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HEALTH CARE ISSUES

The Health Care Department at Murtha Cullina is pleased to provide clients and friends with information about topics of interest in the health care area.

If you have questions about the issues addressed in this newsletter, or any other matters involving health care legal issues, please feel free to contact the following attorneys:

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OIG ANGST MAKES ASC BUYOUTS BY HOSPITALS MORE PROBLEMATIC

H. Kennedy Hudner

A glum day for doctors looking to sell their interest in ambulatory surgery centers, at least if they want to sell to the local hospital. The latest advisory opinion from the Office of Inspector General says that it would be concerned if the hospital was required to pay more for the doctor's interest than the doctor did when he first bought into the ASC.

For investors in an established ASC with a successful track record, this is a problem. Typically the shares of a successful, on-going business command a solid premium over the cost paid by the founding partners.

THE FACTS: Seven doctors created a limited liability company and started an ASC. The opinion (OIG Advisory Op. No. 07-05) is sketchy on how long the ASC had been running and how successful it was, but the implication was that it had been up and running long enough to be successful and for the fair market value of the units in the LLC to have risen above their original cost.

Three of the doctors – all orthopedic surgeons – owned 94% of the units. They proposed to sell enough units directly to the hospital to give the hospital a 40% share in the LLC. None of the other doctors would sell any of their interests.

THE PROBLEM: The problem is not that the hospital was bailing out a failing ASC, but that the hospital was buying into a *successful* ASC. The doctors had paid for their shares before the ASC had opened. Now, as an on-going business, the fair market value of the investment units had risen. If the hospital paid fair market value, it would run afoul of the Anti-Kickback Safe Harbor regulations for ASCs, which require that ***the amount of payment to an investor in return for the investment must be directly proportional to the amount of the capital investment of that investor.*** [1]

The OIG didn't like the proposed transaction and refused to give it a clean bill of health. It reminded its audience that it is generally uneasy about joint ventures between those in a position to refer business (*e.g.*, orthopedists) and those furnishing services covered by Medicare (*e.g.*, hospitals).

[1] See 42 C.F.R. Section 1001.952(r)(4)

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Although the OIG did not question that the purchase price was at fair market value, it stuck to the literal reading of the regulation, which refers to the amount of capital *investment*, not the percentage of *ownership interest*. Since the hospital's shares would cost it more than those of other investors, the distribution of profits to the hospital would never be directly proportional to the amount of capital invested by the hospital. The OIG was also bothered by the fact that the hospital was buying units directly from the doctors rather than the ASC, and that the funds being paid would not be used to expand or enhance the ASC.

THE BOTTOM LINE: The OIG simply did not like the idea that the hospital was paying a premium for the doctors' ASC units. As the advisory opinion noted, the payment "…raises the possibility that one purpose of the Hospital's investment is to reward or influence a subset of the Investing Physicians whose referrals of patients to the Hospital or to the ASC itself may be particularly valuable."

And all this despite the fact that the OIG did not challenge the fair market value of the proposed purchase. This is important. Fair market value has long been the gold standard by which to gauge the legality of countless hospital-physician arrangements. The notion is that if you are paying fair market value for services, products, or shares in a joint venture, then by definition you are not paying anything extra to induce referrals. By this advisory opinion, however, the OIG is implicitly peeking behind the fair market value to see what the parties are *really* up to. It sees doctors receiving a "premium" on their original investment and, on that alone, is suspicious enough to refuse to approve it.

One wonders how the OIG would handle a situation where an ASC was failing and the doctors wanted to be bought out at their original investment value, even though fair market value was less.

If you are a physician investor in an ASC, selling your interest to the local hospital just got more complicated. There are indirect ways of achieving the same economic end, but they may be susceptible to OIG scrutiny as well. We look forward to further guidance from the OIG to see how it will deal with the tension between business realities of fair market value on the one hand, and a strict reading the Anti-Kickback regulations on the other.

Should you have any questions concerning this issue, feel free to contact Kennedy Hudner (860-240-6029), Mark Korber (860-240-6030), Paul Knag (203-653-5407) or Elizabeth Neuwirth (203-653-5411).

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