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An important health care law update from the law firm of Jackson Walker.

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Closure of Stark Whole Hospital Exception Survives Court Challenge

By **Jed Morrison**

On August 16, 2012, the United States Court of Appeals for the Fifth Circuit dismissed a challenge to the constitutionality of the Affordable Care Act ("ACA") provision that effectively eliminates the "whole hospital" exception in the Stark Law. Coupled with the U.S. Supreme Court's decision upholding the overall constitutionality of the ACA earlier this summer, the Fifth Circuit ruling (at least within the Fifth Circuit) may practically put the final nail in the coffin for new physician-owned hospitals participating in the Medicare program.

The Stark Law prohibits physicians from referring Medicare or Medicaid patients for certain "designated health services" to entities with which they have a financial relationship, unless an exception applies. The whole-hospital exception historically permitted physicians to have an ownership interest in a hospital and still refer Medicare and Medicaid patients to that hospital, if they complied with the provisions of the exception. The ACA effectively closed that door, however, for any hospitals not operational by March 23, 2010, and with Medicare provider agreements in place by December 31, 2010. Thus, new physician-owned hospitals could not participate in the Medicare/Medicaid programs, or--more properly stated--could not accept Medicare or Medicaid referrals from their physician owners.

Earlier this year the U.S. District Court for the Eastern District of Texas ruled in favor of the Department of Health and Human Services in a suit brought by Physician Hospitals of America, upholding the constitutionality of the law. The hospitals appealed, and the Fifth Circuit actually vacated that lower court ruling. Instead, the appeals court dismissed the case on jurisdictional grounds, concluding (under long-standing Supreme Court precedent) that the plaintiffs had failed to exhaust their available administrative remedies before filing their challenge in court. The hospitals argued that due to expense and delay, no *practical* appeal mechanism existed, but the Fifth Circuit disagreed.

While grandfathered hospitals still may participate and accept Medicare and Medicaid referrals from their physician owners, the ACA severely restricts those facilities' operations. They may not increase the number of beds or operating rooms after March 23, 2010, and may not increase the percentage of physician ownership after that same date. The plaintiff hospitals in this case, for example, were grandfathered Medicare hospitals seeking to expand their beds and operating rooms.

The law has not eliminated such specialty hospitals. Many physician-owned hospitals are choosing not to participate in Medicare or Medicaid at all, and are staying busy with commercial and private pay patients.

Although the Fifth Circuit ruling is only binding on providers located

in Mississippi, Louisiana and Texas, Jackson Walker L.L.P. is unaware of any similar challenges to the law in other jurisdictions. While the court's decision on jurisdictional grounds leaves open the possibility of a new challenge once a hospital has exhausted its available Medicare appeal mechanisms, such a challenge will be time consuming and expensive. The whole hospital exception under Stark, therefore, may largely be a thing of the past.

If you have any questions about the Fifth Circuit opinion, you may contact **Jed Morrison** at **jmorrison@jw.com** or 210.978.7780 or any other member of the **Jackson Walker L.L.P. health care section**.

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