

Hot Topics in Healthcare Valuation

Presenters

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Presenter Bio

Robert James Cimasi, MHA, ASA, MCBA, FRICS, CVA, CM&AA, serves as Chief Executive Officer of **HEALTH CAPITAL CONSULTANTS (HCC)**, a nationally recognized healthcare financial and economic consulting firm headquartered in St. Louis, MO, serving clients in 49 states since 1993. Mr. Cimasi has over 35 years of experience in serving clients, with a professional focus on the financial and economic aspects of healthcare service sector entities including valuation consulting and capital formation services; healthcare industry transactions, including joint ventures, mergers, acquisitions, and divestitures; litigation support & expert testimony; and certificate-of-need and other regulatory and policy planning consulting.



Mr. Cimasi is a nationally known speaker on healthcare industry topics and the author of numerous peer-reviewed articles, chapters in legal treatises and anthologies, and nationally published books, including: *“Healthcare Valuation: The Financial Appraisal of Enterprises, Assets, and Services”* [2014 - John Wiley & Sons]; *“Accountable Care Organizations: Value Metrics and Capital Formation”* [2013 - Taylor & Francis]; and, his most recent book, *“The Adviser’s Guide to Healthcare – 2nd Edition”* [2015 - AICPA].

He serves on the editorial boards of NACVA’s *The Value Examiner* and *NACVA QuickRead*. In 2006, Mr. Cimasi was honored with the prestigious *“Shannon Pratt Award in Business Valuation”* conferred by the *Institute of Business Appraisers (IBA)*, and, in 2011, he was named a Fellow of the *Royal Institution of Chartered Surveyors (RICS)*. In 2016, Mr. Cimasi was named a *“Pioneer of the Profession”* as part of the recognition of the *National Association of Certified Valuators and Analysts (NACVA)* *“Industry Titans”* awards, which distinguishes those whom have had the greatest impact on the profession. You can see his full CV at: https://www.healthcapital.com/hcc/html2pdf30/RCimasi_CV.pdf



Presenter Bio

Todd A. Zigrang, MBA, MHA, FACHE, ASA is the President of **HEALTH CAPITAL CONSULTANTS (HCC)**, where he focuses on the areas of valuation and financial analysis for hospitals, physician practices, and other healthcare enterprises. Mr. Zigrang has over 20 years of experience providing valuation, financial, transaction and strategic advisory services nationwide in over 1,000 transactions and joint ventures involving acute care hospitals and health systems; physician practices; ambulatory surgery centers; diagnostic imaging centers; accountable care organizations, managed care organizations, and other third-party payors; dialysis centers; home health agencies; long-term care facilities; and, numerous other ancillary healthcare service businesses. Mr. Zigrang is also considered an expert in the field of healthcare compensation for physicians, executives and other professionals.



Mr. Zigrang is the co-author of the “*Adviser’s Guide to Healthcare – 2nd Edition*” (AICPA, 2015), numerous chapters in legal treatises and anthologies, and peer-reviewed and industry articles such as: *The Accountant’s Business Manual* (AICPA); *Valuing Professional Practices and Licenses* (Aspen Publishers); *Valuation Strategies*; *Business Appraisal Practice*; and, *NACVA QuickRead*. Additionally, Mr. Zigrang has served as faculty before professional and trade associations such as the American Bar Association (ABA); the National Association of Certified Valuators and Analysts (NACVA); Physician Hospitals of America (PHA); the Institute of Business Appraisers (IBA); the Healthcare Financial Management Association (HFMA); and, the CPA Leadership Institute. You can see his full CV at https://www.healthcapital.com/hcc/html2pdf31/TZigrang_CV.pdf



Overview

- The threshold of *commercial reasonableness*
- Discord between value-based reimbursement models and fraud and abuse laws
- The value of medical practices in the absence of positive net cash flow
- The valuation of service lines separately from the valuation of the medical practice
- The various components of physician compensation, including clinical (e.g., RVU or salary); coverage and call; medical directorship; and, administrative

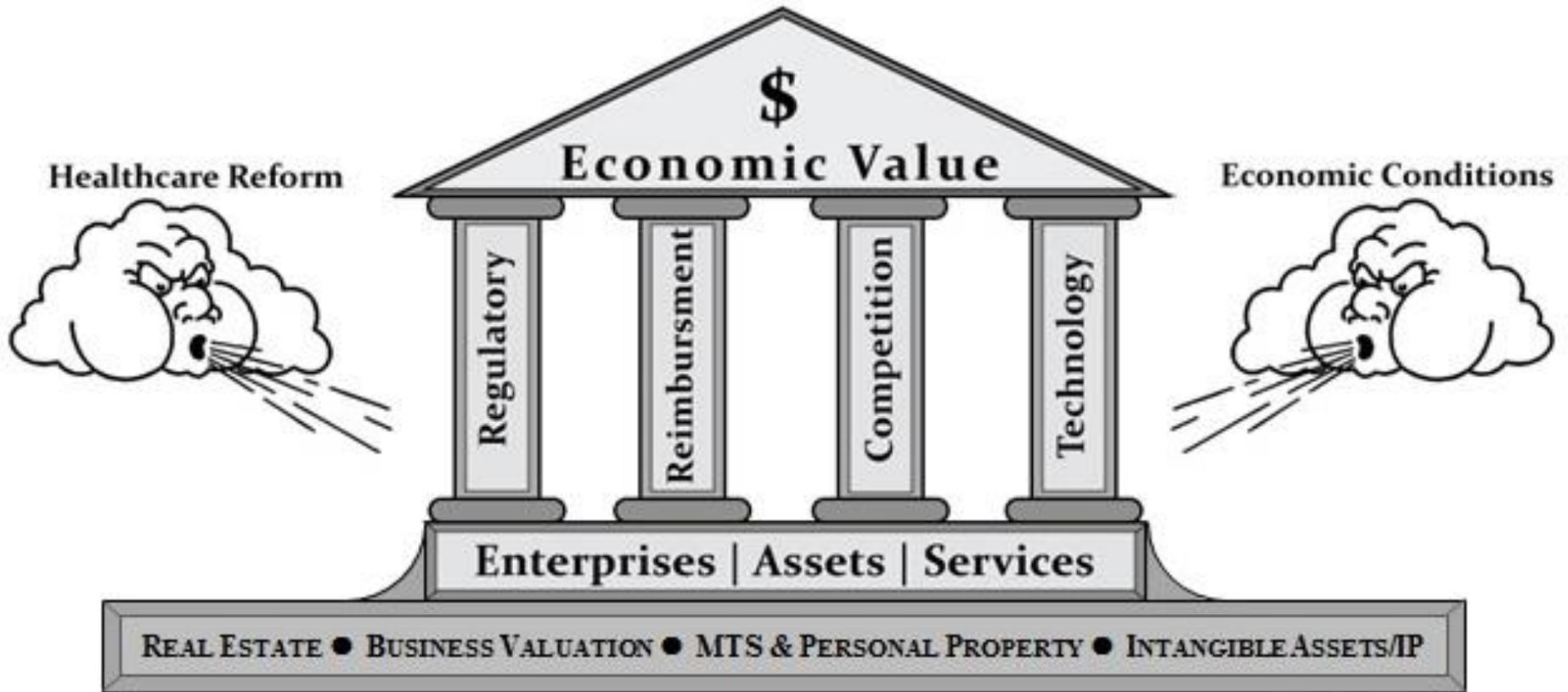


Overview

- Healthcare industry is different from other industries
 - Third party payor system
 - Highly regulated
 - Market entry barriers
 - Innovation does not impact healthcare productivity as it does in other industry sectors
 - Skilled healthcare labor cannot be delegated to less expensive unskilled workers in foreign labor markets
 - Unlike mass production, healthcare consumers believe that quality is correlated with the amount of physician labor expended



The Four Pillars



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Healthcare Fraud & Abuse Laws

The Anti-kickback Statute

- A felony for any person to “*knowingly and willfully*” solicit or receive, or to offer or pay, any “*remuneration*”, directly or indirectly, in exchange for the referral of a patient for a healthcare service paid for by a federal healthcare program
 - Affordable Care Act – “*With respect to violations of [the Anti-Kickback Statute] a person need not have actual knowledge of this section or specific intent to commit a violation of this section*”
- Punishable by up to five years in prison and/or criminal fines up to \$25,000
- Numerous safe harbors available – most require transaction to not exceed *fair market value* and be *commercially reasonable*



Healthcare Fraud & Abuse Laws

Stark Law

- Federal prohibition against physician self-referral
- Prohibits physicians from referring Medicare or Medicaid patients to an entity for Designated Health Services (DHS) if the physician, or an immediate family member, has a *financial relationship* with that entity
- Numerous exemptions – most require transaction to not exceed *fair market value* and be *commercially reasonable*



FMV & Commercial Reasonableness

- An arrangement must simultaneously be at *Fair Market Value* (FMV) and be *commercially reasonable* to be deemed legally permissible
 - **Fair Market Value** - Looks to the reasonableness of the range of dollars paid for a product or service
 - **Commercial Reasonableness** - Looks to the reasonableness of the business arrangement generally



Commercial Reasonableness Definition

- Internal Revenue Service
 - The 1993 Exempt Organizations IRS text “Reasonable Compensation”
 - “**Reasonable compensation** is...the amount that would ordinarily be paid for **like services** by **like organizations** in **like circumstances**.” [emphasis added]
 - Chapter 2 of Publication 535 “Business Expenses”
 - “...**reasonable pay** is the amount that a **similar business** would pay for the **same or similar services**” [emphasis added]
 - Federal Regulations on “Excess Benefit Transactions”
 - “**reasonable compensation** [is]...the amount that would ordinarily be paid for **like services** by **like enterprises** (whether taxable or tax-exempt) under **like circumstances**” [emphasis added]



Commercial Reasonableness Definition

- Department of Health and Human Services
 - An arrangement which appears to be “...a sensible, prudent business agreement, from the perspective of the particular parties involved, even in the absence of any potential referrals” is *commercially reasonable*
- Stark Law
 - “An arrangement will be considered ‘commercially reasonable’ in the absence of referrals if the arrangement 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 DHS referrals.”



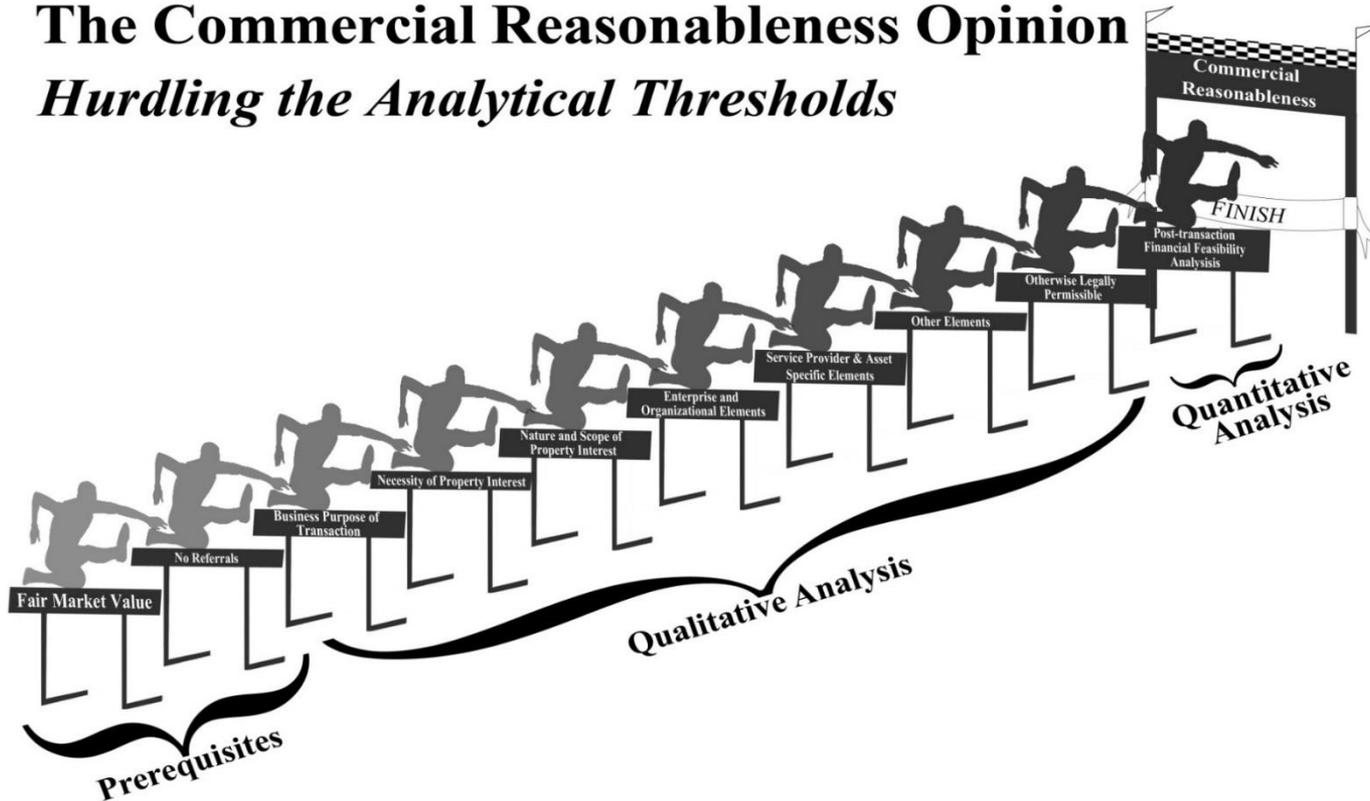
Commercial Reasonableness Definition

- Office of the Inspector General
 - A commercially reasonable transaction is a transaction in which “...*the aggregate services contracted do not exceed those which are reasonably necessary to accomplish the Commercially Reasonable business purpose of the service.*” [emphasis added]

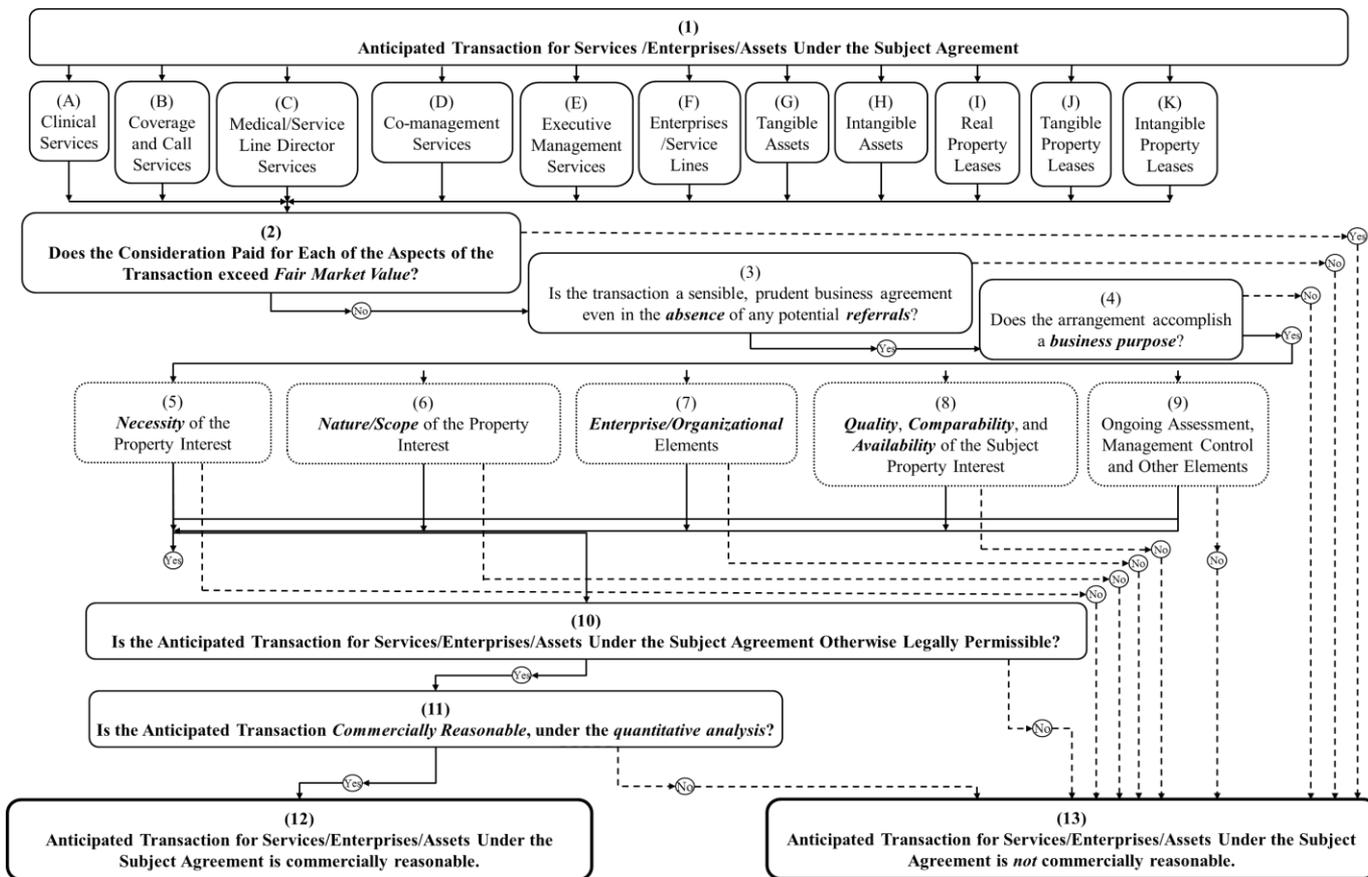


Commercial Reasonableness Analysis

The Commercial Reasonableness Opinion
Hurdling the Analytical Thresholds



Steps in Determining Commercial Reasonableness



Relationship to FMV and Distinguished from FMV

- While FMV looks to the “*range of dollars*” paid for a product or service, the threshold of Commercial Reasonableness looks to the reasonableness of the business transaction generally
- Commercial Reasonableness is a separate and distinct, but related, threshold to FMV
- Furthermore, the consideration and analysis of one threshold does not preclude the analysis of the other threshold



Distortion of the Commercial Reasonableness Analysis

- Government regulators (more specifically, the OIG and the DOJ) have, in some cases, challenged vertical integration transactions under various federal and state fraud and abuse laws, partly basing their arguments on the concept, termed the *Practice Loss Postulate* (PLP), that the acquisition of a physician practice, which then operates at a “*book financial loss*,” is dispositive evidence of the hospital’s payment of consideration based on the volume and/or value of referrals



"United States ex rel. Drakeford v. Tuomey Healthcare System, Inc." 675 F.3d 394, 407 (4th Cir. 2012); "United States ex rel. Parikh v. Citizens Medical Center" Case No. 6:10-cv-00064, (S.D. TX. September 20, 2013), Memorandum and Order, p. 27-28; "United States ex rel. Reilly v. North Broward Hospital District, et al." Case No. 10-60590-CV (S.D.Fla. September 11, 2012), Relators Third Amended Complaint Under Federal False Claims Act, p. 31; "United States ex rel. Payne et al. v. Adventist Health System et al." Case No. 3:12cv856-W (W.D.N.C. February 13, 2013), Relators Amended Complaint, p. 56; "Health System Practice Losses Make Headlines, Plaintiffs Make New Stark Law" By Eric B. Gordon and Daniel H. Melvin, BNAs Health Care Fraud Report, Bloomberg BNA, November 25, 2015, <http://www.mwe.com/files/Publication/a1a5d17c-3c79-4380-baef-0d11822334a1/Presentation/PublicationAttachment/5bb1e6ca-6491-4907-9a57-1049c2f3eec6/Gordan-Melvin.pdf> (Accessed 12/15/15).

Summary of the Practice Loss Postulate

- In maintaining the economic delineation between physicians and hospitals, the PLP focuses exclusively on immediate and direct financial (cash) returns on, and returns of, investments by healthcare organizations related to vertical integration transactions
- The PLP ignores other economic benefits associated vertical integration in healthcare
 - Social benefit and qualitative gains
 - Avoidance of cost and efficiency gains



Summary of the Practice Loss Postulate

(A)	(C)	(E)
Physician wRVU Cash Compensation Retention Bonus Medical, Retirement, etc. Benefits Nose Coverage		Unallocated Financial Deficit Attributed under PLP as "Practice Losses"
(B)	Total Physician wRVU Related Expense	(D)
Physician wRVU Related Economic Operating Expense Physician wRVU Related Economic Capital Expense		"Receipts" to Hospital Total Physician wRVU Reimbursement from all Payors

Summary of the Practice Loss Postulate

<p>(E)</p> <p>Unallocated Financial Deficit</p> <p>Attributed under PLP as "Practice Losses"</p>	<p>(F)</p> <p>Non- Monetary Benefits</p>	<p>(G)</p>	<p>(H)</p>	
		<p>Avoidance of Cost</p>	<p>Create Operational Efficiencies</p>	
		<p>Economies of Scope</p>		
		<p>Economies of Scale</p>		
		<p>Organization as a Factor of Production</p>	<p>Diversify Supply Chain</p>	
		<p>Social Benefits</p>		<p>Provide Continuum of Care</p>
				<p>Achieve Care Coordination</p>
				<p>Satisfy the <i>Triple Aim</i></p>
<p>Improve Population Health</p>				
<p>Complimentary and Requisite Care Mapping of Services</p>				

Summary of the Practice Loss Postulate

- Consequently, under the PLP, a “*book financial loss*” on a physician practice borne by a vertically integrated health system, when viewing that practice as a stand-alone economic enterprise, is viewed as evidence of legally impermissible referrals under the Stark Law
 - This regulatory conjecture hinders the ability of a vertically integrated health system to withstand fraud and abuse scrutiny, and erects a barrier to satisfying the threshold of Commercial Reasonableness



Distortion of the Commercial Reasonableness Analysis

- This misguided theory overly simplifies the Commercial Reasonableness analysis, such that the threshold has been *“contorted to cap a physician's compensation at levels that he or she could generate if he or she remained an independent seller of physician services, even if part of that compensation is paid for supervising non-physician members of a multidisciplinary team in the efficient delivery of quality care.”*



Failure of the PLP's Commercial Reasonableness Argument

- Losses on vertically integrated physician practices do not contraindicate the threshold of Commercial Reasonableness
- Hospitals routinely invest in initiatives, service lines, and uses of capital that do not immediately (or may never) yield direct financial (cash) returns on, or returns of, their investment, such as:
 - Emergency rooms, trauma services, pathology labs, and neonatal intensive-care units (NICU);
 - Research labs and clinical studies;
 - Principal research investigators, medical directors, and other types of physician executives;
 - Education of Residents; and,
 - Artwork and other aesthetics with the aim for therapeutic benefits to patients



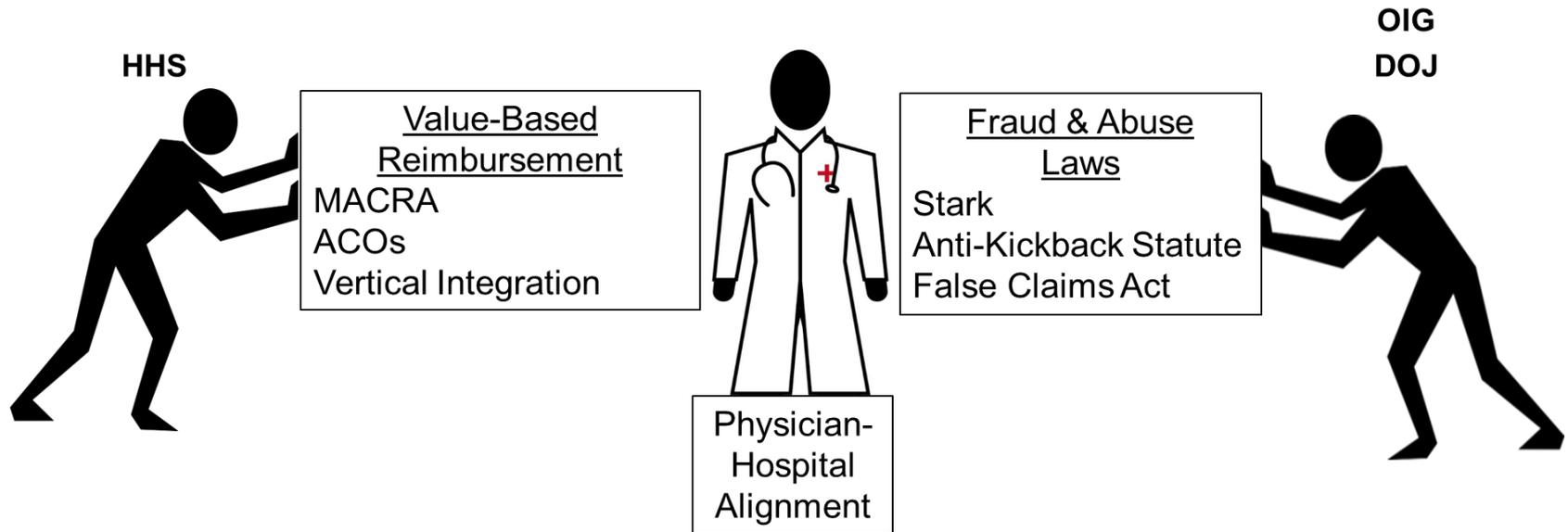
Failure of the PLP's Commercial Reasonableness Argument

- However, these investments may allow hospitals to reap other forms of utility aside from financial (cash) gains, e.g., the avoidance of cost or the generation of social benefits
- Therefore, despite the lack of immediate or direct financial (cash) return on, or return of, certain investments by healthcare entities, these services may nevertheless satisfy the threshold of Commercial Reasonableness
- For example, the investment may be “*necessary*” for the continued operation of the healthcare entity, or may satisfy a “business purpose” of the healthcare enterprise apart from obtaining referrals



Inherent Conflict between VBR and Fraud & Abuse Laws

“The Left Hand Doesn’t Know What the Right Hand is Doing”



Inherent Conflict between VBR and Fraud & Abuse Laws

- The goals of *value-based reimbursement* (VBR) and federal fraud and abuse laws are fundamentally discordant
 - *Medicare Access and CHIP Reauthorization Act* (MACRA) (as well as the ACA) has furthered the transition to VBR, which payment models seek to reduce the overutilization of services, by incentivizing the provision of efficient, evidence-based care (in part through the utilization of big data), through a “*carrot and stick*” approach, i.e., through shared savings and losses



Inherent Conflict between VBR and Fraud & Abuse Laws

- The goals of VBR and federal fraud and abuse laws are fundamentally discordant
 - In order to provide coordinated, efficient care to meet these VBR goals, many organizations are considering various alignment strategies that amass the needed specialties and resources to provide for the full continuum of a patient episode of care, to take advantage of the VBR reforms



Inherent Conflict between VBR and Fraud & Abuse Laws

- As a result of aligning, particularly when aligning through employment arrangements with hospitals and health systems, many hospitals or health systems sustain practice losses
 - Due to a number of reasons, including:
 - Encountering a more adverse payor mix in a hospital setting
 - Needing to pay more competitive salaries to employed providers
 - The treatment of ancillary services by the hospital or health system



Value of Medical Practices in the Absence of Positive Net Cash Flow

- Contrasting viewpoints in the valuation community surrounding issues related to the valuation of intangible assets in physician practice enterprises:
 - Existence of value for intangible assets of a healthcare professional practice enterprise in the absence of positive net cash flow being generated by the operations of the entity in its entirety
- Valuation methodologies available for use by the valuation analyst, that:
 - Are legally permissible
 - Have a sound theoretical economic and financial foundation
 - Are feasible to implement in practice



Positive Net Cash Flow is not Required to Support the Value of an Intangible Asset

- This claim is unfounded and appears to be based upon:
 - A misunderstanding of the nature of the cash flows generated by the entirety of an enterprise;
 - An incorrect (or absent) application of the concept of highest and best use; and/or,
 - A misunderstanding regarding the nature of economic benefit

Positive Net Cash Flow is not Required to Support the Value of an Intangible Asset

- Aggregate Cash Flow Versus Incremental Cash Flows
 - In comparing the value indications arrived at by employing Income Approach Based Methods with those determined through Cost Approach Based Methods, a distinction should be made regarding the nature of the identified cash flows utilized
 - Cash flow of an enterprise in its entirety is an aggregation of multiple contributory incremental cash flows
 - Example – Capital Budgeting Decision by enterprises as relates to a single asset



Positive Net Cash Flow is not Required to Support the Value of an Intangible Asset

- Aggregate Cash Flow Versus Incremental Cash Flows
 - “*the sum of the parts does not equal the whole*”
 - Can be utilized to explain the deviation in value resulting from synergies which may exist among multiple assets employed by an enterprise
 - Efficiently operating enterprises will likely be capable of generating excess returns above the economic costs associated with the ownership of the assets comprising the enterprise
 - “*Synergy Gains*”
 - A firm that fails to operate efficiently may realize asynergies



Positive Net Cash Flow is not Required to Support the Value of an Intangible Asset

- Aggregate Cash Flow Versus Incremental Cash Flows
 - The incremental cash flow generated by certain of the assets owned by the enterprise may be negative, and of a sufficient magnitude to offset the positive incremental cash flows of the aggregation of the remaining assets
 - Example - An enterprise that has a significantly disadvantageous vendor contract relative to similar market participants
 - In the absence of this onerous contract, the enterprise would be capable of generating a significantly increased cash flow



Positive Net Cash Flow is not Required to Support the Value of an Intangible Asset

- Aggregate Cash Flow Versus Incremental Cash Flows
 - The value of the tangible assets would not necessarily be impaired by the existence of intangible assets that are not generating positive cash flow
 - The differences in the physicality of the existence of tangible assets, in contrast to intangible assets, do not confer primacy in the determination of value
 - The value of an asset, tangible or intangible, is not derived from the nature of its physical existence, but from the expectation of future benefit to be derived from the ownership of the asset



Positive Net Cash Flow is not Required to Support the Value of an Intangible Asset

- Highest and Best Use
- “That use among possible alternatives which is legally permissible, socially acceptable, physically possible, and financially feasible, resulting in the highest economic return.”
- “The selection of the appropriate premise of value is an important step in defining the appraisal assignment. Typically, in a controlling interest valuation, the selection of the appropriate premise of value is a function of the highest and best use of the collective assets of the subject business enterprise.”

- Dr. Pratt



Positive Net Cash Flow is not Required to Support the Value of an Intangible Asset

- Highest and Best Use
 - *“That use among possible alternatives which is legally permissible, socially acceptable, physically possible, and financially feasible, resulting in the highest economic return.”*
 - *“Each of these alternative premises of value may apply under the same standard, or definition, of value. For example, the fair market value standard calls for a ‘willing buyer’ and a ‘willing seller.’ Yet, these willing buyers and sellers have to make an informed economic decision as to how they will transact with each other with regard to the subject business.”*

- Dr. Pratt



Positive Net Cash Flow is not Required to Support the Value of an Intangible Asset

- Highest and Best Use
 - *“That use among possible alternatives which is legally permissible, socially acceptable, physically possible, and financially feasible, resulting in the highest economic return.”*
 - *“In other words, is the subject business worth more to the buyer and the seller as a going concern that will continue to operate as such, or as a collection of individual assets...In either case, the buyer and seller are still ‘willing.’ And, in both cases, they have concluded a set of transactional circumstances that will maximize the value of the collective assets of the subject business enterprise.”*

- Dr. Pratt



Positive Net Cash Flow is not Required to Support the Value of an Intangible Asset

- Highest and Best Use
 - A business enterprise that fails to produce sufficient evidence to indicate a reasonable likelihood that it would, as a going concern enterprise, in the reasonably foreseeable future, be able to generate sufficient economic benefit to support the invested capital utilized to generate the revenue stream of the enterprise, cannot support a valuation premise of Value-in-Use as a Going Concern
 - In that event, the adoption of the “*Value-in-Exchange*” premise of value is indicated



Positive Net Cash Flow is not Required to Support the Value of an Intangible Asset

- The historical inability of a particular owner to generate a positive net cash flow emanating from the subject asset does not require (or even imply) that a typical investor in a similar asset would be likewise incapable of utilizing a subject intangible asset to produce a positive stream of economic benefit



The Avoidance of an Economic Cost is Equivalent to an Economic Benefit

- The foundation of the value of the subject asset is the aggregate utility, appropriately discounted to reflect the delay in the realization of the expected utility and the risk associated with actually achieving the anticipated level of utility

The Avoidance of an Economic Cost is Equivalent to an Economic Benefit

- The impact of a decrement to an economic cost is equivalent to an increase in economic benefit
 - Expected Utility = Expected Economic Benefits – Expected Economic Costs
 - $\Delta\text{Value} = \Delta\text{Expected Utility}$
 - $\Delta\text{Expected Utility} = \Delta\text{Expected Economic Benefits} - \Delta\text{Expected Economic Cost}$

The Avoidance of an Economic Cost is Equivalent to an Economic Benefit

- The deductibility of the periodic interest payments reduces the overall tax expense for the enterprise, thereby increasing the economic cash flow available to the owners of the subject enterprise
- Patent valuers often utilize the Relief from Royalty Method to determine the value of a particular patent for transactional purposes, whereby the “relief” from having to license the patent from another party is a recognized economic benefit to the company that holds the patent



The Avoidance of an Economic Cost is Equivalent to an Economic Benefit

- Federal tax regulations allow for the deductibility of qualified periodic interest payments by enterprises from their tax bill
 - This tax shield benefit is commonly accepted to have value implications for an enterprise
- This increase in economic cash flow will be, in the case of a discount net cash flow analysis, capitalized into a marginal increase in the value of the enterprise, i.e., the decrement in economic costs related to the decrease in the tax expense for the enterprise will, all things being equal, lead to an increase in the value of the enterprise



Monetary & Non-Monetary Economic Benefit

- Economic benefit can be derived from both monetary and non-monetary sources
- The ultimate source of value is the expected utility to be derived from the ownership of a property interest.
- Financial remuneration is an intermediary economic benefit, whose value emanates from its exchange for an asset which directly provides utility, and likely provides little monetary economic benefit
- For this reason, the lack of anticipated monetary cash flows from an asset does not preclude the assignment of value to an asset



Monetary & Non-Monetary Economic Benefit

- Tax-exempt, not-for-profit entities, in the accomplishment of their charitable mission, may provide non-monetary benefits to the “*owners/investors*” in the charitable organization
- The lack of anticipated monetary cash flows from an asset does not preclude the assignment of value to an asset, since a rational economic actor may well be willing to convert a portion of their monetary wealth into the anticipated non-monetary utility to be derived from ownership or control of an asset



Monetary & Non-Monetary Economic Benefit

- This charitable mission provides the basis for the healthcare enterprise's tax-exempt status
- Presumably, in lieu of a financial return benefit, the tax-exempt organization will, in the service of their stated charitable mission, generate a social benefit for the community it serves
 - Examples:
 - Provision of indigent care to the community in which it operates
 - Its role as organizers and integrators of care in a community



Bankruptcy Law Recognizes the Value of Intangible Assets & TAWF

- Value is dependent upon the “*employer’s expectation that experienced employees will report to work tomorrow morning.*”
- “*The employer also expects that these employees:*
 - *are trained in how to perform their duties and responsibilities,*
 - *know how to operate any equipment for which they are responsible,*
 - *are knowledgeable of the goals and protocols of the subject organization, and*
 - *are experienced working with and communicating with each other.*”



Bankruptcy Law Recognizes the Value of Intangible Assets & TAWF

- The bankruptcy courts have repeatedly established that a debtor company's assembled workforce is in fact an asset that is subject to transfer
 - See *Glosband v. Watts Detective Agency, Inc.*
 - See *Robinson v. Watts Detective Agency, Inc.*
 - See *3DFX Interactive, Inc., Debtor, William A. Brandt, Jr, Trustee, v. nVidia Corporation, et al.*



Bankruptcy Law Recognizes the Value of Intangible Assets & TAWF

- Glosband v. Watts Detective Agency, Inc.
 - While individuals themselves are not property, if an assembled group of employees is transferred, there is a reasonable assumption that at least some of those employees would remain with a new owner for a period, giving them property value within the meaning of the Bankruptcy Act
 - The court: *“Certainly the aggregate of a business’ employees, even if they be individually not property, is “property” within the meaning of the Bankruptcy Act.”*
 - The jury could reasonably have found an expectancy that at least some of the employees would stay on for some indefinite time period



Bankruptcy Law Recognizes the Value of Intangible Assets & TAWF

- Robinson v. Watts Detective Agency, Inc.
 - Affirmed the reasoning in *Glosband*
 - The term “*property*” within the Bankruptcy Act was described as generous, including anything of value, not limited to tangible assets
 - The court noted that the expansive definition has been used to ascribe value to the continuance of a contractual relationship, such as an employment contract



Bankruptcy Law Recognizes the Value of Intangible Assets & TAWF

- 3DFX Interactive, Inc., Debtor, William A. Brandt, Jr, Trustee, v. nVidia Corporation, et al.
 - Holding: Although Generally Accepted Accounting Principles (GAAP) may be informative to the valuation professional's determination of FMV, GAAP *"will not determine what constitutes an asset or the fair market value of an asset"* for bankruptcy purposes
 - The court found the *"Revenue Procedure, like [GAAP,] to be unhelpful because the tax and accounting implications of how assets are listed on a company's balance sheet often have little to do with what a willing buyer and willing seller would agree is the fair market value of those assets."*



Bankruptcy Law Recognizes the Value of Intangible Assets & TAWF

- If the value assigned by the bankruptcy courts to a subject intangible asset under a forced liquidation premise (i.e., in the absence of sufficient net cash flows of the enterprise in its entirety to offset the investment in the invested capital of the enterprise) is greater than zero, then, ipso facto, the value under a non-liquidation premise must also be greater than zero

Bankruptcy Law Recognizes the Value of Intangible Assets & TAWF

- As held in the 3DFX Interactive case, tax and accounting implications of how assets are listed on the company's balance sheet have little to do with the FMV of those assets
- Based on the rulings of the tax courts, the valuation question is not whether an intangible asset has value in the absence of positive net cash flow to the enterprise in its entirety, but instead is to what degree value can be assigned to an intangible asset in the absence of positive net cash flows



Professional Standards and Healthcare Regulations Regarding Valuation Methodologies and Intangible Assets

- Professional Standards Do Not Preclude the Use of Cost Based Approaches
 - The use of Cost Based Approaches is not precluded by appraisal standards, and may even be required in the event that the value in exchange premise recognizes the highest and best use of the assets comprising the subject enterprise



Professional Standards and Healthcare Regulations Regarding Valuation Methodologies and Intangible Assets

- Professional Standards Do Not Preclude the Use of Cost Based Approaches
 - USPAP Standards Rule 9-3 states:
 - “*In developing an appraisal of an equity interest in a business enterprise with the ability to cause liquidation, an appraiser must investigate the possibility that the **business enterprise may have a higher value by liquidation of all or part of the enterprise than by continued operation as is.***” [Emphasis added.]
- The comment to USPAP Standard 9-3 states:
 - “*This Standards Rule requires the appraiser to recognize that **the continued operation of a business is not always the best premise of value because liquidation of all or part of the enterprise may result in a higher value.***” [Emphasis added.]



Healthcare Regulations Regarding Valuation Methodologies and Intangible Assets

- The Healthcare Industry Regulatory Environment Precludes the Use of Income Based Approaches in Valuing Certain Healthcare Related Intangible Assets
- Stark prohibits a physician from making a referral of designated health services (DHS) to an entity with which the physician, or the physician's family member, has a financial relationship, and where payment for such a service may be made under Medicare
 - Exceptions to the Stark Laws are available, and payments made under those arrangements may not be determined in a manner that takes into account the volume or value of any referrals or other business generated between the parties in order to be in compliance



"Limitation on certain physician referrals" 42 U.S.C. § 1395nn(a)(1); "Limitation on certain physician referrals" 42 U.S.C. § 1395nn(e)(1)(A)(iv); "Limitation on certain physician referrals" 42 U.S.C. § 1395nn(e)(1)(B)(iv); "Limitation on certain physician referrals" 42 U.S.C. § 1395nn(e)(2)(B)(ii); "Limitation on certain physician referrals" 42 U.S.C. § 1395nn(e)(3)(A)(v); See generally "Exceptions to the referral prohibition related to compensation arrangements" 42 C.F.R. § 411.357; "Criminal Penalties for Acts Involving Federal health care programs" 42 U.S.C. § 1320a-7b; "Exceptions" 42 C.F.R. § 1001.952(b)(5); "Exceptions" 42 C.F.R. § 1001.952(c)(5); "Exceptions" 42 C.F.R. § 1001.952(d)(5).

Healthcare Regulations Regarding Valuation Methodologies and Intangible Assets

- The *Anti-Kickback Statute* (AKS) deems it a felony to solicit, offer, receive, or pay remuneration of any kind for the referral of a patient for healthcare services paid by federal healthcare programs
 - Safe Harbors to AKS are available, and payments made under those arrangements may not be determined in a manner that takes into account the volume or value of any referrals or other business generated between the parties in order to be in compliance



"Limitation on certain physician referrals" 42 U.S.C. § 1395nn(a)(1); "Limitation on certain physician referrals" 42 U.S.C. § 1395nn(e)(1)(A)(iv); "Limitation on certain physician referrals" 42 U.S.C. § 1395nn(e)(1)(B)(iv); "Limitation on certain physician referrals" 42 U.S.C. § 1395nn(e)(2)(B)(ii); "Limitation on certain physician referrals" 42 U.S.C. § 1395nn(e)(3)(A)(v); See generally "Exceptions to the referral prohibition related to compensation arrangements" 42 C.F.R. § 411.357; "Criminal Penalties for Acts Involving Federal health care programs" 42 U.S.C. § 1320a-7b; "Exceptions" 42 C.F.R. § 1001.952(b)(5); "Exceptions" 42 C.F.R. § 1001.952(c)(5); "Exceptions" 42 C.F.R. § 1001.952(d)(5).

Healthcare Regulations Regarding Valuation Methodologies & Intangible Assets

- The U.S. ex rel. Singh v. Bradford Regional Medical Center case held that the appraiser, who utilized an income approach to value the healthcare professional practice intangible asset, comprised of a covenant not to compete, took into account the volume or value of referrals in determining the value of the property interest
- The Bradford case is important to valuation professionals due to its holding, which infers that income based approaches may not be appropriate when appraising certain intangible assets of medical practices, as doing so may raise an inference that the volume or value of referrals has been considered in determining payments for those assets



"Limitation on certain physician referrals" 42 U.S.C. § 1395nn(a)(1); "Limitation on certain physician referrals" 42 U.S.C. § 1395nn(e)(1)(A)(iv); "Limitation on certain physician referrals" 42 U.S.C. § 1395nn(e)(1)(B)(iv); "Limitation on certain physician referrals" 42 U.S.C. § 1395nn(e)(2)(B)(ii); "Limitation on certain physician referrals" 42 U.S.C. § 1395nn(e)(3)(A)(v); See generally "Exceptions to the referral prohibition related to compensation arrangements" 42 C.F.R. § 411.357; "Criminal Penalties for Acts Involving Federal health care programs" 42 U.S.C. § 1320a-7b; "Exceptions" 42 C.F.R. § 1001.952(b)(5); "Exceptions" 42 C.F.R. § 1001.952(c)(5); "Exceptions" 42 C.F.R. § 1001.952(d)(5).

Valuation of Service Lines separately from Valuation of the Medical Practice

Two general types of services provided by a physician practice

Professional Component

Work Requiring Physician or Mid-Level Provider Contribution of Time and Effort

Ancillary Services & Technical Component (ASTC)

Services that are ancillary to physician services and/or technical related, not requiring physician contribution



Valuation of Service Lines separately from Valuation of the Medical Practice

- In healthcare, the appraisal of a service line that is integrated into a physician practice needs to address 2 controlling issues:
 - Under professional valuation standards, the disclosure of the use of a hypothetical condition is required to value an existing ASTC service line that is integrated with a physician professional practice, as a hypothetical, stand-alone enterprise
 - Significant attention must be paid to ensure that transaction does not run afoul of the specific regulatory restrictions pertaining to valuation of healthcare enterprises



Valuation of Service Lines separately from Valuation of the Medical Practice

- Isolation of the net economic benefit to be produced by the subject “*carve out*” ASTC enterprise includes the following:
 - Identifying the procedures to be included
 - Separating out the technical only, ASTC revenue stream
 - Determining the most probable economic operating expense burden that would be incurred to produce the technical only ASTC revenue stream
 - Determining the most probable economic capital expense burden that would be incurred to produce the technical only ASTC revenue stream



Physician Compensation Benchmarking Sources

	A	B	C	D	E
	Name	Publisher	Clinical	Medical Director	On-Call
1	Medical Group Compensation and Financial Survey	American Medical Group Association	x	x	
2	Cost Survey for Single-Specialty Practices	Medical Group Management Association	x		
3	Physician Compensation and Productivity Survey Report	Sullivan Cotter and Associates, Inc.	x	x	x
4	Physician Compensation Survey	National Foundation for Trauma Care	x		
5	Physician Executive Compensation Survey	American College of Physician Executives		x	
6	Physician Compensation and Production Survey	Medical Group Management Association	x		
7	Physician Salary Survey Report: Hospital-Based Group HMO Practice	John R. Zabka Associates	x	x	
8	Survey Report on Hospital and Healthcare Management Compensation	Watson Wyatt Data Services		x	
9	Cost Survey for Multispecialty Practices	Medical Group Management Association	x		
10	Healthcare Executive Compensation Survey	Integrated Healthcare Strategies		x	
11	Physician On-Call Pay Survey Report	Sullivan Cotter and Associates, Inc.			x
12	Management Compensation Survey	Medical Group Management Association		x	
13	Survey of Manager and Executive Compensation in Hospitals & Health Systems	Sullivan Cotter and Associates, Inc.		x	
14	Executive Compensation Assessor	Economic Research Institute		x	
15	Top Management and Executive	Abbott Langer Association, Economic Research Institute, and Salaries Review		x	
16	Executive Pay in the Biopharmaceutical Industry	Top 5 Data Services, Inc.		x	
17	Executive Pay in the Medical Device Industry	Top 5 Data Services, Inc.		x	
18	Hospital Salary & Benefits Report, 2007-2008	John R. Zabka Associates, Inc.		x	
19	US IHN Health Networks Compensation Survey Suite	Mercer, LLC		x	
20	Intellimarker	American Association of Ambulatory Surgery Centers	x	x	
21	Medical Directorship and On-Call Compensation Survey	Medical Group Management Association		x	x



Physician Clinical Services

- Gainsharing
 - Arrangement “*under which a hospital gives physicians a share of the reduction in the hospital’s costs (that is, the hospital’s cost savings) attributable in part to the physicians’ efforts*”
 - Historically, gainsharing has been found to violate *Civil Monetary Penalty Statute* (prohibits hospital for providing a payment to a physician as an inducement to reduce services) and AKS
 - 2005: OIG began to approve gainsharing arrangements due to benefits of decreased costs and increased quality
 - 2009 Physician Fee Schedule solicited comments regarding a possible new exception to Stark Law for shared savings programs (despite CMS’s own concern for potential abuse)



Physician On-Call Services

Growing Need for Compensation for Provision of On-Call Services
Due to:

- Physician shortage and increased demand due to aging *Baby Boomers*
- Aging physician workforce
- Physicians demanding more “*regular*” work hours
- Physicians increasingly building practice through participation in ambulatory surgery centers and physician-owned specialty hospitals
- Physicians often receive inadequate payment for services provided while on-call as patients in the ED are often uninsured or under-insured



Physician On-Call Services

- **OIG Approval of On-Call Compensation Arrangements**
 - September 2007 (Opinion 07-10)
 - First advisory opinion addressing on-call compensation arrangements
 - Physician's paid per-diem rate for on-call duties
 - On-call arrangement had sufficient safeguards to prevent Fraud – almost met the Personnel Services and Management Safe Harbor
 - Per Diem rates tailored to physician's burden and likelihood of response
 - Independent third party determined per diem rates were at FMV
 - Payment not affected by volume or value of referrals
 - All physicians had equal on-call coverage, payment not higher for certain specialties



Physician On-Call Services

- OIG Approval of On-Call Compensation Arrangements
- May 2009 (Opinion 09-05)
 - Physicians paid on-call compensation for services to patients ineligible for Medicaid/other state health insurance programs - payment covered physician fees, emergency & inpatient services
 - Valuation methodology for compensation considered patient acuity, average length of stay, and physician time
 - On-call arrangement had sufficient safeguards to prevent Fraud
 - almost met the Personnel Services and Management Safe Harbor
 - Payments to physicians for services rendered, rather than availability (e.g., “*lost opportunity*”)



Physician Administrative Services

- Assessing FMV of Medical Directorships
 - Employer should document the methodology used to set compensation
 - Beneficial for employer to track and document the actual number of hours the medical director spends performing the services, as well as to make sure the documentation is consistent with the hours outlined in the medical director agreement
 - *“Justifying the need for medical director services goes hand-in-hand with showing that the services are actually furnished”*



Questions & Answers

