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Understanding Fair Market Value Compensation and Commercial Reasonableness

These Regulations, If Violated, Can Cause Serious Problems for Neurosurgeons and the Entities with Which They Contract

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Financial relationships between hospitals and physicians must be both commercially reasonable (CR) and at fair market value (FMV) to meet certain regulatory requirements. Ensuring compliance with these requirements is critical; involved parties who fail to do so may be subject to sanctions and penalties under the Stark Law, the Federal Anti-Kickback Statute (AKS), the False Claims Act (FCA), and Internal Revenue Service (IRS) 501(c)(3) status for tax-exempt organizations.

For example, a 2014 case examined employment compensation and bonus agreements between three neurosurgeons and six medical oncologists at a Florida hospital. The government, through a whistleblower, alleged that the agreements exceeded FMV and were not CR. The hospital ultimately reached an $85 million settlement with the government to resolve the allegations. That is an exorbitant cost for any health system to bear.

Often, when such cases surface, two primary questions come to mind: What does it mean for compensation agreements to be FMV and CR? How do these concepts apply to me as a practicing neurosurgeon?

Generally speaking, transactions between potential referral sources must be consistent with both FMV and CR. An analysis of a transaction may determine that it is FMV but not CR, or vice versa, at which point the transaction would be non-compliant. All types of healthcare providers—physicians, advanced practice providers, imaging providers, pharmaceutical and device manufacturers, hospitals, home health agencies, and skilled nursing facilities, among others—are affected by FMV and CR.

Federal regulations and the IRS provide the ground rules and definitions for FMV: The transaction must be at arm's length in an open and unrestricted market, with bona fide bargaining between a willing buyer and a willing seller where neither is under compulsion to buy or sell. In healthcare, FMV cannot consider the volume or value of anticipated or actual referrals. In other words, when determining FMV, no consideration for post-transaction buyer synergies are considered, even though such synergies often exist.

Interestingly, regulatory guidance for determining FMV is not prescriptive. The guidance merely indicates that a valuator should use multiple, objective compensation surveys, such as those published by the American Medical Group Association, the Medical Group Management Association, SullivanCotter and others. Regulatory guidance further indicates that clinical compensation rates should be used for clinical services, while administrative rates should be used for administrative services.

FMV cautions for neurosurgeons

A neurosurgeon entering into an agreement with a potential referral source (for example, an arrangement between a hospital and a physician for clinical, administrative, or call coverage services) needs to understand that his or her ability to generate revenue for the other party via referrals should not be considered in determining the level of compensation paid. In general, neurosurgeon

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compensation should be valued based on the market where the services are provided, along with the neurosurgeon's level of skill, effort, time, quality, and reputation. Valuation of physician compensation is based on the individual facts and assumptions of the arrangement. It's important to note that no two arrangements are alike.

Examples of compensation that may not be FMV compliant include:

- Excess compensation in the form of benefits, where the excess benefits added to the neurosurgeon compensation exceed FMV.
- High compensation associated disproportionately with productivity, where the neurosurgeon is producing at a low level and paid at a high level when compared to peers, without qualitative factors to support the productivity-to-compensation differential.
- Unusual compensation, where the types of compensation paid to the neurosurgeon are not consistent with other employed neurosurgeons or other employed physicians.
- Risk-free sign-on bonuses, where a neurosurgeon receives a sign-on bonus exceeding market levels, with no requirement to pay back that bonus if the neurosurgeon leaves employment after a short period of time.

The Centers for Medicare and Medicaid Services (CMS) considers an arrangement commercially reasonable in the absence of referrals if the arrangement would make commercial sense if it meets these requirements: It's entered into by a reasonable entity, of similar type and size, and a reasonable physician (or family member or group practice), of similar scope and specialty, even if there were no potential referrals. In theory, most business transactions must be CR, or there would be no reason for them to occur. While CR assesses the overall arrangement, including the qualitative considerations such as strategy and operations, FMV primarily assesses the financial aspects of the arrangement, such as the range of dollars.

CR is typically analyzed in five parts. These include business purpose, provider, facility, resources, and independence and oversight. A valuator will ask the following questions, among others, when conducting the analysis:

- What is the business purpose of the transaction?
- What is the expertise of the neurosurgeon who will provide the services? Is this expertise required to provide the service, or could the service be performed by a lower-level provider?
- Does the facility require the service? Has the facility demonstrated an investment in the service?
- What resources will the parties need to effectively provide the service? How does the neurosurgeon help provide the resources?
- What processes does the facility have in place to monitor the arrangement? How does the organization measure the effectiveness of the arrangement?

Commercial reasonableness cautions

Recall that an arrangement may meet the requirements of FMV but not meet the requirements of CR. In this case, the "cents" of the transaction (the FMV) may not align with the "sense" of the transaction (the CR). Following are two hypothetical examples of potential commercially unreasonable arrangements involving neurosurgeons:

1. A hospital paying neurosurgeon specialty compensation rates for administrative work that only requires the skill set of a primary care physician. It would not make good business sense to pay a neurosurgical hourly rate for the service when that service could be obtained at a lower rate.
2. A health system maintaining, at two of its facilities, neurosurgery medical director agreements that contain duplicative protocols and policy requirements. It would not make good business sense to pay for the same service twice.

The value of neurosurgeon incentive compensation was determined by reviewing hospital contribution margins of the neurosurgeon, or hospital net margin was utilized to fund the incentive pool. In the first case, by utilizing a contribution margin analysis to directly determine compensation, the value of referrals of the neurosurgeon to the hospital is considered.

In the second case, it does not make good business sense to determine the level of compensation for one neurosurgeon based upon a hospital's net margin, which represents the culmination of many factors, events and decisions made over the course of a year.

Considering the implications

As a whole, it is important for neurosurgeons to understand their financial relationships with referral sources, including how the FMV and CR were considered. Negative health system press makes headlines almost daily, and physicians should keep in mind that patients are paying attention these days. Patients have access to more information than ever and are more actively participating in provider choice based on that information.

As a neurosurgeon, continued awareness of these regulations is paramount. Otherwise, you may unknowingly be a source of referral violations that are potentially costly in terms of time, dollars and reputation.

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