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STARK PHASE III ALERT

On August 27, 2007, the Centers for Medicare & Medicaid Services (CMS) released the much-anticipated Phase III regulations implementing the Stark Law's prohibitions against physician self-referrals. The final rule appeared in the Sept. 5th Federal Register and will become effective December 4, 2007.

Although this industry must wait on further guidance from CMS regarding the future of "under arrangements," "per click" and percentage compensation contracts changes to which were proposed in the 2008 Physician Fee Schedule but not addressed in this most recent rulemaking, Phase III revises the Stark regulations in a number of important ways. Perhaps most significantly, Phase III requires physicians to "stand in the shoes" of certain affiliates with respect to certain financial arrangements. The practical consequence of this will be to require many physician arrangements previously analyzed under the Stark Law's indirect compensation exception to be reevaluated under the more stringent requirements of the direct compensation exception. In addition, Phase III provides greater flexibility in connection with a number of exceptions, including those relating to physician recruitment and physician retention, and it expands the temporary noncompliance exception to include a "holdover" of a personal services arrangement for up to six months.

The key provisions of the Stark Phase III regulations are summarized below.

Group Practice Productivity Bonus

Phase III revises the rule regarding payment of productivity bonuses to members of a group practice. The revisions clarify that, for purposes of calculating a physician's productivity bonus, those services and supplies that are appropriately billed "incident to" under current Medicare rules may be included in a bonus calculation consistent with the special rules for such compensation set forth in 42 C.F.R. § 411.352(i), p. 51016, but services and supplies having their own statutory benefit category, including diagnostic tests, may not be included in such calculation. Although the bonus paid based on such "incident to" services cannot be directly related to the volume or value of referrals of designated health services (DHS) by the physician in the aggregate, Phase III confirms



that bonus payments may be directly related to DHS personally performed by such physician or for DHS referrals by the physicians if the referrals are for services “incident to” services personally performed by the physician.

Hourly Rate Safe Harbor

Phase III eliminates the safe harbor for hourly compensation paid to physicians (42 C.F.R. § 411.351, p. 51015). CMS determined that utilization of the safe harbor, which relied on physician compensation surveys that were expensive to obtain or no longer available, was impractical. However, CMS stated that it will continue to scrutinize the fair market value of physician compensation arrangements and that making reference to multiple, objective, independently published salary surveys remains a prudent practice for purposes of evaluating and supporting a claim of fair market value.

Recruitment Agreements

Phase III includes two important amendments related to the regulations relating to physician recruitment agreements (42 C.F.R. § 411.357(e)(4)(iii) and (vi), p. 51048). With respect to incremental costs for physicians recruited to replace a physician who retired, died or relocated outside of the recruiting hospital’s service area in the preceding 12 months, the costs allocated to the physician practice need not be limited to actual additional incremental costs attributable to the recruited physician, but they can alternatively be the lower of a per capita allocation or 20% of the practice’s aggregate costs.

Phase III also softens the previous bright line prohibition on imposing practice restrictions on the recruited physician by permitting restrictions that do not “unreasonably restrict the recruited physician’s ability to practice medicine” in the hospital’s service area (emphasis added). In the preamble, CMS states that the following types of restrictions would be permitted under the revised regulations: moonlighting restrictions, patient and employee non-solicitation provisions, requiring treatment of Medicaid and indigent patients, confidentiality provisions, requiring repayment of losses created by the physician that are absorbed by the practice, and reasonable liquidated damages. Significantly, the preamble to Phase III also departs from the Phase II preamble position by allowing non-compete provisions that do not constitute “unreasonable” practice restrictions.

Recruitment Exception - Relocation of Practice

Phase III includes several amendments to the relocation of practice component of the physician recruitment exception (42 C.F.R. § 411.357(e)(2)(iv) and (3), p. 51051). First, Phase III clarifies that established physicians must relocate their practices from outside the hospital’s service area to inside that service area, in addition to showing either (1) the physician has moved his or her medical practice at least 25 miles or (2) the physician’s new medical practice derives at least 75% of its revenues from professional services from patients not seen or treated by the physician in his or her prior medical practice. This clarification addresses commenter confusion in situations in which a



recruited physician's current practice is within the service area, but can also meet the 25 mile/75% alternative test.

Second, Phase III adds exceptions to the relocation requirement for physicians who were (1) employed for at least two years prior to the recruitment agreement by a Federal or State bureau of prisons, the Department of Defense, Department of Veterans Affairs, or a facility of the Indian Health Service, and (2) did not maintain a private practice in addition to the full-time government employment. Lastly, Phase III grants the Secretary authority to determine in an advisory opinion that the physician is exempt from the relocation requirement because he or she "does not have an established medical practice that serves or could serve a significant number of patients who are or could become patients of the recruiting hospital."

Recruitment Exception – Geographical Area Served by Hospital

Phase III amends the definition of "geographic area served by the [recruiting] hospital" (42 C.F.R. § 411.357(e)(2), p. 51048) to (1) clarify the service area for non-rural hospitals that do not meet the previous Phase II definition and (2) introduce an alternative test for defining the service area available to rural hospitals. The Phase II service area definition ("lowest number of contiguous zip codes from which the hospital draws at least 75 percent of its inpatients") has been retained. However, Phase III clarifies that, in the case of a non-rural hospital that draws less than 75% of its inpatients from contiguous zip codes, the service area is deemed to be all contiguous zip code locations of the hospital's patients. In addition, rural hospitals may now elect to define their service area as all contiguous zip codes from which the hospital draws up to 90% of its patients, plus non-contiguous zip codes if contiguous zip codes contain less than 90% of the hospital's patients. If the hospital includes non-contiguous zip codes under the revised regulations, it must successively add the zip codes with the highest percentage of the hospital's patients until the 90% threshold is reached.

Written Certification in Lieu of Written Offer for Retention Payments

Phase III relaxes a key component of the exception for retention payments to physicians in underserved areas: the requirement that the physician have a bona fide written recruitment offer (42 C.F.R. § 411.357(t)(1), p. 51065). In addition to a written recruitment offer, the amended exception now permits the recruiting hospital to pay a retention bonus based on a written employment offer or a written certification from the physician. Under this new alternative, the physician must make a detailed certification that the hospital must take reasonable steps to verify. The physician must certify, among other things: that he or she has received a bona fide employment opportunity that requires the physician to move at least 25 miles and outside the hospital's service area, the identity and location of the potential employer, and the date and economic terms of the employment opportunity. The retention payment arrangement must comply with the Stark physician recruitment exception, and the payment cannot exceed the lower of 25% of the physician's current income or the reasonable costs of recruiting a replacement.



Physician Organizations

Phase III adds a new definition for “physician organizations,” which are defined as “a physician (including a professional corporation of which the physician is the sole owner), a physician practice, or a group practice that complies with the requirements of 42 C.F.R. § 411.352, p. 51062.” CMS’s purpose for this new provision is to close a loophole regarding “indirect compensation arrangements.” CMS explains that these compensation arrangements have been too narrowly construed in the past and, as a result, too many arrangements between DHS entities and group practices were permitted to fall outside of the physician self-referral law. Specifically, CMS has stated in its commentary that, under the new definition, a physician will be deemed to have a direct compensation arrangement with an entity furnishing DHS if the only intervening entity between the physician and the DHS entity is his or her physician organization. CMS accordingly elaborates that it will deem a physician to be “standing in the shoes” of his or her physician organization, so that he or she will be deemed to have the same compensation arrangements, with the same parties and on the same terms, as the physician organization has with the DHS entity.

Temporary Noncompliance Exception

Phase III revises prior regulations so that a provider or a physician that inadvertently allows a physician's personal services agreement to expire will no longer be automatically in violation of the Stark Law (42 C.F.R. § 411.353(f), p. 51024). Phase III allows "holdover" of a personal services arrangement for up to six months following the expiration of a personal services agreement as long as the personal services agreement met the conditions of the personal services exception. The holdover personal services arrangement must be on the same terms and conditions as the original agreement. Additionally, CMS indicates that in the event a hospital provides a physician with non-monetary compensation in excess of the limit, the parties can cure the non-compliance if the physician repays the excess value within 180 days of receipt or by the end of the calendar year in which it was received, whichever is earlier.

Physician Sale of Equipment to Hospitals

Under Phase II, if a physician sold a piece of equipment to a hospital on an installment basis and retained a security interest in the equipment to secure the hospital's payment, he or she would have been deemed to have an ownership interest in the hospital (42 C.F.R. § 411.357(f), p. 51027). Phase III addresses this issue by expressly stating that the security interest creates only a compensation relationship between the physician and the hospital, not an ownership relationship.

Compliance Training

Phase III revises the provision in Phase II that excluded any programs for which continuing medical education (CME) credit is available from the Stark exception for compliance training provided by a hospital to physicians who practice in the hospital's local community or service area (42 C.F.R. § 411.357(o), p. 51061). Under Phase III, the



compliance training exception now includes training programs that offer CME credit, provided that compliance is the "primary purpose" of the CME program.

Non-monetary Compensation

Phase III makes two major changes to the non-monetary compensation exception (42 C.F.R. § 411.357(m), p. 51024). Under the prior regulations, non-monetary compensation that does not exceed \$300 a year (adjusted for inflation in 2007 to \$329) was accepted from the Stark Law, provided certain conditions were met. Under Phase III, if an entity has inadvertently provided non-monetary compensation in excess of the allowable amount, the exception may still apply, provided the value of the excess amount is no more than 50% of the limit, and the physician returns the excess compensation by the end of the calendar year in which the excess compensation was received, or within 180 days of receipt, whichever is earlier. In addition, Phase III allows entities, without regard to the \$300 limitation, to provide one annual medical staff appreciation function (e.g., holiday party) for the entire medical staff. It should be noted that gifts provided in connection with such a function are subject to the \$300 limit.

Should you have any questions, please do not hesitate to contact one of our healthcare attorneys at the offices below.

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