

Healthcare FINANCIAL MANAGEMENT

Percentage Compensation Arrangements: Suspect, but not Illegal

BY FRANK P. FEDOR, JD

Percentage compensation arrangements, in which a service is outsourced to a contractor that is paid in accordance with the level of its performance, are widely used in many business sectors. The HHS Office of Inspector General (OIG) has shown concern that these arrangements in the healthcare industry may offer incentives for the performance of unnecessary services or cause false claims to be made to Federal healthcare programs in violation of the antikickback statute and the False Claims Act. Percentage compensation arrangements can work and need not run afoul of the law as long as the healthcare organization carefully oversees the arrangement and sets specific safeguards in place. These safeguards include screening contractors, carefully evaluating their compliance programs, and obligating them contractually to perform within the limits of the law.

Percentage compensation arrangements are widely used because they apportion risk efficiently. A provider outsources a service it could not perform effectively or inexpensively to a contractor with focused expertise in the area. Payment to the contractor then is tied to the level of performance.

Despite the benefits of such a system, the HHS Office of Inspector General (OIG) frequently expresses concern that percentage-based compensation arrangements could lead to fraud and abuse by providing a financial incentive for unnecessary services to be performed or false claims to be submitted to Federal healthcare programs.

However, most questionable practices arise not from the percentage payment arrangement, but rather from the

provider's lack of targeted oversight. Providers should structure percentage arrangements to include safeguards that allow them to enjoy the benefits of the arrangement while protecting themselves from liability for the acts of the contractor. Such safeguards also demonstrate their intent to comply with Federal laws and regulations.

The OIG most frequently invokes the Federal antikickback statute and the Federal False Claims Act in presenting its objections to percentage compensation arrangements. The antikickback statute is a criminal law that prohibits the payment or receipt of remuneration intended to induce a person to refer an individual for services or purchase any item for which payment may be made by a Federal healthcare program. A conviction for criminal violation of the antikickback statute will result in mandatory exclusion from Federal healthcare programs and may result in imprisonment and a fine. Separately, the OIG also may prosecute a civil violation, seeking a monetary penalty and program exclusion for the violator.

The False Claims Act is a civil law that prohibits knowingly making false claims to request payment from the government. A violation subjects the defendant to mandatory payment of treble damages, plus a discretionary civil monetary penalty for each false claim made. Although the case law still is developing in this area, a violation of the antikickback statute may provide the basis for a civil action alleging violation of the False Claims Act.^a

There are significant differences in the role that percentage compensation can play in the violation of these two laws. These differences are important to understand in

a. *United States, ex. rel. Thompson v. Columbia/HCA Healthcare Corporation*, 20 F. Supp.2d 1017 (S.D. Texas 1998); *United States, ex. rel. Pogue v. American Healthcorp, Inc.*, 914 F.Supp 1507 (M.D. Tenn. 1996).

By adopting appropriate safeguards, providers can obtain the benefits of percentage compensation arrangements without violating the False Claims Act or antikickback statute.

designing safeguards to minimize the risk of noncompliance. It therefore is important at the outset to categorize percentage compensation arrangements by the type of service being provided and the law that is most pertinent to the arrangement. The major distinction is that a percentage compensation arrangement can be used as proof of the elements of inducement and intent, both of which must be proved to establish a violation of the antikickback statute. With regard to the False Claims Act, a percentage payment arrangement can be construed only as a potential incentive for making false statements and alone does not contribute to proving that a claim was false or was made with the knowledge that it was false.

The Antikickback Statute

With regard to the antikickback statute, the OIG primarily is interested in two types of activities that it believes have the inherent propensity to be technical violations of the statute: marketing services and sales agents. The OIG's concern about percentage compensation arrangements with respect to marketing services is offered below:

In our preamble to the 1991 final safe harbor rules... we explained that the antikickback statute on its face prohibits offering or acceptance of remuneration, *inter alia*, for the purposes of 'arranging for or recommending purchasing, leasing, or ordering any...service or item payable under Medicare or Medicaid.' Thus, we believe that many marketing and advertising activities may involve at least technical violations of the statute.... Since publication of the 1991 rule, we have continued to learn of abusive relationships involving marketing activities that adversely affect the Federal healthcare program and their beneficiaries.^b

Two advisory opinions further elaborate the OIG's concerns about percentage compensation arrangements. In Advisory Opinion No. 98-1, Company A, a manufacturer of orthopedic soft goods, requested an opinion concerning its arrangement with Company B, a marketing, consulting, and billing firm for home medical equipment, whereby Company B would receive 20 to 25 percent of collected revenues for the distribution, marketing, and billing of the manufacturer's products.

b. OIG Advisory Opinion No. 98-1, March 19, 1998. A similar statement occurs in OIG Advisory Opinion No. 98-4, April 15, 1998. To read an OIG advisory opinion, go to <http://www.dhhs.gov/progorg/oig/advopn/> and click on the year of the advisory opinion sought.

The OIG explained that "[p]ercentage compensation arrangements are potentially abusive...because they provide financial incentives that may encourage overutilization of items and services and may increase program costs." The OIG opinion focused on three reasons why the percentage compensation arrangement was problematic:

- The percentage arrangement created a significant financial incentive that increased the risk of abusive marketing and billing practices;
- There was an opportunity for such abuse because the arrangement allowed the marketing firm to have direct contact with physicians and Medicare patients; and
- The arrangement had no safeguards against fraud and abuse.

The OIG pointed out that payment would be made by third parties rather than by the physicians who ordered the goods. The implication is that the payer would have no way of verifying whether the goods were actually ordered or delivered.

This opinion is a straightforward risk analysis. A percentage compensation arrangement in a marketing context may be a technical violation of the antikickback statute. The OIG refuses to provide an individual safe harbor to the manufacturer because the arrangement offers the opportunity to unduly influence referral sources and patients, the percentage compensation provides a powerful incentive to exploit this opportunity, and insufficient safeguards are built into the arrangement.

Advisory Opinion No. 98-4, expands the scope of the OIG's concern regarding percentage compensation arrangements. A physician practice requested an opinion on whether its management services contract with a medical practice management company would constitute illegal remuneration under the antikickback statute. Among the services provided by the management company would be marketing. For all of its services, the management company would be reimbursed for its costs and paid a percentage of net practice revenues. The OIG repeated its concern that many marketing and advertising activities may involve at least technical violations of the antikickback statute because the percentage of net revenue compensation that the marketing company would receive would be paid in part for marketing services and for arranging managed care contracts. The opinion states, "Where such compensation is based on a percentage, there is at least a potential technical violation of the antikickback statute."

Opinion No. 98-4 is an expansion beyond Opinion No. 98-1 because it is entirely silent as to what type of marketing services the management company had contracted to perform. If the management company had access to referring physicians or to Medicare patients, as the orthopedic supply marketing company in Opinion No. 98-1 did, then there would be a similar potential for violation of the antikickback statute. But if the management company's placement of print or broadcast advertisements was the marketing activity that raised the OIG's concern, the opinion is extraordinarily broad and calls into question the legality of any marketing activity for which payment is made on a percentage basis in the absence of unspecified safeguards.

The OIG also has analyzed percentage compensation arrangements with independent sales agents for applicability of the antikickback statute. In Opinion No. 98-10, the OIG notes that because "[s]ales agents are in the business of recommending or arranging for the purchase of the items or services they offer for sale... any compensation arrangement between a Seller and an independent sales agent... potentially implicates the antikickback statute, irrespective of the methodology used to compensate the agent."^c The OIG identifies a "nonexhaustive" list of six suspect characteristics of relationships among sellers, agents, and purchasers "that appear to be associated with an increased potential for program abuse, particularly overutilization and excessive program costs." These include:

- Compensation based on percentage of sales;
- Direct billing of a Federal healthcare program by the seller;
- Direct contact between the sales agent and the physician or beneficiary;
- Direct contact between the sales agent and Federal healthcare program beneficiaries;
- The possibility of undue influence exerted by sales agents, such as healthcare professionals; and
- Sale of items that are separately reimbursable by a Federal healthcare program.

Nonetheless, Opinion No. 98-10 is one of two advisory opinions favorable to independent contractor sales agents who are compensated on a percentage basis. In Opinion No. 98-10, this favorable finding resulted because the percentage arrangement was the only suspect characteristic. In Opinion No. 99-3, it was because the arrangement was one of only two such characteristics.^d This flexibility of the OIG shows that percentage arrangements do not always run afoul of the antikickback statute.

The False Claims Act

In the context of the False Claims Act, the OIG has a completely different concern with percentage compensation arrangements. Here, the existence of the arrangement does not help to prove that the law has been violated, but instead encourages and invites agents to recklessly or knowingly violate the law.

The OIG issued its first strong statement in this regard in 1997 with Medicare Fraud Alert OIG 97-01, which it issued in the midst of its investigation of laboratory billing irregularities in Ohio.^e The alert pointed out that "the practice of fragmenting lab billings was promoted by consulting firms that promised to increase hospital revenue in return for a commission consisting of a percentage of the first year's increase." Moreover, the OIG had discovered "that there are a number of consulting firms which offer to maximize billings for radiology, emergency room, and laboratory services by discovering and correcting coding 'errors' in return for a percentage of the resulting revenue increase." The OIG harshly criticized such arrangements, threatening criminal prosecution of hospital officials involved in such arrangements:

There is little incentive for consultants to correct coding errors which do not increase their consulting fees. This arrangement is ripe for upcoding, unbundling, and other manipulation which increases costs to the Medicare program. However, hospital business managers tend to rely heavily on representation made by the consultant, and fixing responsibility in a hospital organization can be difficult. Organizational charts, reporting relationships, and lines of authority can and should be explored and documented in personal interviews with hospital officials. These can be essential elements in developing a criminal case.

More recently, the OIG again addressed billing consultants working on a percentage basis in Advisory Opinion No. 00-1.^f It ostensibly addressed the question of whether a consulting firm's percentage contract to provide auditing and training services to a provider would subject the consultant to sanctions under the Federal antikickback law. Although there was no kickback issue in the facts presented, the OIG nevertheless indicated its concern about the potential for abusive billing that a consultant has in a percentage compensation arrangement. The consultant retrospectively audited one year of a hospital's billings in certain discrete areas and was paid on the basis of how much was recovered from this retrospective year. The consultant did not audit bills reimbursed by Federal or state healthcare programs as either a primary or secondary payer. Unsurprisingly, the OIG stated that there was little risk of a violation of the antikickback

c. OIG Advisory Opinion No. 98-10, August 31, 1998.

d. OIG Advisory Opinion No. 99-3, March 23, 1999.

e. Published at 1 *BNA Health Care Fraud Report* 27, Jan. 15, 1997.

f. OIG Advisory Opinion No. 00-1, March 16, 2000.

statute, but warned of a vague “spillover effect:”

In other circumstances, prospective advice and training programs could implicate the antikickback statute, False Claims Act, and other legal authorities. By way of example only, such statutes may be violated if a hospital pays a consultant based on a percentage of collections to train the hospital’s coders to characterize services in ways that may result in upcoding of the services being ordered.

The OIG has expressed this same concern with regard to billing companies. While the OIG has stated that “percentage based billing arrangements are not illegal per se” and that “[a] physician may contract with a billing service on a percentage basis,”^g it has expressed concerns about the role of percentage-based compensation in billing arrangements for some time. In 1998, it developed specific compliance guidance for third-party medical billing companies.^h More recently, it published on its Web site a statement on third-party billing companies by Lewis Morris, the assistant inspector general for legal affairs, before a subcommittee of the House Committee on Commerce.ⁱ Mr. Morris said that, “[t]here can be little doubt that payment arrangements where billing companies are reimbursed on a percentage basis create an environment ripe for abuse” and, as one of three “tentative suggestions for reform,” recommended that “Congress should consider measures to expressly prohibit the use of payment incentives in third-party billing contracts, no matter how the arrangement is structured.”

The general controversy concerning percentage compensation also has affected arrangements between consultants who act as provider representatives in Medicare and Medicaid appeals. In these arrangements, a consultant contracts to represent a provider in, for example, an administrative appeal of a Medicare reimbursement determination of an intermediary or of HCFA before the Provider Reimbursement Review Board (PRRB). The OIG has never expressed concern about a percentage compensation arrangement in this context. In such a situation, the provider is exercising its legal right to challenge the legal or factual basis of the administrator’s action. This process contains several inherent safeguards:

- It is adversarial, with both the provider and the government having the same right and opportunity to make their respective case;
- The provider must meet a burden of factual proof and argue why its legal interpretation is correct;

- The relief requested cannot be obtained until the PRRB and the HCFA administrator agree with the contentions of the provider; and
- A dissatisfied party has the right to appeal any decision through the Federal courts.

This is an area where providers should not hesitate to use a percentage compensation arrangement.

Creating Safeguards

In addressing a current or prospective percentage compensation arrangement, the first question to resolve is whether the antikickback statute could be invoked. Many such arrangements, (e.g., billing services) usually do not raise an antikickback violation concern. However, a contract with a billing company may implicate the antikickback statute if it includes marketing services that also are compensated on a percentage basis.^j If any question about the arrangement’s legality exists, it should be discussed with counsel experienced in the area.

If there is no clear antikickback problem, there is no legal reason to avoid a percentage compensation arrangement. The most important considerations in this instance are the honesty and competence of the contractor and the diligence of the provider in selecting and supervising its agents. The following safeguards should be considered as ways to lessen the suspect nature of percentage compensation arrangements and fulfill the basic compliance responsibility of a provider for the acts of its agents:

Screen contractors. The provider should check to see whether the contractor has been excluded from Federal healthcare programs. (Excluded entities are listed in the OIG Web site at www.dhhs.gov/progorg/oig/cumsan/index.htm.) The provider also should determine the contractor’s level of experience and competence by calling the contractor’s references. The mechanism to accomplish this may already exist, because the provider probably is conducting similar screening of new employees.

Evaluate the contractor’s compliance program. The provider should determine what internal safeguards the contractor has adopted to ensure that it maintains ethical and competent service. Important information can be deduced by comparing the level of sophistication of the contractor’s compliance plan with that of the provider organization. The contractor also should be asked to explain what internal monitoring it conducts to confirm the accuracy of its services, how it measures the competency of its employees, how it maintains employees’ competency through training, what productivity levels it sets, and what internal incentives it creates for its employees.

Include compliance obligations in the contract. The

g. Draft OIG Compliance Program for Individual and Small Group Physician Practices, 65 *Federal Register*, June 12, 2000, pp. 36818, 36830.

h. OIG Compliance Program Guidance for Third-Party Medical Billing Companies, 63 *Federal Register*, December 18, 1998, p. 70138-70152.

i. Testimony of Lewis Morris before the House Committee on Commerce, Subcommittee on Oversight and Investigations, on Medicare: Third-Party Billing Companies, available at www.hhs.gov/oig/testimony/00406fin.htm.

j. See, for example, the OIG Compliance Program Guidance for Third-Party Medical Billing Companies, 63 *Federal Register*, December 18, 1998, pp. 70138, 70143 at footnote 40.

compliance responsibilities of the contractor should be enumerated in the contract to make them legally binding. The OIG's Compliance Guidance for Third-Party Billing Companies recommends the coordination of compliance responsibilities in the contract.

Contractually specify the obligation to bill accurately. This responsibility is assumed, but should be spelled out in the contract to provide further protection for the contracting organization.

Include a right to terminate the contract for breach of compliance responsibilities. This provision permits the provider to "discipline" the contractor, a capability that is required in an effective compliance program.

Specify the contractual duty to advise of errors or overpayments. The provider should leave no doubt that the contractor is required to bring such matters to the provider's attention, and that failure to do so is a breach of the contract.

Consider the economic feasibility of including compensation for the identification of errors. The contract need not require a consultant or billing company to audit for errors if that is not why it was retained. But a payment structure that provides some incentive to report discovered errors removes much of the fundamental objection to percentage compensation arrangements and demonstrates the provider's intent to be diligent.

Independently verify the work of the contractor. The provider is legally responsible for the work of its agents, including independent contractors. Verification could take the form of auditing the work of a billing company or verify-

ing the billing recommendations of a consultant. If the consultant's recommendations are correct, the consultant should be able to explain the basis for the recommendations in sufficient detail to permit someone else to decide whether they make sense.

Incorporate the safeguards adopted in the provider's compliance program. The operation of the safeguards incorporated into the contract with the contractor should be part of the provider's compliance program.

Conclusion

Providers should not avoid percentage compensation arrangements, but should evaluate what type of compliance risk may exist and take the necessary steps to address that risk. In a situation that does not implicate the antikickback statute, the provider should take such steps regardless of the payment mechanism. Similarly, contractors should understand the role that compliance safeguards play in making their services attractive to providers. ■

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