Published in Anesthesiology News
July 2011

FAIR MARKET VALUATION: THE DEATH SPIRAL OF PHYSICIAN COMPENSATION

BY: MARK F. WEISS, J.D.

We hear the word “fair” a lot these days. We’re asked to pay our “fair” share of taxes. We’re asked to bear our “fair” share of the sacrifice. Not to go *too* Ayn Rand on you, but it’s painfully obvious that those demanding your “fair” share also are demanding the right to determine what’s fair.

If you are on board with this concept so far, you probably aren’t surprised by the epidemic of “fair” infecting the permitted parameters of agreements between physicians and hospitals. Of course, I’m talking about “fair” in the context of fair market value, one of the key factors in a number of compliance concerns—from federal and state anti-kickback laws, to Stark and state law prohibitions on so-called self-referral, to the limits of deals entered into by not-for-profit hospitals and health systems.

And you also probably won’t be shocked to learn that, in reality, the fair market valuation process often is hardly fair, is blind to value and generally ignores the true market. In a sense, it’s simply Orwellian

doublespeak. Well, that's not exactly true; it has a tremendously real impact on physician compensation, and that impact is negative.

The Hospital–Valuation Consultant Complex

You're likely familiar with the term military–industrial complex, used to portray the cozy relationship among politicians, defense contractors and the armed forces. It describes the fact that the defense industry and its players give political contributions to politicians who then endorse defense spending, which results in purchases by the armed forces from the defense industry.

Thanks to the expanded scope of compliance laws turning on the issue of fair market value and the increasing trend of hospital–physician transactions—such as hospital acquisition of physician practices, hospital employment of physicians, coverage agreements and the push toward so-called hospital–physician alignment through accountable care organizations—the relationship between hospitals and health systems, the large purchasers of valuation services and the large valuation consulting firms selling those services has tightened. Hospitals and their executives rely on valuation opinions to avoid being prosecuted for violating the law and are willing to pay for those defensive opinions.

Consultants desire the substantial fees they charge hospitals for the rote number crunching they perform. In a very real sense, they do understand value—at least with respect to their services—in that they take relatively small amounts of labor and sell it for the value it truly represents: the value of safety for their clients.

But at the same time, they are overly careful to cover their behinds in terms of an improper valuation opinion. This leads to nonsensical ceilings on opined value in order to build so much safety into the opinion that it becomes something other than a true valuation of your services.

Here's the kicker: Hospitals and their administrators are happy to receive the by-product—a valuation that fits well below the full amount of the compensation or support that they would otherwise have to pay if the market were truly analyzed. It's uncertain whether hospitals actively encourage this level of "safety" or whether they are merely happy to receive its benefits; either way, it creates a false ceiling that ignores fairness, value and the actual market.

The 75th Percentile

This overcautiousness causes valuation consultants to often state that they never opine as to the bona fides of a deal at more than the 75th percentile of value as reported on national, or large-area regional (eg, "Western") studies. Of course, some valuation consulting firms conduct their own studies and sell that information to those same hospital clients.

Think about this for a minute: In order for the 75th percentile to exist, there must be a top value, not to mention the other values that are found in the fourth quartile, the highest quartile. Those fourth quartile values cannot simply be assumed to be outside the realm of actual fair market value. Yet valuation consultants ignore the existence of that top quartile, which *must* exist in order to determine the 75th percentile maximum as to which they will opine.

To recap:

- The hospital gives the consultant money for the valuation opinion.

- The consultant gives the hospital protection in the form of a valuation opinion as to fair market value.

- The consultant gives the hospital the benefit of a valuation that ignores everything above the 75th percentile (in other words, it relieves the hospital of the burden of paying anything above an arbitrary cap).

The Compensation Death Spiral

As if the present impact of artificially capping the market were not bad enough, let's look at its effect as that process continues to play out over time.

We'll start with a physician who's negotiating with Community Hospital or its medical foundation over the amount of compensation under a new employment relationship in connection with the purchase of her practice by the hospital.

Setting aside all of the strategic issues with respect to maximizing compensation, the valuation consultants engaged by Community Hospital opine that the 75th percentile of compensation for the physician's specialty, gleaned from averaging national compensation surveys, is $X. The consultants are adamant that they won't opine as to a value greater than the 75th percentile. Community Hospital agrees

to pay physician compensation at the 75th percentile as the fair market value of her services in connection with the 2011 employment contract.

During 2011, these valuation consultants and their competitors are all referencing the same national compensation surveys, and they're all pointing to somewhere near $X as the 75th percentile (the maximum per-physician compensation with the medical specialty that they will bless in their valuation opinions).

By the time our physician and the hospital are negotiating the renewal of her employment contract in 2014, because of the prevalence of deals in effect from 2011 to 2014 at the $X maximum, the national compensation surveys relied on by Community Hospital's valuation consultants now indicate that $X-$Y dollars is the new 75th percentile. In other words, because of the prevalence of valuation opinions at $X three years prior, $X is now at the top of the range in the fourth quartile and can no longer be justified in terms of the protection that valuation consultants seek in issuing their opinions. In its place comes the new 75th percentile, $X-$Y.

Of course, flash forward another two or three years and the 75th percentile is now well below $X-$Y. And the cycle starts all over again, and again, and again.

I once thought that if this continued unabated, physicians would eventually be working for a bag of peanuts. But then I realized that if valuation opinions are still essential at that point in time, it's likelier to be for *three-fourths* of a bag.

What You Must Do

If you'd like to create a better future for yourself with respect to "fair" physician compensation, there are steps that you must begin to take at the micro—that is, personal or group—level.

To begin, you need to understand and appreciate that a strategy in connection with compensation can't be separated from your strategy with respect to the entire contractual relationship with a hospital. And if you are negotiating on behalf of a group, that contracting strategy must be consistent with your group's overall business strategy.

As is the case with respect to any strategic issue of this complexity, it takes considerable time and effort to deploy the required tactics. This includes significant research as to the definition of the relevant market, the development of supporting data, the complete understanding of the valuation process and a complete understanding of the ways—and ways not—to present data in response to a valuation request if one is made.

Of course, on a national level, the hospital–valuation consultant complex deserves intense scrutiny. I am in the process of gathering information from readers like you regarding experiences with artificial caps on valuations for the purpose of a follow-up article. I would appreciate your assistance; please see the contact information below.

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Mark F. Weiss is an attorney who specializes in the business and legal issues affecting radiology and other physician groups. He holds an appointment as clinical assistant professor of

anesthesiology at USC's Keck School of Medicine and practices with the Advisory Law Group, a firm with offices in Los Angeles, Santa Barbara and Dallas. He can be reached by email at markweiss@advisorylawgroup.com and by phone at 800-488-8014.

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