Rockstars and Boat Rockers: Negotiating and Structuring Compensation Arrangements with Rockstar Physicians

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The Affordable Care Act (ACA) has increased attention on the quality and efficiency of health care delivery in the United States. In response, many hospitals and health systems (collectively referred to as hospitals) are working to alter their internal cultures to better incentivize value over volume in patient care.

Cultural transformation in hospitals requires strong physician leadership. Some physicians are better or uniquely able to provide such leadership because of name recognition or influence among their peers. For these and a multitude of other reasons, there is great interest in how and with what incentives institutions may attract and retain the services of well-known, influential physicians—physicians who, metaphorically speaking, are “rockstars.”

Context for This Article

Common perception is that physicians with “rockstar” qualities are highly in demand and may reasonably command compensation outside the norm for other physicians of their training and general practice specialty. This perception, whether based in fact or not, can cause consternation for hospital counsel tasked with drafting, reviewing, or otherwise vetting compensation arrangements with rockstar physicians.

The strict liability Stark Law1 (Stark) will apply to most hospital-physician compensation arrangements. As such, each such compensation arrangement will generally have to meet the requirements for a Stark Law exception. Most of the exceptions for physician compensation arrangements require fair market value (FMV) compensation to the physician referral source.2 Some exceptions also require that the underlying compensation arrangement be “commercially reasonable.”3 However, prevailing practices for establishing

and documenting FMV rely on physician compensation survey data that may not reflect the level and type of compensation historically earned by highly in-demand rockstar physicians; and prevailing notions of what constitutes a commercially reasonable arrangement may not comport with the types of arrangements needed to secure the services of a rockstar physician. This creates a dilemma.

Consternation about these issues may be magnified by concerns about compliance with federal and state anti-kickback statutes (AKS); and, if a hospital is a tax-exempt entity, by concerns about compliance with Section 501(c)(3) of the Internal Revenue Code, specifically including its requirement that the tax-exempt entity operate only for tax-exempt purposes, not generate private inurement, and not engage in excess benefit transactions.

Consternation also may be magnified by the fact that, in the current regulatory environment, any “outside-of-the-norm” physician compensation arrangements seem precarious. In the last several years, False Claims Act qui tam relator activity focused on physician compensation arrangements has notably increased. Qui tam relators and their counsel have targeted FMV as a regulatory requirement that is difficult to understand and relatively easy to plead as a basis for claims of Stark violations. Meanwhile, the federal government seems to have zeroed in on commercial reasonableness as a Stark requirement that historically has been either ignored or misunderstood, with the consequence that the requirement is not met in many high-dollar physician compensation arrangements. Several recent high-profile, high dollar-value judgments and settlements (some with staggering associated legal fees) have underscored the dangers for hospitals entering into questionable compensation arrangements with physicians. The recent cases involving Tuomey Healthcare System (ending with a $237 million...
What Is a “Rockstar” Physician?

The term “rockstar” as used in this article has no formal definition, and probably does not appear in any dictionary. It is a term the authors have coined to refer to physicians who possess characteristics that make them exceptional. These characteristics, including their number, degree, and combination, vary widely among physicians who may be rockstars, making identification of a rockstar somewhat subjective. Regardless, certain concrete criteria may be used to identify and document the status of a physician as a rockstar. These include:

• Rare specialized training and/or certifications;
• Substantial history of peer-reviewed publications;
• Frequent citation of the physician’s publications in the publications of others;
• Substantial history of academic and other leadership appointments;
• Frequent invitations to speak at professional education events;
• Extensive research and funding history; and
• Substantial media coverage focusing on the physician as a thought leader or expert in his field.

Compensation Arrangements with Rockstar Physicians

Hospitals may recruit and secure the services of rockstar physicians through several types of arrangements, and sometimes through combinations of different types of arrangements. An employment arrangement that encompasses all of the services that the physician will provide to the hospital is sometimes appealing to both the hospital and physician, for reasons ranging from practical simplicity to a perception of lower regulatory risk. However, services arrangements other than employment are fairly common, including: medical director/administrative services arrangements that provide for services distinct from a physician’s clinical practice duties; practice support arrangements such as income guarantees; teaching agreements; research services agreements; consulting/speaking agreements; and, in some cases, combinations of these arrangements.

FMV and Commercial Reasonableness Considerations

Of the legal and regulatory constraints that may apply to compensation arrangements between hospitals and physicians, Stark is likely the only one subject to a strict liability standard and contains a statutory definition of FMV. For this reason, the authors have chosen the Stark definition of FMV as the focus of this article.

The Stark statute defines FMV as “the value in arm’s length transactions, consistent with the general market value.” With respect to physician compensation arrangements, Stark’s promulgating regulations define “general market value” as:

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 . . . at the time of the service agreement.

The qualifying statement that compensation must be consistent with that paid in service agreements between parties “who are not in a position to generate business for the other party” arguably makes the Stark definition of FMV more restrictive than definitions of FMV generally accepted for purposes other than compliance with Stark. It is worth noting that the qualifying statement is echoed in government commentary relating to acceptable methods for establishing FMV, including commentary in the Preamble to the Stark Phase I regulations, which states that FMV may be established by:

any method that is commercially reasonable and provides . . . evidence that the compensation is comparable to what is ordinarily paid for the item or service in the location at issue, by parties in arm’s length transactions who are not in a position to refer to one another.

The regulatory definition of FMV indicates that FMV for Stark purposes is a value that should not be influenced by actual or anticipated referrals from a physician. The definition of FMV provided in the Stark regulations says:

Usually, [FMV is] . . . the compensation that has been included in bona fide service agreements with comparable terms at the time of the agreement, where the price or compensation has not been determined in any manner that takes into account the volume or value of anticipated or actual referrals.

For purposes of discussion, there are a few other notable points about the Stark definition of FMV:

• It differs in material respects from other definitions, including the definition relied on by the Internal Revenue Service;
• As defined in Stark, FMV is a hypothetical concept that may not match the value ascribed by the parties to a particular transaction;
• FMV may be different for a physician’s clinical services than the physician’s administrative services; and
• FMV is not necessarily established through arm’s-length negotiations\textsuperscript{14} or calculations of opportunity cost/lost opportunity.\textsuperscript{15} 

Although commercial reasonableness is a requirement of many Stark exceptions, neither the measure nor meaning of commercially reasonable is explicitly defined in Stark. However, through the rulemaking process, the Centers for Medicare & Medicaid Services (CMS) has provided guidance regarding what commercially reasonable means. In a 1998 Stark Proposed Rule, CMS said an arrangement is commercially reasonable if it “appears to be a sensible, prudent business agreement, from the perspective of the parties involved, even in the absence of any potential referrals.”\textsuperscript{16} 

In 2004, in the Preamble to the Stark Interim Phase II Final Rule (and in response to a comment), CMS said:

An arrangement will be considered commercially reasonable . . . if the arrangement would make commercial sense if 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 DHS referrals.\textsuperscript{17} 

The authors interpret this commentary to mean that a commercially reasonable arrangement makes business sense for the parties entering into it, regardless of any physician referrals that may occur before, during, or after the arrangement.

Factors to Consider When Vetting Compensation Arrangements with Rockstar Physicians

The attention given to cases such as \textit{Tuomey} and \textit{Halifax} may reasonably lead one to conclude that FMV and commercial reasonableness are landmines dictating narrow parameters for designing and setting value in physician compensation arrangements. However, there is some precedent and legal support for the premise that parameters may be different—perhaps broader—for arrangements with bona fide rockstar physicians.

In \textit{United States ex rel. Villafane v. Solinger}\textsuperscript{18} (Villafane), the U.S. District Court for the Western District of Kentucky addressed a qui tam relator’s claims that compensation arrangements by and between the University of Louisville Medical School and its affiliates (ULMS) and certain pediatric specialist teaching physicians violated Stark and AKS.
In its analysis of the claims related to Stark Law violations, the trial court rejected what it described as the “hypertechnical” perspective advocated by the plaintiff, and indicated that it was satisfied that the requirement of “substantial academic and clinical services” (a requirement of the Stark Law’s academic medical centers (AMCs) exception) was met by the mere fact that the physicians in question supervised 100 residents per year, regardless that they did not engage in any timekeeping. In regard to the claim that the arrangements failed to meet the FMV requirement of the AMCs exception, the court said that:

- When determining the FMV of compensation paid by ULMS for physician teaching and administrative services, one need not take into consideration the income derived by the physicians from private practice; and

- The chief of staff’s salary, even though near or above the range of compensation supported by surveys of other physicians of the specialty (which was neonatology), did not fail the test of FMV because:
  - The physician was at or near the top of his profession;
  - The physician had substantial responsibilities within the medical school that warranted higher compensation than peers; and
  - Comparing this top physician with physicians represented in general salary surveys was like comparing “apples to oranges.”

The authors caution against relying on Villafane to guide compensation decisions, because it was based on a narrowly focused examination of the AMCs exception, and an appeals court did not review it. However, Villafane is significant for its veiled recognition that not all physician roles and characteristics are the same. Villafane represents a trial court’s recognition that compensation rules, including the bounds of FMV and commercial reasonableness, may differ for certain physicians “at or near the top” of their profession.

Suggested Process for Vetting Compensation Arrangements with Rockstar Physicians

The flowchart on page 13 outlines a process developed for designing and evaluating compensation arrangements for rockstar physicians. The authors designed the process with consideration of: (1) the various legal and regulatory reasons counsel may have consternation about physician compensation arrangements; (2) how and why those reasons might make FMV and commercial reasonableness important topics of consideration in the contract negotiation process; and (3) guidance from government publications and case law regarding what “FMV” and “commercially reasonable” mean in various contexts, and how each might reasonably be established and documented.

Consider the following factors when implementing the compensation analysis process outlined in the flow chart:

1. CMS has indicated that parties may use “any method that is commercially reasonable” to establish FMV, but also that:
   - “Reference to multiple, objective, independently published salary surveys [is] a prudent practice”; and
   - “the appropriate method for determining [FMV] for purposes of [Stark] will depend on the nature of the transaction, its location, and other factors.”

2. The most widely accepted approaches for determining FMV for physician services arrangements rely on the ability to establish “comparability” between a subject arrangement and other arrangements in the marketplace that are not between parties in a position to generate prohibited referrals for one another.

3. Data reported in physician cash compensation surveys:
   - Are generally aggregate cash compensation from all sources, including: patient care services, on-call coverage, medical director services, consulting services, ancillary services (if applicable), owner income (if applicable), and any incentive compensation arrangements;
   - Generally do not include the cash value of employer-paid benefits;
   - Are not representative of all physicians. For example, some subspecialists are not well represented (or are not represented at all) in published survey data;
   - Are from voluntary responses and may be subject to a non-response bias. As such, physicians whose compensation is reported in a survey may have different compensation than those whose compensation is not reported in a survey;
   - Reflect prior year compensation amounts, and may not account for recent changes in compensation trends; and
   - Generally reflect 25th percentile to 90th percentile compensation amounts, meaning that up to 10% of physicians surveyed may make more than the highest reported value.

4. There may be useful physician compensation data sources other than cash compensation surveys. Examples of other data sources include: medical director and on-call compensation surveys; physician executive compensation surveys; compensation reported and searchable as a result of the “sunshine” provisions of the ACA; and, in some cases, data reported by nonprofit entities on a Form 990. Beware of potential pitfalls in relying on data from these sources, including:
   - Difficulty establishing the necessary “comparability” to a subject arrangement, due to a lack of specific information regarding the circumstances or duties associated with the reported compensation amounts; and/or
   - “Tainting” of the data by the potential that they reflect compensation paid to physicians who are in a position...
Sample Rockstar Physician Compensation Analysis

Has the physician successfully completed any standard screening and vetting process?
- National Practitioner Data Bank Query
- Screening for Federal health care program exclusion
- Verification of education and prior work history
- Review of licensure/disciplinary history in all relevant states
- Any committee and board approvals required to negotiate

Is this physician a "rockstar" based on objective criteria? (use consistent, pre-set criteria)

Do the physician’s rockstar qualities relate to or enhance his or her ability to perform the needed services? Is there a reasonable need for this physician’s services absent referrals? (commercial reasonableness analysis)

Is there reasonable and reliable market data to suggest that fair market value for the physician’s services may exceed the range of compensation that is typical for physicians of the specialty? Consider:
- Nature of the published physician compensation data
- Other sources of relevant compensation data
- Nature and extent of rockstar qualities
- Physician’s own relevant compensation history

Is the identified market data "tainted"?
- by non-arm’s length relationships?
- by influence of volume or value of referrals or other business generated?
- by non comparable physician qualities or services?

Can you make reasonable interpretive adjustment to the data to account for the "tainting"?

Negotiate salary within compensation range supported by surveys of other physicians of the specialty

Consult a Physician Compensation Valuation Expert?
to make referrals to the payer of the compensation and, as a result, are not an appropriate basis for establishing FMV under the Stark definition.

Ask the following questions and document the answers when implementing the process outlined on the flowchart on page 13:

1. Does the physician candidate have characteristics that make him or her a rockstar? This question may be answered using a pre-set list of criteria, similar to the one set forth above.

2. What services will the physician candidate provide? Are rockstar characteristics important, essential, or otherwise relevant to providing these services? If the answer is no, then perhaps the status of the physician as a rockstar is irrelevant to the analysis of appropriate compensation or arrangement structure.

3. What are the material characteristics of the market in which the physician will provide the services? Material characteristics may include: market-specific compensation trends; the prevalence of rockstars in the market; and the reimbursement environment in the market.

4. Does the proposed arrangement involve multiple, distinct services and compensation arrangements with the physician? If the answer is yes:
   - Does each arrangement, alone as well as in the context of the others, make commercial sense, even if the physician makes no referrals?
   - Do the arrangements together make commercial sense, even if the physician makes no referrals?
   - Is there overlap between or among the services provided under the arrangements? If so, is that overlap reasonable?
   - Is aggregate compensation through all arrangements subject to a cap? If yes, is the cap reasonable in relation to the range of compensation reported for other physicians of the general specialty, taking into consideration the existence and importance of the physician’s rockstar qualities in the arrangements?
   - If aggregate compensation is not subject to a cap, is the expected aggregate compensation reasonable based on the physician’s qualifications, scope of duties, and compensation history?

Conclusion

This article and the associated flowchart outline a sample compensation analysis process for hospital counsel, compliance officers, or others involved in physician compensation design to ensure a reasoned, standardized approach to compensation analysis for rockstar physicians. Although adherence to a reasoned, standardized process is not a guarantee against questionable outcomes or government scrutiny, it is useful for documenting the logic and basis for decisions when questionable outcomes or government scrutiny occur. As we like to say, “Memories fade, but documentation can be forever.”

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1 42 U.S.C. § 1395nn. Stark prohibits a physician from making referrals for designated health services payable by Medicare to an entity with which he or she (or an immediate family member) has a financial relationship, unless an exception applies. Stark defines “referral” to include most physician orders, “designated health services” to include inpatient and outpatient hospital services, and “financial relationship” to include compensation arrangements.

2 In the authors’ experience, the Stark exceptions most likely to apply to a compensation arrangement with a rockstar physician are: bona fide employment (42 U.S.C. § 1395nn(e)(2)/42 C.F.R. § 411.357(c)); personal services (42 U.S.C. § 1395nn(e)(3)(A)/42 C.F.R. § 411.357(d)); academic medical centers (42 C.F.R. § 411.355(e)); FMV arrangements (42 C.F.R. § 411.357(l)); and indirect compensation (42 C.F.R. § 411.357(p)). All of these exceptions have a requirement regarding FMV.

3 Of the Stark exceptions listed supra note 2, only the personal services and academic medical centers exceptions do not have an explicit requirement of commercial reasonableness. However, these exceptions contain language that is arguably indicative of an implicit requirement of commercial reasonableness.

4 United States ex rel. Drakeford v Tusomey Healthcare Sys., Inc.

5 United States and Elin Baklid-Kunz v. Halifax Hosp. Med. Ctr. (settled for $85 million dollars after the district court issued partial summary judgment in favor of the plaintiffs on claims of Stark Law violations; legal fees were estimated at $21 million at the time of settlement; United States ex rel. Elin Baklid-Kunz v. Halifax Hosp. Med. Ctr., which involves different claims and in which the government did not join, is still proceeding.).

6 Examples include: United States and State of Florida ex rel. Schubert v. All Children’s Health Sys., Inc.; United States ex rel. Singh v. Bradford Reg’l Med. Ctr.; United States ex rel. Kosenske v Carlisle HMA, Inc; and the following settlement agreements entered into between the government and: Covenant Medical Center, Copper Health System, and White Memorial Medical Center.

7 42 USC § 1395nn.

8 42 C.F.R. § 411.351 (emphasis added).

9 Compare to the IRS definition discussed infra note 14.


11 42 C.F.R. § 411.351.

12 The definition generally relied on for matters involving compliance with IRS regulations is from United States v. Cartwright, 411 U.S. 546 (1973), in which the Supreme Court quoted Treas. Reg. Sec. 20.2031-1(b), “Fair market value is the price at which property would change hands between a willing buyer and willing seller, neither being under compulsion to buy or sell and both having reasonable knowledge of the relevant facts.”


14 See United States, ex rel. Kosenske v. Carlisle HMA, Inc., 554 F.3d 88, 97 (3d Cir. Jan 21, 2009) (In ruling on Stark Law claims, the court said: “as a legal matter, a negotiated agreement between interested parties does not ‘by definition’ reflect fair market value. To the contrary, the Stark Act is predicated on recognition that, where one party is in a position to generate business for the other, negotiated agreements between such parties are often designed to disguise the payment of non-fair-market-value compensation.”).