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Fair Market Value: It Is Not As Easy As You May Think

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What to Consider When Determining the Reasonableness of a Proposed Compensation Arrangement

Most health care professionals are well aware of the fact that the Stark law[1] and the anti-kickback statute[2] are the federal government's principal tools in combating governmental payor program fraud, waste, and abuse. Given that the federal government's objective with these laws is to prohibit health care organizations from incentivizing physicians to make unnecessary referrals, in order to comply with both the Stark law and the anti-kickback statute, the total compensation paid by a health care organization to a physician in the context of an employment or independent contractor relationship (*e.g.*, a professional services agreement) must be fair market value (FMV) and commercially reasonable.[3] Although these considerations are relevant in other contexts as well, including leases and asset purchase agreements, this article focuses solely upon the implications of FMV and commercial reasonableness in the context of compensation arrangements with physicians.

Part of the challenge for health care organizations in complying with the Stark law and the anti-kickback statute is determining whether a compensation arrangement is, indeed, FMV and commercially reasonable. Due to the inherent challenges associated with determining FMV and commercial reasonableness, it is often considered best practice in the health care industry to obtain an independent valuation of a proposed compensation arrangement by a qualified expert. Due to time constraints and the extra expense, however, many health care organizations very often make these FMV determinations without the assistance of a qualified expert. Unfortunately, because many organizations do not have comprehensive fact-driven processes, many

are relying upon survey data alone, which may not be enough in all circumstances.

FMV, as used in the context of compensation arrangements with physicians, is generally defined as an amount one would expect to pay as a result of an arm's-length negotiation without the expectation that one or both of the parties is going to generate business for the other.[4] Although the foregoing standard seems straightforward enough, the challenge often lies in determining whether the subject physician is receiving compensation for the value of his or her services, or receiving compensation for the business for which he or she may be expected to generate for the health care organization. It is difficult to know.

Although FMV and commercial reasonableness are often used interchangeably, the two standards are different, and thus, each physician compensation arrangement warrants an independent analysis of each standard. While FMV is an "arm's length" negotiated fee for a physician service in the absence of referrals, commercial reasonableness addresses whether or not it is actually reasonable to pay for the service in the first place. Specifically, "commercial reasonableness" has been defined as an arrangement, in the absence of referrals, that "would make commercial sense if entered into by a reasonable entity of similar type and size and a reasonable physician…of similar scope and specialty even if there were no potential [Designated Health Services] referrals."[5] In other words, the compensation arrangement is a sensible, prudent business arrangement from the perspective of the particular parties involved, even in the absence of any potential referrals. An example of an arrangement that is not commercially reasonable but satisfies the FMV standard is hiring two physicians with FMV compensation for medical director positions when the unit previously operated without issue with just one medical director. A reasonable entity would not pay for the same position twice in the absence of referrals.

As previously mentioned, when determining whether a particular physician compensation arrangement is FMV (if a third-party valuation expert is not involved), many health care professionals primarily rely upon national surveys prepared by Medical Group Management Association (MGMA), Sullivan Cotter or American Medical Group Association (AGMA) to determine how the proposed compensation arrangement compares with such national surveys. In taking such an approach, many health care organizations fail to realize that reliance on a single source may be inadequate in that such survey data may represent nothing more than a relatively gross approximation of what a small number of physicians receive for compensation.

Simply put, the surveys do not address: (i) whether or not the physician services were actually needed; (ii) what the specific duties the physician is required to fulfill; (iii) whether the physician collections are commensurate with the total compensation package received by the physician; (iv) whether the data comprising the survey is reflective of arrangements that are legally compliant with the laws; and (v) if your organization is tax-exempt, whether or not the arrangement is consistent with the federal tax-exempt laws.[6] The mere fact that a group of physicians is receiving a certain level of compensation included in a survey does not in and of itself mean the compensation arrangement is the result of arm's-length negotiations and is, thus, legally compliant. Moreover, since much of the survey data may be dated or not reflect a large enough pool of geographically similarly situated physicians, reference to survey data alone without further consideration of other factors is very likely to provide a false sense of security regarding the legality of the compensation arrangement, or the survey data may prevent a health care organization from entering into a compensation arrangement that may otherwise be

FMV despite it being at or above the upper limits of the survey data.

By way of example, by relying upon survey data alone, a proposed $1.3 million per year compensation arrangement with a Mohs surgeon may be rejected by an organization simply because the survey data indicates that the proposed compensation would be at the 90 percent of the survey data. However, the survey data fails to consider the fact that the particular Mohs surgeon is highly productive, exceptionally qualified, double-boarded, an excellent faculty member, an important resource for community-based dermatologists (who do not perform Mohs surgery), and ultimately will contribute to the overall reputation of the academic medical center as a destination center for high-quality and advanced dermatology services. Accordingly, the fact that a compensation arrangement is either at the high or low end of a survey range should not automatically disqualify the compensation arrangement if all other factors, including the services to be provided, the need for the specialty, the productivity of the physician, and other market factors, justify the compensation.

Conversely, the fact that a physician is being paid at the 25th percentile to perform medical director services does not automatically mean that the compensation arrangement is FMV, especially if the medical director role was created simply as a ploy or means to provide the physician with additional compensation for referrals. However, competitive market forces often tempt health care organizations to stretch beyond the limits of what is commercially reasonable. For example, a highly regarded and productive surgical oncologist asks his employer hospital to increase his compensation so he can pay off his medical school loans and pay his tuition to pursue an MBA. The physician informs his employer that a competing hospital across town is willing to offer the surgical oncologist a "leadership" position, tuition reimbursement for the physician to pursue his MBA, and an increase in his salary that would allow him to pay off his student loans (*i.e.*, the equivalent of $10,000 more in compensation per month). In determining whether it can legally match the offer of the competing hospital, the health care organization must consider the compensation components collectively to determine whether total compensation is at FMV and is commercially reasonable.

Of course, paying for the physician's tuition expenses to pursue an MBA and paying his loans from medical school, on top of an already competitive salary, should raise red flags necessitating an independent opinion from a qualified expert.[7] Most importantly, while competitive offers may justify a reevaluation of the surgical oncologist's current compensation, being held over a barrel by a competing hospital alone does not justify an illegal compensation arrangement.

Therefore, while reference to survey data may be a useful starting point, it should not be the be all and end all. Rather, further factual analysis should be performed to determine whether, but for the guarantee of referrals, the compensation arrangement is commercially reasonable. Accordingly, if you are not obtaining an independent opinion from a qualified valuation expert, it is advisable that you consider and document the following in determining the reasonableness of a proposed compensation arrangement:

- Is there a documented and or historical need for the physician's services?
- Will the services actually be provided, and how will the physician document the provision of his or her services? What is the service, the number of hours, time of day, specialty, duties, and historical collections and compensation?
- Is this a billable service or a coverage or access issue? Are the services administrative or clinical?
- Does the service address a particular community need or your licensure

designation or certification (*e.g.*, stroke center certification or trauma center)?
- How does the proposed compensation compare to the comparative salaries in the area?
- Have you factored in total compensation and not just the salary?
- What is the payor mix and reimbursement?
- Does the physician have practice history of his or her productivity or wRVUs? If so, does the proposed compensation reflect the level of productivity?
- Have you compared the physician's productivity level to market benchmarks to determine whether the physician's per unit compensation is comparable to that of his peers at similar productivity levels?
- You may also look at RBRVS, which takes into account resources used, practice expense, malpractice expense, geographic location, and others.
- Are you going to lose money on the physician given his or her productivity level?
- How difficult is it to recruit and retain physicians to your geographic area? Does that provide justification for exceeding median salary?
- Is this an academic medical center because academic teaching physicians are typically less productive given their teaching responsibilities than non-academic positions?
- While it should not be determinative, in connection with administrative duties, are you considering opportunity cost?

These are just some of the factors that should be considered when determining whether a physician's compensation is FMV and commercially reasonable. If at the end of your factual analysis, the facts support the compensation, and the analysis is well documented, you have most likely reduced the health care organization's risk. The bottom line is that some health care organizations rely exclusively on survey data without further analysis of the facts, and as a result they may end up either exceeding FMV or worse yet, underpaying or losing valuable talent to competitors. Careful analysis and a thorough documented process, subject to careful review and scrutiny by more than one impartial individual, will likely yield a more reliable result than simply relying upon survey data alone.

Endnotes

1. 42 U.S.C. § 1395nn.
2. 42 U.S.C. § 1320a-7b(b).
3. *See* 42 U.S.C. § 1395nn(e)(2); 42 C.F.R. § 1001.952(d), (i). The employment safe harbor under the anti-kickback statute does not specifically require that the arrangement be FMV and commercially reasonable, but rather requires a "bona fide employment relationship with the employer." 42 C.F.R. § 1001.952(i). Despite this fact, we note that an employment arrangement that involves compensation above FMV may raise a question as to whether at least one purpose of the arrangement is to compensate the physician for his or her past or future referrals of federal health care program business.
4. *See* 42 C.F.R. § 411.351 ("Fair market value means the value in arm's-length transactions, consistent with the general market value. 'General market value' means…the compensation that would be included in a service agreement as the result of bona fide bargaining between well-informed parties to the agreement who are not otherwise in a position to generate business for the other party, on the date of acquisition of the asset or at the time of the service agreement. Usually, the fair market price is…the compensation that has been included in bona fide service agreements with comparable terms at the time of the agreement, where the price or compensation has not been determined in any manner that takes into account the volume or value of anticipated or actual referrals…."); *see also* 42 U.S.C. § 1395nn(h)(3) ("The term 'fair market value' means the value in arm's length transactions, consistent with the general market value….").
5. Department of Health and Human Services, Centers for Medicare & Medicaid Services, "Medicare Program; Physicians' Referrals to Health Care Entities With Which They Have Financial Relationships (Phase II)," 69 Fed. Reg. 16093 (March 26, 2004).
6. *See, e.g.*, section 501(c)(3) of the Internal Revenue Code for the requirements applicable to charitable organizations.
7. If the health care organization is a tax-exempt entity, the arrangement likely presents private inurement issues.

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