

Practice Lease ©: How To Employ Physicians without Buying Their Practices!

Hospitals are exploring various alternatives with respect to physician affiliations. For the most part, hospitals and physicians are developing meaningful relationships beyond the traditional physician employment and professional services arrangements. Hospitals are seeking alternatives to the more traditional relationships because traditional relationships have, in many instances, resulted in dissatisfactory relationships on all sides.

For strategic reasons, hospitals and healthcare systems are developing various affiliation models that include employment and other relationships as elements of more sophisticated transactions. In developing new affiliation models, health systems are focusing their attention on their most important customer: the physician. Furthermore, those hospitals that have had various employment arrangements are re-examining these traditionally under-performing arrangements through a realignment of both parties' various incentives. The PracticeLease© is one such model.

PracticeLease© is a model through which a hospital and medical practice may enter a relationship tantamount to a practice purchase without many of the disadvantages. This model facilitates the development of sustainable relationships through the private practice model. These relationships can be structured in a manner consistent with various Stark II exceptions and Anti-Kickback Act safe harbors.

This structure involves the creation of a new company (NewCo) by the hospital, through which NewCo enters into an employment agreement with physician(s) that are part of an existing practice. The practicing physicians will work solely for NewCo. This entity can be structured as a group practice under Stark II. Thus, NewCo may compensate the physicians through a combination of salary, bonus, and/or share of NewCo profits (42 C. F. R. § 411.352).

To the extent ancillary services are provided by NewCo in a manner consistent with the in-office ancillary services and group practice exceptions to Stark II, each employed physician may share profits, including a share of Medicare/Medicaid designated health services profits, as long as such share is not directly determined in a manner that takes into consideration the volume or value of Medicare/Medicaid designated health services (See 42 C.F.R. §§ 411.352; 4113.55(b)).

Furthermore, consistent with Stark II, employed physicians can be required to refer patients to a specific hospital for all services unless the patient requests otherwise, the best interest of the patient dictates otherwise or another Stark II exception-required referral rule applies (See 42 C.F.R. § 411.354(d)(4)).

NewCo can contract directly with the pre-existing practice entity to provide all or some of the following:

- Space for the physicians employed by NewCo;
- Equipment for physicians employed by NewCo; and
- Practice management services.

Space and equipment leases and management services agreements must be structured in a manner consistent with the applicable Stark II exceptions and should also comply with the relevant safe harbors under the Anti-Kickback Statutes. This structure provides physicians with two sources of revenue: employment compensation (salary, bonus and share of profits) and distributions from the pre-existing practice entity, which will function as



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a management services organization. While the benefits to the physicians are obvious, the hospital enjoys all of the benefits of owning a practice with no significant expenditure of capital in order to accomplish this task. Furthermore, should the venture become unsatisfactory or unsuccessful, this arrangement is much easier to unwind than a practice acquisition.

Because every hospital has a physician integration strategy as a part of its overall strategic long range plan, and because hospitals are physician driven organizations, hospitals and healthcare systems must explore alternatives to physician affiliation aside from the traditional employment model. PracticeLease© creates a true partnership.

Additional caution should be undertaken in order to ensure reasonable compensation as outlined by "The 2000 EOCTE (Exempt Organizations Continuing Education) Text" as published by the Internal Revenue Service. In the case of not for profit organizations, the IRS considers many factors in determining whether the compensation arrangement between a hospital and physician violates any laws against private inurement and impermissible private benefit. Since the enactment of intermediate sanctions in 1997 and implementing regulations issued in 2001 by the IRS, physicians who are considered "disqualified persons" risk federal excise taxes for compensation that results in an excess benefit transaction with an exempt organization. This tax ranges from 25% to 200% of the excess benefit. Also, organization managers responsible for the arrangement can also be liable for a tax of 10% of the excess benefit up to \$10,000.00 per person.

As hospitals and health systems embark upon the strategy of more formal organizational alignment with physicians, due diligence and education is imperative for both the governing board and senior management. Upon approval to proceed, the hospital/health system should embark upon a process that involves the feasibility, development and implementation phases with respect to any type of hospital/physician affiliation model, including the PracticeLease©. During the feasibility phase, a new physician alignment model must be developed with input from key physician leaders likely to be involved in or affected by the proposed relationship. It is also suggested that a steering committee of physicians be organized in order to gain buy-in from the hospital's key constituency with respect to the strategic vision for physician alignment.

Other considerations that must be addressed involve the corporate practice of medicine. California, Texas and Iowa strictly follow the doctrine. However, even these states have a variety of exceptions that provide mechanisms with respect to employment of physicians by various entities that are not owned or controlled by physicians, such as charitable institutions, professional LLC's, etc.

PracticeLease© is an excellent solution for both hospitals and physicians who are searching for a meaningful affiliation strategy through the creation of centralized resources for the purposes of improved patient care, enhanced information technology and a collective expertise for the benefit of both parties.

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