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

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Hospitals and physicians must consider many items when a hospital is putting together an employment contract with a physician. 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.

Last week, I provided a general overview of the Stark law, its exception for "bona fide employees", and how required referrals can comply with the Stark law. A link to that post is found here. This second part highlights common litigation themes and policy considerations related to required referrals.

As a quick recap, yes, an 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.

Also, 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.

Litigation pursuant to Stark and other anti-fraud abuse provisions has increasingly become aggressive over the last several years. Some common themes arising in Stark violation cases pertaining to compensation arrangements and required referrals include:

- Perpetual and persistent losses from employed physicians may be a factor in a whistleblower's claims of non-fair market value, non-commercially reasonable compensation
- Evidence that profits from referrals for inpatient and ancillary services were considered in setting compensation or assessing whether to move forward with a transaction is a red flag
- Inflated relative value unit ("**RVU**") values or other inaccurate information will undermine the reliability of an opinion of fair market value or commercial reasonableness
- Compensation for services that are not needed or not performed is generally not fair market value and not commercially reasonable
- Payment of costs that would normally be borne by a physician is a fair market value and commercial reasonableness pitfall
- Third-party fair market value analyses have no value if based on skewed information provided by the medical system.

Strong policy exists in favor of required referrals. Consistent with the patient-centered objective related to hiring physicians in the first place, medical systems often determine that retaining patients in their networks through this type of restriction leads to better coordination of care, better outcomes, and increased ability to lower risk through a unified, controlled network.

Alternatively, some medical systems do not include any contractual referral restrictions and will either: 1) rely on their quality to drive referrals; 2) simply do not "believe in" referral restrictions; or 3) are unable to include them because of historical physician objections. These systems typically have open medical staffs and/or strength in their market. Typically they elect to build "destination" programs and rely on the market's acknowledgment of their superior quality.

Though a physician's initial reaction to a contractual referral restriction will likely be negative, experience indicates that the restrictions are generally not of great concern. A physician that considers employment should believe in and promote the network. If a physician is not willing to make downstream referrals within a network, then that physician probably should not pursue an employment relationship, regardless of whether there is a contractual restriction. Additionally, the Stark required exception regarding a patient's best medical interests provides a physician wide latitude to refer outside the system.

The typical and best practice is to address this issue directly during the employment negotiations. If the physician does not already have a predictable referral pattern, then the employer should ask if the physician would feel comfortable referring patients within the system for typical types of consults or procedures. If the answer is "no," then this should lead to a discussion of potential physician misperceptions or of specific actions to improve the network's quality. In any event, a physician should assess employment based on the assumption that the physician will refer to that system whenever appropriate.

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.