HEALTH CAPITAL Topics

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Surviving Fair Market Value & Commercial Reasonableness Thresholds

There has been increasing regulatory scrutiny related to avoiding violations of federal fraud and abuse laws in transactions between healthcare providers. Included in this scrutiny are physician compensation arrangements which must be scrutinized under the traditional concept of Fair Market Value (FMV) *as well as* the complementary standard of *"commercial reasonableness*". For providers to meet one of several Stark Law exceptions and Anti-Kickback safe harbors, compensation arrangements are required to be at FMV *and* be commercially reasonable. If these two thresholds are not met, the Federal False Claims Act (FCA) may also be violated if a healthcare provider knowingly submits a claim for reimbursement to a government entity for services under compensations arrangements which are deemed to be Stark and Anti-Kickback violations.[1] Accordingly, compensation arrangements for physician and executive services (e.g. medical directorships) must be both at FMV *and* commercially reasonable to avoid liability under the Stark Law, the Anti-Kickback Statute, and the FCA.[2]

The test for *commercial reasonableness* is a threshold which is distinct from that of the standard of FMV. While FMV looks to the *reasonableness* of the "range of dollars" paid for a product or service, the standard of *commercial reasonableness* looks to the *reasonableness of the business arrangement generally*.[3] Consequently, a compensation arrangement may be simultaneously at FMV and also be determined to be *commercially unreasonable.*

Definition of Fair Market Value

Federal fraud laws define FMV somewhat differently than it is defined by traditional business valuation principles. Under Stark II Phase I, the Health Care Financing Administration (HCFA; now CMS) defined FMV "*the value in arm's-length transactions, consistent with general market value."*[4] Elaborating on that definition in 2001, HCFA provided the following guidance for determining when a payment for services provided is at FMV:

> *We believe the relevant comparison is aggregate compensation paid to physicians practicing in similar academic settings located in similar environments.* ***Relevant factors include geographic location, size of the academic institutions, scope of clinical and academic programs offered, and the nature of the local health care marketplace*** *. . . . we intend to accept any method [for establishing FMV] that is* ***commercially reasonable and provides us with evidence that the compensation is comparable to what is ordinarily paid for an item or service in the location at issue, by parties in arm's-length transactions who are not in a position to refer to one another*** *. . . . The amount of documentation that will be sufficient to confirm FMV . . . will vary depending on the circumstances in any given case; that is, there is no rule of thumb that will suffice for all situations.* [5]

In 2004, CMS noted that valuation methods under Stark Law "*must exclude valuation where the parties to the transaction are at arms-length but in a position to refer each other."*[6] Because FMV under Stark Law does not "*necessarily comport with the usage of the term in standard valuation techniques and methodologies,*"[7] a purely market-driven determination of FMV may not always be considered *commercially reasonable* for the purposes of federal fraud laws.[8] For example, even if an arrangement meets traditional FMV standards, if it does not meet commercial reasonableness standards, it may not withstand scrutiny under Stark.

FMV is also a critical requirement under several Anti-Kickback safe harbors.[9] While FMV is not specifically defined within the Anti-Kickback Statute,[10] the Office of Inspector General (OIG) has nevertheless provided guidance on this issue and stated (in the widely-circulated 1992 "Thornton Letter") that:

> "*When considering the question of FMV, we would note that the* ***traditional methods of economic valuation do not comport with the proscriptions of the Anti-Kickback statute****. Items ordinarily considered in determining the FMV may be expressly barred by the Anti-Kickback statute's prohibition against payments for referrals. Merely because another buyer may be willing to pay a particular price is not sufficient to render the price to be paid FMV. The fact that a buyer in the position to benefit from referrals is willing to pay a particular price may only be a reflection of the value of the referral stream that is likely to result from the purchase."*[11]

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What is Meant by the Term "Commercially Reasonable"?

The Department of Health and Human Services has interpreted "*commercially reasonable*" to mean that an arrangement appears to be "*a sensible, prudent business agreement, from the perspective of the particular parties involved, even in the absence of any potential referrals."*[12] The Stark II Phase II commentary also suggests 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 DHS referrals.*"[13]

Among the questions to consider in determining the *commercial reasonableness* of a compensation arrangement to meet a specific *business purpose* include: (1) is it necessary to have a physician perform a certain service?; and, (2) is it necessary to have a physician *of that specialty* perform a certain service? For example, the FMV compensation for more specialized physicians and surgeons is generally higher than that of general practitioners and non-physician practitioners. As a result, if a specialized physician is receiving compensation within the higher range of FMV to perform duties that a less skilled practitioner could perform for less compensation, the arrangement may not be deemed to be *commercially reasonable* despite the fact that it is within the range of FMV for that specialist. In such situations, there tends to be a presumption of fraud, unless the healthcare provider can show that using the specialty physician was reasonably necessary for specified reasons, e.g. due to his or her experience and moral authority, or that the position's requirements could not have been done sufficiently by a less-skilled practitioner.

To that end, the IRS has listed several specific factors to weigh in determining the *commercial reasonableness* of a physician compensation arrangement:

(1) Specialized training and experience of the physician;
(2) The nature of duties performed and the amount of responsibility;
(3) Time spent performing duties;
(4) Size of the organization;
(5) The physician's contribution to profits;
(6) National and local economic conditions;
(7) Time of year when compensation is determined;
(8) Whether the compensation is in part or in whole payment for a business or assets;
(9) Salary ranges for equally qualified physicians in comparable organizations.[14]

Another element which IRS assesses in determining whether compensation is reasonable is the independence of the board or committee that determines the physician compensation arrangement.[15]

Considerations of Commercial Reasonableness

With regard to FMV under Stark and Anti-Kickback, a 2002 Federal District court stated *"Payments exceeding FMV are in effect deemed 'payment for referrals."*[16] Later courts have developed more analytical approaches to determining if a compensation arrangement will survive Fraud and Abuse scrutiny, particularly by looking to whether physicians are actually performing the services outlined in the arrangement, e.g. whether they are working the volume of hours anticipated by the arrangement. In those circumstances where the physicians are not actually performing those services which are required within the scope of the compensation agreement, courts have found that the compensation arrangement does not meet standards of commercial reasonableness.[17] For this reason, a typical requirement of a medical director agreement, for example, is that contemporaneous logs are kept which document the number of actual hours worked, as well as the fulfillment of the tasks, duties, responsibilities and accountabilities which are mandated in the compensation agreement for that position.[18]

In a 2004 *qui tam* action, a more specific test to determine whether an arrangement is commercially reasonable was proposed by a government expert.[19] In *U.S. v. SCCI Hospital Houston,* a whistleblower suit which eventually settled, the U.S. challenged the *commercial reasonableness* of the compensation paid by the hospital to three physician medical directors.[20] In this case, the government's financial expert stated that *commercial reasonableness* depends on the agreement being *essential to the functioning of the hospital*.[21] The expert noted that in order to be commercially reasonable, there had to be *sound business reasons* for paying medical director fees to referring physicians.[22]

The expert in the *SCCI Hospital Houston* case looked to several factors in assessing *commercial reasonableness* including: (1) the size of the hospital, number of patients, patient acuity levels and patient needs; (2) the quality, activities and involvement of medical staff and the need for medical direction; (3) the number of regular committees and meetings that require physician involvement; and (4) the quality of hospital management and interdisciplinary coordination of patient services.[23]

The expert also stated that commercial reasonableness depends on the hospital performing a regular assessment of the actual duties performed by the medical directors, as well as assessing how effectively the medical director is performing his duties and whether there is a bona fide need for continuing the services.[24]

In 2000, the OIG issued a notice which suggested that an effective compliance program, whereby regular internal

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monitoring and auditing is conducted, may be an effective way to assure that services and items provided are considered to be *reasonable and necessary*, as well as whether any incentives for unnecessary services exist.[24] Reflecting the importance of *reasonable necessity,* the OIG determined in a 2007 Advisory Opinion that an on-call physician compensation arrangement which did not meet an Anti-Kickback safe harbor was nevertheless reasonable because the structure of the arrangement was tailored to the specific unmet needs of the hospital.[25]

In summary, compensation arrangements will likely be deemed "*commercially reasonable*" if they are FMV and, the arrangements list the actual duties being performed by the physician; those services are reasonably necessary to the provider based on the details of the situation; and, the services could not be adequately provided for less compensation.

During its engagements with prominent health law firms across the nation, Health Capital Consultants (HCC) regularly works with legal counsel to assess the rapidly changing regulatory environment related to the valuation of FMV and *commercial reasonableness* with respect to physician and executive compensation. For more information on HCC's expertise and capabilities in this area, contact HCC President, Robert James Cimasi, MHA, ASA, CBA, AVA, CM&AA at rcimasi@healthcapital.com, or call 1-800-FYI-VALU.

[1] 31 U.S.C. § 3729.
[2] "All Eyes on Physician-Hospital Arrangements," By Lewis Lefko, HealthLeaders Media, Jan. 24, 2008, www.healthleadersmedia.com (Accessed 9/18/2008).
[3] "Tread Carefully When Setting Fair Market Value: Stark Law Must Be Considered," Joyce Frieden, Nov. 1, 2003, *available at* http://findarticles.com/p/articles/mi_m0CYD/is_/ai_110804605 (Accessed 9/26/08).
[4] 66 Fed. Reg. 944 (Jan. 4, 2001).
[5] 66 Fed. Reg. 916, 944 (Jan. 4, 2001).
[6] 69 Fed. Reg. 16,107 (March 26, 2004).
[7] 69 Fed. Reg. 16,093 (March 26, 2004).
[8] "Successful Medical Practice Valuation," By Reed Tinsley, CPA, Physicians News Digest, July 2008, http://www.physiciansnews.com/business/708tinsley.html (Accessed 9/19/2008).
[9] "Fair Market Value: The Lawyer's Perspective," By Kimberley Elting, et. al., Health Care Compliance Forum, Oct. 2006. *See* 42 C.F.R. 1001.952.
[10] "Fair Market Value: The Lawyer's Perspective," By Kimberley Elting, et. al., Jones Day, Health Care Compliance Forum, Oct. 2006.
[11] Letter from D. McCarty Thorton, Associate General Counsel, Office of Inspector General (HHS) to T.J. Sullivan, Technical Assistant, office of the Associate Chief Counsel, Employee Benefits and Exempt Organizations, Dec. 22, 1992, http://www.oig.hhs.gov/fraud/docs/safeharborregulations/acquisition122292.htm (Accessed 9/24/2008).
[12] 63 Fed. Reg. 1700 (Jan. 9, 1998).
[13] 69 Fed. Reg. 16107 (March 26, 2004)
[14] "Physician Compensation Arrangements," By Daniel K. Zismer, 1999, pg 204.
[15] "Physician Compensation Arrangements," By Daniel K. Zismer, 1999, pg 205.
[16] *American Lithotripsy Society v. Thompson*, 215 F.Supp.2d 23, 27 (D.D.C. July 12, 2002).
[17] See United States of America ex rel. Roberts v. Aging Care Home Health, Inc., et al., 474 F.Supp. 2d 810, 818 (W.D. La. Feb. 16, 2007); see also United States v. Rogan, 459 F.Supp. 2d 692 (N.D. Ill. Sept. 29, 2006)
[18] "Fair Market Value in Healthcare Transactions," By: Lewis Lefko, Haynes & Boone, LLP, July 20, 2007.
[19] United States ex rel. Darryl L. Kaczmarczyk, et al. v. SCCI Health Services Corp., Civ. No. H-99-1031 (S.D. Tex. April 12, 2004).
[20] "Fair Market Value in Health Care Transactions," By Lewis Lefko, Haynes and Boone, LLP, July 20, 2007, http://www.worldservicesgroup.com/publications.asp?action=article&artid=2086 (Accessed 9/18/2008).
[21] "Fair Market Value in Health Care Transactions," By Lewis Lefko, Haynes and Boone, LLP, July 20, 2007, http://www.worldservicesgroup.com/publications.asp?action=article&artid=2086 (Accessed 9/18/2008).
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[23] "Fair Market Value in Health Care Transactions," By Lewis Lefko, Haynes and Boone, LLP, July 20, 2007, http://www.worldservicesgroup.com/publications.asp?action=article&artid=2086 (Accessed 9/18/2008).
[24] "Fair Market Value in Health Care Transactions," By Lewis Lefko, Haynes and Boone, LLP, July 20, 2007, http://www.worldservicesgroup.com/publications.asp?action=article&artid=2086 (Accessed 9/18/2008).
[24] "OIG Compliance Program For Individual and Small Group Physician Practices," Notice, 65 Fed. Reg. 59434 (Oct. 5, 2000).
[25] OIG Advisory Opinion No. 07-10, September 20, 2007, pg. 10.

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