



HealthCare Appraisers
INCORPORATED

**Establishing and Documenting
Fair Market Value Compensation**

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

Regulatory Overview: Abridged Version

- Thou shalt not enter into compensation arrangements that are not commercially reasonable.
- Thou shalt generally heed guidance set forth in the Stark and Anti-kickback statutes.
- Thou shalt not pay physicians at rates above FMV.



The Laws and Regulations

- Anti-Kickback Law
- Stark Law
- False-Claims Act
- Prescription Drug Marketing Act



Establishing and Documenting
Fair Market Value Compensation


HealthCare Appraisers
INCORPORATED

The Government is Watching

- Kickbacks

- Speaker fees
- Meetings (advisory, training, planning, conferences)

- Clinical trial fraud

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

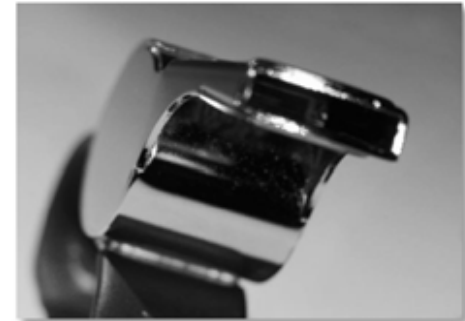
- Other related types of fraud

- Off-label marketing
- Sale of samples



The Punishments

- Between 2001 and the end of 2006, \$3.9 billion has been recovered from drug manufacturers as a result of cases brought by whistleblowers:
 - TAP - \$875 million settlement (2001)
 - Abbott Labs - \$622 million (2003)
 - Warner-Lambert (Pfizer) – \$430 million (2004)
 - Eli Lilly - \$36 million (2005)



The Punishments

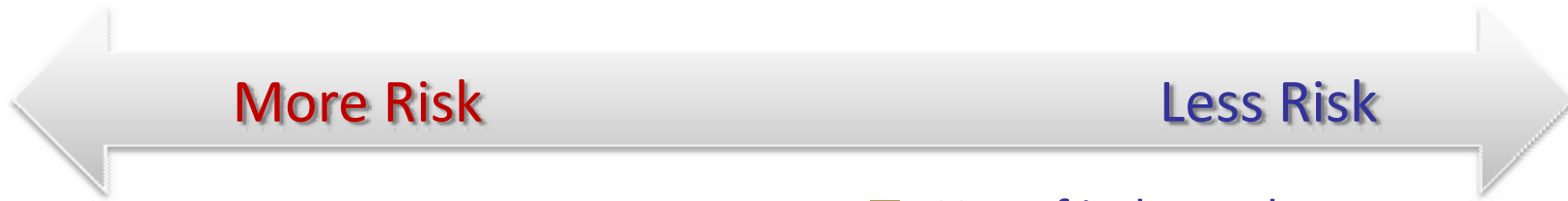
- In a recent series of government settlements with medical device companies concerning *payments to physician consultants*, the companies involved were required to pay a total of \$311 million dollars.
- The settlement agreements reiterated that compensation for such arrangements must be at FMV and required the manufacturers to seek *independent third party opinions* to establish FMV anytime physician consultant compensation will exceed \$500 per hour.
- HCA's CIA required independent FMV assessment for arrangements exceeding \$150 per hour.



Establishing FMV

- Two completely acceptable approaches –
 - Internally prepared analysis/documentation (unless an agreement with the government requires independent FMV analysis above certain dollar thresholds)
 - Use of a FMV consultant
- This presentation applies equally to both approaches.

The Healthcare Valuation Risk Continuum



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

Establishing and Documenting
Fair Market Value Compensation


HealthCare Appraisers
INCORPORATED

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 means 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.

Does the Government Really Mean FMV?

- FMV is a term of art.
- The IRS really means FMV. Opposing experts regularly battle over valuation theory.
- Do healthcare regulators really mean FMV, or does the arrangement just have to be “fair”?
- Federal healthcare regulators are more likely to defer to reasonable methodologies and good intentions than would the IRS.

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 Standard

- FMV involves a *hypothetical* scenario.
- FMV is distinctly different from *investment value* (which considers synergies among the parties).
- FMV is not *necessarily* established through...
 - Earnest negotiations
 - An amount that is requested
 - Opportunity cost
 - CMS position on the value of clinical vs. administrative services

The Determination of FMV

- Federal regulators have historically provided little guidance on the way fair market value compensation should be calculated.
- However, a significant body of knowledge exists related to business valuations.



Valuation Approaches

- Income Approach
- Cost Approach
- Market Approach



Establishing and Documenting
Fair Market Value Compensation


HealthCare Appraisers
INCORPORATED

The Income Approach



- 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.*

The Cost Approach



- 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.

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.”

Potential Valuation Pitfalls

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



“Tainted” Market Data

- Generally, any market data used to establish FMV must be “arms-length.”
- Federal regulations dictate that “tainted” data must not be used to establish FMV.
- Therefore, industry survey data may not be a sound basis for establishing FMV.



Physician Compensation: Sources of Market Data

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

Sample Compensation by Medical Specialty (MGMA)

	Median	75 th Percentile	90 th Percentile	Hourly Rate (75 th)	Hourly Rate (90 th)
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

Establishing and Documenting
Fair Market Value Compensation


HealthCare Appraisers
INCORPORATED

CMS “Safe Harbor” Compensation

	Hourly Rate (75 th)	Hourly Rate (90 th)	Hourly Rate CMS “Safe Harbor”
Cardiology	\$264	\$324	\$146
Nephrology	\$209	\$252	\$106
Neurology	\$168	\$217	\$ 96
OB/GYN	\$195	\$245	\$130
Oncology	\$287	\$508	\$116
Psychiatry	\$128	\$151	\$ 86
Rheumatology	\$145	\$200	\$ 92

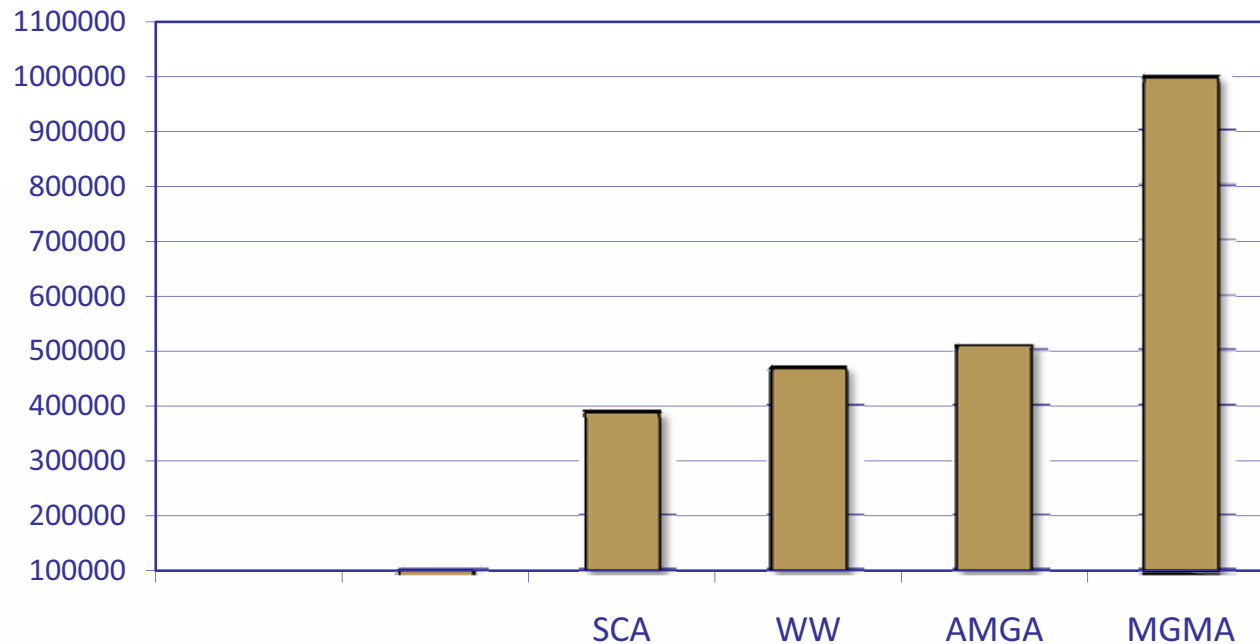
Establishing and Documenting
Fair Market Value Compensation


HealthCare Appraisers
INCORPORATED

Beware of Survey Anomalies

■ Hematology/Oncology Compensation

90th Percentile Values



Establishing and Documenting
Fair Market Value Compensation

HealthCare Appraisers
INCORPORATED

Description of Subject Arrangements

- Payments to physicians for personally performed services
 - Thought Leader / Medical Director / Promotional Presentations / Educational Programs
 - Physician participation in clinical studies (*e.g.*, principal investigator, etc.)
- Other payments to physicians not covered in today's presentation...
 - Licensure / royalty payments
 - Payments involving intellectual property (*e.g.*, data)



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.



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 is grossed-up for benefits.
- Makes a series of adjustments to the benchmark data based on:
 - The extent of thought leader time required.
 - Specific requirements of the position.
 - The 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.



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

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.





HealthCare Appraisers

INCORPORATED

75 NW 1st Avenue, Suite 201
Delray Beach, FL 33444
561-330-3488

858 Happy Canyon Road, Suite 240
Castle Rock, CO 80108
303-688-0700

www.HealthCareAppraisers.com

Daryl Johnson

djohnson@hcfmv.com