



How Much Is Too Much? Hospital's Excessive Pay to Employed Physicians Leads to Costly Stark Settlement

By William H. Maruca



An Iowa hospital has reached a deal with the Justice Department to pay \$4.5 million to settle a false claims dispute alleging Stark Law violations arising out of its compensation

arrangements with five employed physicians. The case, which reportedly began in 2005 with complaints from the health system's competitors, raises significant issues about the threshold beyond which a physician's salary may cross the line into illegality.

According to the Justice Department's press release, Covenant Medical Center in Waterloo, Iowa, was accused of violating the Stark Law by paying commercially unreasonable compensation, far above fair market value, to five employed physicians who referred their patients to Covenant for treatment. These physicians were allegedly among the highest paid hospital-employed physicians not just in Iowa, but in the entire United States. Two of the five physicians were reportedly each paid more than \$2 million per year. The employed physicians included neurosurgeons, orthopedic surgeons and gastroenterologists and were not named in the settlement. U.S. Attorney Matt Dummermuth told the *Des Moines Register* that none of the doctors would face sanctions under the matter.

By entering into settlement agreement (available [here](#)), the hospital denies any wrongdoing and contends that the compensation it paid to the five employed physicians was consistent with the fair market value of the services provided by those physicians.

A competing private practice, Cedar Valley Medical Specialists, had noted that the salaries paid by Covenant were more than triple the salaries paid to comparable physicians by Minnesota's Mayo Clinic. The salaries were disclosed publicly in the health system's Form 990 tax filings.

Stark Employment Exception

The Stark physician self-referral law prohibits physicians from referring Medicare patients to providers of any of a dozen designated health services (DHS), including hospital inpatient and outpatient services, if the physician or a family member has a financial relationship with the DHS provider that does not meet an exception. The Stark law and its final regulations carve out amounts paid by an employer to a physician (or immediate family member) who has a bona fide employment relationship with the employer for the provision of services if the following conditions are met:

- (1) The employment is for identifiable services.
- (2) The amount of the remuneration under the employment is:
 - (i) Consistent with the fair market value of the services; and
 - (ii) Except [for certain productivity bonus arrangements], is not determined in a manner that takes into account (directly or indirectly) the volume or value of any referrals by the referring physician.
- (3) The remuneration is provided under an agreement that would be commercially reasonable even if no referrals were made to the employer.

Productivity bonuses based on services performed personally by the physician (or immediate family member of the physician) are permissible. In newspaper interviews, the hospital's CEO had defended the salaries as justifiable because of the unusually heavy workload of the physicians.

The Stark law is a "strict liability" statute, meaning that if all elements of an exception are not met, "close enough" is not an adequate defense, and no improper intent need be established. The elements of the Stark exception that may have been in question are whether the pay was consistent with fair market value and whether it was commercially reasonable in the absence of referrals. Without a full trial, we can only speculate what evidence the hospital would have produced to support its fair market value and commercial reasonableness analysis and what evidence the government would have used to challenge it. Nevertheless, it is fair to say that a thorough, independent compensation analysis performed at the time the contracts were entered into could have provided significant protection.

Government enforcement of Stark has been erratic, and generally Stark counts have been tacked onto other false claims allegations as part of *qui tam* whistle-blower cases brought by private parties such as disgruntled competitors or employees. There is no indication that this matter involved any such whistle-blower litigation, and it is possible that Cedar Valley may have been precluded from bringing such an action because of its own public complaints that appeared in the newspaper. A *qui tam* whistle-blower (referred to as a "relator"

Staying Well Within the Law

under the False Claims Act) must be the original source of information establishing a violation, and facts or allegations that have appeared in the media may not support the original source requirement.

Anti-Kickback Exception

The Medicare and Medicaid Anti-Kickback statute (AKS) provides criminal and civil penalties for individuals or entities that knowingly and willfully offer, pay, solicit or receive remuneration in order to induce business reimbursable under the federal or state health care programs. There is a corresponding exception under the AKS, which provides:

“... “remuneration” does not include any amount paid by an employer to an employee, who has a bona fide employment relationship with the employer, for employment in the furnishing of any item or service for which payment may be made in whole or in part under Medicare, Medicaid or other Federal health care programs.”

Note that only amounts paid for furnishing covered items or services, i.e., actual hands-on patient care, are protected under this exception. Also, the U.S. Court of Appeals for the Third Circuit has adopted the “one purpose” doctrine under which if one purpose of a payment is to induce referrals, it is illegal regardless of whether it is based on fair market value.

Generally, it is more difficult to prove the requisite intent to establish a violation of

the AKS, but in a 2005 interview with the *Des Moines Register*, Covenant’s CEO, responding to Cedar Valley’s complaints about the hospital’s excessive pay arrangements, was reported as stating that the doctors’ pay was based on a formula that takes the amount of business they brought to the institution and subtracts expenses. It is not clear whether this was an accurate quote or paraphrase, but if it was, it may have provided evidence of intent to induce the physicians to “bring business” to the hospital, i.e., make referrals.

Tax Considerations

Left unspoken is whether the hospital or the physicians may face additional liability under the Internal Revenue Code’s excessive compensation rules for nonprofits. The intermediate sanctions provisions of Section 4958 of the Code define an excess benefit transaction as when a disqualified person receives improper personal gain from the exempt organization. Rather than revoking the charity’s tax-exempt status, Section 4958 allows the IRS to impose an excise tax against the disqualified person and the organization manager who approved the transaction. A “disqualified person” is any person who was in a position to exercise substantial influence over the affairs of the tax-exempt organization. In the health care setting, physicians may be disqualified persons, depending upon their extent of influence or control due to positions such as chief of staff, department head or other medical staff appointment.

The IRS has stated that in determining whether physician compensation is excessive, the exempt organization should provide assurance that the total compensation package provided to a physician (base salary, bonuses and benefits) is reasonable for the physician’s specialty and area. Generally, compensation is more likely to be reasonable if it is established at arm’s length by an independent board of directors or committee subject to a conflict of interest policy and is based on current compensation studies of similarly situated employees in similar geographic locales.

“Pigs Get Fat, Hogs Get Slaughtered”

Nearly every physician wants to be paid the maximum amount he or she is worth. (I have known a few altruistic exceptions.) Hospitals that want to lock up their most profitable physicians may be willing to pay what it takes. Both physicians and hospitals need to recognize the risks of pushing the envelope too far. If a compensation scheme is off the charts, the parties should consider how they would respond to a challenge and do their homework in advance, including commissioning a compensation survey that supports the arrangement.

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