Practical Advice for Your Clients on Common FMV Issues

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Introduction
To capitalize on the flood of alignment opportunities available with physicians, hospital executives must work closely with legal counsel to structure compliant physician service agreements (PSAs) that can withstand regulatory scrutiny. Whether a direct employment or contracting arrangement, one compliance topic present itself in nearly every PSA: fair market value (FMV) compensation. The determination of FMV compensation entails a rigorous and analytical process. Without proper planning, communication, and support, this process can create frustration for both the hospital and the physician.

To complicate matters, recent cases, such as the Tuomey case, caution hospitals to avoid unsupportable valuations and to carefully evaluate the methodology of the valuation expert (1). Undoubtedly, hospitals have and will continue to rely on legal counsel to assist in evaluating the opinions of independent appraisers. This purpose of this article is to provide legal counsel practical advice on avoiding common pitfalls of the valuation process and assessing valuation methodologies.

Structure a Reasonable Compensation Rate at the Onset of the Negotiations
Often a hospital will not engage a valuation expert at the onset of the negotiation of a PSA. Valuations can be expensive and hospitals will avoid incurring the cost for an arrangement that may not transpire. In these situations, developing a preliminary compensation rate that is both reasonable and supportable is vital. This will help avoid a situation whereby the hospital must reduct an offer during the negotiation process. The following provides several common valuation guidelines to consider:

- Compensation for clinical services should be correlated to physician productivity. For example, if a physician’s personally performed work relative value units (work RVUs) equal the median, then median compensation reflects a reasonable compensation rate for these services.

- An inverse relationship exists between the reported compensation per work RVU and work RVU volume. The Medical Group Management Association (MGMA) compensation survey documents this concept and illustrates this inverse relationship (2). As an example, if a physician’s work RVU volume is at the 90th percentile, a compensation rate per work RVU at the 90th percentile will likely result in total compensation that falls outside of FMV.

- Be wary of developing a compensation proposal based solely on offers made by local, competing hospitals. Previous Stark law guidance indicates that market data utilized in determining FMV compensation should exclude referral relationships (3). Although a local offer from a competing hospital might be considered, from a valuation standpoint it should not be the sole basis to support FMV compensation.

- When determining compensation for physician administrative services ensure that the compensation survey data matches the services to be provided. Stark II Phase III indicates that clinical compensation may not be an appropriate proxy for physician administrative services (4). Other sources of data (i.e., published medical director compensation surveys) should be considered (5).

- When developing a compensation rate for call coverage services, avoid relying solely on on-call survey data (6). Rather, consider the factors that directly impact the physician’s burden of call such as ability to bill/colllect, payor mix, call volume, and patient acuity.

Additionally, some hospitals utilize customized internal compensation calculators for physician compensation arrangements. These calculators serve as a compliance tool and typically consider multiple valuation approaches. Most calculations are created by third parties and demonstrate the application of a consistent methodology among a hospital’s compensation arrangements. Additional benefits to these calculators include ease of use, expedited negotiations, and cost savings related to third party valuations. Although the calculators are meant to cover the majority of physician compensation arrangements, they do not preclude a hospital from going outside the compensation indication derived from the calculator when unique credentials, experience, or circumstances exist.

When Possible, Obtain an Independent FMV Opinion Early in the Negotiation Process
This step will be essential for higher risk PSAs as there is typically a lot at stake for the Hospital from both a political and regulatory perspective. Few things can bring a deal to a screeching halt faster than reducing PSA compensation because it cannot be supported as FMV. It is vital at the onset of a negotiation to determine if a FMV opinion is needed and then to obtain one from a reputable firm as soon as is reasonably possible. The FMV opinion will set the “ceiling” of dollars that can be paid for the physician’s services. Importantly, it will prevent the communication of potentially unrealistic compensation terms to the physician.

As with any PSA, the terms may evolve throughout the negotiations. By having a valuation expert involved early in the process, the FMV opinion can be promptly updated to match the most current terms of the PSA.
Allow the Valuation Expert to Communicate with the Physician throughout the FMV Process

As with any relationship, trust is a critical factor for success. Permitting the valuation expert meet with the physician, thoroughly explain the valuation process, and keep the physician involved in the process of data collection and analysis provides a level of transparency. It communicates to the physician that the hospital’s intentions are to pay a compensation rate that is reasonable, compliant, and fair. This also offers the physician an open platform to discuss any unique aspects of his/her practice and to ensure that those aspects are understood and addressed in the valuation.

Ensure That a FMV Opinion Is Obtained for Each Service Within the PSA

Bundling (or stacking) services within a PSA is prevalent in the market. Bundled services often include (but are not limited to) clinical services, medical directorships, call coverage, and quality improvement. To meet regulatory compliance requirements, a FMV opinion is usually obtained for each service. However, determining FMV is only the first step when it comes to a PSA with bundled services. As discussed below, further evaluation of the entire arrangement is generally necessary.

Evaluate the Reasonableness of the Total Package of Services in the PSA

Although the payment for all services with a PSA may be set at a FMV rate, it is imperative to assess whether all services are required and whether all services can be reasonably provided. A simple example of a potentially unreasonable arrangement would be the following:

- PSA between a hospital and one primary care physician
- Clinical services will be fifty-five hours per week, fifty-two weeks per year
- Medical directorship services will be twenty-five hours per week, fifty-two weeks per year
- Call coverage services will be 365 days per year

The scheduled clinical and medical director hours combined with the call coverage requirements are well above industry norms for one physician. This schedule may not be sustainable over the term of a typical PSA. Other potential areas of concern would be validating the Hospital’s need for the medical director and the call coverage services.

Simple, logical steps to compliance can be missed during the negotiation process. For example, the Tuomey case provided a framework of questions that should have been considered in evaluating the reasonableness of the arrangement.

- Are full-time benefits being paid to part-time physicians?
- Is compensation commensurate with productivity?
- Is the provider making money in the arrangement? If not, is there a reasonable basis?
- Is the term of the PSA reasonable?
- Is the compensation for administrative services based on significant duties?

Bottom Line

The determination of FMV compensation remains a key factor for a compliant PSA. With careful guidance and planning, all parties can avoid the frustrating pitfalls of the FMV process and ensure that a supportable valuation is obtained.

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3 16054 Federal Register Volume 69, No. 59 (March 26, 2004).
4 51012 Federal Register Volume 72, No. 171 (September 5, 2007).
5 Administrative compensation surveys include (but are not limited to) Cejka Executive Search’s 2011 Physician Executive Compensation Survey, Sullivan Cotter & Associates, Inc.’s 2011 Physician Compensation and Productivity Survey, and Medical Group Management Association’s 2011 Medical Directorship and On-Call Compensation Survey.
6 There are two commonly used call coverage compensation surveys which include Medical Group Management Association’s 2011 Medical Directorship and On-Call Compensation Survey and Sullivan Cotter & Associates, Inc.’s 2011 Physician On-Call Pay Survey.