What's FMV Got to Do With It?
The Role of Fair Market Value in Physician Employment Arrangements

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Overarching Hypothetical

• Assume:
  • Community-based, non-profit health system ("System") with several hospitals
  • System's physician growth and alignment strategy committee and the CEO of one of the System's wholly-controlled hospitals ("Hospital") desire to employ physician specialist ("Physician")
  • Hospital has an affiliate:
    • An organization, which (1) is wholly controlled by System, and (2) serves as the System's principal "physician organization" ("Phy. Org."), meaning that it employs many of the physicians on the Hospital's medical staff
  • State law also permits Hospital to employ physicians directly, and some physicians are in fact employed directly by the Hospital
  • Thus, the System has two legitimate options: employ Physician through Hospital or through Phy. Org.
Overarching Hypothetical (cont’d)

- Questions?
  1. Does it matter which option System selects for employing Physician?
  2. What if: Physician demands a flat fee salary of $1,200,000, but independent valuation company issues written report, stating that based on its review of national compensation surveys and Physician’s historic productivity (as measured by personally worked relative value units, "worked RVUs"), it could support – as being consistent with fair market value ("FMV") – aggregate compensation of $1,075,000 per annum, which would place the Physician just above the 75th percentile for compensation in the Physician’s specialty on a nationwide basis, provided, however, Physician achieves a personal productivity threshold at or around the 75th percentile or above?
  3. What if: Physician’s aggregate compensation will be comprised of two components: (a) flat fee of $800,000 and (b) personal productivity bonus equal to 10 percent of bonus pool comprised of net revenue of Physician’s clinical department at Hospital, subject to a maximum total cap of $1,200,000?

Anti-Kickback Statute (42 U.S.C. § 1320a-7b(b))

- Prohibition: Unlawful for one person, knowingly and willfully, to offer/pay (or solicit/accept) remuneration to a second person to induce it/him/her to refer patients/generate business that is covered, in whole or in part, by a Federal health care program.
- Elements:
  • State of mind: knowingly and willfully (U.S. ex rel. Starks)
  • Inducement: "one purpose" test
  • Conduct: to refer, order, purchase, lease, recommend or arrange for
  • Covered Items/Services: Paid for, in whole/in part by a Federal health care program
- Exceptions/Safe Harbors: Immunity
- Risk analysis/Policy objectives: (1) overutilization/increased program costs; (2) patient freedom of choice; (3) market competition and (4) patient access to care
Anti-Kickback Statute: Employment Exception and Safe Harbor

- **Statutory exception**, 42 U.S.C. § 1320a-7b(b)(3) = AKS prohibitions do not apply to “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”

- **Regulatory exception** (42 C.F.R. § 411.357(c)) = “remuneration” does not include “any amount paid by an employer to an employee, who has a *bona fide* employment relationship with the employer, for employment in the furnishing of an item or service for which payment made be made in whole or in part under Medicare, Medicaid or other Federal health care programs”

- Term “employee” has the definition set forth in Section 3121(d)(2) of the Internal Revenue Code

- IRS has developed a 20-factor test to determine who is a *bona fide* employee

  - Focus on employer “control” and “direction”


- Two prohibitions.
  1. **Referral Prohibition.** A physician may not refer a patient to an entity for the furnishing of certain designated health services (“DHS”) that may be paid by Medicare, and
  2. **Billing Prohibition.** The entity may not bill Medicare or anyone else for DHS provided to such improperly referred patients, if
     - A financial relationship exists between the physician and the entity; and
     - No statutory or regulatory exception applies
Stark Law: Overview (cont’d)

- Observations.
  1. DHS = hospital inpatient and outpatient services (other than lithotripsy)
  2. Financial relationship = sin qua non of Stark Law
     - direct or indirect and may take the form of ownership/investment interests or compensation arrangements
     - Violation can result in refund obligations, various civil monetary penalties, and permissive program exclusion
     - Also may give rise to civil False Claims Act (“FCA”) cause of action: claim for reimbursement that violates the Stark Law’s billing prohibition is inherently false (present and/or cause to present)
     - Failure to refund may trigger reverse false claim liability

Stark Law: Compensation Arrangements

- A direct compensation arrangement involves an direct exchange of “remuneration” between physician and DHS Entity, meaning that there is no "intervening person or entity" between them, 42 C.F.R. § 411.354(c)(1)
  - "Stand in the Shoes" provisions (effective December 4, 2007): a physician-owner of a "physician organization" (e.g., a group practice) is deemed to stand in the shoes of his/her physician organization for purposes of physician organization’s compensation arrangements
  - Effect? Causes physician practice not to serve as an "intervening entity" with respect to physician owners of practice
  - If there is one or more intervening entity/person(s), then arrangement cannot be direct
Indirect Compensation Arrangement: Definition

• An indirect compensation arrangement exists if three separate requirements are met, 42 C.F.R. § 411.354(c)(2)
  1. There is an unbroken chain of two or more "financial relationships" between the referring physician and the DHS entity
  2. The aggregate compensation (in the compensation arrangement closest to the physician) "varies with or takes into account" the "volume or value of referrals or other business generated" (the "Volume/Value standard") between the referring physician and the DHS Entity
  3. The DHS Entity knows or should know that prong #2 above is satisfied

Stark Law: Special Rules on Compensation

• Unit-Based (including Percentage-Based) Payment Methodologies, such as $55 per worked RVUs or 10 percent of net sales or net earnings
• Satisfy the "set in advance" standard, and
• Do not trigger the Volume/Value standard
  • provided that (1) the unit or percentage value is consistent with fair market value ("FMV"), and (2) the unit or percentage does not vary during the term of the arrangement in a manner that reflects the volume/value of referrals or other business generated, 42 C.F.R. § 411.354(d)
Stark Law: Special Rules on Compensation (cont’d)

• An employer, consistent with the common law duty of loyalty owed by an employee to his/her employer, may require its employee to refer patients to the employer and/or its provider/supplier/practitioner network, provided certain safeguards are honored, 42 C.F.R. § 411.354(d)(4)
  - Safeguards include, for example:
    • Written employment agreement that includes requirement
    • Referral requirement must give way to:
      • Patient’s best clinical interests
      • Patient’s freedom of choice
      • Payor/managed care network preferences/limitations

Stark Law: Employment Exception (42 C.F.R. § 411.357(c))

• Arrangement must be for identifiable services
• Arrangement must be commercially reasonable, even in absence of referrals
• Arrangement must provide for:
  • compensation which is fair market value, and
  • which is determined in a manner that does not take the volume/value of physician-employee’s referrals into account
• Note. Employer may pay employee a productivity bonus based on employee’s personally performed services
Stark Law: Indirect Compensation Arrangements Exception (42 C.F.R. 411.357(p))

• Closest compensation arrangement to the referring physician must be:
  • For identifiable services
  • Commercially reasonable, even in absence of referrals
  • Fair market value for items/services actually provided

• Moreover, the compensation itself must not be determined in a manner that takes into account the volume/value of referrals or other business generated for the DHS entity

• Finally, overall arrangement cannot violate the Anti-Kickback Statute or rules/regulations governing billing/claims submission

Halifax Medical Center: A Case Study

• United States of America ex rel. Baklid-Kunz v. Halifax Hospital Medical Center, et al. (“Halifax”)
  • No. 6:09-CV-1002-ORL-31 DAB (M.D. Fla. 2009)
Halifax Medical Center: Diagram

Halifax Physician Employee Compensation

- Base salary
- Incentive compensation
  - Bonus pool for medical oncologist employees was funded using monies from the operating margin of Halifax’s Medical Oncology program
  - Specifically, the parties agreed to allocate 15 percent of the operating margin, if any, to an incentive bonus pool for the medical oncologist employees
  - Once the pool was established, Halifax Staffing Company allocated it among the medical oncologists based on their relative productivity, as measured by each physician’s personally performed professional services
Halifax: Defense Strategy/Dilemma

- Eliminate Halifax Staffing Company, Inc. on grounds that it is a mere “instrumentality” of Halifax Hospital Medical Center versus presenting Halifax Staffing Company, Inc. as a separate and distinct legal entity?
  - The former enabled Halifax's attorneys to argue the physicians are direct employees of Halifax Hospital Medical Center, thereby placing their compensation squarely within the ambit of the broadly worded AKS exception and safe harbor for payments by an employer to a *bona fide* employee
  - The latter would have permitted the defense to try to take advantage of the flexibilities inherent to the Indirect Compensation Arrangements definition and exception under the Stark Law
- Defense chose former strategy
- Court stated that, ultimately, it was a difference with no meaning because the applicable exceptions had essentially overlapping requirements
Halifax: Court’s AKS Ruling

• Defense contended that physicians (e.g., medical oncologists) were *de facto bona fide* employees of Halifax Hospital Medical Center
• Defense: Compensation including incentive bonus payments protected by AKS exception/safe harbor for “any amounts” paid by employer to its *bona fide* employees
• Relator: Exception/safe harbor do not protect outright payments for referrals
• Court:
  • In an Order dated November 26, 2013, granted summary judgment in favor of Halifax Hospital Medical Center with respect to the AKS allegations, ruling that relator’s position would eviscerate the AKS’s *bona fide* employment exception and safe harbor
  • In sum, AKS exception/safe harbor protect payments to *bona fide* employees even if payments are expressly for referrals

Halifax: Court AKS Ruling (cont’d)

• In determining whether the AKS exception/safe harbor applied, Halifax Court undertook two step analysis:
  • First, were medical oncologists *bona fide* employees?
    • Court ruled that the term “employee” has the definition set forth in Section 3121(d)(2) of the Internal Revenue Code, which focuses on the right to “control” and “direct” the individual, not just regarding what gets done, but also about how it gets done
    • Although IRS focuses on a 20 factor test, Court enumerated 25 separate factors to consider in the totality
  • Note: Neither the 20 factor nor the 25 factor test mentions *fair market value*
Halifax: Court AKS Ruling (cont’d)

- **Second**, Court followed long-standing proposition that, consistent with the common law duty of loyalty, an employer is entitled to control and direct its physician-employees referrals
- HHS-OIG Advisory Opinion (04-09) (favorable opinion regarding $50 per hour payment for services to employed physicians in a position to refer patients)
- HHS-OIG Advisory Opinion (09-02) (favorable opinion regarding payment by outpatient mental health clinic to employed professional counselor, even though payment was based not only on counselor’s revenues, but those of clinic as a whole)
- HHS-OIG Advisory Opinion (98-09) (favorable opinion regarding hospital’s proposal to pay employed non-physician clinicians a bonus based on the number of inpatient hospital admissions they can bring about)
- Text of the AKS exception: “any amount”
- So, what is DOJ and valuators doing – delta theory

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Halifax: Court AKS Ruling (cont’d)

  - Qui tam relator challenged health system’s decision to compensate employed physician’s based on the volume of his referrals
  - Court ruled:
    - “AKS does not "prohibit[ ] hospitals from requiring that employee physicians refer patients to that hospital," 211 F. 2d Supp. at 1050
    - AKS does not prohibit hospitals from paying employed-physicians for patient referrals.  Id. at 1050
Halifax: AKS Observations

• Observations
  • An employer can mandate employee’s referrals
  • An employer can pay for employee’s referrals
  • Bona fide employee is defined without regard to quantum of payment or fair market value ceiling
  • Does it really hold that an employee ceases to become a bona fide employee because, in government’s view, he or she is paid too much?
  • As an initial matter, statutory and regulatory immunity is extended to “any amount,” NOT an amount that is consistent with fair market value
  • Moreover, why is it okay to pay some amount of money for referrals, but not a lot of money for referrals?

Overarching Hypothetical

• Refresher. What if: Physician’s aggregate compensation will be comprised of two components: (a) Flat fee of $750,000, and (b) personal productivity bonus equal to 10 percent of bonus pool comprised of net revenue of Physician’s clinical department at Hospital, subject to a maximum total cap of $1,200,000? Third party valuation report supports $1,050,000.
• Conventional wisdom (based on some notorious settlements) suggests that Health System, Phy. Org. or Staffing Company should not agree to pay physician $1,200,000. But why?
• Standard response: if physician is compensated in an amount that exceeds fair market value then, by definition, he or she is not being paid for services rendered, but for referrals.
Overarching Hypothetical (cont’d)

- Contrary viewpoint:
  - Third party valuation is not the equivalent of the market; it is a proxy of the market
  - Account for increased conservatism among valuators
  - Exception and safe harbor use words, “any amount”
  - Effort to “write in” FMV is inappropriate and arguably *ultra vires*
  - Congress and HHS-OIG know how to expressly require FMV
  - Neither common law nor IRS precedent look to FMV as an index of whether an individual is or is not a *bona fide* employee.
  - Courts and HHS-OIG have made it quite clear that when it comes to a *bona fide* employee, employer may require and pay for referrals

Stark Law Analysis

- Overarching Hypothetical asks whether it makes a difference which entity employs the referring physician
- *Halifax* litigants and Court downplayed the difference
- Under Stark Law, however, there potentially is a world of difference
  - Halifax Hospital Medical Center had/has no physician owners
  - “Financial relationship”, if any, had to take the form of a *direct* or an *indirect* compensation arrangement
  - Government pled/argued in the alternative
  - Defense counsel argued that Halifax Staffing Company was not an “intervening entity,” but an instrumentality that should be collapsed into Halifax Hospital Medical Center
  - Court accepted defense’s position
Stark Law Analysis (cont’d)

- Given Halifax Hospital Medical Center’s position, Stark Law analysis turned to the direct compensation arrangement between Halifax Hospital Medical Center and the medical oncologists -- i.e., the base salary and incentive bonus.
- Defense argued that incentive bonus fit squarely within the statutory and regulatory carve out, which states that an employee’s compensation is not determined in a manner that takes into account for purposes of the bona fide employment exception if it takes the form of a productivity bonus based on services performed personally by the referring physician.
- Court rejected the argument on the grounds that bonus was not “based on services performed personally”; rather, it was it was “divided up” based on services personally performed.

Stark Law Analysis (cont’d)

- What appears to have bothered the Court in Halifax is that the size of the bonus pool would vary with the volume/value of the medical oncologists’ referrals to Halifax Hospital Medical Center.
- In other words, the source of the monies to pay the bonus was not only the Hospital’s collections for professional component services, but also facility fees (i.e., DHS) generated as a result of the medical oncologists’ referrals.
- The problem with that particular logic, however, is that is always the case whenever a DHS entity (such as a hospital) offers to pay a physician-employee compensation.
- Specifically, because money is fungible, and because a hospital, by way of example, derives the majority of its revenues from facility fees, the rationale of the Halifax Medical Hospital Court would eviscerate the vast majority of hospital-physician employee compensation arrangements, including those that are structured on an exclusively flat fee basis.
Stark Law Analysis (cont’d)

• By accepting Halifax’s position regarding the Halifax Staffing Company, Court focused on the private aspects of a litigation – i.e., to resolve a dispute between a small handful of litigants

• But, Court also has an obligation to attend to the public aspects of a dispute, namely, to uphold and maintain the law

• At the time CMS considered and adopted the physician stand in the shoes provisions, it also considered whether to adopt organizational stand in the shoes provisions
  • The latter doctrine would allow a parent company to be collapsed into and become as one with its wholly-owned DHS entity
  • Thus, under that proposed doctrine, the Halifax Staffing Company and Halifax Hospital Medical Center would collapse into one another
  • The organizational stand in the shoes doctrine was ultimately rejected, however, raising the question whether a private litigant may essentially revive it because of a strategy that it believed suited its objectives?

Stark Law Analysis (cont’d)

• Arguably, Court should have held Halifax Hospital to its own corporate structure, meaning that the Staffing Company should have been treated as an “intervening entity” between the referring medical oncologists and Halifax Hospital Medical Center

• In that event, the financial relationship between and among the parties would have to take the form of an indirect compensation arrangement (“ICA”) or nothing at all
Stark Law Analysis (cont’d)

• As noted above, the definition of an ICA has three requirements.
  • Prong #1. An unbroken chain of financial relationships is met through the chain: Hospital ➔ Staffing Company ➔ Medical Oncologist
  • Prong #2. Arguably, this prong is met because, in the aggregate, the size of the bonus pool and, derivatively, the size of each individual bonus varies with the volume/value of the referrals of the medical oncologists
  • Prong #3. A bit of a toss up, depending on analyses performed by Hospital and its counsel, including any legal advice it may have received
• Assuming, for sake of argument, that ICA Definition is satisfied, then, the analysis turns to whether “financial relationship” satisfies the requirements of a statutory or regulatory exception

Stark Law Analysis (cont’d)

• ICA Exception:
  • Closest compensation arrangement to the referring physician (i.e., the salary/incentive bonus) is:
    • For identifiable services (✓)
    • Commercially reasonable, even in absence of referrals (✓)
    • Fair market value for items/services actually provided (✓)
  • Overall arrangement does not violate the Anti-Kickback Statute or rules/regulations governing billing/claims submission (✓)
  • And, the compensation itself must not be determined in a manner that takes into account the volume/value of referrals or other business generated for the DHS entity
Stark Law Analysis (cont’d)

• **ICA Exception:**
• This leaves one last question: is the compensation determined in a manner that takes into account the volume/value of referrals or other business generated for the DHS entity?
• Not the same inquiry as ICA Definition because in this context:
  • We do not have to contend with the words “vary with”
  • We do not have to contend with the word “aggregate”
  • We can rely on “special rules on compensation”

Stark Law Analysis (cont’d)

• **Unit-Based (including percentage-based) payment methodologies, such as a physician’s pro rata share (i.e., percentage) of a bonus pool does not “take into account the volume or value of referrals or other business generated”**
  • provided that (1) the unit or percentage value is consistent with fair market value (“FMV”), and (2) the unit or percentage does not vary during the term of the arrangement in a manner that reflects the volume/value of referrals or other business generated, 42 C.F.R. § 411.354(d)(2), 411.354(d)(3)
  • In Halifax, the percentage varied from year to year, but the variance was based on each physician’s personally performed services, which, by definition, do not constitute “referrals” or “other business generated”
• According to CMS, the statute in general and the special rules in particular permit a percentage based payment methodology for personal services “even when the physician receives the payment through a DHS referral, as long as as the individual payment is set at fair market value at the inception of the arrangement and does not subsequently change during the term of the arrangement in a manner that takes into account DHS referrals.” 69 Fed. Reg. 16054, 16068 (March 26, 2004)

Final Review of Overarching Hypothetical

• Physician demands a flat fee salary of $1,200,000, but independent valuation company issues written report, stating that it could support -- as being consistent with fair market value (“FMV”) -- aggregate compensation of $1,075,000 per annum, which would place the Physician just above the 75th percentile for compensation in the Physician's specialty on a nationwide basis.
• Overarching Hypothetical asks whether it makes a difference which entity employs the referring physician
• We have studied the Halifax approach.
• But, what if Physician were hired as a bona fide employee of Phy. Org.?
• In that event, Phy. Org would serve as an “intervening entity” and the inquiry would turn on whether Phy. Org.’s aggregate compensation to the physician “varies with or takes into account” the “volume or value of referrals or other business generated” between the referring physician and the DHS Entity
Final Review of Overarching Hypothetical

- $1,200,000 per annum is a flat fee and, by definition, does not vary with anything?
- But, does it in the aggregate take the volume/value standard into account?
- Theories:
  - Required referrals (42 C.F.R. § 411.354(d)(4))
  - CMS has taken the position in preamble that a flat payment could trigger the Volume/Value standard if it exceeds FMV
  - This remains untested in the courts
  - Moreover, its application to employed-physicians in light of 42 C.F.R. § 411.354(d)(4) is dubious at best

Thank you

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