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## Stark Phase III Rules Loosen Recruitment and Retention Requirements

On September 5, 2007, the Centers for Medicare & Medicaid Services (CMS) published long-awaited final "Phase III" rules under the Stark Law (Physician Self-Referral Law, Sec. 1877 of the Social Security Act, 42 U.S.C. § 1395nn). While the Phase III rules generally are designed to close perceived "loopholes" in Stark exceptions, there are several instances where CMS' response relaxes restrictions as a result of the health industry's needs for flexibility. In particular, the rules for recruitment and retention of physicians have changed under Stark Phase III to make it somewhat easier to meet community need for physician services in the face of the growing national shortage of physicians.

### Recruitment Payments

*Clarification of the definition of "recruit".* CMS has clarified the list of physicians who may qualify for recruitment subsidies. Under current rules, a new recruit may include only physicians who relocate to the hospital's geographic area, or who are recently graduated residents, fellows, or other physicians who do not have an "established practice" in the hospital's geographic area for at least a year. Under the Phase III rules, the following physicians also will qualify for recruitment payments: physicians who were employed full-time for at least two years (without maintaining a private practice) for a federal or state bureau of prisons, the U.S. Department of Defense, U.S. Department of Veterans Affairs, or the Indian Health Service. In addition, CMS will issue advisory opinions, upon request, regarding any other physician not included on the preceding list who the requesting hospital believes does not have an "established practice" that serves a significant number of patients who are or could become patients of the recruiting hospital.

*Expansion of the hospital's "geographic area".* CMS has clarified the definition of a hospital's "geographic areas" to expand the sites to which a physician may be recruited. Currently, a hospital's geographic area is defined as "the lowest number of contiguous zip codes from which the hospital draws 75 percent of its inpatients." Under the Phase III rules, a hospital's geographic area may include one or more zip codes from which the hospital draws no inpatients if such "no patient" areas are surrounded by the zip codes from which the hospital draws 75 percent of its inpatients (90 percent of inpatients for rural hospitals). In addition, if fewer than 75 percent of inpatients are drawn from contiguous zip codes, then the physician can relocate to any contiguous zip code from which a hospital draws inpatients. There is an

even more expansive special rule for rural hospitals. If a rural hospital draws fewer than 90 percent of its inpatients from its contiguous zip codes, then a recruit can be located in certain noncontiguous zip codes starting with the noncontiguous zip code in which the hospital draws the largest percentage of inpatients and including others in decreasing order until the 90 percent threshold is reached. A rural hospital also may request a CMS advisory ruling to permit it to locate a recruit outside the geographic area served by the hospital if there is demonstrated need for the physician. Finally, CMS clarified that “contiguous zip codes” do not need to be contiguous to the hospital, they need only be contiguous to each other.

*Overhead allocation for physician recruited to a group to replace a physician who has retired, relocated, or died.* Under the current Stark rules, a hospital can provide only limited overhead assistance to a medical group that recruits a physician to join the group under an income guaranty arrangement financed by the hospital. The overhead subsidy paid by a hospital under such an arrangement is currently limited to “actual additional incremental expenses” incurred by the group that are associated with the new recruit. Where an existing member of a medical group retires, relocates, or dies, the medical group generally will incur no additional incremental overhead costs to replace the departed physician, and under the existing rules, no overhead subsidy could be paid by a hospital to the group to encourage it to replace the departed physician for the benefit of the community. Absent such a subsidy, many medical groups have been unwilling to assume the financial risk of recruiting such a replacement. Under the Phase III rules, CMS will now permit an overhead allocation payment by a hospital to a medical group that recruits a physician under such circumstances, if it replaces the departed physician within 12 months of departure. The payment under the income guaranty arrangement may be up to the lower of a per capita allocation of the host group’s overhead costs or 20 percent of aggregate overhead costs of the group.

*Reasonable practice restrictions permitted.* CMS also will now permit a medical practice that recruits a physician under an income guarantee from a hospital to impose “reasonable” restrictive covenants on the recruit. Currently, the medical group can impose only “conditions related to quality of care” and can not impose reasonable noncompete or nonsolicitation restrictions. This change

will make income guaranty arrangements more palatable to medical groups that have been concerned about sponsoring new recruits who would be free to compete with the medical group at the end of the income guaranty period.

*Recruitment of non-physician practitioners (NPPs).* The Preamble to the Phase III Final Rule has a useful discussion of recruitment payments for NPPs. CMS reminds providers that since NPPs are not physicians, financial relationships with them do not qualify as Stark-prohibited relationships. CMS added, however, that if the payment “subsidizes” the physician’s recruitment of the NPP, then there is a “substantial risk” of fraud and abuse.

## **Retention Payments in Underserved Areas**

*Retention payments outside of HPSAs.* In a major change to the Stark exception for retention payments, CMS is now permitting certain payments to retain physicians who are not located in Health Professional Shortage Areas (HPSAs). Retention payments will now also be available to physicians in rural areas. In addition, while there has historically been an opportunity for retention payments in other areas of demonstrated community need (as determined through the CMS advisory opinion process), no hospital has obtained a published advisory opinion. Given the more liberal attitude toward physician retention reflected in the Phase III rule, there may now be a real opportunity for advisory opinions permitting necessary retention payments by hospitals (that are located outside of HPSAs and rural areas) that have conducted manpower-planning studies and found there to be a demonstrated community need in their markets. The issue here is whether the advisory opinion process will prove nimble enough to respond in a timely manner to relocation offers made to local physicians. Substantial advanced planning by the hospital may speed the review process considerably, and make it a viable avenue of relief.

*Physician certifications.* Previously, the facility seeking to retain a physician had to obtain a copy of the bona fide relocation offer to the physician as a precondition to making a retention payment to the physician. The offer had to be a “recruitment offer” to relocate 25 miles outside of the hospital’s geographic area. The problem was that certain relocation offers were confidential and could not be disclosed by the physician, or were made only verbally. Under the current rules, hospitals and federally qualified health centers (FQHCs)

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can not make a retention offer to those targeted physicians. Under the Phase III rules, hospitals, FQHCs and rural health clinics (RHCs) may rely either on a bona fide written offer or on an extensive written certification from the target physician that he or she has a bona fide "recruitment or employment" opportunity that would involve relocating at least 25 miles to a location outside of the geographic area served by the facility. The facility can rely on the physician's written certification so long as there is sufficient information by which the facility can verify the offer and as long as the facility takes reasonable steps to verify it. Retention payments based upon verification may be up to the lesser of 25 percent of current physician's current income or the cost of recruiting a new physician. (In the case of a bona fide written offer, a facility can pay the lesser of (1) the difference between the offer amount and the physician's current income, or (2) the cost of recruiting the new physician).

*Relocation requirement.* The Phase III rule changes the relocation requirement. Under the current rule, the physician must receive an offer to relocate "25 miles outside the geographic area of the hospital making the retention payment". Under the Phase III rule, the offer can be to relocate "25 miles and outside the geographic area of the hospital making the retention payment". The inclusion of the word "and" means that a retention counteroffer can be made if the physician would move anywhere outside of the hospital's geographic area (as defined in the rule), even one foot outside of that area, as long as the physician would be relocating his or her practice at least 25 miles from its present location. The physician would no longer need to be 25 miles outside of the hospital's geographic area.

*Retention payments available to RHCs.* Finally, CMS has expanded the retention exception to permit retention payments by RHCs as well as by Hospitals and FQHCs.