The Fair Market Value Conundrum

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Types of Arrangements

- General FMV guideposts - FMV 101
- Employment arrangements
- Practice acquisitions
- Medical directorships/call coverage
- Chemo infusion under arrangements
- Co-management arrangements
- Restructuring “per click” and “under arrangements” deals (e.g., stereotactic radiosurgery JVs)
- Hospital lease/management arrangements (e.g., for radiation therapy)
FMV 101: Healthcare Arrangements & Transactions

- Generally, any transaction between potential referral sources must be (i) consistent with FMV; and (ii) commercially reasonable.
- A transaction can be “FMV,” but not commercially reasonable, and vice versa.
- Healthcare regulations impose specific guidance that directly impacts FMV analysis:
  - Avoid tainted market values
  - Avoid improper valuation methodologies
Examples of arrangements that may be consistent with FMV but *not* commercially reasonable

- A hospital enters into an arrangement with physicians involving a profitable service line and foregoes much of the expected future profits.
- A hospital enters into a one-year lease of physician-owned equipment at a “short-term rate premium,” but the lease continues to renew year after year.
- A hospital enters into a transaction with a physician group whereby the transaction costs (e.g., management time, attorney fees, valuator fees) exceed the expected benefit of the arrangement.
- Hospital leases at prevailing rents excessive space, which it does not need, in underutilized building owned by MDs.
“Tainted” Market Data

• Generally, any market data used to establish FMV must be “arm’s-length.” Healthcare transactions are frequently suspect.

• A market approach is the preferred valuation approach for many types of compensation arrangements.

• For certain types of arrangements, virtually no “non-tainted” data is available.

• The valuator must consider alternate approaches.
  – Consider whether the arrangement can be “cross walked” to a non-healthcare setting. If the arrangement would make sense in a non-healthcare setting, it may make sense in healthcare (provided that referrals are never considered/valued).
FMV Considerations in Employment Arrangements

• Confucius Statistician say…If you torture the data long enough, it will confess to the crime it did not commit.

• MGMA data can be misused in a variety of ways, including:
  – Cherry picking from among different tables (e.g., regional data vs. state data)
  – 90th percentile compensation times 90th percentile wRVU productivity
  – Failure to consider ownership/ancillary profits that may be inherent in 90th percentile compensation
FMV Considerations in Employment Arrangements

- Compensation “stacking” (or as Juliet would say, “A rose by any other name…”)
  - Medical director fees
  - Management fees
  - Administrative fees
  - Quality bonuses
  - Sign-on bonuses
  - Retention bonuses
  - Tail coverage, etc.

- Consider that the data reported by the compensation surveys generally include all sources of income.

- Contemplate possible future changes in CMS reimbursement (including RVU values).
FMV Considerations in Employment Arrangements

• Sources of compensation survey data
  – Medical Group Management Association (MGMA)
  – Sullivan Cotter & Associates
  – Hospital & Healthcare Compensation Service
  – American Medical Group Assn (AMGA)
  – Watson Wyatt Data Services
Salary Survey Data
Hematology/Oncology - 2008

90th Percentile

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Salary Survey Data
Hematology/Oncology - 2009
90th Percentile

- WW
- HCS
- SCA
- AMGA
- MGMA
Salary Survey Data
Radiation Oncology - 2009
90th Percentile

- HCS
- SCA
- AMGA
- MGMA
Independent Contractor Model

• Instead of employment, new arrangements are gaining traction whereby medical oncologists retain their own practice, and are compensated on a productivity basis (e.g., per wRVU) for their clinical services.

• A transaction may involve the purchase of the oncologists’ tangible assets and payment for workforce in place (or an employee leasing arrangement).

• The wRVU rate payable to the oncology group is a “gross” rate that includes certain overhead expenses incurred by the group practice.

• The FMV analysis should give careful consideration to pre- and post-transaction compensation to the physicians.
FMV Considerations in Co-Management Arrangements

- These arrangements typically involve physician/hospital ventures to manage hospital service lines, with compensation consisting of base and incentive components.
- Oncology service lines seem very appropriate for co-management arrangements.
- Pay for performance models seem to have broad support (including with regulators).
Service Line Co-Management Example

- Hospital
  - New building
- Hospital Licensed Oncology Center
- Private Physician Offices
- Oncology, LLC
  - Leasehold improvements
  - Equipment
  - Non-clinical staff
- Manage Co., LLC
  - Facility Lease
  - Office Lease
  - Service Line Co-Management Agreement

Coping with New Economic Realities: Positioning for Future Success
FMV Considerations in Co-Management Arrangements

- Compliance with FMV is critical for regulatory compliance, but also for the ultimate success of the project.
- Available valuation methodologies are limited and somewhat subjective.
- In considering the primary valuation approaches (cost, income and market), an income approach can likely be eliminated.
- Using a cost approach, FMV of the management fee can be established by assessing the estimated number of work hours needed to provide the management services multiplied by a FMV hourly rate.
  - However, the exact number of required work hours cannot reasonably be determined in advance.
  - Further, a key ideal of most co-management arrangements is to reward results rather than time-based efforts.
FMV Considerations in Co-Management Arrangements

• A market approach recognizes that each co-management arrangement is unique, and considers specific market and operational factors related to the subject arrangement.
  – Break the specific services down into specific tasks and objectives, and then compare to other arrangements
  – On an item by item basis, assess the relative worth of each task/objective, and determine necessary adjustments to the comparable arrangements.
• The cost and market valuation methodologies described above must be reconciled to arrive at a final conclusion of value.
• The FMV of the total management fee must be established, as well as the base and incentive components.
FMV Considerations in Infusion Under Arrangements

• Stark IV regulations generally prohibit the under arrangement entity from being the “provider of the service.”
• No bright-line answer on how to avoid being the DHS entity.
• e.g., certain clinical staff must be employees of the hospital.
• Higher hospital reimbursement levels may appear enticing, but
  – Heed caution regarding a “top down” approach; and
  – Consider the “before” and “after” analysis.
FMV Considerations in Infusion Under Arrangements

- A “top down” approach “passes through” all of the hospital's reimbursement, less a portion retained by hospital related to its services (e.g., certain staff, billing, and other hospital services).

- This approach leaves open significant opportunity for challenge.
  - The actual services provided by the under arrangement entity must be FMV, and the valuation approach should primarily consider the value of such services.
  - The level of reimbursement received by a hospital may have no bearing on the FMV of the services.
  - Consider a “crosswalk” to non-healthcare scenarios.
FMV Considerations in Infusion Under Arrangements

- Stark affects investment in “under arrangements” entities and turn-key management or leasing companies
  - Stark prohibition on ownership interest in entity that performs the DHS (411.351, definition of “entity”, effective Oct 1, 2009)
    - Exception for under arrangements contract with a single group
    - Exception for ownership interests in rural providers and public companies
  - CMS declined to provide guidance on what it means to “perform” the service (i.e., what combination of providing space, equipment, supplies, non-physician clinicians, administrative staff, executive services)
  - FAQ on topic promised for 12 months
Cancer Center Example
Permissible Under Arrangements Venture

Payors
- Facility Fees
- Pro Fees

Community Hospital
- Infusion
- RT
- Space Lease
- Cost plus fixed fee

MO/RO Group
- Professional services
- Medical Directorship
- Infusion equipment
- RT equipment
- Nonclinical staff
- Supplies
- Management Services
- Equipment Lease + Services Agreement

Community Cancer Center
- Hospital licensed Infusion/RT service
- Non-physician clinicians

Coping with New Economic Realities: Positioning for Future Success
Medical Director Rates

- Sources: Integrated Healthcare Strategies
  - Medical Oncology
  - Radiation Oncology
# Cancer Center/Oncology Medical Director Fees

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## Radiation Oncology Medical Director Fees

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Making the Transaction Work (If at all possible)

- Ensure that the valuators do not instill undue conservatism in the analysis. Ensure that the valuators can support their assumptions, methodologies, and findings.
- Identify the intended goals of the transaction, and consider multiple structural alternatives.
- Walk the regulatory line carefully. Some deals are not meant to be.
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