use of public funds to benefit private individuals or for-profit entities.
 - What is legitimate compensation?
 - Payments for items or services needed to ensure the non-profit mission
 - Payments must not exceed FMV for the items or services provided
 - Penalties: Loss of non-profits status (back taxes owed) or “intermediate sanctions”

Why FMV Matters

Recent Cases & Settlements

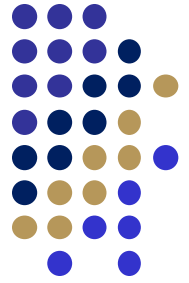


- **Memorial Health – 2014**
 - Physician compensation paid to employed primary care doctors. Ex-CEO relator
- **Bradford Case – 2014** (physician part continues)
 - Hospital pays independent physicians for use of camera and non-compete
- **Tuomey Case – 2014** (appeal); 2013 (\$237.5 million verdict)
 - Hospital employs doctors part-time for outpatient surgeries only, doctors remain independent for inpatient work; purpose and FMV questioned
- **Recent OIG Opinions**
 - 12-22 – Favorable opinion on co-management transaction
 - 12-15 – Favorable opinion on call coverage arrangements
 - 12-06 – Negative opinion on two ASC-Anesthesia transactions
- **Recent Settlements (in 2014)**
 - Halifax Hospital – (\$85 million settlement) Multiple compensation arrangements with employed physicians challenged based under technical and FMV arguments
 - All Children’s Health System – (\$7 million settlement) FMV of compensation and the Hospital’s implementation of its compensation plan challenged; clarified Stark’s relationship to Medicaid
 - Infirmary Health System – (\$24.5 million settlement) Technical issues with compensation and compliance with in-office ancillary services definition challenged

Commercial Reasonableness



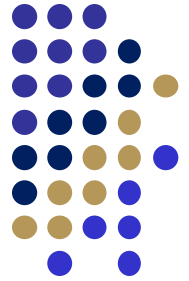
- Not officially defined in Stark, but commentary defines it
 - Subjective Concept: Sensible, prudent business agreement from the perspective of the parties
 - Objective Concept: Would make commercial sense if entered into by a reasonable entity of similar type and size and a reasonable physician of similar scope and specialty, **even if there were no potential for DHS referrals**
- Key questions: Would the parties do this deal if there were no referrals? Does the deal stand on its own?



VALUATION APPROACHES

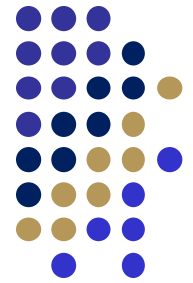


Types of Valuation - Glossary



- CV – Compensation Valuation (where most pitfalls happen)
 - PSA's, Employment, Management, Other (Lithotripsy, Perfusion, Employee Lease, Equipment Lease)
- BV – Business Valuation
 - Majority/Minority interest purchase/sale - Hospitals, Practices, ASC's,
 - Contribution to JV
- FF&E or M&E – Furniture, Fixtures and Equipment/Machinery and Equipment
- Real Estate – MOB lease rates, Facility purchase

Establishing FMV: 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.

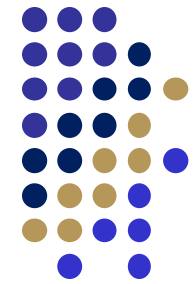
In general valuation terms, the Market Approach looks to comparable transactions to value the asset.

Establishing FMV: Market Approach



- Real Estate – Comparable property analysis
 - Square footage
 - Location
 - Age
- M&E – Comparable equipment analysis
 - Make
 - Model
- BV – Comparable transaction analysis
 - Revenue
 - Earnings
- CV – Identify independent provider comparables
 - Example – Sleep Study Scoring

Establishing FMV: Cost Approach



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

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.

Establishing FMV: Cost Approach



- Real Estate – Construction costs per sq. ft.
- M&E – For used equipment –
 - Replacement Cost New – Trend analysis to estimate current value (depreciation curve)
- BV –
 - Assets (Tangible + Intangible) less Long Term Debt
- CV –
 - Make vs. Buy calculation
 - Cost plus margin commensurate with market/risk
 - Example – Part time employee leasing

Establishing FMV: Income Approach



Income 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 using one or more methods that convert anticipated economic benefits into a present single amount.

Establishing FMV: Income Approach

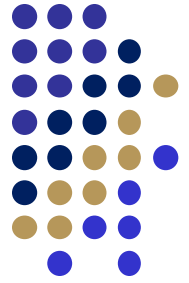


- Real Estate – Rent analysis
- M&E – Rarely used (vending machine)
- BV – ASC
 - Discounted Cash Flow (variable cash flows)
 - Capitalization of Earnings (“fixed” cash flows)
- CV
 - Issues due to referrals
 - Contractual JV (risk/reward mismatch) – April 2003 OIG Special Advisory Bulletin

FMV Opinion Synthesis



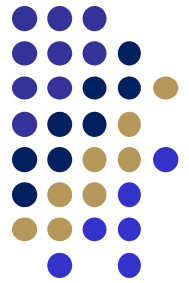
- In appraisal practice generally, the appraiser evaluates the indications of value provided under each approach to arrive at an opinion of value.
- The appraiser has to assess the relative strengths and weaknesses of each approach and/or method relative to the subject arrangement.
- The results of one approach may or may not be the best reflection of the appropriate level of value.
- Professional judgment is required to determine the value range based on the information gathered and the valuation analyses completed.



COMMON PITFALLS

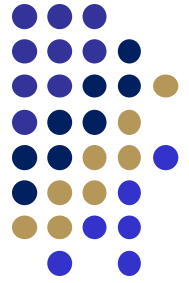


Common Valuation Issues & Pitfalls



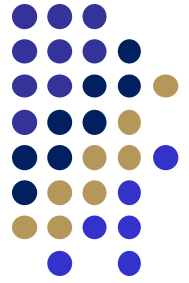
- Problems with Market Approach
 - Comparable data limited or non-existent
 - May include transactions between parties in a position to refer to one another
- Problems with the Cost Approach
 - Substitution of equivalent service transactions may not be practical
 - Book Value (or Cost to Replace) may understate value – Part time
- Problems with Income Approach:
 - Income/Revenue often considers the income from referrals

Pitfall - Call Coverage



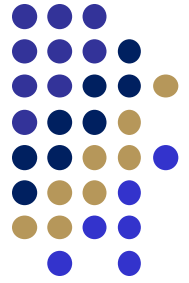
- Notwithstanding that market rates paid by other area hospitals may not be comparable to your hospital, “market data” as reported by physicians are frequently inaccurate.
- So...market data is largely useless in establishing and defending call coverage compensation.
- OK, now what?
- First, consider the guidance set for in OIG Advisory Opinion 07-10.

Pitfall - Call Coverage



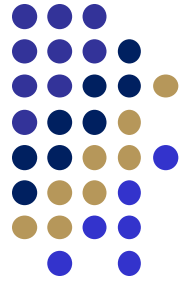
- The OIG gave several examples of “problematic compensation structures that might disguise kickback payments”:
 - Payment structures based on “lost opportunity” or similarly designed payments that do not reflect *bona fide* lost income;
 - Payment structures that compensate physicians when no identifiable services are provided;
 - Aggregate on-call payments that are disproportionately high compared to the physician’s regular medical practice income; or
 - Payment structures that compensate the on-call physician for professional services for which he or she receives separate reimbursement from insurers or patients, resulting in the physician essentially being paid twice for the same service.

Pitfall - Call Coverage



- Among the factors that the OIG found relevant to determination of the *per diem* rate are:
 - The severity of illness typically encountered by that specialty in treating a patient presenting at the ED;
 - The likelihood of having to respond when on-call at the ED;
 - The likelihood of having to respond to a request for inpatient consultative services for an uninsured patient when on-call; and
 - The degree of inpatient care typically required of the specialty for patients that initially present at the ED.

Pitfall - Call Coverage



- Consider the hourly rate applicable for the physician specialty's clinical services.
- Establish a percentage, or “on-call factor,” that matches the *burden* of the call coverage arrangement.
- Consider, but be cautious in the application of, survey data (*e.g.*, Sullivan Cotter's call coverage survey).
- Other call coverage issues:
 - Restricted vs. unrestricted call
 - Concurrent call
 - Compensation for unfunded care

Pitfall - Physician Employment



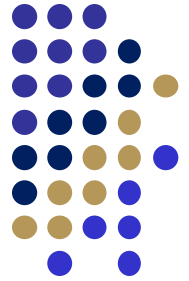
- Compensation at the 90th percentile as compared to 90th *percentile compensation per wRVU*. Are they the same?
 - No. If you are going to use MGMA data related to “compensation per wRVU,” you really must understand what MGMA says about its own data and how it should be interpreted and applied.
- As one example (from 2013 MGMA data), for orthopedic surgery:
 - 90th percentile cash compensation = \$976,000
 - 90th percentile wRVUs = 13,795
 - 90th percentile compensation per wRVU = \$113.16
 - Therefore, $13,795 \times \$113.16 = \$1,561,000!!$ (i.e., 160% of the 90th percentile)

Pitfall - Physician Employment

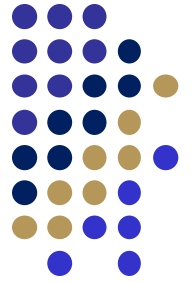


- Compensation “stacking”
 - A new industry watchword
 - If you call elements of compensation by enough different names, you can stack it taller and taller.
 - All sources of compensation (including benefits) should be aggregated in considering compliance with FMV.

Pitfall - Physician Employment



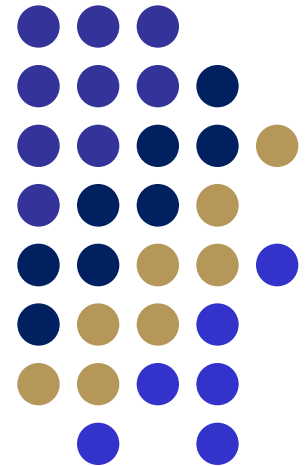
- A particular dilemma –
 - If a medical oncologist is employed by a hospital, the hospital likely will:
 - Bill for infusion services at a higher rate
 - Potentially benefit from 340b pricing (typically a savings of 30-35%)
 - Can these savings be shared with the physician?
 - Strategic / investment value vs. FMV



QUESTIONS?



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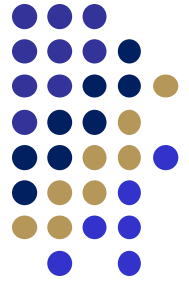
APPENDIX – SUPPLEMENTAL SLIDES

Anti-Kickback Statute Definition of FMV



- No statutory definition.
- Safe harbor regulations require FMV but do not define it.
- **OIG Guidance**
 - Special Fraud Alert – Arrangements for the Provision of Clinical Laboratory Services (October 1994):
 - Presumption that compensation outside of FMV is in exchange for referrals.
 - "By 'fair market value' we mean value for general commercial purposes. However, 'fair market value' must reflect an arms-length transaction which has not been adjusted to include the additional value which one or both of the parties has attributed to the referral of business between them."
 - OIG Compliance Guidance for Individual and Small Group Practices (October 2000):
 - "The OIG's definition of 'fair market value' excludes any value attributable to referrals of Federal program business or the ability to influence the flow of business. Adhering to the rule of keeping business arrangements at fair market value is not a guarantee of legality, but is a highly useful general rule."
 - OIG Supplemental Guidance for Hospitals (January 2005):
 - Hospitals should have appropriate processes for making and documenting reasonable, consistent, and objective determinations of FMV.
 - Is the determination of FMV based upon a reasonable methodology that is uniformly applies and documented?
 - If FMV is based in comparables, the hospital should ensure the market rate for the comparable services is not distorted.

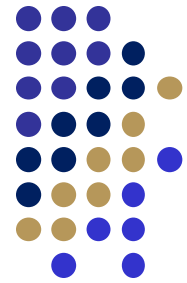
Stark Definition of FMV



- 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.**
- “...the definition of “fair market value” in the statute and regulation is qualified in ways that do not necessarily comport with the usage of the term in standard valuation techniques and methodologies. For example, the methodology ***must exclude valuations where the parties to the transactions are at arm’s length but in a position to refer to one another.***” [emphasis added]

Why FMV Matters

Comparison of Key Laws



	Stark	Anti –Kickback	IRS Private Inurement
Parties at Risk	Physicians & DHS Entities only	Everyone	Non-Profit Entities & Individual or For-Profit entity
Types of Referrals	DHS referrals only	Any Federal Program Referrals	Existence of referrals okay; but are they strategic value?
Intent Required	Strict liability, no intent required	Intent required	Depends on situation; Rebuttable presumption key
Criminal vs. Civil	NOT Criminal Civil penalties only	Both Criminal and Civil penalties	Civil; penalties vary, depending on circumstances
Exceptions/ Safe Harbors	Exceptions are <u>mandatory</u> (if no exception met, arrangement is prohibited)	Safe Harbors are <u>voluntary</u> (if not in a safe harbor, may still be okay)	Rebuttable Presumption (in Intermediate Sanctions rules)
FMV	Most exceptions require FMV	Not required, but OIG has said lack of FMV is evidence of a possible kickback	All payments for reasonably necessary items and services must be at FMV (IRS std)
Commercial Reasonableness	Many exceptions require CR	Not required, but OIG strongly prefers it	Goods or services must be necessary to achieve entity’s mission or objectives.

Why FMV Matters

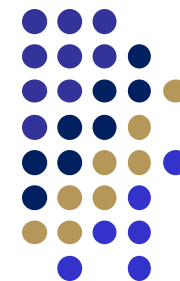
Some Older Cases to Also Consider:



- **United Shockwave Settlement** – July 2010
 - Urologists use referral threats to win lithotripsy contract at hospital
- **OIG Advisory Opinion 10-16** – September 2010
 - OIG questions requestor's survey method for determining FMV
- **OIG Advisory Opinion 09-09** – July 2009
 - Footnote questions the viability of the income approach
- **Covenant Settlement** – August 2009
 - Iowa doctors on a PCE deal allegedly overpaid – expenses questioned
- **Kosenske Case** – Appellate Opinion - January 2009
 - FMV is hypothetical, not what actual parties can negotiate
- **Villafane Case** – April 2008
 - FMV unsuccessfully challenged in academic medical center case in Kentucky
- **Derby Case** – IRS case from 2008
 - Intangible Assets case
- **Tenet - Alvarado/Northridge Cases** – 2006

Basics of Valuation

Above or Below FMV?



	Hospital Pays Physicians (e.g., Med Director, Call Coverage, etc.)	Physicians Pay Hospital (e.g., Space Lease)
Physicians refer Patients to Hospital <i>(Stark & AKS apply)</i>	BELOW Upper Limit of FMV	ABOVE Lower Limit of FMV
Hospital Refers Patients to Physicians <i>(only AKS applies)</i>	ABOVE Lower Limit of FMV	BELOW Upper Limit of FMV
Both Parties Refer Patients to Each Other <i>(Stark and AKS apply)</i>	WITHIN FMV Range	WITHIN FMV Range