REPRINTED FROM GREAT BOARDS, Spring 2010

The Board's Role in Compensation Oversight for Employed Physicians:

AN INTERVIEW WITH DAN GRAUMAN, PRESIDENT AND CEO, DGA PARTNERS

By Elaine Zablocki

In August, 2009, Covenant Medical Center of Waterloo, Iowa, agreed to pay $4.5 million plus interest to settle allegations of healthcare fraud arising from its financial relationships with five employed physicians. The Stark Law prohibits a hospital from compensating physicians for patient referrals, and can construe pay that is above market comparables as constituting improper payments to direct business its way.

The Justice Department alleged that the Covenant physicians—two orthopedic surgeons, two neurosurgeons, and a gastroenterologist—were among the highest-paid physicians in their fields in the entire country, making as much as $2.1 million. These salaries were three times greater than the compensation paid to other physicians who referred patients to Covenant, according to the CEO of Cedar Valley Medical Specialists, a competing independent physician group in Waterloo, which brought the issue to the attention of federal regulators, according to an Iowa newsletter, *Health Capital Topics*. Covenant denied any wrongdoing, but decided to settle the case.

The Covenant case has drawn increasing attention to the question: How should hospitals determine appropriate compensation for employed physicians? How should not-for-profit hospital boards maintain appropriate oversight over physician compensation?

For answers *Great Boards* Editor Elaine Zablocki interviewed Daniel M. Grauman, president and CEO of healthcare management consultants DGA Partners. DGA's consultants help healthcare organizations and their legal counsel determine and document fair market value of physician compensation, and structure equitable compensation for employed physicians.

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Published by

Bader & Associates

Governance Consultants,

Potomac, MD

Elaine Zablocki, Editor

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Government agencies are increasing their scrutiny of physician compensation arrangements.

NEW CONCERNS SURFACE ON PHYSICIAN COMPENSATION

Q. How significant is the Covenant Medical Center case?

A. It is definitely bringing new attention to the issue of physician compensation. There have been similar cases over the years pertaining to excessive compensation for physicians. However, the conventional wisdom right now seems to be that various government agencies are increasing their scrutiny of these arrangements. In part it's due to the underlying trend toward greater physician employment. As hospitals and health systems employ more physicians and develop physician enterprises, they must grapple with the question of how to set appropriate compensation levels.

Q. In the past hospitals have taken comfort because they believed that when they employ physicians, they won't face the same degree of governmental oversight as they do regarding financial arrangements with independent physicians. It now appears that there are risks even when physicians are employed.

A. The risks have always been there. In the past some hospital leaders did not fully appreciate those risks. They believed that the employer/employment relationship offered certain protections. It doesn't.

Q. Do some hospitals have more latitude than others?

A. In fact, certain healthcare organizations do have broader options. Academic medical centers with faculty practice plans have additional choices in how they compensate physicians, and at what levels. Typically faculty physicians derive income from a range of functions, including research, clinical practice, teaching, and training, so compensation arrangements are complex. For the approximately 125 academic medical centers in the United States, there are probably 125 different ways that compensation is calculated. However, some observers may draw unwarranted conclusions based on arrangements at academic medical centers. They may assume that you can compensate in whatever way you wish in all hospital settings, which is definitely not the case.

To persuade government agencies that employed physicians are paid reasonable compensation, the hospital needs to consider the physician's roles and responsibilities, credentialing and training, the work effort involved, and whether the physician is employed full-time or part-time. Most importantly, the hospital needs to be aware of market-based compensation levels in each specific market.

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Q. DGA Partners renders fair market value opinions on compensation arrangements, including compensation for employed physicians. What are the major elements necessary to persuade government agencies that employed physicians are being paid reasonable compensation at market rates?

A. The hospital needs to consider the physician's roles and responsibilities, credentialing and training, the work effort involved, and whether the physician is employed full-time or part-time. Most importantly, in setting a physician's compensation level, the hospital needs to be aware of market-based compensation levels in each specific market for comparable physicians in the relevant specialties. There are a number of publicly available physician compensation surveys, some at no charge and others on a commercial basis. However, these surveys only provide a benchmark, as they typically aggregate data at broader regional levels. It is always best to obtain local data, if at all possible. Or, if that isn't an option, it is probably best to combine the results of numerous surveys. These survey combinations should always be done consistently, not in a manipulative way. Finally, a hospital can seek guidance and an opinion from a healthcare valuation expert with experience in physician compensation.

TIME FOR A PHYSICIAN COMPENSATION COMMITTEE?

Q. What is the board's oversight obligation regarding physician compensation?

A. There's an analogy with executive compensation. The board is responsible for oversight of senior management compensation, and physicians are equally or even more highly compensated. While this may have been overlooked in the past, actually the governing board at a tax-exempt, not-for-profit hospital is subject to similar responsibilities, whether it's a CEO or a senior physician who is being paid at a high level.

Each board member has a fiduciary and compliance responsibility to ensure that all highly compensated employees, including physicians, are paid in a way that is reasonable and consistent with fair market value. If compensation levels are being set in a haphazard way, board members need to understand and appreciate that this means potential exposure for the organization.

Q. Hospital boards often have executive compensation committees. Is it time for them to consider having a physician compensation committee?

A. Yes, they should consider this option carefully. Certain hospitals we work with already have board committees on physician compensation, and we find this leads to a more thoughtful, well-defined process. However, it depends first on how many physicians you employ. If you just employ a few physicians here and there, perhaps in the ICU plus one or two additional areas, it probably isn't a priority. But if you are launching a strategy that depends on considerable physician employment (as many health systems are considering) or if you already employ many physicians, then it is appropriate to raise the issue to a new level and institute a board oversight committee on physician compensation.

Q. What are the responsibilities of the physician compensation committee?

A. First, it needs to develop a physician compensation policy, including specific guidelines on the process of determining appropriate compensation for each and every physician. It should also set policies pertaining to the actual physician compensation models, in terms of mechanisms used to compute compensation.

Once the board committee has developed guidelines and standards, then it needs to ensure that the resulting compensation levels make sense. They should be reviewed annually for consistency with fair market value. If certain physicians appear to be paid more than fair market value, the committee should check to see whether there are reasons that explain and justify these anomalies, or else instruct management to develop plans to correct the situation.

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The physician compensation committee should look closely at higher-risk physician compensation arrangements such as physician executives, medical directors, and physicians who are key admitters to the hospital.

Q. What sort of situations should the committee review and approve?

A. It should look closely at higher-risk physician compensation arrangements such as physician executives, medical directors, and physicians who are key admitters to the hospital. It should look at physicians in leadership roles in high-profile product lines such as cancer care or neurosurgery. Special issues may arise when practices are being acquired, or when physicians are compensated based on productivity and then end up in high percentiles of market rates. The committee should also review situations where a physician is paid for multiple roles, such as a doctor who derives compensation from seeing patients and is also paid a separate consulting fee for managing a clinical department, recruiting physicians for a group practice or provider network, or helping the hospital build/enhance a clinical product line. The physician's compensation might come from multiple sources, such as the hospital and the hospital-owned group practice, but total compensation should make sense as a whole, reflect actual responsibilities, and be consistent with fair market value.

Q. In addition to overseeing high-risk employment arrangements, how should the committee be informed about other compensation arrangements within the organization?

A. The committee should review a table or graph that essentially shows the actual compensation level for each and every employed physician, and how that compensation compares to relevant fair market comparisons.

Q. Should there be limitations on committee membership?

A. All or a majority of the members of the physician compensation committee, and especially the committee chairperson, should be independent directors, without any significant economic relationship with the organization. It is particularly important that employed physicians and other members of the medical staff should not be named to this committee.

Q. Should the general counsel attend committee meetings?

A. Yes, certainly during the initial meetings, up to the point where committee members are substantially educated and informed about all the relevant issues. After that, while the counsel doesn't need to be present at every meeting, he or she should certainly consider attending major meetings, such as an annual review of all compensation levels.

Q. Should the physician compensation committee rely on independent compensation consultants and outside legal advisors?

A. The ones that we know do this. Independent compensation consultants and external counsel generally offer a broad view of the marketplace. They are an additional signal to any potential oversight agencies that the hospital has made every possible effort to base compensation on fair market value.

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From time to time we find specific circumstances where the desired compensation level goes right up against defensible limits.

INTERNAL CONTROLS NEEDED

Q. DGA Partners is familiar with compensation arrangements for employed physicians. Do you often find that employed physicians are paid at rates higher than the market would justify?

A. I wouldn't say it's often. However, from time to time there are specific circumstances at a particular hospital where the desired compensation level goes right up against defensible limits, given the available information on comparable salary arrangements.

Q. In many hospitals, the lines of authority over physician pay are unclear. Why is that?

A. In large hospitals you typically have multiple management players involved in physician compensation arrangements. You have the CEO, the CFO, the chief medical officer, and the executive for the employed physician group. You may have clinical chairmen, especially in academic medical centers. You have product line executives, senior vice presidents who are responsible for major aspects of operations, and then you generally have in-house legal counsel. In any given situation several executives may have a role in negotiating the compensation arrangement with a particular physician, or may have operational responsibility for certain employed physicians.

We see regularly that this leads to confusion. There are multiple people in the organization responsible for employed physicians, and they are not all equally knowledgeable about compensation arrangements and fair market value considerations. There's also a great deal of variability in what we might call the internal controls. The best situation would be to establish an internal process with appropriate checks and required approvals before hiring a new physician in an important role. That doesn't always exist.

Sometimes an operations person just embarks on the hiring process on their own, because they're really busy and don't think about an internal review.

Q. What would those internal controls look like?

A. You would have a documented process. Suppose a senior vice president is responsible for a major product line, and needs to hire a new physician as assistant medical director. Before the executive starts talking with any physician about the job and potential compensation levels, there should be a formal requisition. Someone in finance and someone in the legal department should both sign off on the request and provide parameters on what compensation levels would be appropriate.

Now that sounds like a logical process, but I can tell you it doesn't always happen that way. Sometimes an operations person just embarks on the hiring process on their own, because they're really busy and don't think about an internal review. Then they get to the 11th hour, when they've already negotiated a tentative agreement, and someone in the organization notes that they have to check and review whether this is within fair market value.

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Q. Have you ever had to tell a hospital that you couldn't write an opinion supporting compensation it had agreed to pay? If so, what happened?

A. Yes, this happens from time to time. We inform the hospital that the compensation level they are contemplating for the physician is not consistent with fair market value. We go on to tell them the level that would make sense, and offer suggestions on how to restructure the compensation arrangement. The hospital can point to us as the experts who have recommended these changes, and attempt to save the relationship. Hopefully, the draft or current employment agreement makes reference to the need to comply with relevant laws and regulations, including fair market value guidelines.

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GREAT BOARDS is published by Bader & Associates | Governance Consultants | 12225 Seline Way, Potomac, Maryland 20854
Phone: 301-340-0903 | Fax: 240-595-6162 | E-mail: bbader@GreatBoards.org | www.GreatBoards.org

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Graphic Design by: **Ruzow Graphics, Inc.** | www.ruzowgraphics.com

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