PHYSICIAN ALIGNMENT:
LEGAL AND FAIR MARKET VALUE
COMPLIANCE

Health Care Compliance Association
17th Annual Compliance Institute
April 22, 2013

Donnessa Vessakosol
Strategic Value Group, LLC

Cheryl Camin Murray
Winstead PC
Presentation Overview

I. Current Factors Impacting Hospitals and Physician Groups
II. Alignment Strategies
III. Impact of Healthcare Reform
IV. Legal and Regulatory Guidance Impact
V. Overview of General Valuation Concepts
VI. Valuation Considerations for Transactions
VII. Questions and Answers
Current Factors Impacting Hospitals

• Remaining uncertainty regarding implementation of the PPACA

• Reimbursement challenges. Negative pressures on reimbursement include Federal cuts to medical spending and limited reimbursement increases from insurers

• Tepid economic growth and elevated unemployment dampening demand for healthcare

• Financial accountability for quality

• Competition for physicians coupled with shortages

• Consolidation of both providers and payors

• Compliance challenges

Current Factors Impacting Hospitals

Shift from Volume-based (Fee-for-service) to Value-based Payment Structure

- Fee for Service
- Episodic
- Condition-Based Chronic/Acute
- Primary Care Medical Home
- Global ACO
Current Factors Impacting Physician Practices

• Declining reimbursement
• Practice expenses continuing to climb
• Growing pressure to invest in EHR systems
• Difficulty recruiting new physicians
• Changing physician workforce expectations
• Physician employment by systems or hospital-owned groups is increasing (Specialists, PCP’s)
• Acquisition activity is high. Increased transaction activity related to physician-hospital alignment, hospital affiliations and other cooperative structures
• More complicated transactions

Source: HSC Issue Brief, May 2011
Current Market Dynamics
Physician Practices

Number of Announced Physician Medical Group Transactions

- 2008: 37
- 2009: 29
- 2010: 40
- 2011: 53

Alignment Strategies

- A **limited alignment** describes an arrangement where the relationship is relatively easy to unwind.
- A **moderate alignment** is a more complex relationship. It typically involves some financial risk by both parties and is more difficult to unwind than a limited alignment.
- A **full alignment** describes the most comprehensive form of alignment in which the physicians are hired as employees of the hospital or health system or have a contractual relationship, typically involving some exclusivity or noncompetition terms.

<table>
<thead>
<tr>
<th>Limited Alignment</th>
<th>Moderate Alignment</th>
<th>Full Alignment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Affiliated</td>
<td>Fully Integrated</td>
<td></td>
</tr>
</tbody>
</table>
# Alignment Strategies

<table>
<thead>
<tr>
<th>Type of Alignment</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Limited Alignment</td>
<td>Call Coverage&lt;br&gt;Medical Directorships&lt;br&gt;IPA/PHO&lt;br&gt;Pay for Quality</td>
</tr>
<tr>
<td>Moderate Alignment</td>
<td>MSO&lt;br&gt;Joint Venture&lt;br&gt;Co-Management&lt;br&gt;Professional Services Agreement&lt;br&gt;Lease Arrangement&lt;br&gt;ACO</td>
</tr>
<tr>
<td>Full Alignment</td>
<td>Physician Employment&lt;br&gt;Practice Acquisition</td>
</tr>
</tbody>
</table>
Physician Alignment Pitfalls

• Lack of awareness of how physicians impact finances and value
• Management not willing to share power with physicians
• Physician leadership won't adjust to new circumstances
• Lack of governance roles for physicians
• Not all models work for all physician groups
• Failure to perform adequate due diligence
• Over promise and under deliver
Health Care Reform’s Impact on Physician and Hospital Alignment Strategies

Increased interest in aligning the interests of physicians and hospitals:

• Physicians may no longer invest in hospitals
• Hospitals continue to employ physicians
• Hospitals continue to purchase ancillary services owned by physicians
• Incentives for hospitals to coordinate care and payment with physicians (i.e., bundled payments and accountable care organizations)
Unique Legal Issues: 

Overview

- Federal Anti-Kickback Statute
- Federal Stark Law
- Medicare/Medicaid
- HIPAA
- State Laws
  - Licensure
  - Fee-Splitting
  - Corporate Practice of Medicine
Unique Legal Issues:  
**Anti-Kickback Statute**

- Makes it illegal for any person to knowingly and willfully pay or receive any compensation in return for:
  - a referral for any item or service paid for by a federal health care program; or
  - purchasing, leasing or ordering any good, facility, service or item paid for by a federal health care program.

(42 U.S.C. §1320a-7b(b) and implementing regulations at 42 C.F.R. §1001.952)
Unique Legal Issues: 
*Anti-Kickback Safe Harbors*

- Rental of space or equipment
- Personal services and management contracts
- Sale of practice
- Amounts paid by employers to employees with bona fide employment relationships
- Practitioner recruitment
- Small investment interests
- Investments in a group practice
- Ambulatory surgical centers
Unique Legal Issues: Stark Law Prohibition

- Prohibits a physician from making referrals for “designated health services” to entities with which the physician or immediate family member has a direct or indirect financial relationship.
- Only applies to Medicare Designated Health Services (or DHS).
- Intent is not a factor—strict liability.
Unique Legal Issues: Stark Law Exceptions

- Rental of office space or equipment
- Bona fide employment relationships
- Personal service arrangements
- Physician recruitment
- Isolated transactions
- Group practice and in-office ancillary services
- Fair market value compensation
- Specific providers
Bona Fide Employment Relationships

*Bona fide employment relationships*:  
(1) The employment is for identifiable services.  
(2) The amount of the remuneration under the employment is:  
   (i) consistent with *fair market value*; and  
   (ii) not determined in a manner that takes into account (directly or indirectly) the volume or value of any referrals by the referring physician.  
(3) The remuneration is provided under an agreement that would be *commercially reasonable* even if no referrals were made to the employer.
Compensation Stacking Issues

Multiple Compensation Arrangements:

• Salaried Physician
• Independent Contractor and Medical Director Agreements
• Service Line Co-Management Arrangements
• On-Call Services
• Need FMV Policies and Procedures
Bradford Regional Medical Center

- Hospital subleased a nuclear camera from a practice
- Compensation was not fair market value
- Violated the Stark Law because the arrangement took into account anticipated referrals
Tuomey Medical Center

- Violated Stark Law for part-time employment agreements
- Had third-party determination of fair market value
- Ordered to repay $45 million in medical reimbursement
North Ridge Medical Center

- Employed 12 physicians with compensation in excess of FMV
- Compensation nearly doubled physicians’ previous income
- Post-hire referrals increased
- Stark Law violations
- Exception for employment arrangements requires compensation be FMV, commercially reasonable, and not take into account the volume or value of referrals
Covenant Medical Center

• Covenant paid five employed physicians amounts that the government alleged were above fair market value and were not commercially reasonable.
• Defendants claimed the compensation formulas were based on personally performed services and consistent with FMV.
• DOJ claimed the physicians salaries were among the highest in the country.
• In 2009, Covenant paid $4.5 million to settle the False Claims Act allegations, based on the underlying Stark Law violations.
Unique Legal Issues: 

*State Laws*

- Requirements vary by state
- State corporate, licensure and privacy laws
- Fee-splitting statutes
- Corporate practice of medicine
- Anti-referral laws
Tax Exempt Hospital Restrictions

• Internal Revenue Code 501(c)(3) Exemption Standards
  • No private inurement
  • Only incidental private benefit

• Intermediate Sanctions
  • Excess benefit for disqualified person
  • Presumption of reasonableness
Compliance Uses of Valuation

• Valuation engagements for compliance reasons often originate from Hospital or Physician Group Legal Counsel (internal and/or external) or Compliance Officer

• Ensure compliance with laws and regulations including Stark, Anti-Kickback, Private Benefit, Inurement and Commercial Reasonableness.

• Important to note there may be a difference between Business use of valuation and Compliance use.
## Standard(s) of Value

<table>
<thead>
<tr>
<th>Fair Market Value</th>
<th>Tax Purposes, Seller Advisory, Management Decision-Making</th>
</tr>
</thead>
<tbody>
<tr>
<td>• “...the price at which the property would change hands between a willing seller and a willing buyer neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts.” Revenue Ruling 59-60</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Fair Market Value</th>
<th>Regulatory Stark and Anti-Kickback Statute Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>• “means the value in arm’s-length transactions, consistent with the general market value. General market value means “the price that an asset would bring as the result of bona fide bargaining between well-informed buyers and sellers who are not otherwise in a position to generate business for the other party, or 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.” § 411.351 42 CFR</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Fair Value</th>
<th>Financial Reporting</th>
</tr>
</thead>
<tbody>
<tr>
<td>• “Price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.” ASC 820 (fka SFAS 157)</td>
<td></td>
</tr>
</tbody>
</table>
# Standard(s) of Value

<table>
<thead>
<tr>
<th>Investment Value</th>
<th>Strategic and Financial Investors</th>
</tr>
</thead>
<tbody>
<tr>
<td>• “The value to a particular investor based on individual investment requirements and expectations.” ASA BV Standards</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Reasonable Compensation</th>
<th>Regulatory Stark and Anti-Kickback Statute Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>• “the amount that would ordinarily be paid for like services by like organizations in like circumstances” Reg. 1.162-7(b)(3)</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Fair Market Value to Beneficiary</th>
<th>Value to a Medicare or Medicaid beneficiary to influence provider selection</th>
</tr>
</thead>
<tbody>
<tr>
<td>• “transfers of items or services for free or for other than fair market value” Sec 1128A(a)(5) of the Social Security Act</td>
<td></td>
</tr>
<tr>
<td>• Fair market value is based on the value to the beneficiary according to OIG Advisory Opinion 06-01</td>
<td></td>
</tr>
</tbody>
</table>
## Potential Valuation Methods

<table>
<thead>
<tr>
<th>Alignment Example</th>
<th>Income Approach</th>
<th>Market Approach</th>
<th>Cost Approach</th>
</tr>
</thead>
<tbody>
<tr>
<td>Call Coverage</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Medical Director</td>
<td></td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Pay for Quality</td>
<td></td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>MSO</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Joint Venture</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Co-Management</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Professional Services Agreement</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Lease Arrangement</td>
<td></td>
<td>X</td>
<td>X</td>
</tr>
</tbody>
</table>
## Valuation Methods

<table>
<thead>
<tr>
<th></th>
<th>Income Approach</th>
<th>Market Approach</th>
<th>Cost Approach</th>
</tr>
</thead>
<tbody>
<tr>
<td>ACO</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Physician Employment</td>
<td>X</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Practice Acquisition</td>
<td>X</td>
<td></td>
<td>X</td>
</tr>
</tbody>
</table>

Note: Not all approaches listed above are applicable in all situations.
Utilizing the Valuation

• Note the scope of work performed – a valuation is not a replacement for due diligence.

• Make sure that valuation is consistent with the final terms of the transaction.

• Realize that the purchase price may be set by a valuation and not negotiated in the same context as in other industries.

• Be prepared for greater post-transaction scrutiny from valuation experts, auditors and regulatory officials.
Key Considerations

• Structure of the Transaction
• Asset vs. Equity
• Determination of what assets and liabilities are included
• Go forward Physician Compensation Unit of Measure
  – Different valuation methods for different assets and payment streams
  – Staged transactions
  – More complex transactions with multiple components
  – Sum of the parts versus the whole; premise of value
  – Reasonableness/Sanity check
Key Considerations

• Consistency between analysis and go-forward agreements such as physician compensation and other service agreements
• Accounting for transactions may create numbers that are different from Compliance valuation
• Definition of Goodwill (valuation definition vs. healthcare definition)
• Intangible value relative to DCF
DISCLAIMER

• These materials should not be considered as, or as a substitute for, legal or valuation advice; and they are not intended to nor do they create an attorney-client relationship.

• Since the materials included here are general, they may not apply to your individual legal or factual circumstances.

• You should not take (or refrain from taking) any action based on the information you obtain from these materials without first obtaining legal counsel or professional advice.

• The views expressed in this presentation do not necessarily reflect those of the firms, or their respective lawyers, professionals or clients.
**Donnessa Vessakosol** is a Manager with Strategic Value Group, LLC, a valuation advisory firm, which specializes in healthcare related valuation for transactional, compliance and financial reporting purposes. Ms. Vessakosol has extensive experience in healthcare-related reimbursement, operations, financial analysis, physician compensation, mergers and acquisitions, and valuation.

**Cheryl Camin Murray** is a Shareholder in Winstead’s Healthcare Industry Group as well as the Corporate, Securities/Mergers & Acquisitions Practice Group. Her practice focuses on healthcare matters, advising providers and businesses on entity formation and structural, contractual and regulatory healthcare issues. Cheryl’s experience includes counseling clients on fraud and abuse, illegal remuneration, HIPAA, the HITECH Act, and Stark Law matters as well as compliance with other state and federal health laws.
Questions and Answers

Donnessa Vessakosol
dvessakosol@strategicvaluegroup.com
(214) 432-2131

Cheryl Camin Murray
cmurray@winstead.com
(214) 745-5142