

Facility Expansion options for a Physician-owned Hospital

The Affordable Healthcare Act of 2010 (“the Act” or “ACA”) prohibits doctor-owned hospitals from expanding, and prevents new doctor-owned hospitals at all, if they are going to serve Medicare or Medicaid patients. The law, passed in 2010, blocked building any new physician owned hospitals and prevented existing ones from adding beds or operating/procedure rooms in order to qualify for Medicare payments.

Hospitals with physician ownership as of March 23, 2010, are grandfathered for the same percentage of physician ownership they had on that day. For example, if a hospital had 20% physician ownership on March 23, 2010, the ACA allows it to keep 20% physician ownership without violating the law, but the percentage of physician ownership cannot increase beyond 20 percent. If the hospital was not yet enrolled in Medicare as of March 23, 2010, it had until December 31, 2010, to enroll and whatever percentage of physician ownership it had at that time was the maximum amount it could have in the future. The ACA bars any new physician ownership in hospitals after December 31, 2010.

The restrictions on expansion also include limits on the number of operating rooms, inpatient beds and procedure rooms at physician-owned hospitals. The ACA capped these rooms and beds at their March 23, 2010 amount, or their December 31, 2010 amount, if the hospital was not yet enrolled in Medicare as of March 23, 2010. The result is that there will be no new Medicare enrolled physician owned hospitals in the United States and those that exist have restrictions on expansion.

The country has between 240 - 270 doctor-owned hospitals, which are subject to the above restrictions as stated in section 6001 of the ACA, which puts severe restrictions on opening new physician-owned hospitals or expanding existing ones.

The Stark Law, which places limitations on certain physician referrals, addresses physician ownership more broadly to include immediate family members of physicians as well. Federal regulations previously provided for the “whole hospital” exception to the Stark Laws. This particular safe harbor required that the referring physician/owner: (1) have a financial interest in the whole hospital, and not just a specific part; (2) be authorized to perform services at the hospital; and (3) be expected to actually perform the agreed upon services. The requirements of Section 6001 substantially modified this exception.

Section 6001 contains specific requirements for and restrictions on physician-owned hospitals, the regulations for which were promulgated at the end of 2011, as follows:

Grandfathered Facilities: All existing physician-owned hospitals that had physician ownership as of March 23, 2010, and possessed a Medicare provider agreement as of December 31, 2010, were “grandfathered” - meaning that they can continue to rely on the protection afforded by the whole hospital exception.

Extent of Physician Ownership: The regulations promulgated in response to the Affordable Care Act specify that if a hospital did not have physician ownership on March 23, 2010, but later adds physician owners, the whole hospital exception will not protect referrals to the hospital by the physician owners. Further, the percentage of physician ownership in place as of the date of enactment of the Affordable Care Act, March 23, 2010, cannot increase. However, there is no requirement that the particular physician owners or investors remain the same. As a result, physician owned shares can change hands, and additional physicians can have an ownership interest in the hospital, so long as the total percentage of physician ownership does not increase.

We note that the direct or indirect (investment by physician's family member or physician owned company) percentage of physician ownership in the Hospitals cannot increase beyond the current structure, which was established in 2010.

Limitation on Expansion: Any expansion in the number of operating rooms, procedure rooms, or beds beyond those existing as of March 23, 2010 (and later changed to December 2010), is prohibited, except as permitted in very limited circumstances.

Provisions Related to Conflicts of Interest: There are a number of provisions within the Affordable Care Act directed at limiting perceived conflicts of interest. First, each year, physician-owned hospitals must provide the Centers for Medicare and Medicaid Services ("CMS") with the identity of each physician owner as well as the nature and extent of each owner's interest in the hospital. Second, each physician-owned hospital is required to include a mechanism to ensure that referring physician-owners disclose to their patients their ownership in the hospital prior to the patient's admission. Third, the hospital may not condition any physician-ownership interests on the physician making or influencing referrals to the hospital. Last, physician-owned hospitals are required to disclose the fact that their owners include physicians in any public website or public advertising.

Provisions to Ensure Bona Fide Investment: The Affordable Care Act and corresponding regulations prescribe certain restrictions regarding the physician-owned hospital's financial relationship with its physician owners or investors. Specifically, (1) a physician-owned hospital (or any owner or investor in the hospital) may not directly or indirectly provide loans or financing for any investment in the hospital by a physician-owner or investor; (2) a physician-owned hospital (or any owner or investor in the hospital) may not either directly or indirectly guarantee a loan, make a payment toward a loan, or otherwise subsidize a loan, for any individual physician owner or investor or group of physician owners or investors; (3) ownership or investment returns must be distributed to each owner or investor in a physician-owned hospital in an amount that is directly proportional to the ownership or investment interest of such owner or investor in the hospital; (4) physician-owners and investors may not receive, directly or indirectly, any guaranteed receipt of or right to purchase other business interests related to the hospital, including the purchase or lease of any property under the control of other owners or investors in the hospital or located near the premises of the hospital; and (5) a physician-owned hospital may not offer a physician-owner or investor the opportunity to purchase or lease any property under the control of the hospital or any other owner or investor in the hospital on more favorable terms than the terms offered to an individual who is not a physician-owner or investor.

Patient Safety: Under the Affordable Care Act and corresponding regulations, all physician-owned hospitals must provide for proper assessment of patients, with the ability to refer and transfer those patients requiring greater resources to other, more appropriate hospitals. Furthermore, the regulations promulgated in response to the Affordable Care Act state, “The hospital inpatient stay or outpatient visit begins with the provision of a package of information regarding scheduled preadmission testing and registration for a planned hospital admission for inpatient care or an outpatient service.” The hospital must also disclose to, and obtain a signed acknowledgement from a patient if the hospital does not have a physician available on the premises during all hours in which the hospital is providing services to that patient.

Limitations and Exceptions Under the Act:

Definition of Physician-Owned Hospital

A “Physician-owned hospital” means any hospital “in which a physician, or the immediate family member of a physician, has an ownership or investment interest. The ownership or investment interest may exist through equity, debt or other means, and includes the interest in an entity that holds an ownership or investment interest in the hospital.” *See 42 C.F.R. § 489.3.*

The Stark Law defines an “immediate family member” to include a physician’s: husband or wife; birth or adoptive parent, child, or sibling; stepparent, stepchild, stepbrother, or stepsister; father-in-law, mother-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law; grandparent or grandchild; and spouse of a grandparent or grandchild.

Under the Affordable Care Act, the whole hospital exception applies only to physician-owned hospitals that had physician ownership as of March 23, 2010, and had obtained a Medicare provider number by the end of 2010. Furthermore, the definition of “physician-owned hospital” does not include a hospital with physician ownership or investment interests that satisfy the following two requirements:

1) *Publicly Traded Company*

- (i) *Listed for trading on the New York Stock Exchange, the American Stock Exchange, or any regional exchange in which quotations are published on a daily basis, or foreign securities listed on a recognized foreign, national, or regional exchange in which quotations are published on a daily basis; or*
- (ii) *Traded under an automated interdealer quotation system operated by the National Association of Securities Dealers; and*
- (iii) *They are in a corporation that had stockholder equity exceeding \$75 million at the end of the corporation’s most recent fiscal year or on average during the previous 3 fiscal years. “Stockholder equity” is the difference in value between a corporation’s total assets and total liabilities.*

2) *Regulated Investment Company*

Mutual funds Ownership of shares in a regulated investment company as defined in Section 851(a) of the Internal Revenue Code of 1986, if the company had, at the end of its most recent fiscal year, or on average during the previous 3 fiscal years, total assets exceeding \$75 million.

The term “regulated investment company” means any domestic corporation which, at all times during the taxable year:

- (i) is registered under the Investment Company Act of 1940 a management company or unit investment trust, or*
- (ii) has in effect an election under such Act to be treated as a business development company, or*
- (iii) which is a common trust fund or similar fund excluded from the definition of ‘investment company’ and is not included in the definition of ‘common trust fund.’*

Applicable Hospital and High Medicaid Facility

The statute mandates that the Secretary of HHS establish and implement a process under which certain hospitals may apply for certain exceptions and such process must provide individuals and entities in the community in which the applicable hospital is located with the opportunity to provide input with respect to the application. The Act stipulates that for a hospital to qualify under either of the two main exception categories below, the hospital must meet all of the conditions listed under the category as follows:

Applicable Hospital

- Be located in a county in which the percentage increase in the population during the most recent 5-year period (as of the date of the application) is at least 150 percent of the percentage increase in the population growth of the State in which the hospital is located during that period, as estimated by Bureau of the Census;
- The annual percent of total inpatient admissions that represent Medicaid inpatient admissions is equal to or greater than the average percent with respect to such admissions for all hospitals located in the county in which the hospital is located;
- Does not discriminate against beneficiaries of federal health care programs and does not permit physicians practicing at the hospital to discriminate against such beneficiaries;
- Is located in a State in which the average bed capacity in the State is less than the national average bed capacity; and
- Has an average bed occupancy rate that is greater than the average bed occupancy rate in the State in which the hospital is located.

High Medicaid Facility

- Is not the sole hospital in a county;
- With respect to each of the 3 most recent years for which data are available, has an annual percent of total inpatient admissions that represent Medicaid inpatient admissions that is estimated to be greater than such percent with respect to such admissions for any other hospital located in the county in which the hospital is located; and
- Does not discriminate against beneficiaries of Federal health care programs and does not permit physicians practicing at the hospital to discriminate against such beneficiaries.

Applying for Exceptions

Hospitals may apply for an exception to the expansion limitation up to once every 2 years.

Any increase in the number of operating rooms, procedure rooms, and beds for which an applicable hospital is license may only occur in facilities on the main campus of the applicable hospital.

Exception reviews are subject to community input and if a physician-owned hospital is approved for an exception for expansion, the physician owned hospital may not grow more than 200 percent from the base rate.

Facilities may begin applying for exceptions January 1, 2012, with decisions published on CMS's website and in the Federal Registrar 60 days after a completed application is received

Observations from Physician-Owned Hospitals (Responses to ACA rules)

- Certain hospitals are expanding their operating hours, increasing procedures in ways not restricted by the law such as scheduling operations later and on weekends to maximize the use of rooms.
- Building up practice areas, such as same-day surgeries, that don't require admitting patients overnight.
- Adding unlicensed observation beds: CMS recently issued Advisory Opinion 2013-03 ("Opinion"), clarifying that a physician-owned hospital may add unlicensed observation beds without violating the limitation on expansion. The Opinion paves the way for certain physician owned hospitals to expand services with the addition of unlicensed observation beds.

Considerations:

Based on the facts detailed above, how can a physician-owned hospital expand?

- 1) Become a Public company as defined above: One way to achieve that is a reverse merger into a public shell that will allow the Hospital to meet the public company exception to the definition of a physician-owned hospital as long as the resulting company has a stockholders' equity balance of more than \$75 million at the end of the fiscal year with sufficient outside investments.
- 2) Become an Investment company as defined above: This would include restructuring the ownership of the hospital under an investment company (investment fund) will allow a hospital to meet the regulated investment company exception to the definition of a physician-owned hospital as long as the resulting company has a stockholders' equity balance of more than \$75 million at the end of the fiscal year.
- 3) Other possible applicable hospital exceptions: Marcum's analysis indicates the following:
 - If the County in which the hospital is located, in the last 5 years appears has met the 150% threshold when compared to the average population growth in the state it is located in.
 - Examine whether the percentage of inpatient admissions that represent Medicaid patients is at least equal to the average hospital in the County.
 - A hospital management should examine whether the average bed capacity is less than the national average bed capacity.
 - A hospital should examine whether the Hospitals have an average bed occupancy rate that is greater than the average bed occupancy rate in their state.
- 4) If the hospital is considered High Medicaid facility.
- 5) Combining a license with another facility.
- 6) Contracting with an independent long term care facilities: Contracting with a long-term care facility allows the hospital to rent unused space and enables the hospital to recover part of its fixed costs.

Management of physician-owned hospitals may also want to consider the following incremental measures while assessing the feasibility of the exceptions above:

- Adding unlicensed observation beds based on the Hospitals' needs.

- Expanding certain services on behalf of others: Due to constraints on expansion, Marcum recommends that management continues to examine profitability by type of service provided and analyze each hospital's demand for specific services to determine whether the current facilities reflect the most profitable mix of services. In this time of limited financial resources available to hospitals, duplicate services, and lower margin or loss generating procedures should be reduced or eliminated.
- Monitor the Hospitals' qualification for the Disproportionate Share hospital (DSH) program based on the percentage of Medicaid and Medicare patients treated at the Hospitals subject to a statutory formula. This can lead to additional revenues for the Hospitals.