Analyzing Risk in Hospital–Physician Transactions

HEALTH CARE COMPLIANCE ASSOCIATION
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ANALYZING RISK

• Deal Pressure—We have to make this deal work, whatever it takes!
  • What is Fair Market Value?

• Business Pressure—How did we get here? We can’t afford to pay this much!
  • What is Commercially Reasonable?

• Identify the key compliance issues in each transaction—Every deal is different
ISSUES ANALYZED

- Analysis must consider both compensation valuation and business valuation in conjunction with each other

- Will this transaction generate Zero earnings or a loss post-closing?
  - Is the transaction FMV?
  - Is it Commercially Reasonable?
If the Practice does not have excess earnings, can the hospital pay for:

- Tangible Assets
  - Fixed Assets
  - Supplies
  - Accounts Receivable

- Intangible Assets
  - Name
  - Workforce in Place
  - Patient List
  - EMR
  - Non-Compete
QUAGMIRES

- Reconciling the Income Approach and the Market Approach in the components of the transaction

- Reconciling the Net Revenue derived from DHS Revenue
Key Legal Issues

- Fair Market Value
- Not based on the volume or value of referrals or other business generated by the referring physician
- Commercially Reasonable in the absence of referrals
Context

- **Fair Market Value.**
  - An explicit requirement of ten exceptions to the Stark Law and three Anti-Kickback Statue Safe Harbors.
  - An implicit requirement to avoid liability under the Anti-Kickback Statue in the absence of a Safe Harbor.
  - An implicit issue in the indirect compensation definition.

- **Volume or value of referrals or other business generated between the parties.**
  - Prohibition in all but one of the ten Stark Law exceptions and all three Anti-Kickback Statue Safe Harbors that contain the fair market value requirement. Implicitly includes fair market value as an issue in the prohibition.

- **Commercially Reasonableness.**
  - Required for eight of the ten Stark Law exceptions and all three Anti-Kickback Statue Safe Harbors that contain the fair market value requirement.
Fair Market Value
Stark Law Definition

• The value in arm’s–length transactions, consistent with the general market value

• “General Market Value” – the price/compensation that would be included in an agreement as a 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, at the time of the agreement.
Arm’s Length Bargaining

U.S. ex rel. Kosenske V. Carlisle HMA, Inc.,
554 F.3d 88 (3rd Cir. 2009)

• Arm’s-length negotiation between a hospital and a physician will not be bona fide bargaining between parties “who are not otherwise in a position to generate business between the parties.”

U.S. ex rel. Singh v. Bradford Regional Medical Center,
752 F. Supp. 2d 602 (W.D. Pa. 2010)

• “While the value agreed upon by parties who are in a position to refer business to each other and who take into account anticipated referrals will be a fair value as between the parties, such an arrangement is not “fair market value” under the Stark Act.”
FMV of Compensation

- Generally, the fair market price is the compensation that has been included in bona fide service arrangements 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.  42 C.F.R. 411.351
Reliance on Valuation

• “Good faith reliance on an independent valuation may be relevant to intent, but it does not establish the ultimate issue of the accuracy of the valuation figure itself.” 72 F.R. at 51015. See, e.g., Tuomey and Bradford

• “Depending on the circumstances, the ‘volume or value’ restriction will preclude reliance on comparables that involve entities and physicians in a position to refer or generate business.” 66 F.R. at 944
Anti-Kickback Statue

- Does not explicitly impose a fair market value or commercial reasonableness requirement on hospital/physician financial relationships.

- **Implicit element** – essential element of an anti-kickback statute violation is a payment for the purpose of inducing referrals. 
  

- Consequently, if the intent and conduct of the parties is to pay fair market value for services which will be actually rendered and not also for the purpose of inducing referrals, then the arrangement does not violate the statue. See *U.S. v. Bay State Ambulance and Hospital Rental Service, Inc.*, 874 F.2d 20, 29-30 (1st Cir. 1989); 64 F.R. 63518, 63519-21 (Nov. 19, 1999)

FMV of Employment Relationship

U.S. v. Borrasi, 639 F.3d 774 (7th Cir. 2011)

• Defendant argues that statutory exception for “any amount paid by an employer to an employee (who has a bona fide employment relationship with such employer) for employment in the provision of covered items or services” protected payments to employees even if in excess of fair market value for the services provided.

• Court held that “one purpose” rule applied in employment context.
Volume or value of referrals or other business generated between the parties

- An element of the Fair Market Value definition as well as an independent regulatory requirement

- Regulatory safe harbor: Unit-based/time-based compensation deemed not to take into account VOVOR/OBGBTP if unit compensation is fair market value and does not vary

- VOVOR: “Referrals”—Medicare Only

- OBGBTP: Any payor

- Query: Is VOVOR/OBGBTP a factor in analyzing fixed compensation?

- Compare:
  - *Bradford Regional Medical Center*
Fixed Compensation

Fixed aggregate compensation can take into account the volume or value of referrals where the fixed compensation exceeds fair market value for the items or services provided or is inflated to reflect the volume or value of a physician’s referrals or other business generated.

Commercial Reasonableness--Stark Law

- An arrangement is commercially reasonable if it is:
  - A sensible, prudent business arrangement
  - From the perspective of the parties involved,
  - Even in the absence of potential referrals.

69 F.R. at 16093
Commercial Reasonableness--Anti-Kickback Statue

- The purpose must be reasonably calculated to further the business of the lessee or purchaser.

- Space, equipment, or services that the lessee or purchaser needs, intends to utilize, and does utilize in furtherance of its commercially reasonable business objectives.

64 Fed. Reg. 63518, 63525 (Nov. 19, 1999)
Commercial Reasonableness-AKS


• Compensation paid at flat annual rate for part-time employment providing principally academic services. Government argued agreement was not commercially reasonable because, even though reasonable on its face, the hospital entered into the agreement with individual who was not qualified and made no effort to ensure the services were actually performed.


• Agreement, standing alone was commercially reasonable, but not commercially reasonable when hospital entered into multiple agreements for the same service with different physicians that, in the aggregate, exceeded the hospital’s need for the service.
Potential Factors

• Is it commercially reasonable in the absence of referrals?
  
  • Are specific elements of the agreement standing alone commercially reasonable, as well as in conjunction with each other.

  • E.g., length of term becomes a more important factor as more impediments to termination are imposed in the provisions of the agreement.

• Non-exhaustive list: length of the term; renewal/evergreen provisions; termination for cause provisions; termination without cause provisions; full time/part-time employment; compensation terms- fixed vs. production formula; periodic review of fixed or production formula compensation; ability to adjust compensation/formula; net cost of the agreement to the hospital; eligibility for pension, welfare and fringe benefits; scope of duties; requirements for documentation (administrative vs. clinical time and amount of time expended); duplication of work required. In an equipment or real estate lease: the justification for any terms that are not typical in a commercial real estate or equipment lease.
Fair Market Value
Determining Fair Market Value

- Approaches to Value
  - Income Approach
  - Market Approach
  - Cost (Asset) Approach
Approaches to Value - Income Approach

- Based on principle that value is directly related to the present value of the future benefits of ownership

- Converts anticipated economic benefits into a present single value

- Methods:
  - Discounting future projected benefits (DCF)
  - Capitalizing normalized historical benefits (CCF)

- Generally used to value operating companies that produce positive cash flow
Approaches to Value-Market Approach

- Based on principle that a prudent investor will pay no more for an asset than market price
- Compares the risk and return characteristics of similar investments
- Methods
  - Analysis of recent sales of similar assets/entities
  - Developing multiples from comparable practices
Approaches to Value-Cost (Asset) Approach

- Value is based on entity’s underlying assets and liabilities
- Based on principle that a prudent investor will pay no more for an asset than the cost to obtain (by purchase or reproduction)

- Methods:
  - Current replacement cost
  - FMV assets less FMV liabilities
Practical Issues in Hospital Physician Transactions
Areas of Conflict in FMV–Intangibles

- Assigning value to intangibles using the cost approach (not supported by net cash flow under income approach)
  - Argument for: avoidance of costs
    - Costs to recruit and employ workforce
    - Costs to recreate patient records
  - Argument against:
    - Not income-generating assets
    - OIG guidance (Thornton Letter)

Thornton Letter (OIG)
- Addresses payments for the following types of assets:
  - Goodwill
  - Value of ongoing business unit
  - Covenants not to compete
  - Exclusive dealing agreements
  - Patient lists of patient records
- Letter cited payments for above items as inappropriate
- Likely payments to mask payment for future business referred from phy
Example 1

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Income</td>
<td>0</td>
</tr>
<tr>
<td>Comp/WRV</td>
<td>40</td>
</tr>
<tr>
<td>Market Comp</td>
<td>50</td>
</tr>
</tbody>
</table>

Conclusion = 0 excess earnings

Therefore - Revert to Asset Approach

Assign value to the tangible assets: A/R
- FA
- Supplies

But what about: Non-Physician work force
Other intangibles, Charts & Medical Records
Physician work force
Conclusion: Items identified have values

What degree of risk is hospital willing to take?
Use of Market Data

1. **Fair Market Value – Stark Law Definition:**
   - The value in arm’s-length transactions, consistent with the general market value
   - “General Market Value” – the price/compensation that would be included in an agreement as a 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, at the time of the agreement.

**QUESTION:** Is it not a violation of this definition to use market data for physicians that ARE in fact in a position to refer?
Use of Market Data cont.

2. **Self perpetuating**
   A. Implication of more physicians being employed each year by hospitals
   B. The concept that the median becomes the low point of FMV
   C. The mathematical result is the median will continue to rise each year

3. Higher WRVU’s result in lower compensation per WRVU

4. Development of the DATA point “Comp per WRVU”

   Mathematical Equation = \[
   \frac{\text{Compensation}}{\text{WRVU's}}
   \]
Relationship between FMV and Commercial Reasonableness

An arrangement is commercially reasonable if it is a sensible, prudent business arrangement from the perspective of the parties involved, even in the absence of potential referrals.
Determining Commercial Reasonableness

A. First step in determination of whether an agreement is commercially reasonable must be: “Is the transaction consistent with fair market value?”

I. Standard definition of FMV addresses many of the issues thought to require a commercial reasonableness assessment

II. Any transaction that fails to be consistent with fair market value is commercially unreasonable

III. If a transaction meets the FMV standard, it may be commercially unreasonable for other reasons
Commercial Reasonableness

Underlying Principles

• All business transactions must aid organizations in accomplishing their strategic, operational, and/or financial objectives

• Assesses the overall arrangement, including qualitative considerations such as strategy and operations, whereas fair market value primarily assesses the financial aspects of the arrangements (range of dollars only)

• Considers the aggregate terms of the overall arrangements and asks the question: “Does this deal make sense?”
Applying Guidance to Assess Commercial Reasonableness

Healthcare organizations and providers should use several analyses to determine whether an arrangement meets the standard of commercial reasonableness. The analyses include inquiries relating to the specific terms of a proposed arrangement in relation to the transactions:

1. Business purpose
2. Provider of service
3. Appropriateness with regard to the healthcare provider’s facility and patient population
4. Suitability, considering the human and capital resources of the healthcare entity

These assessments each address various aspects of potential transactions, including overall economic sense and relationship to the business goals of the organization proposing to enter into a physician arrangement.
Business Purpose Analysis

- Arrangements between physicians and hospitals should be reasonably necessary to effectuate appropriate patient care and commercially reasonable business purpose without inducing prohibited referrals and compensation arrangements—“Legitimate Business Purpose.”
Facility Analysis

- The size and patient population of a particular medical facility should be considered in assessing the reasonableness of a proposed arrangements to which that facility will be a party.
  - Do sound business reasons exist for a specific services arrangement
- Arrangements characterized as unnecessary or those creating overutilization are presumably neither reasonable nor economically sensible.
  - Carefully consider whether physician services are necessary to carry out the purpose of a proposed arrangement or whether non-physician providers can satisfactorily perform the services
  - Whether a certain position requires the services of a physician trained in a particular specialty
  - Does size and patient population justify the specific arrangement
Independence and Oversight Analysis

In *U.S. v. SCCI Hospital Ventures*, government’s financial expert asserted several specific factors that are critical to a determination of commercial reasonableness related to physician services arrangements. These factors included whether:

i. **The hospital performs regular evaluations of the *actual* duties performed by the physician**;

ii. **The hospital assesses the effectiveness of the physician’s performance**;

iii. **There is a sustained, bona fide need for the physician services**

iv. **Whether the services were duplicative**
Internal Medicine Case Study
## Facts

Practice consists of 10 Physician and 6 Nurse Practitioners

| Contribution Margin on Physician Personally Performed Services is | 2,925,000 |
| Net Income of practice including revenue from Nurse Practitioners is | 3,705,000 |
| Physician Compensation in Private Practice per physician is | 370,500 |
| Average Work RVUs per physician is | 6,500 |

- Hospital is a not for profit hospital located in an urban community.
- Hospital desires to acquire the practice and employee the providers.
- Physicians are interesting in employment, but only if the hospital can match their current compensation.
The hospital has proposed the following arrangements to the physicians:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
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<tbody>
<tr>
<td>Base Compensation</td>
<td>273,000 per year</td>
</tr>
<tr>
<td>Bonus per WRVU in excess of required WRVUs</td>
<td>50</td>
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<tr>
<td>WRVUs required to earn the base</td>
<td>6,500</td>
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<tr>
<td>Signing Bonus</td>
<td>50,000</td>
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<tr>
<td>Supervision of Physician Extenders</td>
<td>15,000 per NNP</td>
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<tr>
<td>Medical Directorships</td>
<td>300 per hour</td>
</tr>
<tr>
<td>All Physicians guaranteed directorships of</td>
<td>60,000 per year</td>
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You have been asked to advise the hospital regarding this offer.
## Internal Medicine Facts

<table>
<thead>
<tr>
<th></th>
<th>Dr.</th>
<th>NPP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of Providers</td>
<td>10</td>
<td>6</td>
</tr>
<tr>
<td>Average WRVUs Produced</td>
<td>6,500</td>
<td>3,000</td>
</tr>
<tr>
<td>Total WRVUs Produced</td>
<td>65,000</td>
<td>18,000</td>
</tr>
<tr>
<td>Collections</td>
<td>6,500,000</td>
<td>1,800,000</td>
</tr>
<tr>
<td>Cost before Compensation</td>
<td>0.55</td>
<td>3,575,000</td>
</tr>
<tr>
<td>Net Income Before Compensation</td>
<td>2,925,000</td>
<td>1,200,000</td>
</tr>
<tr>
<td>NPP Compensation</td>
<td>70,000</td>
<td>420,000</td>
</tr>
<tr>
<td></td>
<td>780,000</td>
<td>780,000</td>
</tr>
<tr>
<td>Profit Accruing to Internists</td>
<td>780,000</td>
<td>(780,000)</td>
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<tr>
<td>Net Income Available for Compensation</td>
<td>3,705,000</td>
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## Internal Medicine Facts Continued...

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<tbody>
<tr>
<td>Compensation per WRVU without NPP profit</td>
<td>45</td>
<td>N/A</td>
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<tr>
<td>Compensation per WRVU with NPP profit</td>
<td>57</td>
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### Industry Data

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<tr>
<td>Median</td>
<td>42</td>
<td></td>
</tr>
<tr>
<td>75%</td>
<td>48</td>
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Discussion of Case One
Cardiology Case Study
History

- A five physician cardiology practice is currently practicing in an urban setting where the indigent population is higher than the industry norm. This is documented by the number of cases that the cardiologist do while on call for which they do not realize any reimbursement. They are not being paid for call.

- In addition, the practice acquired one nuclear camera at the beginning of last year and it has a long remaining life. Outpatient referrals from the physicians dropped significantly after they acquired the camera.

- The physicians currently are producing at a higher level than the industry median, but earning less than the median compensation for cardiologists. The Dr.’s are also experiencing a decrease in reimbursement for the technical revenue from their nuclear camera.
The physicians have approached the hospital, asking it to acquire the practice and employ them. They are 2nd generation physicians in a 35 year old practice and they remember when they bought in to the practice for $500,000 each 25 years ago. They believe that they provide the best and highest quality service in the community and that their patients are sicker than their peers. Therefore, in their view they are not comparable to the “average” physician.

The hospital is our client and has had some discussion with the physicians and then realized they should probably ask their attorneys if they can do what they have proposed.
They have made the following proposal:

1. Acquire the professional practice for book value of the assets without any goodwill.
2. Acquire the technical revenue stream for the discounted value of $4,000,000. (DCF Value of $1,000,000 a year into the future.)
3. Compensate the physicians at $55 per WRVU, plus an additional $5 per WRVU if the physicians meet certain quality criteria.
4. However, regardless of WRVUs produced, the hospital has agreed to guarantee the salaries for 5 years at $500,000.
5. Pay the physicians for call.
## Overview

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<th>Professional</th>
<th>Total</th>
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<tbody>
<tr>
<td>Revenue</td>
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<td>3,200,000</td>
<td>5,000,000</td>
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<td>Departmental Expenses</td>
<td>800,000</td>
<td>2,000,000</td>
<td>2,800,000</td>
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<tr>
<td>Income Available for Compensation</td>
<td>1,000,000</td>
<td>1,200,000</td>
<td>2,200,000</td>
</tr>
<tr>
<td># of WRVUs Performed</td>
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<td></td>
<td>55,000</td>
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<tr>
<td># of WRVUs Performed/Dr.</td>
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<td>11,000</td>
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<tr>
<td>Total Comp/WRVU</td>
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<td>40</td>
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<tr>
<td>Compensation per physician</td>
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<td>440,000</td>
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## Overview Continued...

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<td>Industry Median Comp/WRVU</td>
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<tr>
<td>Industry 75% Comp/WRVU</td>
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<td>Industry Median WRVUs</td>
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<td>Industry Median Compensation</td>
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<tr>
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Discussion of Case Two
Contact Information

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