



**Practical Considerations When Determining,  
Documenting and Defending FMV Compensation  
to Physician Thought Leaders**

**Daryl P. Johnson, MAcc, AVA**  
**Managing Principal, HealthCare Appraisers, Inc.**

# Guest Speaker: Daryl P. Johnson, MAcc, AVA

## Managing Principal, HealthCare Appraisers, Inc.

- Mr. Johnson is a frequent speaker and author on healthcare valuation topics.
- He is Managing Principal and Co-Founder of HealthCare Appraisers and has more than 25 years of healthcare valuation, financial and operational experience, focusing primarily on any type of agreement or compensation arrangement which may have Stark and/or Anti-Kickback implications.
- Prior to founding HealthCare Appraisers, Mr. Johnson served as the chief financial officer and chief operating officer of a national, publicly traded, cancer management company and the chief operating officer of a national, neuro-musculoskeletal physician management company.
- Mr. Johnson has also been responsible for the development and operation of a national network of outpatient bone marrow transplant centers; clinical trials programs; clinical laboratories; ambulatory surgery centers; imaging centers; and physical therapy programs.



# Objectives of This Webinar

- Describe the regulatory backdrop and definitions applicable to establishing complaint physician compensation rates
- Describe approaches and data sources that can be used to establish defensible compensation rates
- Set forth particular valuation approaches that can be used in the unique arena of establishing physician compensation
- Identify pitfalls to be avoided when establishing physician compensation rates

# Description of Subject Arrangements

- Payments to physicians for personally performed services
  - Thought Leader | Advisory Boards | Medical Director | Promotional Presentations | Educational Programs
  - Generally, time-based compensation arrangements
- Other payments to physicians not covered in today's presentation...
  - Licensure | royalty payments | clinical trials (PI)
- Payments involving intellectual property (e.g., data)



# Regulatory Overview: Abridged Version

- Compensation arrangements must be commercially reasonable.
- Compensation amounts paid to potential referral sources must follow guidance set forth by applicable healthcare regulations (*e.g.*, Stark, Anti-Kickback and false claims statutes).
  - Legal counsel should determine which Federal and/or state statutes may be applicable under various circumstances.
- Compensation amounts must not exceed fair market value (FMV).

# Areas of Government Concern

## ■ Kickbacks

- Speaker fees
- Advisory boards
- Meetings (planning, conferences, etc.)
- Training, surgical demonstrations, etc.



## ■ Clinical trial fraud

- Providing remuneration for clinical studies which may have no legitimate value as a means to induce physicians to prescribe/use specific products

# Recent Fines

- Novartis - \$422.5 million & \$237.5 million (2010)
- Pfizer - \$2.3 billion (2009)
- Eli Lilly - \$1.4 billion (2009)
- Bayer HealthCare – \$97.5 million (2008)
- Biovail Pharmaceuticals - \$22.2 million (2008)
- Biomet, DePuy Orthopedics, Smith & Nephew, and Zimmer – \$311 million + 5 year CIA (2007)
- Schering-Plough - \$435 million (2005)
- Medtronic - \$40 million (2006)
- Lincare - \$10 million (2006)
- Pfizer (Warner-Lambert) - \$240 million (2004)



# One Point of Interest

- In the government settlements with medical device companies concerning *payments to physician consultants (previous slide)*...
  - The settlement agreements reiterated that compensation for such arrangements must be at FMV and required the manufacturers to seek *independent third party opinions* to establish FMV anytime physician consultant compensation will exceed \$500 per hour.
- Hospital Corporation of America's (HCA) CIA required independent FMV assessment for arrangements exceeding \$150 per hour (albeit over 8 years ago).

# Commercial Reasonableness

- The term “commercially reasonable” is defined as an arrangement that 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 business referrals between the parties.
- This definition is based on guidance provided by CMS in the preamble to the Stark II Phase II regulations at *69 Fed. Reg. 16093 (March 26, 2004)*.

# Commercial Reasonableness Simplified

- The easiest way of insuring commercial reasonableness is to consider whether the compensation arrangement would be entered into with the physician assuming no possible or expected side benefit.
- Consideration can be given to whether an arrangement might be entered into by a non-healthcare company under similar circumstances.

# The Determination of FMV

- Federal regulators have historically provided little guidance on the way FMV compensation should be calculated (and they are prohibited from providing any opinions regarding FMV).
- However:
  - FMV is a “term of art” with a very specific definition and meaning.
  - A significant body of knowledge exists related to business valuations.



# Fair Market Value Defined

- **IRS Definition:** In Revenue Ruling 59-60 the Internal Revenue Service defines fair market value as “the amount at which property would change hands between a willing seller and a willing buyer when the former is not under any compulsion to buy and the latter is not under any compulsion to sell and when both have reasonable knowledge of the relevant facts.”
- **CMS Definition:** “...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, on the date of acquisition of the asset.” Usually, the fair market price is the price at which *bona fide* sales have been consummated for assets of like type, quality, and quantity in a particular market at the time of acquisition.”

# Implications of the FMV Definition

- The “FMV standard” contemplates a hypothetical transaction between a willing buyer and a willing seller.
- This definition is sometimes counterintuitive to common logic, as most equate “FMV “ with *value in general*. In fact, there are numerous definitions of value, with FMV being only one definition.
  - Notably, *strategic value* is different from with FMV.

# The Compensation Risk Continuum



- Higher compensation rates
- Extensive time requirements/  
multiple payment arrangements
- Contracts exist with many  
physicians
- Lower compensation rates
- Few hours
- Contracts exist with  
relatively few physicians

# The Valuation Process Risk Continuum



- No formal valuation process
- Payment rates are based upon:
  - Market surveys
  - Physician “demands”
- Strict adherence with FMV definition
- Formal documentation process
- Use of accepted valuation approaches
- Applicable market data is free from bias
- Logical, defensible, reproducible conclusions
- Use of independent credentialed appraiser

# Establishing FMV

- Two completely acceptable approaches:
  - Internally prepared analysis/documentation
    - Unless an agreement with the government requires independent FMV analysis (as a requirement of a CIA, for example), there is no requirement for a pharma company to obtain outside valuation analyses.
  - Use of a FMV consultant
- This presentation applies equally to both approaches.

# Valuation Approaches

(Don't worry...we won't spend much time discussing these approaches)

- Income Approach
- Cost Approach
- Market Approach



# The Income Approach



Income Cost Market

- The Income Approach is defined according to the International Glossary as “a general way of determining a value indication of a business, business ownership interest, security, or intangible asset using one or more methods that convert anticipated economic benefits into a present single amount.”
- The use of an Income Approach in evaluating healthcare transactions may appear to give consideration to the value of possible referrals among the parties, and *generally* is not applicable in establishing FMV physician payment rates.

# The Cost Approach



Income Cost Market

- The Cost Approach is defined according to the International Glossary as “a general way of determining a value indication of an individual asset by quantifying the amount of money required to replace the future service capability of that asset.”
- The Cost Approach is based upon the Principle of Substitution - *i.e.*, the premise that a prudent individual will pay no more for a property than he/she would pay to acquire a substitute property with the same utility.
- A Cost Approach can be applicable in establishing physician compensation rates, as a form of *make vs. buy* analysis.

# The Market Approach



- The Market Approach is defined according to the International Glossary as “a general way of determining a value indication of a business, business ownership interest, security, or intangible asset by using one or more methods that compare the subject to similar businesses, business ownership interests, securities, or intangible assets that have been sold.”
- A Market Approach is the best means of establishing FMV of physician compensation rates, provided that the market data is free from bias. ***What??***

# Potentially “Tainted” Market Data

- Generally, any market data used to establish FMV must be “arm’s-length”.
- Federal regulations indicate that “tainted” data should not be used to establish FMV.
- Therefore, industry survey data may not be a sound basis for establishing FMV.
- Reliance upon non arm’s-length data may be one of the most prevalent healthcare potential valuation pitfalls.



# Potential Valuation Pitfalls

- Use of “opportunity cost”
- Reliance upon “good faith negotiations” or meeting the compensation demands of the physicians



# Physician Compensation: Sources of Market Data

- Medical Group Management Association
- Sullivan, Cotter and Associates, Inc.
- Hospital & Healthcare Compensation Service
- Towers Watson Data Services (f/k/a Watson Wyatt)
- American Medical Group Association
- Integrated Healthcare Strategies (f/k/a Clark Consulting)

# Using Physician Compensation Market Data

- Consider (*i.e.*, use) multiple data sources.
- Consider multiple years of survey data.
- Avoid cherry-picking from the data.
  - National vs. regional
- Consider adjusting “W-2/1099 data” to independent contractor data (*i.e.*, gross up the values to reflect payroll taxes and benefits).
- Recall that most physician surveys reflect compensation from clinical services.
- How many hours are in a year? 1,800? 2,000? 2,080?

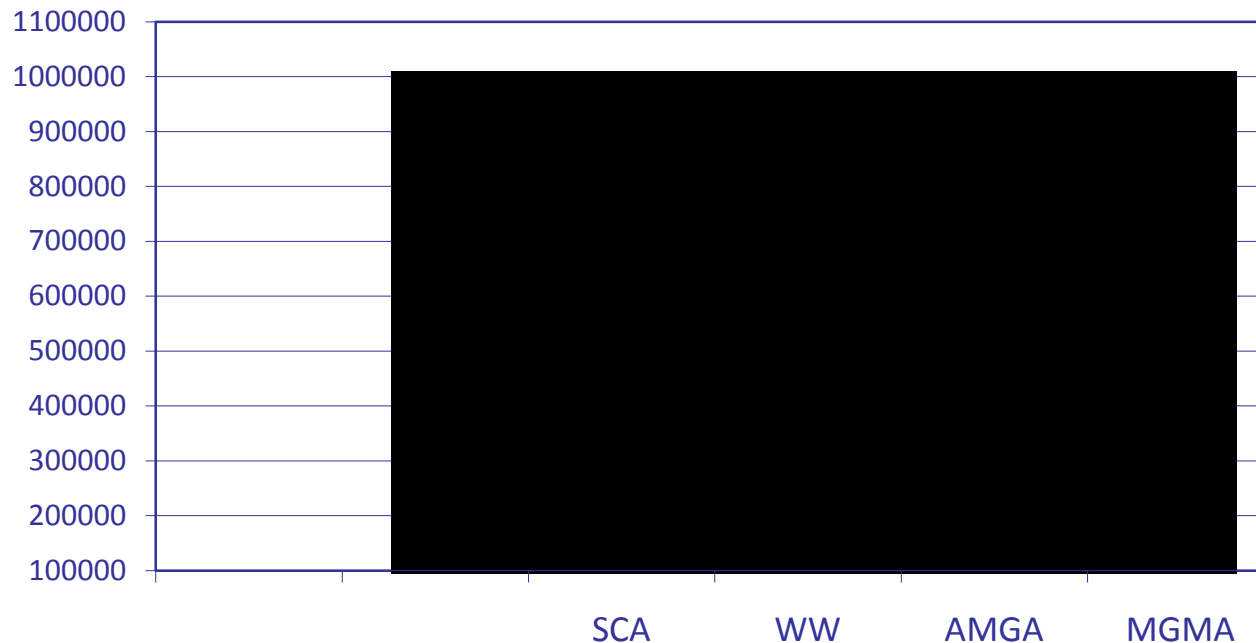
# Sample Compensation by Medical Specialty (MGMA)

	Median	75 <sup>th</sup> Percentile	90 <sup>th</sup> Percentile	Hourly Rate (75 <sup>th</sup> )	Hourly Rate (90 <sup>th</sup> )
Cardiology	\$368,000	\$492,000	\$613,000	\$264	\$324
Nephrology	\$292,000	\$377,000	\$466,000	\$209	\$252
Neurology	\$220,000	\$299,000	\$394,000	\$168	\$217
OB/GYN	\$271,000	\$350,000	\$451,000	\$195	\$245
Oncology	\$363,000	\$538,000	\$997,000	\$287	\$508
Psychiatry	\$186,000	\$224,000	\$267,000	\$128	\$151
Rheumatology	\$200,000	\$256,000	\$360,000	\$145	\$200

# Beware of Survey Anomalies

## ■ Hematology/Oncology Compensation

90th Percentile Values



# Objectives in Determining the FMV of Thought Leader Compensation

- A reliable and comprehensive valuation approach should provide the following:
  - An evaluation methodology that analyzes each parameter in an objective, consistent and repeatable way.
  - A FMV outcome that encompasses all relevant parameters.
- A FMV outcome that can be supported via *independent* market data.

# Relevant Parameters to Consider: The FMV of Thought Leader Compensation

- Extent of the services (*i.e.*, how many hours)
- The nature of the specialty
- Credentials/qualifications of the thought leader
- The specific services contemplated by the arrangement



# A Cost Approach: The “Thought Leader Compensation Algorithm”

- Utilizes survey benchmark compensation data, by medical specialty, as the starting point
  - Considers multi-year data
  - Compensation data grossed up for benefits
- Makes a series of adjustments to the benchmark data based on:
  - Extent of thought leader time required
  - Specific requirements of the position
  - Skills/experience of the specific thought leader

# Factors Based on Specific Duties and Responsibilities

- Number of hours associated with each duty and/or responsibility
- The specific duties and responsibilities of the position
- The complexity of each duty and/or responsibility
- Level of leadership required
- Specific objectives and deliverables
- Potential impact of thought leader/consultant on organizational and/or product success



# Factors Based on Thought Leader Qualifications

- Educational credentials and specialized training
- Professional certifications
- Leadership experience
- Academic appointments
- Research experience and funding history
- Invited presentations
- Publication history
- Other professional leadership activities/  
recognition in the healthcare community



# “Scoring” the Thought Leader Algorithm

- Establish relative weightings for the pertinent factors.
- Identify interdependencies among the factors (*e.g.*, extent of time requirement vs. qualifications of thought leader).
- Consider potential redundancy of qualifications.



# Applying the Algorithm Scoring

(Values are for example purposes only)

- A cardiologist with an international sphere of influence with exceptional experience and qualifications, performing complex duties:
  - Up to 140% of the 90<sup>th</sup> percentile (or \$454 per hour)
- A cardiologist with a national sphere of influence performing routine duties:
  - Up to the 90<sup>th</sup> percentile (\$324 per hour)
- A cardiologist with a regional sphere of influence performing routine duties:
  - Up to the 75<sup>th</sup> percentile (\$264 per hour)

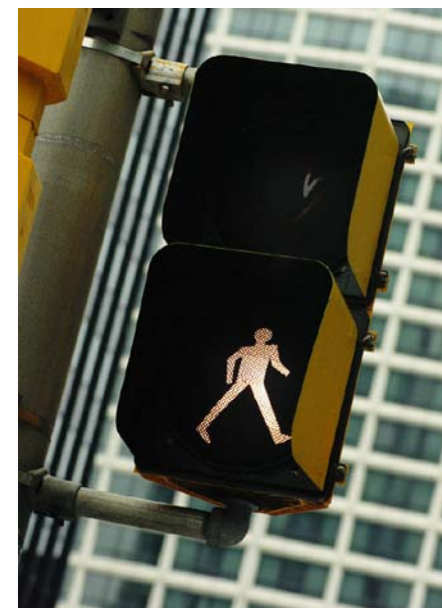
# Sample Compensation by Medical Specialty (MGMA)

	Median	75 <sup>th</sup> Percentile	90 <sup>th</sup> Percentile	Hourly Rate (75 <sup>th</sup> )	Hourly Rate (90 <sup>th</sup> )
Cardiology	\$368,000	\$492,000	\$613,000	\$264	\$324
Nephrology	\$292,000	\$377,000	\$466,000	\$209	\$252
Neurology	\$220,000	\$299,000	\$394,000	\$168	\$217
OB/GYN	\$271,000	\$350,000	\$451,000	\$195	\$245
Oncology	\$363,000	\$538,000	\$997,000	\$287	\$508
Psychiatry	\$186,000	\$224,000	\$267,000	\$128	\$151
Rheumatology	\$200,000	\$256,000	\$360,000	\$145	\$200

Data is for example purposes only, and should not be relied upon.

# A Market Approach

- Place reliance upon “non-tainted” data.
- Consider physician compensation arrangements that are free from referral bias.
- “Crosswalk” the arrangement to a non-healthcare setting.



# Examples of Non-Tainted Market Data

- Fees paid to physicians who are not in a position to refer:
  - Expert witness fees
  - Physician consultants/executives
- Fees paid to comparably qualified non-physicians:
  - Consultants
  - Attorneys



# Potential FMV Pitfalls

- Placing reliance upon non arm's-length market data
- Straying from the FMV definition
- Using a potentially troublesome valuation approach (*e.g.*, “opportunity cost”)



# In Summary

- Increased government scrutiny means there are many reasons to develop and maintain FMV assessment of arrangements with physician thought leaders.
- The methodology used to determine FMV should be reliable, comprehensive and reproducible.

# Questions?

October 19, 2010

FMV Compensation to  
Physician Thought Leaders

  
**HealthCare Appraisers**  
INCORPORATED



# HealthCare Appraisers

INCORPORATED

## Thank You

For more information, please contact:  
Daryl P. Johnson, MAcc, AVA – [djohnson@hcfmv.com](mailto:djohnson@hcfmv.com)

75 NW 1st Avenue, Suite 201 | Delray Beach, FL 33444  
561-330-3488 | [www.HealthCareAppraisers.com](http://www.HealthCareAppraisers.com)

Delray Beach | Denver | Dallas | Chicago | Philadelphia