"Insider" Edition—Required Referrals and the Stark Law (Part One of Two)

10/30/2017

When a hospital is putting together an employment contract with a physician, there are many items for both the hospital and the physician to consider. One question we have seen more and more hospitals ask is whether a hospital may insert a provision into its physician employment contracts requiring hospital-employed physicians to refer patients to other hospital-employed physicians without violating the Stark Law.

In short, the answer is yes. The employment agreement between a physician and a hospital may include a requirement that the physician refer within the medical system. However, for a hospital to require referrals, the physician must first be a "bona fide employee" and second, the "required referrals" must be in writing and subject to: 1) patient choice; 2) third-party payer determination of provider; and 3) the physician's judgment regarding the patient's best medical interests.

In addition, a hospital may in theory "require" hospital-employed emergency room physicians to refer to hospital-employed physicians. It seems, however, that timely care will most often be in the "patient's best medical interests" when a non-employed physician is on call and ready to treat the presenting patient. Thus, in the emergency context, the conditions may swallow the requirement.

I am addressing this issue in two parts. The first part discusses a general overview of the Stark law, its exception for "bona fide employees", and how required referrals can comply with the Stark law. The second part, which will be posted next week, highlights common litigation themes and policy considerations related to required referrals.

Generally speaking, the Stark law prohibits physicians from referring Medicare patients for certain "designated health services" to entities with which the physician (or an immediate family member of the physician) has a financial relationship, unless an exception applies. See 42 U.S.C. § 1395nn(a)(1). Designated health services covered by the Stark law include: 1) clinical laboratory; 2) physical therapy, occupational therapy, and speech-language pathology services; 3) radiology and certain other imaging services (including magnetic resonance imaging, computerized axial tomography scans, ultrasound and nuclear medicine); 4) radiation therapy services and supplies; 5) durable medical equipment and supplies; 6) parental and enteral nutrients, equipment and supplies; 7) prosthetics, orthotics, and prosthetic devices and supplies; 8) home health services; 9) outpatient prescription drugs; and 10) all inpatient and outpatient hospital services. See 42 U.S.C. § 1395nn(h)(6). Notably, ambulatory surgery centers services are not considered designated health services, and are thus not covered by Stark regulations. Otherwise, the law has broad coverage, is fairly complicated and complex, and seems to be in a fluid state.

Regardless, the Stark law has an express exception applicable for "bona fide employees," and further, this exception allows an employer to require that its bona fide employee make certain referrals.

For a bona fide employment relationship to comply with Stark regulations, the employment must be for "identifiable services," and the amount of remuneration must be: 1) consistent with fair market value; 2) reasonable; 3) determined through arm's length negotiations; and 4) set in advance for the term of the agreement. The compensation cannot be determined in a manner that "takes into account" volume or value of referrals, and compensation must be provided pursuant to an agreement that would be "commercially reasonable" even if no referrals were made to the employer. Here, the majority of litigation (and industry confusion) seems to center on the meaning of certain key terms and phrases, such as "fair market value," "taking referrals into account," and "commercially reasonable". Also, employers should consider including an "evergreen" provision that provides for the employment agreement to automatically renew in order to limit the risk of expired contracts—which is a common Stark compliance risk.

Once you determine that a physician is a "bona fide employee," such physician may be required to refer. However, to comply with Stark regulations, any referral requirement must be in writing and must be subject to: 1) patient choice; 2) third-party payer determination of provider; and 3) the physician's judgment regarding the patient's best medical interests. See 42 C.F.R. § 411.354(d)(4).

Further, the required referrals must "relate solely" to the physician's services that are covered in the arrangement, and the referral requirement must be "reasonably necessary to effectuate the legitimate business purposes" of the arrangement. Also, the physician cannot "be required to make referrals that relate to services that are not provided by the physician under the scope of his or her employment contract." Interpreted narrowly, this arguably means the referral requirement is limited to situations in which the physician is required to refer to his or her employer for personally performed services, such as when an employer who owns a facility requires an employed physician to refer to the employer for surgeries the physician is employed to personally perform.

Alternatively, an argument exists that the restriction was not meant that broadly, and instead was meant to prevent tying wholly unrelated referrals to an agreement, such as a hospital hiring a medical director for its quality assurance program and then, as a condition of that medical director agreement, requiring the physician to refer all the physician's patients to the hospital. Under this alternative interpretation, it could be argued that if referrals relate to the services provided by the physician, e.g. they are a necessary corollary to those services, such as laboratory services needed to guide the physician's treatment decision, then requiring the laboratory testing to be performed at the employer's laboratory "relates to services" the physician is being paid to perform.

A hospital may insert a provision into its physician employment contracts requiring hospital-employed physicians to refer patients to other hospital-employed physicians without violating the Stark Law. Whether the physicians actually make the required referrals is likely a separate issue, which will be further discussed in part two of my post next week.

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