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The Legal Aspects of Health Care Joint Ventures

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I. Introduction

A recent survey of approximately 700 hospital executives conducted by Ernst & Whinney indicated that one-third of the hospitals they represented were already involved in at least one joint venture and sixty-four percent were interested in pursuing joint ventures. Nearly forty percent of the existing joint ventures were ambulatory care facility joint ventures. Thirty percent of the respondents expressed interest in alternative delivery systems, with sixteen percent already involved in health maintenance organizations and preferred provider arrangements. Other respondents were involved in other types of joint ventures, including medical office buildings, clinical laboratories, laundry facilities and substance-abuse programs. Almost half of the respondents indicated that "most" of their competitors were involved in joint ventures and ninety-eight percent thought that there will be more joint ventures in the future.[1]

Health care providers are entering joint ventures for numerous reasons, including:

* Generation of income from existing and new sources
* Controlling competition
* Creating and maintaining relationships between medical staff and hospital
* Retaining present patients and expanding the number of new patients
* Providing tax shelters
* Enhancing access to capital
* Creating economies of scale

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1. Ernst & Whinney, Health Care Joint Ventures, Survey Results (1985).

* Sharing costs and financial risks and rewards
* Providing management expertise.

Joint ventures have been structured to undertake a variety of types of projects with a number of different types of participants. The participants include physicians, hospitals and proprietary corporations. In addition to ambulatory care centers and alternative delivery systems, joint venture projects include commercial real estate developments, clinical laboratories, shared service ventures, nursing homes, life care communities, radiology facilities and home health care sales and services. The various types of ventures and the variety of participants create a series of legal issues, the most significant of which are the subject of this article. After discussing in general terms the organizational formats which may be used for a joint venture, this article discusses the following legal issues: certificate of need, corporate practice of medicine, fraud and abuse, tax, antitrust, employee benefit plans, labor and employment matters and securities laws. In several instances, these issues have been examined in the context of their impact upon joint ventures in specific health care activities, including alternative delivery systems and home health care joint ventures.

II. Joint Venture Characteristics and Organizational Formats

It is important that joint venturers share a common understanding of the term "joint venture". The term "joint venture" does not define a specific type of legal entity—instead, it refers to a relationship which has certain characteristics and which may take a number of different forms. The characteristics include: (1) a relationship which is formed to accomplish a certain goal and is limited in scope to those activities necessary to carry out that goal, (2) contributions—in some form or another—by each venturer to the enterprise, (3) a joint interest in the enterprise, (4) a sharing of profits and losses, and (5) a sharing of decision-making and right of control.

A number of organizational formats can be utilized to accomplish the goals of a joint venture. The most common formats are general and limited partnerships, for-profit and not-for-profit corporations, and contractual relationships. Although tax considerations often call for the formation of a partnership, each of these organizational formats involves distinct characteristics which must be evaluated in light of a joint venture's purposes.

A general partnership is recognized under common law as an association of two or more persons engaged in business for profit. The relationship between the general partners is governed by a written partnership agreement and typically a state general partnership statute which follows the Uniform Partnership Act. The partnership agreement should address such matters as: initial and further capital contributions by the partners; remedies for a partner's failure to contribute; allocation of profits and losses; distribution of cash flow; management resolution in the event of deadlock between the managing partners; contracts with related parties; income tax components; the transfer of interest in the venture; and events of dissolution.

The general partnership is a pass through device for tax purposes. Thus, if the venture incurs losses or gives rise to substantial deductions in its initial years, the general partners will be able to recognize such losses or take such deductions to offset their income from other sources, provided, of course, that they are taxable entities. On the other hand, general partners are jointly and severally liable for the obligations of the partnership. Each general partner is expected to participate in the management and control of the venture. If a general partner remains passive, the securities laws may become applicable.[2]

A limited partnership is a partnership which is organized under a state's limited partnership statute and which has at least one general partner and one limited partner. The general partner is fully liable for partnership obligations while the limited partners are liable only to the extent of their investment. The control of the limited partnership typically resides with the general partner. The limited partners are not able to participate in control or management decisions without jeopardizing their limited liability, except in the case of certain actions specifically enumerated in the applicable limited partnership statute.

Another possibility for the venturers is to carry out their joint venture through a corporate structure. The venturers would either own stock in a for-profit corporation, or be the members of a charitable, nonprofit corporation. Among the advantages to utilizing a corporate structure to carry out the purposes of the joint venture is the existence of a fairly clear and well established body of law governing corporations. More importantly, however, corporate law provides for limited liability for stockholders and members of the corporation as long as adequate capitalization exists and corporate formalities are respected. In addition to being protected from personal liability, stockholders or members are further protected in

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2. *See infra* note 146.

that no one stockholder or member can bind the others in matters involving day-to-day business operations.

If only individuals are to be involved in the joint venture as shareholders, then a Subchapter S corporation may be used. A Subchapter S corporation is a corporation which is treated in a manner similar to a partnership for some federal income tax purposes. The corporation is not treated as a separate taxable entity, but rather the income and losses of the corporation are treated as directly incurred by the shareholders. Typically, an S corporation is taxed, however, as a separate entity for state income tax purposes.

The advantage of an S corporation is that it offers many of the tax advantages of a partnership while limiting the liability of the participants to the extent of the assets of the corporation (assuming the corporation is adequately capitalized and corporate formalities are observed). The major disadvantage is that the amount of deduction which a shareholder can take with respect to an S corporation is limited to the amount of capital the shareholder either contributed or loaned to the S corporation. In this regard, an S corporation should be contrasted to a partnership in which a partner's deductions may exceed the amount of his contributions to the partnership where, for example, the deductions are attributable to real estate purchased with non-recourse financing.

While a contractual arrangement between joint venturers is a readily familiar mechanism for creating a relationship, it is not a favored approach for joint venturers because in many situations courts will treat the contractual relationship as a general partnership. Therefore, it is more advantageous to create a general partnership using a written agreement so that an accepted body of common law interpreting the general partners' relationship is available.

III. Legal Issues

A. *Certificate of Need Requirements*

Most states have a certificate of need program requiring an applicant which is a health care facility or is deemed part of a health care facility to obtain a certificate of need from a particular state agency in two circumstances: (1) when it is making a health care related expenditure in excess of a specified statutory amount, and

(2) when it is involved in a "substantial change of service".[3]

When a joint venture is undertaken, the hospital corporation, in order to protect its assets should the joint venture not succeed, will usually not be the joint venturer. Instead, the corporation undertaking the joint venture will be a "sister" corporation of the hospital corporation as both the hospital and the sister corporation will be controlled by a common parent corporation. The legal issue which arises in this context is whether the involvement of the sister corporation will enable the venturers to avoid the requirement of a certificate of need for the joint venture. It is possible that the state regulatory agency will argue that the common parent relationship in and of itself will make the joint venture "part of" a health care facility, namely the hospital, and that therefore a certificate of need will be required if the hospital itself would have been required to obtain a certificate of need had it been the joint venturer. While this argument should not succeed if corporate formalities have been observed, such arguments by state agencies should be anticipated.[4]

In determining whether a project is "part of" a health care facility and hence whether a certificate of need is required, the state regulatory agency looks to such factors as whether the project is legally, administratively, financially, physically and, in terms of its services, so intertwined with the particular health care facility that it would be appropriate to view it functionally as part of that facility. As tests for such a functional relationship, the state regulatory agency inquires into whether (1) the facility will be constructed by a corporation which is not a health care facility; (2) the ownership of the facility will be in the name of a health care facility; (3) a corporation other than a health care facility will assume responsibility for the control of the operation, maintenance and administration of the facility; (4) a corporation other than a health care facility will be the truly necessary party to the business arrange-

3. A "substantial change of service" is typically defined as an addition of a service which entails: annual operating costs in excess of a stated amount; an increase in bed capacity beyond a specific number of beds; an addition of a major service to those available at a health care facility or satellite clinic or unit thereof; the establishment of a unit of a facility; the establishment of a unit or service of a facility off the premises of the health care facility; or any increase in licensed bed capacity of a facility or service unit of the facility. A substantial change of service need not involve a health care related expenditure in excess of the statutory amount. *See generally* 42 U.S.C. §§ 300k-300t14 (1976 & Supp. IV 1980); 42 C.F.R. §§ 121.1-123.608 (1985).

4. District of Columbia v. Washington Hosp. Center Health System, No. 6970-83 (App. D.C. Oct. 5, 1983)(settlement agreement).

ments; (5) at the conclusion of the business arrangement, the health care facility will own the facility or will have the option to purchase the facility; (6) the facility will be on the health care facility's campus; and (7) the construction and operation of the facility will involve any guarantees or subsidies by the health care facility.

The creation of an ambulatory care center by a joint venture comprised of a sister corporation of a hospital and a group of doctors provides an example of how a situation might be analyzed under the certificate of need laws. In this example, a partnership will be created between the doctors and a sister corporation of a hospital to purchase space in which to conduct the ambulatory care center program. The physicians will provide the medical services in the facility under a lease from the partnership. Another corporation affiliated with the hospital will provide administrative services, such as scheduling appointments for the physicians. Neither the hospital nor its parent corporation will guarantee any loans for the construction of the facility.

In the context of this example, the ambulatory care facility should not be deemed "part of" a health care facility under the tests set forth above for the following reasons: (1) it will not be constructed by a health care facility; (2) a non-health care facility will own the space; (3) a non-health care facility (i.e. the physicians) will control the operation, maintenance and administration of the space; (4) a non-health care facility will be the truly necessary party to the business arrangements; (5) the hospital will not own the space or have the option to purchase the space at the conclusion of the business arrangements; and (6) the hospital will not subsidize or guarantee the program. Accordingly, a certificate of need should not be required for this type of joint venture.

B. *The Corporate Practice of Medicine*

Many joint ventures, including those involving physicians, supplant or supplement the traditional role played by physicians. Generally, statutes authorizing the formation of corporations to carry on any lawful business do not authorize the formation of corporations for the purpose of practicing medicine.[5] Furthermore, physician licensing statutes provide that unlicensed persons may not engage in the practice of medicine. A corporation cannot ob-

5. People *ex rel* Kerner v. United Medical Serv. Inc., 362 Ill. 442, 456, 200 N.E. 157, 164 (1936). *See also* United States v. Kitner, 216 F.2d 418, 421 (9th Cir. 1954).

tain a license to engage in the practice of medicine because it cannot meet the license requirements such as age, education, and high moral standards.[6] Therefore, any corporation engaged in the practice of medicine is subject to liability under a state's physician licensing statute.[7]

The basis for the corporate practice of medicine doctrine has been the courts' determination that the association of a corporation with the learned professions is against public policy. This determination is based upon the belief that corporate considerations would intrude upon the highly confidential physician-patient relationship.[8]

Even though all jurisdictions agree that a corporation cannot obtain a license to practice medicine, they do not agree on the issue of whether a corporation is practicing medicine by employing or exercising control over licensed practitioners. Many states, including New York and California, hold that a corporation is illegally engaged in the practice of medicine if it employs qualified licensed physicians to perform the medical services.[9] Courts have also applied the doctrine when a corporation does not directly employ physicians, but merely places them on an approved list and compensates them on a fee for service basis rather than by a salary arrangement. In *People ex rel. State Board of Medical Examiners v. Pacific Health Corporation,*[10] the California Supreme Court held that the policy of the doctrine may not be circumvented by "technical distinctions in the manner in which the doctors are en-

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6. *See* Dr. Allison, Dentist, Inc. v. Allison, 360 Ill. 638, 641-42, 196 N.E. 799, 800 (1935). "To practice a profession requires something more than the financial ability to hire competent persons to do the actual work. It can be done only by a duly qualified human being, and to qualify something more than mere knowledge or skill is essential. The qualifications include personal characteristics, such as honesty, guided by an upright conscience and a sense of loyalty to clients or patients, even to the extent of sacrificing pecuniary profit, if necessary. . . . No corporation can qualify."

7. *See* People v. John H. Woodberry Dermatological Institute, 192 N.Y. 454, 85 N.E. 697, 698 (1908).

8. *See* Garcia v. Texas State Bd. of Medical Examiners, 384 F. Supp. 434, 440 (W.D. Tex. 1974), *aff'd mem.*, 421 U.S. 995 (1975), in which the court asked: "To whom does the doctor owe his first duty—the patient or corporation? Who is to preserve the confidential nature of the doctor-patient relationship? What is to prevent or who is to control a private corporation from engaging in mass media advertising in the exaggerated fashion so familiar to every American? Who is to dictate the medical and administrative procedures to be followed? Where do budget considerations end and patient care begin?" 384 F. Supp. at 440.

9. *See* New York v. Abortion Information Agency, Inc., 37 A.D.2d 142, 330 N.Y.S.2d 927 (1971); People *ex rel.* State Bd. of Medical Examiners v. Pacific Health Corp., 12 Cal. 2d 156, 158, 82 P.2d 429, 430 (1938), *cert. denied,* 306 U.S. 633 (1939).

10. 12 Cal. 2d 156, 82 P.2d 429 (1938), *cert. denied,* 306 U.S. 633 (1939).

gaged, designated or compensated by the corporation."[11] A minority of jurisdictions hold, however, that a corporation may contract with physicians to furnish medical treatment.[12]

Many courts have selectively applied the doctrine. For instance, in *People ex rel. State Board of Medical Examiners v. Pacific Health Corporation*, the California Supreme Court distinguished for-profit and not-for-profit corporations and stated that its ruling was not intended to prohibit charitable, cooperative corporations from providing health care services.[13] The court based this distinction on the public policy notion that interference with the physician-patient relationship and "commercialization" of the practice of medicine is most likely to arise when the physician is employed or supervised by a profit-seeking entity.[14] The federal district court in *Group Health Association v. Moor*[15] held that a group of individuals may incorporate as a nonprofit corporation and contract with a physician for medical services for a stipulated period at fixed compensation without violating the District of Columbia's physician licensing statute. Importantly, the court reasoned that the "physicians . . . are rather in the position of independent contractors, and the plaintiff does not in any way undertake to control the manner in which they attend or prescribe for their patients."[16]

In addition to the selective application of the corporate practice of medicine doctrine, the doctrine itself appears to be in decline. Only one court has applied the doctrine in recent years. In *Garcia v. Texas State Board of Medical Examiners*,[17] the federal district court held that a nonprofit corporation formed for the purpose of providing medical care to low income groups through salaried physicians could constitute the illegal corporate practice of medicine.[18]

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11. 12 Cal. 2d at 158, 82 P.2d at 439.

12. State v. Lewin, 128 Mo. App. 149, 106 S.W. 581 (1907) (a corporation formed for the purpose of furnishing medical and surgical treatment has the power to contract with physicians who render the medical and surgical services); State Electro-Medical Institute v. State, 74 Neb. 40, 43, 103 N.W. 1078, 1079 (1905) ("Making contracts is not practicing medicine. Collecting the compensation therefore is not practicing medicine, within the meaning of this statute. No professional qualifications are requisite for doing these things").

13. 12 Cal. 2d at 159-60, 82 P.2d at 431.

14. *Id. See* Hansmann, *Reforming Nonprofit Corporation Law*, 129 U. PA. L. REV. 497, 539-40 (1981).

15. 24 F. Supp. 445 (D.D.C. 1938), *aff'd sub nom.* Jordon v. Group Health Assoc., 107 F.2d 239 (D.C. Cir. 1939).

16. 24 F. Supp. at 446; *See also* Note, *The Role of Prepaid Group Practice in Relieving the Medical Care Crisis*, 84 HARV. L. REV. 887, 961 (1971).

17. 384 F. Supp. 434 (W.D. Tex. 1974), *aff'd mem.*, 421 U.S. 995 (1975).

18. 384 F. Supp. at 440.

The court based its decision, however, on a Texas statute which only authorizes licensed physicians to form a nonprofit corporation organized for the purpose of delivering health care if the trustees of the corporation are persons duly licensed to practice medicine.[19]

Furthermore, some state legislatures have expressly overruled the common law prohibition against the corporate practice of medicine by enacting comprehensive statutes which allow the formation of corporations for the purpose of delivering health care services. In 1979, the Illinois legislature enacted the Medical Corporation Act[20] authorizing the formation of corporations "for the study, diagnosis and treatment of human ailments and injuries,"[21] thus overruling *People ex rel. Kerner v. United Medical Service, Inc.*[22] which held that Illinois law prohibited corporations from practicing medicine.[23]

Finally, some states have selectively overruled the common law prohibition by enacting statutes which allow certain corporate forms to provide health care services. Those corporate forms most often include charitable hospital corporations, nonprofit health service corporations (Blue Cross/Blue Shield), professional corporations and health maintenance organizations.

The risk of vulnerability under this doctrine may be reduced in a joint venture by taking one or more of the following actions: (1) forming a nonprofit corporation; (2) forming a corporation whose directors or trustees are health care providers; (3) forming a corporation which independently contracts with, rather than employs, physicians; or (4) forming a corporation which does not accept the fee for a physician's services.

C. *Medicare and Medicaid Prohibitions on Fraud and Abuse*

One of the major concerns of health care providers entering into joint ventures is the potential for violation of the Medicare[24] and Medicaid[25] prohibitions on fraud and abuse. The federal statutes provide that whoever knowingly and willfully solicits or receives any remuneration (including a kickback) for referring an individ-

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19. *Id.* at 438.
20. ILL. REV. STAT. ch. 32, §§ 631-648 (1984).
21. ILL. REV. STAT. ch. 32, § 632 (1984).
22. 362 Ill. 442, 200 N.E. 157 (1936).
23. *Id.* at 454, 200 N.E. at 163. *See* Real v. Kim, 112 Ill. App. 3d 427, 436, 445 N.E.2d 783, 790 (1983).
24. 42 U.S.C. §§ 1395-1395zz (1982 & Supp. I 1983).
25. 42 U.S.C. §§ 1396-1396zz (1982 & Supp. I 1983).

ual for the furnishing of items or services reimbursed under Medicare or Medicaid or for purchasing (leasing, etc.) or arranging for the purchasing (leasing, etc.) of any good, service or item reimbursed under Medicare or Medicaid shall be guilty of a felony. Offering or paying the remuneration is similarly a felony. The broad language of the statutes is partially limited by express exemptions for discounts which are properly disclosed and reflected in costs claimed or charges made by the provider and for compensation paid by employers to employees for providing covered services.[26]

As originally conceived, the Medicare antifraud and abuse prohibitions were designed to deter unethical and unlawful practices which resulted in increased costs to the Medicare and Medicaid programs. "Classic" referral schemes discussed in case law included gifts of alcoholic beverages in exchange for nursing home pharmacy business[27] and kickbacks to physicians for sending samples for testing to certain laboratories.[28] Even in these relatively straightforward early cases, troubling issues were raised as to the broad scope of the statute. Arguments that payments were at least in part for services, or that the actual cost to the Medicare system was not increased, did not prevail. In *United States v. Ruttenberg*,[29] the court noted that the proscribed arrangement not only had the potential for increasing costs but also for masking possible government price reductions and encouraging the provision of unnecessary services and supplies.[30] The courts in both *Ruttenberg* and *United States v. Hancock*[31] appeared strongly influenced by the fact that a party in a position to "open up" or "control" federal funds had received payments for exercising its judgment in a certain fashion.[32] Other decided cases confirmed that payments for referrals, in conjunction with services of a minimal nature, might violate the statute.[33]

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26. 42 U.S.C. § 1395nn(b)(1),(2) & (3) (1982); 42 U.S.C. § 1396h(b)(1),(2) & (3)(1982).

27. United States v. Perlstein, 632 F.2d 661 (6th Cir. 1980), *cert. denied*, 449 U.S. 1084 (1981).

28. United States v. Hancock, 604 F.2d 999 (7th Cir.), *cert. denied*, 444 U.S. 991 (1979).

29. 625 F.2d 173 (7th Cir. 1980).

30. *Id.* at 177 n.9.

31. 604 F.2d 999 (7th Cir.), *cert. denied*, 444 U.S. 991 (1979).

32. 625 F.2d at 176-77; 604 F.2d at 1002. *United States v. Hancock* cited a frequently reiterated definition of a "kickback": " 'a percentage payment . . . for granting assistance by one in a position to open up or control a source of income. . . .' WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY (1966) . . ." 604 F.2d at 1002.

33. *See* United States v. Tapert, 625 F.2d 111 (6th Cir. 1980), *cert. denied*, 449 U.S. 952 (1980), and *cert. denied*, 449 U.S. 1034 (1980), where for example, the defendant labora-

Some of the fact patterns addressed by the courts have been fairly complex. In *United States v. Universal Trade and Industries, Inc.*,[34] the court upheld a conviction against Universal, a large medical laboratory, which had been approached by the administrator of a medical clinic "looking for a new laboratory to do his clinic's laboratory tests."[35] Universal agreed to set up a laboratory in a small room at the clinic, at no cost to the clinic. It was further agreed that the administrative director of Universal would handle all administrative matters for this laboratory, including personnel. The lab would do simple tests on-site and send complicated tests to Universal. Once established, the lab would be owned by a separate corporation. While the clinic would not have invested any money, it would own stock in the corporation. The clinic owners were to be further remunerated by receiving a percentage of profits, and its director was to be paid a percentage of gross revenues as an administrative salary.[36] Despite the attempt to characterize the payments as "administrative fees," and the plan to provide an equity interest for the physician owners, the scheme was successfully challenged as violative of the Medicaid statute. Key facts cited by the court included the lack of a contribution by the clinic for the stock of the on-site laboratory and the non-performance of administrative duties by the director.[37]

In a recent case, *United States v. Greber*,[38] Dr. A. Alvin Greber,

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tory was alleged to have made payments, labeled "consulting fees," to doctors (1) to induce them to send laboratory work to the defendant, (2) to cause them to form a corporation to allow doctors to gain an ownership interest in defendant, and (3) to cause them to encourage other doctors to send their lab work to defendant. Defendants challenged the sufficiency of the government's information under which they were charged, to establish a crime under 42 U.S.C. § 1396n(b), and challenged the vagueness of the statute itself. According to the information, the work had been performed and the billing was in accordance with Medicaid statutes and regulations. Nonetheless, because the payments were acknowledged to be at least in part for referrals, they were sufficient to constitute illegal kickbacks under even the less specific language of the pre-1977 version of 42 U.S.C. § 1396h(b). According to the court, Congress, in 1977, amended 42 U.S.C. § 1396h(b) "so as to remove any possible doubt that conduct such as that involved in the present case violates the Act." (footnote omitted) 625 F.2d at 113.

34. 695 F.2d 1151 (9th Cir. 1983).

35. *Id.* at 1152.

36. *Id.*

37. *Id. Cf.* Tanquilut v. Illinois Dep't of Public Aid, 78 Ill. App. 3d 55, 396 N.E.2d 1126 (1979), where the court overturned an administrative finding adverse to a physician practice which leased space in its building to a pharmacy. The court determined that the agency had not adduced sufficient evidence that the rental fee, based in part on a percentage of gross receipts, was excessive, nor shown evidence of patient steering or excessive prescription practices.

38. 760 F.2d 68 (3d Cir. 1985).

Chairman of Internal Medicine at Philadelphia's Metropolitan Hospital Parkview Division, was convicted by a jury in the U.S. District Court in Philadelphia on federal charges of fraud, making false statements on Medicare documents, and paying kickbacks to physicians to increase sales at Cardio-Med, a medical equipment company he owned. The facts, much simplified, were as follows: Cardio-Med billed Medicare for performing Holter Monitor tests, as ordered by a patient's physician. Cardio-Med, in turn, paid the referring physician for interpreting the results of the monitoring.[39]

The government took a very aggressive stance in regard to the legal basis for a conviction under the fraud and abuse statutes. According to the government's trial memorandum, even if it were true, as defendant asserted, that Cardio-Med paid a reasonable fee for actual services, i.e., interpretation of Holter Monitor tests, the fact that the physicians rendered the services would be an insufficient defense under the antifraud and abuse statutes:

> The same evil remains even if the physician actually performs a service for the remuneration or kickback that would have been properly compensable from Medicare funds if it had been billed directly by the physician to Medicare . . . . Even assuming that the doctor did the interpretation, this still has the pernicious effect of leaving the physician under a financial incentive to overutilize the Holter Monitor services, while insulating him from accountability for his actions since only Cardio-Med, and not the physician, is on record with Medicare as having billed for the service.[40]

The Third Circuit recently affirmed the district court's decision, stating that "if one purpose of the payment was to induce future referrals, the Medicare statute has been violated."[41]

In addition to case law, guidance as to the application of the antifraud and abuse provisions of the Medicare and Medicaid laws can be found in letters issued by the Health Care Financing Administration (HCFA), the federal agency charged with enforcement of the statute. HCFA has taken the position in several letters, for example, that any agreement in which a physician agrees to refer his patients exclusively to one hospital would violate the statute.[42]

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39. *Id.* at 69-70.

40. Brief for Government at 15-16, United States v. Greber, No. 83-00414 (E.D. Pa. 1983).

41. 760 F.2d at 69.

42. Letter from Martin L. Kappert to Regional Administrator in Atlanta (Jan. 8, 1980)(information on 1977 Fraud and Abuse Amendments); Letter from Irv. Cohen, Deputy Director—Office of Program Validation—Bureau of Quality Control (Mar. 18, 1980)(clarification of HCFA interpretation of illegal remuneration provisions of Medicare-Medicaid Anti-Fraud and Abuse Amendments).

For example, in the letter dated March 18, 1980, HCFA wrote:

> We agree . . . that, while the physician's income is not directly tied to the number of admissions provided the hospital, payment of any remuneration in exchange for an exclusive referral agreement with the hospital would seem to be prohibited under the language of section 1877(b).[43]

Even in the absence of an express referral requirement, a risk of an antifraud and abuse charge may arise if a course of conduct develops whereby a provider routinely and exclusively refers all of its patients in need of services to one entity. If such a course of conduct exists, HCFA might argue the existence of an *implied* exclusive referral contract, and initiate enforcement proceedings.

In addition to addressing general issues involving physician remuneration and practices, HCFA has commented on so-called "finder's fees" paid by durable medical equipment (DME) suppliers to health care professionals who are in a position to direct patients to particular suppliers. Intermediary Letter, No. B-85-2, April, 1985[44] was purportedly issued in response to questions received by HCFA in regard to payments received by health care professionals in a position to direct patients needing DME to particular suppliers. In this Letter, HCFA addressed the referral of patients by respiratory therapists. Therapists who had referred patients would receive a fee from the supplier for setting up the necessary equipment, instructing the patient in the use of the equipment, or performing monthly maintenance on the equipment. The Letter states that these payments to therapists might constitute a violation of the fraud and abuse provisions if "intended to induce the referral of patients to the suppliers." Even if the respiratory therapist performs services, the arrangement will be analyzed to see if all or some of the payment is intended to induce a referral rather than compensate for services.

The Letter indicates that such arrangements will be reviewed on a case-by-case basis. However, HCFA may consider the following factors, among others, in evaluating whether a payment is, in effect, a prohibited referral fee, or "kickback":

> [W]hether the therapist provides services to the DME supplier only for those patients which he refers, whether the supplier uses therapists to install and service equipment for patients not referred by therapists, whether

43. Letter from Irv. Cohen (Mar. 18, 1980).

44. Program Memo. to Carriers, No. B-85-2, *Medicare/Medicaid: Finders and Referral Fees to Therapists*, [1985 Transfer Binder] MEDICARE & MEDICAID GUIDE (CCH) ¶ 34,544 (Apr. 1985).

there are unusual geographic or medical reasons for using therapists in certain areas, and how similar equipment is installed and maintained by other suppliers in the area.[45]

The reasoning of this Letter would seem to apply to any party having control or influence over patient referrals, including employees of a non-institutional provider and a provider itself. While there may be arguments that the Intermediary Letter should be interpreted strictly and limited to its facts, the Letter makes it clear that payments for services will be carefully scrutinized. Even if the fee is reasonable, such payments will, according to HCFA, violate the law if they are made for patient referrals.

As should be clear from the discussion of the case law and interpretations by the government of the antifraud and abuse provisions, these statutes pose real problems for entities interested in joint venturing. Because of the breadth of the statute and the government's aggressive approach, as well as the uncertainty as to how the statutes will be applied to joint enterprises, there can be no guarantees that participation by several entities in a health care venture will not violate the antifraud and abuse provisions of Medicare and Medicaid.

More specifically, if a contractual arrangement is to be used, special care should be exercised. For example, if a visiting nurse association (VNA) contracts to provide services to a supplier, the agreement should be non-exclusive. The VNA must be free to refer patients to any supplier, as appropriate. Furthermore, the supplier must be free to utilize other nursing agencies to render services to the patient when that is appropriate. At the same time, the VNA must provide services to a range of patients, including patients referred to the supplier by physicians, not simply those patients with whom the VNA has had initial contact. The contract should specify that in all instances the patient chooses the supplier, and the actual operation of the arrangement must reflect that contract provision. In other words, patients must be given a real opportunity to exercise choice of supplier, and payment for services to professionals must not take place prior to patient choice and must not be contingent upon patient choice. Special care should be taken that VNA's are not paid by suppliers for services which are already provided by a hospital, and which are part of its "rate" (e.g., discharge

45. *Id. See also* Intermediary Letter, No. B-84-9, *Payments to Respiratory Therapists by Durable Medical Equipment Suppliers and the Illegal Remuneration Provisions of the Social Security Act*, [1984-2 Transfer Binder] MEDICARE & MEDICAID GUIDE (CCH) ¶ 34,127 (Sept. 1984).

planning).

The services that are provided through a contractual arrangement must be provided to patients regardless of referral source. The services provided must be medically necessary, and strong utilization review should be present. The fees that are paid by a supplier to a service entity must be reasonable in light of the services that are in fact rendered. The parties contracting must understand that they will have to be prepared to show that the arrangement does not increase charges to the patients or costs to the Medicare and Medicaid system; fundamentally, they must be able to show that the payments are not for patient referrals.

Carrying out a joint venture through a partnership appears to provide more protection from successful prosecution under the antifraud and abuse provisions, although again, there can be no guarantees. Under the partnership arrangement, a new supplier or provider is created to compete independently with other suppliers/providers for business. There are no longer two entities, one of which can be characterized as referring to the other, but a single entity representing a joint investment by two parties. To strengthen this legal distinction, however, the parties should form a bona fide partnership which would engage in a genuine business venture, with each partner sharing in distributions based solely on each partner's proportionate contribution to the partnership and not on volume of business or number of patients. Each partner should be at risk for its pro rata share of all losses suffered by the joint venture in proportion to their respective ownership interests.

It is helpful if parties with a "captured" patient base, such as hospitals, do not participate directly. In other words, if a reorganized hospital system is interested in, for example, home health care, it is advantageous for the home care venture to be carried out through an affiliate of the hospital and not the hospital itself. In addition, of course, the hospital corporation must not receive any payments that could be characterized as kickbacks for referring its patients to the venture entity. Even in this situation, there is no guarantee that the government would not attempt to look through the affiliate to the provider entity and view a partnership distribution to the affiliate as an "indirect" payment to the related party made to induce a referral.

If one partner is a hospital affiliate, there should be no requirement, explicit or implicit, and no increased remuneration, for the hospital to refer any patients to the partnership's joint venture. Patients discharged from the hospital should be presented with realistic options for obtaining supplies and services from a variety of sources. Furthermore, the partnership should not limit its marketing efforts to patients discharged from the hospital.

D. *Tax Issues*

While most joint ventures will not seek a determination of tax-exempt status, obtaining tax-exempt status for a joint venture may be possible depending on the venture's purposes. In general, a hospital shared service consortium does not qualify under section 501(c)(3)[46] for tax exemption,[47] unless it satisfies one of the three following narrow exceptions:

> (i) The consortium members are related entities, *i.e.*, part of a single tax exempt parent-subsidiary group;[48]
> (ii) The consortium conducts substantive programs that the Service regards as inherently exempt in nature such that the organization independently qualifies for exemption under the "charitable, educational, scientific" criteria of section 501(c)(3), *e.g.*, a research laboratory operated in conjunction with the teaching program(s) of one or more member hospitals;[49] or
> (iii) The consortium provides services to exempt organizations in a situation where the services are not otherwise commercially available[50] or provides the services at or below cost.[51]

If a shared service consortium will not satisfy any of these narrow exceptions, the joint venture corporation must be organized and operated in accordance with the requirements of section 501(e)[52] to be eligible for tax-exemption. Section 501(e) of the Internal Revenue Code was enacted to allow tax-exempt hospitals to join together to provide certain specified, ostensibly commercial services on a cooperative basis free from federal taxation.[53] For example, a joint venture formed by several hospitals to provide laboratory or diagnostic imaging services may seek to qualify for federal tax-exemption under this section. A hospital shared service consortium satisfying the organizational and operational requirements of section 501(e) will be deemed a "charitable" organization under section 501(c)(3) and may be eligible for foundation classifi-

46. I.R.C. § 501(c)(3).
47. I.R.C. § 502(a).
48. Treas. Reg. § 1.502-1(b).
49. Priv. Ltr. Rul. 8230002.
50. *Cf. id.*
51. *See* Rev. Rul. 71-529, 1971-2 C.B. 234. *See also* Rev. Rul. 72-369, 1972-2 C.B. 245; G.C.M. 38987 (Feb. 13, 1983).
52. I.R.C. § 501(e).
53. *See* HCSC-Laundry v. United States, 450 U.S. 1, 5-6 (1981).

cation under sections 509(a)(1)[54] and 170(b)(1)(a)(iii)[55] as a publicly supported organization by virtue of its contributions, under section 509(a)(2) as publicly supported by virtue of its earned income or under section 509(a)(3)[56] as a supporting organization.

More likely as part of a reorganized hospital system, a tax-exempt corporation will be formed to engage in a joint venture with for-profit entities. Among the issues that might be raised by this scenario are: (1) whether the new corporation would qualify for tax-exempt status; (2) whether entering into a partnership with a for-profit entity would threaten the tax-exempt status of the new corporation; and (3) whether some of its activities would generate unrelated business taxable income (UBTI).[57]

To qualify for exemption, the new corporation would have to satisfy both an organizational and operational test. To meet the organizational test, the corporate purposes of the new corporation, as stated in its articles of organization, would have to be limited to exempt purposes, *e.g.*, charitable, educational or scientific purposes.[58] The operational test may be divided into three major parts: (1) the primary activity test, which precludes the corporation from conducting a substantial part of its activities for non-exempt purposes;[59] (2) the trade or business test, which precludes exempt status if a primary activity of the corporation is the conduct of an unrelated trade or business (defined as a business the conduct of which is not "substantially related" to the exercise or performance by such organization of the purpose or function constituting the basis for its exemption);[60] and (3) the private benefit test, which requires that the net earnings of the corporation not inure to the private benefit of non-exempt entities.[61]

Assuming that, at least initially, the new corporation's primary activity would be its participation in the joint venture by means of a partnership, and its primary source of income would be distributions from the partnership's net profits, the new corporation would have to demonstrate that (1) its activities on behalf of the partnership are consistent with its exempt purposes, and (2) that the part-

54. I.R.C. § 509(a)(1).
55. I.R.C. § 170(b)(1)(a)(iii).
56. I.R.C. § 509(a)(3).
57. I.R.C. § 513.
58. Treas. Reg. § 1.501(c)(3)-1(b).
59. Treas. Reg. § 1.501(c)(3)-1(c)(1).
60. *Id.*
61. Treas. Reg. § 1.501(c)(3)-1(c)(2).

nership business is "substantially related" to the performance of the new corporation's exempt purposes. For example, to the extent the new corporation would be responsible for the supervision of the clinical and educational services provided by the partnership, it could argue that its activities on behalf of the partnership were consistent with its exempt purposes. Furthermore, to demonstrate that the partnership business is "substantially related" to the new corporation's performance of its exempt purposes, it would be important to stress the clinical and educational component of the venture and to be able to differentiate the partnership business from the purely commercial activities of the non-exempt venturer.

Another hurdle to be overcome would be the private benefit test. For many years, the IRS appeared unwilling to deviate from the general rule that participation of an exempt entity as a general partner in a partnership with a for-profit corporation was inconsistent with tax-exempt status.[62] This rule has been relaxed recently with regard to joint ventures involving medical office buildings and radiology equipment, where the IRS was satisfied that the interests of the tax-exempt organization were adequately protected.[63]

While caution should be exercised in this area, it appears at this time that in the context of an exempt organization's participation in a partnership with a non-exempt organization, the Service will generally apply a so-called "facts and circumstances" test to determine whether such participation will threaten the tax-exempt status of the former. The for-profit entity should not, of course, be deriving any unreasonable benefits in the way of excessive salaries or other prerequisites as a result of the exempt entity's contributions to the partnership. The investors in the partnership should not be the same persons who control the tax-exempt entity. Assuming further that the proprietary entity is receiving earnings from the partnership strictly in proportion to its ownership interest or investment, the Service will weigh the "incidental" benefit to the proprietary entity derived from the exempt entity's capital contributions to the partnership against the "public benefit" derived from the exempt entity's pursuit of its exempt purposes through the partnership structure. In addition to emphasizing the special clinical and educational services of the partnership, the new

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62. Priv. Ltr. Rul. 7820058.

63. *See* Priv. Ltr. Rul. 8234029 (hospital's for-profit subsidiary, a general partner in medical office building—"MOB"); Priv. Ltr. Rul. 8217022, as amended by Priv. Ltr. Rul. 8226146(MOB); Priv. Ltr. Rul. 8344099 (joint venture to purchase and operate a CAT Scanner); *See also* Priv. Ltr. Ruls. 8206093, 8409102.

corporation should be able to demonstrate that without joint venturing with the proprietary company, it would not be able to pursue the activity.

Of course, even if a tax-exempt status is obtained, to the extent that the Service finds that the partnership business is unrelated to the performance of the new corporation's exempt purposes, the income would be treated as UBTI.[64] If the UBTI were to constitute a significant portion of the new corporation's income, its tax-exempt status would be jeopardized.

Finally, where the partnership format is chosen as a vehicle to provide certain tax benefits to individuals or the for-profit entity, care must be exercised to avoid triggering the tax-exempt entity leasing rules;[65] and where a certain "tax shelter ratio" (computed by comparing investments to deductions) will be generated and securities issues raised, the tax shelter, be it a partnership or a corporation, must register with the IRS.[66]

E. *Antitrust Issues*

The recent increase of joint ventures in the health care industry between potential competitors has made the industry more susceptible to scrutiny under federal and state antitrust laws. In general, every joint venture among horizontal competitors raises antitrust risks, and the risks are significantly greater if the venture could have some impact on prices charged by the participants or if the participants have a dominant share in the market. For antitrust purposes, a joint venture may be defined as "an integration of operations between two or more separate firms, in which the following conditions are present: (1) the enterprise is under the joint control of the parent firms, which are not under related control; (2) each parent makes a substantial contribution to the joint enterprise; (3) the enterprise exists as a business entity separate from its parents; and (4) the joint venture creates significant new enterprise capability in terms of new productive capacity, new technology, a new product, or entry into a new market."[67] A joint venture may be a jointly owned corporation, but it is not necessary that either the parents or the joint venture be corporations.

Joint ventures, in which separate entities combine their opera-

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64. Rev. Rul. 68-376, 1968-2 C.B. 246; Priv. Ltr. Rul. 7841061.
65. I.R.C. § 168(j).
66. I.R.C. §§ 6111 and 6112.
67. Brodley, *Joint Ventures and Antitrust Policy*, 95 HARV. L. REV. 1523, 1526 (1982).

tions to achieve limited purposes, could constitute a contract, combination, or conspiracy in restraint of trade in violation of section 1 of the Sherman Act.[68] Only some types of agreements in restraint of trade have been found to be so anticompetitive in purpose or effect that they have been denounced as "illegal per se", i.e. illegal without inquiry into purpose, effect, or legitimate business justification. Traditionally, courts have applied the *per se* rule to price fixing arrangements[69] and market division.[70]

Taking the example of alternative delivery systems in the context of section 1 of the Sherman Act, provider controlled alternative delivery systems are particularly susceptible to an application of the *per se* rule.[71] Independent insurer or employer-sponsored alternative delivery systems are not as susceptible to antitrust challenge because the non-provider controlled alternative delivery system corporation can negotiate a fee schedule individually with each provider, avoiding a horizontal arrangement among providers.[72] In order for a provider-sponsored alternative delivery system to avoid the charge that individual providers are combining, conspiring, or contracting to fix prices, and to avoid the application of the *per se* rule, in favor of the less stringent rule of reason,[73] it

68. 15 U.S.C. § 1 (1982). In the antitrust context, organization of the joint venture as a corporation rather than as a partnership or a contractual relationship will make it less likely that the joint venture itself constitutes a contract in restraint of trade in violation of section 1. The participants, to the extent that they may enter into anticompetitive agreements within the context of the joint venture would be protected by the doctrine set forth in Copperweld Corp. v. Independence Tube Corp., 104 S. Ct. 2731 (1984) (a corporation cannot conspire with its wholly owned subsidiary).

69. *See* Albrecht v. Herald Co., 390 U.S. 145 (1968) (vertical maximum price fixing); Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, Inc., 340 U.S. 211 (1951) (horizontal maximum price fixing). *See also* Klor's, Inc. v. Broadway-Hale Stores, Inc., 359 U.S. 207 (1959) (group boycott).

70. *E.g.*, United States v. Topco Assoc., 405 U.S. 596 (1972). Some joint venture operations are actually a management tool for effecting market division. Market divisions can also arise through competitors forming a joint venture that will only serve a specific territory, such as a free-standing emergi-center relegated to a certain market.

71. *See* Arizona v. Maricopa County Medical Soc'y, 457 U.S. 332 (1982) (*per se* rule applied to invalidate a maximum fee schedule set by physicians).

72. Advisory Op., Health Care Management Assocs., 3 Trade Reg. Rep. (CCH) ¶ 22,036 (June 8, 1983).

73. Under the rule of reason, a court analyzes "the joint venture's structure, the conduct and intent of the venture's participants, and the resulting competitive effects to determine whether a transaction unlawfully restrains trade." Brodley, *supra* note 67, at 1535. In Berkey Photo, Inc. v. Eastman Kodak Co., 603 F.2d 263 (2d Cir. 1979), *cert. denied*, 444 U.S. 1093 (1980), the Second Circuit outlined more specific factors which might be the subject of a rule of reason analysis in determining whether a joint venture imposes an unreasonable restraint on competition: "the size of the joint venturers; their share of their respective markets; the contributions of each party to the venture and the benefits derived; the likeli-

must ensure that the prices it arranges are the product of an arms-length negotiation between the individual provider and a "negotiating committee" of the board of directors of the alternative delivery system brokerage corporation which is composed of, or at least dominated by, non-provider trustees or directors such as employers. This non-provider controlled negotiating committee should have sole authority to arrange fees with participating providers, thus precluding "any contract, combination or conspiracy" among providers in restraint of trade.[74]

A joint venture could also violate the prohibitions of section 2 of the Sherman Act[75] against monopolies if concentration of market power in the new entity were used to impede competition in the field, or if monopoly in one market were used to create monopoly in another market.[76] The elements of an offense under section 2 are possession of monopoly power in a relevant market and the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident.[77] Monopoly power, for purposes of establishing an offense of monopolizing under section 2, is defined as power to control prices and exclude competition with respect to a particular geographical market.[78] If, for example, a company providing traditional indemnity insurance for health care benefits forms a health maintenance organization or a preferred provider organization, it might be leveraging its monopoly power in the group insurance market to impede the development of other alternative delivery systems, to exclude certain providers from participating in its alternative delivery system and to control

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hood that, in the absence of the joint effort, one or both parties would undertake a similar project, either alone or with a smaller firm in the other market; the nature of the ancillary restraints imposed and the reasonableness of their relationship to the purposes of the venture." 603 F.2d at 302.

74. *See* Glen Eden Hosp., Inc. v. Blue Cross & Blue Shield of Michigan, 555 F. Supp. 337 (E.D. Mich. 1983) (court declined to analyze under the *per se* rule a hospital reimbursement committee established by Blue Cross which included hospital administrators.) Applying the rule of reason, the court stated that "[t]he ability of hospitals in the instant case to veto recommended changes does not, without more, demonstrate concerted action in restraint of trade." *Id.* at 342. *See also* Federal Trade Commission enforcement statement regarding physician agreements to control medical prepayment plans in 46 FED. REG. 48982 (October 5, 1981).

75. 15 U.S.C. § 2 (1982).

76. *See* Berkey Photo, Inc. v. Eastman Kodak Co., 603 F.2d 263 (2d Cir. 1979), *cert. denied*, 444 U.S. 1093 (1980).

77. *See* Borough of Lansdale v. Philadelphia Electric Co., 692 F.2d 307 (3d Cir. 1982).

78. *Id.* at 311.

reimbursement prices to providers.[79]

Certain joint ventures might also be characterized under the antitrust laws as "tying arrangements." A tying arrangement, which may be considered a *per se* violation of the Sherman Act, occurs when (1) one party agrees to sell a product or service (the "tying product") only if the buyer agrees to buy a second product or service (the "tied product"); (2) the seller has sufficient economic power with regard to the tying product to coerce purchase of the tied product; (3) a substantial amount of commerce is involved; and (4) the arrangement produces anticompetitive results in the tied market.[80] An example from the home health care field would be an exclusive arrangement whereby a home health care affiliate provided care only to patients discharged from its hospital affiliate. A plaintiff could probably show the existence of two products but might not be able to justify application of the *per se* standard which would presumably require a showing that the seller of the tying product (home health care) had sufficient economic power to force purchase of the tied product (hospital care).[81] In the absence of such market power, a rule of reason analysis would probably apply.

Less likely, but still possible, would be a challenge on the basis that services were "tied" to products. For example, all patients receiving home care from a hospital affiliate might be provided with TPN products from a certain supplier with whom the hospital affiliate had an exclusive contract. An on-going case which alleges unlawful tying is being litigated in Ohio federal district court against Timken Mercy Medical Center, which allegedly had contracts with a nursing home and a VNA, which constituted a tying arrangement.[82] To reduce the risk of attack under a tying theory, one type of health care provider, such as a hospital, should not tie its services to those of another. Furthermore, if the provider has market power over the provision of one service or product, it must be cautious about combining that service or product with the sale of another service or product. The level of competition, barriers to competition, and the existence of potential plaintiffs would all be relevant.

Joint ventures in the home health care industry may run afoul of

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79. *See* Weiss v. York Hosp., 548 F. Supp. 1048 (M.D. Pa. 1982).

80. *See, e.g.*, Bob Maxfield, Inc. v. American Motors Corp., 637 F.2d 1033, 1037 (5th Cir. 1981).

81. *See* Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 104 S. Ct. 1551 (1984).

82. Rudner v. Abbott Laboratories, Inc., No. 84-998 A (N.D. Ohio 1984).

the Robinson Patman Price Discrimination Act.[83] The Robinson Patman Act, amending the Clayton Act in 1936,[84] made it unlawful in most instances for one engaged in commerce to discriminate in price between purchasers of like commodities where, among other things, the effect would be to injure competition.[85] The Nonprofit Institutions Act, enacted in 1938, exempted from the Robinson Patman Act "purchases of supplies for their own use by schools . . . hospitals, and charitable institutions not operated for profit."[86] Based on this defense to the Robinson Patman Act, many hospitals, for example, purchase supplies, such as pharmaceuticals, at favorable prices, for use in connection with or resale to their patients. A hospital may contemplate a similar strategy in connection with a joint venture. For example, a hospital may contemplate entering a joint venture in home care, directly or through a subsidiary, with the joint venture supplying pharmaceuticals, purchased at discount, to patients in their homes. If all parties in the venture are nonprofit, the analysis might proceed along the lines of *Abbott Laboratories v. Portland Retail Druggists Association.*[87]

In *Abbott*, it was not disputed that the pharmaceutical manufacturer sold its products to Portland hospitals at prices lower than it charged commercial pharmacies for the same products.[88] The hospitals then dispensed the medications to a variety of individuals, whom the court, in analyzing the case, grouped into a number of categories.[89]

In general, the court concluded that the Nonprofit Institutions Act exemption was a limited one and would not automatically cover all hospital purchases. The "test" would be whether the purchases were for use by the hospital "in the sense that such use is a part of and promotes the hospital's intended institutional op-

83. 15 U.S.C. §§ 13-13b, 21a (1982). The Robinson-Patman Act applies only to the sale of commodities. There are not many health care joint ventures aside from those in the home health care industry selling commodities.

84. Robinson-Patman Price Discrimination Act, Pub. L. No. 74-692, 49 Stat. 1526 (1936).

85. 15 U.S.C. § 13(a) (1982).

86. 15 U.S.C. § 13c (1982) (originally enacted as Act of May 26, 1938, ch. 283, 52 Stat. 446).

87. 425 U.S. 1 (1976) (the more recent case of Jefferson County Pharmaceuticals Ass'n v. Abbott Laboratories, 103 S. Ct. 1011 (1983), was directed toward the purchase and resale of pharmaceuticals by government entities. However, the case did reaffirm the heavy presumption against exemptions to the antitrust laws). *See also* De Modena v. Kaiser Found. Health Plan, Inc., 743 F.2d 1388 (9th Cir. 1984), *cert. denied*, 105 S. Ct. 1230 (1985).

88. 425 U.S. at 6.

89. *Id.* at 9-10.

eration in the care of persons who are its patients."[90]

More specifically, the court found that categories 1-3 (sales to inpatients, for use in their treatment in the hospital; to patients admitted to the emergency room, for use in their treatment in the emergency room; and to outpatients for their personal use on the hospital premises) were clearly for the hospital's own use.[91] Categories 4 and 5 (sales to inpatients and to emergency room patients upon discharge for personal use off the premises, and to outpatients for personal use off the premises), to the extent they encompassed "genuine take-home prescriptions" intended to continue and/or supplement for a limited reasonable time treatment administered to patients at the hospital, were also for the hospital's own use. However, a *refill* of a take-home prescription was not for the hospital's own use.[92]

According to the court, the final two relevant categories, sales to staff physicians for dispensation in their private practice and sales to walk-in customers, were further from the hospital's own use. In particular, extension of the exemption to the walk-in customer, in the absence of an emergency, would convert the hospital pharmacy into "just another community drug store" with an unfair advantage over competing community pharmacies.[93] The court refused to adopt a physical line of demarcation at the hospital's door, but looked instead to the hospital's continued participation in the medical supervision and treatment begun at the hospital.[94]

The court concluded that additional recordkeeping would be necessary if the hospital dispensed in any non-exempt circumstances, since appropriate price adjustments would be required.[95] Justice Marshall, concurring in the opinion of the court, stated that in his view, the purpose of the "own use" limitation was to prevent nonprofit institutions from taking advantage of the antitrust exemption by buying supplies at low cost in order to resell them at a profit.[96] While Congress was interested in helping charitable institutions by lowering their expenses, it did not intend to help them indirectly, at the expense of competition, by giving them

90. *Id.* at 14.
91. *Id.*
92. *Id.* at 15.
93. *Id.* at 18.
94. *Id.* at 15.
95. *Id.* at 20.
96. *Id.* at 22 (Marshall, J., concurring).

the means to raise money.[97]

In *De Modena v. Kaiser Foundation Health Plan, Inc.*,[98] the court broadly defined the term charitable institution and found that it encompassed the Kaiser Health Plan, an HMO.[99] The court then rejected the wholesale application of the *Abbott* categories to an HMO, choosing instead to determine the basic institutional function of the health plan and to decide which sales were in keeping with this function. Because an HMO provides continuing and often preventive health care for its members, any sale of drugs to a member falls within the basic function of the HMO.[100]

Based on the "own use" analysis in *Abbott* and in *De Modena*, it is possible that sales to home care patients by a charitable home care corporation could be characterized as for its "own use." The strength of the argument would depend on the extent to which the new entity had as its charitable purpose the provision of continuing care to patients in their homes. While an antitrust challenge, based in part on the Robinson Patman Act, has been mounted against a provider of home hyperalimentation, the provider was a hospital which had not traditionally been characterized as serving home patients.[101] However, while arguably a charitable home care corporation might be found to be entitled to the Nonprofit Institution Act exemption, based on the policy arguments articulated in the two cases noted above, it is unlikely that the exemption would extend to sales by a partnership, formed between a for-profit and a not-for-profit entity, even if the sales were to individuals characterized as patients of the partnership. Therefore, this issue and its economic ramifications for the venture should be considered carefully with the proposed venturers prior to implementation of the venture.

If the venture can qualify as a joint venture for antitrust purposes it will be judged under a more lenient standard. The Supreme Court in *Arizona v. Maricopa County Medical Society*[102] noted that the foundation in that case, whose price fixing it condemned as a *per se* violation of the Sherman Act, was not "analogous to partnerships or other joint arrangements in which persons

97. *Id.* at 22-23 (Marshall, J., concurring).

98. 743 F.2d 1388 (9th Cir. 1984), *cert. denied,* 105 S. Ct. 1230 (1985).

99. *Id.* at 1392.

100. *Id.* at 1392-93.

101. Home Parenteral Care, Inc. v. Sisters of St. Joseph Peace, No. 84-144 (D. Ore. 1984).

102. 457 U.S. 332 (1982).

would otherwise pool their capital and share the risks of loss as well as the opportunities for profit."[103] The Court added that "in such joint ventures the partnership is regarded as a single firm competing with other sellers in the market."[104]

Perhaps the most important characteristic of a joint venture for antitrust purposes is the creation of a new producing organization.[105] Providers, for instance, cannot simply join together and call themselves a joint venture in order to escape a *per se* evaluation under the antitrust laws without creating some new productive capacity. In *Maricopa*, the Supreme Court noted that the combination of physicians in the form of a foundation which sets prices did not permit them "to sell any different product."[106] In *Timken Roller Bearing Co. v. United States*,[107] the Supreme Court held that labelling a project a "joint venture" which "perhaps every agreement and combination could be so labelled" would not shield allegedly unlawful activity from antitrust condemnation.[108]

Therefore, for example, a provider-sponsored PPO must convince a court that its PPO brokerage corporation is really a new and distinct entity and that individual providers would not enter the market unless they could organize the joint venture/PPO brokerage corporation for purposes of risk spreading. The PPO "whole" must be "truly greater than the sum of its parts," and must be a "different product."[109] A provider would argue that the PPO provides a unique and effective system of coordinated health care delivery at a time when public concern over spiraling health costs is intense. Coordination of managerial expertise, development of the right mix of professional participation and a consistent utilization review mechanism, as well as a fuller integration of physician and hospital interests and shared risk taking, will increase both the consumer benefit and competitive advantage of the PPO.

F. *Employee Benefit Plans: Internal Revenue Code Compliance*

Joint ventures can have significant consequences for employee benefits. The tax-favored status of many employee benefit plans, e.g., pension, profit-sharing, self-insured medical reimbursement,

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103. *Id.* at 356.
104. *Id.*
105. *See* United States v. Penn-Olin Chemical Co., 378 U.S. 158, 169 (1964).
106. 457 U.S. at 356.
107. 341 U.S. 593 (1951).
108. *Id.* at 598.
109. Broadcast Music, Inc. v. Columbia Broadcasting System, 441 U.S. 1, 21-22 (1979).

cafeteria and funded welfare plans, depends on demonstrating that the benefits of such plans do not unduly discriminate in favor of officers, shareholders or highly compensated employees.[110] In testing whether impermissible discrimination exists, the employees of affiliated employers are treated as employed by a single employer and leased employees are treated as employed by the recipient of their services.[111] In addition, tax-qualified pension and profit-sharing plans must include special provisions (including minimum benefit or contribution rules and often accelerated vesting), if more than sixty percent of the benefits are earned by officers and certain shareholder-employees (so-called "top-heavy" plans).[112] In determining whether a particular plan is top-heavy, benefits and contributions under certain other plans of the employer and of any affiliated employers must be aggregated.[113]

The affiliation of employers will not necessarily lead to the disqualification of the employee benefit plans of the affiliated employers or limit the opportunity of affiliated employers to establish new plans. Nevertheless, demonstrating satisfaction of the non-discrimination standards is more complex when employers are affiliated. Employers may be limited as to the type and amount of tax-favored benefits they may offer their employees by the need to satisfy the non-discrimination standards on an aggregate basis. The effect of affiliation on the top-heavy determination is more difficult to predict and may be either helpful or injurious, depending on the precise facts. In any case, however, plan amendments may be required to ensure the plans properly reflect the existence of affiliated employers.

Two or more trades or businesses will be deemed affiliated if

(i) one organization owns at least 80% of another organization or
(ii) the same five or fewer individuals, estates or trusts own, in aggregate

> (a) at least 80% of two or more organizations, and
> (b) more than 50% of such organizations, taking into account for this purpose only the smallest interest of each individual, estate or trust in each such organization.

The trades or businesses which may be affiliated under this rule include, but may not be limited to, corporations (based on voting rights or value), partnerships (based on capital or profits interests),

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110. *See generally* I.R.C. §§ 105(h), 125, 401, 410 and 505.
111. I.R.C. §§ 414(b), (c), (m) and (n).
112. *See* I.R.C. § 416.
113. I.R.C. § 416(c)(2).

trusts (based on actuarial interests) and sole proprietorships.[114] In addition, certain attribution rules apply which may cause interests owned by one person or entity to be treated as owned by another person or entity.[115]

Two or more organizations will also be deemed to be affiliated if the organizations constitute an affiliated service group.[116] Generally, the formation of an affiliated service group requires a degree of cross-ownership similar to that described above (but with considerably lower thresholds) and also that one organization regularly perform services for the other organization in providing services to third parties. No cross-ownership is required, however, if the principal business of one organization is the performance of management services for another, or another and related, organizations.

An individual providing services to an organization (the "recipient") who is not otherwise an employee of the recipient under common law principles may nevertheless be treated as an employee of the recipient if he has performed services for the recipient, of a type historically performed by employees in the business field of the recipient, on a substantially full-time basis for a period of at least one year pursuant to an agreement between the recipient and any other person.[117] Such an individual will not be treated as a leased employee, however, if the leasing organization covers the individual under a money purchase pension plan which provides immediate participation, full and immediate vesting and an employer contribution rate of at least 7½% (determined without taking account of the employer's Social Security contributions).[118]

G. *Labor and Employment Matters*

The entering of a joint venture also raises questions under the federal labor laws. The principal issue will be, once again, whether the contracting parties, or the entity they create, may properly be viewed as separate employers, or whether they will constitute a single employer for purposes of these laws as well.

114. Proposed Treas. Reg. 1.414(c)-2.
115. Proposed Treas. Reg. 1.414(c)-4.
116. I.R.C. § 414(m).
117. I.R.C. § 414(n)(2).
118. I.R.C. § 414(n)(5).

1. *Fair Labor Standards Act*

The federal Fair Labor Standards Act of 1938[119] provides for the payment of minimum wages to non-exempt employees.[120] It also prohibits employers from employing any such employee for a workweek longer than 40 hours "unless such employee receives compensation for his employment in excess of [40] hours at a rate not less than one and one-half times the regular rate at which he is employed."[121] The Department of Labor has taken the position that an employee's work for two or more entities during the same workweek must be aggregated for purposes of these minimum wage and overtime provisions where (1) there is an arrangement between the entities to share the employee's services, (2) one of the entities is acting directly or indirectly in the interest of the other entity (or entities) in relation to the employee, or (3) the entities are not completely disassociated with respect to the employment of the employee and may be deemed to share control of the employee, directly or indirectly, by reason of the fact that one of them controls, is controlled by, or is under common control with the other entity.[122]

Under the Department's regulations, an employee who performs services for more than one of the entities participating in a joint venture may be deemed to be working for a single employer so that the employee's total hours and compensation must be aggregated for purposes of determining (1) the employee's regular rate of pay and (2) both entities' compliance with the minimum wage and overtime provisions. As one court stated:

> [W]here an employee works for two or more employers during the same workweek pursuant to an arrangement between such employers for the interchange of the employee, or if one company controls, is controlled by, or is under common control with, directly or indirectly, the other company, the entire employment must be considered as a whole for the purposes of the Act and the employers are joint employers and each is jointly liable for the full amount of underpayments irrespective of what portion of the joint employment may have been performed for each joint employer.[123]

The term "employer" is defined in the Act as including: "any person acting directly or indirectly in the interest of an employer in

119. 29 U.S.C. §§ 201-219 (1976 & Supp. IV 1980).
120. 29 U.S.C. § 206 (1976).
121. 29 U.S.C. § 207(a)(1) (1976).
122. 29 C.F.R. § 791.2 (1985).
123. Mitchell v. Thompson Materials & Construction Co., 12 Wage & Hour Cas. (BNA) 367, 369 (S.D. Cal. 1954).

relation to an employer."[124]

Several courts have held that, under this definition, personal liability may be imposed on the officers and directors of an employer for minimum wage or overtime pay violations regardless of whether fraud or some other basis for disregarding the corporate form is shown.[125] The only test to be applied is whether the person on whom liability is sought to be imposed was actively engaged in the management, supervision, and oversight of the corporation's operations.[126]

2. *National Labor Relations Act*

Multiple business entities may also be deemed to constitute a "single employer" for purposes of the National Labor Relations Act (the NLRA).[127] The NLRA guarantees to employees the right to engage in concerted activities for mutual aid and protection[128] and also provides for the election of bargaining representatives in appropriate bargaining units.[129] The National Labor Relations Board (the Board), which has the responsibility to administer the Act, has generally considered four factors to determine whether two or more companies should be treated as a single employer: (1) functional interrelation of operations; (2) centralized control of labor relations; (3) common management; and (4) common ownership or financial control.[130] Common control of labor relations has been described as the most critical factor to a determination that a single employer exists,[131] while common ownership is the least important.[132]

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124. 29 U.S.C. § 203(d) (1976).

125. *E.g.*, Marchak v. Observer Publications, Inc., 493 F. Supp. 278, 282 (D.R.I. 1980); Schultz v. Chalk-Fitzgerald Construction Co., 309 F. Supp. 1255, 1257 (D. Mass. 1970).

126. Donovan v. Agnew, 712 F.2d 1509 (1st Cir. 1983).

127. 29 U.S.C. §§ 151-168 (1976).

128. 29 U.S.C. § 157 (1976).

129. 29 U.S.C. § 159 (1976).

130. *E.g.*, Radio & Television Broadcast Technicians Local 1264 v. Broadcast Services of Mobile, Inc., 380 U.S. 255, 256 (1965) (per curiam); *quoted with approval in* South Praire Construction Co. v. Local 627, International Union of Operating Engineers, 425 U.S. 800, 802 n.3 (1976).

131. *See, e.g.*, Soule Glass & Glazing Co., 246 N.L.R.B. 792, 794 (1979), *enforced in part*, 652 F.2d 1055 (1st Cir. 1981).

132. *Cf.* United Telegraph Workers v. NLRB, 571 F.2d 665, 667 (D.C. Cir.), *cert. denied*, 439 U.S. 827 (1978) ("Because common ownership is necessarily a feature of any conglomerate organization, and because common ownership is not determinative where common control is not shown, the Board held that the Union failed to demonstrate that [a holding company and five subsidiaries] were a single employer").

A determination that a single employer exists for purposes of the NLRA can have numerous implications for the labor relations of the various entities. In the first place, it will affect the scope of potential bargaining units. For example, a typical bargaining unit is generally limited by the Board to those employees of an employer who have the requisite "community of interests."[133] Where, however, two or more entities are properly considered a single employer for purposes of the Act, the scope of the potential bargaining unit—and any election designated for the unit—may include the employees of all the related entities.[134] In some circumstances, this might work to the advantage of the entities engaged in a joint venture because it is normally easier for a union to organize a smaller group of employees than a larger group. At the same time, by insisting on the larger unit, the entities may avoid the prospect of having to deal with numerous unions and bargaining units.[135]

On the other hand, if one or more of the entities participating in a joint venture is already organized, the Board may find that an "accretion" to the preexisting bargaining unit has occurred when the joint venture is established. Under these circumstances, the previously unorganized entity may be obligated to observe the terms of any existing collective bargaining agreement or to bargain with the union representing the preexisting unit over the terms of a new agreement.[136] Generally, the Board has looked to the following factors to determine whether an accretion to an existing bargaining unit has occurred: (1) degree of interchange among employees, (2) geographical proximity of new operation, (3) integration of operations, (4) functional integration, (5) centralized control of administration, (6) similarity of working conditions, skills and functions, (7) common control over labor relations, (8) collective bargaining history, and (9) number of employees at the new or acquired facility compared with those in the bargaining unit at existing operation.[137]

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133. 1950 NLRB Ann. Rep. 39 (1951) (In resolving the unit issue, "the Board's primary concern is to group together only employees who have substantial mutual interests in wages, hours, and other conditions of employment").

134. *E.g.*, Blumenfeld Theatres Circuit, 240 N.L.R.B. 206, 216 (1979).

135. Congress has recognized the problems that would be created by a proliferation of bargaining units in the health care field. *See* Vicksburg Hospital, Inc. v. NLRB, 653 F.2d 1070, 1075 (5th Cir. 1981).

136. *See, e.g.*, Texlite, Inc., 46 L.R.R.M. (BNA) 1264 (1960); Continental Can Co., 127 N.L.R.B. 286 (1960).

137. *See* Consolidated Edison Co., 132 N.L.R.B. 1518 (1961); Essex Wire Corp., 130 N.L.R.B. 450 (1961).

In addition to these representation issues, if a single employer is found to exist, each of the entities participating in a joint venture may be held liable for the other's violations of the NLRA.[138] At the same time, each of the entities may be denied the protection of the secondary boycott provisions contained in the NLRA. These provisions make it an unfair labor practice for a labor organization to threaten or coerce any employer for the purpose of forcing it to cease doing business with any other employer.[139] Under these provisions, a labor union having a dispute with one employer cannot picket or strike another employer with which it has no dispute in order to coerce or induce the other employer to put pressure on the first employer with which the labor organization does have a dispute. If, however, the two entities are properly regarded as a single employer for purposes of the Act, the secondary boycott provisions dò not apply and the union is free to strike or picket either of the entities in order to achieve its purpose.[140]

3. *Anti-Discrimination Statutes*

In some circumstances, multiple entities may also be deemed to be a single employer for purposes of Title VII of the Civil Rights Act of 1964,[141] which prohibits discrimination against employees on the basis of their race, color, sex, religion, or national origin.[142] In general, courts have applied the tests for single employer status developed by the National Labor Relations Board to Title VII cases.[143] As under the NLRA, the consequence of a finding of single employer status may be that one of the entities participating in a joint venture may be held liable for the unlawful acts of another one of the entities.[144] This result is particularly likely when an officer or agent of the entity personally directed or participated in

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138. *See, e.g.*, Royal Typewriter Co. v. NLRB, 533 F.2d 1030, 1043 (8th Cir. 1976) (affirming Board treatment of a wholly owned subsidiary and its parent corporation as a single entity because the parent possessed the present and apparent means to exercise control in matters of labor negotiations even though the day-to-day labor relations matters were not under the parent's control).

139. 29 U.S.C. § 158(b)(4) (1976).

140. *See* Curtin Matheson Scientific, Inc., 248 N.L.R.B. 1212, 1213-14 (1980) (discussing the development of the "single-employer" branch of the ally doctrine in secondary boycott cases).

141. 42 U.S.C. §§ 2000e-2000e-17 (1982).

142. 42 U.S.C. § 2000e-2(a)(1) (1982).

143. *See* Mas Marques v. Digital Equipment Corp., 637 F.2d 24, 27 (1st Cir. 1980).

144. *E.g.*, Baker v. Stuart Broadcasting Co., 560 F.2d 389, 392 (8th Cir. 1977).

the allegedly unlawful action of the other entity.[145]

H. *Compliance with Securities Laws*

Joint ventures organized as limited partnerships or corporations will raise securities laws issues.[146] Unless an exemption applies, any offer or sale of a security must be registered with the Securities and Exchange Commission.[147] Typically, ownership of a stock or investment as a limited partner will involve the owner in the ownership of a "security" because the investment is premised on a reasonable expectation of profits and the profits are to be derived from the efforts of others. Since registering with the SEC might be very expensive and therefore prohibitive in the context of a smaller joint venture, it is very important to obtain an exemption. The principal federal exemption available is under section 3(a)(11) of the Securities Act of 1933[148] and Rule 147 adopted thereunder which offer an exemption for intrastate offerings. The requirements for this exemption include the following:

1. the issuer is a resident of the state in which the offering is to occur;
2. the issuer's business is genuinely local (to that state) in character;
3. all the proceeds of the offering are to be used within that state;
4. all offerees or purchasers are residents of that state;
5. the securities offered pursuant to the exemption come to rest in the hands of persons in that state; and
6. the entire issue of securities is offered and sold in such an intrastate exempt transaction.[149]

Three limited offering exemptions are also available under regulation D.[150] Rule 504[151] involves an offering of $500,000 or less with no limit on the number of offerees or purchasers. Rule 505[152] involves an offering of up to $5,000,000 where there are not more than 35 purchasers and an unlimited number of "accredited inves-

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145. *See, e.g.*, Linskey v. Heidelberg Eastern, Inc., 470 F. Supp. 1181, 1183-84 (E.D.N.Y. 1979); EEOC v. Upjohn Corp., 445 F. Supp. 635, 638 (N.D. Ga. 977).

146. For securities purposes, a general partnership can be characterized as an investment contract if there is an investment of money in a common enterprise with an expectation of profits coming from the efforts of other parties. More particularly, if a general partner is passive, an investment contract may be created and the securities laws may be applicable. On the other hand, if all the general partners contribute to these efforts, then the securities laws should not be applicable.

147. Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (1982).

148. 15 U.S.C. § 77(c)(a)(ii) (1982).

149. 17 C.F.R. § 230.147 (1985).

150. 17 C.F.R. § 230.501-230.506 (1985).

151. 17 C.F.R. § 230.504 (1985).

152. 17 C.F.R. § 230.505 (1985).

tors."[153] Rule 506[154] has no dollar limitation but there must not be more than 35 non-accredited investors—all of whom have knowledge and expertise in financial and business matters so that they are capable of evaluating the merits and risks of the investment—and an unlimited number of accredited investors. Under Regulation D, general solicitation and advertising are prohibited, securities issued are, with one exception, restricted as to resale,[155] specific disclosure requirements are (except in the case of a Rule 504 offering) imposed and a notice filing on Form D[156] is required to be made. In addition, the distinct requirements of "Blue Sky" on state securities laws must be satisfied in order for an offering to be exempt.[157]

IV. Conclusion

Although the legal issues created by a joint venture can be complex, they typically can be surmounted. The major difficulty may instead be in the financial feasibility of a given project. Before involving lawyers in the project, it is prudent to conduct a thorough feasibility study so that the joint venture proves to be a unifying rather than a divisive vehicle, particularly when the participants are hospitals and physicians.

153. *See* 17 C.F.R. § 230.501(e) (1985).
154. 17 C.F.R. § 230.506 (1985).
155. 17 C.F.R. § 230.502 (1985).
156. 17 C.F.R. § 230.503 (1985).
157. 17 C.F.R. § 230.501-230.506 (1985) (Regulation D preliminary notes).