CMS Publishes New FAQ: Hospitals Must Review and Update Existing Physician Recruitment Contracts Now for Compliance with the Recently Issued Stark II, Phase II, Regulations

Action Required By July 26, 2004

Highlights of the CMS FAQ:

The Centers for Medicare and Medicaid Services (“CMS”) posted a new FAQ guidance on its Web site on July 14, 2004.1 CMS’s guidance states that existing recruiting arrangements must comply with the new Stark II, Phase II, regulations that go into effect by July 26, 2004.

Each financial relationship with a physician must be evaluated for compliance with the Stark law based on its specific facts and circumstances—including physician recruitment arrangements hospitals have with individual physicians and with “host” practice groups into which recruited physicians have been placed.

CMS’s FAQ notes that hospitals and physicians have had a legal obligation to comply with the Stark laws since their effective dates (i.e., January 1, 1992, for clinical laboratory service referrals and January 1, 1995, for other designated health services).

While awaiting the final regulations detailing the requirement for specific exceptions, providers must have complied with a reasonable interpretation of the statute.

The Phase II regulation—including the physician recruitment exception provided at 42 CFR § 411.357(e)—is effective July 26, 2004. Existing recruiting arrangements must comply with the new Stark II, Phase II, regulations by July 26, 2004.

1 The FAQ appears at: http://questions.cms.hhs.gov/cgi-bin/cmsphp.cfg/php/enduser/std_adp.php?p_faqid=3163&p_created=1089816819
Continuing obligations (i.e., obligations for which performance is not yet required or is not yet complete) under an existing recruitment arrangement must comply with the Phase II regulations by July 26, 2004.

However, past payments under an income guarantee do not need to be recalculated so long as, at the time they were paid, the arrangement complied with a reasonable interpretation of the Stark statute.

In addition to the Stark law, all recruitment arrangements are also subject to the federal Fraud and Abuse Anti-kickback Law (42 U.S.C.1320a-7b(b)) which may prohibit recruitment arrangements even if they do not violate the Stark law.

**Highlights of the Recruitment Exception:**

The Stark II statute and the March 26, 2004, Phase II final regulations provide a recruitment exception for payments by a hospital^2^ to induce a physician to

- relocate to the geographic area served by the hospital, and
- join the hospital’s medical staff.

The **geographic area served by the hospital** is defined as:

- the area composed of the lowest number of contiguous zip codes from which the hospital draws at least 75% of its inpatients.

A physician will be deemed to have **relocated his/her practice** if the physician either:

- moves his/her medical practice (not residence) at least 25 miles, **or**
- derives 75% of the revenues of his/her new medical practice from professional services furnished to patients (including hospital inpatients) not seen by the physician during the prior three years.

The Phase II regulations’ preamble characterizes “cross-town recruitment of an established physician’s practice from a competitor hospital” as “potentially abusive.”

The regulations permit **cross-town recruitment only** in limited circumstances:

- residents
- physicians who have been in medical practice less than one year.

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^2^ The Phase II final regulation includes federally qualified health centers (FQHCs) under the recruitment exception, but excludes other DHHS entities (such as home health agencies or nursing homes) from the exception because they pose a “risk of abuse.”
Under the Phase II recruitment exception payments can be made either directly to the recruited physician or through an existing group practice.

A hospital may make a recruitment payment **directly to the recruited physician** if:

1. The recruited physician relocates his/her medical practice to the hospital’s geographic area;
2. The arrangement is set out in writing and signed by the parties;
3. The arrangement is not conditioned on the physician’s referral of patients to the hospital;
4. The amount of the recruitment payment is not determined (directly or indirectly) based on the volume or value of actual or anticipated referrals or other business generated between the parties; and
5. The recruited physician is allowed to establish medical staff privileges at any other hospital and to refer business to any other entities (except as otherwise permitted under certain employment arrangements and services contracts).

Unlike the proposed regulations, the Phase II final regulations allow employment and services contracts to limit a recruited physician’s freedom to (a) maintain staff privileges elsewhere and (b) make referrals through “reasonable credentialing restrictions on physicians becoming competitors” of the recruiting hospital.

A hospital may provide recruitment support **through an existing practice group** either (a) **indirectly** through the other physician or group practice or (b) **directly** to the recruited physician to induce him/her to join an existing physician or group practice, if the following additional conditions are met:

1. The written agreement must be signed by the party to whom the payments are directly made.
2. The remuneration must be passed directly through to and remain with the recruited physician (except for actual costs incurred by the physician or group practice in recruiting the new physician).
3. With an income guarantee, the costs allocated to the recruited physician may not exceed the **actual additional incremental costs** attributable to the recruited physician (i.e., a group cannot allocate a pro-rata share of existing space, staffing or other office overhead costs to the recruited physician).
4. The records of actual additional incremental costs and passed through amounts must be maintained for at least five years.
5. The remuneration may not take into account the volume or value of referrals by the recruited physician, the group practice, or any physician affiliated with the group practice.
6. The group practice may not impose additional practice restrictions on the recruited physicians (such as a non-compete or non-solicitation restriction), except those related to quality of care.
7. The arrangement may not violate the Fraud and Abuse Anti-kickback law.
8. The arrangement may not violate any federal or state law or regulation governing billing or claims submission.

**Highlights of the Retention Exception:**

The new physician retention exception allows a hospital to make a payment *directly* to a physician to retain the physician in the geographic area serviced by the hospital if the area is a health professional shortage area (HPSA).

Although HPSAs are limited to certain primary care specialties, retention payments to physicians are permitted in *any* specialty as long as the geographic area is a HPSA for at least one specialty.

In Phase II, CMS indicated that retention payments might also be appropriate in areas where the need for the physician can be demonstrated through a Stark Advisory Opinion.

The retention exception only applies where payments are made *directly* to the physician who is to be retained. The retention exception “does not protect payments made indirectly to a retained physician via another person or entity, including a physician practice.”

Under the retention exception, a hospital may make a retention payment *directly* to a physician if all of the following conditions are satisfied:

1. The physician is on the hospital’s medical staff.
2. The payment is to retain the physician’s medical practice in the geographic area served by the hospital that is part of a HPSA (without regard for the physician’s specialty).
3. The arrangement is set out in writing and signed by the parties.
4. The arrangement is not conditioned on physician’s referral of patients to the hospital.
5. The amount of the retention payment is not determined (directly or indirectly) based on the volume or value of actual or anticipated referrals.
6. The physician is allowed to establish medical staff privileges at any other hospital and is allowed to refer business to any other entities (except as otherwise permitted under certain employment arrangements and services contracts).
7. The physician has a *bona fide*, firm written recruitment offer from an unrelated hospital or FQHC that specifies the remuneration being offered and requires the physician to move his or her practice at least 25 miles and outside of the geographic area served by the hospital.
8. The retention payment is limited to the lower of:
   a. The amount resulting from subtracting (i) the physician’s current income from physician and related services from (ii) the income the physician would receive from comparable services in the bona fide recruitment offer over no more than 24 months; or
   b. The reasonable costs which would be incurred by the hospital or FQHC in recruiting a new physician to the geographic area served by the hospital or FQHC to replace the retained physician.

9. Any retention payment is subject to the same obligations and restrictions, if any, on repayment or forgiveness of indebtedness as the bona fide recruitment offer.

10. The hospital or FQHC may enter into a retention arrangement with a particular referring physician no more frequently than once every 5 years.

11. The amount and terms of the retention payment is not modified during the term of the arrangement in any way that takes into account the volume or value of referrals or other business generated by the physician.

12. The arrangement does not violate the Fraud and Abuse Anti-kickback Law.

13. The arrangement does not violate any federal or state law or regulation governing billing or claims submission.

**What Hospitals Need to Do Now:**

**Hospitals need to take the following steps now:**

- Inventory all existing physician recruitment and retention agreements.
- Determine whether there are any obligations under those physician recruitment contracts that will not have been completely performed before July 26, 2004, including any remaining payments, loans draws or loan forgiveness.
- Review the existing physician recruitment contracts for compliance with the Stark II, Phase II, physician recruitment exception.
- If any existing physician recruitment contract does not comply with the Stark II, Phase II, physician recruitment exception, it must be amended—or terminated—to achieve compliance by July 26, 2004.
If you have any questions or require further information regarding these or other matters, please call your regular Nixon Peabody contact, or feel free to contact one of the attorneys listed below:

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Health Services Practice Group

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