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**Memorandum**

Date *JAN 31 1991*
[Signature]
From Richard P. Kusserow
Inspector General

Subject OIG Management Advisory Report: "Financial Arrangements
Between Hospitals and Hospital-Based Physicians,"
OEI-09-89-00330

To Gail R. Wilensky, Ph.D.
Administrator
Health Care Financing Administration

This management advisory report alerts you to potential violations of the anti-kickback statute (statute), section 1128B of the Social Security Act (42 U.S.C. Section 1320a-7b). We have identified potential violations in the financial arrangements between some hospitals and hospital-based physicians. These agreements 1) require physicians to pay more than the fair market value for services provided by the hospitals, or 2) compensate physicians for less than the fair market value of goods and services that they provide to hospitals.

BACKGROUND

Hospital-based physicians include specialists such as anesthesiologists, emergency room physicians, pathologists, radiologists, and teaching physicians. Each of these specialties is dependent on the hospital environment to obtain referrals from other specialists practicing at their hospital. In turn, the hospitals are somewhat dependent on the hospital-based physicians because they provide essential services to the hospitals.

Hospitals recently began to view these physicians as potential new revenue sources. Some hospitals have reduced payments to hospital-based physicians, and some are requiring payments from those physicians.

Medicare pays for the services of hospital-based physicians in a variety of ways. Usually, Medicare pays physicians directly for the services delivered. However, when pathologists perform clinical laboratory services for hospital inpatients under part A, some portion of Medicare's payments to the hospital are for that pathology service. Different methods of payment may apply in each instance.

Medicare payments for anatomic pathology services are more complicated. Technical and professional components are paid separately. The former go directly to hospitals and the latter to the pathologist.

Legal Criteria

The statute makes it illegal to offer, pay, solicit or receive remuneration for referring business payable under Medicare or Medicaid. Unlike most applications of the statute concerning Medicare compensation arrangements, the focus here is on remuneration made to hospitals.

The statute is very broad, covering indirect or covert forms of remuneration, bribes, kickbacks and rebates as well as direct or overt ones. Three significant cases have interpreted the statute.

In United States v. Greber 760 F.2d 68, 69 (3rd Cir.), cert. denied, 474 U.S. 968 (1985) the Court held that, "if one purpose of the payment was to induce future referrals, the Medicare statute has been violated." The reasoning in Greber was adopted by the Ninth Circuit Court of Appeals in the United States v. Kats 871 F.2d 105 (9th Cir. 1989.) In Kats the Court found that the statute is violated unless the payments are "wholly and not incidentally attributable to the delivery of goods and services."

In United States v. Lipkis 770 F.2d 1447 (1985), the Ninth Circuit Court of Appeals reviewed an arrangement between a medical management company which provided services to a physician's group and a clinical laboratory. The laboratory returned 20 percent of its revenues obtained from the physician group's referrals to the management company. The defendants alleged that these payments represented fair compensation for "specimen collection and handling services." Ibid. at 1449. The court rejected this defense, noting "the fair market value of these services was substantially less than the [amount paid], and there is no question [the laboratory] was paying for referrals as well as the described services." Ibid. Thus, applying the reasoning of the Ninth Circuit Court of Appeals in Lipkis, an inference can be drawn that illegal remuneration occurs when a contract between a hospital and hospital-based physicians calls for the rental of space or equipment or provision of professional services on terms other than fair market value.

If a provider's conduct falls within the purview of the statute, it can be prosecuted unless the conduct meets a statutory exception or "safe harbor" (when finalized). It should be observed that there is no statutory exception or contemplated "safe harbor" provision which applies to the conduct described herein.

Analysis

Contracts which require physicians to split portions of their income with hospitals are highly suspect, although not per se violations of the statute. Usually there is little basis to require hospital-based physicians to turn over a percentage of their earnings to the hospital. In addition, in many arrangements the fees hospitals receive are vastly in excess of the value of the services (such as billing services) they provide to the hospital-based physicians.

Examples of Agreements

We have reviewed many agreements that provide payments or remuneration to hospitals in excess of the fair market value of the services provided by them. Because many of these arrangements may violate the statute, disclosure of the terms of these agreements are rare, and therefore it is very difficult to establish the prevalence of these agreements. Several medical societies and anonymous parties have shown us the following contract provisions without identifying names and locations.

- o A group of emergency room physicians pays a hospital half of its cash receipts exceeding \$600,000 annually.
- o A hospital provides no, or token, payback to pathologists for Part A services in return for the opportunity to perform Part B services at that hospital.
- o Radiologists must pay 50 percent of their gross receipts to a facility's endowment fund.
- o Thirty-three percent of all profits above a set amount must be paid by a radiology group to a hospital for its capital improvements, equipment, and other departmental expenditures.
- o A radiologist group was required to purchase radiology equipment and agreed to donate the equipment to the hospital at the termination of the contract. The hospital has an unrestricted right to terminate the contract at any time.

- o When net collections for a radiology group exceed \$230,000, 50 percent is paid to the hospital, and the hospital reserves the right to unilaterally adjust the distributions if it determines that the physician group has not fulfilled the terms of the contract.
- o A radiologist group pays 25 percent of the profits exceeding \$120,000 to the hospital for capital improvements. Fifty percent of the profits exceeding \$180,000 go to this purpose.
- o A radiology group pays for facilities, services, supplies, personnel, utilities, maintenance, and billing services furnished by the hospital on a fee schedule that begins at \$25,000 for 1989, and rises to \$100,000 by 1993. Payments are due only if the radiologist's gross revenue exceeds \$1,000,000 in the previous year.

CONCLUSION

All of these examples appear to violate the statute because they provide compensation to the hospitals that exceeds the fair market value of the services the hospitals provide under the contracts. It also appears the payment of the remuneration is intended to provide the hospital-based physician with referrals from the other physicians on the hospital's medical staff.

These illegal financial arrangements may have several unfortunate results. The remuneration gives the hospitals a financial incentive to develop policies and practices which encourage greater utilization of the services of hospital-based physicians. Additionally, hospital-based physicians faced with lowered incomes may be encouraged to do more procedures in order to offset the payments to the hospitals. These problems are among the recognized purposes of having the anti-kickback statute on the books in the first place.

Illegal arrangements may also complicate the development of physician fee schedules if physician practice costs are artificially inflated by arrangements not based on fair market values.

RECOMMENDATION

The HCFA should instruct its contractors to: (1) notify physicians and hospitals about potential legal liability when they enter into agreements not based on the fair market value of necessary goods and services exchanged; and (2) refer identified cases to the Office of Inspector General for possible prosecution or sanctions.

To reduce potential legal liability all contracts between hospitals and hospital-based physicians should:

- o be based on the fair market value of services (The nature and value of all services performed should be stated separately and the fair market value should be documented),
- o be unrelated to physician income or billings (these agreements are not per se illegal but are suspect), and
- o be limited to goods and services necessary for the provision of medical services by the hospital-based physicians, and typical of what hospitals provide hospital-based physicians.

It should be noted explicitly that these criteria do not establish a "safe harbor." Compliance with these criteria will not immunize parties from liability under the statute.

We would appreciate your comments on this report within 30 days. If you have any questions please contact me or have your staff contact Barry Steele at FTS 646-3138.