CASE STUDY

Grassi Healthcare Advisors Helps Investor Group Open Multiple Urgent Care Centers

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Introduction

Investing in the healthcare industry comes with a unique set of challenges. Many states, like New York, Massachusetts and New Jersey prohibit the corporate practice of medicine. For one Grassi Healthcare Advisors (GHA) client, this created a myriad of obstacles that needed to be overcome to achieve their goal of developing multiple urgent care centers in New York.

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The Challenge

Under the prohibition of the corporate practice of medicine, only licensed healthcare providers can own a healthcare practice. This investor group planned to lease and build out a number of sites for urgent care centers, outfit and equip them, hire the non-clinical staff to work in them, and provide the necessary support services like billing and human resources. They did this through forming a management service organization (MSO) to provide these functions and aligned themselves with an independent group of physicians who formed a professional corporation (PC) to provide patient care in these sites.

Complex issues arise for the investors in this relationship, such as exchanging funds between the clinical and corporate sides of the business, determining reasonable rates of service, and maintaining compliance with all federal and state requirements. The client needed to understand both the commercial reasonableness and fair market value of the services they plan to provide, as well as recovery of their financial investment in building out and equipping the sites.

Our Charge

The purpose of this project was to provide valuation consulting services to assist our client in determining the commercial reasonableness and fair market value of the services they would provide to the PC.

Standard of Value

The standard of value used in this project was fair market value. “Fair market value” is defined as the price at which a property would change hands between a willing buyer and a willing seller, both having knowledge of all the relevant facts and neither being under any compulsion to buy or sell.

The definition of fair market value has generally been interpreted to be based only on information that was known or knowable as of the valuation date. In other words, consideration of subsequent events that were not known or knowable as of the valuation date that affect fair market value generally should be disregarded in the valuation process.

Applicable Laws

GHA’s assistance was also necessary to protect the client from violating the Anti-Kickback Law and Stark Laws. The following descriptions of these laws are taken from the BVR/AHLA Guide to Healthcare Industry Finance and Valuation, Fourth Edition:

Anti-Kickback Statute

The federal anti-kickback statute, 42 U.S.C. § 1320a-7b(b), sets forth the general principle that healthcare providers may not exchange remuneration in return for referrals of federal healthcare program business. "The federal physician self-referral law or Stark Law, 42 U.S.C. § 1395nn, incorporates a similar principle by prohibiting certain physician referrals to entities that physicians have a compensation arrangement with unless the arrangement meets an applicable exception by, among other things, not providing compensation based on the volume or value of referrals by the physician."

The anti-kickback statute prohibits the knowing and willful offer, payment, solicitation, or receipt of "any remuneration (including any kickback, bribe, or rebate) directly or indirectly, overtly or covertly, in cash or in kind," to include or reward referrals of items or services reimbursable by a federal healthcare program.

Courts have interpreted the anti-kickback statute to prohibit arrangements if one purpose of the arrangement is the inducement of referrals of federal healthcare program patients, regardless of whether there are other appropriate purposes for the arrangement.

Investment and compensation arrangements between healthcare providers should be structured in a manner that does not ascribe value to referrals of federal healthcare program business to avoid implicating the anti-kickback statute.

One of the primary means to ensure there is no remuneration for referrals in an arrangement is to make sure that the parties pay

or receive fair market value in exchange for the items or services provided. Some of the most commonly cited instances of potentially improper remuneration are where a party provides items or services to another party for more or less than fair market value or provides an inappropriate discount or premium to the fair market value purchase price of an investment interest.

Stark Laws

The Stark Law "prohibits physicians that have a financial relationship with an entity from referring patients to such entity for certain 'designated health services' provided to Medicare beneficiaries, unless such financial relationship meets one of the exceptions enumerated under the statute or the regulations promulgated thereunder." The Stark Law also prohibits entities from billing individuals or Medicare for designated health services furnished pursuant to a prohibited referral, and any payments received in violation of this prohibition must be refunded.

For a compensation arrangement between an entity providing designated health services and a referring physician to avoid the prohibitions on physician referrals, the exceptions under the Stark Law generally require that remuneration under such compensation arrangement be: (a) set in advance; (b) consistent with fair market value; and (c) not determined in a manner that takes into account the volume or value of referrals or other business generated.

New York Law Public Health Law ("PHL") Section 238

The NY Law PHL Section 238 section 1 states "a practitioner authorized to order clinical laboratory services, pharmacy services,

radiation therapy services, physical therapy services or x-ray or imaging services may not make a referral for such services to a health care provider authorized to provide such services where such practitioner or immediate family member of such practitioner has a financial relationship with such health care provider."

The NY Law PHL Section 238 Section 5 indicates that services provided including the rent or lease of office space between a health care provider other than a general hospital and a practitioner must be in writing at the fair market value of the services.

The Solution

On the advice and under the direction of legal counsel, the investor group turned to GHA to help them tackle these complexities and proceed with confidence. GHA professionals collaborated with valuation and tax specialists from Grassi Advisors and Accountants to evaluate the terms and pricing laid out in the investor group's management services agreement (MSA) and confirm they were at fair market value and commercially reasonable. Commercial reasonableness is defined as an arrangement that furthers a legitimate business purpose of the parties regarding their arrangement and consideration of the parties' characteristics, including their size, type, scope, and specialty. An arrangement may be commercially reasonable even if it does not result in profit for one or more of the parties.

This assessment included an evaluation of physician practice management group fees, a projection of payroll costs and taxes, a valuation of overhead costs, and a financial pro forma that laid

out the expenses and fees in compliance with New York law, which prohibits fees to be set as a percentage of revenues. GHA issued an opinion based on a comprehensive review of the client's data and independent third-party market data. Correlation studies were conducted to validate the fair market value of the fees, as compared to other MSOs and the cost structure of similar medical practices to the PC. Fair market value was determined in accordance with Stark Laws and anti-kickback statutes.

In addition to determining the fair market value and commercial reasonableness of service fees, GHA also provided data to help the MSO negotiate management fees with the urgent care facilities. They based these negotiations on projected and actual expenses, including non-clinical payroll, non-clinical payroll taxes, general and administrative expenses, building and occupancy expenses, IT costs, billing, marketing, etc. These fees were structured as cost plus a percentage.

Not only did the GHA report provide the foundation for making important financial decisions, it also provided documentation supporting the client's assertion of compliance with state and federal mandates, safeguarding the organization in the event of future scrutiny.

The study conducted for the client is not static. The model built and the comparisons to benchmarks can be updated annually as significant changes in the business and the market occur. Performing this regular review ensures that the original assumptions, which gave the client and their counsel confidence that the pricing was at fair market value, remain appropriate.

The Results

Based on GHA's recommendations, which were supported by client data and industry benchmarks, the investor group confidently moved ahead with establishing service fees and finalizing the MSA. Since then, the client has opened over 6 urgent care centers in New York. The financial pro forma now serves as a framework for similar development projects. The financial analysis also opened the door for conversations about tax strategies and best practices that can improve the organization's bottom line.

For more information on how Grassi Healthcare Advisors can provide guidance and compliance support for your investments in the healthcare industry, please contact Joseph Tomaino, CEO of Grassi Healthcare Advisors, at 212.223.5020 or jtomaino@grassihealthcareadvisors.com.

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