Physician-Health System Compensation Plans

Lessons from the Tuomey Case and Other Recent Settlements

White Paper

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INTRODUCTION

The recent settlement of Tuomey Healthcare System's ("Tuomey" and/or the "Health System") infamous case involving asserted compliance violations advances salient points for structuring physician-hospital compensation arragements. The issue in the case related to compensating employed physicians in excess of fair market value (FMV) to lock up referrals to a healthcare system. Significantly, the parties reached a settlement of some $72.4 million due in refunds and penalties to the federal government. In review, the case originally was filed in 2005 by a qui tam relator who asserted that Tuomey violated the Stark law in its compensation structure of part-time employed physicians, maintaining that the Health System had paid those physicians over and above FMV for the primary reason of "purchasing" referrals. While an independent valuation expert provided a favorable FMV opinion on the compensation being paid under the employment arrangement, a government valuation concluded that the total compensation Tuomey paid to these employed physicians (in particular, for outpatient procedures) was 19 percent higher than their collections for those professional services. In other words, Tuomey deliberately operated at a significant loss with respect to these physicians, allegedly anticipating making up the difference in the technical (facility) fees.

Since 2005, there have been two trials and two Fourth Circuit appellate decisions in this matter. Along the way, the liability for Tuomey ranged from about $45 million to $237 million! In the first appeal, the Fourth Circuit cited two salient conclusions:

1. The facility fee (or technical fee) resulting from personally performed services are "referrals" under the Stark law. Accordingly, Tuomey's compensation arrangement was indirectly cognizant of the anticipated referrals from these physicians and took into account the volume (or value) of those referrals. Based on this circuit court's findings, the jury in the second trial found that Tuomey had impermissible relationships with those physicians, thus violating both Stark law and the False Claims Act (FCA). It further concluded that Tuomey had submitted in excess of 21,000 false claims to Medicare. That jury returned a verdict against Tuomey and awarded $237 million in FCA damages and penalties!

2. Later, the Fourth Circuit affirmed the jury's decision and Tuomey, and the Department of Justice (DOJ) sought a settlement. Now, almost a decade after the filing of the initial qui tam complaint, Tuomey and DOJ agreed to a $72.4 million settlement, with the relator receiving $18.1 million (25%) of the recovery! The settlement amount was based largely on Tuomey's concluded ability to pay (the second jury verdict exceeded Tuomey's annual revenues).

This case and its findings (and now its final settlement terms) provide significant lessons and after-the-fact conclusions for all parties involved, including healthcare advisors and FMV appraisers.

LESSONS LEARNED

As healthcare consultants, advisors to health systems and physicians alike, plus performing FMV and commercial reasonableness opinions for such clients, often through and/or working in conjunction with healthcare attorneys, we find ten major takeaways or underlying tenets to live by in light of Tuomey and other recent rulings and settlements. No matter how important the transaction appears to be, there are certain principles that all parties, including the independent valuator and consultant-advisor, must keep in mind.

…"rules are rules" and they must be followed without exception, even if the transaction is ultimately nullified or made less financially viable to maintain regulatory and legal compliance.

1. ***Legal/regulatory compliance must take precedence over all other considerations.*** Many of these transactions make sense by benefiting the community that the health system and physicians support, and they are in the economic best interests of all, even for federal and state governments. Nonetheless, the "rules are rules" and they must be followed without exception to maintain regulatory and legal compliance, even if the transaction is ultimately nullified or made less financially viable.

2. ***An advisor must evaluate the transaction on its specific merits and, even more, regarding the regulatory boundaries, without consideration for the value of referrals, utilization of hospital facilities, or any other downstream revenues post-transaction.*** This concern hits to the heart of the Tuomey case and other asserted violations.

3. ***Rigorous due diligence of each potential transaction is an essential requirement.*** Due diligence measures must be completed by all the parties involved, including those that are specific to the transaction (i.e., health systems, physicians, etc.), plus consultants/advisors, attorneys, and independent valuation firms. The due diligence must be conducted with independence and without regard to the tactical or strategic value of the transaction.

4. ***The independent appraisers of FMV and/or the transactional advisors must build an internal firewall separating the two initiatives.*** Although it may be inappropriate to assume both roles in a transaction, if a consultant is advising on the transaction and is asked to review or consider the financial terms, a firewall should be established to

ensure that those constructing the transaction recommend to the dealmakers a defensible economic scenario. Often, the dealmakers doing the negotiations are compromised if they are also asked to be involved extensively in the financial analysis in support of the deal. The tenet is to ensure the engagement of a separate, independent FMV firm for completion of the FMV analysis as well as a separate financial advisor to structure the transaction.

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5. ***Transactional advisors/consultants should elicit the counsel of healthcare legal specialists, ensuring that an additional validation results.*** Expert legal counsel should be fully aware and sign off on the key tenets (particularly economic) of the transaction before the completion of the transaction. While this does not mean that the attorneys do the job of the financial analysts/consultants, they should have a role in determining the appropriateness of the economic and non-economic terms and conditions.

6. ***Everyone should learn from relevant past mistakes and precedent cases.*** Though no two cases are identical and each situation should be considered upon its characteristics and merits, Tuomey and other cases involving the Stark law (such as the Halifax decision) can serve as a guide for forming our own conclusions within each transaction.

Every transaction should be constructed under the premise that, ultimately, government scrutiny and review will occur.

7. ***No independent valuation firm should allow their independence to be impugned for the sake of a particular outcome.*** While it is tempting to maintain positive relationships and thus secure future work from a particular health system or client, the independent valuation firm and the advisor to the transaction should never compromise its professional expertise (i.e., to acquiesce to a transaction that is at risk from the standpoint of regulation).

8. ***While emphasizing compliance and adherence to regulations and avoiding undue risks, the independent consultant advisor and/or the valuation firm must complete all assignments with accuracy and consistency.*** Every transaction should be constructed under the premise that, ultimately, government scrutiny and review will occur.

9. ***Notwithstanding the heightened governmental scrutiny, opportunities still avail for "win-win" fully-compliant transactions.*** The parties to such transactions can indeed

stay within the "white lines" and the advisors and attorneys should do their job in assisting to structure a transaction that is truly of benefit to the health system, the physicians and other providers, and the community in which they serve.

10. ***Gathering the full facts and performing thorough due diligence is essential and the best deterrent to regulatory compliance concerns.*** This effort may require more time, work, and even fees, but in the end, it is worth the extra time and expense.

CONCLUSION

The Tuomey case and others like it have undoubtedly had, and will continue to have in the future, an immense effect on health system, physician, and other provider transactions—and well they should. Though challenging to complete within compliance guidelines, legal transactions are possible that result in win-win arrangements for the good of all parties. Opportunities are available that comply with all the rules and regulations.

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Many factors must be considered to stay within regulatory compliance boundaries, yet there are still opportunities to create economically viable and regulatory compliant alignment and integration transactions. All parties—both outside and internal to the transaction—must be in sync with the requirements, understanding that not adhering to the regulations is unacceptable. Often, there are those that seem oblivious to the regulatory requirements and may regard their particular transaction as too small or under the radar of government scrutiny. Whether involved externally or internally to the transaction, all players should have quite the opposite attitude in anticipation of a governmental review.

At Coker Group, we are committed to adhering to the principles outlined in this paper relative to physician-hospital compensation transactions. We perform services that include FMV opinions; we assist in the negotiation process, as well. We avoid conflicts that arise from opinions on financial transactions for FMV when we are asked to be involved in a financial review as a transactional advisor/negotiator. But, even when we perform both financial analyses and transactional advisory services—all a part of the "deal-making" process—we build an internal firewall to prevent a potential conflict of interest. Simply, we recuse ourselves from over involvement. Still, there are many challenges and potential unknowns about the overall regulatory veracity of such transactions. As with the Tuomey case, much is left to interpretation. Our pledge: Together, we will work diligently in completing such transactions and in learning how best to conform to governmental regulatory requirements.