Impact of “Illegality” of Payment Arrangement under Stark Law on Payment for Services of Referring Physicians

Lessons Learned When It Comes to Discussions with Physicians Who Are Parties to Expired or Expiring Agreements

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A recent case points out the dangers in use of the fraud and abuse laws to justify a health care provider's failure to pay for services rendered by a referral source. In this case, the court found as a matter of law that a hospital that received services from a physician who was a referral source still must pay for services even though it did not have a written agreement with the physician that meets one of the statutory exceptions (called safe harbors) under the Stark law. This case has implications for both health care providers and physicians (or physician groups) that are in negotiations to enter into new agreements and/or renew expiring agreements for the provision of services by physicians that are referral sources to a provider that provides services that are covered by the Stark law.

The Stark Law

Under the Stark law, physicians are prohibited from having a financial relationship with a health care provider to which they refer business if the provider provides certain services (called designated health services) that are listed in the Stark law and the regulations under the statute. The purpose of this statute is to prohibit referrals by one or more physicians who will benefit financially from the referrals. Violations of the Stark law can lead to significant civil penalties, debarment from participation in the Medicare program, and draconian criminal penalties.

Included within these prohibited financial relationships are arrangements for the payment of compensation by a health care provider for services rendered by a
referring physician or physician group. This statute contains certain exceptions to the prohibition of compensation arrangements, one of which is the exclusion of “personal service arrangements.” Some of the requirements to meet this exception are that the arrangement for the provision of personal services be set out in writing, have a term of at least one year, be signed by the parties, and specify the services contemplated by the arrangement.

A significant number of health care providers that provide designated health services (such as hospitals, clinical testing laboratories, and durable medical equipment suppliers) have adopted internal compliance policies that require all financial arrangements with referral sources be in writing and meet the requirements of the personal services arrangement or other statutory safe harbors. In the event that a provider is accused of violation of the Stark law or other fraud and abuse laws, its adoption and adherence to these internal policies will be viewed favorably under the sentencing guidelines for violations of these laws.

To comply with the requirements of this statutory exception, most health care providers insist that compensation arrangements with physicians have at least a one-year term. This “minimum term” requirement is easily applied in negotiations of new compensation arrangements with physicians or physician groups; however, where “old” compensation arrangements are expiring or have expired and problems arise in negotiating compensation and other provisions as part of the renewal and/or extension of such expiring or expired agreements, it may become difficult if not impossible for the provider to adhere to its previously adopted compliance policy as to agreements of this type. Depending on the “compliance culture” within its organization, the provider may choose to discontinue the payment of compensation for services that continue to be provided by the physicians or physician group even after expiration of the written agreement for such services.

More typically, the provider will continue to pay the physician(s) at the same rate and in the same amount as is (or was) provided in the expiring (or even expired) agreement, and the physician(s) will continue to provide services to the provider. A recent decision by a federal District Court in Kansas addresses the applicability of the Stark law to an expired written personal services agreement between a hospital and a referring physician.

**The Braun Case**

In *Braun v. Promise Regional Medical Center-Hutchison Inc.*, physician Steven D. Braun sued for unpaid compensation for services that he had provided a local hospital, the Promise Regional Medical Center-Hutchison, Inc. (PRMC). Since 1997, Dr. Braun had served as medical director for PRMC under a written employment agreement. In accordance with the terms of the employment agreement, in April 2008, the hospital terminated the agreement on written notice to Dr. Braun as of the date specified in the notice; however, Dr. Braun continued to provide services to the hospital as its medical director for over 30 months (from April 30, 2008 until December 22, 2010) without receipt of compensation for these services.

After Dr. Braun accepted a position with another health care provider, he discontinued providing services to PRMC. He then sued the hospital in Kansas federal court and alleged that he was entitled to damages for unjust enrichment, breach of contract, and intentional interference by PRMC with a prospective business advantage (a potential services arrangement that Dr. Braun had been pursuing while still providing services to PRMC). In defense to Dr. Braun’s claim for unpaid compensation, PRMC argued that it could not compensate Dr. Braun for the services he provided after it had terminated his employment agreement since a written agreement was not in
place with him as was required in order for the services arrangement to meet a statutory exception and safe harbor under the Stark law.

In refusing to dismiss Dr. Braun’s claim for unjust enrichment (despite the absence of an agreement, benefit provided as to which payment for value was not made), the District Judge found that it was inequitable for PRMC to refuse to pay Dr. Braun for services he had performed after the hospital had terminated his employment agreement. In reaching this conclusion, the court acknowledged that the purpose of the Stark law was to preclude financial relationships between physicians and health care providers of certain services; however, the District Judge noted that “[t]he Stark Act, however, does not by its terms prohibit unwritten agreements [with physicians who have financial relationships with hospitals] or limit the power of a court to issue equitable remedies where there are no agreements. The Stark Act only carves out an exception from its prohibition of referrals for persons and entities who have certain written personal service arrangements.”

Although the court granted PRMC’s request to dismiss the complaint as pertains to Dr. Braun’s claim for tortious interference with a prospective business advantage, the judge refused to dismiss the plaintiff’s claims for unjust enrichment and for breach of contract.

**Implications of **Braun** on Contract Negotiations with Physicians**

The **Braun** case severely limits the use of the fraud and abuse laws either by a health care provider to avoid paying for services or by a physician or other referral source as a legal justification not to perform services under an agreement with the provider. This tactic is most often used by a health care provider (such as a hospital, physician group, or outpatient provider of health care services) in its negotiations with a physician, physician group, or other service provider regarding the potential extension of a contract for services that by its terms will soon expire.

Typically, the underlying service agreement will expire as of a specified date, and there is no contractual requirement for the continued provision of services by the physician to the health care provider after expiration of the service agreement. This problem is particularly acute where the remaining term of the agreement is less than one year — arguably a failure to comply with one of the requirements for the personal services arrangement exception to the Stark law. Another potential use of this tactic would be where some provision of the written agreement does not comply with another requirement of the personal services arrangement exception, such as failure of the compensation method contained in the agreement to meet a safe harbor requirement.

**Contract Expiration: Scenario #1 — Provider’s Discontinuation of Payment for Services**

Once a personal services arrangement that meets the personal services arrangement exception expires by its terms, three possible scenarios can take place. Under the first scenario, the health care provider (as did PRMC in the **Braun** case) may choose to discontinue payment for services to the physician (no agreement — no compensation). Despite the provider’s refusal to pay for services provided, however, the physician continues to provide services to the health care provider of the type specified in the expired agreement. (Moreover, the provider does not notify the physician to discontinue providing services of the type contemplated by the expired agreement.) In other words, the provider continues to receive services but does not compensate the provider for the services. What are the potential legal consequences if this takes place (Scenario #1)?

In Scenario #1, the provider (as did PRMC in **Braun**) runs the risk of becoming
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responsible to pay for the value of the services provided by the physician at the fair market value of the services. The fair market value of the services provided after expiration of the services agreement may be different than the compensation payable under the expired agreement. Most jurisdictions will require payment for services under the legal theory that it is unjust for the provider of services not to receive compensation for services rendered. Since the provider did not pay the physician for services rendered, however, it is unlikely that it violated the Stark law by not paying for the services. (In *Braun*, the court goes further and indicates that even by paying for services, no Stark violation has taken place.)

**Contract Expiration: Scenario #2 — The Physician’s Discontinuation of Services**

The second potential consequence of the expiration of a compensation arrangement is the physician’s refusal to provide services under the terminated agreement. From a legal standpoint, the physician does not have any responsibility to continue providing services to the health care provider after expiration of the compensation arrangement. In other words, the physician’s position is “no contract — no services.” By discontinuing services, the physician has not breached any written agreement with the health care provider, and no oral agreement has been reached for the continued provision of services.

From the health care provider’s perspective, the discontinuation of the provision of services by the physician does not create any legal liability issues vis-à-vis the physician. Moreover, since there is no compensation arrangement with the physician, the provider need not be concerned about the applicability of the Stark law to its relationship with the physician. The health care provider, however, may be in violation of other legal or regulatory requirements. For example, as a condition of participation in the Medicare program, the Centers for Medicare & Medicaid Services (CMS) may require that the provider have a medical director. The inability to bill Medicare for health care services will create severe adverse financial consequences to the provider.

**Contract Expiration: Scenario #3 — Continued Payment for Services Provided**

There is one additional scenario that could take place after expiration of a compensation arrangement that meets the personal services arrangement exception to the Stark law. Since the health care provider still needs the services of the physician (to meet regulatory requirements, for example), it may continue to accept the services. Because the physician may need the compensation from the provider to meet its operating expenses, the parties may choose to continue the compensation arrangement even after it expires by its terms. In other words, the provider may continue paying the physician for services rendered at the same rate as was specified in the now expired compensation arrangement. Does this create any problems for either the provider or the physician?

From the provider’s perspective, it is unlikely that the provider has any exposure for failure to pay the physician the fair market value for the services provided by the physician. The provider can point to the continued provision of services by the physician and the physician’s cashing of the post-expiration checks for services rendered. If the physician felt that the payment was inadequate for services rendered after expiration of the written agreement, why did the physician deposit the checks promptly upon receipt from the provider? It is likely that the physician will be “estopped” (a legal term that precludes taking a position by reason of the actions or inactions) from asserting that the compensation was inadequate.

However, what about the “illegality” of the compensation arrangement under the Stark law? The District Judge in *Braun* concluded that the claim for unjust enrichment did not constitute an agreement be-
between Braun and PRMC that would be illegal under the Stark law. "A ‘compensation arrangement’ under the Stark Act is a kind of an agreement between a physician and a health care entity. It is not an equitable remedy imposed by a court to prevent unjust enrichment. Therefore, plaintiff’s unjust enrichment claim will not necessarily violate the Stark Act if it requires the court to engage in a fiction at law where there has been no agreement between the physician and a health care entity."

In *Braun*, the court required PRMC to pay Dr. Braun compensation as if an agreement had been in place. Applying the same logic to Scenario #3 (continued payment and continued services), if the provider does not pay for services (as did PRMC in *Braun*), it would be subject to a claim for unjust enrichment from the physician. Thus, by paying compensation to the physician, the provider avoids the claim of unjust enrichment and, under the District Judge’s reasoning, avoids any problems with the arrangement also falling outside of the Stark law (personal services arrangement must be in writing).

In summary, Scenario #3 is the safest approach from both the provider's and the physician's perspective. The physician, however, will likely be estopped from claiming entitlement to compensation for sums above that which the health care provider pays the physician and that are accepted by the physician for services provided.

**LESSONS LEARNED FROM BRAUN**

In negotiations with physicians and other providers of services, health care providers should take heed of the *Braun* decision — particularly as to an expiring service arrangement or contract that the recipient of services wants to terminate. In the *Braun* case, if the hospital did not want to pay Dr. Braun for medical director services after it had terminated his employment agreement, it should have obtained services of the type provided by Dr. Braun from another physician for an agreed upon compensation under a written agreement that met a Stark safe harbor.

The decision by the District Judge did not answer the question of why the hospital continued to utilize Dr. Braun’s services without paying for same. This case also serves as a reminder to hospitals and other health care providers that bill Medicare or other governmental payors to make certain that, both as part of their policies and in practice, written agreements that comply with the Stark and anti-kickback safe harbors are in place with all referral sources to which the hospital or service provider also pays for services rendered.
Finally, the health care provider should consider carefully the potential collateral consequences of not receiving services of the type called for under an expiring or terminated personal services arrangement. For example, the provider may be legally required to have a medical director who provides supervisory services at the facility that the provider owns and operates. If the contractual relationship between the hospital or other facility and the physician is not required to be in writing, then Scenario #3 might be the safest approach for the provider — pay the entity that previously provided services at the rate of compensation provided in the expiring agreement.

Regardless, health care providers and physicians should be extremely careful in discussions with physicians that are parties to expired or expiring services arrangements. Risks abound on both sides of the negotiating table.