Unsure Footing: Stark Phase III's "Stand in the Shoes" Provisions

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I. Introduction

Lawyers trying to comprehend and apply the federal physician self referral ban, commonly referred to as the "Stark Law"[1] , often feel like they are standing on shifting sand, unsure of how the next wave of proposed or final regulations from the Centers for Medicare & Medicaid Services ("CMS") will change their footing. Such uncertainty is understandable given the breadth and complexity of the regulations adopted by CMS and CMS' penchant for revisiting (and sometimes changing) its interpretation of the Stark Law. Nevertheless, many in the legal community hoped that the completion of the rule making process would clear up most of the areas of uncertainty. In September of 2007 CMS finished the process of adopting final regulations interpreting the Stark Law with the publication of Phase III of the regulations ("Phase III").[2] The final rules provide clear guidance with respect to certain provisions of the Stark Law; however in other areas Phase III undermines interpretations of the Stark Law previously considered firm and introduce new areas of unsure footing for health care lawyers.

One of Phase III's more unsettling changes is the expansion of the "stand in the shoes" provisions. These provisions now treat as direct compensation arrangements certain arrangements which were previously considered to be, at the most, indirect compensation arrangements between a physician and an entity furnishing designated health services ("DHS"). This is significant because many of these arrangements were not structured to satisfy the Stark Law direct compensation arrangements exceptions. As a result many arrangements involving a DHS Entity and a physician organization, which were previously believed to be compliant with the Stark Law or even outside of the realm of the Stark Law, need to be reconsidered.

II. Background and Applicability of the "Stand in the Shoes" Provisions

CMS adopted the new "stand in the shoes" provisions primarily to close a perceived loophole in the Stark Law and to make it clear that certain compensation arrangements should be treated as direct compensation arrangements. The Stark Law generally prohibits a physician from referring Medicare patients to an entity furnishing DHS ("DHS Entity") if the physician, or a family member of the physician, has a financial relationship with the DHS Entity. A financial relationship includes a direct or indirect ownership or investment interest in the DHS Entity or a direct or indirect

compensation arrangement with the DHS Entity. The "stand in the shoes" provisions change the treatment of certain compensation arrangements involving a DHS Entity and a referring physician's medical practice and provide that the referring physician is deemed to have the same direct compensation arrangements as his medical practice.

For example, assume Physician A is employed by Practice, which is organized as a professional corporation that has two or more shareholders, and that the Practice leases office space from Hospital. Prior to the adoption of Phase III it was commonly believed that such an arrangement did not create a direct compensation arrangement between Physician A and Hospital because Physician A was not a party to the lease. Such analysis was supported by Phase II of the regulations in which CMS provided that sole shareholders of "wholly-owned professional corporations" are deemed to "stand in the shoes" of their medical practices but specifically did not extend the applicability of the "stand in the shoes" provisions beyond such limited circumstances.[3] As a result, whether Physician A's referrals of Medicare patients to the Hospital for DHS complied with the Stark Law rested solely on whether the Practice's lease arrangement with the Hospital created an indirect compensation arrangement between Physician A and the Hospital.[4] If so, many believed the arrangement complied with the Stark Law if it satisfied the cumbersome indirect compensation arrangement exception.

For a couple of reasons however, CMS has shifted course and now does not agree that such arrangements should be treated as indirect compensation arrangements. One reason is that CMS feels that applying the indirect compensation arrangement exception to such arrangements inserts an unnecessary step to complying with the Stark Law and ignores the true nature of the relationship between physicians and their medical practices. CMS believes that it is "easier, more efficient and consistent with the purposes of" the Stark Law to treat such arrangements as direct compensation arrangements.[5] However CMS' primary reason for the change is that CMS believes that there was a loophole in the regulations which parties were relying on to claim that compensation arrangements between a physician's medical practice and a DHS entity were not subject to the Stark Law if the physician was not a direct party to the arrangement. CMS asserts that parties were applying the "definition of indirect compensation arrangement too narrowly"[6] and determining that such arrangements did not create an indirect compensation arrangement between the physician and the DHS Entity if the physician's compensation from his medical practice did not vary depending upon the volume or value of his referrals to the DHS Entity. CMS believes that such analysis is overly simplistic and ignores the true relationship between a physician and his medical practice.

In Phase III CMS closed this loophole by making several changes to the regulations. First, CMS revised the definition of "direct compensation arrangement" to provide that a physician is deemed to have the same direct compensation arrangements as his "physician organization".[7] Second, CMS defined "physician organization" to include professional corporations, physician practices and group practices.[8] CMS did not define the term "physician practice" however it is apparent that CMS intends for the term to include most, if not all, entities which employ or contract with physicians for the purpose of practicing medicine. Finally, CMS added a provision making it clear that the parties to a compensation arrangement who are subject to the "stand in the shoes" provisions include the physician organization which enters into the arrangement and all members,

employees and independent contractor physicians of such physician organization.[9] Accordingly, the "stand in the shoes" provisions apply
not only to those physicians who own the physician organization but also to all physicians who render medical care through such organization, regardless of whether such physician is an employee or independent contractor.

The end result of the foregoing changes is that a physician who is an owner, employee or independent contractor of a physician organization is deemed to have a direct compensation arrangement with any DHS Entity with which his physician organization has a direct compensation arrangement. This is the case even if the physician is not, by the common use of the term, a party to the arrangement. CMS believes that the foregoing changes reduce the risk of fraud and abuse by incorporating "a commonsense understanding of the relationship between group practices and their physicians."[10] Regardless, it is clear that the Phase III will have a significant impact. Arrangements which were previously considered to be indirect compensation arrangements or even not subject to the Stark Law will need to be reconsidered to determine if they are, in light of the changes, direct compensation arrangements and, if so, whether they satisfy any of the exceptions applicable to direct compensation arrangements. For instance, the lease arrangement described above between Practice and Hospital is now deemed to be a direct compensation arrangement between the Hospital and each of Physician A and all other physician owners, employees and independent contractors of Practice. Accordingly, such arrangement needs to satisfy the lease exception to the Stark Law in order for Physician A or any of the Practice's owners, employees or independent contractor physicians to refer Medicare patients to the Hospital. Restructuring the arrangement to comply with the lease exception will probably pose few problems for most parties. However other types of arrangements may be more difficult to restructure.

III. Limitations on the Applicability of the "Stand in the Shoes" Provisions

Notwithstanding the fact that CMS intends for the Phase III "stand in the shoes" provisions to have a broad scope, the provisions do not apply to all arrangements involving physicians. If there is an intervening entity between the physician organization and the DHS Entity the physicians of such physician organization will not be deemed to have a direct compensation arrangement with the DHS Entity.[11] For example, no direct compensation arrangement exists between a hospital and a referring physician by virtue of the physician's physician organization entering into a management contract with a subsidiary of the hospital. However even this seems likely to change. In Phase III CMS expressed concern with these types of arrangements and solicited comments on whether the "stand in the shoes" provisions should cover such situations.[12] Moreover, in the proposed rules for the 2008 Physician Fee Schedule CMS showed that it is also focusing on the DHS Entity side of the arrangement by soliciting comments on whether DHS Entities should be deemed to "stand in the shoes" of their subsidiaries.[13]

The "stand in the shoes" provisions also do not apply if the entity between the referring physician and the DHS Entity is not a physician organization. For example, assume a group of physicians, who are the owners of a physician organization, organize an entity separate and apart from the physician organization for the sole purpose of entering into a contract with a hospital to lease equipment or provide non-patient care services to the hospital. In Phase III CMS tacitly recognizes

that such organizations are not physician organizations subject to the "stand in the shoes" provision and that the physician owners of such organization do not have a direct compensation arrangement with the hospital.[14] This too is probably subject to change however. CMS clearly is uncomfortable with these types of arrangements as it solicited additional comments on whether to apply the "stand in the shoes" provisions to such indirect relationships. In addition, CMS emphasized that such arrangements "may involve illegal kickbacks" even if they are not within the realm of the Stark Law.[15] It seems likely then that CMS has not yet closed the book on the reach of the "stand in the shoes" provisions and that further changes may have an even broader impact.

IV. When is Stand in the Shoes effective?

The Phase III regulations provide that its provisions were effective as of December 4, 2007. Given the halting nature in which the regulations have been finalized however it should come as no surprise that even that date is not set in stone for all arrangements.

First of all, Phase III specifically provides that those arrangements which were in place as of the date of publication of Phase III are not subject to the "stand in the shoes" provision during the original term of the arrangement (or, if the arrangement was in a renewal term on September 5, 2007, such renewal term). However it is important to note that the grandfather provision only applies to those arrangements which satisfy the indirect compensation arrangement exception. This poses a risk for those arrangements which were considered not to be covered by the Stark Law prior to Stark III and thus were not structured to satisfy the indirect compensation arrangement exception. Under Phase III those arrangements will not enjoy the grandfather treatment and will be treated as direct compensation arrangements immediately.

In addition, physicians affiliated with academic medical centers ("AMCs") and certain integrated 501(c)(3) health care systems are not subject to the "stand in the shoes" provision until December 4, 2008. After promulgating Phase III CMS received numerous comments regarding the significant impact the stand in the shoes provisions will have on certain relationships between physicians and DHS entities within academic medical centers ("AMC") and certain integrated 501(c)(3) health care systems. Many in the industry feared that common arrangements utilized by AMCs and integrated 501(c)(3) health care systems would violate the Stark Law because the arrangements could not be modified by December 4, 2007 to satisfy any of the direct compensation arrangement exceptions. For example, one common scenario involves the relationship between a subsidiary of an AMC, which provides funding to its faculty practice plan, and a physician who is an employee of the AMC's faculty practice plan and who refers Medicare patients for DHS to the AMC subsidiary. Prior to Phase III, this type of arrangement was commonly treated as an indirect compensation arrangement and was structured to satisfy the indirect compensation arrangement exception. After Phase III the parties are required to treat the arrangement as a direct compensation arrangement between the AMC subsidiary and the physician. Significantly, there is no simple way to restructure many of these types of arrangement to comply with a direct compensation exception.

Heeding industry warnings, on November 15, 2007, CMS issued a final rule delaying implementation of the "stand in the shoes" provisions until December 4, 2008, but only with respect to the following arrangements: 1) arrangements involving a referring physician, a faculty practice plan of an AMC, and a component of that AMC that furnishes DHS; and 2) arrangements

involving a referring physician, a component of an integrated 501(c)(3) health care system, and a component of that integrated 501(c)(3) health care system that furnishes DHS.[16] Such delay should give CMS time to develop a narrow exception for these beneficial financial relationships so that they will not violate the Stark Law.

V. Conclusion

Health care lawyers waited a long time for CMS to complete the rule making process and adopt final regulations interpreting the Stark Law. The process is now complete; however in many areas lawyers should continue to be wary of shifting ground. The expansion of the "stand in the shoes" provisions in the Phase III regulations has changed the treatment of many arrangements previously considered to be outside of the reach of the Stark Law or in compliance with the Stark Law's indirect compensation arrangement exception. Lawyers reconsidering such arrangements in light of Phase III will undoubtedly find that some arrangements are easy to restructure while others are difficult, if not impossible. Making the task more difficult is the likelihood that CMS will expand further the scope of the "stand in the shoes" provisions and once again change the footing for those lawyers trying to apply the Stark Law.

NOTES

1. 42 U.S.C. ? 1395nn.
2. 72 Fed. Reg. 51012 (Sept. 5, 2007).
3. 69 Fed. Reg 16054, 16125 (March 26, 2004).
4. An indirect compensation agreement exists if the referring physician is connected, through financial relationships, to the DHS Entity by an unbroken chain of intervening entities and the referring physician receives compensation from the entity (or person) with which the physician has a direct financial relationship that takes into account the volume or value of referrals the referring physician makes to the DHS Entity.
5. 72 Fed. Reg. 51028
6. Id.
7. Id.
8. Id.
9. Id.
10. Id. at 51027-51028
11. Id. at 51028-51029
12. Id. at 51029
13. 72 Fed. Reg. 38122 (July 12, 2007).
14. 72 Fed. Reg. at 51030
15. Id.
16. 72 Fed. Reg. 64161-64162 (Nov. 15, 2007).

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