

New Stark Regulations Raise Questions About Hospital Assistance for Physician Recruiting

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In recent years, hospitals facing physician shortages in their service area have addressed this problem by offering financial assistance to private practices on their medical staff to defray the costs of recruiting new physicians. Typically, the assistance has been

in the form of a loan the practice could use for paying recruiting expenses, increased overhead, and the new physician's salary during practice build up. Alternatively, loans have been offered directly to new physicians to repay education loans. In most cases, these loans have been forgivable if the new physician continued to work in the service area for 3 to 5 years. Hospitals, physician practices, and individual physicians have entered into these arrangements relying on pronouncements from the Internal Revenue Service and CMS which deemed them acceptable as long as certain requirements were met. These included: (i) interest rates and loan documentation were commercially reasonable, (ii) the new physician agreed to participate in Medicare and was not required to refer patients to the hospital, and (iii) the borrower recognized the loan forgiveness as income as the forgiveness was earned. New regulations issued by CMS under the Stark Law call into question several of the assumptions made in many of these transactions and suggest that providers reconsider specific elements of both existing and future transactions.

On March 26, 2004, CMS issued final Stark II, Phase II regulations which went into effect on July 26, 2004. Under the Stark Law, unless an exception applies, physicians may not refer Medicare patients to another provider (such as a hospital) for certain designated health services if the physician has

a financial relationship with the provider. The new regulations provide more detailed criteria for the Stark Law exception authorizing physician recruitment

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assistance, including forgivable loans, provided by hospitals to physicians or practices expected to refer patients to the hospitals. While many elements of these regulations will be familiar to organizations that have engaged in these arrangements, there are at least three requirements in the new regulations which may differ from prior understanding of what was permissible.

First, loan proceeds must be passed through fully to the new physician or used for costs the practice actually incurs for the recruitment. Thus, the calculation of funds needed for a new physician income guarantee may not allocate a portion of existing overhead to that new physician. Rather, only "actual additional incremental costs attributable to the recruited physician" may be used to determine what amount of loan proceeds may be used to pay a new physician's guaranteed salary.

Second, documentation and record keeping requirements are strict. The arrangement must be reflected in documents that are signed not only by an authorized representative of the practice, but also by the recruited physician. To assure that loan proceeds are spent consistent with regulatory requirements, the practice must retain records of its actual expenditures for five years.

Third, and perhaps most significant, any practice receiving recruitment assistance from a hospital is prohibited from imposing a non-compete on the recruited physician.

The new regulations contain explicit standards defining when a physician is deemed to be relocating, which hospitals and practices in more urban areas may need to understand. However, hospitals in rural areas generally assist recruitment of physicians who come from well outside their service area so these provisions should have little impact.

Perhaps the most troublesome aspect of the new regulations is the intent not to "grandfather" existing physician recruitment arrangements. In other words, CMS has made it clear that the new regulations apply to existing arrangements entered into long before institutions could have had any idea what these regulations would say. Thus, existing arrangements must be reviewed and amended to assure compliance with the new regulations. Since both hospitals and practices which refer patients to the hospitals face significant exposure for violation of the Stark Law, it is in the interest of all parties to bring these arrangements into compliance with the new regulations. We strongly suggest both hospitals and physician practices review any arrangements for recruiting physicians in which they continue to participate, such as by earning forgiveness from the continued employment of a recruited physician.

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