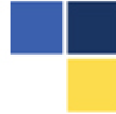
HINSHAW
& CULBERTSON LLP



Health Law ALERT

Federal Court Rejects Challenge to Physician-Owned Hospital Restrictions

August 23, 2012

The Stark Law generally prohibits a physician (or an immediate family member) from making a referral for “designated health services,” including inpatient and outpatient hospital services, covered by the Medicare program, to a hospital with which the physician has a “financial relationship” (i.e., an ownership, investment or compensation arrangement) unless an exception applies. However, it excludes an ownership or investment interest in a “whole hospital” from the definition of a financial relationship. The “whole-hospital exception” permits referring physicians to maintain ownership and investment interests in hospitals as long as: (1) the referring physician is authorized to perform services at the hospital; and (2) the referring physician’s ownership or investment interest is in the whole hospital itself, as opposed to merely a distinct part of the hospital. 42 U.S.C. § 1395nn(d)(3)

Section 6001 of the Patient Protection and Affordable Care Act eliminated the whole-hospital exception, but it grandfathered in existing facilities and new facilities that met certain requirements. In addition, Section 6001 prohibited physician-owned Medicare hospitals from expanding after March 23, 2010, and banned any new physician-owned Medicare hospitals that were not certified as Medicare providers prior to December 31, 2010.

Physician Hospitals of America (PHA) and Texas Spine & Joint Hospital (TSJH) jointly filed suit in the U.S. District Court for the Eastern District of Texas, challenging the constitutionality of Section 6001 of the Patient Protection and Affordable Health Care Act. PHA is a trade organization that supports physician-owned hospitals. TSJH had invested considerable resources in a planned $37 million 20-bed expansion and argued that Section 6001 unconstitutionally restricts it from continuing with the planned expansion. PHA and TSJH alleged that Section 6001 is exclusionary and unconstitutional, eliminates competition for nonphysician-owned hospitals, and will ultimately have a negative impact on patient choice and medical care affordability. Plaintiffs also alleged that Section 6001 violates their due process and equal protection rights under the Fifth Amendment, effects a retroactive taking of their real and personal property, is void for vagueness, and is contradictory.

In March 2011, the U.S. District Court for the Eastern District of Texas granted summary judgment in favor of the U.S. Department of Health and Human Services (HHS) Secretary, finding that the provision did not violate due process or equal protection, and did not constitute an unlawful taking. *Physician Hosps. of Am. v. Sebelius,* No. 6:10-cv-277 (E.D. Tex. Mar. 31, 2011).

The U.S. Court of Appeals for the Fifth Circuit vacated that ruling, but dismissed the case after concluding that plaintiffs had to exhaust administrative remedies before bringing their action in court. *Physician Hosps. of Am. V. Sebellius,* No. 11-40631 (5th Cir. Aug. 16, 2012). The Firth Circuit relied on federal exhaustion of administrative remedies requirements set forth by the U.S. Supreme Court in

Shalala v. Illinois Council on Long Term Care, Inc. 529 U.S. 1 (2000), which allow direct resort to the courts when requiring presentment and channeling through the agency "would mean no review at all." The Firth Circuit ruled that the *Illinois Council* exception does not include cases in which the exhaustion of administrative remedies would require extraordinary expenses that are unrecoverable if the plaintiff is unsuccessful after administrative and judicial review.

In light of this ruling, physician-owned hospitals will continue to have very limited opportunities for growth or expansion.

Physician Hosps. of Am. V. Sebellius, No. 11-40631 (5th Cir. Aug. 16, 2012)

For further information, please contact Michael A. Dowell or your regular Hinshaw attorney.

Hinshaw & Culbertson LLP prepares this publication to provide information on recent legal developments of interest to our readers. This publication is not intended to provide legal advice for a specific situation or to create an attorney-client relationship. We would be pleased to provide such legal assistance as you require on these and other subjects if you contact an editor of this publication or the firm.

Copyright © 2012 Hinshaw & Culbertson LLP. All Rights Reserved. No articles may be reprinted without the written permission of Hinshaw & Culbertson LLP, except that permission is hereby granted to subscriber law firms or companies to photocopy solely for internal use by their attorneys and staff.

ATTORNEY ADVERTISING pursuant to New York RPC 7.1. The choice of a lawyer is an important decision and should not be based solely upon advertisements.