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Fair Market Value in Health Care Transactions: A Primer

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Fair Market Value under the Stark Law and Anti-Kickback Statute

Few phrases are more common in today's health care regulatory environment than "fair market value." The phrase has spawned an industry of experts offering fair market value appraisals and experts to train and accredit the experts. It is often misunderstood as a cure-all for every high risk transaction, and can be the determinative factor in whether a transaction is successfully completed. New case developments have raised the issue of whether or not even an expert third party appraisal is sufficiently determinative of fair market value. It is incumbent on every health care practitioner to understand the concept of fair market value and its ramifications on an individual transaction.

I. The Stark Law

The Stark Law prohibits physicians from referring Medicare patients to an entity for designated health services (DHS)¹ if the physicians, or their immediate family members, have a financial interest in the entity.² The statute provides several exceptions, many of which involve establishing that transactions between the physician and the entity were consistent with fair market value. Violations of the Stark Law are enforced on a basis somewhat akin to strict liability: if a financial arrangement fails to satisfy even one element of an exception, any resulting referral is a per se violation.³

A. Fair Market Value Defined by the Statute—42 U.S.C. § 1395nn(h)(3)

The Stark Law offers the following definition of fair market value:

The term "fair market value" means the value in arms length transactions, consistent with the general market value, and, with respect to rentals or leases, the value of rental property for general commercial purposes (not taking into account its intended use) and, in the case of a lease of space, not adjusted to reflect the additional value the prospective lessee or lessor would attribute to the proximity or convenience to the lessor where the lessor is a potential source of patient referrals to the lessee.⁴

This definition of fair market value revises the standard IRS definition of fair market value for commercial purposes in response to the co-dependant relationship between medical facilities and

¹ Designated Health Services include clinical laboratory services, radiology and certain other imaging services, parenteral and enteral supplies, outpatient prescription drugs, physical therapy, radiation therapy services and supplies, prosthetics and orthotics devices and supplies, inpatient and outpatient hospital services, occupational therapy, speech-language pathology services, durable medical equipment and home health services. 42 C.F.R. § 411.351.

² 42 U.S.C. § 1395nn.

³ Anne B. Claiborne et al., *Legal Impediments to Implementing Value-Based Purchasing in Healthcare*, 35 AM. J. L. & MED. 442, 444 (2009).

⁴ 42 U.S.C. § 1395nn(h)(3) (2006).

individual physicians.⁵ The compensation between medical facilities and physicians may not take into account the quantity or value of referrals or other dealings between the parties in general.⁶

B. Fair Market Value Interpreted by Regulations

The statutory definition of fair market value is further expanded by federal regulations that interpret the Stark Law.⁷ The applicable regulation largely restates the definition in the statute but adds a definition of the term “general market value” used in the statutory definition. General market value refers to

the price that an asset would bring as the result of bona fide bargaining between well-informed buyer 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 the 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.⁸

Under the standard of general market value, buyers and sellers are viewed as hypothetical actors rather than specific entities or individuals.⁹

For the definition of fair market value concerning lease spaces, the regulation adds that “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.”¹⁰

C. Exceptions to the Stark Law

The Stark Law provides a number of exceptions to its restrictions on referrals. Listed below are the 10 exceptions that require compensation between physicians and the other financially related entities be based on fair market value. The statutory language excludes these situations from referral prohibitions by designating the transactions as “not constitut[ing] a financial relationship,” which places them outside the purview of the statute’s regulation.¹¹

⁵ Allen D. Hahn & H. Guy Collier, *Fair Market Value: Appraisal Practice in an Evolving Legal Framework*, 12 No. 3 J. HEALTH CARE COMPLIANCE 5, 7 (2010).

⁶ *Id.*

⁷ 42 C.F.R. § 411.351

⁸ 42 C.F.R. § 411.351.

⁹ *Estate of Bright v. United States*, 658 F.2d 999, 1006-07 (5th Cir. 1981).

¹⁰ 42 C.F.R. § 411.351.

¹¹ 42 C.F.R. § 411.357.