

# Catch-22 for Hospital/Physician Joint Ventures

BY DANIEL MURPHY

The Department of Health and Human Services, Office of Inspector General (OIG) published an advisory opinion on June 19 that could have a chilling effect on hospital/physician joint ventures.

The opinion (OIG Advisory Opinion No. 07-05) addresses a proposed ambulatory surgery center (ASC) joint venture between a hospital and existing physician owners of the ASC. OIG concluded in the opinion that a proposed sale of ownership interests in an established ASC from a group of existing physician investors to a local general acute care hospital could result in a violation of the federal Anti-Kickback Statute (AKS).

Particularly troubling, OIG stated that the return on the owners' investments in the ASC would not be "directly proportional" to the capital invested by each investor if the hospital paid a higher price per ownership unit than the initial physician investors did. According to OIG, this situation would present a risk under the AKS.

## Background

Along with the Department of Justice, OIG is responsible for enforcing the AKS. OIG also allows parties considering entering into arrangements that are not clearly permitted under the law to request non-binding advisory opinions on the legality of the proposal.

In this case, a group of three orthopedic surgeons who owned 94 percent of the company that operates the ASC proposed to sell a 40 percent ownership interest in the company to the hospital. The ASC is enrolled as a Medicare provider and offers multi-specialty surgical services. Two gastroenterologists and two anesthesiologists, who would not participate in the proposed transaction, owned the remaining 6 percent of the company.

The opinion requestors certified that the price for the units to be purchased by the hospital would be consistent with current fair market value, which exceeds the price paid by the physician investors when the company was founded. The

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requestors also informed OIG that the orthopedic surgeons did not offer to sell the ownership units to any party other than the hospital. OIG found that the hospital was "in a position to make or influence referrals directly or indirectly to the ASC or its Physician Investors."

## OIG Findings

OIG first analyzed the proposed arrangement to determine whether it would meet the AKS safe harbor for investments in ASCs jointly owned by hospitals and physicians. If the proposed arrangement could meet all criteria of the safe harbor, it would enjoy protection under the AKS. Safe harbors under the AKS are not mandatory, however, which means that the proposed arrangement could still be permissible, even if it does not fit into the safe harbor.

OIG concluded that the proposed arrangement failed to satisfy several components of the safe harbor, including the requirement that "the amount of payment to an investor in return for the investment be directly proportional to the amount of capital investment of that investor." OIG therefore evaluated the proposed arrangement under the AKS generally to evaluate whether it "pose[d] a minimal risk" of violation.

For three main reasons, OIG concluded that the proposed arrangement could lead to AKS violations. First, the proposed sale would result in a cash payment from the hospital to the orthopedic surgeons, and not in a capital infusion to the company. Second, only a subset of the physician investors (the orthopedic surgeons) would sell ownership interests to the hospital. According to OIG, this could indicate that one of the hospital's purposes in purchasing the interests would be to reward or influence valuable referral sources. Finally, OIG

found that, because the hospital would pay a higher price for the ownership units than the founding physicians paid, profit distributions based on each party's percentage ownership would by definition represent a lower return to the hospital.

## The Catch-22

The AKS generally requires pricing of transactions between referral sources to be fair market value. OIG accepted the requestors' certification here that the price of the ownership units would constitute fair market value. However, OIG's interpretation of "directly proportional" returns in this opinion would make it impossible for an ASC to, one, sell ownership units at a fair market value price and, two, offer "directly proportional" returns to investors whenever the value of the ASC company changes.

The Catch-22 created by the opinion stems from, first, possible OIG misapplication of the "directly proportional" element of the safe harbor and, second, a misunderstanding of fundamental business valuation methods. First, OIG essentially interpreted the directly proportional element of the safe harbor to require exactly equal returns on investment for all investors. This interpretation may exceed the scope of the safe harbor. Sec-

ond, OIG failed to recognize that prices for ownership interests incorporate the level of risk for the investments, which changes over time.

When the physician investors founded the ASC, they assumed the large risk of an unproven company with no history of success. Under virtually any business valuation methodology, higher-risk investments command lower prices than safer comparable investments. When the hospital proposed to purchase ownership interests from the orthopedic surgeons, the operating history of the ASC had reduced the uncertainty of the investment and increased the fair market value of the company. Following OIG's reasoning, the hospitals should have paid a price below fair market value, based on business conditions no longer relevant to the present state of the company. This result could not have been OIG's intention.

## Conclusion

The possibly contradictory and problematic implications of the opinion on hospital/physician joint ventures have already generated outcry from various sectors of the healthcare community. If the opinion remains in force, however, it introduces a new challenge to the already heavily scrutinized arena of hospital/physician joint ventures.

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