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Requiring Referrals from Employees and Contractors

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Many providers mistakenly believe that the federal Stark law prohibits hospitals and other employers from requiring employed or contracted physicians to refer healthcare services to the employer. Stark actually allows a hospital or other employer to require contracted physicians to refer items or services to the hospital if the items or services relate to the physician's services under the contract and certain additional conditions are satisfied.

Stark Regulations. Stark's "special rules on compensation" state:

A physician's compensation from a bona fide employer ... or other arrangement for personal services may be conditioned on the physician's referrals to a particular provider, practitioner, or supplier, provided that the compensation arrangement meets all of the following conditions. The compensation arrangement:

- (i) Is set in advance for the term of the arrangement.
- (ii) Is consistent with fair market value for services performed (that is, the payment does not take into account the volume or value of anticipated or required referrals).
- (iii) Otherwise complies with an applicable exception under [42 CFR] §411.355 or §411.357.
- (iv) Complies with both of the following conditions:
 - (A) The requirement to make referrals to a particular provider, practitioner, or supplier is set out in writing and signed by the parties.
 - (B) The requirement to make referrals to a particular provider, practitioner, or supplier does not apply if the patient expresses a preference for a different provider, practitioner, or supplier; the patient's insurer determines the provider, practitioner, or supplier; or the referral is not in the patient's best medical interests in the physician's judgment.
- (v) The required referrals relate solely to the physician's services covered by the scope of the employment, the arrangement for personal services, or the contract, and the referral requirement is reasonably necessary to effectuate the legitimate business purposes of the compensation arrangement. In no event may the physician be required to make referrals that relate to services that are not provided by the physician under the scope of his or her employment, arrangement for personal services, or contract.

42 CFR § 411.354(d)(4). CMS explained the rule as follows:

Several commenters objected to permitting employers to require employees to refer to specific DHS entities, notwithstanding the conditions imposed under § 411.354(d)(4). ...

Response: In limited circumstances, required referrals are a reasonable and appropriate aspect of certain health care business arrangements that should not, in and of themselves, implicate [Stark]. ... Thus, § 411.354(d)(4) will apply to employment ... and other contractual arrangements that include required referrals only to the extent those referrals relate to the physician's services that are covered under the contractual arrangement and the referral requirement is reasonably necessary to effectuate the legitimate purposes of the compensation relationship. For example, an entity that employs or contracts with a physician on a part-time basis to provide services to the entity cannot condition the employment or contract—or any compensation under the employment or contract on referrals of the physician's private practice business (for example, patients seen by the physician when he or she is not working part-time for the entity).

69 FR 16069 (3/26/04).

[W]e believe that [Stark] was not intended to interfere unduly with legitimate employment and health system structures. As discussed above, we have narrowed the rule for directed referrals in § 411.354(d)(4) to employers ... and certain contractual arrangements (including many emergency room physician contracts). We have concluded that a referral restriction will not violate the volume and value of referrals standard in [Stark] if—

- The referring physician is compensated at fair market value for services performed in an arrangement that otherwise fits within the employment (or another) exception;
- The referral restriction relates solely to the physician's services covered by the scope of the employment or contract and is reasonably necessary to effectuate the legitimate purposes of the compensation relationship; and
- Referrals are not required (directly or indirectly) — [i] when the patient expresses a different choice; [ii] when the patient's insurer determines the provider, or [iii] when the referral is not in the best medical interest of the patient in the physician's judgment.

We believe this narrower rule strikes a reasonable balance between the legitimate business needs of employers and health systems, and protection of patient choice and physician judgment.

Id. at 16087. CMS reaffirmed the rule in its 2007 commentary, and confirmed that it applies to personal services arrangements in addition to employment contracts:

The Phase I special rules on compensation permitted entities furnishing DHS to condition physician compensation in certain circumstances on the physician's compliance with referral restrictions, if certain conditions

were satisfied. Phase II clarified that the required referral provision applies to employment, managed care, and personal service arrangements only, and set forth new requirements specifying that: (1) the required referrals must relate solely to the physician services covered by the arrangement; and (2) the referral requirement must be reasonably necessary to effectuate the legitimate purpose of the compensation arrangement (69 FR 16069). In this Phase III final rule, we are amending the regulatory text in § 411.354(d)(4) to include expressly contracts for personal services. 72 FR 51030 (9/5/07).

Possible Contract Language. Consistent with Stark rules, hospitals and other employers wishing to require referrals should include an appropriate provision in their contracts that tracks the requirements in § 411.354(d)(4). Something like the following may work, depending on the circumstances:

Referrals. To the extent allowed by applicable law and regulations, including but not limited to 42 C.F.R § 411.354(d)(4) as it shall be amended, Physician shall be required to refer patients to [Employer] for services related to Physician's Services, and Physician's compensation shall be conditioned on Physician's referrals to [Employer], provided that: (i) the requirement to make referrals to [Employer] does not apply if the patient expresses a preference for a different provider, or the patient's insurer determines the provider; or the referral is not in the patient's best medical interests in Physician's judgment, and (ii) the requirement to make referrals does not apply to referrals for services that are unrelated to Physician's Services rendered pursuant to this Agreement.

Providers should discuss such language with their own attorney before incorporating such a provision in their contracts, or seeking to enforce the provision against a physician.

Beware the Anti-Kickback Statute. The foregoing exception applies only to Stark and physicians covered by Stark. There is no similar exception under the federal Anti-Kickback Statute ("AKS") permitting employers to require referrals from physicians or other providers; just because a transaction is allowed under Stark does not necessarily mean it satisfies the AKS. Nevertheless, the AKS's "bona fide employee" exception does apply to contracts in which remuneration is:

paid by an employer to an employee, who has a bona fide employment relationship with the employer, for employment in the furnishing of any item or service for which payment may be made in whole or in part under Medicare, Medicaid or other Federal health care programs.

42 CFR § 1001.952(i). In the past, the OIG has interpreted the exception to permit employee compensation arrangements that are based on referrals to some extent, including paying commissions to employees. (See, e.g., 54 FR 3093 (1989)). As a practical matter, I think it unlikely that the OIG would challenge an employee compensation arrangement that otherwise

satisfied the conditions in the Stark exception, 42 CFR § 411.354(d)(4).

Independent contractor relationships are more problematic. To satisfy the AKS “personal services” safe harbor, the compensation paid to the contractor may “not be determined in a manner that takes into account the volume or value of any referrals or business otherwise generated between the parties for which payment may be made in whole or in part under Medicare, Medicaid or other Federal health care programs.” (42 CFR § 1001.952(d)(5)). The OIG has challenged contractor compensation arrangements that are based on referrals, including payment of commissions. (See, e.g., 54 FR 3093 (1989); OIG Adv. Op. 98-10). Nevertheless, unlike Stark, the AKS is an intent-based statute; accordingly, it is not essential for the transaction to fit within a regulatory safe harbor. So long as the compensation relationship is otherwise reasonable and reflects fair market value for the clinical services actually performed, I think it unlikely that the OIG would charge an employer with an AKS violation merely because it required contractors to refer patients for items related to the services covered by the contract subject to the limitations in the Stark exception, 42 CFR 411.354(d)(4).

Check State Laws. Although unlikely, it is possible that state laws may also be implicated. Providers should check their own state laws to ensure a referral requirement is allowed, or consult with a knowledgeable attorney before implementing a referral requirement.

For questions regarding this update, please contact:

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