Selling an Outpatient Imaging Center: A Primer

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Introduction

In 2003, the shareholders of a group practice agreed to fund and build an outpatient-imaging center. A number of factors made the proposition realistic and intriguing. For one, ample space was available on the first floor of their growing practice. The modalities and equipment, once purchased, could be deployed and installed fairly quickly within the space already available. Secondly, procedures reimbursed extremely well, and the equipment could be financed at a reasonable cost. The shareholders felt confident that they would recoup their cost in a relatively short period of time. Lastly, given the number of referrals that were being sent to other facilities, the prospect of retaining that business within one convenient location was viewed as favorable to the demands and interests of the patients. As with the creation of their internal lab facility, the shareholders tried to put the convenience of the patients at the forefront of many operational decisions. An internal imaging facility spoke to this emphasis. Given these factors, and using a combination of cash and financing, the practice funded the build-out, and the imaging center opened for business in 2004.

The center performed well early in its operation. However, in 2007, a tonal shift began to occur across imaging facilities in the United States. While hospital-based imaging revenues remained constant and/or improved, declines in outpatient imaging reimbursement\(^1\) caused the center to become significantly less profitable in a short period of time (Figure 1). Among many questions in his first year at the practice, the recently hired administrator had to decide if the practice should continue to manage and operate the imaging center given the revenue decline and
what alternatives existed to alleviate the burgeoning debt and financial loss assigned to the operation.

The administrator first created a small committee that included a shareholder and the practice’s financial consultant as well as the clinic’s general counsel. The initial premise for the committee was simple: approach local hospital groups, where imaging revenue continued to be significant, and sell the imaging center under a negotiated agreement. The consultant had prior experience with imaging center sales and, if they could reach a deal, would provide much needed insight from the standpoint of financial structure and framework. The clinic’s counsel was retained to substantiate any sales agreement from both a legal and organizational standpoint. With varied backgrounds and expertise, the administrator hoped to gain perspective and leverage the experience of the committee in making an informed decision.

 Alternatives Considered

The first alternative the administrator considered was to sell the imaging center outright. One of the main concerns with this alternative was an immediate loss of autonomy and oversight. The shareholders had enjoyed operational control and input for a number of years, and this option did not speak to their desire to maintain some semblance of day-to-day involvement with the center. The second concern was that an outright sale would represent only an immediate infusion of cash. The shareholders and administrator welcomed any immediate cash for the sale of the center but, in the long term, preferred a recurring source of income. This was particularly important given the fact that the imaging center typically absorbed
between $300,000 and $350,000 in clinical overhead each year. Despite these concerns, this alternative had a number of benefits, the most significant being that salary and operational expenses would essentially go away. With operating expenses that exceeded well over $750,000 annually, the sale of the center would bring welcome relief to the month-to-month cash outlay for the clinic.

The second alternative revolved around maintaining the current operation. The benefit of this approach was that it allowed the clinic to maintain its autonomy in the overall management and direction of the operation. This spoke to a major desire of the shareholder group. The downfall of this alternative, however, was two-fold. First, it did not address the immediate concern of financial viability. Based on the administrator’s analysis of 2012 data, the clinic would need to generate an additional $432,000 in gross charges to cover the expense of the operation. This equated to an additional 619 tests annually if reimbursements remained equal.

Second, imaging reimbursement in the long-term remained hard to measure and anticipate\(^2\). This unpredictability caused wariness of this choice.

The third alternative involved selling the imaging center and negotiating an agreed upon management fee for providing operational oversight. One of the more intriguing aspects of this alternative was it had an opportunity for recurring cash flow via the management fee. A management fee would be vetted through a contract or business associate agreement (BAA) assigning the clinic input and authority over the day-to-day operation of the imaging center. A recurring cash flow addressed the shareholder group’s concerns of identifying a means to cover overhead and general clinic operating expenses. Along with retaining at least some
control in this arrangement, the upside was significant. As for the downside, the long-term viability of such a relationship with a third party or facility could be viewed as a concern. If the relationship soured, the arrangement could dissolve fairly quickly along with the management fee. Also, the federal Stark Law\(^3\) and the Anti-Kickback Statute\(^4\) had specific regulations in place governing the relationship a provider group has with an entity and self-referrals to that facility. If the agreement did not address this, the clinic could face legal and federal persecution.

**Decision and Chosen Solution**

The decision process was long and arduous. The shareholders wanted every opportunity for the administrator to succeed in identifying a reasonable solution. In addition to his reliance on the committee, the administrator reached out to practice leaders in the community with similar operations that included imaging centers. He conducted several interviews and gathered information on their strategies. The administrator then reviewed the opportunity costs of a decision to sell (Figure 2) and leveraged that analysis against a weighted balance scorecard (Figure 3). Based on these analyses, including a review of the pros/cons (Figure 4), the administrator selected option 3. From a financial and strategic standpoint, this represented the best long-term cash viability solution for the practice and gave the clinic a strong, but not complete, position of control. The opportunity costs alone in both year one and year two showed that selling the imaging center and negotiating a management fee was the most favorable position when compared to the other alternatives (Figure 2). He presented his analysis to the committee, then the shareholders, and
received a unanimous vote of acceptance. Given this vote and support, the administrator moved forward toward acquiring bids and implementation.

Once the decision was made, the administrator used a combination of resources to vet and discuss possible opportunities with potential suitors. Clinic counsel worked directly with the potential buyers in defining a management agreement that met federal Stark and Anti-Kickback regulations, specifically that the agreement satisfied the “Personal Services and Management Contracts” safe harbor provision(s)\(^5\). Under this safe harbor, the agreement needed to meet certain conditions including\(^6\):

A) The length of the management agreement must be for a minimum of one year, and the compensation must be defined prior to execution;

B) The management agreement must be consistent with fair market value; and

C) The management agreement cannot take into account the volume or value of any referrals or revenue generated between both parties.

The administrator, in agreement with counsel, knew that formulating a contract that met the provisions of this safe harbor rule (under Stark and Anti-Kickback statutes) was critical to any negotiation.

The administrator instructed the financial consultant to review the structure and financial framework of any proposed deal. In addition, the administrator moved forward and sought a firm to perform a fair market value (FMV) appraisal of the imaging center as a whole. The purpose of the FMV appraisal(s) was to vet and
appropriately assign value to the maximum worth of the imaging suite upon sale. Clinic counsel was extremely adamant that this be pursued and completed prior to negotiating and signing any agreement; protecting the clinic and any purchasing entity from possible litigation regarding collusion or improper practice was a priority. It was also important that the group negotiated terms for the transfer of staff and resources prior to any agreement. These employees and team members were long-term contributors to the clinic, and the administrator wanted to ensure their well being in any potential agreement. After reviewing the above points, the administrator made the appropriate announcement to impacted staff members regarding the clinic’s position and the imaging center’s potential acquisition.

**Lessons/Learned – Outcomes**

The lessons learned from this process have proved to be enlightening for clinic leadership. Based on a number of proposals the administrator received in 2012, a management fee would generate a healthy cash margin for the clinic, approximately $360,000 annually. This, compared to the sole sale of the center at the FMV of its assets, gave the clinic an amenable position. With this fact coupled with the ability for the clinic to maintain day-to-day operational oversight, the shareholders and administrator believed that this path represented the best choice for the clinic as a whole.

**Recommendations**

1) Do not settle for a simple buyout unless it is the best option. Compare more than one deal and make sure to get an appropriate value for the entity at large. This can
be achieved by obtaining a fair market value appraisal. Companies and groups perform these appraisals all the time. Having two or three in hand is a major part of any negotiation.

2) Involve a lawyer throughout the process because of the legal implications for both parties involved in the sale.

3 42 USC § 1395nn
4 42 USC § 1320a7b(b)
5 42 C.F.R. § 1001.952(d)
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Appendix

Figure 1: Imaging Center Profit/Loss

![Imaging Center Profit/Loss Graph]

- Dollars ($) vs. Years (1 to 8)
- Profit/Loss line graph
- Yearly profits/losses:
  - Year 1: $800,000
  - Year 2: $600,000
  - Year 3: $400,000
  - Year 4: $200,000
  - Year 5: $0
  - Year 6: ($200,000)
  - Year 7: ($400,000)
  - Year 8: ($600,000)
Figure 2: Opportunity Costs

<table>
<thead>
<tr>
<th>Opportunity Cost(s)</th>
<th>Sell Imaging Center (w/o Management Fee)</th>
<th>Don't Sell Imaging Center</th>
<th>Sell Imaging Center (w/ Management Fee)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit/Loss (Year 1)</td>
<td>$616,000</td>
<td>($325,000)</td>
<td>$976,000</td>
</tr>
<tr>
<td>Profit/Loss (Year 2 and Beyond)</td>
<td>$0</td>
<td>($325,000)</td>
<td>$360,000</td>
</tr>
</tbody>
</table>
Figure 3: Balance Scorecard

<table>
<thead>
<tr>
<th>Alternative</th>
<th>Long Term Financial Viability (25%)</th>
<th>Recurring Revenue (40%)</th>
<th>Managerial Oversight/Autonomy (25%)</th>
<th>Imaging Employee Satisfaction (10%)</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alternative #1</td>
<td>6</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>2.25</td>
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<tr>
<td>Alternative #2</td>
<td>3</td>
<td>5</td>
<td>9</td>
<td>9</td>
<td>5.9</td>
</tr>
<tr>
<td>Alternative #3</td>
<td>9</td>
<td>9</td>
<td>7</td>
<td>7</td>
<td>8.3</td>
</tr>
</tbody>
</table>


<table>
<thead>
<tr>
<th>Alternatives</th>
<th>Pros</th>
<th>Cons</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alternative #1: Sell Imaging Center Outright to Local Hospital or Health System</td>
<td>*Immediate Cash Infusion  *Salary and operational expenses would effectively go away</td>
<td>*Loss in clinic autonomy as imaging center becomes a hospital outpatient department (HOPD)  *Singular versus recurring infusion of cash</td>
</tr>
<tr>
<td>Alternative #2: Stay the Course</td>
<td>*Clinic maintains autonomy and retains ownership</td>
<td>*Does not address concerns of profitability and viability  *Long-term procedural reimbursement from payors hard to measure and anticipate</td>
</tr>
<tr>
<td>Alternative #3: Sell Imaging Center to Local Hospital and Share in Operational Management via A Negotiated Management Fee</td>
<td>*Clinic maintains some (but not total) control over operation  *Management fee will bring a recurring flow of cash</td>
<td>*Some loss in autonomy and control  *Long-term viability of relationship a concern  *Federal Stark and Anti-Kickback regulations will need to be addressed</td>
</tr>
</tbody>
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