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News, Articles, and Updates

Physician Integration Strategies: A Look at Evolving Models

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With healthcare reform here to stay, hospitals are increasingly seeking to align with physicians in their community in new ways so that both sides succeed as changes to the healthcare delivery and reimbursement systems unfold. As part of this evolving strategy, hospitals and health systems are entering into various hospital–physician integration transactions. This article describes certain evolving hospital–physician integration models and provides insights into the legal and practical issues these models may present.

Physician–Hospital Integration Models

**Entire practice acquisition**: The hospital or its affiliate (usually a foundation or captive or “friendly” professional corporation (PC)) purchases all of the assets of the physician practice, directly employs all of the physician and non-physician personnel, and assumes all equipment and space leases.

**Employment and practice lease**: The hospital or its affiliate directly employs all of the physicians and leases all of the space, equipment, and non-physician staff of the physician practice.

**Lease of entire practice**: The physicians continue to be owners/employees of their existing practice, but are leased to the hospital or its affiliate. The hospital or its affiliate also leases all of the space, equipment, and non-physician staff of the physician practice.

**Purchase of ancillaries**: With respect to specialties that provide significant ancillary services (e.g., cardiology), the hospital or its affiliate purchases the ancillary business in combination with the Employment & Practice Lease or the Lease of Entire Practice models. Alternatively, the hospital could only purchase the ancillaries and engage the physician practice to provide medical directorship services to the hospital-based ancillary service line.

Potential Legal Issues

Among the laws to consider in structuring these arrangements are the federal fraud and abuse laws, namely, the anti-kickback statute (AKS) and the Stark law. The AKS is an intent-based criminal law that prohibits the offer, payment, receipt, or solicitation of any remuneration in exchange for referrals of federal healthcare services. The Stark law is a strict-liability civil law that prohibits a physician from making a referral of “designated health services” (includes inpatient and outpatient hospital services) to an entity with which the physician has a financial relationship, unless the arrangement meets an exception.

The AKS and Integration

Physician integration transactions can help achieve *bona fide* goals and objectives, such as better aligning the hospital’s goals with physician incentives in order to improve quality and reduce costs. However, if the transaction does not result in genuine integration between the physicians and the hospital, there is a risk that the arrangement could be viewed, under the AKS, as a sham designed to provide physicians guaranteed compensation in exchange for referrals to the hospital.
Arguably, integration is easier to achieve in models that involve the employment of the physicians (i.e., the Entire Practice Acquisition and Employment & Practice Lease models), because the employer/employee relationship inherently involves a certain amount of control that is lacking in an independent contractor situation, such as the Lease of Entire Practice model. However, any integration transaction may be suspect unless the physicians are actually required to achieve meaningful levels of integration, which can include initiatives such as:

- Participating in the development and implementation of standardized policies, including policies regarding evidence-based medicine, service excellence, clinical pathways, IT, and quality
- Participating in the development and/or implementation of hospital-wide policies and procedures and participation in hospital committees and network development, as appropriate
- Participation in quality assurance and improvement programs
- Participation in healthcare reform-related initiatives such as accountable care organizations and value-based purchasing programs (e.g., bundled payments)
- Installing and utilizing hospital EMR, EHR, and other healthcare technology
- Participating in hospital charitable initiatives, including providing services to underinsured and uninsured patients

**The Stark Law’s Volume and Value Standard**

In order to achieve alignment with hospital goals, many hospitals are opting to compensate the physicians, in whole or in part, based on performance. One common methodology involves compensating the physicians based on work relative value units (wRVUs), although other methodologies are possible. Any arrangement that involves varying compensation could be problematic under the Stark law, unless the arrangement meets an exception.

There are several exceptions that are potentially applicable to the integration models, such as the “employment” exception, the “personal services arrangement” exception, and the “indirect compensation arrangement” exception. While the precise requirements of these exceptions vary, they all have in common a requirement that the compensation paid to the physician must not take into account the volume or value of referrals generated by the physician to the hospital—the so-called “volume and value standard.”

With respect to models that involve physician employment, if the physician is employed directly by the hospital, then the Stark law “employment” exception is applicable. With respect to performance-based compensation, the “employment” exception includes a carve-out from the volume and value standard for services that are personally performed by the physician. This would allow a hospital to pay a physician fair-market-value compensation based on personally performed wRVUs or another measure of personal productivity.

Oftentimes, however, the physician is not directly employed by the hospital, but rather is employed or engaged by a “friendly” PC or other entity that is affiliated with the hospital. In such instances, the “indirect compensation arrangement” exception is potentially applicable. With respect to the volume and value standard, an argument can be made that wRVUs are a measure of the time and intensity of a physician’s service and thus do not vary with the volume or value of referrals to the hospital. Furthermore, most physician office-based services are not “designated health services” and therefore, the majority of wRVUs generated will not implicate the Stark law. However, with respect to physician services that do generate a technical component referral for the hospital, a regulator could take the view that wRVU-based compensation implicates the volume and value standard because hospital billings will increase inherently with the amount of hospital-based wRVUs generated by the physicians. This argument may be especially problematic for physician specialties that do, in large part, generate revenues from hospital visits or other hospital-based services.

Compensation methodologies based on wRVUs or other variable components also implicate the AKS. There are safe harbors that, if met, would exempt an arrangement from scrutiny, including safe harbors for employment and personal services arrangements. However, variable compensation arrangements will generally not meet the requirements of some of these safe harbors, but, because the AKS is intent based, compliance with a safe harbor is not mandatory. Instead, if it can be established that the compensation paid to the physicians is fair market value and the arrangement as a whole is commercially reasonable, then it is less likely that the payment of wRVU-based compensation will be viewed as a violation of the AKS.

**“Pooled” Compensation Arrangements**

In addition to the issues surrounding volume and value standard, challenges may arise in the context.
of a hospital seeking to compensate physicians through a “pooled” arrangement. Many independent physician practices historically “pool” revenues and pay physicians a portion of the overall profits. Generally, physicians want to continue a “pooled” arrangement in connection with any hospital integration transaction. These “pooled” arrangements often include dollar amounts relating to “referrals” amongst the physician; thus, these arrangements need to be carefully structured to comply with the parameters of the Stark law. Although, the “employment” exception is not available for these arrangements, there are various alternative ways to structure the arrangement. Hospitals that wish to offer physicians “pooled” compensation structures should discuss the regulatory intricacies with their legal counsel.

Additional Considerations

In addition to the legal technicalities of structuring a physician integration transaction, there are several other practical concerns that a hospital or health system should take into consideration when pursuing a physician integration strategy:

- The hospital or health system should carefully consider which model fits the goals and objectives of its organization. Although it is possible to integrate various physician groups through different models, it is often easier and more cost-effective to offer one model to interested physicians.

- The organization should consider to what extent physicians should be involved in the governance and management of the PC or other integration vehicle.

- If a new “friendly” PC is being formed in connection with the alignment, this entity must be formed and organized before the go-live date of the first integration transaction. Also, the PC needs to have payer contracts in place before the go-live date.

- Consider performing an audit of the physician practice’s recent medical and billing records in order to confirm that any billing error rate is within acceptable parameters.

- If the alignment model involves the lease of the physician’s existing office space, it is important to confirm that all rental amounts are fair market value, particularly if the space is owned by referring physicians.

- The organization should discuss any proposed alignment transaction with its benefits consultants as these transactions may potentially trigger ERISA rules.

- In all the models, it is crucial for compliance purposes that all of the compensation paid to the physicians be fair market value and commercially reasonable, and be confirmed as such in a written valuation report from an independent and reputable healthcare valuation firm.

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