Co-Management Arrangements
A Focus on How Payments Work and are Valued

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Service Line Co-Management Relationships

• **Purpose:** Recognize and appropriately reward participants for developing, managing and improving the quality and efficiency of a particular hospital service line
• **Scope:** May cover inpatient, outpatient, ancillary and/or multi-site services
• **Participants:** May include one or more physicians, medical groups or faculty practice plans, or a joint-venture entity owned in part or entirely by participating physicians or medical groups

Service Line Co-Management Arrangements

**Example:** Potential Scope of Cardiology Service Line

- Open Heart Surgery
- Cath Lab
- Echocardiography
- Vascular Surgery
- Invasive Radiology
- Inpatient Cardiac & Vascular
- ECG
- Cardiac Rehabilitation
Direct Contract Model

- Payors
- Hospital
- Operating Committee
- Specialty Group I
- Specialty Group II
- Other Specialty Group(s)

Joint Venture Model

- Payors
- Hospital
- Service Line Physicians/Groups
- Management Company
- JV Management Company
- Co-Managers
- JV Members

Service Line Co-Management Arrangements

- Typically two levels of payment under the Co-Management Arrangement:
- Base Fee: A fixed annual base fee that is consistent with the FMV of the time and efforts of the participating physicians
  - Includes compensation for service line development, management, and oversight
- Bonus Fee: A series of predetermined payments that are contingent on the achievement of specified, mutually agreed upon targets
  - Targets must be objectively measurable and based on program development, quality improvement and efficiency.
  - Must be fixed, fair market value arrangement; independent appraisal strongly advised
Service Line Co-Management Arrangements

Examples of Co-Management Services

- Development of Service Line
- Medical Director services
- Budget process
- Strategic/business planning process
- Community relations and education
- Patient, physician and staff satisfaction surveys
- Development of clinical protocols and performance standards

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Service Line Co-Management Arrangements

Examples of Co-Management Services

- Ongoing assessment of clinical environment and work flow processes
- Physician staffing
- Patient scheduling
- Staff scheduling and supervision
- Human resource management

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Service Line Co-Management Arrangements

Examples of Co-Management Services

- Case management activities (e.g., discharge planning, arranging follow-up services and supplies, call back processes)
- Materials management
- Medical staff-related activities and committee participation
- Credentialing assistance
- Coordination with and reporting to hospital
- Intensity of service: do, assist, or advise
Typical Features of a Co-Management Arrangement

- Compensation for the manager’s services is typically comprised of a base fee and an incentive fee.
- However, for small service lines and/or in unique instances when the services are very limited in scope (e.g., sleep labs, wound care centers), there may only be a base fee.
- The co-management arrangement may or may not involve the creation of a new entity (i.e., a JV, which may or may not be owned in part by the hospital).
- Thus, the “manager” may consist of the physicians only, or the physicians and the hospital within the framework of a joint venture.
- The co-management agreement will require replacement or redefinition of existing medical director agreements to accommodate the services provided by the managers. Notwithstanding, all medical directors must be paid from the base fee management fee.

Valuation Process – Riskiness of Co-Management Arrangements

- Among the spectrum of healthcare compensation arrangements, certain co-management arrangements have traditionally been viewed as having a relatively “high” degree of regulatory risk if FMV and commercial reasonableness cannot be demonstrated.
  - By design, these agreements exist between hospitals and physicians who refer patients to the hospital.
  - Application of traditional valuation methodologies has been limited and less objective as compared to other compensation arrangements.
  - In most cases, physicians are not being compensated under the traditional “hours worked and logged” approach.
  - The “effective” hourly rate paid to physicians may be higher than rates which would be considered FMV for hourly-based arrangements (since a significant component of compensation is at risk).
Valuation Process
Approaches to Value

- Available valuation approaches include:
  - Cost Approach
  - Market Approach
  - Income Approach

- In considering these valuation approaches, an income approach can likely be eliminated since the possible or expected benefits of the co-management agreement may not translate directly into measurable income.

The Cost Approach

- The Cost Approach can be used to estimate the “replacement” or “replication” cost of the management/administrative services to be provided by the manager.
- Very difficult, if not impossible, to accurately determine the specific costs involved in managing a service line.
- An analysis by “proxy,” or an approach that estimates the number of medical director hours required to manage the service line in the absence of a management arrangement, (which is then multiplied by an FMV hourly rate) yields one indication of value.
- However, within the framework of a joint venture management company, this approach does not consider the hospital’s contribution.
- Further, a key ideal of most co-management arrangements is to reward results rather than time-based efforts.

The Market Approach

- The Market Approach recognizes that there are certain management/administrative requirements associated with every service line management arrangement.
- However, it is also understood that each co-management arrangement is unique and may include and prioritize different market and operational factors.
- Therefore, within the framework of the Market Approach analysis, consideration must be given to the required management tasks.
  - Specific tasks and responsibilities of the managers must be identified.
  - On an item-by-item basis, the relative worth of each task/responsibility is “scored” relative to other comparable arrangements.
  - An indication of value of the management services is then established by comparing the “scoring” of the subject agreement to other service arrangements in the marketplace.
Valuation Synthesis

- The Cost and Market valuation methodologies should be reconciled to arrive at a final conclusion of value.
- The Cost Approach may "underestimate" the value of the arrangement because in the case of joint ventures, the Cost Approach only considers physician participation (i.e., medical directors).
- The Market Approach may "overestimate" the value of the arrangement because market comparables may not be exact.
- While it may be appropriate to give equal weighting to the two approaches, the valuator may conclude that one method should be weighted more heavily than the other.
- Once the FMV of the total management fee is established, an assessment must be made regarding the split between the base fee and incentive fee components.
- The FMV of the base fee must encompass payment of any medical director fees or administrative services related to managing the service line.

What Drives Value?

- As a percentage of the service line net revenues, the total fee payable under a co-management arrangement typically ranges from 2% to 4.5% (on a calculated basis).
- The fee is fixed as a flat dollar amount, including both base and incentive components, for a period of at least one year.
- Commonly, the base fee equals 50-70% of the total fee.
- The extent and nature of the services drive their value. Thus, the valuation assessment is the same whether the manager consists of only physicians or physicians and hospital management.
- Determinants of value include:
  - What is the scope of the hospital service line being managed?
  - How complex is the service line? (e.g., a cardiovascular service line is relatively more complex than an endoscopy service line)
  - How extensive are the duties being provided under the co-management arrangement?
  - How many physical locations are being managed?

Size adjustments based on service line revenue:
- Large programs may be subject to an "economies of scale" discount.
- Small programs may be subject to a "minimum fee" premium.
- Consider the appropriateness of the selected incentive metrics:
  - Is the establishment of the incentive compensation reasonably objective?
  - Consider the split of base compensation and incentive compensation.
- Occasionally, certain other services (e.g., call coverage) may be included among the co-management duties. (Some hospitals prefer to embed call coverage in the co-management fee to avoid a separate compensation arrangement with the physicians.)
Possible Pitfalls of Co-Management Arrangements

- The service line/revenue stream to be managed must be defined objectively, and there should be no overlap between multiple service lines which may be subject to co-management arrangements (e.g., surgery service line and orthopedic surgery service line).
- A co-management arrangement typically contemplates that no third-party manager is also providing similar services on behalf of the hospital or its service line.
- Care must be taken to ensure that employed physicians who are part of co-management arrangements are not double paid for their time.
- Employment compensation based solely on wRVUs is self-normalizing.

Possible Pitfalls of Co-Management Arrangements

- Medical director agreements related to the managed service line must be compensated through the base management fee.
- There can be no passive owners, active participation and significant time and effort are required by busy physicians.
- Documentation requirements

QUESTIONS?