September 2013 Volume 10 Number 1

Tuomey – Another Verdict - FMV Boxing Match Continues

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Introduction

Those familiar with the ongoing *qui tam* case of *U.S. ex rel. Drakeford vs. Tuomey Healthcare System, Inc.*[1] know why it has been compared by some to a multi-round boxing match. The case has had truckloads of twists and turns, and after a recent retrial verdict against the hospital, the second jury verdict rendered in the case,[2] Tuomey now faces mammoth liability for Stark Law[3] and False Claims Act[4] violations. Given the size of the verdict relative to Tuomey's size and ability to pay, it is highly likely that it will be appealed. There are, simply put, a veritable plethora of legal questions in this case, which are discussed quite eloquently by others, including David Summer's companion article in this edition of *eSource*. Thus, for the most part, this article will not address the legal issues in great detail, and will instead focus attention on the larger economic and valuation implications of the case.

In short, when the dust settles, one might wonder how is it that a small 301-bed hospital in a rural town of just over 40,000 residents is potentially liable for up to $357 million, likely one of the largest Stark Law verdicts ever handed down.[5] Similar cases, some with arguably far worse facts, have been settled for a fraction of that amount.[6] In the end, the economic aspects of the case came down to a battle of valuation experts who disagreed as to whether the compensation plan under the physician arrangements in question were "commercially reasonable," consistent with "fair market value" ("FMV") and whether compensation "took into account the volume or value of referrals" as those terms are defined in the Stark Law and accompanying regulations.[7]

Key Valuation Concepts

One legal issue that cannot be avoided in this context is the Stark Law definitions of FMV, "commercial reasonableness," and whether compensation "takes into account the volume or value of referrals," all of which have been the subject of some debate in recent years, including notable comments, which are discussed further below, made by the Fourth Circuit in the *Tuomey* case itself, when it ruled on the appeal of the first trial.[8] The foundation of healthcare valuation is that most compliant transactions must have compensation that is commercially reasonable, consistent with the Stark FMV definition and does not take into account the volume or value of referrals. The Stark FMV definition is particularly important in that The Centers for Medicare & Medicaid Services ("CMS") has stated that it is different from traditional notions of FMV in other settings, such as IRS guidance in other industries.[9]

The CMS commentary to the Stark regulations, in particular, spends a large number of pages discussing these elements in great detail. For example, it covers aspects such as (i) avoiding the use of otherwise comparable transactions between parties in a position to refer to one another;[10]

(ii) specific types of transactions that are “deemed” not to take into account the volume or value of referrals;[11] and (iii) whether transactions make sound business sense in the absence of the referrals between the parties.[12] Among the types of compensation that are addressed at length are both (a) fixed compensation and (b) percentage based compensation formulas.[13]

The Fourth Circuit also provided its own noteworthy interpretation of these key Stark provisions, stating in this important passage:

> It stands to reason that if a hospital provides fixed compensation to a physician that is not based solely on the value of the services the physician is expected to perform, but also takes into account additional revenue the hospital anticipates will result from the physician's referrals, that such compensation by necessity takes into account the volume or value of such referrals.[14]

Three Valuations

Some of the key facts that all three valuators associated with the case grappled with include:

- The arrangements were for 10 year terms, and involved part-time employment, solely to provide ***outpatient*** surgeries; it was understood that the physicians remained in private practice for the balance of their time, including any ***inpatient*** surgeries performed at Tuomey’s facilities.
- Despite their part-time employment status, the physicians received full-time benefits and reimbursement of full professional liability insurance costs as part of their compensation package; they also agreed to non-competition provisions.
- Compensation involved a plan where the physicians received an amount that included both base salary that fluctuated based on net collections associated with the surgeries performed and a separate productivity “bonus” of 80 percent of net collections, making it virtually impossible for the part-time employment services to be profitable to Tuomey (without improper consideration of associated technical revenue).

At the time of entering into the transactions, Tuomey had obtained a valuation, in the form of a three-page opinion letter, which described the transactions and concluded the compensation was consistent with FMV, but with little supporting documentation or explanation of the methodology behind the valuation opinion. By way of example, the opinion did even not discuss the benefits provisions.[15]

At trial, the government argued (i) that the compensation was neither commercially reasonable nor FMV based on its own valuation expert, who cited primarily physician salary survey data,[16] and (ii) that the motivation for the alleged violations was the hospital’s desire to prevent the loss of its patient volume to an upstart nearby competing surgery center.

Tuomey countered by engaging a second valuator as a trial expert, and based on more extensive analysis than Tuomey’s original valuator, he argued that the compensation was consistent with FMV, citing various factors, including the difficulty of recruiting replacement physicians to Tuomey’s service area. However, this valuator also indicated that “there are some terms that are included in these agreements that we do not generally observe….”[17]

This “battle of experts” was one critical aspect of the two trials, and raises a number of key issues for discussion. When faced with competing or divergent valuation opinions, what can a court or jury (or even private parties) do to correctly determine FMV of compensation in a transaction? The government seems to disfavor “opinion shopping” (seeking out multiple appraisals to utilize the most favorable one to the particular party), and thus, some might argue it is necessary to rely

on the more conservative valuation to be certain that compensation is consistent with FMV and to mitigate any argument of opinion shopping.[18] On the other hand, the commentary in the Stark regulations states that the government intends to accept "any method that is commercially reasonable" to determine FMV.[19] Given that broad regulatory guidance, if multiple appraisals are capable of using different reasonable methods, one might suggest that any valuation may be selected and relied upon, provided it is based on a reasonable method, even if other opinions are more conservative.

In proving its case in the retrial, the government only needed to prove that any one of the three key Stark Law elements was not satisfied (commercial reasonableness, FMV, or that the compensation took into account the volume or value of referrals); in *Tuomey* the government argued that all three were not satisfied, and ultimately, the government's arguments carried the day.

Lessons Learned

The lessons learned in *Tuomey* (so far) include some important thoughts to remember, including:

- Arrangements with referral-source physicians are subject to high-risk. They should be carefully scrutinized to ensure that they are commercially reasonable, that compensation is consistent with FMV and that the arrangement does not take into account the volume or value of referrals.
- FMV under the Stark Law has some unique aspects, requiring significant experience to ensure that compensation is compliant with the regulatory guidance. Appraisers must be independent and knowledgeable about the healthcare industry. They must avoid consideration of the volume or value of referrals in determining the appropriate value.
- Arrangements that result in losses require a special level of scrutiny to ensure they are defensible. Losses may be supportable in some circumstances, but one needs to differentiate between justifiable losses and losses that simply result from overpayment of physicians.
- Unusual arrangement terms can be risky, particularly with respect to commercial reasonableness. Whether it makes good business sense to enter into a unique arrangement structure depends in large part whether the same parties would do the same deal if there were no referrals whatsoever.
- Parties must not ignore the non-cash remuneration, such as employment benefits and insurance costs, which played a key role in the government's argument that the overall compensation was unreasonable compared to the services provided.

Conclusion

Given their symbiotic relationship, physicians and the other entities that make up the healthcare industry will continue to enter into a multitude of legitimate transactions. The boxing match will continue between the parties in the *Tuomey* case, but the larger economic picture is perhaps more clear now that two juries have spoken. While it is not over, it seems that *Tuomey* already stands for the proposition that the economic risk of transactions with referring physicians is especially high, and when coupled with a unique transaction structure, a thorough understanding of the regulatory scheme and valuation process is an absolute prerequisite to wading into these dangerous waters.

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1 *U.S. ex rel. Drakeford vs. Tuomey Healthcare System, Inc.* (C.A. No: 3:05-cv-2858-MBS).

[2] The appeal of the first jury verdict resulted in that verdict being vacated by the Fourth Circuit Court of Appeals, and the case was remanded for a second trial. (No. 10-1819 (Fourth Cir. Mar. 30, 2012)).

[3] Physician Self-Referral Prohibition (more commonly known as the "Stark" law), 42 U.S.C. §1395nn

[4] 31 U.S.C. §§ 3729 – 3733.

[5] Population statistics from U.S. Census Bureau. Potential liability is taken from several articles reporting the verdict, including "High-stakes decision" by Joe Carlson, *ModernHealthcare.com*, May 11, 2013 (http://www.modernhealthcare.com/article/20130511/MAGAZINE/305119971).

[6] Two such settlements include the Covenant Medical Center settlement for $4.5 million – (http://www.justice.gov/opa/pr/2009/August/09-civ-849.html), and the Bradford Regional Medical Center case, which reportedly settled in 2012 for $2.75 million; see article by Marcie Schellhammer in the Bradford Era, published September 5, 2013 (http://www.bradfordera.com/news/article_b840892c-15d9-11e3-8557-0019bb2963f4.html).

[7] The definition of "fair market value" is found in the Stark statute at 42 U.S.C. § 1395nn (h)(3), with further elaboration in the regulations (42 C.F.R. § 411.351) and associated commentary at *66 Fed. Reg. 944, January 4, 2001* and *69 Fed. Reg. 16107, March 26, 2004*. The definition of "commercial reasonableness" is found only in the regulatory commentary at *66 Fed. Reg. 914, January 4, 2001* and *69 Fed. Reg. 16093, March 26, 2004.* The concept of compensation "taking into account the volume or value of referrals" is referenced throughout the Stark regulations and commentary, but most notably in 42 CFR § 411.354 (d)(2), as well as *66 Fed. Reg. 876, January 4, 2001* and *69 Fed. Reg. 16068, March 26, 2004.*

[8] (No. 10-1819 (Fourth Cir. Mar. 30, 2012)).

[9] See comments in preamble to Stark II Phase II regulations at *69 Fed. Reg. 16107, March 26, 2004.*

[10] *69 Fed. Reg. 16107, March 26, 2004*.

[11] See *66 Fed. Reg. 877, January 4, 2001.*

[12] *69 Fed. Reg. 16093, March 26, 2004.*

[13] 42 CFR § 411.354 (d), as well as *66 Fed. Reg. 876, January 4, 2001* and *69 Fed. Reg. 16068, March 26, 2004.*

[14] *(No. 10-1819 at *25, (Fourth Cir. Mar. 30, 2012)).*

[15] The initial valuation opinion letter was prepared by Cjeka Consulting, and is part of the Federal Court record in the case (as an exhibit to pre-trial motion briefs) (C.A. No: 3:05-cv-2858-MBS).

[16] The government's valuation expert was Myers and Stauffer, LC, and its associated valuation report is part of the Federal Court record in the case (as an exhibit to pre-trial motion briefs) (C.A. No: 3:05-cv-2858-MBS).

[17] Tuomey's valuation expert at trial was Integrated Healthcare Strategies, and its associated valuation report is part of the Federal Court record in the case (as an exhibit to pre-trial motion briefs) (C.A. No: 3:05-cv-2858-MBS). The quotation is found on page 13 of that valuation report.

[18] An example of this is the settlement of the Parkridge Medical Center case in Tennessee, where two appraisals were conducted, and the hospital apparently relied on the higher one. This was reported by Nina Youngstrom in the *Report on Medicare Compliance*, Volume 21, Issue 34, September 24, 2012, as reprinted in AISHealth (http://aishealth.com/archive/rmc092412-02).

[19] See *66 Fed. Reg. 944, January 1, 2004.*