Insights

Is Your ASC Too Cheap?

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The development and growth of ambulatory surgery centers (“ASCs”) has continued and even accelerated in recent years. Shifts in allowable cases from inpatient to outpatient, temporary closures of hospital outpatient departments because of COVID, and private equity funding have all bolstered this growth.

This has been particularly true for multi-specialty centers with strong orthopedic case mixes and for orthopedic-only centers. These centers are attracting significant interest from new physicians and ASCs often compete for their investment.

Since the 1980s, the federal government has made clear that ASCs must charge “fair market value” for equity in an ASC. For a new and speculative facility, the initial investment requirement may be low, when the success of the center is less certain. A newly formed entity with no facility constructed, no license, and no payor contracts should be valued at significantly less than an ASC with even just a short operating history.

Notwithstanding that, even for the newest ASC, the recommended best practice is to obtain a formal valuation from an independent third-party valuation firm with specific experience valuing ASCs. This ensures that an ASC will not run afoul of federal and applicable state anti-kickback rules by offering an investment at less than “fair market value.” Although obtaining an independent valuation may cost $10,000 or more, the assurance it provides is well worth the upfront cost.

Unfortunately, some ASCs continue to just pick a number that they think is “meaningful,” although it has no real tie to the actual value of the ASC’s equity. For example, a 10% equity interest in an ASC might be worth $500,000. If the ASC only charges $300,000 for such equity, the physician is arguably receiving a $200,000 discount, which may be viewed as a “payment” for a future referral stream to the ASC.

If an ASC across town loses an investor because its competitor ASC is charging less than fair market value, it may report the competitor to federal or state authorities, which in turn could trigger a government investigation.

These below-fair-market-value arrangements are sometimes in place simply out of habit (e.g., “That is what we have always charged”) or because of an understandable concern that newer physicians may not be able to afford the buy-in (e.g., “They already have so much debt from school”). Notwithstanding, with a quality valuation, physicians should have little trouble financing an equity investment using a third-party lender.

It is important to note these same concerns do not exist when a physician retires or otherwise stops using an ASC. Under these circumstances, there are no longer referrals from that physician back to the ASC and no kickback can therefore occur. In fact, it is common for the final redemption of shares from a physician to be at a price below what they paid and/or below fair market value.

If you have any questions regarding your ASC buy-in or buy-out process, or the necessity of obtaining a fair market valuation, please contact Thomas N. Hutchinson.

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