OIG Advisory Bulletin on “Contractual Joint Ventures”

Turn-Key Management Agreements Singled Out

By Amy E. Cella

In its Special Advisory Bulletin of April 23, 2003 (the “Bulletin”), the Office of Inspector General (“OIG”) identified certain “contractual joint ventures” involving a captive referral base that may violate the anti-kickback statute. The Bulletin expresses OIG’s suspicion of turn-key management agreements between two existing providers where the manager is also a competing supplier of Medicare reimbursable items or services.

Focus of Bulletin

The Bulletin focuses on arrangements where a provider, such as a hospital (referred to here as “Hospital X”), has a captive referral base and another entity, such as a DME company, mail order pharmacy or dialysis services company (referred to here as “Company Z”), is an existing provider of Medicare reimbursable goods or services that independently bills the Medicare program. Hospital X does not currently provide the services contemplated for the new business. Hospital X and Company Z enter into a turn-key management agreement where Company Z provides virtually all of the operational elements of the business: capital, employees, supplies and accounting/billing. Hospital X bills under its provider number. Hospital X pays Company Z a “management fee” for these comprehensive turn-key services with the practical result that Hospital X and Company Z divide the profit from the service.

OIG questions whether the arrangement includes illegal remuneration under the anti-kickback statute. Specifically, OIG focuses on the difference between the price Hospital X pays for the items from Company Z and the amount Hospital X receives from Medicare for those items. OIG contends that this difference is remuneration offered by Company Z in exchange for Hospital X’s patients from its captive referral base. OIG cautions that such remuneration is unavailable for safe harbor protection and will subject the entire arrangement to scrutiny; in effect, treating this turn-key management arrangement as a sham.

What Does it Mean?

The Bulletin has produced a fair amount of concern and confusion. However, it can be boiled down to a fairly simple analogy to the fundamentals of the anti-kickback statute.

The anti-kickback statute would prevent Hospital X from channeling all of its DME referrals to Company Z in return for a share of Company Z’s profit; a classic kickback. Similarly, the Bulletin can be read to say that Hospital X and Company Z are not permitted to do the same thing by dressing it up as a turn-key management agreement where Company Z provides the DME and distribution know-how as a “manager” of Hospital X’s new DME service or subsidiary. Under this management agreement, Company Z is entirely capable of running the business on its own, but instead the return from the business is apportioned to the parties under the management agreement. OIG sees the portion of the profit retained by Hospital X as Company Z’s payment for the captive referral stream that comes from Hospital X.

Just as OIG sought to caution against sham joint ventures in 1989 in its “Special Fraud Alert on Joint Venture Arrangements,” here it appears the effort is to launch a caution about management agreements that, in OIG’s view, simply disguise a kickback. The key question, however, is to distinguish when the management arrangement is a sham, and when it is an appropriate business relationship. We have tried to distill some of those factors below in the section titled “Elements of a Suspect Management Agreement.”

OIG Perspective

The Bulletin uses the DME arrangement, described above, to highlight its suspicions of comprehensive management contracts under the anti-kickback statute. OIG states that Company Z impermissibly provides Hospital X with an opportunity to earn a fee from its captive referral base by entering into the exclusive management arrangement with Company Z. Even if relevant safe harbors are met for the component agreements (management, staffing, purchased items), OIG considers the “opportunity” Hospital X has in the arrangement to earn a portion of the DME reimbursement to be a separate form of remuneration. OIG considers this remuneration as a separate “payment” from Company Z to Hospital X that does not fall within
the four corners of the safe harbors that protect the component agreements. This “opportunity,” according to the OIG, cannot qualify for its own safe harbor protection.

Elements of a Suspect Management Agreement

Hospital X
- captive referral base
- new line of business
- no investment in inventory or equipment
- no capital contribution
- no provision of employees, billing services or management
- Medicare provider number used for the "contractual joint venture" business

Company Z
- existing supplier of items or services
- independently bills the Medicare program under its own Medicare provider number for separate business
- provides all items and services necessary to operate business substantially similar to its own competing business
- provides all employees necessary to manage business substantially similar to its own competing business

Tips to Ensure Compliance
- Monitor Negotiations. Initial contacts between the potential manager and the provider are important. Intent can be established from how the arrangement was initially described.
- Limit the Extent of Relationship With the Manager or Supplier. If a provider enters into a management contract but invests its own capital in the new inventory, or if a provider enters into a supply contract for inventory but manages and operates the business itself, the arrangement would not rise to the level of a contractual joint venture and the Bulletin should not apply.
- Term of Agreement. The length of the term of the agreement may be an important factor in determining the intent of the parties. According to one former OIG official, a limited term agreement where a hospital transitions into the “management role” would not raise as much suspicion as a 10 year management agreement with a potential competitor.

Conclusion
The Bulletin virtually condemns turnkey management agreements where the owner does not provide the new line of business with more than a captive referral base and a Medicare billing number. Seen is this light, the Bulletin will only apply to a small class of management arrangements. The Bulletin does not address partnerships, limited liability companies or give any indication how its criteria would be applied to outpatient surgery joint ventures.

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Interesting Additional Issues
- Safe Harbors Not Enough. OIG’s statement that carving out different aspects of the relationship into separate contracts and qualifying each contract under a safe harbor may still leave the parties vulnerable to an anti-kickback violation could be interpreted to mean that the OIG is attempting to lessen the protection the safe harbors currently afford. OIG does not actually say that arrangements that squarely meet one or more safe harbors will still risk prosecution. Instead, OIG warns providers that coming close to, but not meeting each, requirement of the safe harbor will subject the arrangement to a facts and circumstances test. OIG further warns that parties should be aware that each separate exchange of remuneration must qualify for safe harbor protection or satisfy the facts and circumstances test. To this end, OIG warned that it will consider all contracts between the parties to determine the intent of the arrangement – and will not limit any enforcement review to the four corners of one document. Perhaps most important, OIG warns that the “opportunity to earn a fee” may itself be a separate transaction element much like in the 1989 Bay State Ambulance case.

- Discount Safe Harbor. OIG describes the unavailability of the discount safe harbor to protect discounts Company Z provides to Hospital X when purchasing items in connection with the management contract. OIG reasons that the discount may not be an arms-length transaction if offered as part of the parties’ common business relationship.

- New Line of Business. OIG’s reliance on the owner establishing a new line of business has created some confusion. Given the underlying message against sham arrangements, it seems possible that a transfer by the owner of its existing line of business
### Interesting Additional Issues (cont.)

To the manager would still trigger the heightened suspicion regardless of whether the line of business is new or existing. The key element for this analysis should be whether the owner completely divests itself of all actual control and financial exposure.

- **Legal Structure.** Commentators have raised the distinction between the new business being organized as a subsidiary of the owner or as an internal division. The Bulletin expressly states “The new business line may be organized as a part of the existing entity or as a separate subsidiary.” Either way, the key is whether the business is designed to capitalize on the owner’s existing referral base.

- **Trend to Scrutinize Management Agreements.** Some commentators have suggested that OIG has increased suspicion of all management agreements. However, the coincidence of timing of OIG’s release of the Bulletin and Advisory Opinion 03-8, which focused on percentage compensation arrangements, is just that—a coincidence. The fundamental issues in the releases are different and should not be read as a heightened scrutiny for management agreements *per se*.

- **Antitrust Underpinnings.** OIG describes one of the harmful effects of kickbacks as “unfair competition…freezing out competitors unwilling to pay kickbacks.” A thread throughout the Bulletin is the manager as a “would be competitor” of the new business. OIG’s suggestion that one purpose of the anti-kickback statute is to protect competition and deter unfair business practices appears to be beyond the scope of Congress’ intent in enacting the statute, as well as OIG’s authority.

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