



## Physician Compensation: 10 Key Legal Considerations

### **SCOTT BECKER**

312.750.6061 | [sbecker@mcguirewoods.com](mailto:sbecker@mcguirewoods.com)  
77 West Wacker Dr.  
Chicago, IL 60601-1818

### **GRETCHEN TOWNSHEND**

312.849.8237 | [ghtownshend@mcguirewoods.com](mailto:ghtownshend@mcguirewoods.com)  
77 West Wacker Dr.  
Chicago, IL 60601-1818

### **HOLLY CARNELL**

312.849.3687 | [hcarnell@mcguirewoods.com](mailto:hcarnell@mcguirewoods.com)  
77 West Wacker Dr.  
Chicago, IL 60601-1818

### **MELESA FREERKS**

312.849.8258 | [mfreerks@mcguirewoods.com](mailto:mfreerks@mcguirewoods.com)  
77 West Wacker Dr.  
Chicago, IL 60601-1818

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[www.mcguirewoods.com](http://www.mcguirewoods.com)

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# Physician Compensation: Ten Key Legal Considerations

As the trend of hospital employment of physicians continues, federal and state governments have increased their focus on physician compensation and compliance with healthcare laws. In the past several years, investigations focusing on compensation paid by a hospital to its physician employees have dramatically increased. This paper briefly discusses 10 key considerations related to hospital-physician compensation arrangements.

## 1. Key Federal Laws Affecting Physician Compensation

Three main laws impact employment arrangements between hospitals and physicians: the Stark Law, the federal Anti-Kickback Statute and Internal Revenue Service (IRS) guidelines.

- a. *The Stark Law* was enacted by Congress in 1989 as a response to studies that showed potential overutilization of lab services for patients whose referring physicians had a financial interest in the laboratories. Today, the Stark Law generally prohibits a physician or immediate family member who has a financial relationship with an entity, such as a hospital, from making referrals to that entity for “designated health services” covered by Medicare, unless a specific exception applies. The Stark Act, like the Anti-Kickback Statute, has an exception for bona fide employment arrangements. The Stark Law is a strict liability statute and civil penalties may be imposed for violations.
- b. *The Anti-Kickback Statute*, known as the Fraud and Abuse Statute, makes it a crime to pay, offer, solicit or receive remuneration, directly or indirectly, to induce referrals or services of Medicare or Medicaid business, unless a safe harbor applies. If an arrangement does not meet a safe harbor, the arrangement is not presumptively illegal; rather, because the statute is intent-based, the payment or receipt of payment must also be made “knowingly and willfully.” However, the statute is worded broadly and in order to constitute a violation, only one purpose of the payment must be to influence referrals. A violation of the Anti-Kickback Statute is a felony.
- c. *The Internal Revenue Code* provides for certain not-for-profit entities, such as hospitals, to qualify as a § 501(c)(3) organization exempt from federal income taxation. This exemption provides numerous benefits in addition to tax exemption, such as the ability to apply for certain grants and use of tax-exempt bond financing. The exemption also carries many obligations, such as the requirement that the organization must serve a public, rather than a private, interest. The IRS regulations create special rules regarding compensation structures for employed physicians. Specifically, a tax-exempt hospital cannot pay more than reasonable compensation for services rendered to the organization. Violations of the IRS guidelines may cause a hospital to lose its tax-exempt status and may result in the imposition of civil sanctions.

## 2. Bona Fide Employment Arrangements

Both the Stark Law and the Anti-Kickback Statute contemplate employment of physicians by hospitals, and accordingly, both include an exception to accommodate the compensation paid by a hospital employer to a physician employee. The Bona Fide Employment Relationship exception to the Stark Law provides that physicians are permitted to be compensated as employees of hospitals as long as the amount paid to the physician is: (i) for identifiable services; (ii) consistent with the fair market value for services performed; and (iii) not determined in a manner that takes into account the volume or value of referrals by the referring physician to the hospital. Further, the remuneration provided

under the employment agreement between the hospital and physician must be commercially reasonable even if no referrals were made by the physician to the hospital. The Anti-Kickback Statute safe harbor for employment relationships is not as narrow as the Stark Law exception and provides that “remuneration” does not include any compensation paid by an employer to an employee, who has a bona fide employment relationship with the employer.

### **3. Fair Market Value Requirement**

To comply with the laws described above, compensation paid to physicians by hospitals must be generally consistent with fair market value (FMV) and not take into consideration the value or volume of referrals an employed physician may bring to the hospital or the hospital’s affiliates. Specifically, a hospital may not base any part of a physician’s compensation on the expected value of business the physician will refer to the hospital. Rather, the compensation must be consistent with fair market value for the actual services provided by the physician on behalf of the hospital. It is generally permissible to pay a physician fair market value for his or her own personal productivity. Fair market value is defined by the Stark Law as the “value in arm’s length transactions, consistent with the general market value.” The federal regulations have interpreted “general market value” to refer to the compensation that would be included in a service agreement as the result of a bona fide bargaining arrangement between well-informed parties to the agreement who are not otherwise in a position to generate business for the other party, at the time of the service agreement. The safest approach for determining fair market value is to seek an independent valuation firm to perform a compensation review.

### **4. No Payment for Ancillary Services**

Under the Stark Law and the Anti-Kickback Statute, physicians cannot receive payment for the volume or value of referrals made for technical services. Specifically, this means that although a physician may be compensated for the services that he or she personally performs (e.g., consultations and surgeries), the physician cannot be compensated in any manner for referring a patient for ancillary services such as diagnostic tests, physical therapy or the prescription of durable medical equipment. A physician, however, may be compensated for personally performing the professional component of an ancillary service (i.e., radiology reads). The rules regarding ancillary services in a hospital-physician relationship are different from the rules regarding ancillary services applicable to a physician practice. In a physician group practice setting, under certain circumstances the practice is permitted to distribute revenues generated from ancillary services to physician members of the group practice — a hospital, however, is strictly prohibited from making such payments to its physician employees.

### **5. IRS Guidelines and Tax-Exempt Entities**

The IRS has stated that when determining whether a physician’s compensation is appropriate, the tax-exempt hospital should ensure the total compensation package provided to a physician is reasonable for the physician’s specialty and area. The IRS created a rebuttable presumption whereby physician compensation is reasonable if: (i) the compensation arrangement is approved in advance by an authorized body of the applicable tax-exempt hospital, which is composed of individuals who do not have a conflict of interest concerning the employment arrangement; (ii) prior to making its determination, the authorized body obtained and relied upon appropriate data as to comparability; and (iii) the authorized body adequately and timely documented the basis for its conclusion concurrently with making that determination. If, however, an employment arrangement does not satisfy the rebuttable presumption requirements, a facts and circumstances approach will be followed, and intermediate sanctions may be imposed if it is found that the compensation is excessive. Intermediate

sanctions may include the imposition of an excise tax against the physician and the hospital manager who approved the employment arrangement. The intermediate sanctions rules apply only to compensation arrangements with “disqualified persons.” Disqualified persons are persons who are in a position to exercise substantial influence over the organization; this can include employed physicians, especially where the employed physician is highly compensated or holds an administrative position. However, even if a compensation arrangement does not involve a disqualified person, a tax-exempt institution cannot pay more than fair market value due to the restrictions on private inurement.

## 6. Fair Market Value Surveys

Fair market value is typically supported by surveys from third parties. In its commentary to the Stark Law, the Centers for Medicare and Medicaid Services recommends the use of multiple, objective, independent, published surveys for evaluating the FMV of physician compensation. Commonly used surveys to determine the FMV of a physician’s compensation are the (i) Medical Group Management Association (MGMA) compensation survey; (ii) the Medical Group Compensation and Financial Survey published by the American Medical Group Association; and (iii) the Physician Marketplace Statistics survey published by the American Medical Association. Using fair market value surveys alone, however, is not enough. The surveys must be appropriately applied to the given compensation arrangement and considered alongside other factors. For example, the base data used to calculate future compensation should be a reasonable indicator of future productivity, i.e., there should be no cherry-picking of baseline data to yield a higher future compensation figure. Furthermore, as discussed above, ancillary profits should not be taken into account when evaluating compensation. It is also unreasonable to use median survey figures to determine compensation for all physicians — a physician’s compensation should generally reflect his or her own productivity. Lastly, hospitals must take into account all sources of physician revenue to ensure the sum of the parts is still FMV and commercially reasonable. For example, if a physician holds multiple medical director positions, is eligible for bonuses and maintains a private practice, consideration must be given to each of these revenue sources when determining the FMV of physician’s compensation.

## 7. False Claims

A claim for items or services resulting from a violation of the Stark Law or Anti-Kickback Statute constitutes a false claim under the False Claims Act (FCA). The FCA imposes liability on persons and companies who defraud governmental programs. The FCA includes a *qui tam* provision that allows people who are not affiliated with the government to file actions on behalf of the government (informally called whistleblowing). Over the past several years, the federal government has continually amended the FCA to provide it with more teeth. Numerous cases demonstrate the application of the FCA to healthcare companies. Most recently, in July 2013, the Department of Justice announced that it will intervene in a False Claims Act lawsuit against Infirmity Health System Inc. and its related entities, including IMC-Diagnostic and Medical Clinic P.C. and Diagnostic Physicians Group P.C. The lawsuit alleges that IMC-Diagnostic and Medical Clinic, improperly paid Diagnostic Physicians Group physicians compensation that included a percentage of the money collected from Medicare for tests and procedures the doctors referred to the clinic. The *qui tam* plaintiff alleges that the improper payments resulted in the submission of false claims to the Medicare program and violate both the Stark Law and the Anti-Kickback Statute.

## 8. Relevant Cases Examples

Below are some recent cases and settlements that have focused on the Stark Law or Anti-Kickback Statute issues related to physician compensation.

- a. *Covenant Medical Center (Waterloo, IA)*. Covenant was alleged to have violated the Stark Law by paying commercially unreasonable compensation to five physicians in return for referrals. The physicians were allegedly among the highest-paid hospital-employed physicians in the entire United States, with two of the five physicians making more than \$2 million per year. The hospital settled for \$4.5 million.
- b. *Toumey Hospital (Sumter, SC)*. In *Toumey*, after a multiyear legal battle a jury concluded that the compensation paid to physicians under certain part-time employment agreements violated both the False Claims Act and the Stark Law. The jury concluded that even though Tuomey relied upon an expert assessment of the fair market value of the employment agreement, when other factors were considered, the arrangements were in essence payment for referrals. Under the False Claims Act, Tuomey's penalties could exceed \$350 million.
- c. *King's Daughters' Hospital and Health Services (Madison, IN)*. In this case, the hospital self-disclosed its conduct involving employment contract bonuses based on services that the physicians did not personally render. Such an arrangement constitutes a violation of the Stark Law. The hospital settled for \$391,500.
- d. *St. Joseph Medical Center (Towson, MD)*. St. Joseph paid \$22 million to settle allegations of payment of kickbacks to MidAtlantic Cardiovascular Associates under the guise of professional services agreements in return for the group's referrals to the hospital. The settlement specifically resolved issues relating to professional services agreements that were being investigated for being above fair market value, not commercially reasonable or for services not rendered.

## 9. Compliance Measures

To protect itself and its employed physicians, a hospital should employ certain practices to standardize physician employment arrangements.

- a. A hospital should ensure that all compensation contracts with physicians are in writing, are signed by all parties and do not take into consideration the volume or value of referrals. The hospital should also ensure that internal documentation is retained to support the fair market value nature of the compensation. The documentation should include the manner in which the compensation was determined and if the surveys were utilized, and whether an opinion from a third-party valuation firm was sought.
- b. All physician compensation arrangements should include a clear job description outlining the specific duties and services to be performed. Hospitals should also maintain an analysis and record of why a physician position is reasonably needed by the hospital. This may be particularly important where the need for the position may not be inherently clear or where a newly created position is being filled.
- c. Hospitals should strongly consider obtaining third-party support for physician compensation arrangements where the physician is unusually productive or the compensation structure is outside normal practice.
- d. As part of periodic compliance reviews, the hospital and physician should ensure that all agreements meet a core exception under the Stark Law and will comply or substantially comply with a safe harbor to the Anti-Kickback Statute.

- e. It is also important that each compensation relationship is periodically reviewed on an ongoing basis to ensure the compensation is still consistent with FMV and complies with applicable law.
- f. A hospital should also consider adopting a reasonable compensation cap, especially if the arrangement is pursuant to a productivity-driven compensation structure. This concept is based on IRS guidance and may be more important where the arrangement has the potential for unusually high compensation.

## 10. Other Applications of the Key Federal Laws

The Stark Law, Anti-Kickback Statute and IRS guidelines generally apply to all financial arrangements between hospitals and physicians, including lease arrangements, medical directorships, recruitment stipends and even seemingly *de minimus* financial arrangements such as holiday parties, medical staff activities and CME allowances. Because of the broad applicability of these federal laws, each financial relationship between a hospital and physician should be structured to strictly comply with an applicable Stark Law exception and comply, or substantially comply, with an Anti-Kickback Statute safe harbor.