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Best Practices in Regulatory-Compliant Physician Compensation Plan Design

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The negotiations have concluded, the contract has been submitted for legal review and the physician candidate has scheduled the moving truck. Everything is proceeding according to plan… until the compliance team calls to say that a fair market value opinion supporting the arrangement is required. The next few days (or weeks) give rise to unexpected stress levels. The valuation firm has requested a stack of data to analyze what seems, on the surface, to be a straightforward compensation plan. The candidate grows anxious to see the final contract. Internal pressure to get a signed contract rises. Is this deal going to fall apart in the final hour? What went wrong?

This last-minute scramble to "paper the deal" is surprisingly common. Fortunately, with proper planning and diligence, the valuation process for a physician employment arrangement can be greatly simplified. Based on our review of thousands of such arrangements, we present some best practices that can help avoid a deal-threatening crisis.

1. Be familiar with internal requirements for outside valuation opinions and engage a reputable valuation consultant early in the process

While internal valuation review is allowed, previous government guidance indicates a preference for independent third-party appraisals, as internal assessments may be subject to bias from deal pressure and give rise to consistency concerns. As a result, many hospitals and health systems have developed policies that specify when an outside opinion must be obtained. Familiarity with such policies by those involved in contract negotiations allows early identification of deals that require outside review. Obviously, the sooner the valuation process begins, the more likely it becomes that the opinion will be ready prior to completing negotiations. It is preferable to present FMV-compliant terms to the candidate initially than to withdraw an offer that is ultimately not supportable.

When engaging an independent consultant, employers are encouraged to be as transparent as possible with the physician candidate regarding the FMV review. Allowing the physician to have access to the consultant may lessen suspicion of what can appear to be a "black box" process or be perceived as a negotiating tactic.

2. Answer the "why" question

A compliant physician compensation arrangement must be commercially reasonable. The key question surrounding commercial reasonableness is: "Would the parties enter into this arrangement even if there were no potential referrals?" When assessing commercial reasonableness, it can be helpful to consider the following: (i) Does the employment of this physician serve a legitimate business or mission-driven purpose absent consideration of referrals? (ii) Do the qualifications of the candidate align with the position's requirements? (iii) Does the method of compensation make sense given the nature of the services? (iv) Can a single physician reasonably perform all of the duties that are being requested? (v) Is the proposed compensation reasonable in the context of what the physician was earning prior to employment? (vi) Is there a solid business case to justify potential practice losses without considering referrals? If the answer to any of these questions is "no," then consider whether the commercial reasonableness of the arrangement can be supported.

3. Understand the market survey data before using it

Employers and physician recruiters often reference one or several market surveys when developing compensation proposals, and physicians review survey data to assess a potential employment offer. When relying on market data, it is vital to have an understanding of what the data represents and how it should be used. Here are some key points:

(i) The compensation data reported by the surveys typically is "all in." That is, it represents total cash compensation from all sources, including patient services, administrative duties, call coverage, ownership distributions and ancillary margins. This definition is important to understand when establishing the agreement's core compensation measures. The use of a high compensation rate coupled with additional payments for various other services may give rise to "stacking" concerns.

(ii) The "compensation per unit" data reported by the market surveys (e.g., compensation per wRVU, compensation as a percentage of collections) is inversely correlated with production. In other words, the highest compensation per wRVU rates often are attributable to physicians at the lower end of the production spectrum. This phenomenon is a byproduct of the survey data collection and reporting methods. The surveyors gather data regarding annual total cash compensation and annual clinical production and use this information to calculate compensation per unit rates for the reporting practices. As a result, the highest compensation per unit rates often reflect physicians on salary guarantees with low productivity. To yield FMV total compensation, the rate of compensation per production unit for a high producer will be lower than that for a low producer in many cases.

4. Perform diligence in selecting "benchmark" compensation metrics

Although value-based compensation is gaining momentum, productivity-based compensation remains the dominant model. Employers should avoid blindly defaulting to median compensation rates for use in production-based compensation plans. While the median rate can result in FMV compensation in many cases, there are certain instances where it may not be appropriate. For example, a median compensation per wRVU rate applied to a very highly productive physician may result in annual compensation that benchmarks materially higher than his or her clinical production. Alternatively, even a median rate may result in a substantial compensation increase for the physician and cause sustained practice losses for the new employer. In any case, the compensation rate should reflect what is supportable based upon the facts, circumstances and economics of the specific arrangement.

5. More complex doesn't mean better

We frequently encounter tiered production compensation plans with escalating conversion rates. Under such plans, the physician's conversion rate increases as production increases. Unless these plans are carefully structured, it is common for these arrangements to result in a material disconnect between annual compensation and production. It is useful to perform sensitivity modeling to evaluate the potential total cash compensation under various production scenarios. If the plan results in compensation that benchmarks materially higher than clinical production, evaluate whether the physician will reasonably achieve the production levels at which the distortion occurs. If so, consider redesigning the plan. Plans that align compensation rate benchmarks with annual production benchmarks (e.g., 75th percentile compensation per wRVU applied to 75th percentile annual wRVU production) will almost certainly be problematic from a compliance standpoint.

6. Identify and address common compensation stacking issues

Physicians are being compensated for more clinical and administrative duties than ever before. A physician may receive a base salary, production-based incentive compensation and several additional forms of compensation that may include quality-based compensation, call coverage compensation, medical director compensation and midlevel provider supervision compensation. As these various forms of compensation are "stacked" on top of one another, it can result in aggregate compensation to the physician, whether on an annual or "per unit" basis, that exceeds supportable levels.

To mitigate stacking concerns, employers should ensure that separate forms of compensation are attributable to separate and distinct services and time. It is a good practice to structure medical directorships as hourly arrangements, with detailed time sheets required, rather than annual stipends. Midlevel provider supervision payments are also becoming commonplace. Before implementing such compensation, employers should evaluate whether these duties reasonably warrant additional compensation (e.g., the services result in a productivity drag that impacts the physician's potential to earn production compensation), or whether the physician is already being compensated for this time in his or her base salary. Additionally, midlevel providers can contribute significantly to a physician's performance relative to quality objectives. If the physician is eligible for both a quality-based bonus and midlevel provider supervision compensation, employers should ensure that the compensation reflects separate and distinct personally-performed services.

It is common for physicians to be compensated for providing emergency department call coverage. In our experience, many employers require a certain number of shifts to be provided on an uncompensated basis (usually at least five shifts per month). Additionally, as mentioned previously, since the surveys' compensation data reflects total cash compensation, the reported compensation rates already include a certain "market-level" amount of call pay. Therefore, to avoid a disproportionately high level of call compensation relative to the market, it is advisable to build in similar uncompensated coverage requirements and provide additional compensation only for shifts in excess of this threshold.

Recruitment packages often include signing bonuses, commencement bonuses, student loan assistance and other up-front one-time payments. It may seem obvious, but these payments must also be considered when assessing the physician's total compensation. To evaluate whether stacking is a concern, it can be beneficial to evaluate the physician's potential total compensation under the agreement on a "per unit" basis based on expected clinical production. If this metric approaches or exceeds the 75th percentile, consider whether this benchmarking makes sense for the subject arrangement. A relatively high implied compensation per wRVU rate may be justified for a physician who devotes a significant amount of time to administrative duties or provides a disproportionately high amount of call coverage.

Physician employment arrangements are becoming increasingly complex, and the risk of a non-compliant arrangement are significant. The considerations outlined herein should be of assistance to employers seeking to successfully navigate the FMV review process. When in doubt, seek independent guidance as early as possible in the process to ensure the best outcome possible. ■

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