



WHEN HOSPITALS HIRE PHYSICIANS

This article is excerpted from the chapter "Direct Employment," in *Linking Hospitals and Physicians: A Values-Based Guide to Legal Structures*,



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published by the Catholic Health Association. The book's primary authors are Sr. Jean deBlois, CSJ, PhD, vice president, Mission Services, Catholic Health Association, St. Louis; and Lisa J. Gilden, JD, partner, McDermott Will & Emory, Washington, DC. *Linking Hospitals and Physicians* supplies practical guidance for those involved in structuring partnerships between healthcare organizations and physicians, including hospital and network leadership teams, physicians, attorneys, mission leaders, ethicists, healthcare sponsors,



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managed care executives, and trustees. For ordering information, see the advertisement on the inside front cover, or call 1-314-253-3458.

In the direct employment model the hospital purchases one or more physicians' tangible assets and, possibly, their goodwill. Rather than creating a separate entity, however, the hospital directly employs the physicians to provide medical services, usually at the same locations where they practiced before the acquisition. In many cases the physicians' offices become part of the hospital's outpatient department.

The hospital enters into employment agreements with each of the physicians. The hospital provides all the personnel, space, equipment, and

Elements of the Direct Employment Model

supplies the physicians need to provide the medical services, and the hospital bills and collects for such services under its provider number. Since both physician and hospital care are provided through the same corporate entity, "full integration" is achieved.

Mission Signpost *It is imperative that Catholic organizations and physicians adequately explore their common goals and expectations before they reach an employment agreement. It is also important that the Catholic hospital know something of the practice patterns, employment procedures, and billing and collection practices of physicians it hopes to employ. Moreover, the hospital should have some discussion with the office personnel of potential physician employees, since they will likely become part of the Catholic hospital's staff under the employment agreement. In all discussions preceding execution of an employment agreement, the Catholic organization's values and operating principles should be fully explained and the implications for medical practice explored. In addition, physicians and staff that become employees of the Catholic hospital should be assured of fair, respectful employment practices and procedures.*

A variation on the direct employment model is sometimes used in states that permit tax-exempt entities other than hospitals to employ physicians. In this variation, another tax-exempt entity in the hospital system employs the physicians, rather than the hospital employing them directly. In this case, the tax-exempt organization bills and collects for the services of its employed physicians.

Mission Signpost *Although the employment model is widely used, little critical thought seems to have been given to questions this model raises for physicians as professionals. Hospitals should consider*



questions such as the following before employing physicians: Does employing physicians undermine their primary allegiance to patients? Does employment afford physicians the autonomy needed for professional practice? When physicians are asked to circumscribe certain practices as a condition of employment (e.g., prescriptions for contraceptives or referrals for tubal ligations), is the hospital establishing unrealistic expectations that physicians cannot meet? What mechanisms could be put in place to support the fiduciary nature of the patient-physician relationship?

CORPORATE STRUCTURE

In most cases, rather than forming a new entity, the existing hospital corporation employs the physicians. Often the hospital sets up a "physician services division" within its existing corporation to operate the physicians' practices. However, as noted previously, where state law permits, some hospitals have formed separate tax-exempt organizations to directly employ the physicians.

GOVERNANCE

When the hospital employs the physicians, the hospital's board of directors holds ultimate responsibility for the physicians' services. Since the hospital is tax exempt, it is required to have a community board. Under the IRS's most recent position, no more than 49 percent of the hospital's board can consist of interested physicians and hospital managers. The remaining 51 percent must be independent civic leaders.

Historically, many tax-exempt hospitals' boards have not had a significant number of physician members. Some hospitals directly employing physicians have designated one or two board seats for representatives of the employed physicians. More often, to address physician concerns, hospitals have created medical affairs and other committees made up of representatives of the employed physicians. The IRS accepts these committees as long as they do not participate in determining physician compensation.

When the physicians are employed by a separate tax-exempt organization, the board of directors of that organization must be structured to comply with the IRS rules discussed in the section on governance of clinics. Physicians are permitted to serve on the board as long as a tax-exempt organization with the community board has a controlling relationship with the organization *and* physicians are not involved in compensation decisions.

CORPORATE PRACTICE OF MEDICINE ISSUES

Many states adhere to the corporate practice of medicine doctrine, which precludes a corporation

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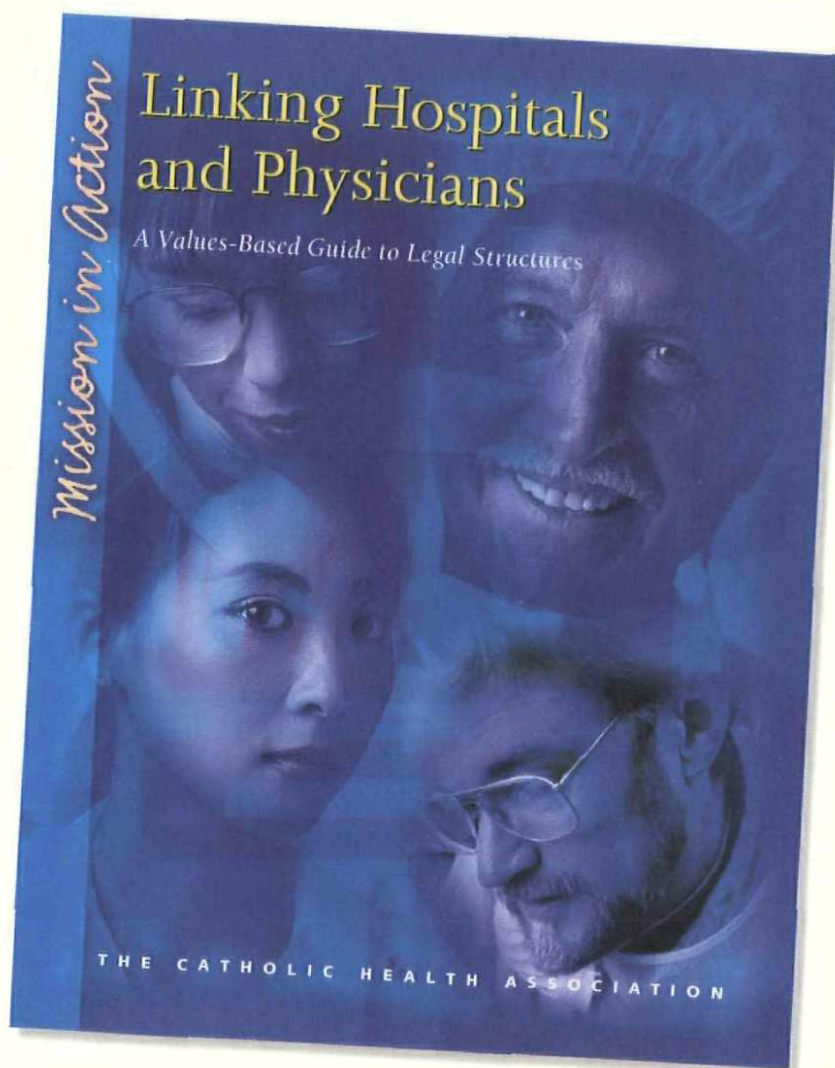
other than a professional corporation from employing physicians. In states that do not recognize an exception for hospitals or other tax-exempt organizations, the direct employment model is not available.

MEDICARE FRAUD AND ABUSE/STARK LAW ISSUES

Several Medicare fraud and abuse and Stark law provisions are important to tax-exempt organizations directly employing physicians:

- Organizations must pay a fair market price for the physicians' assets.
- The Stark law expressly permits paying an employed physician a productivity bonus for services the physician personally provides, although it generally prohibits payments based on the volume or value of referrals.

Mission Signpost *If productivity bonuses are to be used, it is important to define reasonable*





parameters for productivity to ensure behaviors that promote and express commitment to patient and community well-being. In any event, total physician compensation should be reasonable.

- When the hospital is the employer, it can require the physicians it employs to refer patients to the hospital if the referral is consistent with the patient's medical needs.

TAX-EXEMPTION ISSUES

To protect its tax-exempt status, the tax-exempt organization's payments for the physicians' assets and services must be at fair market value and at reasonable levels.

The organization should obtain an appraisal of the assets to support the price paid. If the organization pays physicians a productivity bonus, it should take steps to ensure that the total amount paid to any physician falls within the range of reasonable compensation.

The tax-exempt organization must continue to provide community benefits, as evidenced by provision of emergency services open to all, charity care and community outreach, and services based on assessment of community need.

LICENSURE ISSUES

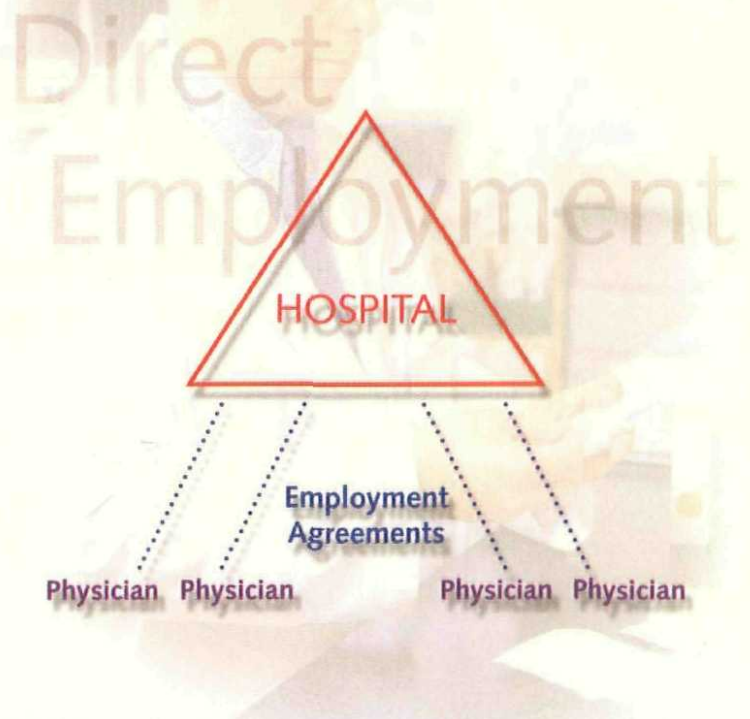
When the employed physicians are operating as an outpatient department of the hospital, the hospital should determine how hospital licensure laws will apply to the physicians' offices. Some state laws require off-site offices to meet "hospital standards," including strict physical space and equipment requirements, which may be difficult for an office located in a medical office building. When the physicians are to be employed by a separate tax-exempt organization, some states require the organization to obtain licensure as a "clinic."

REIMBURSEMENT ISSUES

In some situations, Medicare and Medicaid reimbursement for hospital-based physicians may be less than that of physicians located elsewhere. If a hospital is planning to employ the physicians directly, it should determine whether the proposed structure will lower physician reimbursement.

EMPLOYEE BENEFITS ISSUES

Those hospitals employing physicians directly may consider creating deferred compensation plans for employed physicians to make up for benefits they lose when they join the same benefit plans offered to other hospital employees. Before establishing deferred compensation plans, hospitals should obtain expert advice on the complex rules governing them. □



DIRECT EMPLOYMENT MODEL

ADVANTAGES

- This model can be less complex than others if no new legal entity is formed to employ the physicians.
- The model is fully integrated.
- When the hospital employs the physicians, it may bill directly and collect for physician services and, in most situations, require physicians to refer patients to the hospital.
- Employment agreements can

ensure that values-based, needed services be provided to persons and communities in need.

DISADVANTAGES

- Physicians are often reluctant to become hospital employees because they fear limits on their autonomy (which is why some hospitals form separate tax-exempt organizations to employ the physicians).

- When physicians are hospital employees, they will not have a board separate from the hospital board, although the hospital may form an advisory committee to address physician issues.

- When physicians are hospital employees, their office locations may have difficulty complying with hospital licensure issues.

- The hospital is responsible for all activities within the medical practice.