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The Impact of the "*Per-Click*" Ruling on Valuing Diagnostic Outpatient Enterprises (Part Two of a Two-Part Series)

This summer, the D.C. Court of Appeals increased the level of uncertainty regarding reimbursement for providers of diagnostic outpatient services related to their compliance with one of the most prominent regulatory hurdles in healthcare: the *Stark Law*. On June 12, 2015 the D.C. Court of Appeals released its ruling in *Council for Urological Interests v. Burwell*, a case challenging the ban promulgated by the *U.S. Department of Health and Human Services* (HHS) on unit-of-service, or "*per-click*," fee payment systems for equipment or space leases between a hospital and a referring physician.[1] As discussed in Part One of this two-part series entitled "*Court Strikes Down Per-Click Restrictions, or Does It*?" the D.C. Court of Appeals voided the current ban on per-click payments as an improper exercise of agency authority by HHS.[2] However, the D.C. Court of Appeals did not permanently overturn the ban; rather, the court allowed HHS the opportunity to "*re-write*" the ban on per-click arrangements to be in compliance with the guidelines of the original statute.[3]

Increasing uncertainty regarding the status of the ban may have an impact on the value many diagnostic outpatient enterprises, such as those providing x-rays and *magnetic resonance imaging* (MRI) services. Prior to the ban on per-click arrangements, HHS expressed concern regarding the potential for fraud and abuse arising from the overutilization of space and equipment in per-click payment arrangements.[4] With the D.C. Court's ruling, the ban may be modified or even eliminated altogether, and per-click payment arrangements may return once again for equipment and space leases. Part two of this two-part series will explore the potential impact that the *Council for Urological Interests* ruling may have on the valuation of diagnostic outpatient enterprises.

Valuation analysts should be cognizant of the influence revenue may have on the overall value of a diagnostic imaging enterprise. The current levels of revenue produced by an enterprise, as well as the anticipated level of revenue to be generated in the future, are key factors in determining the economic value of an ownership interest in the subject enterprise.[5] Holding all other relevant variables constant (including: (1) *operating profit margins*; (2) *requisite working and fixed capital expenditure levels*; and, (3) *investment risk profile*) the greater the level of revenue produced by an enterprise, the greater the net economic benefit that would accrue to the owner of the subject enterprise, and therefore the greater the economic value of the enterprise.[6] In the short, run however, diagnostic outpatient enterprises have a significant level of fixed capital costs related to the machines and office/procedure rooms. As a result, fluctuations in the revenue of a diagnostic outpatient enterprise may have significant impact on the value of the enterprise, as declines in revenue without corresponding decreases in expenses will lead to declines in operating profit, and a reduction in economic value for the enterprise.

Forecasting of revenue begins by understanding the underlying factors that comprise the revenue stream of the asset, i.e. revenue is the product of *price* and *quantity*.[7] The forecasting of revenue should therefore proceed by projecting the: (1) quantity of the product or service that will be sold in the future; and, (2) the most probable price at which that product or service will transact.[8] The payment system utilized is a key consideration when *projecting revenue streams* for the valuation of any type of *freestanding outpatient enterprises*.[9]

As such, valuation analysts should be aware of potential shifts in reimbursement yield that may impact the *price* portion of the revenue formula for a diagnostic outpatient service. A potential shift toward the renewed acceptance of per-click payment systems may allow hospitals and diagnostic outpatient enterprises to receive compensation for each procedure performed (per-click) or utilization of exam room. This method of reimbursement contrasts with the *Medicare Physician Fee Schedule* (MPFS), which reimburses providers based on a pre-determined "*allowable fee*" for a physician,[10] the *Hospital Outpatient Prospective Payment System* (HOPPS), which reimburses hospital operating and capital costs based on the *relative weight* for a given coded procedure multiplied by a conversion factor,[11] and bundled payment models, which reimburses providers for multiple procedures combined, or *bundled*, together into a single *episode of care*.[12] Additionally, per-click reimbursement models may offset decreases in reimbursements for the technical components of many diagnostic outpatient services that have arisen under the *Affordable Care Act*.[13]

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Valuators should also watch for potential changes to patient volume, which may impact the *quantity* portion of the revenue formula for a diagnostic outpatient service. As stated above, changes in utilization demand can impact patient volume, which helps drives revenue for an entity.[14] In a pure per-click payment arrangement, diagnostic outpatient services receive payments for each unit-of-service, which are often driven by a referring physician who may have an ownership interest in a diagnostic outpatient service. In the past, HHS has expressed concern regarding the potential for fraud and abuse due to overutilization of space and equipment in per-click payment arrangements, as a hospital may refer all its patients to a particular diagnostic service center in exchange for continued referrals.[15] With the potential for per-click payment arrangements to return, it may be prudent for valuators to determine if utilization patterns have increased under a per-click payment arrangement. Even if per-click payment arrangements were to return, these types of arrangements for equipment and space leases may still violate the Anti-Kickback Statute, which could reduce potential patient volume growth.[16]

Should the ban on per-click arrangements be abandoned, diagnostic imaging enterprises would have the potential to generate increased revenue beyond what was possible during the ban, and, as a result, this increased revenue would lead to an increase in the economic value of the enterprise, as discussed above. However, should the ban on per-click arrangements remain intact, the current levels of revenue realized by diagnostic imaging enterprises would be likely to continue, and there would no impact on the economic value of the enterprise.

As HHS is considering how to respond to the *Council for Urological Interests* ruling, valuators should be hesitant to make any drastic changes to current valuations for diagnostic outpatient enterprises. At the same time, following the developments related to the reconsideration of per-click payment arrangements will help improve your base of knowledge when performing valuations of diagnostic outpatient services in the future, and allow you to respond promptly when (or if) the regulatory changes do occur.

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1 “Council for Urological Interests v. Burwell” No. 13-5235, 2015 WL 3634632 (D.C. Cir. June 12, 2015) p. 1.
2 “Court Strikes Down Per-Click Restrictions, or Does It?” Health Capital Topics, Vol. 8, No. 7, July 2015.
3 “Council for Urological Interests v. Burwell” No. 13-5235, 2015 WL 3634632 (D.C. Cir. June 12, 2015) p. 21.
4 “Medicare and Medicaid Programs; Physicians’ Referrals to Health Care Entities with Which They Have Relationships” Federal Register, Vol. 66, No. 3 (January 4, 2001) p. 878.
5 “Healthcare Valuation: The Financial Appraisal of Enterprises, Assets, and Services” By Robert James Cimasi, MHA, ASA, FRICS, MCBA, AVA, CM&AA, Hoboken, New Jersey: John Wiley & Sons, 2014, p. 497.
6 *Ibid*, p. 497-498.
7 *Ibid*, p. 65.
8 *Ibid*.
9 *Ibid*, p. 561.
10 *Ibid*, p. 115.
11 *Ibid*, p. 124.
12 “Healthcare Valuation: The Four Pillars of Healthcare Value” By Robert James Cimasi, MHA, ASA, FRICS, MCBA, AVA, CM&AA, Hoboken, New Jersey: John Wiley & Sons, 2014, p. 236.
13 “Patient Protection and Affordable Care Act” Pub. L. No. 111-148, § 3135(a), 124 Stat. 119, 436 (March 23, 2010); Cimasi, Healthcare Valuation: The Financial Appraisal of Enterprises, Assets, and Services, 2014, p. 552.
14 Cimasi, Healthcare Valuation: The Financial Appraisal of Enterprises, Assets, and Services, 2014, p. 560.
15 “Medicare and Medicaid Programs; Physicians’ Referrals to Health Care Entities with Which They Have Relationships” Federal Register, Vol. 66, No. 3 (January 4, 2001) p. 878.
16 “Court Upholds CMS' Prohibition on 'Under-Arrangements' Transactions, Strikes Down CMS' Prohibition on 'Per-Click' Equipment Rental Arrangements” The National Law Review, June 29, 2015, http://www.natlawreview.com/article/court-upholds-cms-prohibition-under-arrangements-transactions-strikes-down-cms-prohi (Accessed 8/20/15).

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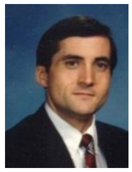

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