THE MSO’S PROGNOSIS AFTER ACA: A VIABLE INTEGRATION TOOL?

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Introduction & Overview

MSOs: A Brief History and Basics

Key Legal Issues

Key Valuation Issues

Post-ACA Implications for MSOs

Hypothetical Study
A Brief History

The 1990s

• Managed Care
• Anticipating: FFS → Capitation
• Focus on Integration
• Surge in MSOs
• Employment Alternative
A Brief History

• In the 2000s
  – Breakup of IDS

• In 2010
  – Patient Protection and Affordable Care Act
  – Accountable Care Organizations
MSO Basics

• Management Service Organization (MSO)
• Provides non-clinical services to providers
  – Administrative and Other services
• May acquire practice’s assets & enter lease arrangement with practice
• Assistance with Contracting
  – managed care, group purchasing
MSO Services

- Administrative
- Operational
- Financial
- Coding
- Billing
- Collection

- Personnel
- IT
- Office Space
- Equipment
- Education
- Compliance
- Credentialing

- Managed Care Contracting
- Strategic Planning
- IPA

Legal & Regulatory Issues

- Stark
  - Social Security Act §1877
  - 42 USC §1395nn
- Antikickback Statute
  - Social Security Act §1128B(b)
  - 42 USC §1320a-7B(b)
- Key Exceptions & Safe Harbors
Legal & Regulatory Issues

MSO Services

– Stark Exceptions

• **Personal Services Arrangements Exception**
  
  42 U.S.C. § 1395nn(e)(3); 42 CFR 411.357(D) et seq.
  
  1. a written agreement that specifies the services covered by the arrangement;
  
  2. that the arrangement cover all of the services to be provided by the physician to the entity;
  
  3. that the term of the agreement must be for one year or more;
Legal & Regulatory Issues

MSO Services
– Stark Exceptions
• Personal Services Arrangements Exception
  4. that the aggregate services contracted for must not exceed those that are reasonable and necessary for the legitimate business purposes of the arrangement;
  5. that the compensation to be paid over the term of the agreement be set in advance, not exceed fair market value, and not be determined in a manner that takes into account the volume or value of any referrals or other business generated between the parties; and
  6. that the services to be performed under the arrangement not involve the counseling or promotion of a business arrangement or other activity that violates any state or federal law.

• Fair Market Value Compensation Exception
  42 U.S.C. §1395nn(b)(4); 42 CFR 411.357(l)
  “Compensation resulting from an arrangement between an entity and a physician... For the provision of items or services (other than the provision of office space) by the physician...to the entity, or by the entity to the physician”
Legal & Regulatory Issues

MSO Services
– Stark Exceptions
  • Fair Market Value Compensation Exception
    1. writing, signed by the parties, and covers only identifiable items or services, all of which are specified in the agreement,
    2. writing specifies the time frame for the arrangement, which can be for any period of time and contain a termination clause, provided the parties enter into only one arrangement for the same items during the course of the year. An arrangement made for less than one year may be renewed if the terms and compensation for the same items or services do not change,

Legal & Regulatory Issues

MSO Services
– Stark Exceptions
  • Fair Market Value Compensation Exception
    3. writing specifies the compensation which must be set in advance, consistent with fair market value, and not determined in a manner that takes into account the volume or value of referrals or other business generated by the referring physician,
    4. Compensation for the rental of equipment may not be determined using a formula based on (i) A percentage of the revenue raised, earned, billed, collected, or otherwise attributable to the services performed or business generated through the use of the equipment; or (ii) Per-unit of service rental charges, to the extent that such charges reflect services provided to patients referred by the lessor to the lessee
Legal & Regulatory Issues

MSO Services
– Stark Exceptions

• Fair Market Value Compensation Exception
  5. the arrangement is commercially reasonable (taking into account the nature and scope of the transaction) and furthers the legitimate business purposes of the parties,
  6. the arrangement does not violate the Antikickback statute or any federal or state law or regulation governing billing or claims submission, and
  7. the services to be provided do not involve the counseling or promotion of a business arrangement or other activity that violates a federal or state law.

Legal & Regulatory Issues

MSO Services
– Stark Exceptions

• Payments By Physician For Items And Services
  42 U.S.C. §1395nn(e)(8); 42 CFR 411.357(i).
  – Available where no others exception applies
  – Allows for payments by physician to an entity as compensation for items or services
  – Price must be consistent with fair market value
Legal & Regulatory Issues

MSO Services
– Antikickback Safe Harbor
– Personal Services And Management Contracts

42 C.F.R. § 1001.952(d)

• “remuneration” does not include any payment made by a principal to an agent as compensation for the services of the agent, as long as
1. set out in writing and signed by the parties.
2. covers all of the services the agent provides to the principal for the term of the agreement and specifies the services to be provided by the agent.

3. If the agreement provides for the services of the agent on a periodic, sporadic or part-time basis, the agreement specifies exactly the schedule of such intervals, their precise length, and the exact charge for such intervals.
4. term is for not less than one year.
Legal & Regulatory Issues

MSO Services
– Antikickback Safe Harbor
– Personal Services And Management Contracts
  5. aggregate compensation paid to the agent over the term of the agreement is set in advance, is consistent with fair market value in arms-length transactions and is not determined in a manner that takes into account the volume or value of any referrals or business otherwise generated between the parties for which payment may be made in whole or in part under Medicare, Medicaid or other Federal health care programs.

Legal & Regulatory Issues

MSO Services
– Antikickback Safe Harbor
– Personal Services And Management Contracts
  6. services performed under the agreement do not involve the counseling or promotion of a business arrangement or other activity that violates any State or Federal law.
  7. The aggregate services contracted for do not exceed those which are reasonably necessary to accomplish the commercially reasonable business purpose of the services.
Legal & Regulatory Issues

MSO Leases – Office Space

• Stark Exceptions
  – Rental of Office Space
    42 U.S.C. § 1395nn(e)(1); 42 CFR 411.357(A)
    1. Set out in writing, signed by the parties, specifies the premises, 1 year term
    2. Premises don’t exceed what’s reasonable & necessary for the business purpose, used exclusively by the lessee
    3. Payments for any common area space are made on a pro rata basis

• Rental charges set in advance, consistent with FMV, don’t take volume or value of referrals or other business generated into account, not based on a percentage of revenue or units that reflect services to referred patients

• Lease is commercially reasonable even if no referrals between the party

• 6 month holdover allowed
Legal & Regulatory Issues

MSO Leases – Office Space
• Antikickback Safe Harbor
  – Space Rental
    42 C.F.R. § 1001.952(b)
    1. Set out in writing, signed by the parties
    2. 1 year
    3. aggregate payment amount as well as the premises, equipment, or services covered be specified in advance
    4. must be based on fair market value and cannot vary based on the volume or value of any Medicare or state health care program-covered referrals or business generated between the parties

Legal & Regulatory Issues

Leases - Equipment
• Stark Exceptions
  – Rental of Equipment
    42 U.S.C. § 1395nn(e)(1); 42 CFR 411.357(b)
    1. Set out in writing, signed by the parties, specifies the equipment, 1 year term
    2. doesn’t exceed what’s reasonable & necessary for the business purpose, used exclusively by the lessee
    3. Rental charges are set in advance, consistent with fair market value and don’t take into account the volume or value of referrals or other business between the parties.
Legal & Regulatory Issues

MSO Leases – Equipment

• Stark Exceptions
  – Rental of Equipment
    42 U.S.C. § 1395nn(e)(1); 42 CFR 411.357(b)
  4. Agreement is commercially reasonable even if no referrals between the parties
  5. Six-month holdover allowed

Legal & Regulatory Issues

MSO Leases – Equipment

• Antikickback Safe Harbor
  – Rental of Equipment
    42 C.F.R. § 1001.952(c)
  1. Set out in writing, signed by the parties
  2. 1 year
  3. aggregate payment amount as well as the premises, equipment, or services covered be specified in advance
  4. must be based on fair market value and cannot vary based on the volume or value of any Medicare or state health care program-covered referrals or business generated between the parties
Legal & Regulatory Issues

MSO Transactions

• Stark
  – Isolated Transactions
    42 U.S.C. § 1395nn(e)(6); 42 CFR 411.357(F).
    1. One time sale of property or practice, where the amount of the payment is consistent with fair market value and does not take into account, directly or indirectly, the volume or value of any referrals between the parties.
    2. Remuneration must be commercially reasonable
    3. No additional transactions between the parties for six months

Subsidiary Model

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<th>Hospital</th>
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<th>Services Agreement</th>
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Physician
Legal & Regulatory Issues

Stark
– Indirect Compensation
42 CFR 411.357(P)
1. the compensation received by the physician from the person or entity with which the referring physician has the direct financial relationship is "fair market value" for services and items actually provided "not taking into account" the volume or value of referrals for the entity furnishing designated health services;

Legal & Regulatory Issues

• Stark
  – Indirect Compensation
2. the compensation arrangement between the physician and the entity with which the physician has the direct financial relationship is set out in writing, is signed by the parties, and specifies the services covered; and
3. the arrangement does not violate the federal health care program Anti-Kickback Statute or any laws or regulations governing billing or claims submission
Equity Model

Legal & Regulatory Issues

MSO Transactions
- Antikickback Statute
- Small Investment Interest Safe Harbor

42 C.F.R. § 1001.952(a)(2)

1. No more than 40% of the value of the investment interests of each class of investments may be held by investors who are in a position to make or influence referrals to, furnish items or services to, or otherwise generate business for, the entity.

2. No more than 40% of the gross revenue of the entity may come from referrals or business otherwise generated from investors.
Legal & Regulatory Issues

MSO Transactions

– Antikickback Statute
– Small Investment Interest Safe Harbor

3. terms of investment interest offered to a passive investor, who is
   in a position to make or influence referrals to, furnish items or
   services to, or otherwise generate business for the entity, must
   be no different than the terms offered to other passive investors

4. The terms on which an investment interest is offered to an
   investor who is in a position to make or influence referrals to,
   furnish items or services to, or otherwise generate business for
   the entity must not be related to the previous or expected
   volume of referrals, items, or services furnished, or amount of
   business otherwise generated, from that investor to the entity.

Legal & Regulatory Issues

• Transactions

– Antikickback Statute
– Small Investment Interest Safe Harbor

5. There may not be any requirement that a passive investor
   make referrals to, be in a position to make or influence
   referrals to, furnish items or services to, or otherwise
   generate business for the entity as a condition for
   remaining as an investor.

6. The entity or any investor may not market or furnish the
   entity’s items or services (or those of another entity as
   part of cross-referral agreement) to passive investors
   differently than to non-investors.
Legal & Regulatory Issues

MSO Transactions
- Antikickback Statute
- Small Investment Interest Safe Harbor

7. Neither the entity nor any investor (nor other individual or entity acting on behalf of the entity or any investor in the entity) may loan funds to or guarantee a loan for an investor who is in a position to make or influence referrals to, furnish items or services to, or otherwise generate business for the entity if the investor uses any part of such loan to obtain the investment interest.

8. The amount of payment to an investor in return for the investment interest must be directly proportional to the amount of the capital investment of that investor.

Other Potential Pitfalls

Corporate Practice of Medicine
Other Potential Pitfalls

Corporate Practice of Medicine  Antitrust

Other Potential Pitfalls

Corporate Practice of Medicine  Antitrust
Tax Exempt Organizations
VALUATION OF MSOs AND MSO ARRANGEMENTS

Valuation of MSOs and MSO Arrangements

• Standards of value
  – Fair market value
    • Industry definition
      – Internal Glossary of Business Valuation Terms
    • Internal Revenue Service
      – Valuation of business interests or assets, at Rev. Rul. 59-60
## Valuation of MSOs and MSO Arrangements

- **Standards of value, cont’d**
  - Health care regulatory definitions of fair market value
    - Stark, at 42 C.F.R. §411.351
    - Federal anti-kickback statute, at 42 C.F.R. §1001.952(b)(6) for space rental and 42 C.F.R. §1001.952(c)(6) for equipment rental
    - State self-referral and anti-kickback laws

## Valuation of MSOs and MSO Arrangements, cont’d

- **Commercial reasonableness**
  - Pertinent Stark exceptions requiring commercial reasonableness (not an all-inclusive list)
    - Office space rental exception, 42 U.S.C §1395nn(e)(1)(A)(v)
    - Equipment rental exception, §1395nn(e)(1)(B)(v)
    - Isolated transactions exception, §1395nn(e)(6)(A)
    - Certain group practice arrangements with a hospital exception, §1395nn(e)(7)(A)(vi)
    - Personal services arrangement exception, §1395nn(e)(3)(A)(iii)
    - FMV compensation exception, 42 CFR §411.357(l)(4)
Valuation of MSOs and MSO Arrangements, cont’d

- Commercial reasonableness, cont’d
  - Pertinent anti-kickback statute safe harbors requiring commercial reasonableness (not an all-inclusive list)
    - Space rental safe harbor, 42 C.F.R. §1001.952(b)(6)
    - Equipment rental safe harbor, §1001.952(b)(6)
    - Personal services and management contracts safe harbor, §1001.952(d)(7)
    - Sale of practice safe harbor, §1001.952(e)(2)(iv)

Valuation of MSOs and MSO Arrangements, cont’d

- Commercial reasonableness, cont’d
  - Joint role of counsel, valuator and management
  - Sample questions to consider in assessing commercial reasonableness
    - Are the MSO services consistent with the operational needs and financial goals of the purchaser of the services, without consideration of referrals of business between the parties to the management service agreement?
Valuation of MSOs and MSO Arrangements, cont’d

• Sample questions to consider in assessing commercial reasonableness, cont’d
  – Does the MSO’s service offering(s) represent services that the purchaser cannot perform internally without substantial changes in operations?
  – Does the subject MSO’s service offering and price point represent the best choice when compared to other viable options in the marketplace?

Valuation of MSOs and MSO Arrangements, cont’d

• Sample questions to consider in assessing commercial reasonableness, cont’d
  – If the purchaser already provides the agreed-upon services, can the MSO provide the agreed-upon services at a level of efficiency, quality, or effectiveness greater than the purchaser of the services?
  – Are the MSO’s fee arrangements for the agreed-upon services consistent with the appropriate regulatory standard definition of fair market value as obtained from appropriate market data or a qualified valuation firm?
Valuation of MSOs and MSO Arrangements, cont’d

- Sample questions to consider in assessing commercial reasonableness, cont’d
  - If the MSO arrangement includes office space and/or equipment rental, are the lease and/or pass-through terms consistent with market terms (see AKS safe harbors for guidance)
  - Has legal counsel provided assurances that the arrangements are structured under the appropriate health care regulatory framework?

Valuation of MSOs and MSO Arrangements, cont’d

- Valuation of MSO fee arrangements
  - Application of broad valuation approaches and related methodology
    - Cost-based approach
      - Cost to reproduce method
        » Current cost of a similar new service with the nearest equivalent utility
      - Cost to replace method
        » Current cost of an identical new service
Valuation of MSOs and MSO Arrangements, cont’d

• Application of broad valuation approaches and related methodology, cont’d
  • Income-based approach
    – Buyer-side profitability method
      » Evaluation of profitability with and without the services of the MSO
    – Seller-side ROI method
      » MSO’s return on investment relative to investments in assets, technology, personnel, etc.
    – Comparative profitability analysis methods
      » Relative profitability of buyer and seller, given risks assumed by each

Valuation of MSOs and MSO Arrangements, cont’d

• Application of broad valuation approaches and related methodology, cont’d
  • Market-based approach
    – Guideline published survey data method
      » MSO expense costs in published surveys
    – Guideline contracts method
      » Contracts for similar services, normalized, scored and/or weighted to account for relevance
Valuation of MSOs and MSO Arrangements, cont’d

• Valuation of MSO fee arrangements
  – Synthesis and reconciliation
    • Evaluation of reliability of various methods
    • Exclusion of unreliable methods
    • Point value, range of value
    • Reasonableness tests, rules of thumb
    • Sensitivity analyses

Valuation of MSOs and MSO Arrangements, cont’d

• Valuation of MSO fee arrangements
  – Reporting fundamentals
    • No formal valuation standards for compensation arrangements
    • Business valuation reporting standards are instructive
Valuation of MSOs and MSO Arrangements, cont’d

• Valuation of MSO business enterprises
  – Application of broad valuation approaches and related methodology
    • Asset-based approach
      – Adjusted net asset method
    • Income-based approach
      – Example: Discounted future cash flow method
    • Market-based approach
      – Guideline company transaction method
      – Guideline public company method

Valuation of MSOs and MSO Arrangements, cont’d

• Valuation of MSO business enterprises
  – Discounts and premiums
    • Discount for lack of marketability
    • Discount for lack of control
  – Synthesis and reconciliation
    • Evaluation of reliability of various methods
    • Exclusion of unreliable methods
    • Point value, range of value
    • Reasonableness tests, rules of thumb
    • Sensitivity analyses
Valuation of MSOs and MSO Arrangements, cont’d

• Valuation of MSO business enterprises
  – Reporting fundamentals
    • Business valuation standards apply
    • Continually improving body of knowledge in health care business valuation theory and practice

Valuation of MSOs and MSO Arrangements, cont’d

• Reviewers’ tips and traps
  – Does the appraiser clearly understand the parties to the arrangement or transaction, along with the compliance ramifications of the relationships that exist among the parties?
  – Does the appraiser understand the nature of the compensation arrangement that exists under the MSO arrangement, and is the valuation analyst aware of the compliance implications of compensation that varies with the volume or value of referrals of designated health services?
  – Did the valuation analyst interview representatives of the MSO and the managed organization, and does the report summarize those interviews and the resultant findings?
Valuation of MSOs and MSO Arrangements, cont’d

• Reviewers’ tips and traps
  – Has the analyst explained the consideration of the three broad valuation approaches and why certain approaches were or were not considered?
  – Has valuation analyst employed valuation method that are logically explained in the report, and if certain methods are commonly found in these types of appraisals and not found in the subject valuation, and the analyst explained why such method was not considered in the subject analysis?
  – Does the analyst’s synthesis of the various methods receive adequate explanation, with well-documented, logical conclusions, based on reasoned judgment?

POST ACA IMPLICATIONS FOR MSOS
The Questions

Physicians are asking themselves:
• How do I transition from fee-for-service to value-based care?
• Which health system should I join?
• How do I optimize outcomes, satisfaction, and safety while minimizing the cost and leveraging informatics?


MSOs Can

• Assist with reimbursement transitions through the strategic and financial services
• Be an interim step, giving physicians a glimpse of the administrative processes and how a health system operates.
• Provide an IT platform
A Continuing Integration Tool

- Hospitals can use MSO’s to support independent practices through billing, EHR, and administrative services
- Hospitals get insight into community and medical staff needs, assistance with retention
- A mechanism to assist physicians with declining medical income due to rising administrative costs.

A Continuing Integration Tool

- Hospital – Physician Partnership
- Joint Equity Ownership of MSO
- Interim step where full integration and/or employment are not viable options yet
- Open the door initially to a collaborative relationship, and grow into closer integration
- Supporting IPAs, PHOs, ACOs
MSOs and Health Plans

• Integration between health plans and physicians is a relatively new phenomenon.
• Establishment by a health plan of an MSO to provide management services to the medical group
• Generally turnkey operations, and consist of billing, collection, and employment of clinic non-physician employees

MSOs and Health Plans

• MSO purchases the assets of the medical practice, but the physicians continue to own the group practice entity and employ the physicians.
• MSO provides the turnkey services to the practice for a fee, generally in the form of a percentage of revenues.
MSO HYPOTHETICAL

Cast Of Characters

Willie N. Able
UMH VP
Director of UPM

UMH
Urban Memorial Hospital

J.D. Esquire
UMH’s outside counsel

Kashin Advisors
Private Equity & Valuation Firm

MPN
Mega Physicians Network
Local IPA

H.I. Power
Hospital CEO

Dr. Gitwell
Family Practice
MPN Board Member

UMH
Urban Physician Management
UMH’s MSO
• 400-bed acute care hospital in Mega City

• Urban Physician Management ("UPM"), a management services organization operated by UMH
Cast Of Characters

- Resisted employment by UMH, preferring to remain autonomous
- Highly profitable practice
  - Profits from mid-level providers and ancillaries
  - Not yet fully implemented on EHR system
- Influential with other primary care providers

Cast Of Characters

- Successful leader of IPA
Cast Of Characters

- Wants to use MSO as aggressive tool to affiliate with non-employed physicians
- Wants to use MSO as backbone for health information
- Wants to strengthen PCP network, build a platform for Clinically Integrated Network and ACOs
- Intends MSO to be central to CIN, ACOs, PCP network, independent specialist network

MSO Hypothetical

- Power meets with Able, his VP over UPM
  - Lays out aggressive strategy for MSO
  - Insists on Dr. Gitwell as instrumental to development of the PCP network and the IPA's role
  - Agrees to set meeting with Mr. Esquire
MSO Hypothetical

- Power, Able and Esquire meet

Legal Analysis

- Mr. Esquire points out benefits of the MSO:
  - Limited risk if things don’t work out
  - Dr. Gitwell’s ancillaries and mid-level providers
  - More collaborative relationship
Legal Analysis

• Mr. Esquire points out additional options:
  – sale/leaseback of Dr. Gitwell’s building and/or equipment
  – administrative personnel
  – Dr. Gitwell investing in the MSO

Legal Analysis

• Mr. Esquire anticipates a need for:
  – Letter of intent/term sheet
  – MSO Services Agreement:
    • List of Services
    • IT Services
  – APA / Lease?
  – Due Diligence
Legal Analysis

• IT issues:
  – Stark exception for EHR items and services
    • Has physician already obtained equivalent items or services?
  – Can Dr. Gitwell rescind his existing contract?
  – MSO as a foundation for the communitywide HIT, and the community physicians.

Legal Analysis

• **Long term strategy:**
• MSO / IPA collaboration
  – Develop relationships with physicians in IPA
  – Services to IPA
  – Dr. Gitwell advising the MSO on strategic direction
  – Potential antitrust issues
**Legal Analysis**

- **Long term strategy:**
- MSO as a vehicle to get physicians on the same EHR system
- Compatible with CIN strategy.
- PCPs and specialists are different
- MSO as the technological foundation for diabetes ACO by the IPA

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**MSO Hypothetical**

- Power, Able and Dr. Gitwell meet
  - Dr. Gitwell was initially reluctant, but ultimately agreed to use his influence and allow his practice to be the model for the MSO
– Able contacts Kashin Advisors to begin a valuation of the MSO fee arrangement at behest of Esquire
  • Kashin is engaged by Esquire under attorney/client privilege

Valuation Analysis

• Valuation Analysis
  – Cost-based approach
    • Replacement cost methodology
    • Cost of substituted service of nearly equivalent utility
    • 10.5 percent rate, based on percent of net medical revenue
  – Income-based approach
    • Buyer-side analysis
    • Benchmarking of pediatric overhead, assuming operational data with and without MSO arrangements
    • 17.8 percent rate, based on percent of net medical revenue
Valuation Analysis

• Valuation Analysis, cont’d
  – Market-based approach
    • 26 guideline contracts, normalized to similar service menu
    • 10 percent rate for PCPs; 11 percent rate for pediatric practices, based on percent of net medical revenue

Valuation Analysis

• Valuation Analysis, cont’d
  – Synthesis and reconciliation
    • Cost and market approaches deemed most reliable
    • Ultimately relied on market approaches
    • Concluded on range of rates from $77,000 to $86,900 or 10.0 to 11.0 percent of net medical revenue for the MSO’s services.
Outcome

• Based on the Gitwell / MSO meeting and valuation, the parties agree on a Term Sheet and sign a Services Arrangement
  – $7,000 per month
  – Relying on AKS Personal Services and Management Contracts Safe Harbor and the Stark Fair Market Value Compensation Exception.

Outcome

• Begin operating
• Dr. Gitwell – wants to show success of his practice to other providers in the community
• Set meeting with Antitrust counsel to discuss the best way for the MSO and the IPA to join forces.
• MSO starts work to obtain software for ACO diabetes program
• Hospital can continue work on CIN, and can offer MSO to doctors that are part of the CIN