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Counsel's Corner: Do-It-Yourself Valuation: Do You Need an Outside Appraiser to Determine Fair Market Value?

By Albert ''Chip'' Hutzler[1]

The number of transactions that implicate the federal health care laws is staggering. Couple that with the fact that these laws require that remuneration in those transactions to be consistent with ''fair market value'' (FMV),[2] and the question quickly becomes how to accurately and consistently determine FMV for so many transactions. The fact that determining FMV is anything but intuitive and straightforward further complicates the picture.[3] For hospitals, pharmaceutical and device companies, or other large health care organizations, much of the work of determining FMV is handled internally. This article addresses the challenges and best practices for the ''do-it-yourself'' (DIY) valuations that are, in many circumstances, simply an unavoidable fact of life.

The Difficulty of Determining FMV for Health Care Transactions. Because the guidance provided by the government is limited and somewhat vague, determining FMV in any specific case can be extremely difficult. The key passages of the Stark regulations and commentary that define FMV[4] acknowledge that it is purposely different from the IRS version of the FMV standard[5] and provide vague and disjointed guidance on how to determine FMV in a series of separate pronouncements.[6] On the one hand, the guidance suggests that parties may use ''any reasonable method'' to determine FMV.[7] On the other hand, the commentary indicates that FMV is de-

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[2] Laws and regulations that have FMV requirements include: (i) the physician self-referral prohibition or ''Stark'' law (42 U.S.C. § 1395nn); (ii) the federal anti-kickback statute (42 U.S.C. § 1320a-7b); (iii) Internal Revenue Service private benefit guidance and intermediate sanctions rules (see Treas. Reg. 53.4958 et seq.); and (iv) the Foreign Corrupt Practices Act (15 U.S.C. § 78dd-1).

[3] The IRS issued its FMV standard in Revenue Ruling 59-60, and the Stark law modified it in 42 U.S.C. § 1395nn(h)(3) and 42 CFR § 411.351. A 947-page textbook on the subject, *BVR/AHLA Guide to Healthcare Industry Compensation and Valuation*, edited by Timothy Smith and Mark O. Dietrich (2012), provides a glimpse of just how difficult it can be to determine FMV in the context of the IRS and Stark definitions.

[4] The definition is in 42 CFR § 411.351. Commentary on the Stark definition is found at: 72 Fed. Reg. 51015 (Sept. 5, 2007); 69 Fed. Reg. 16107 (March 26, 2004); 66 Fed. Reg. 944 (Jan. 4, 2001); and 63 Fed. Reg. 1686 (Jan. 9, 1998).

[5] The Stark commentary states, ''[m]oreover, the definition of 'fair market value' in the statute and regulation is qualified in ways that do not necessarily comport with the usage of the term in standard valuation techniques and methodologies.'' The commentary also indicates that commenters suggested that CMS create a rebuttable presumption similar to the IRS notion (*see* Treas. Reg. 53.4958 et seq., which includes provisions that create a rebuttable presumption that the parties did not intend to confer a private benefit, thereby reducing or eliminating liability, if they rely in good faith on a qualified independent valuation), but CMS declined to create a similar framework, stating instead, ''[w]hile good faith reliance on a proper valuation may be relevant to a party's intent, it does not establish the ultimate issue of the accuracy of the valuation figure itself.'' 69 Fed. Reg. 16107 (March 26, 2004). Previously, the OIG had also explained the rationale for its differences from IRS guidance in 56 Fed. Reg. 35972 (July 29, 1991).

[6] *See* note 3.

[7] 66 Fed. Reg. 944 (Jan. 4, 2001).

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fined in a way that limits the ability to use traditional methods that are used in the IRS context.[8] Furthermore, in the Stark commentary, CMS made it clear that DIY valuations are allowed, stating:

We agree that there is no requirement that parties use an independent valuation consultant for any given arrangement when other appropriate valuation methods are available. However, while internally generated surveys can be appropriate as a method of establishing fair market value in some circumstances, due to their susceptibility to manipulation and absent independent verification, such surveys do not have strong evidentiary value and, therefore, may be subject to more intensive scrutiny than an independent survey.[9]

While the guidance clearly indicated a preference for independent third-party appraisals whenever possible, CMS recognized that it is not feasible to require independent appraisals in every case. Simply put, CMS recognized that there are too many transactions that are subject to the FMV requirement to insist that all valuations be conducted by an independent third party. That said, settlements and corporate integrity agreements involving the government often require the settling party to obtain outside valuations for a subset of its riskier transactions for an agreed-upon period of time.[10]

When Are Do-It-Yourself Appraisals Sufficient? Despite the fact that health law regulatory guidance allows for DIY valuations, questions remain as to when DIY valuations are sufficient and when independent third-party appraisals should be obtained. The fact that DIY appraisals are allowed at all suggests the government felt that in some circumstances, a DIY appraisal would be sufficient. The key passage from the commentary above suggests that the government's concerns with DIY appraisals revolve mainly around the risk of bias and manipulation and concerns about rigor and consistency of internal valuations.[11]

An organization's decision concerning which transactions to value internally and which to value externally should be based on the risk of those factors (internal bias, rigor, etc.), as well as the relative risk of exposure to health care liability. Some transactions are riskier than others simply because their characteristics alone may tend to suggest inducement, whether or not any inducement actually exists, including, for example, those with high dollar remuneration amounts, or those with physicians who are large, rather than merely occasional, referral sources.[12] Some transactions that may seem simple to value may in actuality be quite risky solely because that there are substantial referrals between the parties. Because entities that receive referrals from physicians face substantially greater penalties and financial risk under the Stark law scheme (because they file the Medicare claims for the ''designated health services'' or DHS), they are more apt to need the extra protection of an external appraisal.[13]

Do-It-Yourself Valuation Best Practices. If an organization decides to conduct a DIY valuation, it must understand that there is no set off-the-shelf methodology that will fit every circumstance. However, despite the inherent risks of the DIY approach, there are some things the organization can do to protect itself from potential liability. A few best practices include:

- Use a consistent valuation method;
- Use multiple valuation approaches;
- Use multiple objective surveys;
- Avoid cherry picking survey data;
- Beware of productivity ratios in the survey data;
- Beware of anecdotal data;
- Beware of strategic value;
- Avoid valuations based on ''opportunity cost'' calculations;
- Beware of stacking multiple compensation elements on top of each other (*i.e.,* consider whether the aggregate compensation makes sense);
- Beware of double payments—understand the current reimbursement system, including the split between the ''professional'' and ''technical'' services;
- Beware of circular databases—databases heavily influenced by one's own transactions are dangerous;
- In physician practice acquisitions, be sure to consider post-transaction compensation;
- Beware of placing value on intangible assets—they might have value, depending on the circumstances, but valuing them correctly requires experience, skill and caution;
- Avoid rewarding internal valuators based on deal success or related profits (e.g., ancillary revenue);
- Consider valuation frameworks—have the framework reviewed by independent third-party;
- Be sure to separately consider and document commercial reasonableness;
- Have a consistent policy for when to refresh DIY valuations.

[8] *See* note 4.

[9] 66 Fed. Reg. 945 (Jan. 4, 2001).

[10] *See* for example, corporate integrity agreement between OIG and HCA Inc. (2000), and deferred prosecution agreements between the Department of Justice and Stryker, Zimmer and other device manufacturers (2007).

[11] 66 Fed. Reg. 945 (Jan. 4, 2001).

[12] The U.S. Court of Appeals for the Fifth Circuit recently found that the simple fact that physicians upon employment by a hospital received higher compensation than they had received previously was enough evidence to survive a motion to dismiss (*United States ex rel. Parikh v. Brown*, 587 Fed. Appx. 123, 2014 BL 276211 (5th Cir. 2014)). The case was later settled and dismissed, *Parikh v. Citizens Med. Ctr.*, 5th Cir., No. 10-64, *dismissed by stipulation*, 5/7/15.

[13] The Stark law prohibits financial relationships between physicians and entities they refer patients to for DHS unless the financial relationship fits into a Stark exception (42 U.S.C. § 1395nn(a)(1)). Penalties for any DHS entity that violates Stark are based on the magnitude of DHS claims it files (42 U.S.C. § 1395nn(g)). DHS is a defined list of certain specific medical services (mostly imaging, lab and other ''technical'' component or ancillary services), which importantly include all inpatient and outpatient hospital services, and most orders for drugs or medical devices (42 U.S.C. § 1395nn(h)(6)).

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Conclusion. DIY valuations may be considered riskier than external assessments but they are a necessary operational component for many health care organizations. Those entities can reduce the potential health care law violation risk by engaging in a number of important steps. Although some of the recommended steps may be easier to implement than others, given the associated risks of exposure, all of them are worth considering.