[We redact certain identifying information and certain potentially privileged, confidential, or proprietary information associated with the individual or entity, unless otherwise approved by the requestors.]

[name and address redacted]

Re: Advisory Opinion No. CMS-AO-2005-08-01

Dear [name redacted]:

We are writing in response to your request for an advisory opinion regarding the interests of physician-shareholders in [name redacted] (the "Practice"), a nonprofit, tax-exempt multi-specialty group medical practice. Specifically, you seek a determination that the stock held by the physician-shareholders is not an ownership or investment interest in the Practice and, thus, does not constitute a financial relationship that could potentially restrict the physician-shareholders' referrals or the submission of claims for Medicare designated health services under section 1877(a) of the Social Security Act (the "Act").

You have certified that all of the information provided in your request, including all supplementary materials and documentation, is true and correct and constitutes a complete description of the relevant facts and agreements among the parties. In issuing this opinion, we have relied solely on the facts and information presented to us. We have not undertaken an independent investigation of this information. If material facts have not been disclosed or have been misrepresented, this advisory opinion is without force and effect.

Based on the unique facts certified in your request for an advisory opinion and supplemental submissions, we conclude that the stock held by physician-shareholders of the Practice does not constitute an ownership or investment interest for purposes of section 1877(a) of the Act (42 U.S.C. § 1395nn(a)). We express no opinion regarding compliance with any other provision of Section 1877 as it applies to the Practice or any of the physician-shareholders.

This opinion may not be relied on by any persons other than [name redacted], the requestor of this opinion (the "Requestor"), and is further qualified as set forth in section IV below and in 42 C.F.R. §§ 411.370 through 411.389.

I. FACTUAL BACKGROUND

The Practice is a large independent, nonprofit group medical practice that owns and operates outpatient clinical, educational and research sites in 34 [state name redacted (hereinafter "State")] communities. The Practice employs more than 700 physicians, representing 86 different medical specialties.

In [year redacted], the Practice was organized under [State business corporation law (hereinafter "Chapter A")] which, at the time, provided for the issuance of capital stock,

regardless of a corporation's nonprofit status. Although [State law was] subsequently amended to provide for nonstock corporations, the Practice continues to exist validly under and is governed by the provisions of [Chapter A], its articles of incorporation, and form of organization.[1] These documents require that the Practice be organized and operated as a charitable corporation with all of its assets held in a charitable trust.

In [year redacted], the Practice was granted exemption from federal income taxation under section 501(c)(3) of the Internal Revenue Code. Based on its charitable, nonprofit status, the Practice is also exempt from [State] income taxation.

Physician employees who meet clinical and citizenship standards may become shareholders after two years of full-time employment. A qualifying physician may acquire one non-transferable share of the Practice's stock for $1,000.[2] If a physician-shareholder leaves the Practice, he or she must return the share of stock, and the Practice returns the physician's $1,000 purchase price without interest. The Requestor has certified that there are no dividends paid on practice stock, either overtly or disguised as part of the salaries or other compensation paid to the physician-shareholders. The stock ownership entitles the physician-shareholder to a vote on matters pertaining to the Practice.

Physicians who acquire Practice stock must sign the Practice's *Agreement by and Among Physician Shareholders* and the *Contract of Regular Employment*. These documents, along with the Practice's articles of incorporation and bylaws, require, *inter alia*, that the tangible property of the Practice be perpetually owned by the Practice and its successors free and clear of the claims of the physician-shareholders, that the physician-shareholders shall have no claim to the assets of the Practice except the right of the return of their original investment, and that no distribution shall be made to any physician-shareholder in excess of the return of his or her original investment. In addition, should the physician-shareholders determine to dissolve the Practice, all assets of the Practice (after payment of outstanding liabilities) shall be transferred to educational, scientific, or charitable organizations selected by a majority vote of the physician-shareholders.

II. LEGAL ANALYSIS

A. Law

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[1] The [statutory amendments] added a new Chapter [(hereinafter "Chapter B")] providing for nonstock corporations and "grandfathered" nonprofit corporations established prior to [date redacted], to permit a corporation established under [Chapter A] to continue valid existence under [Chapter A] to the extent that the provisions of [that Chapter] are not inconsistent with the articles of incorporation and form of the organization of the corporation.

[2] There has been no change in the price of a share since the inception of the Practice in [year redacted].

Under section 1877 of the Act (42 U.S.C. § 1395nn), a physician may not refer a Medicare patient for certain designated health services ("DHS") to an entity with which the physician (or an immediate family member of the physician) has a financial relationship unless an exception applies.[3] Section 1877 also prohibits the entity furnishing the DHS from submitting claims to Medicare, the beneficiary, or any other entity for Medicare DHS that are furnished as a result of a prohibited referral. A financial relationship includes both ownership or investment interests and compensation arrangements. CMS regulations provide that stock ownership constitutes an ownership or investment interest. 42 C.F.R. § 411.354(b)(1).

Section 1877 enumerates several exceptions to both ownership or investment interest and compensation arrangement prohibitions. Entities that violate the statute are subject to denial of payment of all DHS claims, refund of amounts collected for DHS claims, and civil money penalties for knowing violations of the prohibition. Violations may also be pursued under the False Claims Act, 31 U.S.C. §§ 3729 through 3733.

B. Analysis

The primary issue raised by the Requestor is whether the purchase of stock by the physician-shareholders results in an ownership or investment interest for purposes of section 1877(a) of the Act. Based on the combination of the factors discussed below, we conclude that the stock held by the physician-shareholders under [applicable provisions of State business corporation law] does not constitute a financial relationship between the parties or implicate the provisions of section 1877 limiting referrals by the physician-shareholders to the Practice or the submission of claims for Medicare DHS by the Practice. In these circumstances, the physician-shareholders in the Practice are essentially similar to members in a nonprofit corporation and their stock holdings in the Practice under [Chapter A] bear none of the financial attributes or benefits typical of an ownership or investment interest**.**

1. The stock held by the physician-shareholders exhibits none of the benefits typical of stock ownership.

Although the physician-shareholders nominally purchase "shares" in the Practice, they do so as a formality under the singular terms of [Chapter A] and do not receive any of the purchase and ownership rights or financial risks and benefits typically associated with stock ownership. The purchase and ownership rights related to Practice stock are restricted in such a way that a physician-shareholder's financial interests cannot be affected by his or her ownership of the stock (apart from the initial $1,000 expenditure).

Continually since [year redacted], when the Practice was incorporated, the par value of a share of stock has been $1,000. Stock value neither appreciates nor depreciates; it is

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[3] In 1993, the physician self-referral prohibition was made applicable to the Medicaid program. 42 U.S.C. § 1396b(s).

unaffected by the financial performance of the Practice as a whole or any of its physician-shareholders. There are no dividends paid on Practice stock, either overtly or disguised as part of the salaries or other compensation paid to the physician-shareholders.

A share of stock gives a physician only a vote. Shares of stock in the Practice are non-transferable. Physicians are permitted to purchase only one share of stock and it must be returned to the Practice (interest-free, for the original purchase price of $1,000) upon termination of the physician-shareholder's employment with the Practice or his or her failure to meet the clinical and citizenship requirements for shareholder status. The physician-shareholders in the Practice are essentially similar to members in a nonprofit corporation.[4]

2. Physician-shareholders have no right to distribution of the net income, assets or profits of the Practice.

The Practice has been granted tax-exempt status under section 501(c)(3) of the Internal Revenue Code and [State] law. These laws prohibit the inurement of the net earnings of the Practice to any private shareholder or individual. While the Practice is in operation, its assets are held in trust for the sole use of the Practice in the furtherance of its charitable purposes. In the event of dissolution, 100 percent of the Practice's assets (net of outstanding obligations) must be distributed to educational, scientific, or charitable organizations. None of the assets will be distributed to individual physician-shareholders. Accordingly, the physician-shareholders lack the pecuniary incentive to enhance their investment interests normally held by purchasers of stock in for-profit corporations.

We note that similar arrangements involving substantially the same facts but with larger share prices or amounts of investment might produce a different result.

III. CONCLUSION

Based on the unique facts certified in your request for an advisory opinion and supplemental submissions, we conclude that the stock held by the physician-shareholders in the Practice does not constitute an ownership or investment interest (and, thus, does not create a financial relationship) for purposes of the physician self-referral prohibition in section 1877(a) of the Act. Pursuant to the advisory opinion process established in 42 C.F.R. §§ 411.370 through 411.389, when evaluating a business arrangement, CMS must determine (1) whether the arrangement described by the parties constitutes a financial arrangement that could potentially restrict a physician's referrals, and (2) whether the arrangement qualifies for any of the exceptions to the referral prohibition. Because we have determined that the stock held by the physician-shareholders in the Practice does not constitute a financial relationship that implicates the referral prohibition of section

[4] Pursuant to the interpretation adopted in the January 4, 2001 Final Rule, we do not regard being a member of a nonprofit corporation as an ownership or investment interest. 66 Fed. Reg. 856, 864 (Jan. 4, 2001); *see also*, 63 Fed. Reg. 1659, 1707 (Jan. 9, 1998).

1877(a), it is not necessary for us to evaluate the potential application of an exception to the statute. We have not considered, nor do we express an opinion about, any other relationship between the Practice, the physician-shareholders, or any other entity.

IV. LIMITATIONS

The limitations applicable to this opinion include the following:

- This advisory opinion is issued only to the Requestor of this opinion. This advisory opinion has no application to, and cannot be relied upon by, any other individual or entity.

- This advisory opinion may not be introduced into evidence in any matter involving an entity or individual that is not a requestor of this opinion.

- This advisory opinion is applicable only to the statutory provisions specifically noted above. No opinion is expressed or implied herein with respect to the application of any other Federal, state or local statute, rule, regulation, ordinance or other law that may be applicable to the Practice or the Requestor, including, without limitation, the Federal anti-kickback statute, section 1128B(b) of the Act (42 U.S.C. § 1320a-7b(b)).

- This advisory opinion will not bind or obligate any agency other than the U.S. Department of Health and Human Services. CMS reserves the right to reconsider the questions and issues raised in this advisory opinion and, where the public interest requires, rescind, modify or terminate this opinion.

- This advisory opinion is limited in scope to the specific arrangement described in this letter and has no applicability to other arrangements, even those which appear similar in nature or scope.

- No opinion is expressed herein regarding the liability of any party under the False Claims Act or other legal authorities for any improper billing, claims submission, cost reporting, or related conduct.

This opinion is also subject to any additional limitations set forth at 42 C.F.R. §§ 411.370 through 411.389.

Sincerely,

Herb B. Kuhn
Director
Center for Medicare Management