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(L-R) David Glusman and Thomas Reinke of Marcum LLP. Courtesy photos

COMMENTARY

There are other standards of value (and valuation approaches) that are relevant for many business transactions, situations, and disputes in the health care industry, but are not governed by the AKS and Stark.

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In the heavily regulated health care industry, attorneys are generally aware of the importance of fair market value (FMV). Our prior article addressed the impact of the anti-kickback statute (AKS) and the Stark Law (Stark) on the definition and elements of FMV. However, there are other standards of value (and valuation approaches) that are relevant for many business transactions, situations, and disputes in the health care industry, but are not governed by the AKS and Stark.

Situations that are outside of the health care related definition of FMV include those that do not involve referrals and payment from federal health plans for healthcare services as defined by the Centers for Medicare and Medicaid Services (CMS). This includes many business and financial transactions, mergers and acquisitions, valuations in divorce situations and damages resulting from business disputes. It also may include transactions among providers that involve business relationships or health care programs not paid for by federal insurance programs.

Other Standards of Value

There are generally five standards of value that may be applicable in transactions or situations not subject to the AKS or Stark.

The first of these is the traditional definition of fair market value according to IRS Revenue Ruling 59-60 and most professional valuation standards. Under this definition FMV is the price, expressed in terms of cash equivalents, at which property would change hands between a buyer and a seller. Both parties must be acting at arm's length in an open and unrestricted market, not under compulsion to buy or sell, and have reasonable knowledge of the relevant facts. The professional literature on valuation outside of healthcare widely uses this definition, or very slight modifications of it.

This FMV standard is used most often in valuations for gift, estate, and income tax matters, and in litigation matters such as damage claims. It may also be used in buy-sell agreements such as acquisitions or mergers. One interesting aspect of The FMV standard is consideration of goodwill.

Goodwill, while an integral part of the FMV standard, is excluded in many health care transactions subject to AKS and CMS rules, but outside of these transactions, goodwill can generally be included in valuations. This standard of FMV is determined by considering the three methods: the asset approach, the income approach, and the market approach. These methods indicate the range of values at which a business might sell, but the range is not intended to provide an actual transactional value (the price at which the business might actually be sold or purchased).

FMV is more of a guide than an indication of what you'll receive when dealing with a specific buyer. That's because the actual price can be influenced by many factors, such as specific buyer or seller pressures, changes in circumstances, or simple immediate market conditions.

The second standard of value is fair value. Fair value (sometimes referred to as the financial reporting standard) is used by businesses in reporting the values of assets in accordance with generally accepted accounting principles (GAAP). For example, this standard of value is used in business combinations to allocate purchase prices on acquiring companies' books.

Fair value under GAAP is used primarily for reporting of transactions according to recognized accounting rules and for evaluating the current carrying value of previously acquired assets. While not part of the standard, a fair value determination may also serve as a starting point for negotiation,

and subsequently be adjusted by excluding certain GAAP line items such as impaired assets or goodwill.

Consider that fair value emanates from state laws dealing with shareholder dissent actions or from matrimonial law (the term “value” may be substituted for “fair value” in some of these statutes). Each state statute and the related precedential court cases usually has its own court-determined definition of fair value. Judicial interpretation of fair value can result in the partial or entire application of one of the other standards, such as FMV or investment value. Often the main difference between fair value and FMV is that the fair value generally excludes any discounts for lack of control or lack of marketability. This is so that the dissenting or oppressed shareholder is fairly treated and receives the pro rata value of their interest on a controlling basis.

Investment or strategic value is an additional standard of value. It is generally defined as the value in the hands of a particular investor based on individual requirements and expectations, according to the International Glossary of Business Valuation Terms. This standard may be used when a business is deciding on an opening offer price, especially if there are competitive bids. In that case, a buyer-specific rate of return might be used to determine the price for the business’s expected stream of cash flows, usually taking into account business combination efficiencies and related strategic issues.

The determination of strategic value results in the value of the business to a specific buyer or investor. Often, particular investors—such as competitors, joint venture partners, suppliers or customers—may be willing to pay a premium above fair market value due to synergies between the buyer and the acquisition target. This approach to value may be used in transactions in the

high-stakes medical equipment industry, such as when an established manufacturer acquires a competitor's emerging new technology.

The next standard of value, intrinsic value, is the value that an investor considers, based on available facts, to be the "true" or "real" value that will become the market value when other investors reach the same conclusion (according to the International Glossary of Business Valuation Terms). This standard is not often seen in practice when valuing private business interests. Instead, it's used primarily by investment analysts and bankers to seek out the fundamental price of a publicly traded security. The value of a publicly traded company takes into consideration these elements that are not found private business interests.

The key takeaway from this review is that value and fair value are situational and vary by the nature of the transaction. It is important for attorneys to be aware of the different standards of value and to work closely with their clients and a valuation professional to determine their perspective on valuation methods and standards.

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