

# Hospital Focused Legal Update

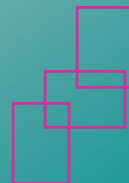
Spring Managed Care Forum

Dale C. Van Demark

April 24, 2009

## Hospital Focused Legal Update/Overview

- Effects of the recent economic developments
- Continued scrutiny regarding tax exemption
- Update on gainsharing
- Current trends in clinical integration
- Context - Community boards



## Hospital Focused Legal Update/Community Board

- Community board requirement is a part of the community benefit standard
  - Promotion of health is charitable purpose
  - Operations must benefit the “community as a whole”
  - “Independent civic leadership” deemed important
- Community board is one in which a majority is independent
- Who is not “independent”
  - Affiliated physicians
  - Officers
  - Employees

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## Hospital Focused Legal Update/Community Board

- Increasing scrutiny / increasing responsibilities:
  - Sarbanes-Oxley
    - Nonprofit health systems that proactively adopt Sarbanes-Oxley principles “will accrue qualitative benefits associated with better financial and managerial reporting” which is likely to result in higher credit ratings.
      - Fitch Report (August 2005): “Sarbanes-Oxley and Not-For-Profit Hospitals: Increased Transparency and Improved Accountability”

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## Hospital Focused Legal Update/Community Board

- Sarbanes-Oxley (cont'd)
  - Strong hospital governance and management can mitigate risks associated with the recent down-turn and help to avoid a rating downgrade
    - Moody's Report, April 14, 2009
- Governance
  - “The Internal Revenue Service believes that a well-governed charity is more likely to obey the tax laws, safeguard charitable assets, and serve charitable interest than one with poor or lax governance.”
    - IRS Guidance: “Governance and Related Topics – 501(c)(3) Organizations” ([http://www.irs.gov/pub/irs-tege/governance\\_practices.pdf](http://www.irs.gov/pub/irs-tege/governance_practices.pdf)) posted February, 2008

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## Hospital Focused Legal Update/Community Board

- Oversight
  - Compliance
    - “[A] director’s obligation includes a duty to attempt in good faith to assure that a corporate information and reporting system, which the Board concludes is adequate, exists, and that failure to do so under some circumstances, may, in theory at least, render a director liable for losses caused by non-compliance with applicable legal standards.” - *Caremark*
    - “Corporate Responsibility and Corporate Compliance: A Resource for Health Care Boards of Directors,” OIG and AHLA
    - “An Integrated Approach to Corporate Compliance: A Resource for Health Care Organization Boards of Directors,” OIG and AHLA

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## Hospital Focused Legal Update/Community Board

### – Oversight (cont'd)

- Compliance (cont'd)
  - Recent Eli Lilly CIA requiring standards for compliance oversight by board
- “With a new era of focus on quality and patient safety rapidly emerging, oversight of quality also is becoming more clearly recognized as a core fiduciary responsibility of health care organization directors.”
  - “Corporate Responsibility and Health Care Quality: A Resource for Health Care Boards of Directors,”  
OIG and AHLA

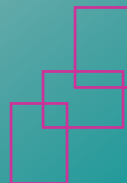


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## Hospital Focused Legal Update/Community Board

### – Best Practices:

- “Best practices” - sources
  - Nonprofit Sector
  - IRS
  - Senate Finance Committee
  - Law Firms/Bar Associations
- “Best practices” – scope
  - Compliance driven
  - Duty of care
- “Best practices” best practices
  - Balance



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## Hospital Focused Legal Update/Economic Developments

- The Bad News:
  - Direct impact of financial market crisis – sophisticated financing techniques to lower the cost of borrower, and provide comfort to the market, are disappearing
    - Monoline insurer ratings drops
      - Increases the cost of financing – lower rated hospitals cannot benefit from the delta between higher rated insurer and themselves
    - Auction rate securities market collapse
      - Increase interest rate on hospital ARS
    - Calls on variable rate demand bonds
    - Consequences:
      - Immediate issues regarding increased costs
      - Fewer options for new financing arrangements

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## Hospital Focused Legal Update/Economic Developments

- The Bad News (cont'd):
  - Direct impact of financial market crisis – losses on investments
  - Impact of the broader economic downturn
    - Loss of jobs
      - Decreases private insurance coverage; Increases safety net program participation (Medicaid)
        - Lower reimbursement
        - Susceptible to cuts (California and Massachusetts)
      - Increase in charity care patients, bad debts
      - Deferral of elective procedures
        - Decreases revenue
        - Increases ER visits

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## Hospital Focused Legal Update/Economic Developments

- The Bad News (cont'd):
  - Ratings agencies are downgrading hospitals
    - Moody's U.S. Public Finance Special Comment (December 2008) identified factors:
      - Decreases in clinical revenue
      - Increased competition for insured patients
      - Increase in charity care and bad debt
      - Liquidity declines due to losses on investments
      - Increased risk of violations of liquidity covenants in financing arrangements
      - Increased leverage due to aggressive capital investment strategies

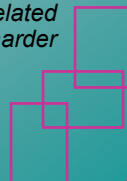


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## Hospital Focused Legal Update/Economic Developments

- The Bad News (cont'd):
  - Standard & Poor's Commentary Report (January, 2009):

*“Not unlike a patient struggling with multiple ailments, health care providers are facing operating, financial, and economic conditions that are more severe than in 2008 and certainly worse than the preceding years. To be sure, fundamental operating trends, such as weaker revenues, slower growth in inpatient volumes, tight labor markets, and rising capital and operating costs were already evident prior to 2008. In our opinion, the weak investment markets and recession have only accelerated the pressure on this sector. And emerging challenges such as rising pension costs and state budget stress, with the related impact on Medicaid rates and eligibility, will make it even harder for the sector to stay healthy.”*



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## Hospital Focused Legal Update/Economic Developments

- The Bad News (cont'd):
  - Effects are being felt:
    - American Hospital Association Trendwatch: The Economic Downturn and Its Impact on Hospitals (January, 2009)
      - 96% - uncertainty about future economics very or somewhat important factor in decision to stop capital projects
      - 84% - decline in operating performance very or somewhat important factor in decision to stop capital projects
      - 83% - unavailability of usual sources of capital very or somewhat important factor in decision to stop capital projects
      - 76% - decline in value of reserves very or somewhat important factor in decision to stop capital projects

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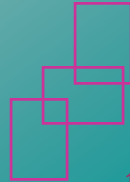
## Hospital Focused Legal Update/Economic Developments

- The Good News:
  - Recent consensus is that the recession is stabilizing
  - Financing arrangement options may be more limited, but they are more insulated from certain broader market troubles

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## Hospital Focused Legal Update/Economic Developments

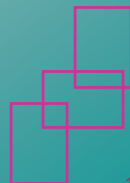
- Legal Risk Areas:
  - Fiduciary obligations of directors requires attention to financial issues in context of charitable mission
    - Balance between charitable mission and financial position
    - Keep in mind: Increased public demand for exemption to be linked with charity care
  - Compliance with debt covenants



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## Hospital Focused Legal Update/Economic Developments

- Legal Risk Areas (cont'd):
  - Insolvency
    - Board owes fiduciary obligation to creditors
      - Tension – creditors interests (financial) and hospital mission (charitable)
    - Bankruptcy
      - Generally, chapter 11 (to maintain operations during workout)
      - Patient care ombudsman (to report on quality)



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## Hospital Focused Legal Update/Tax Exemption

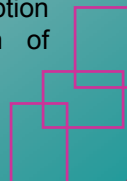
- Federal Exemption
  - Organized and Operated
  - Areas of increased attention:
    - Executive compensation
    - Community benefit
  - Increased scrutiny methods:
    - New 1023
    - New 990



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## Hospital Focused Legal Update/Tax Exemption

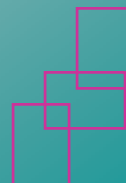
- Executive Compensation
  - Focus of the IRS for many years
  - Significant compliance issue
    - Rebuttable presumption promotes compliance
      - Board oversight and defined process to set compensation
      - Independence in oversight
    - The good news: IRS Exempt Organization (TE/GE) Hospital Compliance Project Final Report (2009) – “Nearly all hospitals in the study reported complying with key elements of the rebuttable presumption procedure available to establish compensation of certain executives and disqualified persons.”



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## Hospital Focused Legal Update/Tax Exemption

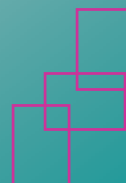
- Executive Compensation (cont'd):
  - The bad news: IRS Exempt Organization (TE/GE) Hospital Compliance Project Final Report (2009) – “More work must be done to assess the impact that the rebuttable presumption procedure (including the use of for profit comparables) and the initial contract exception. . . are having on establishing executive compensation amounts *and the ability of the IRS to challenge compensation paid by many tax-exempt organizations.*” (emphasis added)



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## Hospital Focused Legal Update/Tax Exemption

- Executive Compensation (cont'd):
  - Investigation and Enforcement:
    - Compliance check/“soft audit” letters
    - 990 Schedule J
    - (Survey/reports (IRS, GAO))
  - Areas of concern:
    - Rebuttable presumption compliance
    - All compensation counted:
      - Spousal travel
      - Car allowances
      - Club membership

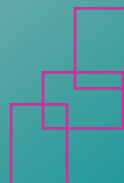


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## Hospital Focused Legal Update/Tax Exemption

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- Executive Compensation (cont'd):
  - Keys for community boards:
    - Reasonableness of compensation is a compliance matter, which means it is a board-level matter
    - To avoid problems:
      - Comply with the rebuttable presumption protocols

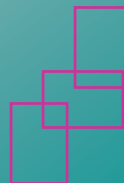


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## Hospital Focused Legal Update/Tax Exemption

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- Community Benefit
  - The legal standard for determining whether a hospital satisfies requirements for exemption:
    - Maintain an emergency room open to all regardless of ability to pay (not an absolute requirement)
    - Provision of non-emergency care to all able to pay, themselves, through insurance or public programs
    - Participation in Medicare and Medicaid programs
    - Community board
    - Maintain an open medical staff
    - Application of surplus funds to improving facilities, equipment, patient care, medical training, research and education



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## Hospital Focused Legal Update/Tax Exemption

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- Community Benefit (cont'd):
  - Standard for at least 40 years
  - Recent scrutiny from Congress (notably Senator Grassely and others)
  - Competing “best practices” for quantification
    - Catholic Health Association (supported by Senator Grassley)
    - American Hospital Association
      - Key differences
        - Counts bad debt and Medicare shortfalls

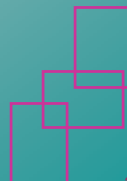


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## Hospital Focused Legal Update/Tax Exemption

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- Community Benefit (cont'd):
  - Reporting (Schedule H, Form 990)
    - Reporting on broad range of activities, policies and costs
    - Reporting to the community



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## Hospital Focused Legal Update/Tax Exemption

- Community Benefit (cont'd):
  - IRS Exempt Organization (TE/GE) Hospital Compliance Project Final Report (2009)
    - Most recent in a long line of investigations
    - Context
      - Rev Rul 69-545 – continued application
        - Some, but minor modification from administrative guidance
        - Supported, though critiqued by case-law as recently as 2003
        - Since 2004, Congress has been reviewing/investigating charities and questioning the community benefit standard
      - Hints of possible congressional modifications of community benefit standard

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## Hospital Focused Legal Update/Tax Exemption

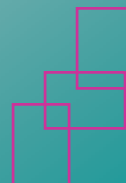
- Community Benefit (cont'd):
  - Fundamental policy issue: what benefit do tax exempt organizations provide to receive tax exempt status?
  - Push toward charity care
    - Terminology
    - Easy to understand and explore
    - Not a basis for exemption in and of itself – still a policy issue on Federal level
  - Why the report is important
    - Findings indicate a clear distinction between type of hospital (e.g., critical access, large urban, research focused) and amount and type of community benefit
    - Highlights the benefits (from an analysis perspective) of the Schedule H information that will be gathered

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## Hospital Focused Legal Update/Tax Exemption

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- Community Benefit (cont'd):
  - Keys for Community Boards
    - Regular review of community benefit calculation and reporting (state, Federal and community)
    - Monitor

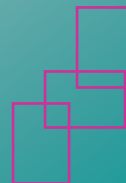


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## Hospital Focused Legal Update/Tax Exemption

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- State and local scrutiny
  - Different standards for exemption
    - Charity care more of a focus
      - Utah, Pennsylvania, Texas
    - Can have statutory, regulatory or constitutional components
    - Varied reporting requirements
  - Many examples of state level challenges
    - Illinois – Provena, lots of publicity



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## Hospital Focused Legal Update/Tax Exemption

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- State and local scrutiny
  - Continued investigation and challenges likely

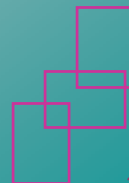


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## Hospital Focused Legal Update/Gainsharing

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- “Gainsharing” – arrangement in which a hospital gives physicians a share of reductions in hospital’s costs attributable to a physician’s efforts
- Multiple gainsharing models
  - Should be thought of in the larger context of clinical integration approaches
  - Incentive payment programs v. shared savings programs (proposed Stark regulations)



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## Hospital Focused Legal Update/Gainsharing

- Primary Federal statutes affecting gainsharing:
  - Civil Monetary Penalty
    - Prohibits hospital from knowingly making a payment to a physician as an inducement to reduce or limited services to Medicare/Medicaid beneficiary who is under physician's care
  - Stark Law
    - Prohibits physicians from referring Medicare patients for DHS to entities with which physician has a financial relationship
    - Numerous exceptions; none that squarely protects gainsharing or quality incentive programs – proposals published
    - No CMS advisory opinions

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## Hospital Focused Legal Update/Gainsharing

- Primary Federal statutes affecting gainsharing (cont'd):
  - Anti-Kickback Statute
    - Prohibits knowing and willful solicitation or receipt of remuneration, directly or indirectly, in return for referral
    - Voluntary safe-harbors
  - Other potentially applicable statutory schemes
    - Tax exempt law (sharing of profits concern)
    - False Claims Act (bootstrapping)

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## Hospital Focused Legal Update/Gainsharing

- **OIG Guidance (Advisory Opinions)**
  - **Primary concerns:**
    - Stinting on care
    - Quality maintenance
    - Selective patient intake
    - Early discharge
  - **Helpful features**
    - Cost-saving features clearly defined
    - Credible medical support
    - Not disproportionate to Medicare/Medicaid payments
    - Objective historical clinical measures
    - Disclosure to patients
    - Objective parameters to avoid cherry-picking
    - Reasonable limitation of duration and amount of incentives
    - Payments are on a per capita basis
    - Physicians already on staff

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## Hospital Focused Legal Update/Gainsharing

- **OIG Guidance (Advisory Opinions)**
  - **Problematic features**
    - Lack of demonstrable connection between individual actions and cost reduction
    - Individual actions not specifically identified
    - Insufficient safeguards (quality)
    - Quality indicators questionable
    - No independent verification of impact on quality

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## Hospital Focused Legal Update/Gainsharing

- Other government actions
  - Medicare Prescription Drug, Improvement, and Modernization Act of 2003
    - Medicare Health Care Quality Demonstration
    - Determine whether “gainsharing is an effective means of aligning financial incentives to enhance quality and efficiency of care across an entire system of care
  - Deficit Reduction Act of 2005
    - Multiple gainsharing demonstration projects
    - Test and evaluate methodologies and arrangements between hospitals and physicians designed to govern the utilization of inpatient hospital resources and physician work
  - Acute Care Episode Initiative (2009)
    - Bundled payments
  - CMS Proposals

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## Hospital Focused Legal Update/Gainsharing

- CMS Proposals Key Factors:
  - Objective medical evidence and independent review
  - Participating physicians and payment amounts
  - Cost savings for shared savings programs
  - Protecting quality of care
  - Documentation
  - Sharing of global savings

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## Hospital Focused Legal Update/Clinical Integration

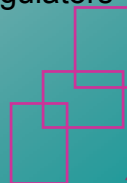
- “Clinical Integration” – very broad term that can include:
  - Gainsharing and other compensation programs designed to align performance and pay
  - Joint ventures among providers
  - Employment of physicians
  - Physician governance



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## Hospital Focused Legal Update/Clinical Integration

- Recent trend is for more clinical integration between health systems and physicians
  - “Clinic” model
  - Physician employment
  - Some movement toward simplicity
- Antitrust laws
  - Greater enforcement
  - Clinical integration still can satisfy regulators (TriState Health Partners, Inc.)



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## Hospital Focused Legal Update/Clinical Integration & Gainsharing

- Regulatory environment:
  - Government as purchaser/Government as regulator
    - Encourage innovation v. Control behavior
    - Reduce costs v. Increase costs
  - Variety of sources of law – each directed at a different issue:
    - Stark; Anti-Kickback; Tax Exempt; Antitrust; HIPPA; State licensure; Medicare/Medicaid reimbursement
    - Applicable safe harbors and exceptions do not overlap; directed at narrow issue



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## Hospital Focused Legal Update/Clinical Integration & Gainsharing

- Keys for community boards:
  - Increased OIG scrutiny and evolving regulatory environment:
    - Compliance – active oversight
  - Efficiency and quality goals:
    - Avenues are available
    - Integrated approach to clinical integration



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# Hospital Focused Legal Update

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Questions?

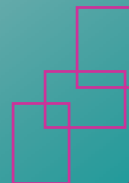


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# Hospital Focused Legal Update

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Dale C. Van Demark  
Partner  
dvandemark@EBGLAW.COM  
(202) 861- 4187



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