

OIG Issues Advisory Opinion 13-09 on Ownership Interests in Group Purchasing Organization By Hospitals and Other Providers

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On July 16, the U.S. Department of Health & Human Services, Office of Inspector General (OIG) issued an unfavorable Advisory Opinion concerning an arrangement involving a proposal to offer members of a group purchasing organization (GPO) an equity interest in the GPO's parent organization in exchange for the member to:

- Extend its contract with the GPO for 5 to 7 years;
- Commit not to decrease purchasing volume; and
- Relinquish its right to a portion of the administrative fees that would otherwise have been passed through to the members.

This Advisory Opinion was requested by a publicly traded company (Company) that provides financial and performance improvement technology-based products and services to primarily hospitals and health that operates a GPO, which negotiates discounts and other terms in contracts with manufacturers and distributors and other vendors on behalf of the GPO's members. The GPO's revenues comprise 60% of the Company's consolidated net revenues. Vendors pay administrative fees to the GPO ranging from 0.25% to 3% of the purchase prices of items and services sold to the GPO's members under the GPO contracts.

The GPO offers two models to its members. Under a fee-for-service contract option: the GPO passes through to the member 100% of the administrative fees the GPO receives from vendors for the member's purchases; the member pays the GPO a negotiated fee for the GPO's services; and there are no minimum purchase requirements. Under a shareback contract option, the GPO passes through to the member a negotiated percentage (typically 50%) of the administrative fees the GPO collects from vendors for the member's purchases (i.e., the shareback) and the member does not pay any fees to the GPO, but often has minimum purchase requirements. If the member fails to reach its minimum purchase requirement, the shareback amount is reduced pro rata (e.g., 75% of total

minimum purchases results in 75% of the shareback amount the member would have received if it had met its minimum purchase requirement).

Under the Proposed Arrangement, the Company would offer current and prospective GPO members an equity interest in the Company. In return for an equity interest, the GPO member would extend its current (or a new member would enter into a new) GPO agreement for a term of 5 to 7 years and also commit not to decrease the volume of its purchases through the GPO. The purchase volume would be based on an analysis of historical purchases of the member. The member would also forego a portion of the otherwise-applicable administrative fees. The Company would offer three possible options: (1) maintain status quo; (2) the member could keep 66% of the current shareback and receive an amount of equity roughly equivalent to the market value of the forfeited shareback; or (3) the member could keep 33% of the current shareback and receive an amount of equity roughly equivalent to the market value of the forfeited shareback.

The OIG identified two safe harbors to the Federal Anti-Kickback Statute which were potentially applicable to the proposed arrangement, the *GPO safe harbor* and the *discount safe harbor*. The OIG first determined that the *GPO safe harbor* could not apply because the proposed arrangement involved fees paid by vendors to the GPO (which can be protected by the *GPO safe harbor*), but also involved remuneration transferred between the Company and the GPO members (which cannot be protected by the *GPO safe harbor*).

An important aspect to this Advisory Opinion was that the OIG also determined that the equity interests the Company proposed to transfer to members under the proposed arrangement was *remuneration* that would not meet the discount safe harbor, or any Anti-Kickback safe harbor. Unlike administrative fees passed through to GPO members, the equity interests in the Company were not discounts GPO members could report to meet the discount safe harbor requirements. CMS requires GPO members to treat distributions of a portion of administrative fees received from a GPO as discounts or rebates.

The OIG analyzed the proposed arrangement on the totality of its facts and circumstances. The OIG noted that there have been several government studies on the effects of GPOs and whether they raise conflicts of interest, and that the OIG concluded also that the three key elements of the arrangement increased the risk of fraud and abuse for the following reasons:

- The Company would ask members to forego a portion of their distributions of administrative fees in exchange for equity interests in the Company, which could not be reported as rebates or discounts and therefore, would not reduce costs to Federal Health Care programs or other payors;
- The Company would require members accepting an equity interest to extend their contracts by five to seven years and the amount of the equity interest offered would be tied to past purchases of items, including items reimbursed by Federal Health Care programs;
- Under the extended contracts, members would not be permitted to decrease the volume of their purchases, thereby locking them in for five to seven years regardless of whether the GPO obtained the best prices for them;
- Although the members' returns on investment through their equity interests would not be directly tied to their own future purchases, their returns would be positively correlated with their own future purchases because the GPO's revenues make up a substantial portion of the Company's revenues; and
- The GPO would retain more administrative fees, which could boost the Company's revenues and potentially result in higher returns for investors, including the referral source investors.

The OIG concluded that the proposed arrangement presented more than a minimal risk of fraud and abuse because it would allow the Company to give remuneration to GPO members to reward past referrals and to induce them to continue purchasing equal or higher volumes of items reimbursed by Federal Health Care programs over an extended period of time. Moreover, the OIG determined that the Proposed Arrangement could potentially generate prohibited remuneration under the Anti-Kickback Statute and OIG could potentially impose administrative sanctions based on the facts provided.

A copy of OIG Advisory Opinion #13-09 can be obtained on the OIG's web site at: <http://oig.hhs.gov/advisory-opinions>.

