

HEALTH CARE LAW UPDATE

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Hospital Law Issues

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STARK III RULE – WHAT HOSPITALS NEED TO KNOW

CMS recently published its Phase III regulations under the federal Stark law, which will become effective on December 4, 2007. Phase III is significant because it clarifies many issues under the Stark law. Set forth below is a brief summary of some of the more notable changes and clarifications.

“Stand in the Shoes”

One of the more significant changes made by CMS is the introduction of the “stand in the shoes” concept. Phase III now deems a physician owner, employee or independent contractor to “stand in the shoes” of his medical practice as long as the only intervening entity between the physician and the entity providing designated health services (“DHS Entity”) is his medical practice.

Prior to the introduction of this concept, a physician group that, for example, leased office space from a hospital could have relied on the indirect compensation arrangement exception to Stark. Under Phase III, each physician in that group is now deemed to have a direct compensation relationship with the hospital. This means that the parties now have to rely on a direct exception to Stark, in this case, the space lease exception.

A limited grandfather clause permits arrangements entered into prior to September 5, 2007 to continue without amendment during the current term of the arrangement. Thereafter, the agreement will need to be revised to comply with Phase III.

Space and Equipment Rentals

Phase III clarifies that amendments to the rent or other lease terms that are material to rental charges may only be accomplished by terminating the original lease and entering into a new lease, provided, that the new lease may not be entered into during the first year of the original lease term.

Personal Service Arrangements

CMS eliminated the fair market value safe harbor within the personal service arrangement exception which protected certain hourly compensation because it found that compliance with such safe harbor was often burdensome or unrealistic.

Phase III added a holdover provision similar to that in the space and equipment lease exceptions that now permits a holdover of a personal services arrangement on the same terms as the original agreement, for up to six months after expiration.

In addition, similar to leases, CMS clarified that amendments to the compensation and related provisions in a personal service arrangement may be accomplished only through a new agreement, and not during the first year.

Physician Recruitment

Phase III amends the definition of “service area” so that a hospital may recruit physicians from more locations, such as: (i) when there is no combination

of contiguous zip codes from which the hospital draws at least 75% of its inpatients, and (ii) when a zip code from which the hospital gets no patients is surrounded by contiguous zip codes used to reach the 75% test.

Phase III clarifies that the relocation requirement is a two-part test requiring the recruit both to move his practice from outside to inside the service area, and also to meet either the 25-mile or 75% of revenues test.

Notably, Phase III clarifies the types of reasonable practice restrictions that may be imposed on recruits by group practices, including reasonable non-competes and non-solicitation clauses, a requirement to treat Medicaid and indigent patients, a requirement to repay certain losses of the practice, and a requirement to pay reasonable liquidated damages.

Non-Monetary Compensation

Phase III adds provisions to cure inadvertent violations by a DHS Entity that provides non-monetary compensation in excess of \$300 (adjusted annually by CPI), as long as the value of the excess compensation is no more than 50% of the limit and the physician repays the amount within the shorter of 180 calendar days or the end of the calendar year. A DHS Entity may not use this cure mechanism more than once every three years with respect to the same physician.

In addition, entities with a formal medical staff are now allowed to have one medical staff appreciation function each year for the entire medical staff outside of the \$300 plus CPI limit.

Other Changes/Clarifications

Phase III also made changes to or clarified the provisions of a few other exceptions, including,

the exceptions for in-office ancillary services, retention payments made to physicians, charitable contributions by a physician, professional courtesy, academic medical centers and compliance training.

Practical Recommendations

Hospitals must comply with Phase III by December 4, 2007. Set forth below are some recommendations that may be helpful to ensure continued compliance with the Stark law:

- Review all existing arrangements with physicians and determine the specific Stark law exception that each relied on. Some arrangements that previously relied on the indirect compensation exception may now need to satisfy a direct compensation exception.

- To the extent amendments are being considered to leases or service agreements with physicians, keep in mind that certain types of amendments (e.g., changes to rent and compensation) require that a new agreement be entered into.

- Carefully review any personal service arrangements that previously relied on the fair market value safe harbor, and make sure that the compensation otherwise can be supportable as being consistent with fair market value (preferably via a written assessment).

- Carefully review existing physician recruitment arrangements. Some of the Phase III clarifications may require amendments to such existing arrangements.

We send these Updates to our clients and friends to provide information on recent developments in the law. The Updates, however, should not be relied on for legal advice in any particular matter. If you would like additional information, please contact: Gary W. Herschman at 973-643-5783 or Anjana D. Patel at 973-643-5097.

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