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Health Law Client Newsletter

New Stark Law Rules Ease Some Requirements But Tighten Others

On August 27, the Centers for Medicare and Medicaid Services (CMS) released its "Phase III" amendments to the regulations implementing the federal physician self-referral law, commonly known as the Stark Law. That law prohibits physicians from ordering certain "designated health services" for Medicare and Medicaid patients ("DHS") if the physician has a direct or indirect ownership interest in or compensation arrangement with the provider, unless an exception applies. The amendments will be effective on December 4, 2007. This newsletter summarizes some of the key provisions.

Physician Recruitment.

Noncompetition Covenants. Under the old rules, if a hospital provided financial assistance to recruit a physician into an established practice group, the group could not require the new physician to sign a noncompetition covenant. Such covenants will now be permitted if they are reasonable in scope and duration. (CMS has now recognized that the prior rule, which was intended to increase availability of physicians, was actually having the opposite effect). The preamble to the new rules makes clear that a hospital's contract with the group may prohibit the group from including such a covenant in the recruited physician's employment agreement. Before the Stark Law prohibited such covenants, many hospital guarantee agreements prohibited the group practice from enforcing such covenants in certain situations (e.g., when the recruit was terminated by the group without cause); otherwise, the recruited physician would have a repayment obligation that could not be forgiven by the physician's continued service in the community.

Incremental Expenses. In addition, until now a hospital could pay only the "incremental expenses" of a group practice that are directly related to the new physician. This restriction has been relaxed in limited situations. If the recruit is locating in a rural area (as defined in the law) to replace a physician who retired, died or relocated out of the area in the prior twelve months, the practice can allocate to the new physician a portion of the practice group's aggregate costs, on a per capita basis, not to exceed 20% of such costs.

Hospital Service Area. The definition of a hospital's service area—to which the hospital can recruit—includes the lowest number of contiguous zip codes from which it draws 75% of its inpatients. Rural hospitals (i.e. areas not in a metropolitan statistical area) and hospitals in "health professional shortage areas" will now have the option of including the lowest number of contiguous zip codes from which they draw 90% of their inpatients, and if there is no such set of contiguous zip codes, any additional zip codes needed to reach 90%. The broader area definition is not always beneficial, since a hospital cannot recruit physicians who are relocating within this geographic area, even if the physician's relocation satisfies the other requirements of the regulations.

Physician Retention. Until now, payments to retain physicians could be made only by hospitals in "health professional shortage areas" designated by the Public Health Service. The new rules permit such payments by all hospitals in "rural areas" (i.e. areas not in a metropolitan statistical area) if the physician serves a "medically underserved area" or a "medically underserved population." In addition, the rules previously required that the physician have received a written offer of a recruitment or employment agreement from another hospital. The new rules allow the competing offer to come from a hospital, an academic medical center, or a physician group. In addition, the absence of a written offer is not a problem if the physician certifies that he has a bona fide employment opportunity, and provides sufficient information for the hospital to verify this fact. (Other restrictions apply to retention payments.)

"Stand in the Shoes." Compensation arrangements between a DHS provider and a physician group (rather than directly with a physician) have been defined as "indirect" compensation arrangements, which are generally subject to less restrictive requirements than direct arrangements. A new rule provides that physicians will be deemed to "stand in the shoes" of their practice entities. Therefore, if the arrangement is with a physician's practice entity, it will be deemed a direct arrangement. This means that certain previously permissible arrangements will no longer be permitted unless they can qualify for a different exception. For example, an equipment lease agreement between the practice entity and the DHS provider will now need to meet the requirements of the equipment lease exception. There is a "grandfather" provision for any agreement that is in effect prior to September 5, 2007. However, this will not apply to renewals of the agreement's term after the current term expires.

Fair Market Value Exception. There is an exception for payments for services and items (other than real property) if the payment is fair market value and meets certain other requirements. This exception used to be limited to items and services furnished by a physician (or family member) of a group of physicians. It now applies also to items and services furnished by DHS providers to physicians and their families.

Independent Contractor Physicians. One of the requirements for the "in-office services" exception is that the services be ordered and supervised by members of the same group practice or an independent contractor physician who provides the services in the group's facilities and for which the group bills. A new requirement has been added—any such independent contractor physician must have a direct contractual arrangement with the group. This means that if the group contracts with the physician's employer, the independent contractor does not meet this requirement.

Professional Courtesy. Hospitals that reduce copayment and deductible obligations of members of their medical staff under a professional courtesy policy no longer need to report the reduction to the physician's health insurer. (Other requirements apply to such policies.)

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If you have questions concerning this newsletter, please call Dennis Witherell or Jenifer Belt at 800-444-6659, or Ron Christaldi, Barbara Pankau or Erin Aebel at 800-677-7661.

This newsletter is designed to provide general information on matters of interest to health care providers and practitioners and is not intended to constitute legal advice.