O
ne of the most impactful

things an ambulatory surgery
center (ASC) can do to con-
tinue to grow and develop the center
is to bring in new physician partners
through the sale of equity. In addition
to the numerous business, operational
and inter-personal considerations in-
volved with identifying appropriate
physician partners and selling shares
to such partners, there are a variety of
key legal considerations that any ASC
should also keep in mind. This article
addresses such considerations, includ-
ing federal and state anti-kickback
laws, state and federal securities laws
and other legal considerations.

I. FOUR CORE CONCEPTS

Subsequent sections of this article will
address the legal rationale for these
core concepts in greater detail, but
ASCs can go a long way toward ensur-
ing appropriately structured sales of
shares if they are mindful of the follow-
ing four concepts:

1. Physician investors who refer pa-
tients to the ASC should ideally not
be passive indirect referral sources.
2. Physician investors should invest
real capital and take real business
risk on their investment.
3. Physician investors should pay fair
market value for their shares.
4. The terms of investment for physi-
cian investors should not be tied in
any way to the volume or value of
their referrals to the ASC.

II. FEDERAL AND STATE FRAUD
& ABUSE CONSIDERATIONS

The Federal Anti-kickback Statute

The most relevant federal statute ap-
licable to ASCs is the Federal Anti-
Kickback Statute, 42
U.S.C. § 1320a-7b(b),
which generally pro-
hibits anyone from
offering, paying, so-
liciting, or providing
anything of value
(i.e., remuneration)
to another person
in exchange for the
referral of healthcare
business to another
person or entity. The
concept of re-
muneration under
the Anti-Kickback
Statute has been de-

fined broadly to prohibit several types
of payments, discounts or transfers
of anything of value in exchange
for referrals.
A violation of the Anti-Kickback Statute is considered a felony, and individuals or providers who violate the Statute may be subject to penalties, including fines of up to Twenty-Five Thousand Dollars ($25,000) per violation, imprisonment for up to five (5) years, or both. Additionally, the Secretary of the Department of Health and Human Services (DHHS) has the authority to exclude providers, including individuals or entities, who have committed any of the prohibited acts, from participation in the Medicare or Medicaid programs.

**The ASC Ownership Safe Harbor**

When selling shares to physicians in an ASC, ensuring compliance with the Anti-Kickback Statute is critical. In 1999, the Office of Inspector General (OIG) promulgated the “ASC Ownership Safe Harbor” regulations.

There are actually four different “ASC Ownership Safe Harbors”, based on a different ownership structure (physician-hospital JV, physician only JV, multispecialty JV and single specialty JV), but there are numerous common elements among all four variations of the ASC Ownership Safe Harbors.

Joint ventures that are structured consistent with all elements of the applicable ASC Ownership Safe Harbor are deemed immune from prosecution under the Anti-Kickback Statute as to certain ownership issues. Thus, ASC companies generally strive to ensure that their joint ventures, including the sale of shares to physicians, are structured in accordance with the ASC Ownership Safe Harbor.

The core qualitative elements of the ASC Ownership Safe Harbor are as follows:

1. The terms on which an investment interest is offered to an investor must not be related to the previous or expected volume of referrals, services furnished, or the amount of business otherwise generated from that investor to the entity.
2. The entity or any investor (or other individual or entity acting on behalf of the entity or any investor) must not loan funds to or guarantee a loan for an investor if the investor uses any part of such loan to obtain the investment interest.
3. The amount of payment to an investor in return for the investment must be directly proportional to the amount of the capital investment (including the fair market value of any pre-operational services rendered) of that investor.
4. All ancillary services for federal healthcare program beneficiaries performed at the entity must be directly and integrally related to primary procedures performed at the entity, and none may be separately billed to Medicare or other federal healthcare programs.
5. The entity and any surgeon investors must treat patients receiving medical benefits or assistance under any federal healthcare program in a non-discriminatory manner.

In addition to these requirements, there are two quantitative elements most commonly referred to as the “one-third tests”. The one-third tests are as follows:

1. For solely surgeon-owned or single-specialty ASCs, the physician investor must generate not less than one-third of his or her professional income from the performance of ambulatory surgical procedures listed on the Medicare ASC list in order for the ASC Ownership structure to receive Safe Harbor protection.
2. For multi-specialty surgery centers, an investor must meet the one-third professional-income test noted in above (1.) and must also perform not less than one-third of his or her ASC procedures at the ASC in which he or she invests. This is intended to ensure that certain physicians who do not perform services are not being rewarded for the efforts of other physicians or their referrals to other physicians who do perform procedures at the ASC. The OIG’s concern is that such parties refer to the other surgeons and are receiving the benefits of returns from the surgery center due to their indirect referrals.

**OIG Commentary Relating to ASC Ownership**

The OIG has commented negatively on situations where the value of services or items is discounted to a party who is a referral source in exchange for referrals by the party in both its commentary related to the ASC Safe Harbor and the small entity investments Safe Harbor and through Special Fraud Alerts. The OIG has specifically discussed its concern being that a return on investment is a disguised payment for referrals, including situations where shares in the entity to which a physician refers patients are sold to the physician for a nominal value and returns on investment can be over 50% to 100%.

In addition to the ASC Ownership Safe Harbor, the OIG has stated in its commentary that certain “legitimate ASC arrangements may not fit precisely in the final ASC Ownership Safe Harbor. Those that do not fit may be eligible for Safe Harbor protection under the small entity investments Safe Harbor.”

In discussing small entity investments Safe Harbor and the capital invest-
ments made by investors, the OIG has stated:

We do believe, however, that it is useful to analyze joint ventures on a case-by-case basis to determine what the real capital needs of the project are, and whether the capital that has been invested is merely a sham to pay investors for referrals.²

The OIG issued a “Special Fraud Alert” relating to health care joint ventures and the Anti-Kickback Statute in 1989. In the Special Fraud Alert, the OIG identified the features of what it perceived as “suspect” joint ventures under the Anti-Kickback Statute. Specifically, with respect to “Financing and Profit Distribution,” the OIG identified the following as indicators of potentially unlawful activity:

1. The amount of capital invested by the physician may be disproportionately small and the returns on investment may be disproportionately large when compared to a typical investment in a new business enterprise;
2. Physician investors may invest only a nominal amount, such as $500 to $1,500;
3. Physician investors may be permitted to ‘borrow’ the amount of the ‘investment’ from the entity, and pay it back through deductions from profit distributions, thus eliminating even the need to contribute cash to the partnership;
4. Investors may be paid extraordinary returns on the investment in comparison with the risk involved, often well over 50 to 100 percent per year.³

Don’t Forget About State Law!

In addition to the Federal Anti-kickback Statute, most states have additional kickback and fee-splitting laws that should be considered when structuring ASC share sales. While these statutes often closely track the federal law, some states do place more onerous requirements on physician investors, such as requiring certain precise wording when disclosing ownership to patients who are referred to the ASC.

III. THE IMPORTANCE OF FAIR MARKET VALUE

It is important that all shares to physician investors be sold at fair market value. As noted above, this requirement comes straight out of the ASC Ownership Safe Harbor, and there has been growing attention on the critical importance of fair market value sales in recent years.

There is no single correct way that an ASC company must calculate share price in order for the sale to be deemed fair market value. Many ASC companies effectively utilize market data and certain common approaches to the calculation of share price, such as a multiple of historical EBITDA (earnings before deductions for interest, taxes, depreciation and amortization). However, there has been increasing attention on the value of greater precision in determining such share prices, and many ASC companies have moved toward utilizing third-party valuation companies to make such determinations.

In 2001, several complaints were filed against Columbia HCA by the United States joining parties in bringing qui tam actions (commonly referred to as “whistleblower suits”). These complaints related in part to the sale of interests to physicians in hospitals and included allegations of sham investments. One example of alleged illegal action claimed by the government and relator in the suit was that despite advice of counsel that “if partnership interests were acquired at below fair market value or for nominal consideration (e.g., nonrecourse notes), the rate of return on investment could appear unreasonably high, thereby raising the implication that the return on investment is, in part, payment for patient admissions or referrals to the Hospitals,” certain HCA executives “offered and provided investments to physicians at minimal or no out of pocket cost to the physicians for the express purpose of inducing referrals.”

Even more recently, in September 2014 Meridian Surgical Partners, LLC settled a qui tam lawsuit (i.e. a “whistleblower suit”) alleging, among other things, that Meridian sold shares to physician investors for below fair market value in its Treasure Coast Surgery Center joint venture. Although Meridian denied such claims, and although the settlement with the government of $3.32 million was a small fraction of the $100 million originally demanded, the attention that the government and judge in such lawsuit gave to the determination of fair market value was illuminating. Both the government prosecutors and the judge stressed how valuable third party valuation would have been to substantiate Meridian’s claim that the shares were really fair market value.

IV. SECURITIES LAWS CONSIDERATIONS

The sale of shares to physicians in an ASC should also be structured consistent with federal and state securities laws as the shares will, in many cases and depending on numerous factors, be considered the sale of securities that would otherwise trigger an obligation to register such securities sales with federal and state securities commissions unless certain federal and state exemptions to such registration requirements are met.
ASC companies should examine federal and state securities laws with the goal of meeting such exemptions from registration, which exemptions are typically available for small offerings to a limited group of potential investors meeting certain characteristics. One of the most critical elements of meeting most available exemptions is the provision of full and proper disclosures to the potential investors of the salient details of investment, as well as the risks of investment.

V. COMMON PITFALLS IN THE SALE OF SHARES

The following list of actions are common pitfalls that some ASC companies can face when selling shares to physicians. Different ASC companies utilize different strategies for the sale of shares effectively, and there is certainly no one right way to structure the sale of shares; however, these actions should generally be avoided:

1. Do not offer less or more shares or a higher or lower price based on the number, volume or value of referrals a physician can generate.

2. Do not reallocate shares based on the volume or value of referrals.

3. Do not focus on individual distributions being tied to the number of patient referrals. Never make any indications that could lead a potential investor to believe that referrals or performance will determine an individual’s “piece of the pie.” Focus on overall distributions and profits.

4. Physicians should not be allowed to invest based upon the fact that they can generate referrals for another physician who may use the center.

5. Avoid providing physicians with estimates as to the amount of revenue that will be generated from their referrals or from another physician’s referrals.

6. Do not offer remuneration or special treatment under various disguises, such as directorship contracts or discounted lease arrangements, in order to induce investors.

7. Do not pressure physician investors to shift their referral patterns.

8. Do not make indications to investors that low-referring physicians will be pressured to withdraw.

9. And of course, shares should be sold at fair market value!

VI. ADDITIONAL NOTES AND CONCLUSIONS

Finally, it should be noted that this article assumes a joint venture structure whereby the investing physicians are all surgeons and are investing as individuals directly in the JV entity. As the healthcare industry continues to see physician practices consolidate into larger groups or become acquired by hospitals, and as physicians gravitate toward IPAs and similar risk-bearing organizations, such larger groups and risk-bearing organizations are beginning to look at investment in ASCs in unique and effective ways. Such investment typically falls outside of the ASC Ownership Safe Harbor, meaning that the investment is not immune from prosecution under the Anti-kickback Statute, but that does not necessarily mean that such investment violates the Anti-kickback Statute.

ASCs considering such novel approaches to ownership would be wise to consider the four core fundamental concepts underlying the Anti-kickback Statute (noted in Section I) no matter which entity or individual is investing to enhance the likelihood of the ownership structure being deemed compliant with federal and state law.1

1. 64 Fed. Reg. 63536.


3. The 1989 Special Fraud Alert was reprinted in the Federal Register in 1994. See 59 FR 65372 (December 19, 1994).