

Analysis of the Interconnectivity between Fair Market Value and Commercial Reasonableness

Among the more pertinent questions facing hospital administrators across the country is: Can fair market value exist without commercial reasonableness and what is commercial reasonableness? Understanding these separate but critical concepts requires exploration of the interdependent relationship between the quantitative aspects of fair market value and the qualitative aspects of commercial reasonableness as they pertain to physician compensation arrangements.

In the current era of mergers and acquisitions within the healthcare industry, a significant focus has been placed on compliance with the fair market value provisions of the Stark Law, which specifies that a transaction must consist of a willing buyer and willing seller with each having all of the relevant facts. However, fair market value extends beyond the merger and acquisition setting as it is also applicable to the rates charged by physicians and overall physician compensation.

The Office of the Inspector General (OIG) and Centers for Medicare and Medicaid Services (CMS) have made it clear through the increased enforcement of the Stark Law and Anti-Kickback Statute that fair market value and commercial reasonableness are intertwined and must coexist. Specifically, the OIG indicated in a recent fraud alert^[1] that it has expanded the focus on compliance to not only include physicians' facilities, but to include the individual physicians as well. To fulfill this expansion, the OIG will put more investigative resources into the field.

In an earlier installment of our series on Physician Compensation, we outlined a few of the impacts these regulations had on the physician compensation landscape. Fair market value and commercial reasonableness are at the center of the Stark and Anti-Kickback actions that resulted in multi-million-dollar settlements and judgements against hospitals. In four of the most recent cases involving Stark violations, hospitals incurred fines and settlement costs totaling more than \$400 million, not including the related legal fees.

Examining physician compensation within the construct of fair market value provides a significant portion of the picture within an OIG review. In determining the fair market value, analysts must develop an understanding of the salient facts which include, but are not limited to, the term, productivity, responsibilities and duties provided in the agreement. Analysts must then utilize published physician compensation surveys to benchmark total compensation. However, in order to see the full picture as outlined by Stark, the principles of commercial reasonableness must be applied to physician compensation.

A critical mistake made by some analysts working in the field today is the tendency to place greater emphasis on fair market value and not enough weight on commercial reasonableness. While closely related, they are not the same. One way to ensure that both measurements are given appropriate consideration is to follow this axiom: If commercial reasonableness does not exist within a physician compensation package, then it will not meet the standards necessary for fair market value.

Fair Market Value: One Half of the Analysis Equation

Fair market value holds a prominent role in the analysis of physician compensation for good reason. Published physician compensation surveys provide a great deal of insight into how agreements measure up against other providers both nationally and regionally. As the prevailing method for valuing physician compensation, the market approach references comparable arrangements in the marketplace and is premised on the idea that no one will pay more for something than one would for an equally desirable substitute. Fair market value also examines compensation considerations that may not be tied to revenue or cash, including call requirements, advisory and quality initiatives.

As noted previously, individual physicians can be held accountable under Stark as the OIG is expanding its enforcement efforts. In accordance with Stark, the financial arrangements must be at fair market value for bona fide services that the physician actually provides. A compensation arrangement may violate the Anti-Kickback statute if even one purpose of the arrangement is to compensate a physician for their past or future referrals. Physicians are encouraged to carefully consider the terms and conditions of medical directorships and other compensation arrangements before entering into them.

Commercial Reasonableness: The Other Half of the Equation

Before an analyst opines on the fair market value of the total compensation for a physician, it is necessary to determine if the proposed service has a legitimate business purpose. The Stark regulations commentary (69 Fed. Reg. 16093 (March 26, 2004)) states that:

“An arrangement will be considered ‘commercially reasonable’ in the absence of referrals if the arrangement 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 (DHS) referrals.”

In very simple terms: why are you entering into the compensation agreement?

The tests involved in determining commercial reasonableness focus on examining both internal and external market factors. Commercial reasonableness can perhaps be best understood by the questions asked during the analytical process. Those questions include but are not limited to the following:

- Does the proposed arrangement represent a reasonable necessity that is essential to the mission, strategy and financial goals of the hospital or other healthcare provider?
- Does the arrangement make rational sense from a general business perspective?
- Does the proposed arrangement contribute to the provider’s profits or development of a needed line of service?
- What is the size of the facility and patient population served by that facility?
- Do patient needs dictate the necessity for a separate and distinct provider?
- Are patient acuity levels such that the arrangement is necessary?
- Does the arrangement provide a duplicative service or potential for misuse?
- Does the provider have controls and/or safeguards in place to eliminate the risk of duplication or misuse?

- Are there regular evaluations of physician duties and performance and the sustained need for their services?
- Is there a formal process for reviewing and approving proposed arrangements?
- How are those evaluations used by the provider?
- What types of monitoring are used by the provider?
- Does the arrangement produce verifiable outcomes?

While evaluating the answer to these and other questions, one must consider the collective terms of the contract. No one issue stands alone. Within these questions, there can be unique circumstances that can assist a hospital in developing a contract that may appear to be above fair market value but is actually in compliance with Stark as it is commercially reasonable.

Consider the following: A rural community hospital has a need for an orthopedic specialist. In its initial search and offer process, they attract little to no interest because the compensation package is not enough to bring the desired talent level into the rural market. In order to make a competitive bid that can both attract and retain an orthopedic specialist from a larger market, it may become commercially reasonable to go beyond the typical market standards in the hospital's region and offer a package that is comparable to one found in a larger market. At the same time, a hospital must answer the question, "Do we really have a need for an orthopedic surgeon?"

Another factor to consider in today's healthcare market is that physician compensation is no longer tied solely to productivity. It also takes into consideration specific quality measures. At present, approximately two percent of all compensation is being tied to hospitals meeting their annual goals. This shift in compensation structure has been driven on reducing the level of patient recidivism. If hospitals have high incidents of recidivism, their reimbursements from CMS will be reduced, resulting in a loss in revenue to the facility.

Comprehensive Analysis: Key to Compliance with Stark

In many ways, physician compensation is still in the "Wild West" phase. There are regulations; however, there is little theoretical guidance related to the valuation of these arrangements. What may be a contract containing fair market value and commercial reasonableness in one city or region of the country may not meet the same criteria in another city or region. The key to compliance under Stark is developing an in-depth understanding of the proposed compensation arrangement from a global and interconnected perspective in relation to fair market value and commercial reasonableness. Simply put, does physician compensation meet the criteria for fair market value and commercial reasonableness? Hospitals must be careful not to rationalize a proposed arrangement to get the desired answer.

The first step toward gaining this perspective is through an objective, third-party analysis. The examination process can often begin by studying the information and the analyses that is part of a hospital's community needs assessment. This survey will typically outline the demand for particular medical services. Other steps can involve interviewing the hospital's management team and talking to the individual doctors under contract.

The analytical process should be in depth and comprehensive in examining all relevant aspects of fair market value and commercial reasonableness. Without giving proper weight to both, hospitals and

physicians under contract could be at great financial risk, as the recent Stark case decisions have demonstrated.

We Can Help!

In light of the Stark Law and other changes in the healthcare industry, maintaining compliance with physician compensation regulations has become more complex for hospitals and healthcare providers alike. Given the risk and complexity, it often makes sense to engage your healthcare attorney as part of any process. If your hospital has questions concerning valuation issues in Stark compliance or other administrative healthcare regulations, please contact the Elliott Davis Decosimo Healthcare Team at 866-417-4059.



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