CHICAGO 2017

Commercial Reasonableness of Physician Compensation

Analytical Update with MACRA

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Presenter Bio

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Ms. Bailey-Wheaton conducts project management and consulting services related to the impact of both federal and state regulations on healthcare exempt organization transactions, and provides research services necessary to support certified opinions of value related to the Fair Market Value and Commercial Reasonableness of transactions related to healthcare enterprises, assets, and services. She is the co-author of a peer-reviewed and industry article published by the American Bar Association (ABA), and has previously presented before the ABA.

Ms. Bailey-Wheaton is a member of the Missouri and Illinois Bars and holds a J.D., with a concentration in Health Law, from Saint Louis University School of Law, where she served as Fall Managing Editor for the *Journal of Health Law & Policy*.

You can see her full CV at https://www.healthcapital.com/hcc/cvs/jbailey.pdf

Presenter Bio

Todd A. Zigrang, MBA, MHA, FACHE, ASA is the President of **HEALTH CAPITAL CONSULTANTS** (HCC), where he focuses on the areas of valuation and financial analysis for hospitals, physician practices, and other healthcare enterprises. Mr. Zigrang has over 20 years of experience providing valuation, financial, transaction and strategic advisory services nationwide in over 1,000 transactions and joint ventures involving acute care hospitals and health systems; physician practices; ambulatory surgery centers; diagnostic imaging centers; accountable care organizations, managed care organizations, and other third-party payors; dialysis centers; home health agencies; long-term care facilities; and, numerous other ancillary healthcare service businesses. Mr. Zigrang is also considered an expert in the field of healthcare compensation for physicians, executives and other professionals.

Mr. Zigrang is the co-author of the "*Adviser's Guide to Healthcare – 2nd Edition*" (AICPA, 2015), numerous chapters in legal treatises and anthologies, and peer-reviewed and industry articles such as: *The Accountant's Business Manual* (AICPA); *Valuing Professional Practices and Licenses* (Aspen Publishers); *Valuation Strategies*; *Business Appraisal Practice*; and, *NACVA QuickRead*. Additionally, Mr. Zigrang has served as faculty before professional and trade associations such as the American Bar Association (ABA); the National Association of Certified Valuators and Analysts (NACVA); Physician Hospitals of America (PHA); the Institute of Business Appraisers (IBA); the Healthcare Financial Management Association (HFMA); and, the CPA Leadership Institute. You can see his full CV at https://www.healthcapital.com/hcc/html2pdf31/TZigrang_CV.pdf

Overview of Presentation

- Review of MACRA
- Review of the *Commercial Reasonableness* Analysis
- Tension Between MACRA and Fraud & Abuse Laws
- Concluding Remarks

Overview

- In response to the advent of *value-based reimbursement* (VBR), most recently through MACRA, which concepts emerging reimbursement models rely upon to incentivize providers to achieve better outcomes at lower cost, hospitals are increasingly seeking closer relationships with physicians
  - Practice acquisitions
  - Direct employment
  - *Provider services agreements* (PSAs)
  - Co-management
  - Joint venture arrangements

"2014 Global Health Care Outlook: Shared Challenges, Shared Opportunities" By Deloitte Touche Tohmatsu Limited, New York City, NY, 2014, p. 13; "The 5 C's of 2013 Health Care" Deloitte Touche Tohmatsu Limited, 2012, http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/us_chs_MondayMemo_2013Healthcare_%205Cs_021313.pdf (Accessed 6/4/14); "Co-Management Arrangements: Common Issues with Development, Implementation and Valuation" By Ann S. Brandy, et. al., American Health Lawyers Association, May 2011, http://www.healthlawyers.org/Events/Programs/Materials/Documents/AM11/hutzler.pdf (Accessed 6/5/14); "Top 10 Factors to Consider When Exploring Joint Ventures as an Affiliation Strategy" By Jonathan Spees, The Camden Group, June 2013, http://www.thecamdengroup.com/thought-leadership/top-ten/top-10-factors-to-consider-when-exploring-joint-ventures-as-an-affiliation-strategy/ (Accessed 6/5/14).

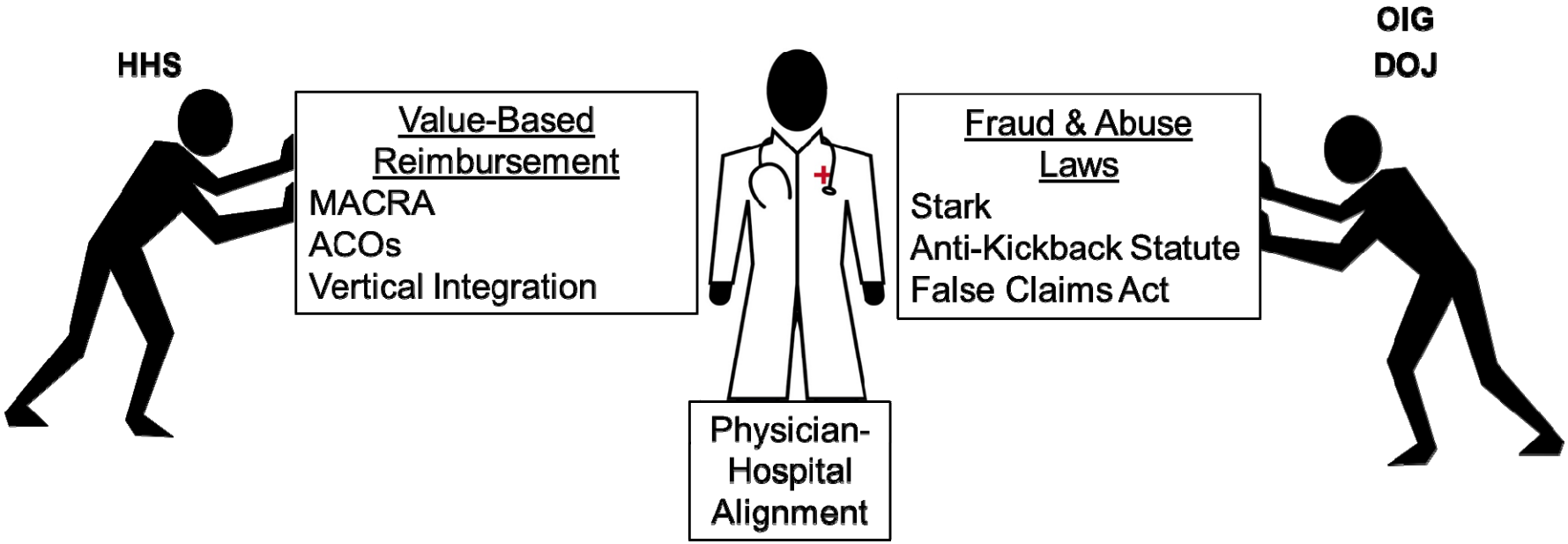
Overview

- Corresponding with this growing trend toward hospital-physician alignment, and specifically toward *vertical integration*, i.e., the "*integration of providers at different points along the continuum of care, such as a hospital partnering with a skilled nursing facility (SNF) or a physician group*," there has been increased federal, state, and local regulatory oversight regarding the legal permissibility of these arrangements
- More intense regulatory scrutiny related to the *Anti-Kickback Statute* (AKS) and the *Stark Law*, especially as these *fraud and abuse laws* relate to potential liability under the *False Claims Act* (FCA)
- Many of the exceptions and safe harbors in both the *Stark Law* and AKS require that any consideration paid to physicians not exceed the range of *Fair Market Value* (FMV) and be deemed *commercially reasonable*

"The Value of Provider Integration" American Hospital Association, March 2014, http://www.aha.org/content/14/14mar-provintegration.pdf (Accessed 1/14/16) p. 2. See "Health Care Fraud and Abuse Control Program Report" U.S. Department of Health and Human Services and U.S. Department of Justice, https://oig.hhs.gov/reports-and-publications/hcfac/ (Accessed 5/18/17). "Health Care Fraud and Abuse Control Program: Annual Report for FY 1997" By The Department of Health and Human Services & The Department of Justice, Report for the United States Congress, Washington, DC, 1998; "Health Care Fraud and Abuse Control Program: Annual Report for FY 2007" By The Department of Health and Human Services & The Department of Justice, Report for the United States Congress, Washington, DC, 2008; "Health Care Fraud and Abuse Control Program: Annual Report for FY 2013" By The Department of Health and Human Services & The Department of Justice, Report for the United States Congress, Washington, DC, 2014. "Criminal Penalties for Acts Involving Federal Health Care Programs" 42 U.S.C. § 1320a-7b(b)(3)(B) (2012); "Limitations on Certain Physician Referrals" 42 U.S.C. § 1395nn(a)(1) (2012); "Personal Services and Management Contracts" 42 C.F.R. § 1001.952(d) (2007); "Bona Fide Employment Relationships" 42 U.S.C. § 1395nn(e)(2) (2010); "General Exceptions to the Referral Prohibition Related to Both Ownership/Investment and Compensation" 42 C.F.R. § 411.355(e)(ii)(B) (2014); "Exceptions to the Referral Prohibition Related to Compensation Arrangements" 42 C.F.R. § 411.357 (2010); "FMV: Analysis and Tools to Comply With Stark and Anti-kickback Rules," By: Robert A. Wade, Esq. and Marcie Rose Levine, Esq., Audio Conference, HCPro, Inc.: Marblehead, MA, March 19, 2008, http://content.hcpro.com/pdf/content/207583.pdf (Accessed 10/29/15), p. 6, 48.

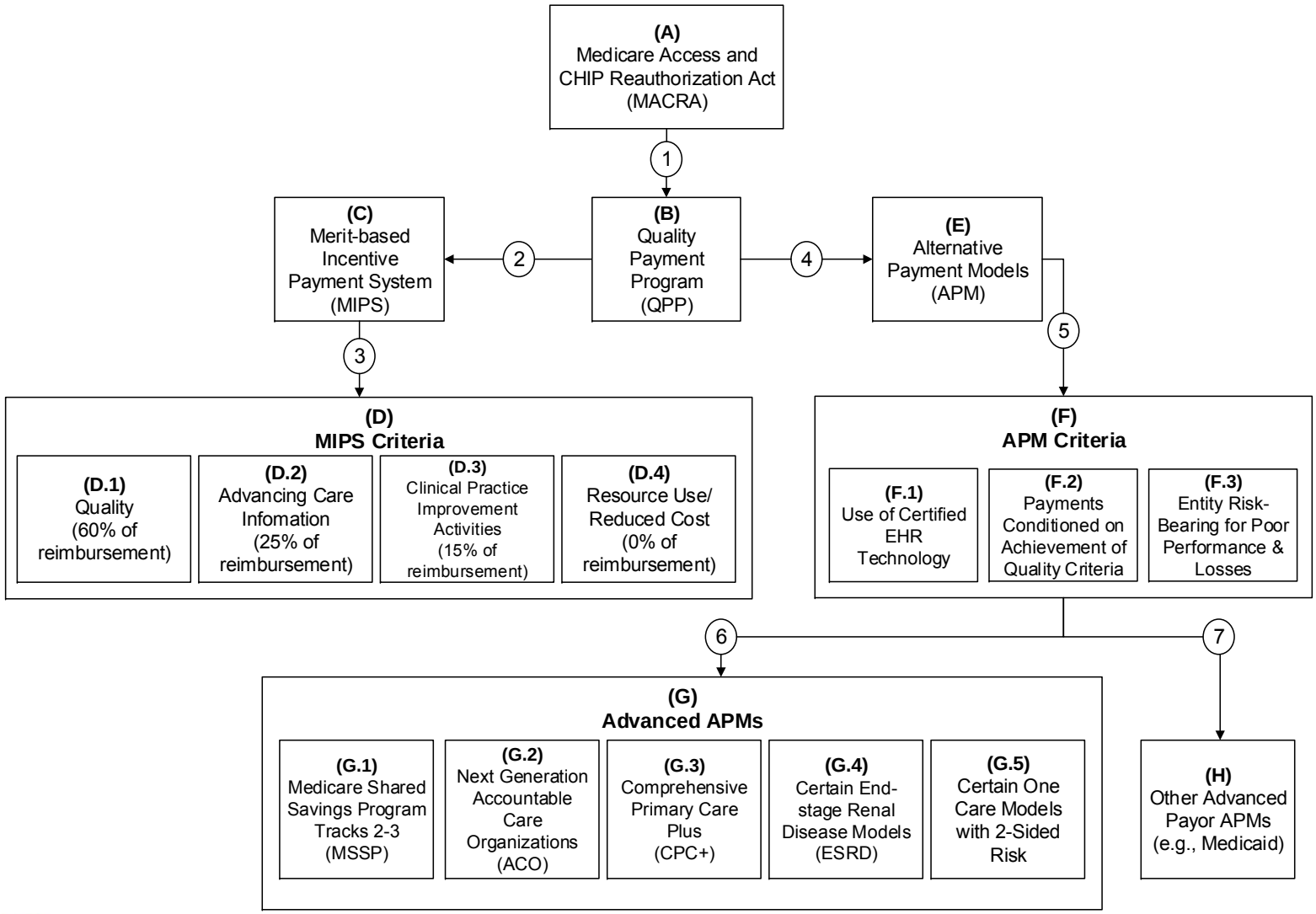
Overview

"*The Left Hand Doesn't Know What the Right Hand is Doing*"



Medicare Access & CHIP Reauthorization Act of 2015 (MACRA)

MACRA Overview



MACRA Overview

- The *Medicare Access and CHIP Reauthorization Act of 2015* (MACRA) in part shifts physician reimbursement from a *volume-based* approach to a *value-based* approach
  - Replaced failed *sustainable growth rate* (SGR) formula with the Quality Payment Program (QPP)
- "*Paying providers based on the quality, value, and results of the care they deliver and not piecemeal for individual services regardless of the clinical need for or appropriateness of those services*"

"Implementing MACRA" Health Affairs (March 27, 2017), http://healthaffairs.org/healthpolicybriefs/brief_pdfs/healthpolicybrief_166.pdf (Accessed 4/3/17), p. 7. "Medicare Program; Merit-based Incentive Payment System (MIPS) and Alternative Payment Model (APM) Incentive under the Physician Fee Schedule, and Criteria for Physician-Focused Payment Models" Federal Register Vol. 81 No. 214 (Nov. 4, 2016) p. 77010.

MACRA Required Participants

- Already participating in an Advanced APM -OR-
- Meet the Minimum Billing/Patient Population Requirements
  - Annually billing Medicare > $30,000 in Part B allowed charges -AND-
  - Annually care for >100 Medicare patients
- To participate in MIPS, providers must:
  - Be a Medicare provider prior to 2017
  - Be a:
    - Physician
    - Physician assistant (PA)
    - Nurse practitioner (NP)
    - Clinical nurse specialist
    - Certified registered nurse anesthetist (CRNA)

"Quality Payment Program" CMS, Quality Payment Program, https://qpp.cms.gov/ (Accessed 4/3/17).

MACRA's QPP Timeline

- **November 4, 2016**: Final Rule Issued by the *Centers for Medicare & Medicaid Services* (CMS)
- **January 1, 2017**: Start of First Performance Period
  - CMS projects up to 90-95% of Medicare Part B billings and 500,000 physicians will be affected by MIPS starting in 2017
- **March 31, 2018**: Performance Data Due to CMS
- **January 1, 2019**: Providers Begin Receiving "*Payment Adjustments*" (based on data that was submitted in March 2018)

"Quality Payment Program" CMS, Quality Payment Program, https://qpp.cms.gov/ (Accessed 4/3/17). "Implementing MACRA" Health Affairs, (March 27, 2017), http://healthaffairs.org/healthpolicybriefs/brief_pdfs/healthpolicybrief_166.pdf (Accessed 4/3/17), p. 7.

MACRA Participation Structure

- Clinicians can choose between two paths:
  - Participation in *Merit-Based Payment System* (MIPS)
    - Clinicians can choose to *not participate*, *participate partially*, or *participate fully*
      - *No participation: 4% downward payment adjustment in 2019*
      - *Partial participation: Positive or neutral payment adjustment*
      - *Full participation: Up to 4% payment adjustment in 2019*

"Quality Payment Program" CMS, Quality Payment Program, https://qpp.cms.gov/ (Accessed April 3, 2017).

MACRA MIPS Reimbursement

- Those who participate fully will earn a positive payment adjustment
- MIPS reimbursement is based on 4 criteria:
  - Quality: Currently determines 60% of Medicare reimbursement, but is decreasing to 30% in 2018
  - Advancing Care Information: Currently determines 25% of Medicare reimbursement
  - Clinical Practice Improvement Activities: Currently determines 15% of Medicare reimbursement
  - Cost: Currently determines 0% of Medicare reimbursement but will increase to 30% in 2018

"What's the Merit-based Incentive Payment System (MIPS)?" Quality Payment Program, Centers for Medicare & Medicaid Services, https://qpp.cms.gov/learn/qpp (Accessed 5/16/17). "Quality Payment Program" CMS, Quality Payment Program, https://qpp.cms.gov/ (Accessed 4/3/17).

Participation in Alternative Practice Models (APMs)

- CMS partners with clinician community to provide added incentives for higher quality and cost-efficient care
- Three main requirements:
  - Certified EHR technology (CEHRT)
  - Reimbursement of payments on measures comparable to MIPS
  - Agreement to take on financial burden or meet specifications of Medical Home

"Implementing MACRA" Health Affairs, (March 27, 2017), http://healthaffairs.org/healthpolicybriefs/brief_pdfs/healthpolicybrief_166.pdf (Accessed 4/3/17), p. 5.

Participation in Alternative Practice Models (APMs)

- Examples of advanced APM models include:
  - *Medicare Shared Savings Program Tracks* (MSSP) *Next Generation ACOs*
  - *Comprehensive Primary Care Plus* (CPC+)
  - *End-Stage Renal Disease Model* (ESRD)
  - *One Care Models with 2-Sided Risk*

"Quality Payment Program" Centers for Medicare and Medicaid Services, Quality Payment Program, https://qpp.cms.gov/learn/apms (Accessed 4/3/17).

Participation in Alternative Practice Models (APMs)

- APMs have increased rapidly
  - From their inception as part of the ACA, the four APMs offered by CMS in 2017 now have:
    - 359,000 participating clinicians
    - 12.3 million participating Medicare and Medicaid beneficiaries
- Whereas participation in MIPS incentivizes high quality yet efficient care through a performance-based payment adjustment, APM participants will earn incentive payments for participating in an innovative payment model

"Quality Payment Program" CMS, Quality Payment Program, https://qpp.cms.gov/ (Accessed 4/3/17). "Changing How Doctors Get Paid" By Dave Barkholz, March 11, 2017, Modern Healthcare, http://www.modernhealthcare.com/article/20170311/MAGAZINE/303119983 (Accessed 5/26/17).

ACRA Payment Structure Timeline

A	B	C	D	E
Performance Year	2017	2018	2019	2020
Payment Adjustment Year	2019	2020	2021	2022
MIPS				
Maximum Positive Payment Adjustment	4%	5%	7%	9%
Maximum Negative Payment Adjustment	-4%	-5%	-7%	-9%
MIPS Performance Category Weights				
Quality	60%	50%	30%	30%
Cost	0%	10%	30%	30%
Improvement Activities	15%	15%	15%	15%
Advancing Care Information	25%	25%	25%	25%
Advanced APMs				
Bonus Quality Payment	5%	5%	5%	5%

ACRA Ramifications

MACRA legislation, which "*fixed*" the Medicare Part B *Sustainable Growth Rate* (SGR) problem, appeared to correct this payment anomaly, i.e., that physician services are worth more to Medicare in hospital employment than in private practice

- In reality, however much protesting hospital representatives did during the negotiations, what MACRA actually did was grandfather in most of the existing payment differentials while reducing some payments for hospital ambulatory services provided more

"The Tangled Hospital-Physician Relationship" By Jeff Goldsmith, Nathan Kaufman, and Lawton Burns, Health Affairs Blog (May 9, 2016), http://healthaffairs.org/blog/2016/05/09/the-tangled-hospital-physician-relationship/ (Accessed 5/16/17). "The Medicare Access And CHIP Reauthorization Act: Effects On Medicare Payment Policy And Spending" By Peter S. Hussey, Jodi L. Liu, and

he Threshold of
ommercial Reasonableness

efinition of ommercial Reasonableness

nternal Revenue Service

- The 1993 Exempt Organizations IRS text "*Reasonable Compensation*"
  - "*Reasonable compensation is…the amount that would ordinarily be paid for like services by like organizations in like circumstances*"
- Chapter 2 of Publication 535 "*Business Exp*enses"
  - "…*reasonable pay is the amount that a similar business would pay for the same or similar services*" [emphasis added]

"Reasonable Compensation" By Jean Wright and Jay H. Rotz, Exempt Organizations Continuing Professional Education (1993), http://www.irs.gov/pub/irs-tege/eotopici93.pdf (Accessed 9/4/2012), p. 3

efinition of
ommercial Reasonableness

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ternal Revenue Service

Federal Regulations on "*Excess Benefit Transactions*"

– "*reasonable compensation [is]…the amount that would ordinarily be paid for like services by like enterprises (whether taxable or tax-exempt) under like circumstances*" [emphasis added]

efinition of ommercial Reasonableness

Department of Health and Human Services (HHS)

- An arrangement which appears to be "…*a sensible, prudent business agreement, from the perspective of the particular parties involved, even in the absence of any potential referrals*" is *commercially reasonable*

"Medicare and Medicaid Programs; Physicians Referrals to Health Care Entities

efinition of ommercial Reasonableness

Stark Law

- *"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 of similar scope and specialty, even if there were no potential DHS [designated health services] referrals*."

"Medicare Program; Physicians Referrals to Healthcare Entities with which They Have

efinition of ommercial Reasonableness

Office of the Inspector General (OIG)

- A *commercially reasonable* transaction is a transaction in which "…*the aggregate services contracted do not exceed those which are reasonably* necessary to accomplish the commercially reasonable business purpose of the service."

lationship to & Distinguished from r Market Value (FMV)

While FMV looks to the "*range of dollars*" paid for a product or service, the threshold of commercial reasonableness looks to the reasonableness of the business transaction generally

Commercial Reasonableness is a separate and distinct, but related, threshold to a FMV analysis

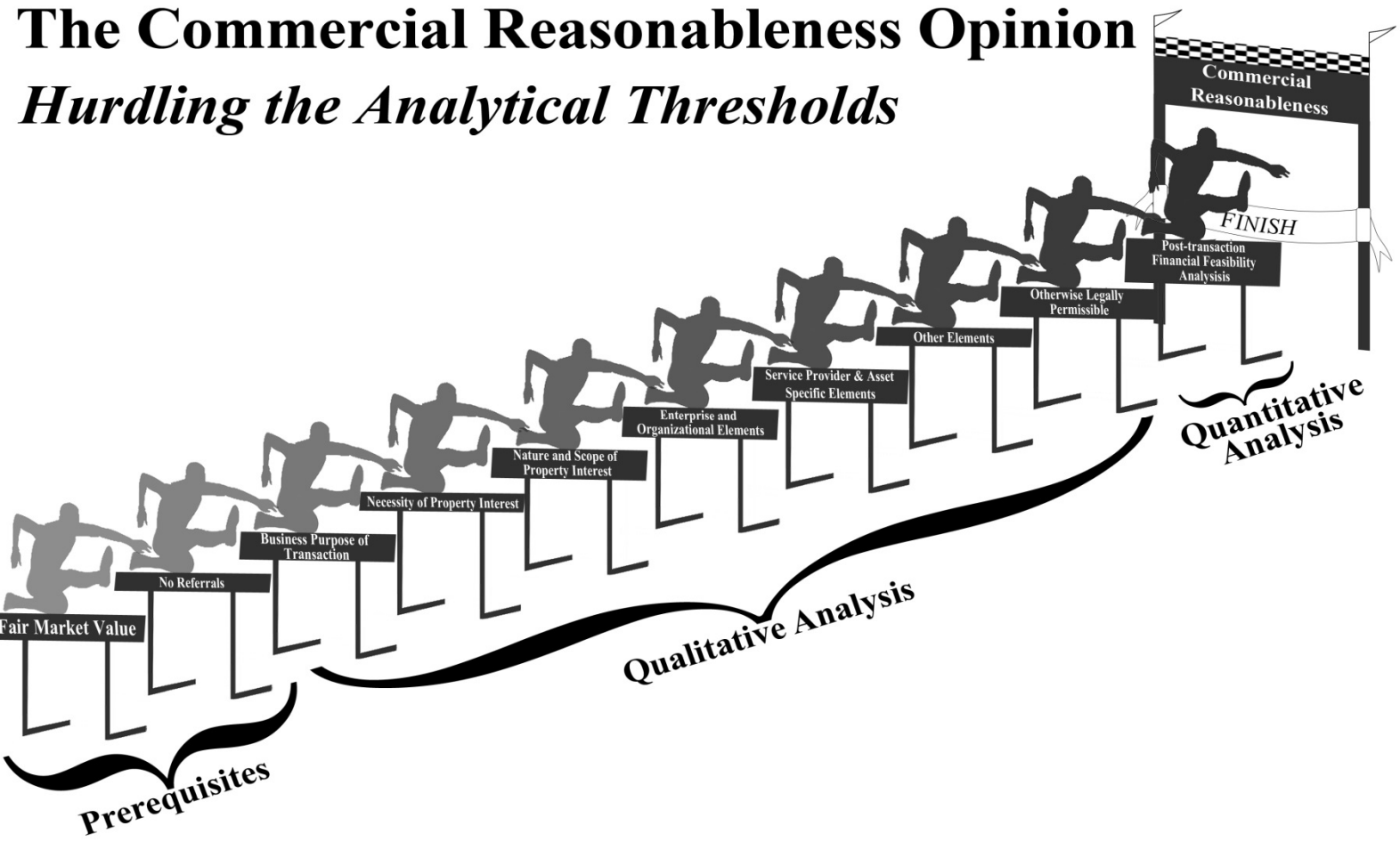
Furthermore, the consideration and analysis of one threshold *does not preclude* the analysis of the other threshold

he Commercial
easonableness Analysis

Comprised of three component phases:

- Ensuring that certain *prerequisites* for the transaction are satisfied
- Developing a *qualitative analysis* of the transaction focusing on furthering the business's interest(s)
- Developing a *quantitative analysis* focusing on the transaction's financial feasibility

e Commercial
asonableness Analysis



he Commercial
easonableness Analysis

Transactional Prerequisites

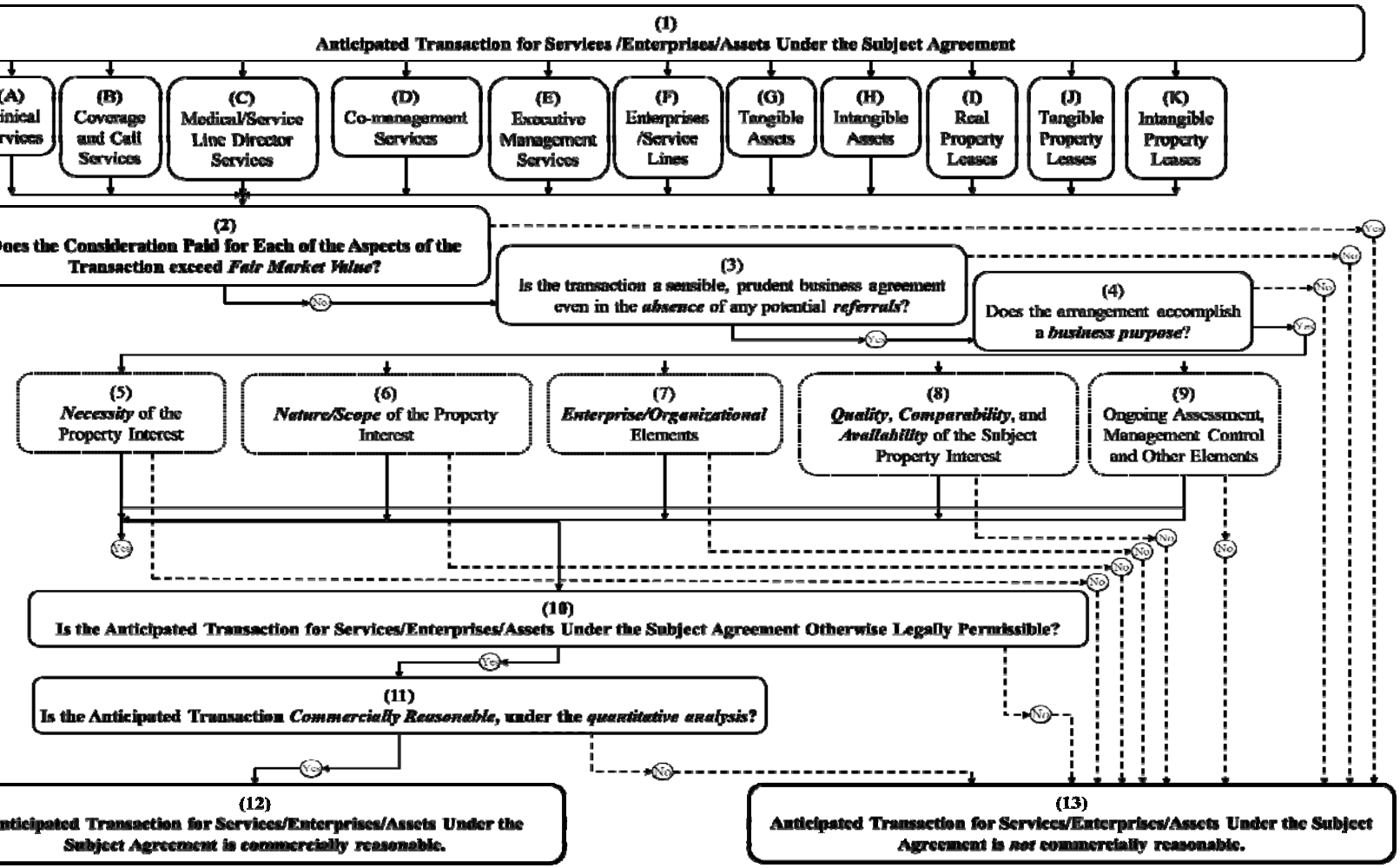
- FMV
  - Consideration paid for all aspects of the transaction must be at fair market value. FMV is implicated by three distinct bodies of law that fall under the federal Fraud & Abuse laws:
    - *The Internal Revenue Code*
    - *The Stark Law*
    - *The Anti-Kickback Statute*
  - An FMV analysis will need to be completed by the appraiser to support the Commercial Reasonableness opinion

he Commercial
easonableness Analysis

Transactional Prerequisites

- "*Sensible, Prudent Business Agreement in the Absence of Referrals*"
  - Applies in the areas of:
    - *"rental of office space"*
    - *"rental of equipment"*
    - *"bona fide employment relationships"*
    - *"personal service arrangements"*
    - *"physician incentive plans"*
    - *"physician recruitment"*
    - *"isolated transactions, such as a one-time sale of property"*
    - *"certain group practice arrangements"*

teps in Determining ommercial Reasonableness



ualitative Analysis

- Does the arrangement accomplish a business purpose?
- Necessity of the property interest
- Enterprise/Organizational elements
- Nature/Scope of the property interest
- Quality, comparability, and availability of the subject property nterest
- Ongoing assessment, management control and other lements
- s the anticipated transaction for services/enterprises/assets nder the subject agreement otherwise legally permissible?

ommercial Reasonableness
ualitative Analysis

siness Purpose

- Transactions have a *business purpose* if they can be "*reasonably calculated to further the business of the lessee or acquirer*"
- Additional business purposes beyond net economic benefit
  - The net economic benefits generated from the invested capital may not be the sole business purpose of the anticipated transaction
  - Includes focus on:
    - Expansion into new geographic areas
    - Expansion into new business lines
    - Diversification benefits (e.g., diversifying payor mix, geographically, etc.)
    - Increased asset utilization
    - Improved research and development

"Medicare and State Health Care Programs: Fraud and Abuse: Clarification of the Initial OIG Safe Harbor Provisions and Establishment of Additional Safe Harbor Provisions Under the Anti-Kickback Statute," 64 Federal Register 63525 (11/19/99).
"Hospital Mergers: Why They Work, Why They Don't," By Larry Scanlan, Chicago, IL: Health Forum, 2010, p. 27.
"Mergers, Acquisitions, and Corporate Restructurings," By Patrick Gaughan, Hoboken, N.J: John Wiley & Sons, 2011, p. 14-15

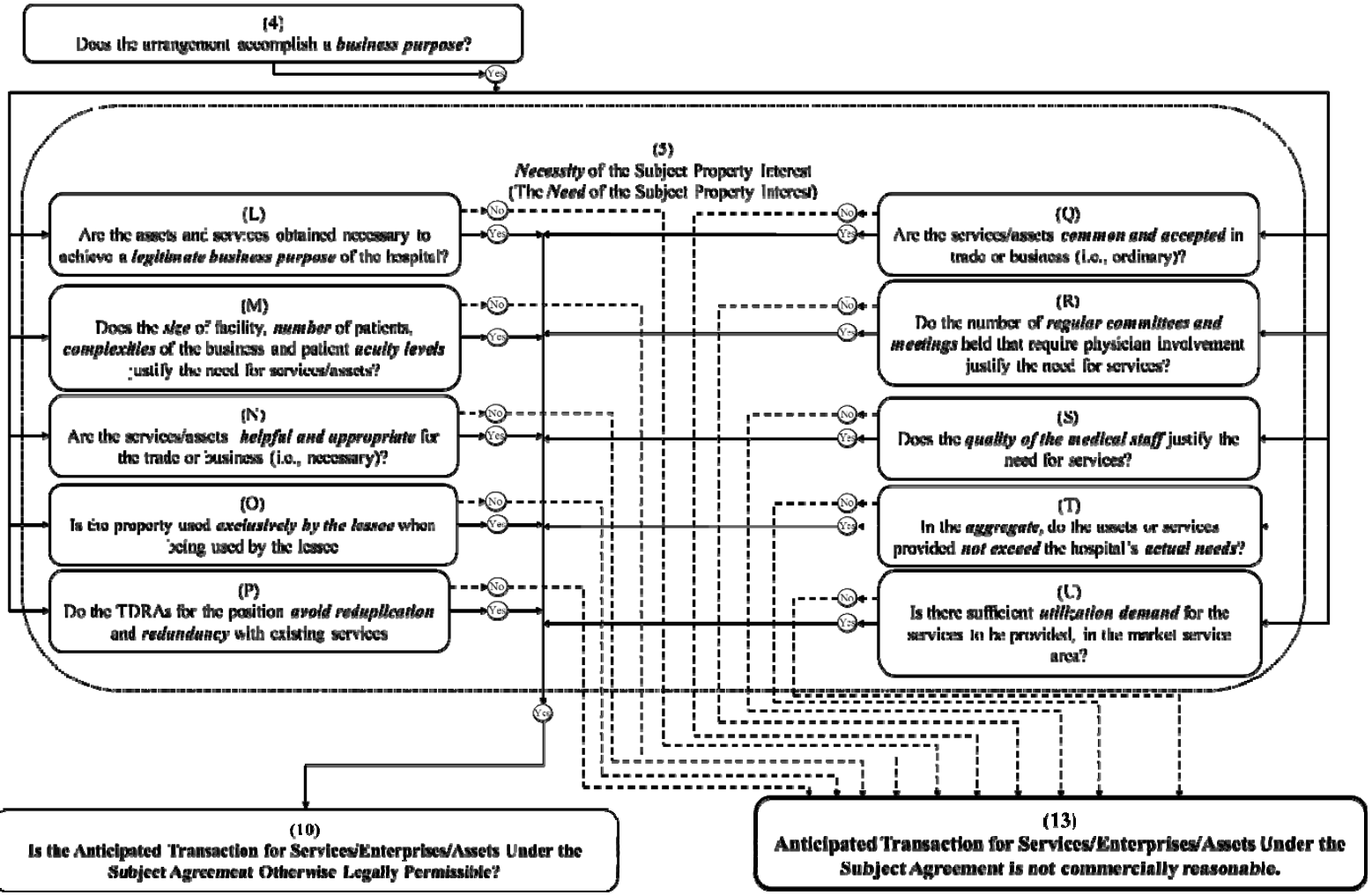
ommercial Reasonableness ualitative Analysis

Necessity of the Property Interest

- The IRS requires a determination of whether the consideration paid for the property interest is
  - "*ordinary*"
    - i.e., "*common and accepted in trade or business"*
  - *"necessary*"
    - i.e., "*helpful and appropriate for the trade or business*", in light of the "*the volume of business handled*" by the acquirer, e.g., the number of "*beds, admissions, or outpatient visits*;" "*the complexities of the business*;" and/or, the "*size of the organization*"

Trade or Business Expenses for Itemized Deductions for Individuals and Corporations for the Computation of Taxable Income for Normal Taxes and Surtaxes, 26 USC Section 162 (1/3/12). "Deducting Business Expenses, Internal Revenue Service, 1/2/2013, http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Deducting-Business-Expenses (Accessed 2/26/13). "Publication 535 Business Expenses, Internal Revenue Service, 2011, http://www.irs.gov/publications/p535/ch02.html (Accessed 2/25/13). "IRS

alytical Process for Assessing the cessity of the Subject Property Interest



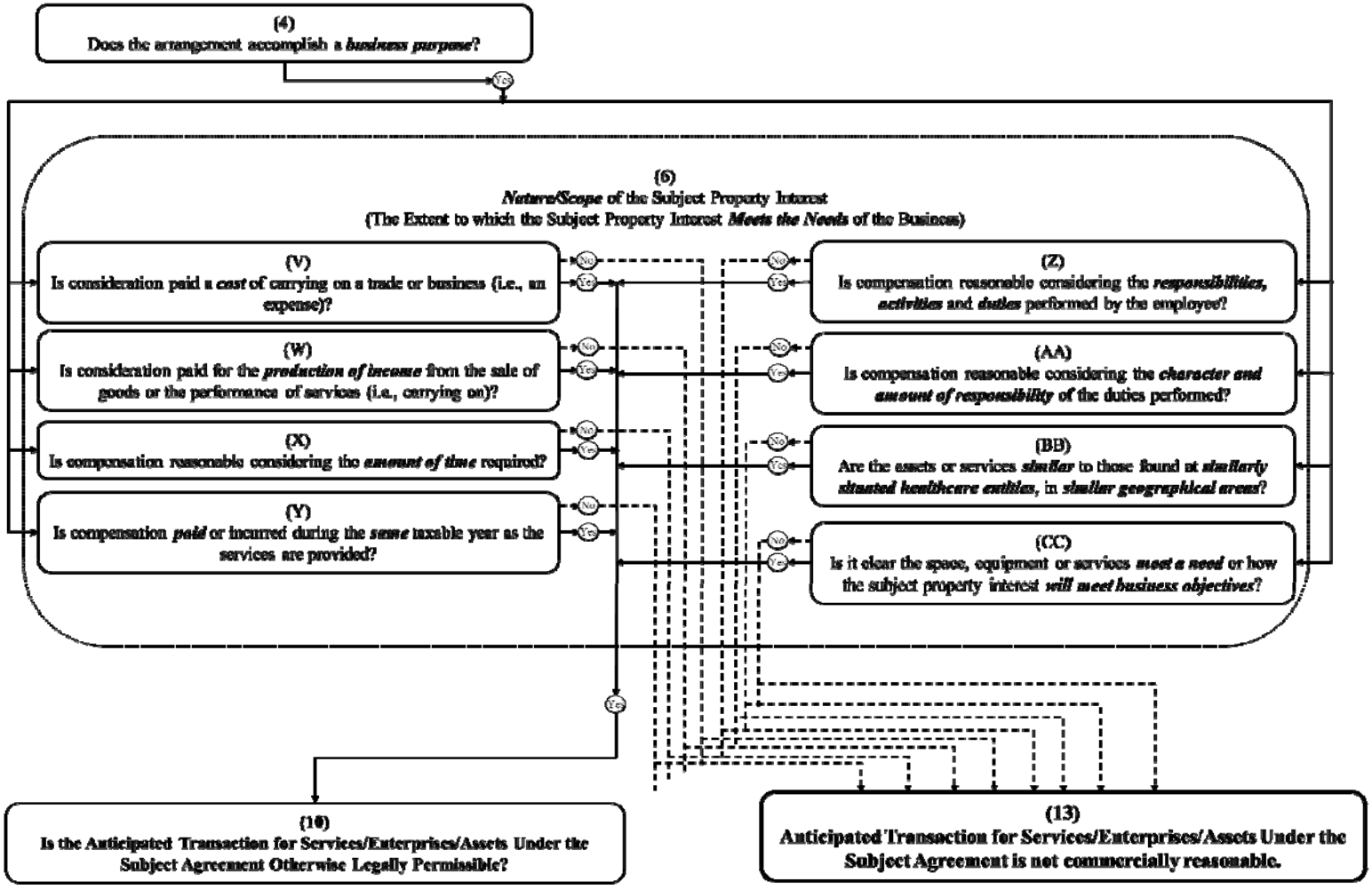
ommercial Reasonableness
ualitative Analysis

Nature and Scope of the Property Interest

- IRS - The nature and scope of services provided should be analyzed to determine as to whether their cost is:
  - A "*cost of carrying on a trade or business*"
  - Undertaken "*for the production of income from the sale of goods or the performance of services*"
  - "…*paid or incurred during the taxable year*"
  - "…*reasonable in terms of the responsibilities and activities…assumed under the contract*"
  - "…*reasonable in relation to the total services received*"

"Unrelated Trade or Business" in "Taxation of Business Income of Certain Exempt Organizations", 26 USC Section 513 (1/3/12). "Trade or Business Expenses for Itemized Deductions for Individuals and Corporations for the Computation of Taxable Income for Normal Taxes and Surtaxes", 26 USC Section 162 (1/3/12). "IRS

lytical Processes for Assessing the ure & Scope of the Subject Property Interest



Commercial Reasonableness Qualitative Analysis

terprise and Organizational Elements

The IRS pronouncements on reasonable compensation for tax purposes offer analysts guidance that a determination should be made as to whether the consideration paid for the property interest is "…*a sensible, prudent business agreement*…" within the context of:

- "*the pay compared with the gross and net income of the business*"
- "*business policy regarding pay for all employees*"
- "*the cost of living in the locality*," based on an analysis of the "*national and local economic conditions*" including whether the acquirer is located in a "…*rural, urban, or suburban*" area

"Medicare and Medicaid Programs: Physicians Referrals to Health Care Entities with Which They Have Financial Relationships", 63 Federal Register 1700, (1/9/98). "Publication 535 Business Expenses", Internal Revenue Service, 2011, http://www.irs.gov/publications/p535/ch02.html (Accessed 2/25/13). "Physician Compensation Arrangements: Management and Legal Trends", By Daniel Zismer,