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***DeBartolo v. HealthSouth Corporation, et al.:* Federal Court Rules Surgeon's Suit against ASC for Enforcing One-Third Test a Decision for State Court**

In *DeBartolo v. HealthSouth Corporation, et al.*, the Seventh Circuit Court of Appeals ruled that a recent lawsuit brought by a surgeon investor in an Illinois ambulatory surgery center ("ASC") when the center attempted to redeem his partnership interest because he failed to perform one-third of his procedures at the center did not involve federal issues. Instead, the appeals court ruled that the case should be filed in state court. This ruling is significant, because it is one of the few written decisions involving redemption of an investor's partnership interest for failure to comply with the ambulatory surgery center safe harbor (the "ASC Safe Harbor")¹ to the federal Anti-Kickback Statute (the "Anti-Kickback Statute")².

Background

Among other things, the Anti-Kickback Statute prohibits a person from receiving any type of benefit from another person or entity in exchange for the referral of a federal healthcare program patient. Like other healthcare providers, ASCs rely on physician referrals for procedures to be performed at the ASCs. Where those referrals are made by physician investors, the Anti-Kickback Statute is implicated.

In 1999, the Secretary of the Department of Health and Human Services ("HHS") used her safe harbor authority to permit certain payments from ASCs to qualified physician investors.³ HHS was concerned that physician investment in ASCs could lead to violations of the Anti-Kickback Statute because the promise of higher dividends could provide a financial incentive for a physician investor to refer patients to an ASC.⁴ At the same time, HHS acknowledged that ASCs could legitimately serve as an extension of the office practice of physicians who invest for practical reasons, including physical proximity and a desire to maintain quality control; and, for those investor-physicians, the risk that dividends would induce improper referrals was low.⁵ Therefore, the Secretary crafted safe harbor elements designed to permit an ASC to make payments to a physician investor who uses the ASC as an extension of his or her office practice.

¹ See 42 C.F.R. § 1001.952(r).

² See 42 U.S.C. § 1320a-7b(b).

³ See Medicare and State Health Care Programs, 64 Fed. Reg. 63, 534 (now codified at 42 C.F.R. § 1001.952(r)).

⁴ *Id.* at 63, 536-37.

⁵ *Id.*

The safe harbor relevant to a multi-specialty ASC reserves safe harbor status for payments to physician owners who: 1) earn at least one-third of their medical income from performing Medicare-approved procedures, and 2) perform at least one-third of those procedures at the ASC. These two thresholds, collectively known as the “one-third/one-third” test, are designed to ensure that the physician investor uses the center as an extension of his or her office practice, and not as a vehicle for illegal referral-based compensation.

The Federal Court’s Ruling

In *DeBartolo*, the surgeon is a limited partner in Joliet Surgical Center, P.S., which is managed by the center’s general partner, Surgicare of Joliet, Inc. When Dr. DeBartolo failed to certify that his practice at the center met the one-third test, which was mandated by the partnership agreement, Surgicare notified him that it was exercising a clause in the agreement allowing it to redeem his interest. Dr. DeBartolo refused the money and initiated an action against the center in federal court, claiming that the requirement in the partnership agreement to conduct one-third of his surgical procedures at the center violates the Anti-Kickback Statute.

The federal district court found that Dr. DeBartolo inappropriately sought private enforcement of the Anti-Kickback Statute and dismissed his case for failure to state a claim upon which relief could be granted. Dr. DeBartolo appealed the decision, and the Court of Appeals ruled that enforcement of the ASC Safe Harbor elements set forth in an ASC’s partnership agreement is a state contractual law concern, dismissing the case on procedural grounds rather than on substantive grounds. As a result, the appeals court left open the possibility that Dr. DeBartolo could re-file the case in state court as a contract dispute and recover damages from the center.

This lawsuit is a recent example of a surgeon investor’s attempt to challenge enforcement of the ASC Safe Harbor elements in the redemption situation. The appeals court declined to opine or offer guidance regarding whether enforcement of the ASC Safe Harbor elements set forth in a partnership agreement is lawful. If Dr. DeBartolo re-files his case in state court, the case may yield an Illinois state court ruling on the issue.

Recommended Steps to Minimize the Risk of Civil Litigation

In light of the ruling in *DeBartolo*, ASCs should take steps to minimize the risk of civil litigation. Among other things, ASCs should determine whether their governing documents, *e.g.*, operating agreement, require redemption where an investor fails to meet the elements of the relevant safe harbor. If so, an ASC should consider taking the steps below in order to minimize the risk of civil litigation following redemption of such an investor:

- Providing investors who fail to meet the safe harbor elements a meaningful opportunity to come into compliance, *e.g.*, by establishing a grace period in the governing documents;
- Applying the redemption requirement consistently, *i.e.*, applying the redemption requirement consistently to all investors who fail to meet the safe harbor elements and applying the redemption requirement consistently irrespective of which element the investors failure to meet (and only where the one-third is not met);
- Offering redeemed investors fair market value for their shares; and
- Reviewing the ASC’s compliance plan to ensure that it is complete and up-to-date.

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