LEGAL REPORT

OIG Builds Yet Another Roadblock to Hospital/Physician Joint Ventures

BY RICH SANDERS

The Department of Health and Human Services, Office of Inspector General published an Advisory Opinion on June 19 that could chill hospital/physician joint ventures as much as the ongoing CON feud in Georgia.

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).

Factual Background

In this case, three orthopedic surgeons, owning 94% of the company that operates the ASC, proposed to sell a 40% 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% 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 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. 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.

OIG concluded that the proposed arrangement could lead to possible AKS violations. First, the proposed sale would result in a cash payment from the hospital to the orthopedic surgeons, 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. OIG's interpretation of "directly proportional" returns in this opinion, however, would make it impossible for an ASC to sell ownership units at a fair market value price and offer "directly proportional" returns to investors whenever the value of the ASC company changes.

The Catch-22 created by the opinion stems from two flaws in the OIG analysis: (1) possible OIG misapplication of the "directly proportional" element of the safe harbor and (2) 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. Second, 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 below fair market value price, based on business conditions no longer relevant to the present state of the company.

Conclusion

Various sectors of the health care industry have already criticized the possibly contradictory and problematic implications of this opinion on hospital/physician joint ventures. 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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