

# Health Care Reform: FINDING YOUR WAY

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## *Physician-Owned Hospitals: A Thing of the Past?*

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### EXECUTIVE SUMMARY

The Patient Protection and Affordable Care Act of 2010 (PPACA) narrows the Stark Law's exception for hospital ownership. The changes to this exception impact providers who want to open new physician-owned hospitals as well as existing physician-owned hospitals. Specifically, the amended exception essentially prohibits new physician-owned hospitals, forbids existing physician-owned hospitals from expanding, and requires physician-owned hospitals to comply with certain procedures.

### BACKGROUND

A referral relationship between a physician owner and a hospital implicates the Stark Law, which is described below. Therefore, the impact of the PPACA amendment to the hospital ownership exception applies only to hospitals that are owned, even in part, by physicians who refer patients to those hospitals.

#### **A. Stark Law Overview**

The Stark Law prohibits a physician who has a financial relationship with an entity that furnishes designated health services, such as a hospital, from making a referral to that entity for designated health services paid for by Medicare. 42 U.S.C. § 1395nn (a)(1)(A). Furthermore, the Stark Law prohibits a hospital from billing for designated health services provided in violation of this prohibition. 42 U.S.C. § 1395nn (a)(1)(B). Designated health services include, among other services, inpatient and outpatient hospital services.

A financial relationship is a physician's direct or indirect ownership or investment interest in the entity or an arrangement involving any direct or indirect remuneration between the physician and the entity. 42 U.S.C. § 1395nn (a)(2) and (h)(1). The prohibition applies to financial relationships with the physician or the physician's family members in the hospital or in an entity that holds an ownership interest in the hospital. Thus, the prohibition applies to both direct and indirect ownership in a hospital by a physician or an immediate member of the physician's family.

Because the Stark Law is a strict liability statute, any violation of the law can subject the hospital to repayment obligations and civil money penalties. 42 U.S.C. § 1395nn(g). There are, however, certain regulatory exceptions to these prohibitions. If a financial relationship between a physician and a hospital fits within an exception, then the physician is not prohibited from making referrals to the hospital.

## **B. The Hospital Ownership Exception**

One exception to the Stark law is the exception for hospital ownership - 42 C.F.R. § 411.357(d)(3). Previously, that exception allowed a physician to refer patients to a hospital in which the physician had an ownership or investment interest if: (1) the referring physician was authorized to perform services at the hospital; and (2) the ownership or investment interest was in the hospital itself (and not merely in a subdivision of the hospital). PPACA amends the hospital ownership exception by creating additional requirements that hospitals must meet in order to qualify for the exception.

### **RELEVANT PROVISIONS OF PPACA**

In addition to maintaining the previous requirements for the Stark Law's hospital ownership exception, the changes put in place by PPACA require hospitals owned by referring physicians to:

1. limit the availability of the exception for hospital ownership to hospitals that, as of December 31, 2010, have: (a) physician ownership or investors; and (b) Medicare provider agreements in effect;
2. limit the ability of a hospital to expand its capacity;
3. require the hospital to put in place certain procedures applicable to referring physicians;
4. prohibit an increase in the aggregate percentage ownership by physicians and limit the terms that a hospital may utilize in offering ownership interests to physicians; and
5. clarify requirements regarding physician availability and hospital capacity.

Hospitals must meet these requirements no later than 18 months after the March 23, 2010 PPACA enactment date.<sup>1</sup>

#### **1. Prohibition of New Physician-Owned Hospitals - 42 U.S.C. § 1395nn (i)(1)(A)**

Under the amended exception for hospital ownership, a physician may refer patients to a hospital in which the physician has an ownership or investment interest if it meets the original hospital exception requirements AND, as of December 31, 2010, the hospital has: (a) physician ownership or investors; and (b) a Medicare provider agreement in effect. 42 U.S.C. § 1395nn (i)(1)(A). Furthermore, in order to qualify for the exception, a hospital cannot have been converted from an ambulatory surgical center on or after March 23, 2010, PPACA enactment date. 42 U.S.C. § 1395nn (i)(1)(F). Therefore, if a hospital is not Medicare-certified by December 31, 2010, then physicians who refer patients to that hospital are prohibited from having an ownership or investment interest in the hospital.

#### **2. Limitation on Expansion of Hospital Capacity - 42 U.S.C. §§ 1395nn (i)(1)(B) and (3); 42 U.S.C. § 1395nn (i)(3)**

Furthermore, the exception for hospital ownership now limits the number of operating rooms, procedure rooms, and beds for which a hospital is licensed to be no greater than the number for which the

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<sup>1</sup> The law requires hospitals to comply with these requirements no later than 18 months after PPACA's enactment (September 23, 2011), but HHS may promulgate regulations that impose a shorter compliance deadline.

hospital was licensed as of the March 23, 2010 PPACA enactment date. Procedure rooms include rooms in which catheterizations, angiographies, angiograms, and endoscopies are performed and do not include emergency rooms or departments. Therefore, PPACA essentially prohibits the expansion of existing hospitals owned by physicians who refer patients to these hospitals.

Certain hospitals, defined below, may apply for an exception from this prohibition one time every two years in order to increase capacity on the hospital's main campus. 42 U.S.C. § 1395nn (i)(3)(A)(i), (B), and (D). The exception cannot be granted for an increase that more than doubles the hospital's number of operating rooms, procedure rooms, or beds from the number in effect as of March 23, 2010 (or the effective date of the hospital's provider agreement if the hospital did not have a provider agreement in place as of the PPACA enactment date, but does have one in place as of December 31, 2010). 42 U.S.C. § 1395nn (i)(3)(C).

A hospital is eligible for this exception if it:

- is located in a county in which the percentage increase in the population during the most recent 5-year period is at least 150% of the percentage increase in the population growth of the state;
- has an annual percent of total Medicaid inpatient admissions equal to or greater than the average percent of total Medicaid inpatient admission for all hospitals located in the county;
- does not discriminate against beneficiaries of federal health care programs and does not permit physicians practicing at the hospital to discriminate against these beneficiaries;
- is located in a state in which the average bed capacity in the state is less than the national average bed capacity; and
- has an average bed occupancy rate that is greater than the average bed occupancy rate in the state.

42 U.S.C. § 1395nn (i)(3)(E).

A hospital is also eligible for this exception if it is a "high Medicaid" facility. A high Medicaid facility is a hospital that:

- is not the sole hospital in a county;
- with respect to each of the three most recent years for which data are available, has an annual percent of total Medicaid inpatient admissions that is estimated to be greater than the percent of total Medicaid inpatient admissions for any other hospital located in the county; and
- does not discriminate against beneficiaries of federal health care programs and does not permit physicians practicing at the hospital to discriminate against these beneficiaries.

42 U.S.C. § 1395nn (i)(3)(F).

The Secretary of Health and Human Services (HHS) must promulgate regulations to carry out a process that hospitals can utilize to apply for the exception by January 1, 2012 and must implement the process by February 1, 2012. 42 U.S.C. § 1395nn (i)(3)(A) (iii) and (iv). Furthermore, the community in which the hospital is located must be given an opportunity to provide input regarding a hospital's application

for an exception. 42 U.S.C. § 1395nn (i)(3)(A)(ii). This means that, realistically, physician-owned hospitals will not be able to expand their services, even if they are eligible for the exception, until late 2012, at the earliest.

3. Procedures Applicable to Referring Physicians - 42 U.S.C. § 1395nn (i)(1)(C)

A hospital owned by physicians who refer patients to the hospital, must not condition any direct or indirect physician ownership or investment interest on the physician owner or investor making or influencing referrals to the hospital or otherwise generating business for the hospital. Additionally, the hospital must:

- Submit an annual report to the Secretary for HHS detailing: (1) the identity of each physician owner or investor and any other owners or investors of the hospital; and (2) the nature and extent of all ownership and investment interests in the hospital.
- Disclose the fact that it is partially owned or invested in by physicians: (1) on any public website for the hospital; and (2) in any public advertising for the hospital.
- Implement a procedure that requires referring physician owners or investors to disclose to a patient being referred to the hospital by the physician: (1) the physician's ownership or investment interest in the hospital; and (2) any investment or ownership interest in the hospital by a treating physician. The physician must disclose this information in time to permit the patient to make a meaningful decision regarding the receipt of care.

4. Aggregate Percentage and Terms of Ownership by Physicians - 42 U.S.C. § 1395nn (i)(1)(D)

The percentage of the total aggregate value of the direct or indirect ownership or investment interests that referring physicians hold in a hospital cannot exceed that percentage as of the March 23, 2010 PPACA enactment date. As a result, PPACA prohibits an existing hospital from adding new physician owners or investors or increasing the ownership or investment interests of existing physician owners or investors unless other physician owners or investors relinquish an equivalent amount of their ownership or investment interest.

Furthermore, the hospital must comply with the following limitations regarding physician ownership or investment:

- The hospital must not offer physician owners or investors terms that are more favorable than those offered to others for: (1) ownership or investment interests; or (2) the opportunity to purchase or lease any property under the control of the hospital or any other owner or investor.
- The hospital and its owners or investors are prohibited from directly or indirectly providing, guaranteeing, making payments toward, or otherwise subsidizing loans or financing for investment or ownership in the hospital by a physician.
- Ownership or investment returns must be distributed to each owner or investor in an amount that is directly proportional to the owner or investor's ownership or investment interest in the hospital.
- Physician owners and investors must not receive, directly or indirectly, any guaranteed receipt of or right to purchase other business interests related to the hospital.

5. Hospital Capacity and Patient Notification Regarding Physician Availability - 42 U.S.C. § 1395nn (i)(1)(E)

Finally, the physician-owned hospital must have the capacity to: (1) assess, and provide initial treatment, to patients; and (2) refer and transfer patients to hospitals with the capability to treat their needs. If a hospital does not have any physicians available on the premises during all hours in which the hospital is providing services to a patient, then the hospital must disclose this fact to the patient before admitting the patient and receive a signed acknowledgement from the patient stating that the patient understands this fact.

## **WHAT THIS MEANS FOR HEALTH CARE PROVIDERS**

1. Expansion Limitation

A hospital that is owned by physicians who refer patients to that hospital, cannot increase the number of operating rooms, procedure rooms, and beds for which it is licensed beyond the number of operating rooms, procedure rooms, and beds for which it was licensed as of the March 23, 2010 PPACA enactment date, unless it meets a listed exception (likely not available until 2012).

*a. Beds*

Arizona hospitals are licensed for specific beds to be used for specific services (e.g. medical/surgical, pediatric, ICU, LDRP). The total number of beds for each of these services equals the total number of licensed hospital beds. The change in the hospital ownership exception clearly prohibits a hospital from increasing this total number of beds.

The statute does not address whether a hospital can change the use of beds if its total number of licensed beds remains the same. In other words, whether a hospital can shift the use of some of its beds from one service to another (e.g. replace some of its ICU beds with medical/surgical beds) while maintaining the hospital's total *number* beds. Because the statute does not explicitly prohibit a hospital from changing the use of a licensed bed, but instead focuses on the *number* of beds, it seems that a change in the service for which beds are licensed is acceptable, so long as the total number of beds is not increased. That said, we do not yet know how HHS will interpret the amended Stark Law and whether they will put in place regulations that interpret the statute to limit an increase in beds used for a specific service.

*b. Procedure Rooms/Operating Rooms*

Hospital licenses in Arizona do not explicitly list operating rooms and procedure rooms (as opposed to inpatient beds, which are explicitly listed on a hospital's license) but those rooms do fall under the licensed hospital premises. The amended Stark Law does not state whether the new limitation applies only in states where operating rooms and procedure rooms are explicitly listed on state licenses or whether the limitation refers to general licensure of the hospital premises. Unless the pending regulations clarify this expansion prohibition to apply only in states that explicitly list operating rooms and procedure rooms on licenses, the addition of new operating or procedure rooms without an equivalent reduction of existing operating or procedure rooms creates a risk of noncompliance with the amended Stark Law.

Furthermore, the amended Stark Law does not explicitly limit the expansion prohibition to the main hospital building. Hospitals frequently have off-site facilities, such as outpatient treatment centers, that are considered departments of the hospital for Medicare and utilize the hospital's Medicare billing number. PPACA does not distinguish operating rooms and procedure rooms in these off-site departments from those in the main hospital building. It is therefore possible that the amended law prohibits any expansion of the number of operating and procedure rooms, including

those rooms located in off-site locations.

Until HHS provides clarification through regulation, hospitals should carefully consider any planned expansion of the number of operating rooms and procedure rooms – including expansions in outpatient facilities that share the hospital’s Medicare provider number (*i.e.* offsite Departments of the hospital).

2. Ongoing Requirements

Hospitals owned by referring physicians must implement policies and procedures no later than September 23, 2011, that require:

- referring physician-owners to disclose their ownership interest in the hospital to patients being referred to the hospital;
- referring physician-owners to disclose the ownership interest of treating physicians to patients being referred to the hospital;
- the hospital to disclose the fact that it is physician-owned on its public website and in any public advertising; and
- the hospital to submit an annual report to HHS regarding its owners.

**FOR MORE INFORMATION**

This Client Alert is the seventh in the “Finding Your Way” advisory series, designed to assist our clients and other health care providers as they prepare to respond to health care reform. Future articles will include discussions regarding the health care reform law’s provisions regarding accountable health organizations, health reform pilot projects, and health reform quality initiatives.

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