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Legal Matters

Medicare Prescription Drug Act Targets Specialty Hospitals

By Nora Liggett, for HealthLeaders News, Jan. 5, 2004

The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (the Medicare Drug Act), which was signed into law on December 8, 2003, contains significant restrictions on physician ownership in specialty hospitals.

The Medicare Drug Act amends the federal physician self-referral law (the Stark Law) to prevent physician investors in new specialty hospitals from taking advantage of one of the most important exceptions to the Stark Law. The Stark Law prohibits physicians who own interests in certain categories of providers (including hospitals) from referring Medicare or Medicaid patients to those providers, unless their ownership fits within an exception. Prior to the passage of the Medicare Drug Act, many physicians were able to own interests in hospitals under an exception to the Stark Law known as the "whole hospital exception." The whole hospital exception allows a physician to refer Medicare patients to a hospital in which he owns an interest as long as the physician has privileges to practice at the hospital and as long as his ownership is in the whole hospital, not just a department of the hospital.

In recent years, the whole hospital exception has come under attack. Many physicians invest in facilities that are licensed by the state as hospitals, but that do not generally provide the full range of services traditionally provided by community hospitals. Many of these newer physician-owned hospitals specialize in certain services, such as orthopedic services or surgery services, which are generally considered to be reimbursed by Medicare at a higher rate than some of the more general emergency or inpatient services regularly provided by community hospitals. Community hospitals have complained that specialty hospitals have an unfair advantage over traditional hospitals. Community hospitals argue that specialty hospitals are "skimming" the profitable procedures, leaving general acute care hospitals to provide the less lucrative patient care needs of the community.

In an apparent response to this complaint, the Medicare Drug Act amends the Stark Law by placing a moratorium on new physician investments in specialty hospitals for a period of 18 months. "Specialty hospitals" are defined as hospitals devoted primarily or exclusively to the care of:

- Patients with cardiac conditions;
- Patients with orthopedic conditions;
- Patients receiving surgical procedures; or
- Any other specialized category of services that the Secretary of Health and Human Services determines is inconsistent with the purpose of the whole hospital exception.

Specialty hospitals that were either in existence or already under development on November 18, 2003 will not be subject to the 18 month moratorium and consequently can still fit with the whole hospital exception to Stark, as long as:

- The number of physician investors does not increase after November 18, 2003;
- The types of specialty services to be provided by the hospital does not change after November 18, 2003; and
- The number of beds in the specialty hospital does not increase after November 18, 2003 by more than 5 beds or 5 percent, whichever is greater.

In determining whether a hospital was "under development" as of November 18, 2003, the Secretary of Health and Human Services will consider any relevant evidence, including whether state regulatory permits or approvals have been obtained, whether financing has been secured, and whether architectural plans for the hospital have been finalized.

In addition to the 18 month moratorium on new specialty hospitals, the Medicare Drug Act requires the Medicare Payment Advisory Commission (MedPac) and Health and Human Services (HHS) to conduct studies of the efficiency, cost, and outcomes of specialty hospitals and to submit reports, along with recommendations for any needed legislative or regulatory changes, to Congress within 15 months of the date the Medicare Drug Act became law.

The moratorium on physician interests in specialty hospitals is seen by some as a boon to general acute care and community hospitals, which have been aggressively lobbying for restrictions on physician ownership in specialty hospitals. Many in the general hospital industry are hoping that the MedPac and HHS reports to Congress will result in Congress' decision to extend the 18-month moratorium into a permanent ban on physician ownership in specialty hospitals. However, it is uncertain at this time what will happen at the end of the 18-month moratorium period. The specialty hospital industry may use this period as an opportunity to actively promote the advantages of specialty hospitals. If the MedPac and HHS reports to Congress show improved outcomes and lower costs of services at specialty hospitals, Congress will be unlikely to extend the moratorium. On the other hand, if the reports paint an unfavorable picture of specialty hospitals, future legislative or regulatory changes could extend the 18-month moratorium into a permanent restriction.

(The opinions expressed in this bulletin are intended for general guidance only. They are not intended as recommendations for specific situations. As always, readers should consult a qualified attorney for specific legal guidance.)

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