Percentage Payments Under New Stark II Regulations

Since its enactment, the Stark legislation has included several exceptions that specifically require compensation to be "set in advance." The meaning of the term "set in advance," and the ability to use percentage payment formulas have been hotly debated ever since. Many have argued that so long as the compensation methodology is set in advance (e.g., a fixed percentage compensation arrangement), the exception's "set in advance" requirement is met.

In its recently issued "final" Stark II regulations, HCFA goes a long way in providing a clear definition of what "set in advance" means. However, HCFA’s new regulations will put the brakes on many percentage-based payment formulas involving physicians.

Percentage payment arrangements have been widely used in healthcare settings:

- Payment to physician groups in "foundation" model integrated organizations;
- Payment to physicians under hospital directorship agreements; and
- Payment to physicians under other hospital professional services agreements.

In attempting to create a bright line test HCFA has given concrete new guidance in this area. Most arrangements about which there was uncertainty are now resolved, with the result that some common percentage payment formulas — such as percent of net or gross revenue — are banned.

"Set In Advance"

The term "set in advance" is now more specifically defined in the final regulations:

"Compensation will be considered 'set in advance' if the aggregate compensation or a time-based or per unit of service-based (whether per-use or per-service) amount is set in advance in the initial agreement between the parties in sufficient detail so that it can be objectively verified."

"Percentage compensation arrangements do not constitute compensation, that is 'set in advance' in which the percentage compensation is based on fluctuating or indeterminate measures or in which the arrangement results in the seller receiving different payment amounts for the same service from the same purchaser."1

Permitted Variable Payments

It is now clear that payments do not literally need to be fixed in advance at a single amount for the duration of the agreement. The following payment methodologies are expressly permitted.

1. Per Service Fee. The example given in the commentary is a percentage based on a fee schedule where there is a single fixed fee for each service, e.g., a fee based on a uniform charge master. If a physician has a contract with a hospital and is paid on a fixed percentage of the charge master fee schedule for each service, the arrangement will be permitted.2

In theory, some percent of net or gross contracts could be translated to this form of payment.

2. Per Use Payment. A hospital could lease equipment to a physician on a per use basis, assuming there is a lease arrangement in place that meets the Stark rental exception. In the commentary, HCFA concedes that a hospital can lease equipment to a physician on a per use basis, even when the physician is generating the referrals.3 Presumably, the converse is true; a physician group could lease equipment to a hospital with the lease paid on a per use basis, even in circumstances where the physicians may be using the equipment or referring to the department.

3. Per Time Period. A lease of space which is less than full-time, but which specifies the particular time period of use is permissible. Such a lease would also have to meet the Stark rental exception for space.4

Prohibited Variable Payments

In the commentary, HCFA states that compensation based on a percentage of a fluctuating amount "such as revenues, collections, or expenses, is not fixed in advance."5 Although only in commentary, this statement is consistent with the applicable regulation language. Consequently, the most typical percentage payment arrangements are now prohibited unless they fit within another

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exception or other structural factors protect the parties.

For example, payments under a professional services arrangement formulated as a percentage of gross billings from a foundation model hospital subsidiary to a referring medical group might be prohibited if designated health services are involved and other exceptions do not apply. The theory that a percentage payment might be permissible as long as the percentage itself is fixed in advance is no longer sustainable. Therefore, arrangements that depended in whole or in part on that position now require review.

Beyond the Bright Line

Not all percentage of net or gross payments will be prohibited. Some arrangements will fall within the "unrelated remuneration" exception, or perhaps an employment or group practice exception. Percentage arrangements based upon a percentage of charges set out in a fixed fee schedule may be acceptable since per-service fee arrangements are now considered set in advance. However, the new fair market value exception will not help, as it contains the set in advance standard.

Some arrangements may be shielded by breaks in an a series of indirect financial relationships, or the application of other exceptions that may apply at another point in a "chain" of financial relationships (both subjects of an upcoming update on the new Stark regulations).

Timing – When are Fixes Due?

As proposed, the new regulations take effect January 4, 2002, in part to give parties time to assure compliance. Assuming that elements of Phase II of these regulations do not modify substance or timing, and that the new Administration does not alter course on Stark, issues related to existing percentage payment arrangements that may be impacted by the new regulations should be resolved before the effective date.


For questions or assistance, we encourage you to contact the Paul Hastings attorney with whom you work to discuss this matter, or: Dan Higgins in our San Francisco office at (415) 835-1632, or via e-mail at danhiggins@paulhastings.com; Ken Yood in our Los Angeles office at (213) 683-6110, or via e-mail at kennethyood@paulhastings.com; Sandy Golze in our San Francisco office at (415) 835-1653, or via e-mail at sandygolze@paulhastings.com; Melinda Hayes in our Los Angeles office at (213) 683-6193, or via e-mail at melindahayes@paulhastings.com; Jim Owens in our Los Angeles office at (213) 683-6191, or via e-mail at jamesowens@paulhastings.com; or Gayl Westendorf in our San Francisco office at (415) 835-1600, or via e-mail at gaylwesterdorfpaulhastings.com.

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