PROVIDER-BASED JOINT VENTURES -
FAIR GAME OR GAMING THE SYSTEM?

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Hospitals and physicians are increasingly examining various types of “provider-based” joint ventures. Under this type of venture, a new entity that is partially owned by both the hospital and physicians is formed. This new entity acts as the actual provider of surgical services. It owns and operates the equipment, employs most of the staff, leases space from the hospital and holds the other assets related to the provision of surgical services. This entity contracts with the hospital to provide surgical services to the hospital’s patients. The joint venture entity is operated as a technical matter, under the hospital’s license and staff bylaws. The hospital bills for the services that are provided under the hospital’s license and billing number as hospital services. In exchange, the hospital pays the joint venture a “fair market value” fee for providing the surgical services. Essentially, the hospital is purchasing the surgical services from the venture and billing the services under its own license.

This provider-based model has gained popularity recently amongst hospitals and physician groups seeking to take advantage of the “provider-based” and “under arrangements” rules that have evolved over the past several years. The following are several of the key risks attendant to this type of proposed model:

A. Federal Anti-Kickback Statute

The Anti-Kickback Statute\(^1\) prohibits the knowing and willful solicitation, receipt, offer or payment of “any remuneration (including any kickback, bribe or rebate) directly or indirectly, overtly or covertly, in cash or in kind” in return for or to induce the referral, arrangement or recommendation of Medicare or Medicaid business.” Violation of the Anti-Kickback Statute can result in both civil and criminal penalties. Federal courts have held that an arrangement violates the Anti-Kickback Statute if any one purpose of remuneration is to induce the referral of patients covered by the Medicare or Medicaid programs.

The Department of Health and Human Services has promulgated certain safe harbors which exempt a variety of financial and compensation relationships from violation of the Anti-Kickback Statute. Safe harbors exist for space and equipment rental, small investment interests and surgery center ownership, among other things. However, the provider-based joint venture structure would not precisely meet the terms of any of these safe harbors. The fact that a financial relationship does not meet the requirements of a safe harbor does not mean that such relationship is per se illegal. However, the payment of a “per click” fee in exchange for the provision of surgical services which are billed under the hospital’s billing number could be interpreted to be payments which are intended to induce referrals of patients to the hospital for services. As such, there is a risk that the proposed joint venture structures could be interpreted to

\(^1\) 42 U.S.C. Section 1320a7-b(b).
violate the Anti-Kickback Statute, i.e., paying an amount with the intent of inducing the referral of business.

In 2003, the Office of the Inspector General (“OIG”) issued a Special Advisory Bulletin regarding contractual joint ventures. In the Special Advisory Bulletin the OIG commented on “questionable contractual arrangements where a health care provider in one line of business expands into a related health care business by contracting with an existing provider of a related item or service to provide the new item or service to the Owner’s existing patient population, including federal health care program patients.” The Bulletin discouraged such arrangements as potentially in violation of the Anti-Kickback Statute due to the risk of payments to joint venture partners being interpreted as remuneration paid in exchange for referrals.

B. The Stark Act

The Stark Act restricts a physician from having a financial or compensation relationship (including an ownership interest) with any entity that provides certain “designated health services.” Designated health services include inpatient and outpatient hospital services. In the proposed joint venture whereby the physician would have an ownership interest in a “provider-based” entity, the physician would arguably have an ownership interest in an entity which would provide inpatient and/or outpatient hospital services. In order to qualify for “provider-based” status, the entity would provide services that would be billed through the Hospital. The joint venture may be contracting with the Hospital to provide services “under arrangements” with the hospital. In regulations promulgated under the Stark Act, the Department of Health and Human Services stated:

We are concerned that the provision of services "under arrangements" could be used to circumvent the prohibition [of the Stark Act] of physician ownership of parts of hospitals. We understand that some hospitals are leasing hospital space to physician groups, which the groups then use to provide services "under arrangements" that the hospital had previously provided directly. These arrangements, especially when they involve particularly lucrative lines of business, raise significant issues under [the Stark Act], as well as the anti-kickback statute.3

Therefore, an ownership interest in an entity such as this model and the related relationship with the hospital may be characterized as a circumvention scheme under the Stark Act. Thus, even though the Stark Act does not prohibit per click payments, it does not mean that the model is permissible.

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2 42 U.S.C. 1395nn.
C. 501(c)(3) Tax-Exempt Status

Many hospitals are tax-exempt entities that are obligated to serve charitable purposes. Internal Revenue Service (“IRS”) regulations restrict hospitals and other tax-exempt entities from making any payments which would constitute private benefit or private inurement. A tax-exempt hospital must be exclusively operated for charitable purposes and none of the Hospital’s assets may inure to the benefit of an individual. There has been significant concern raised related to certain types of joint ventures between hospitals and physicians as to whether such ventures jeopardize the tax-exempt status of a hospital. In General Counsel Memorandum 39862, the Internal Revenue Service negatively commented on joint ventures characterized as “net revenue stream” joint ventures. Such ventures are characterized by a hospital or other exempt health entity entering into a partnership or joint venture with a physician which essentially allows the physician to participate in the net revenue of a hospital and encourages referrals to a hospital. The IRS concluded that:

A hospital entering into such a transaction jeopardizes its tax-exempt status for at least three reasons. First, the transaction causes the hospital’s net earnings to inure to the benefit of private individuals. Second, the private benefit stemming from such a transaction cannot be considered incidental to the public benefits achieved. Third, such a transaction may violate federal law.

In addition to concerns relating to potential private inurement, transactions with a tax-exempt hospital that do not meet certain qualifications may be characterized by the IRS as an “excess benefit” transaction. If the IRS were to deem earnings from a joint venture with a tax-exempt hospital as “excess benefit” compensation, then such compensation could be subject to an excise tax.

D. False Claims Act

Individuals or entities that knowingly file fraudulent or false claims that are payable by the Medicare program are subject to both criminal and civil liability under the False Claims Act. False Claims Act liability may be triggered when: 1) providers submit claims for medically unnecessary services; 2) providers use improper coding or billing practices; 3) a provider submits a claim for services not provided or covered under a federal program; 4) a provider excluded from a federal program submits claims; 5) a provider violates a statute or regulation; 6) a provider falsely certifies it has complied with certain statutes or regulations; or 7) a provider submits claims for services which do not meet quality of care standards.

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4 Treas. Reg. § 1.501(c)(3).
5 General Counsel Memorandum 39862 (Nov. 22, 1991).
6 I.R.C. § 4958.
Where a venture attempts to take advantage of a higher provider-based billing scheme and it is operating in a manner that is really akin to a freestanding facility, it could subject itself to claims of false or improper billing.

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In sum, there are a variety of risks that accompany the use of a “provider-based” or “under arrangements” model for a joint venture between a hospital and a physician group. These risks include potential liability under the Anti-Kickback Statue, the Stark Act, IRS rules and regulations and the False Claims Act. Hospitals and physicians should therefore be discouraged from implementing such a model.