Tenet Indictments and Recruitment Agreements: Canary In The Coal Mine?

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Practice Area: Health Law

On July 17, a federal grand jury in San Diego handed up a 17-count indictment against Tenet Health System Hospitals, Inc. and its subsidiary Alvarado Hospital Medical Center, Inc., charging Tenet and Alvarado Hospital with criminal violations relating to physician relocation agreements. This indictment follows an earlier indictment in June against the chief executive officer of Alvarado Hospital, which contains similar allegations.

Tenet asserts that its corporate policy on relocation agreements is appropriate under the law, and the full story behind these indictments has yet to be told. Nevertheless, the Tenet indictments may be a harbinger of a tougher stance on physician recruitment arrangements, and underscore prior government concerns with recruitment arrangements that benefit not only the recruited physician, but also established physicians in the recruit's practice group. As a result, recruitment agreements entered into with practice groups will continue to receive heightened scrutiny.

The Tenet Indictments
The indictment alleges that Tenet and Alvarado Hospital paid over $10 million to fund more than 100 physician relocation agreements to bring physicians to the San Diego area. Many of these physicians were recruited into existing practice groups; the indictment alleges that at least a portion of the relocation payments were actually disguised kickbacks to established members of these practice groups. For example, the indictment charges that one practice group received $230,000 in relocation payments after physicians from the group solicited funds from Alvarado Hospital while promising that they would be able to "increase the flow of admissions" to the hospital. The indictment charges Tenet and Alvarado Hospital with one count of conspiring to violate the federal anti-kickback statute, and 16 separate counts of offering and paying illegal remuneration in violation of that statute. Each count carries a potential penalty of five years imprisonment and a $25,000 fine, as well as potential exclusion from the Medicare program.

The Anti-Kickback Statute
The federal anti-kickback statute makes it illegal to offer, solicit, or pay any benefit in order to induce or reward the referral of any patient insured by the Medicare, Medicaid, or other federal health care programs. In November 1999, the Office of Inspector General, Department of Health and Human Services ("OIG"), published final regulations for a recruitment "safe harbor" under the anti-kickback statute. While recruitment arrangements are not *required* to satisfy the safe harbor, strict compliance with the safe harbor criteria will insulate an arrangement from prosecution under the anti-kickback statute. The safe harbor sets forth nine separate standards, all of which must be met in order for an arrangement to qualify for safe harbor protection. One of those standards is as follows:

The payment or exchange of anything of value may not directly or indirectly benefit any person (other than the practitioner being recruited) or entity in a position to make or influence referrals to the entity providing the recruitment payments or benefits of items or services payable by a Federal health care program.

In its preamble to the recruitment safe harbor regulation, OIG declined to extend safe harbor protection to so-called "joint" arrangements (where support payments are made to a practice group instead of to the individual physician), due to its concern that joint arrangements may result in improper benefits to the group. OIG did not issue any blanket condemnation of joint arrangements, however; indeed, OIG noted that joint arrangements "can be efficient and cost effective means of recruiting needed practitioners," many of whom "prefer joining an existing group practice to starting a solo practice." At the same time, though, OIG asserted that joint arrangements "can be used to disguise payments for referrals from the group or solo practice to the hospital."

In 2001, OIG issued an advisory opinion that also discussed the antikickback statute as it applies to joint recruitment arrangements. In Advisory Opinion 01-4, OIG stated that joint recruitment arrangements between hospitals and referral sources such as solo practitioners, group practices, or managed care organizations are "subject to a higher degree of scrutiny to ensure that the remuneration is not a disguised payment for past or future referrals."

OIG also stated that a recruitment payment "is more suspect if it directly or indirectly benefits actual or potential referral sources, other than the recruited practitioner."

It is precisely this type of alleged benefit to others that underlies the Tenet/Alvarado Hospital indictments.

Stark Physician Referral Prohibitions

Recruiting arrangements raise issues under the federal Stark law as well. Stark prohibits a physician from making a referral to an entity for the furnishing of designated health services if the physician (or an immediate family member) has a financial relationship with that entity, unless an exception applies.

The Stark statute includes an exception for physician recruitment payments. The Centers for Medicare & Medicaid Services ("CMS") proposed regulations implementing this exception in January 1998; the final rule is expected later this year. As originally set forth in the Stark statute, the recruitment exception specifically applies to payments made by a hospital "to a physician." In the 1998 proposed regulation, CMS appeared to expand the breadth of the exception to cover payments by a hospital "to induce a physician to relocate," without specifically stating that the payment must be made "to the physician." Unlike the preamble to the safe harbor regulations, the preamble to the proposed Stark recruitment exception does not expressly exclude joint recruiting arrangements from the scope of the exception. At one point in the preamble, though, CMS suggested that recruitment payments "to a group practice that intends to employ the physician" might be covered under the new fair market value exception under Stark. It is not clear whether this comment was intended to suggest that joint recruitment arrangements would *not qualify* under the recruitment exception; further guidance on this point is expected when CMS issues final regulations later this year.

Regardless of whether a joint recruitment arrangement qualifies under the recruitment exception, the fair market value exception, or under the new Stark exception for indirect compensation arrangements, the Stark exceptions generally require that payments not vary with, reflect, or take into account the volume or value of referrals or other business generated between the parties. Various Stark exceptions also require compliance with the anti-kickback statute. As a result, any recruitment arrangement must be carefully and narrowly tailored to ensure that the benefits of the arrangement are not tied, directly or indirectly, to expected referrals from the practice group. In addition, any benefit to other members of the group may create a separate financial relationship under Stark, for which a separate exception may be required.

Private Inurement/Private Benefit
Non-profit hospitals face additional constraints with respect to their recruitment arrangements, in order to maintain tax-exempt status. These include issues of private inurement and private benefit, as well as whether the hospital is meeting community benefit requirements. The Internal Revenue Service has provided guidance in a number of sources, including its examination guidelines for tax-exempt hospitals published in 1992 (Rev. Ann. 92-83); a closing agreement entered into with Houston's Hermann Hospital in 1994, which resolved certain exemption issues relating to the hospital's recruitment practices; a revenue ruling regarding tax consequences of physician recruitment incentives issued in 1997 (Rev. Rul. 97-21); and a private letter ruling issued by the IRS in July 1998 that expanded on Rev. Rul. 97-21.

It is unlikely that a newly recruited physician would qualify as an "insider" for private inurement purposes. If recruitment payments benefit other members of a practice group, though, private inurement concerns may arise if any members of the group qualify as "insiders." The private benefit requirements, on the other hand, are not limited to "insiders," and prohibit private benefits that are more than incidental to public purposes. In Rev. Rul. 97-21, the IRS stated that income guarantees and other recruitment support should bear a reasonable relationship to the promotion and protection of the health of the community. If recruitment support goes beyond what is necessary to induce a physician to relocate to the community, and generates a benefit to other members of the practice group, a hospital may be placing its tax exemption in jeopardy.

Recommendations
The Tenet/Alvarado Hospital indictments serve as a reminder to hospitals, physicians, and medical practices regarding the compliance issues posed by recruiting arrangements. All agreements, whether entered into directly with a physician or with a group practice, should comply with certain safeguards: (1) the agreement should be in writing, for a term of at least one year, and should specify all benefits to and obligations of the parties; (2) hospitals (and practice groups) should take care to document both the fair market value of the consideration, and the community need for the recruited physician; (3) the agreement should clearly specify the purposes of the arrangement, namely, to assist the relocation of a physician to the hospital service area in order to fill that community need; (4) the amount of the payment should be no more than is reasonably necessary to induce relocation; (5) the duration of the benefits should not be greater than three years, and the payment of the benefits must not be conditioned on referrals to the hospital or otherwise vary with the volume or value of referrals or other business generated for the hospital; (6) the parties should attempt to conform the arrangement to the recruitment safe harbor to the extent possible; and (7) the agreement should allow for review and revision following the issuance of the final Stark regulations governing the physician recruitment exception.

While there is nothing *per se* illegal or inappropriate with joint recruitment arrangements, parties to such arrangements should scrutinize the potential benefit to persons other than the recruited physician. It remains to be seen how aggressive the government will be in characterizing recruitment support payments as indirect benefits to others. The government is likely to focus not only on outright payments to practice group members, but also on more subtle opportunities for indirect benefit to existing physicians such as through expense allocations, particularly overhead expenses; a key inquiry may be whether the support payments merely offset the additional direct and indirect costs attributable to the addition of a new physician to the practice, or whether the payments have the ultimate effect of reducing the overhead otherwise borne by established members of the practice, thereby increasing their net income. IRS guidance documents note that income guarantees and other support should fall within the range reflected in regional or national surveys, and generally support the imposition of explicit ceilings on total hospital outlays; compliance with these guidelines, even by for-profit entities, also serves to counter challenges under the anti-kickback statute.