

Stark Laws and Fair Market Value Exceptions: An Introduction

*Paul B. Siebrasse, A.S.A.**

This article will focus on one aspect of complexity in modern healthcare, namely the implications of Stark laws and other fraud and abuse provisions, including anti-kickback statutes and HIPAA. Also, this article explores the prevalence of fair market value as an exception in the Stark laws and discusses the meanings of those exceptions. Finally, the article explores basic approaches to assessing fair market value, including cost, income, and marketing approaches.

Key words: Stark laws; anti-kickback statutes; HIPAA; fair market value.

As a kid, I remember driving around with my father in his 1956 Chevy Bel Air—certainly now considered a classic American ride. Today, I drive a car that is vastly superior—superior in its acceleration, braking, fuel economy, comfort, and safety, among other things. But what has enabled this improved performance? Today's cars are dramatically more complex than my father's 1956 Bel Air. This parallel between complexity and performance can also apply to modern healthcare.

This article will focus on one aspect of this complexity, namely the implications of Stark laws and other fraud and abuse provisions. Even with this narrower scope, this article cannot fully address all related issues. Consequently, my review of various laws and compliance methodologies is not exhaustive. Rather, you should consult with appropriate professionals about the details of any particular compliance issue.

The first compliance issue we'll consider are the anti-kickback statutes, enacted as early as 1972. These statutes made it a felony to refer an individual for service or induce a referral for services that are reimbursed by Medicare or a state healthcare program. Another is the Federal False Claims Act introduced in 1985, by which individuals or the federal government may sue for fraud against the U.S.

government, and, if successful, the plaintiff gets a percentage of the awarded damages. In some cases, the Federal False Claims Act allows for damages of three times the amount of damages sustained by the federal government.

In 1996, the now well-known HIPAA was passed by the 104th Congress and signed into law by the president. Among its many provisions, HIPAA provides for the extended portability of health insurance, standards for the electronic transmission of healthcare transaction data, and health information privacy recommendations. In addition to these, HIPAA gives the Department of Health and Human Services (HHS) expanded authority to work with federal, state, and local law enforcement programs to control health plan fraud and abuse, as well as the ability to conduct its own fraud and abuse investigations.

The final thread of laws we'll consider is the Federal Anti-Referral Law or, as it is more commonly known, the Stark laws. Stark I was enacted in 1989 and prohibited physicians from referring Medicare patients to clinical laboratory services in which the referring physician has a financial relationship. Stark II, as amended in 1993 and effective in 1995, more broadly limited physician Medicare referrals to 10 designated health services: clinical laboratory services; physical, occupational, and speech therapy; radiology; radiation; durable medical equipment; prosthetics, orthotics, and prosthetic devices and supplies; home health services; outpatient prescription drugs; inpatient and outpatient hospital services; and parenteral and enteral nutrients, equipment, and supplies.

*Accredited Senior Appraiser as promulgated by the American Society of Appraisers; Managing Director, RSM McGladrey, Inc., 801 Nicolett Avenue, Suite 1100, Minneapolis, MN 55402; phone: 612-376-9575; fax: 612-395-3975; e-mail: paul.siebrasse@rsmi.com.

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Finally, Stark II, Phase I Regulations (effective in 2000) and Stark II, Phase II Regulations (effective in 2004) clarified certain aspects of preceding Stark laws and specified that every physician-based financial relationship meet a defined exception, many of which require that the financial remuneration be consistent with fair market value.

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Given the prevalence of fair market value as an exception in the Stark laws, it's important to understand exactly what that means. The Stark laws do define fair market value, but before we consider it, let's develop a broader understanding.

Black's Law Dictionary defines fair market value as the "price that a seller is willing to accept and a buyer is willing to pay on the open market and in an arm's-length transaction; the point at which supply and demand intersect." Further, *Black's Law Dictionary* defines an arm's-length transaction as "a transaction negotiated by unrelated parties, each acting in his or her own self interest."

The Internal Revenue Service has a definition as well. According to the IRS, fair market value is "the price at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts."

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Naturally, the appraisal profession has its own definition. The American Society of Appraisers Machinery and Technical Specialties define fair market value as "the estimated amount, expressed in terms of money, that may be reasonably expected for a property in an exchange between a willing buyer and a willing seller, with equity to both, neither under any compulsion to buy or sell, and both fully aware of all relevant facts, as of a specific date." Similarly, the Business Valuation Standards of the American Society

of Appraisers define fair market value as ". . . the price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arm's length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts."

As discussed earlier, the Stark laws contain their own definition of fair market value. According to the statute, fair market value is:

the value in arm's-length transactions, consistent with the general market value. 'General market value' means the price that an asset would bring as the result of a bona fide bargaining between well-informed buyers and sellers who are not otherwise in a position to generate business for the other party, or the compensation that would be included in a service agreement as a result of bona fide bargaining between well-informed parties to the agreement who are not otherwise in a position to generate business for the other party, on the date of acquisition of the asset or at the time of the service agreement. Usually, the fair market price is the price at which bona fide sales have been consummated for assets of like type, quality, and quantity in a particular market at the time of acquisition, or the compensation that has been included in bona fide service agreements with comparable terms at the time of the agreement, where the price or compensation has not been determined in any manner that takes into account volume or value of anticipated or actual referrals. With respect to rentals and leases described in §411.357(a), (b), and (l), 'fair market value' means the value of rental property for general commercial purposes (not taking into account its intended use). In the case of a lease of space, this value may not be adjusted to reflect the additional value the prospective lessee or lessor would attribute to the proximity or convenience to the lessor when the lessor is a potential source of patient referrals to the lessee. For purposes of this definition, a rental payment does not take into account intended use if it takes into account costs incurred by the lessor in developing or upgrading the property or maintaining the property or its improvements.

An hourly payment for a physician's personal services (that is, services performed by the physician personally and not by employees, contractors, or others) shall be considered to be fair market value if the hourly payment is established using either of the following two methodologies: (1) The hourly rate is less than or equal to the average hourly rate for emergency room physician services in the relevant physician market, provided there are at least three hospitals providing emergency room services in the market; or (2) The hourly rate is determined by averaging the 50th percentile national compensation level for physicians with the same physician specialty (or, if the specialty is not identified in the survey, for general practice) in at least four of

the following surveys and dividing by 2,000 hours. The surveys are: Sullivan, Cotter & Associates, Inc.—Physician Compensation and Productivity Survey; Hay Group—Physicians Compensation Survey; Hospital and Healthcare Compensation Services—Physician Salary Survey Report; Medical Group Management Association—Physician Compensation and Productivity Survey; ECS Watson Wyatt—Hospital and Health Care Management Compensation Report; William M. Mercer—Integrated Health Networks Compensation Survey.

Whew, now that's added complexity! But after some study, the Stark laws do embody the basic notion of fair market value as described in the other definitions noted here. That is, each definition includes parties that are willing, well-informed, and acting in their self interests. Peculiar to the Stark definition is that the parties are "not otherwise in a position to generate business for the other party." This is where the definition specifically addresses the issue of beneficial referrals and, as such, should be carefully considered in any fair market value assessment.

Given that one Stark exception is referrals that are consistent with fair market values, how does one reasonably measure fair market values? There are three basic approaches to assessing fair market value, whether the object is a 1956 Bel Air or a 1.5T magnetic resonance imaging device. These methods are the cost (or asset) approach, the income approach, and the market data approach.

The cost method involves determining the fair market value by considering the costs associated with replacing or reproducing the subject asset or service with an asset of similar economic functionality or utility as of the valuation date—the Stark qualifiers of type, quality, and quantity. In the context of physician services, the cost method implies that the hourly fair market value of a physician is based on the cost of replacing that doctor with another doctor with similar capabilities, specialties, fellowships, and years of experience among other attributes. Interestingly, the Stark definition of fair market value in the context of physician services goes on to identify compensation studies that are considered authoritative. The cost approach is also frequently used in combination with the next method, the income approach.

The income approach is based on the concept of present value of a future stream of income. The income

approach, as applied in the context of healthcare services, is based on that service offering price, anticipated volumes, and service costs that will yield an internal rate of return consistent with market-based rates of return. Given that the internal rate of return is consistent with market rates and volume and cost are ordinary, then it must follow that the service offering price is consistent with fair market value.

For example, the fair market value of any diagnostic service must generate a cash flow return based on expected volumes and costs sufficient to yield an internal rate of return consistent with rates of return on alternate investments of equal risk.

Finally, the market data approach is based on the principle of substitution. In using this approach, the subject service is contrasted with the price of substitute services provided by others in an open and competitive marketplace. If the subject price or value is similar with competitors, taking into account differences in type, quality, quantity, and location among others, then the price can be considered consistent with fair market value. Market data for a vast array of healthcare services are readily available. These include Medicare reimbursement data along with many other proprietary databases.

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Each of these three methods can be used separately or in combination to form a reasonable basis for assessing fair market value compliance. The Stark laws seem to suggest a preference for the market data approach in its reliance on "bona fide bargaining between well-informed parties." However, each assessment method is well-recognized and widely considered reliable.

In summary, we are clearly not going back to the healthcare environment of the 1950s. The current state of complexity in the healthcare industry is here to stay and likely increase. The assessment approaches introduced here can serve as acceptable methods by which a service provider can be reasonably assured that a particular service price is indeed consistent with fair market value. ■