Stark II Phase II: Physician Recruitment

May 01 2004

Practice Area: Health Law

On Friday, March 26, 2004, the Centers for Medicare and Medicaid Services ("CMS") published the Stark II/Phase II interim final rule. Phase II addressed a variety of issues that either were left open in the Phase I rulemaking, or required further clarification after Phase I. von Briesen & Roper's Stark/Fraud & Abuse Team has published a number of articles relating to Phase II. This article focuses on the changes relating to *physician recruitment* andretention, and what these changes mean for hospitals and physicians.

Overview

Stark contains a statutory exception for payments made to physicians who relocate their practices. CMS issued a proposed rule concerning recruitment payments in 1998. This rule was reserved when CMS issued its Phase I final rules in 2001. In the Phase II final rule, CMS both expands and restricts the scope of the exception. Phase II expands CMS' prior approach by expressly allowing joint recruitment efforts through practice groups, and by allowing retention payments. CMS imposes additional restrictions for joint arrangements, however, such as a prohibition on covenants not to compete.

The Basics

CMS retains the basic elements of the 1998 proposed rule. Hospitals may make physician recruitment payments to physicians who relocate their practices in order to join a hospital's medical staff, if all of the following conditions are met:

1. The arrangement is set out in writing and signed by both parties;
2. the arrangement is not conditioned on the physician's referral of patients to the hospital;
3. the hospital's payment is not tied to referrals; and
4. the physician is allowed to establish privileges at other hospitals.
5. a key addition in Phase II involves additional restrictions for recruiting to an existing group.

Recruitment Payments Made Through Physician Groups

The exception now permits recruitment payments to *groups* under certain circumstances. The statutory exception only addressed recruitment payments made "by a hospital to a physician," suggesting that payments to a physician group (which in turn recruits a physician) would not be appropriate. CMS' concern is that recruitment payments made to physician groups may be "used improperly to pay for referrals from the existing physician practice, in essence creating an improper financial relationship between the hospital and the existing physician practice." This echoes concerns of the Office of Inspector General under the anti-kickback statute relating to direct or indirect benefits accruing to the practice or other established physicians in that practice, a concern that manifests itself in the Tenet indictments in summer 2003.

CMS addresses these concerns by imposing a number of additional restrictions on recruiting payments made to/through an existing practice:

1. The arrangement between the hospital and the physician practice is set out in writing and signed by the parties.
2. Except for actual costs incurred by the physician or physician's practice in recruiting the new physician, the remuneration is passed directly through to or remains with the recruited physician.Recruitment incentives must end up with the recruited physician– any amount retained by the group could be construed as a payment to induce referrals.
3. In the case of an *income guarantee*,costs allocated by the physician practice to the recruited physician may not exceed the actual additional incremental costs to the practice attributable to the recruited physician.
4. Records of the actual costs and the passed-through amounts must be maintained for a period of at least five years and made available to the Secretary upon request.
5. The remuneration for the hospital under the arrangement is not determined in any manner that takes into account the volume or value of any referrals by the recruited physician or any physician affiliated with the physician practice.
6. The physician practice receiving the hospital payments may not impose additional practice restrictions on the recruited physician (for example, a non-compete agreement), but may impose conditions related solely to quality considerations.
7. The recruitment arrangement does not violate the anti-kickback statute, or any Federal or State law or regulation governing billing or claims submission.

The most significant limitation on joint recruiting arrangements involve the income guaranty and the prohibition on practice restrictions. The physician group must identify costs incurred as a result of adding the new physician. Allocations of general overhead, or per-capita cost allocations, presumably could not meet this test (although that may vary with the facts). As a result, the practice will only receive income guarantee payments if the actual additional incremental costs attributed to a recruited physician exceed the collections for services by such physician.

The prohibition on practice restrictions, such as non-competes, may be a significant obstacle for many practice groups and hospitals. It is common practice for physician practices to impose such a restriction on incoming physicians. CMS' concern is that hospital payments should not benefit the physician group: the object of the recruiting arrangement must be to add a new physician to the community, not to protect the group's business interests in the community. The prohibition against non-competes apparently only remains in effect for as long as the financial relationship arising from the recruitment support remains in effect, although the duration of the limit is still unresolved.

What Qualifies as a Relocation?

Recruitment payments are only permitted with respect to physicians who "relocate" to a hospital's service area. In Phase II, CMS shifts the focus to the relocation of the recruited physician's medical practice, rather than the physician's *residence*. This change wasin response to concerns that a physician would need to move his or her residence in order to qualify for the exception. CMS now recognizes that the key concern is the location where the physician practices medicine, not where the physician lives, such that the proper inquiry is whether the recruit "moves" his or her practice to a hospital's service area.

A physician will be deemed to have relocated to the hospital's geographic service area (defined as the lowest number of contiguous postal zip codes from which the hospital draws at least 75% of its inpatients) if:

1. The physician moves his or her medical practice 25 miles; or
2. at least 75% of the physician's revenues are from services provided by the physician to new patients. New patients are those patients not seen or treated by the physician at his or her prior medical practice location during the preceding three years.

Generally speaking, a physician recruitment payment may be appropriate if a physician moves a distance of at least 25 miles, or provides services to more than 75% new patients. This change creates a bright line rule to determine whether or not a physician "relocates" to a hospital's geographic service area for the purposes of the Stark law.

Nevertheless, it is possible for a physician to "relocate" without an actual move if a physician establishes a new practice with a new patient base. If there is a *reasonable expectation* that the recruited physician's medical practice during the physician's start up year will generate at least 75% of revenues from patients not seen at the physician's medical practice during the preceding three years, the physician is deemed to have "relocated."

Exception for Residents & New Physicians
Residents and physicians who have been in medical practice less than one year will be eligible under the physician recruitment exception regardless whether or not the physician actually moves his or her practice location. CMS determined that residents and new physicians have not *established* a medical practice and, therefore, hospitals should be able to recruit them regardless of whether these physicians already work in the hospital's geographic service area.

FQHCs Can Make Recruitment Payments
Phase II expands the reach of the recruitment exception to include federally qualified health centers (FQHCs), which now are eligible to make physician recruitment payments on the same basis as hospitals. The arrangement under which FQHCs make payments to a recruited physician must not violate the anti-kickback statute, and must comply with Federal and State laws and regulations, as well as applicable billing requirements. CMS recognized that FQHCs provide substantial services to underserved populations and allowing recruitment payments for FQHCs will help attract physicians to join their medical staffs. CMS specifically disallowed this exception for other designated health services entities such as nursing homes and home health agencies because of a perceived risk of abuse for these entities.

Community Need
The recruitment exception under Phase II does not expressly require an assessment of community need. Nevertheless, hospitals should consider documenting the need to recruit a new physician to its service area. Under IRS requirements, tax exempt hospitals must evaluate and document the need to pay physicians to attract them to the community. Even if IRS requirements do not apply to a particular hospital (*e.g., for-profit hospital),* documenting community need will assist in demonstrating the reasonableness of any recruitment support package that may be called into question.

Retention Payments for Hospitals and FQHCs in HPSAs
The interim final rule creates a limited exception for *retention* payments.This exception only covers payments made to a physician with a practice located in a health professional shortage area ("HPSA") (regardless of whether the HPSA is designated for the physician's specialty). The physician must have received a firm written recruitment offer from an unrelated hospital or FQHC

- that specifies the remuneration being offered, and
- that would require the physician to move the location of his or her practice at least 25 miles and outside of the geographic area served by the hospital or FQHC making the retention payment.

The retention payment must be limited to the lower of:

1. The difference between the physician's current income from physician and related services and the income the physician would receive from physician and related services in the recruitment offer (over no more than a 24-month period), or
2. the reasonable costs the hospital or FQHC would otherwise have to expend to recruit a new physician to the hospital's or FQHC's service area to replace the retained physician.

Any retention payment must be based on the same methodology, and be subject to the same restrictions, if any, as the recruitment offer. A hospital may enter into a retention arrangement with a physician no more frequently than once every five years and the amount and terms of the retention payment may not be altered during the term of the arrangement in any manner that takes into account the value or value of referrals or other business generated by the physician.

The benefit of this retention exception to hospitals is questionable because it requires physicians to look for another job and receive an offer before a hospital may make a retention payment. In the end, this exception may prove to be not very useful if it forces physicians to look at other job opportunities to be eligible for retention payments (and increasing the likelihood physicians will leave the community).

Impact of Phase II?

In the preamble to the 2001 Phase I rules, CMS telegraphed that it would address joint recruiting arrangements in its Phase II release. As a result, many hospitals and physicians entered into joint arrangements in general conformity with the requirements of the 1998 proposed rule. Hospitals and groups may need to modify existing recruitment arrangements to address the new restrictions imposed by Phase II, such as those relating to income guarantees and non-compete provisions. The new rules become effective on July 26, 2004, so prompt review of existing arrangements is essential; the exact impact of the new rule on existing arrangements is currently the subject of debate.

Additional Resources

The Stark/Fraud & Abuse Team of von Briesen's Health Law Group has assembled a number of resources on the new Phase II regulations under Stark, including a link to the regulations themselves. Articles include both an overview of Phase II, as well as a series of in-depth commentaries on specific aspects of the new rules.
