

# Health Care Reform's Impact on Physician-Owned Hospitals

## Amendment to Whole Hospital Exception Likely Will Result in Significant Adjustments to Long-term Plans



**Howard Fredrick Hahn** is a partner in the law firm of Husch Blackwell Sanders LLP, resident in the firm's Omaha, NE office. Howard focuses his practice in the areas of health care, real estate, and taxation. He regularly advises hospitals and health systems on health care regulatory issues.



**Torri A. Criger** is an associate in the law firm of Husch Blackwell Sanders LLP, resident in the firm's Omaha, NE office. Torri assists clients on health care regulatory issues including Medicare and Medicaid reimbursement, Stark, and anti-kickback law analysis, federal licensure/certification of health care facilities, and health care transactional matters.

**B**uried in the Patient Protection and Affordable Care Act (PPACA) is a provision which will have a significant impact on new and existing physician-owned hospitals. PPACA amends the Ethics in Patient Referrals Act (the Stark law) to place additional regulatory constraints on physician-owned hospitals, limit the expansion of physician-owned hospitals, and effectively prohibit new physician-owned hospitals. According to Physician Hospitals of America (PHA), an advocacy group for physician-owned hospitals, there are approximately 265 physician-owned hospitals located in 38 states that will be affected by the changes to the Stark law.<sup>1</sup>

### **THE STARK LAW AND THE WHOLE HOSPITAL EXCEPTION**

The Stark law generally prohibits a physician (or an immediate family member) from making a referral for "designated health services," including inpatient and outpatient hospital services, covered by the Medicare program, to an entity with which the physician has a financial relationship unless an exception applies.<sup>2</sup> A financial relationship means either an ownership interest or a compensation arrangement.

The Stark law, however, excludes an ownership or investment interest in a "whole hospital" from the definition of financial relationship.<sup>3</sup> The exception, referred to as the "whole hospital exception," permits referring physicians to maintain ownership and investment interests in hospitals as long as (1) the referring physician is authorized to perform services at the hospital; and (2) the referring physician's ownership or investment interest is in the whole hospital itself, as opposed to merely a distinct part of the hospital.

Section 6001 of PPACA substantially restricts the whole hospital exception to the Stark law.<sup>4</sup> However, a physician-

owned hospital with a provider agreement in effect as of December 31, 2010, is grandfathered, and therefore, a physician with ownership in such hospital is permitted to refer Medicare beneficiaries to that hospital without violating the Stark law. Under PPACA, a referring physician may maintain an ownership or investment interest in a hospital if (1) the referring physician is authorized to perform services at the hospital; (2) the referring physician's ownership or investment interest is in the whole hospital itself; and (3) the hospital had ownership or investment interest as of December 31, 2010 and a provider agreement on such date.

On July 2, 2010, the Centers for Medicare & Medicaid Services (CMS) released the 2011 outpatient prospective payment system and the ambulatory surgical center payment system proposed rule (OPPS/ASC proposed rule), which sets forth proposed regulations and solicits public comments on the changes to the whole hospital exception.<sup>5</sup> CMS will accept public comments on the proposed rule through August 31, 2010, and will respond to them in a final rule to be issued by November 1, 2010.

#### **LIMITATION ON EXPANSION**

With two exceptions, discussed *infra*, existing physician-owned hospitals are prohibited from expanding the number of beds, operating rooms, or procedure rooms for which they were licensed as of the date of enactment. The term "procedure rooms" includes rooms in which catheterizations, angiographies, angiograms, and endoscopies are performed. "Procedure rooms" do not include emergency rooms or departments. In the preamble to its proposed rules, CMS acknowledged that the term "procedure rooms" does not include CT or PET scans and is soliciting public comment on whether the term "procedure rooms" should include rooms where CT, PET, or other services not specifically listed are performed.

The limitation on expansion creates uncertainties for physician-owned hospitals currently under development. PPACA gives

physician-owned hospitals until December 31, 2010 to have a Medicare provider agreement in place; however, PPACA states in one subsection that the percentage of physician ownership or investment in a hospital, as well as the number of operating rooms, procedure rooms, and beds for which a hospital is licensed, may not be increased after the date of enactment of the bill.

Nonetheless, PPACA sets a "baseline" number of operating rooms, procedure rooms, and beds at the number of operating rooms, procedure rooms, or beds for which the hospital is licensed as of the date of enactment or, "in the case of a hospital that did not have a provider agreement in effect as of such date, the effective date of such provider agreement." While it appears that PPACA intends to give physician-owned hospitals currently under development until December 31, 2010 to finish construction and obtain a provider agreement, the contradictory language actually may prevent such physician-owned hospitals from completing construction.

In the OPPS/ASC proposed rule, CMS is proposing a regulation which would clarify that the number of operating rooms, procedure rooms, and beds for a hospital that did not have a provider agreement in place on March 23, 2010 is limited to the number it was licensed on the effective date of the provider agreement rather than limiting such hospital to the number it was licensed on March 23, 2010. This regulation would allow a physician-owned hospital currently under development to continue to construct operating rooms, procedure rooms, and beds until the effective date of its provider agreement, provided that its provider agreement is in effect prior to December 31, 2010.

Physician-owned hospitals currently under development that will not have a provider agreement in place before December 31, 2010 and any new physician-owned hospitals will not be grandfathered, and any physician ownership will create a financial relationship within the meaning of the Stark law. According to PHA, since the passage of PPACA,

27 physician-owned hospitals stopped construction, and approximately 40 other physician-owned hospitals are attempting to beat the December 31, 2010 deadline or are transferring ownership to existing hospitals and other parties not affected by the limitation on physician ownership.<sup>6</sup> It is important to note, however, that the transfer or sale of a physician ownership interest may present additional legal hurdles, including the creation of other relationships that may implicate the Stark law.

In addition to the limitation of physical expansion, PPACA also prohibits physician-owned hospitals from increasing the percentage of aggregate physician ownership after the date of enactment. This rule applies to physician-owned hospitals currently under development. The total value of the ownership or investment interest held in the hospital, or in an entity whose assets include the hospital, by physician owners or investors in the aggregate may not exceed such percentage as of March 23, 2010.

The Secretary is required to establish policies and procedures for enforcement of the new limitation and begin conducting audits no later than May 1, 2012.

### **EXCEPTIONS TO THE PROHIBITION ON EXPANSION**

Physician-owned hospitals may apply for an expansion pursuant to one of the two exceptions no more than once every two years. The first exception for “applicable hospitals” is based upon bed occupancy and population growth. To apply for the exception, a physician-owned hospital must (1) be located in a county in which the percentage increase is at least 150 percent of the percentage increase in the total population growth of the state over a five-year period; (2) have an annual percent of total inpatient admissions under Medicaid equal to or greater than the average Medicaid inpatient admissions for all hospitals located in the county in which the hospital is located; (3) not discriminate against beneficiaries of federal

health care programs; (4) be located in a state in which the average bed capacity in the state is less than the national average; and (5) have an average bed occupancy rate that is greater than the average bed occupancy rate in the state in which the hospital is located.

The second exception, known as the “high Medicaid” exception, is based upon the hospital’s total Medicaid admissions. Under the exception, a hospital meeting the definition of a “high Medicaid facility” may apply for an exception which would allow the hospital to increase its procedure rooms, operating rooms, or beds. A “high Medicaid facility” is defined as a hospital (1) that is not the sole hospital in the county; (2) that, with respect to each of the last three most recent years, 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 where the hospital is located; and (3) that does not discriminate against beneficiaries of federal health care programs and does not permit physicians practicing at the hospital to discriminate against such beneficiaries.

The exception process must allow a period of time for community input regarding the exception application. If a hospital satisfies the criteria of one of the two exceptions, and CMS grants the hospital’s exception, the hospital’s increase cannot exceed 200 percent of the “baseline” number of procedure rooms, operating rooms, and beds, and the increase may only occur in facilities located on the main campus of the hospital.

The Secretary is required to establish policies and procedures for hospitals to apply for an exception no later than January 1, 2012.

### **REPORTING AND DISCLOSURE REQUIREMENTS**

In addition to the limitation on expansion, PPACA imposes additional reporting and disclosure requirements on physician-owned hospitals. A physician-owned hospital must disclose that it is partially owned or invested in by physicians on any public

Web site for the hospital and in any public advertising for the hospital. Because PPACA does not specify on the nature or extent of the public notice, CMS is soliciting comments regarding the notice requirements.

Hospitals must have procedures in place for referring physicians to disclose any investment and ownership interest to a patient being referred. Such disclosure must be given with enough time for the patient to “make meaningful decision[s] regarding the receipt of care” and include details on the referring physician’s ownership or investment interest in the hospital and details on any ownership or investment interest the treating physician has in the hospital. CMS is proposing a regulation that obligates physician-owned hospitals to require each physician owner or investor to agree, as a condition of continued medical staff membership or privileges, to provide written disclosure of such physician’s ownership interest to all patients the physician refers to the hospital. Physician-owned hospitals have until September 23, 2011 to have notification and disclosure procedures in place.

PPACA also requires that physician-owned hospitals submit an annual report to the Secretary disclosing the identity of each physician owner or investor and any other owners or investors of the hospital and the nature and extent of all ownership and investment interests in the hospital. The Secretary must have a process in place for collecting this information no later than September 23, 2011.

### LEGISLATION CHALLENGED

PHA and Texas Spine & Joint Hospital jointly filed suit in U.S. Federal Court for the Eastern District of Texas challenging the constitutionality of PPACA’s limitations on physician ownership of hospitals.<sup>7</sup> PPACA prevents the Texas Spine & Joint Hospital, a physician-owned specialty hospital that was in the midst of expansion discussions at the

time PPACA was enacted, from expanding. In the complaint, the parties allege that the amendment to the Stark law is a violation of due process and equal protection rights and that the section is void due to a contradictory, vague, and arbitrary nature.

A motion for a preliminary injunction was also filed that, if granted, would allow the Texas Spine & Joint Hospital to proceed with its plans to expand its facility. Given the detrimental effects PPACA will have on physician-owned hospitals, PHA declared that it will pursue all options available to challenge the legislation: “We want to ensure that physician-owned hospitals and the quality care they provide remain a positive and available choice for patients.”<sup>8</sup> As of July 12, 2010, no decision has been made on the motion for preliminary injunction.

### CONCLUSION

Section 6001 of PPACA significantly impacts the ability of physicians to invest in hospitals. Opponents of physician-owned hospitals, such as Representative Fortney “Pete” Stark (D-CA) and Senators Charles Grassley (R-Iowa) and Max Baucus (D-MT), have long argued that physician ownership creates conflicts of interest and inappropriate incentives for physicians to refer patients to the hospital in which the physician has an ownership interest. The amendment to the whole hospital exception likely will require physician-owned hospitals to make significant adjustments to their long-term outlook and operational and organizational plans.

### Endnotes:

1. Physician Hospital Association, [www.physicianhospitals.org](http://www.physicianhospitals.org) (last accessed July 10, 2010).
2. 42 U.S.C. § 1395nn(a)(1); 42 C.F.R. § 411.353(a).
3. 42 U.S.C. § 1395nn(d)(3); 42 C.F.R. § 411.356(c)(3).
4. Patient Protection and Affordable Care Act (PPACA) Pub. L. No. 111-148, Subtitle A, Section 6001(a)(1)(i)(1)(A). Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, Section 1106(1).
5. The outpatient prospective payment system and the ambulatory surgical center payment system proposed rule, (CMS-1504-P), [www.ofr.gov/](http://www.ofr.gov/)

OFRUpload/OFRData/2010-16043\_PI.pdf (accessed July 10, 2010).

6. Beaulieu, Debra, "Reality of Physician-Ownership Ban Hitting Home for Hospitals," *Fierce Healthcare*, May 7, 2010, available at [www.fiercehealthcare.com](http://www.fiercehealthcare.com) (accessed July 10, 2010).

7. Physician Hospitals of America, Press Release (June 3, 2010); *Physician Hospitals of America, et al v. Sebelius*, 2010cv00277, filed: June 3, 2010 (E.D. Texas).
8. Physician Hospitals of America, Press Release (March 24, 2010).

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