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Closing the Whole Hospital Window: Impact on Hospitals and Physicians

April 6, 2010

Note to Our Clients and Friends: *In the wake of the sea-changing health reform legislation just passed, we are launching a new series of alerts on selected health reform topics that we see as having immediate impact on our clients. This alert on physician-owned hospitals is the first in our series. Please stay tuned for future alerts and click here to visit our special web page for Health Reform IMPACT.*

The Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act (collectively the "Health Reform Legislation"), contains substantial new restrictions on the exception to the Stark law that historically has allowed physicians (or their immediate family members) to have an ownership interest in a hospital (commonly referred to as the "whole hospital exception").[1] The restrictions affect all hospitals, not just specialty hospitals, including those that currently have physician ownership and those that are new or are under development.

Pursuant to the Health Reform Legislation, the whole hospital exception will now be available only to hospitals that have physician ownership and a Medicare provider agreement in place as of December 31, 2010. Note that these same restrictions apply to the so-called rural provider exception. Therefore, the rural provider exception is no longer a viable alternative for physician-owned hospitals that are located in rural areas and that cannot meet all of the requirements of the whole hospital exception.

For those hospitals that qualify for the amended whole hospital exception, the Health Reform Legislation prevents the aggregate percentage of ownership or investment interest held by physicians (directly or indirectly through another entity) in the hospital from exceeding the aggregate percentage of ownership as of March 23, 2010. Thus, according to this provision, a hospital with 30% physician ownership as of March 23, 2010 cannot increase the aggregate level of physician ownership beyond 30% in the future (note that there is uncertainty as to whether March 23, 2010 is, in fact, the measurement date for physician ownership, as will be discussed). Based on the statutory language, a hospital should be able to drop to a lower aggregate level, for example 25%, after March 23, 2010, and then subsequently return to its March 23 level of 30%

[1] The whole hospital exception is located at 42 U.S.C. § 1395nn(d)(3). For purposes of this alert, references to "physicians" having an ownership interest in hospitals will include a reference to "immediate family members" of physicians.

aggregate physician ownership. The statute, however, does not expressly confirm this interpretation.

Despite the critical importance of compliance with Stark law exceptions (due to the nature of Stark as a strict liability statute), the Health Reform Legislation introduces significant complexity due to the use of three dates and the failure to explain the interplay of those dates. For example, for those hospitals that can meet the December 31, 2010 physician ownership and Medicare enrollment deadline, it is not clear how the language prohibiting increases in aggregate physician ownership beyond March 23, 2010 levels will be reconciled with the December 31, 2010 deadline. Specifically, it is unclear whether these hospitals must have had their physician ownership in place as of March 23 or whether they can finalize their physician ownership at a subsequent time prior to December 31, 2010. Some commentators have suggested that the December 31 deadline is meant to allow hospitals under development to add physician investors until that date. Others have suggested that, if hospitals under development can add investors, then hospitals with no physician investors as of the enactment date should be allowed to add them up until December 31.

Further confusion results from the language mandating that a hospital meet the new requirements, including the requirement to have physician ownership in place by December 31, 2010, "not later than 18 months after the date of the enactment [of the amendment]." In this context, the significance of the September 23, 2011 date is unclear, given the previously noted uncertainty introduced by the inclusion of the March 23, 2010 and December 31, 2010 dates.

Of further interest is a provision stating that a hospital cannot be converted from an ambulatory surgical center (ASC) to a hospital on or after the date of enactment. Hospitals must comply with this ASC conversion limitation within 18 months of enactment of the statute. Again, it is unclear how the overriding 18-month compliance date (i.e., September 23, 2011) will interplay with the initial enactment date. The Health Reform Legislation directs the Secretary of Health and Human Services (HHS) to establish policies and procedures to ensure compliance with the new restrictions "beginning on the date such requirements first apply," so presumably HHS will have to clarify this confusion (hopefully sooner rather than later).

The Health Reform Legislation adds stipulations on physicians' investments under the whole hospital exception to ensure bona fide investments by physicians. For example, neither the hospital nor another owner can finance a physician's investment or guarantee or subsidize a physician's loan related to acquisition of ownership in the hospital, and the hospital cannot offer an ownership interest to a physician on more favorable terms than are offered to other investors. Additionally, investment returns must be distributed to each owner in an amount that is directly proportional to the owner's investment interest in the hospital. The hospital cannot offer a physician owner the opportunity to purchase or lease any property under the control of the hospital or another investor on more favorable terms than are offered to an individual who is not a physician owner. Another provision states that physician owners may not "receive, directly or indirectly, any guaranteed receipt of or right to purchase other business interests related to the hospital, including the purchase or lease of any property under the control of other owners or investors in the hospital or located near the premises of the hospital." It will be interesting to see how the Centers for Medicare & Medicaid Services ("CMS") clarifies the scope of this requirement.

The whole hospital exception amendments also strictly limit future operational expansion of physician-owned hospitals. Specifically, subject to a limited exception process to be developed by HHS in future regulations allowing certain hospitals to expand beyond their "baseline" size, a physician-owned hospital cannot increase the number of operating rooms, procedure rooms, and

beds for which it is licensed above the number of operating rooms, procedure rooms, and beds for which it was licensed as of March 23, 2010.

The same confusion that was earlier discussed with respect to the effective dates of the physician ownership limitations arises with respect to the effective dates of the operational expansion limitations, i.e., the statute states that expansion cannot occur at any time on or after March 23, 2010, but then allows a hospital 18 months to comply with the provision limiting expansion. Thus, an argument could be made that a hospital could add, for example, a procedure room after March 23, 2010, so long as the hospital eliminates a procedure room by September 23, 2011. In those jurisdictions in which operating rooms or procedure rooms are not separately licensed, it is unclear how the expansion restriction will be analyzed.

Finally, it is uncertain how a hospital under development can comply with the expansion prohibitions. If the statute is meant to allow a hospital to be completed and physician ownership added after March 23, 2010 but before December 31, 2010, that hospital would not have licensed beds as of March 23, 2010. This date discrepancy is dealt with in the language defining the "baseline" for expansion for excepted hospitals discussed in the following paragraph. A hospital's "baseline" number of licensed beds, operating rooms and procedure rooms means the number as of March 23, 2010, except in the case of a hospital that did not have a provider agreement in effect as of that date, but does have one on December 31, 2010. In that situation, the "baseline" number is established as of the effective date of the provider agreement. Hopefully this helpful language, although arguably inapplicable to hospitals that do not qualify for an expansion exception, will be used by regulators to rationalize the statutory language.

The process for applying for an exception to the expansion restrictions will be available only to a subset of physician-owned hospitals that qualify as "high Medicaid facilities" or hospitals that, among other things, are located in counties with relatively high population growth and relatively high Medicaid inpatient admissions. Any hospital qualifying for an exception will be permitted to expand only on its main campus and to qualify for an exception no more frequently than once every two years. In no event can the hospital expand such that the number of licensed operating rooms, procedure rooms, and beds would exceed 200% of its baseline number.

The amended whole hospital exception also contains various disclosure requirements. For example, a physician-owned hospital is required to submit an annual report to HHS listing each investor in the hospital, including all physician owners. HHS is required to publish, and annually update, this ownership information on the CMS web site. In addition, physician-owned hospitals must have procedures in place that require referring physician owners to disclose to patients, "by a time that permits the patient to make a meaningful decision regarding the receipt of care," their ownership interests and, if applicable, any ownership interest held by the treating physician. The statute does not provide further guidance as to what constitutes a sufficient time for patients to make a meaningful decision, and it is uncertain how this provision would apply in certain scenarios (for example, in the context of emergency services). A physician-owned hospital must also disclose on its web site and in any public advertising the fact that it is partially owned by physicians.

The Health Reform Legislation also imposes additional patient safety criteria on physician-owned hospitals. These additional requirements imposed on hospitals are effective March 23, 2010, but again, the Health Reform Legislation gives hospitals until September 23, 2011 to comply. Beginning no later than May 1, 2012, HHS is required to audit hospitals' compliance with the additional requirements of the amended whole hospital exception.

Although many provisions contained in the amendments to the whole hospital exception took effect March 23, 2010, several provisions remain unclear and may remain subject to varying interpretations until Congress or HHS provides additional guidance.

If you have questions about any aspect of the whole hospital exception, please contact any of the attorneys in our Healthcare Practice Group listed below.

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