The Physician Hospitals of America’s Constitutional Challenge Against The Stark Law Amendments Within The Patient Protection and Affordable Care Act

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Introduction

As stated by The Honorable Justice Gladys Kessler in her recent decision in Mead v. Holder, “The controversy surrounding [The Patient Protection and Affordable Care Act] is significant, as is the public's interest in the substantive reforms contained in the Act. It is highly likely that a decision by the United States Supreme Court will be required to resolve the constitutional and statutory issues which have been raised.”

As we pass the one year anniversary of the enactment of health reform, five federal judges have issued decisions on the constitutionality of the Patient Protection and Affordable Care Act (ACA). Three of the judges have held that the ACA is constitutional while two have held that it is not. As discussed below, these cases are rapidly being appealed and will likely make their way to the Supreme Court in short order. All five cases that have been decided thus far, however, have centered on the constitutionality of Section 1501 of the ACA, the individual insurance mandate.

Another case, quietly making its way through the United States District Court for the Eastern District of Texas, challenges the constitutionality of Section 6001 of the ACA. Section 6001 amended the Stark Law “whole hospital” exception and further restricted Medicare payments for physician self-referrals to physician-owned hospitals. As a result of Section 6001, The Physician Hospitals of America (PHA) estimates that as many as 84 physician-owned hospitals were required to halt ongoing construction projects. In response to the amendments and the ambiguities contained in Section 6001, The Physician Hospitals of America (PHA) and The Texas Spine & Joint Hospital (TSJH) brought a suit challenging the constitutionality of the ACA based on due process, equal protection, and unconstitutional taking claims. This article briefly reviews the arguments made in this case and discusses how the outcome of this case may be dependent upon the outcome of the appellate process for the individual insurance mandate cases.

Stark Amendments Under Section 6001 of the ACA

Unless a specific exception is met, the Stark Physician Self-Referral Law generally prohibits a physician from referring a patient to an entity in which the physician (or an

immediate family member of a physician) has a financial relationship for the furnishing of designated health services (DHS) if the DHS is payable by Medicare/Medicaid.\(^3\)

Before the ACA was enacted, the whole hospital exception to the Stark Law allowed physicians to hold ownership interest in, and refer to, hospitals where they held ownership interests if: (1) the referring physician was authorized to perform services at the hospital; (2) the physician owner held an ownership or investment interest in the whole hospital (and not merely a subdivision of the hospital); and (3) the physician actually performed services at the hospital.\(^4\)

Section 6001 of the ACA amended and added further restrictions to the whole hospital exception. As stated in the PHA and TSJH complaint,

> The Physician Hospital Law contains several provisions that strike at the ability of physicians to take an ownership interest in American hospitals. It prevents any physician-owned hospital from becoming Medicare-certified..., purports to block any increase in the percentage of physician ownership in existing Medicare-certified hospitals and tries to limit expansion of existing Medicare-certified physician owned hospitals.\(^5\)

More specifically, Section 6001 and new regulations passed under Section 6001 (Effective as of January 1, 2011) prohibit future physician investment in hospitals and do not allow hospitals to qualify under the exception unless they had physician ownership or investment and a valid Medicare provider agreement in place as of December 31, 2010. In order to maintain its exception, hospitals may not increase the total percentage of physician ownership as of the day of the enactment of the ACA, March 23, 2010. In addition, hospitals must meet other specified requirements regarding conflicts of interest, bona fide investments and patient safety issues.\(^6\)

The ACA and the new regulations also generally prohibit facility expansion at existing physician-owned hospitals and the conversion of certain facilities into physician-owned hospitals. For instance, the conversion of ambulatory surgery centers to physician owned-hospital on or after March 23, 2010 is generally prohibited. Existing physician-owned hospitals, such as TSJH, even if expansion projects were undertaken prior to the passage of the ACA, may not increase the number of operating rooms, procedure rooms, and beds

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beyond that for which the hospital was licensed on March 23, 2010 (unless an exception, which the PHA claims is illusory, is granted by the Secretary of the Department of Health and Human Services (HHS)).

### TSJH History

The Texas Spine and Joint Hospital is a 20 bed physician-owned hospital located in Tyler, Texas that first opened its doors in a converted Montgomery Ward building in 2002. The Hospital, as with many physician–owned specialty hospitals, has been recognized as a leader in its field. For instance, TSJH was ranked as the number one hospital in Texas for Spine Surgery for 2009 and has consistently ranked in the top 5 percent of hospitals in the nation for spine surgery.

To meet increased demands, TSJH initiated plans in 2008 to undertake a $37 million expansion of its main facility. TSJH spent $2.1 million to purchase land for the purpose of expansion and spent $426,252 in professional fees throughout the zoning process. TSJH then terminated commercial leases on the purchased land in anticipation of construction. These leases, prior to termination, yielded the hospital $533,236 a year in rents. TSJH acquired all requisite state permits for construction, prepared its architectural plans and secured financing for the expansion. On March 23, 2010, with the passage of Section 6001, TSJH halted the project. The PHA estimates that approximately 84 hospitals were in similar circumstances as TSJH and halted ongoing construction projects after the passage of the ACA.

### Constitutional Claims Against Section 6001

On June 3, 2010, PHA and TSJH brought a suit against the secretary of the U.S. Department of Health and Human Services (HHS). The PHA and TSJH claim that Section 6001 of the ACA was (1) unconstitutional under due process because the law was lodged solely for a private and not a public gain; (2) a violation of equal protection because section 6001 was a licensing scheme which picked winners without a basis in rational basis; (3) unconstitutionally vague and ambiguous; and (4) an unconstitutional taking.

For the sake of brevity, I will not discuss all of TSJH’s claims in detail. It appears that their strongest claims against Section 6001 go to the heart of their due process, equal protection, and takings claims. More specifically, it appears that their strongest argument

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7 *Id.*, It is also interesting to note that the Secretary is not required to implement an application process for these exceptions until February 1, 2010 and that even if an exception is granted, physician-owned hospitals which qualify for an exception will not be allowed to expand beyond double the number of operating rooms, procedure rooms and beds it had at the time the ACA was passed. See 42 U.S.C. § 1395nn(i)(3)(A) and 42 U.S.C. § 1395nn(i)(3)(C)(ii).


is that the proffered rational basis upon which Section 6001 was passed was merely pretext for an illegitimate and unconstitutional scheme created to protect the economic interests of a favored group, namely non-physician owned hospitals.

Molly Sandvig, the executive director of PHA, stated that the aim of the case is to show that Section 6001 “treats physicians different than any other class of citizen…Anyone else can own a hospital except a doctor. It's outrageous and not based on what this country's founded on.”

While courts will apply an elevated strict scrutiny review to due process and equal protection claims that implicate fundamental rights or involve a suspect class, this case does not appear to involve a fundamental right and physicians certainly do not qualify as a suspect class. PHA, however, claims that Section 6001 does not even meet the requirements of the more deferential rational basis standard (the lowest level of scrutiny for equal protection and due process claims) which requires that: (1) the challenged statute was predicated upon a legitimate governmental purpose; and (2) the legislative action was rationally related to the legitimate governmental purpose.

Neil Caesar, president of the Health Law Center in Greenville, South Carolina, commenting on the case stated, "At first glance, it seems like [PHA and TSJH] face an uphill battle. Physicians are not a protected class for constitutional purposes. They would have to show that there was no legitimate justification for the carve-out."

Mr. Caesar is correct in declaring the PHA case an uphill battle. The plaintiff generally has the burden of proof under rational basis review, and “legislative Acts adjusting the burdens and benefits of economic life come to the Court with a presumption of constitutionality.” Only rarely have laws been declared unconstitutional for failing to meet the rational basis standard.

The U.S. Department of Health and Human Services filed for summary judgment in the case claiming that a legitimate rational basis existed for Section 6001. HHS claims that Section 6001 was enacted based upon “years of studies, statutory and regulatory moratoria, and legislative proposals.” It pointed to the Congressional Record to show that “Congress explained that physician-owned hospitals had undermined the Stark Law's ‘whole hospital’ exception by taking ‘a subdivision of a hospital’ and [making] it a freestanding hospital in order to circumvent the prohibition in the [Medicare/Medicaid] physician self-referral laws.” It argues that Congress relied on studies that showed

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13 Bakhtiari, supra note 11.
15 Defendant's Motion to Dismiss or, in the Alternative, for Summary Judgment; Memorandum in Support of Defendant's Motion: and Memorandum in Opposition to Plaintiffs' Motion for Preliminary Injunction, Physician Hospitals of America et al. v. Sebelius, et al., 2010 WL 3526180, Civil Action No. 6:10-00277-MHS, (E.D. Texas, Sept. 7, 2010).
16 H.R. Rep. 111-443, pt. 1, at 355 (2010); Id.
“that physician self-referral led to increased utilization rates and that physician-owned hospitals ‘result in unnecessary procedures, increasing health care spending.’”\(^{17}\)

HHS further rationalized Section 6001 by pointing out that the Stark Law itself was “a plainly rational attempt to address the legitimate objective of limiting overutilization of medical services” and that in its 21 years of existence no court had ever held otherwise.\(^{18}\)

Indeed, the debate over physician owned hospitals is not new and Section 6001 was not the first limitation placed on the whole hospital exception. For instance, in 2003, Congress implemented an 18-month moratorium on physician referrals to new specialty hospitals in which they held an interest.\(^{19}\)

Section 6001, however, is different. Section 6001 is in essence a death sentence for physician owned hospitals in that it prevents the establishment of new hospitals and attacks the physician owned hospital’s ability to expand. It does not allow any exception for hospitals that were in the process of expansion or construction at the time of enactment causing such hospitals to essentially forfeit millions of dollars of investments. In addition it places competitive restraints on physician owned hospitals. As previously stated, Section 6001 prohibits expansion of existing facilities and the expansion of physician investment impeding the ability of facilities to meet increased demand and recruit new physicians. (The provision limiting a facility’s percentage of physician ownership post enactment to levels equal to percentage at the time of enactment has, in the year following the enactment of the ACA also caused a number of interesting restraints in the world of mergers and acquisitions.)

PHA and the TSJH, in their response to HHS’s summary judgment motion, suggested that the proffered rationale, in this case, was merely pretext. They rely on *Kelo v. City of New London(119,586),(907,888),\(^{20}\) Bearman v. Parker,\(^\text{21}\) City of Philidelphia v New Jersey,\(^\text{22}\) Craigmiles v. Giles,\(^\text{23}\) Santos v City of Houston,\(^\text{24}\) and Vondy v. White\(^\text{25}\) among other cases, to show that due process, equal protection, and takings challenges survive if the rationale offered by the government is “pretextual.”\(^\text{26}\) In other words, they claim that while the government

\(^{17}\) Id.
\(^{18}\) Id.
\(^{20}\) 545 U.S. 469, 478 (2005).
\(^{22}\) 437 U.S. 617, 624 (1978).
\(^{23}\) 312 F.3d 220 (6th Cir. 2002).
\(^{25}\) 719 F.2d 1265, 1266 (5th Cir. 1983).
\(^{26}\) Plaintiffs' Memorandum in Opposition to Defendant's Motion to Dismiss, *Physician Hospitals of America et al. v. Sebelius, et al.*, 2010 WL 3526181, Civil Action No. 6:10-00277-MHS, (E.D. Texas, September 7, 2010) (“Courts can and should look behind a proffered rational purpose for a law to determine if the alleged purpose is ‘pretext’ for an illegitimate one.”)
may “enact laws that impinge on private property,” they may only do so if they acted upon a reasonable belief that the law was for the benefit of the public. Courts may look beyond the proffered rationale to determine if the true rationale was unpermitted economic protectionism.

PHA and TSJH allege that the true basis for Section 6001 was an agreement made between the American Hospital Association (AHA), the Federation of American Hospitals (FAH), the Catholic Health Association (CHA), the White House, and the Senate Finance Chairman, Senator Max Baucus, in July of 2009. PHA has entered into evidence a joint statement released by the AHA, FAH, and CHA declaring that the hospital lobbies agreed to reduce Medicare payments by $155 billion over ten years to help finance health care reform in exchange for a number of benefits. Included in the agreement package were “restrictions on physician self-referral to hospitals in which they have an ownership interest.”

Although some of the cases cited by PHA are not binding upon the United States District Court for the Eastern District of Texas, it appears based on this line of reasoning that there may be some genuine issues of material fact which may allow the District Court to allow PHA’s and TSJH’s case to survive the initial summary judgment motion. If the District Court allows this case to survive to trial, it will be interesting to see what additional details emerge from the July 2009 meeting and whether or not courts will be willing to consider that the true basis for Section 6001 may have been unpermitted economic protectionism.

Summary Judgment Dependent on the Florida Case

Even though it appears that PHA and TSJH may have a valid claim to challenge the rational basis of Section 6001, a decision may never be reached on the constitutional merits of their case. On February 15, 2011, PHA and TSJH filed a separate motion for summary judgment, based upon the Florida individual mandate case, Florida ex rel. Bondi v. U.S. Dept. of Health and Human Services.

On January 31, 2011, Judge Roger Vinson, ruled in Florida ex rel. Bondi that the individual mandate within the ACA was an unconstitutional extension of Congress’s authority to regulate commerce and that the entirety of the ACA was therefore void because it was not severable. In its February 15, 2010 summary judgment motion, PHA claimed that, because Texas was one of the 26 state plaintiffs in the Florida case, the declaration of unconstitutionality should apply to their case through the doctrine of offensive collateral estoppel.

Two and a half weeks after the initial ruling in the Florida case, HHS submitted a motion for clarification, which was granted on March 3, 2011. Stating that HHS’s motion for clarification could also be interpreted as a motion to stay, Judge Vinson issued a stay on the initial judgment that voided the entirety of the ACA pending appeal.\(^{31}\) (This stay was conditioned upon HHS filing an appeal within seven calendar days of the order, which they did.)

The stay in the Florida case temporarily delays PHA’s claim of collateral estoppel in the Texas case. But it will be interesting to see if a final disposition in the individual mandate cases will ultimately affect the outcome of the PHA case. Oral arguments are now set for the Florida case for June 8 in the United States Court of Appeals for the Eleventh Circuit. Other individual mandate cases may, however, reach a final disposition before the Florida case has a chance to work its way through the appellate process. The U.S. Supreme Court is scheduled to meet on April 15, 2011 to decide whether or not early review is warranted for Virginia’s Constitutional challenge in *Virginia ex rel. Cuccinelli v. Sebelius*.\(^{32}\)

**Conclusion**

If, at the end of the day, federal courts find that Section 1501 does not violate the commerce clause and that it is constitutional, the PHA and TSJH should still have their day in court. The PHA case raises serious questions regarding the constitutionality of the deals made in the pursuit of health reform. What is worse to consider is that, even if Section 1501 is found to have been a constitutional exercise of the commerce clause, the ACA may still be in jeopardy because of its apparent inseverability from Section 6001.

**Post Publication Note:**

This article was prepared for publication shortly after the one year anniversary of the enactment of the Patient Protection and Affordable Care Act (ACA), March 23, 2010. While going through the publication process, Judge Schneider entered a summary judgment ruling in *Physician Hospitals of America et al. v. Sebelius, et al.* on March 31, 2011. The court first determined that it had jurisdiction over PHA’s and TSJH’s claims and then issued a ruling on the merits in favor of the Department of Health and Human Services.

When analyzing Plaintiff’s due process and equal protection claims, the Court recognized that the Secretary presented four justifications for Section 6001: (1) physician ownership leads to overutilization of services; (2) physician ownership results in greater healthcare expenditures; (3) referral patterns undermine public and community hospitals, and (4) physician-owned hospitals provide inadequate emergency care.

The Court then refused to enter into an inquiry as to Congress’ actual purpose for enacting Section 6001. The Court found that the Secretary’s proffered rationale was sufficient to withstand PHA’s due process and equal protection claims unless PHA and

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TSJH could “‘convince the court that the legislative acts on which the classification is apparently based could not reasonably be conceived to be true by the government decisionmaker.’” Judge Schneider dismissed each of Plaintiff’s cited cases that urged the Court to look to the true rationale of the statute as “easily distinguishable or... not binding precedent” and relied on the Supreme Court’s “mandate” that: “‘a statute survives rational basis scrutiny unless the challenging party negates every conceivable rational basis for the law, regardless of the legislature’s actual purpose.’”

After dismissing PHA’s due process and equal protection claims, Judge Schneider similarly dismissed PHA’s and TSJH’s takings claims and claims that the law was void for vagueness. Although the Court found that PHA’s takings claims were ripe, it also found that Section 6001 did not interfere with PHA’s or TSJH’s use of their real property, nor did Section 6001 constitute a regulatory taking that disrupted Plaintiffs’ investment backed expectations.

As to PHA’s claims that Section 6001 was void for vagueness, the Court found that the statute’s effective date was sufficiently clear and that the section of the law delegating administration of the application process for exceptions to the Secretary was a proper delegation of authority. The Court also found that, although the nearly two year delay between the effective date of the regulation and the deadline for the Secretary’s regulations concerning exceptions must have been frustrating, it was not vague or ambiguous under the statute.

Although the Court appeared to be empathetic with PHA’s and TSJH’s position as they recognized the hardships they faced as a result of the amendment, as with many courts before, the Court refused to venture too deeply into the realm of Congressional rationale. The closing of the opinion is particularly insightful as to the thinking of the Court as it granted summary judgment for HHS. It almost sounds of lamentation that it could not intervene further:

In a case like this, Plaintiffs have a particularly heavy burden to show that the justifications for enacting Section 6001 could not reasonably be conceived to be true. Short of that, the Court does not have the authority to judge the wisdom or fairness of Congress's decision. Rather, as the Supreme Court has said, “[t]he Constitution presumes that ... even improvident decisions will eventually be rectified by the democratic process and that judicial intervention is generally unwarranted no matter how unwisely ... a political branch has acted.”

34 Id. (quoting FCC v. Beach Commc’ns, Inc., 508 U.S. at 315).
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