

Practice Loss Postulate (PLP) Regulatory Trend Misapplies Economic Theory to Healthcare Integration

With the emergence of accountable care and value-based reimbursement models, which rely on achieving better outcomes at lower cost, U.S. hospitals are increasingly seeking more integrated relationships with physicians, including vertical integration strategies, such as direct employment and co-management arrangements.¹ In healthcare, a distinction is drawn between *vertical integration*, which “involves grouping organizations that provide different levels of care under one management umbrella,” and *horizontal consolidation*, “which integrates organizations providing similar levels of care under one management umbrella.”²

Corresponding with this growing trend toward vertical integration in healthcare delivery, there has been increased federal, state, and local regulatory scrutiny regarding the legal permissibility of these arrangements. Most notably, government regulators have, in some cases, challenged these transactions under various federal and state fraud and abuse laws, including the Stark Law and the Anti-Kickback Statute, such as *U.S. ex rel. Drakeford v. Tuomey Healthcare System*, as a harbinger case³, as well as, *U.S. ex rel. Parikh v. Citizens Medical Center*, *U.S. ex rel. Reilly v. North Broward Hospital District, et al.*, and *U.S. ex rel. Payne, et al. v. Adventist Health System, et al.*, basing their arguments, in part, on the concept that the acquisition of a physician practice, which then operates at a “book financial loss,” is, in and of itself, dispositive evidence of the hospital’s payment of consideration based on the volume and/or value of referrals.⁴ The underlying principle of this concept, termed the *Practice Loss Postulate (PLP)*,⁵ appears to be the allegation that hospitals enter into these arrangements in order to induce legally impermissible referrals from physicians, thus generating margins/profits that offset those “book financial losses” associated with the acquired physician practices.

In brief, the PLP treats vertically integrated physician practices as stand-alone economic enterprises, which, when stripped of their *ancillary service and technical component (ASTC)* revenue, and relying solely on professional services, i.e., *work relative value unit* related revenue, and paying physicians at *fair market value (FMV)*, are almost certain to generate “book financial losses”.⁶ Through the utilization of the PLP,

regulators are asserting the presupposition that *specific* and *immediate* “book financial losses,” from the operation of the professional practice of the employed physicians is not an *integration support payment*, i.e., a subsidy supporting *vertical integration*, based on the difference between physician compensation at FMV, coupled with practice overhead expenses, and collections on physicians’ professional services. Rather, the PLP asserts that the hospital’s sufferance of these “book financial losses” serves as dispositive evidence of the legally impermissible payment of compensation, remuneration, or consideration based on the volume and/or value of the hospital’s employed physician referrals of ASTC services to the hospital, which require a physician’s authority (i.e., the “*power of prescription*”) to order admission, diagnostic tests, drugs, *durable medical equipment*, and other services for their patients. Consequently, under the PLP, a “book financial loss” on a physician practice borne by a vertically integrated health system, when treating that practice as a stand-alone economic enterprise, is viewed as evidence of legally impermissible referrals under the Stark Law.

The current trend in the regulatory application of the PLP to challenge vertical integration in healthcare is misguided and imprudent. Specifically, the PLP is flawed from an economic perspective, primarily in that it: (1) does not meet the basic requirements for an *economic assumption*; (2) is unsupported by fundamental *economic principles*; and, (3) runs contrary to established and accepted *economic theory*. Additionally, the PLP represents a less than rational interpretation and application of the *commercial reasonableness* threshold, in that it focuses its analysis solely on the financial *quantitative* factors, e.g., *monetary (cash)* returns, and ignores the *qualitative* factors, e.g., the *avoidance of cost*, and the generation of *social benefit*. Should the PLP continue to evolve into accepted “*legal doctrine*,” and ultimately the “*law of the land*,” the result may be to impede the development of innovative new structures of emerging healthcare organizations to the extent that it would cause significant harm to the healthcare economy. This may include the loss of both: (1) operating cost-related efficiencies associated with *vertical integration*; and, (2) the qualitative benefits that *vertical integration* can

provide to a hospital's community in furtherance of its community benefit mission.

Future issues of this e-journal will explore this emerging regulatory topic in greater detail, as **HEALTH CAPITAL CONSULTANTS (HCC)** continues to prepare the current exposure draft for forthcoming publication in a peer-reviewed journal. Members of HCC's executive team have already presented this exposure draft. First, HCC **CEO Robert James Cimasi, MHA, ASA, FRICS, MCBA, CVA, CM&AA**, and HCC **Vice President & General Counsel Jessica Bailey-Wheaton, Esq.**, joined acclaimed healthcare attorney **David Grauer, Esq.**, a partner in the Columbus, Ohio, office of **Jones Day**, to present the exposure draft of the paper, entitled "*Can't See the Forest for the Trees: The Misapplication of Economic Theory to the Increasing Regulatory Trend Against Vertical Healthcare Integration*," at the **American Bar Association, Chicago Medical Society**, and **American Association for Physician Leadership's Physicians Legal Issues Conference** in Chicago, Illinois. Additionally, HCC **President Todd Zigrang** presented on this topic at the **National Association of Certified Valuators and Analysts' 2016 Annual Consultants' Conference** in San Diego, California. Mr. Cimasi will also present on this topic at **NACVA's Business Valuation and Healthcare Valuation Conference**, to be held on September 19-21, 2016, in Washington, D.C.


- 1 "2014 Global Health Care Outlook: Shared Challenges, Shared Opportunities" By Deloitte Touche Tohmatsu Limited, 2014, p. 13; "The 5 C's of 2013 Health Care" By Deloitte Touche Tohmatsu Limited, 2012, http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/us_chs_MondayMemo_2013Healthcare_%205Cs_021313.pdf (Accessed 6/4/14);

- 2 "Co-Management Arrangements: Common Issues with Development, Implementation and Valuation" By Ann S. Brandt, et al, American Health Lawyers Association, May 2011, <http://www.healthlawyers.org/Events/Programs/Materials/Documents/AM11/hutzler.pdf> (Accessed 6/5/14).
- 3 "Integrated Health Care: Literature Review" Essential Hospitals Institute, May 2013, <http://essentialhospitals.org/wp-content/uploads/2013/12/Integrated-Health-Care-Literature-Review-Webpost-8-22-13-CB.pdf> (Accessed 3/14/16), p. 4.
- 4 While the *Tuomey* decision is not on point with the PLP, the decision and case documents of *Tuomey* helps presage, and lay the foundation for, the PLP in later regulatory actions.
- 5 "United States ex rel. Drakeford v. Tuomey Healthcare System, Inc." 675 F.3d 394, 407 (4th Cir. 2012); "United States ex rel. Parikh v. Citizens Medical Center" Case No. 6:10-cv-00064, (S.D. TX. September 20, 2013), Memorandum and Order, p. 27-28; "United States ex rel. Reilly v. North Broward Hospital District, et al.," Case No. 10-60590-CV (S.D.Fla. September 11, 2012), Relator's Third Amended Complaint Under Federal False Claims Act, p. 31; "United States ex rel. Payne et al. v. Adventist Health System et al.," Case No. 3:12cv856-W (W.D.N.C. February 13, 2013), Relator's Amended Complaint, p. 56; "Health System Practice 'Losses' Make Headlines, Plaintiffs Make New Stark 'Law'" By Eric B. Gordon and Daniel H. Melvin, BNA's Health Care Fraud Report, Bloomberg BNA, November 25, 2015, <http://www.mwe.com/files/Publication/a1a5d17c-3c79-4380-baef-0d11822334a1/Presentation/PublicationAttachment/5bb1e6ca-6491-4907-9a57-1049c2f3ecc6/Gordan-Melvin.pdf> (Accessed 12/15/15).
- 6 "The American Heritage Dictionary" Second Edition, Houghton Mifflin Company: Boston, MA, 1985, p. 969. The American Heritage Dictionary defines "*postulate*" as "*Something assumed without proof as being self-evident or generally accepted, especially] when used as a basis for an argument.*"
- 7 "Why Hospital-Owned Medical Groups Lose Money" By David N. Gans, MSHA, FACMPE, MGMA Connexion, April 2012, <http://www.mgma.com/Libraries/Assets/Practice%20Resources/Publications/MGMA%20Connexion/2012/Data-Mine-Why-hospital-owned-medical-groups-lose-money---MGMA-Connexion-magazine-April-2012.pdf> (Accessed 3/29/2016), p. 20.



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Robert James Cimasi, MHA, ASA, FRICS, MCBA, CVA, CM&AA, serves as Chief Executive Officer of **HEALTH CAPITAL CONSULTANTS (HCC)**, a nationally recognized healthcare financial and economic consulting firm headquartered in St. Louis, MO, serving clients in 49 states since 1993. Mr. Cimasi has over thirty years of experience in serving clients, with a professional focus on the financial and economic aspects of healthcare service sector entities including: valuation consulting and capital formation services; healthcare industry transactions including joint ventures, mergers, acquisitions, and divestitures; litigation support & expert testimony; and, certificate-of-need and other regulatory and policy planning consulting.

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Mr. Cimasi is the author of numerous additional chapters in anthologies; books, and legal treatises; published articles in peer reviewed and industry trade journals; research papers and case studies; and, is often quoted by healthcare industry press. In 2006, Mr. Cimasi was honored with the prestigious “*Shannon Pratt Award in Business Valuation*” conferred by the Institute of Business Appraisers. Mr. Cimasi serves on the Editorial Board of the Business Appraisals Practice of the Institute of Business Appraisers, of which he is a member of the College of Fellows. In 2011, he was named a Fellow of the Royal Institution of Chartered Surveyors (RICS).



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