Fair Market Value and Commercial Reasonableness in Hospital/Physician Transactions: What’s the Difference?

This roundtable discussion is brought to you by the Hospitals and Health Systems (HHS) Practice Group’s Fair Market Value Affinity Group.

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Agenda

- The first part of this roundtable discussion will consist of our formal presentation.
- The second part will take the form of a live show with an open mic option for the participants to interact with the rest of the audience.
  - Please press * 1 on your telephone keypad to enter the phone queue.
Disclaimer

The opinions expressed today are the personal opinions of the speakers. We do not intend to, nor do we, imply that our views reflect or are similar to those of the Centers for Medicare & Medicaid Services, the Office of Inspector General, or any other government enforcement agency.
Definitions

- **Fair Market Value**
  - Stark Law
    - *Fair market value* means 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, or 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, on the date of acquisition of the asset or at the time of the service agreement.
    - 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, or 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.

- **Anti-kickback Statute**
  - No definition in 42 C.F.R. §1001.2
Definitions

- Commercially Reasonable
- No “real” definition in 42 C.F.R. §411.351
- Language in the exceptions is illustrative
  - Commercially reasonable even if no referrals were made between the parties
  - Commercially reasonable even if no referrals were made to the employer
  - Reasonable and necessary for the legitimate business purposes of the arrangement(s)
  - Commercially reasonable even if the physician made no referrals to the entity
  - Commercially reasonable (taking into account the nature and scope of the transaction) and furthers the legitimate business purposes of the parties
Enforcement Activity

- Increased “chatter” about FMV and commercial reasonableness...why?
- Government (or *qui tam*) enforcement of FMV and/or commercial reasonableness as a primary basis for a case
  - Covenant Medical Center settlement
  - *United States ex rel. Singh v. Bradford Regional Medical Center*
  - Detroit Medical Center settlement
  - *U.S. ex rel. Elin Baklid-Kunz v. Halifax Hospital Medical Center. et al*
In-house Counsel Concerns

- Physician employment
- Physician practice acquisition
- Joint venture arrangements
- Call coverage and other personal service arrangements
- Management services agreements with physicians or physician organizations
- Co-management arrangements with physicians or physician organizations
- ...just about every arrangement with a physician requires a thorough analysis of FMV and commercial reasonableness
In-house Counsel Concerns

- Whose call is it?
- FMV
  - Outside valuator
  - Compensation tables
  - Real estate broker estimates
  - In-house (or outside) lawyer
- Commercial Reasonableness
  - Corporate “business operations” team
  - Outside valuator
  - In-house (or outside) lawyer
COMMERCIAL REASONABLENESS VS. FMV

DARYL P. JOHNSON
Commercial Reasonableness vs. FMV

- Separate and distinct concepts
- Generally, the concepts are considered sequentially:
  - Does the premise of the transaction make sense? (If not, stop.)
  - What is the value of the transaction?
- Some proposed arrangements are not commercially reasonable.
- Some proposed arrangements may be commercially reasonable, but the FMV compensation may be minimal.
- The entirety of a transaction must be considered in a commercial reasonableness assessment.
Examples of Transactions that (generally) are not Commercially Reasonable

- Lease/leaseback arrangements involving space, staff or equipment
- A pathology group buying ad space on a primary care practice’s website
- Arbitrage arrangements
  - A physician group paid for management services outsources the duties to a third party.
- Illogical carve outs
  - Physicians are employed only for their surgical services.
Examples of Transactions that may be Commercially Reasonable, but the FMV may be Minimal

- Exclusive equipment rental arrangements
- Staff leasing arrangements
- Supply purchase agreements
Other Commercial Reasonableness Considerations

- Compensation stacking
- Aggregation of multiple agreements/responsibilities
- Unanticipated provisions in hospital/physician agreements:
  - Liquidated damages upon termination
  - Unduly long agreement term
  - Indemnification provisions
  - Severance obligation in a medical director agreement
- The “no risk” risk premium
Who Opines on Commercial Reasonableness?

- Some valuators will not provide commercial reasonableness opinions.
- In some instances, the valuator may not be privy to all aspects of a transaction (and thus cannot render an opinion).
- Is it disingenuous for a valuator to render an opinion on an arrangement that he/she thought was not commercially reasonable?
- Who is in a better position than hospital management to determine the need and extent of medical directorships?
HOW DO PARTIES TO A TRANSACTION APPLY THE COMMERCIAL REASONABLENESS REQUIREMENTS?

LAWRENCE VERNAGLIA
Several Stark Exceptions and Safe Harbors Rely on Commercial Reasonableness

Stark exceptions:
- Office space rental
- Employment
- Equipment rental
- Isolated transactions
- Fair market value
- Group practice arrangements with a hospital
- Indirect compensation
- Personal service arrangements (though does not use the term “commercially reasonable” (it says, “The aggregate services contracted for do not exceed those that are reasonable and necessary for the legitimate business purposes of the arrangement(s)”)
Several Stark Exceptions and Safe Harbors Rely on Commercial Reasonableness

**AKS Safe Harbors:**

- Space rental
- Equipment rental
- Personal services and management
- Sale of practice
- Discounts
- Ambulance replenishing
CMS Commentary

- Very little regulatory gloss
- 1998 Stark proposed rule:
  “‘commercially reasonable’ to mean that an arrangement appears to be a sensible, prudent business agreement, from the perspective of the particular parties involved, even in the absence of any potential referrals.”

63 Fed. Reg., 1659, 1700 (Jan. 9, 1998)
In 2001, HCFA confused the issue:

“With respect to determining what is “commercially reasonable,” any reasonable method of valuation is acceptable, and the determination should be based upon the specific business in which the parties are involved, not business in general. In addition, we strongly suggest that the parties maintain good documentation supporting valuation. Finally, with respect to difficult cases, the parties could seek an advisory opinion under section 1877 of the Act. (See § 411.370.)”


Maybe HCFA meant to be commenting on whether the valuation methodology was commercially reasonable vs. the transaction, but that’s not what the preamble says.
CMS Commentary

- In 2004, CMS responded to criticism of the provision that “this interpretation injected an unwarranted subjective element into the test.”

- CMS rebutted, responding: “An arrangement will be considered ‘commercially reasonable’ in the absence of referrals 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.”
So how are transacting parties and counsel interpreting?

- We acknowledge subjectivity – CMS and courts have never given a formulaic definition.
- This is the role of counseling, questioning and probing.
- Verges on an “intent” review (even though we are talking safe harbors and Stark exceptions)
- Counsel and clients must ask “why” this arrangement makes sense – but for referrals.
Role of the FMV opinion

- Parties must actually read the valuator’s opinion.
- What assumptions is the valuator making? Does it fundamentally challenge commercial reasonableness?
- Did the appraiser make a false or unwarranted assumption or exceed scope of engagement?
Q&A

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