

FEDERAL CIVIL ENFORCEMENT

Expert Analysis

New Attack on Physician Compensation Models Under the Stark Law

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A recent decision by the U.S. Court of Appeals for the Third Circuit has thrown in doubt the common practice of hospitals paying doctors based on the amount of work those doctors do.

In *U.S. ex rel. Bookwalter v. UPMC et al.*, the court analyzed the Stark Law's prohibition on self-referrals to presumptively prohibit a hospital from paying surgeons based on their productivity. The court reasoned that it is enough to violate the law if such compensation simply *correlates* with the hospital's own billings, in a controversial ruling and over the objection of the concurring judge.

The court further held that a defendant bears the burden of proving the application of any "safe harbor" protections that make such an arrange-



ment legal, reasoning that safe harbors are affirmative defenses that do not go to the sufficiency of a plaintiff's claim.

The *UPMC* defendants have filed a petition for rehearing en banc, with amicus curiae support of several hospital groups. But the decision threatens to shatter a sound, common practice that guides hospital-physician compensation. At a minimum, it will leave hospitals vulnerable to expensive litigation even when their actions are wholly lawful.

The Stark Law

The Stark Law seeks to regulate conflicts of interest that result from physicians referring patients to other health care businesses the physicians own. Unlike most laws, which closely target only problematic behavior, the Stark Law achieves its purposes by prohibiting a much broader set of financial relationships than anyone believes is problematic and then defining significant exceptions—safe harbors—to render this overbroad prohibition sensible.

On its face, the Stark Law prohibits a hospital from paying a referring physician at all. It prohibits a physician (or an immediate family member) from referring a patient to a facility with which he has a “financial relationship” to receive certain “designated health services” payable by Medicare, and prohibits the facility from seeking Medicare reimbursement for such a referral. 42 U.S.C. §1395nn. A “financial relationship” can be an ownership/investment interest or a direct or indirect “compensation arrangement.” Only safe harbors make such relationships legal.

There is no requirement that the financial relationship induce the referral. The Stark Law is not an anti-kick-back law, despite its similarity to such a prohibition. It is a strict liability statute that allows the Government to obtain restitution and penalties for a referral made where a prohibited financial relationship exists. It can also serve as a predicate for False Claim Act (FCA) liability.

‘UPMC’

The *UPMC* case involves compensation arrangements for neurosurgeons paid by University of Pittsburgh Medical Center (UPMC)-owned subsidiaries for work the doctors did at UPMC hospitals. The surgeons were paid a base salary and had an annual Work Unit (wRVU) quota, the latter of which could adjust a surgeon’s compensation: A neurosurgeon who exceeded his wRVU quota earned a \$45 bonus for every extra Work Unit, but failure to meet the quota could lead to a lower base salary.

Relators filed suit in 2012, alleging that this compensation structure violated the Stark Law, because paying the surgeons based on their own services also rewarded them for referring hospital services related to their procedures. Relators alleged that this resulted in false claims for fraudulent “physician services,” such as surgeries that never happened or were not medically necessary, and also false claims for “hospital services” that were billed in connection with procedures done by the surgeons at UPMC-owned hospitals.

In 2016, DOJ intervened only as to the physician services claims, which it settled with the UPMC entities (with no admission of liability). The DOJ declined to intervene as to hospital

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services claims, but did not seek to dismiss them, and relators pursued the case. The district court dismissed the complaint with prejudice, and relators appealed.

The Third Circuit's Decision

The Third Circuit reversed, finding that all three elements of a Stark Law violation were present, which also sufficiently pled an FCA violation: (1) a referral for designated health services; (2) a compensation arrangement (here, an indirect one); and (3) a government claim for the referred services.

There was no dispute that defendants made Medicare claims for designated health services, which include inpatient or outpatient hospital services. The court found that relators also pled referrals for such services, because every time the surgeons performed a procedure at the UPMC hospitals, they referred the patient for “attendant hospital and ancillary services” billed to Medicare.

As to a compensation arrangement, because the hospitals did not pay the neurosurgeons directly, the court examined whether UPMC’s contracts with the surgeons were indirect compensation arrangements. The court looked at whether relators had pled three elements: (1) an unbroken chain of entities with financial relationships connecting the surgeons with the hospitals; (2) compensation that “varies with, or takes into account” the volume or value of the surgeons’ referrals; and (3) that the hospitals knew, deliberately ignored, or recklessly disregard that fact. See 42 C.F.R. §411.354(c). The court found that the complaint sufficiently pled each of these elements.

First, the court found an unbroken chain of financial relationships as UPMC owns each hospital as well as the entities that employ and pay the surgeons.

Second, in a controversial interpretation of the “volume or value” prong, the majority held that an indirect compensation agreement violates the Stark Law where there is either *causation* or *correlation* between compensation and referrals. In the majority’s view, compensation “varies with” referrals if they are correlated, i.e., “[i]

f compensation tends to rise or fall as the volume or value of referrals rises and falls,” and compensation “takes into account” referrals if there is a causal relationship between the two. The concurring judge disagreed with the majority on this point, taking the position that the “volume or value” prong requires some type of *causal* relationship between compensation and referrals.

In reaching its decision, the majority relied on a prior decision by the Fourth Circuit, in *U.S. ex rel. Drakford v. Tuomey Healthcare System, Inc.* But many practitioners had viewed *Tuomey* as limited to the unusual compensation arrangement at issue, which involved part-time employment for outpatient surgical services that resulted in a very direct correlation between remuneration for a surgeon’s productivity and the services provided by the hospital in connection with such surgeries. *UPMC* significantly expands that decision by applying its holding to a common compensation arrangement that the industry and health-care bar viewed as non-controversial. The majority also does not address that, in the wake of *Tuomey*, CMS released a proposed rule stating that productivity bonuses do not “take into account” physician referrals solely because corresponding hospital services are billed when the physician performs a service.

The *UPMC* majority ultimately concluded that relators sufficiently pled both causation and correlation. As to causation, it held that the surgeons’ “suspiciously high compensation” exceeded fair market value, which

“suggests that the compensation takes referrals into account.” The court considered five combined factors: some surgeons’ compensation exceeded their collections; many surgeons’ pay exceeded the 90th percentile of neurosurgeons nationwide; many surgeons generated Work Units far above industry norms; surgeons’ bonuses per Work Unit exceeded what the UPMC entities collected from Medicare (indicating that loss leaders may be viewed with skepticism); and the existence of the DOJ settlement (notwithstanding that defendants did not admit liability).

The court’s decision suggests that for now, at least in the Third Circuit, hospitals that compensate affiliated physicians according to some metric of work they personally perform face a heightened risk of FCA litigation, with limited defenses until after discovery.

The concurring judge questioned whether any of these factors would be sufficient standing alone to raise a plausible inference of a Stark Law violation, but agreed that taken together, they suggested causation.

The majority also held that compensation was *correlated* with referrals, because as the surgeons performed more procedures, they earned higher pay and also generated referrals for the associated hospital services.

Third, the majority found that relators sufficiently pled scienter as to the UPMC entities, because there was

common control over the entities and common knowledge over the compensation arrangements—including a central coding and billing department and overlapping executives and directors.

Stark Law Exceptions

The court separately addressed the issue of whether the existence of an applicable Stark Law safe harbor is relevant at the motion to dismiss stage given that a defendant bears the burden of showing applicability. It credited defendants’ logic that where an exception applies, the financial relationship does not violate the Stark Law or result in false claims (or at least there is no knowledge of a violation). Relying on a prior case, however, the court held that an FCA defendant must prove that a safe harbor applies. The court also stated that relators had in fact pled that none of the claimed exceptions applied, because the complaint alleged that the surgeons’ compensation exceeded fair market value.

An Uncertain Future

While the defendants’ en banc petition might alter the state of play, the court’s decision suggests that for now, at least in the Third Circuit, hospitals that compensate affiliated physicians according to some metric of work they personally perform face a heightened risk of FCA litigation, with limited defenses until after discovery.