Clinical Co-Management Arrangements: Trends, Issues and FMV Considerations

Healthcare providers are under scrutiny and feel pressure from patients, employers, insurance and the federal and state governments to provide higher quality care at lower costs and higher efficiency.

While there is significant rhetoric around these changes, there has not been a significant change in the reimbursement models that drive the providers of healthcare. The Department of Health and Human Services recently announced its goal of tying 85 percent of all fee-for-service payments to quality and cost measures by 2016. However, both hospitals and physicians still largely operate in a fee-for-service environment with uncertainty about when and how the reimbursement model will change.

Despite this uncertainty, healthcare leaders are exploring and investing in a plethora of new and innovative changes to their delivery models. These models are proactive efforts to build better programs for the future, by aiming to meet stakeholders' need for change, while working to meet unclear market demands. One thing seems to be clear; no matter what reimbursement changes take place, a provider with higher quality, lower costs and a higher efficiency will be better positioned in the long run.

One model many hospitals are exploring, primarily in orthopedics and cardiology, is a clinical co-management relationship between hospitals and the core physician partners in a service line. The purpose of these relationships is to recognize and appropriately reward participating physicians for their efforts in developing, managing and improving quality and efficiency of a particular hospital service line.

When pursuing this relationship, it is imperative the hospital considers its goals for the program, along with the associated metrics to measure such goals. Also central to the implementation of a clinical co-management relationship is the physician payment structure. Usually this structure includes two levels of payment: a base fee and an incentive payment. The base fee is a fixed annual amount related to the time and efforts of participating physicians in the management of the service line and the incentive payment is a series of predetermined payment amounts contingent on the achievement of specific, mutually agreed upon goals.

As with all hospital/physician relationships, clinical co-management relationships and the physician compensations structure need to be both commercially reasonable and fair market value (FMV).

Commercial Reasonableness and Clinical Co-Management Agreements

Commercial reasonableness is defined in the Stark Law as "an agreement that would make commercial sense if entered into by a reasonable entity of similar type and size and a reasonable physician of similar scope and specialty, even if there were no potential DHS referrals."

1. Do we need this management service?
2. Will our business be better with this management service?
3. What is the best structure for this management service?
   - Base/Hourly fee to reward participation
   - Incentive fee to reward quality/accomplishment

Based on the uncertainty previously outlined, the answers to these and similar questions are not always black and white.

Fair Market Value and Clinical Co-Management Agreements

Under valuation standards, a valuator is required to consider three approaches to value: the income Approach, the Cost Approach and the Market Approach.

Income Approach

The Income Approach relies upon the economic principle of expectation. In other words, a business interest, asset or service can be valued based on the expected future economic benefit derived.

In the case of a clinical co-management relationship, a valuator typically considers the following economic benefits:

- Medicare quality incentives/penalties
- Other managed care payer quality incentives
- Innovative/future payment options, such as bundled payments
- Volume supply purchasing discounts (implants)
- Throughput/service efficiencies

There are limitations to the Income Approach, including the difficulty of estimating what economic benefits will be derived with a reasonable degree of certainty. In addition, this approach requires those benefits to be quantified. While clinical co-management relationships often do have economic benefits, many of the expected benefits may not translate directly into measurable income. For these reasons, the Income Approach is not generally the primary methodology for determining the FMV of a clinical co-management relationship.

Market Approach

The Market Approach is the most commonly applied and widely accepted approach to valuing clinical co-management relationships. Under this approach, the valuator looks to the marketplace and evaluates similar agreements and management options for comparability. Generally, management fees are in the range of 2 to 6 percent of service line revenue, depending on the size of the service line and the level or services requires under the agreement.

Conclusion

As stated above, valuation standards require that the valuator consider all three approaches, then use professional judgment to determine which of the three approaches is most appropriate, given the specific facts and circumstances of the subject valuation. Under the FMV standard of value, the selected approach or approaches must be applied in the context of hypothetical market participants engaging in the subject transaction.

This article is part of a series that delves into the economic, compliance and relationship issues that are relevant in hospital physician relationships. To view past articles, click here.

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