

interest in that DHS entity. That is, where a physician has an interest in a retirement plan offered by Entity A, through the physician's (or an immediate family member's) employment with Entity A, we intended to except from the definition of ownership or investment interests any interest the physician would have in Entity A by virtue of his or her interest in the retirement plan; we did not intend to exclude from the definition of ownership or investment interests any interest the physician may have in Entity B through the retirement plan's purchase of an interest in Entity B.

Accordingly we are proposing to revise §411.354(b)(3)(i) to provide that ownership and investment interests do not include an interest in a retirement plan offered by the entity to the physician or immediate family member as a result of the physician's or immediate family member's employment with the entity.

8. "Set in Advance" and Percentage-based Compensation Arrangements

Several of the compensation exceptions in section 1877 of the Act require that the compensation be "set in advance" (or "fixed in advance"). This requirement has been carried over in our regulations implementing those statutory exceptions, and we have also included a "set in

advance" requirement in some of our regulatory exceptions (that is, exceptions promulgated pursuant to our authority in section 1877(b)(4) of the Act to create additional exceptions that pose no risk of program or patient abuse). In §411.354(d), Special Rules on Compensation, we state that compensation will be considered "set in advance" if the aggregate compensation, a time-based or per unit-of - service-based amount, or a specific formula for calculating the compensation, is set forth in an agreement between the parties before the furnishing of the items or services for which the compensation is to be paid. Under Phase I (66 FR 959), the last sentence of §411.354(d)(1) read,

Percentage compensation arrangements do not constitute compensation that is 'set in advance' in which the percentage compensation is based on fluctuating or indeterminate measures or in which the arrangement results in the seller receiving different payment amounts for the same service from the same purchaser.

We had explained in that rule, in response to a public comment, that "[p]ercentage compensation that is determined by calculating a percentage of a fluctuating or indeterminate amount, such as revenues, collections or expenses, is not fixed in advance" (66 FR 878). Following publication of the Phase I rule, however, we received anecdotal accounts about contracts for physician services under which payment was calculated based on a percentage of

the revenue raised by a physician's own professional services. Therefore, we delayed the effective date of the final sentence of §411.354(d)(1) through four **Federal Register** notices, to allow us to revise the provision "to avoid unnecessarily disrupting existing contractual arrangements for physician services" (68 FR 74491, December 24, 2003; 68 FR 20347, April 25, 2003; 67 FR 70322, November 22, 2002; 66 FR 60154 and 60155, December 3, 2001).

In the Phase II interim final rule with comment period, in the section on physician compensation, we explained that percentage compensation arrangements were of particular concern to academic medical centers and to hospitals "which argued that percentage compensation is commonplace in their physician compensation arrangements" (69 FR 16068). We were persuaded that our original position was overly restrictive, and accordingly, we deleted the last sentence in §411.354(d)(1) and clarified that the specific formula must be set forth in sufficient detail before the furnishing of the items or services and the formula may not be modified within the time period in any manner that reflects the volume or value of referrals or any other business generated between the parties.

Despite our intent that percentage compensation arrangements could be used only for compensating physicians for the physician services they perform, it has come to our attention that percentage compensation arrangements are being used for the provision of other services and items, such as equipment and office space that is leased on the basis of a percentage of the revenues raised by the equipment or in the medical office space. We are concerned that percentage compensation arrangements in the context of equipment and office space rentals are potentially abusive. We note that section 1877(e)(1)(A)(vi) of the Act, with respect to office space rentals, and section 1877(e)(1)(B)(vi) of the Act, with respect to equipment rentals, allow us to impose requirements on office space and equipment rental arrangements as needed to protect against program or patient abuse. Although we are concerned primarily with percentage compensation arrangements in the context of equipment and office space rentals, we believe there is the potential for percentage compensation to be utilized in other areas as well. Therefore, relying on our authority in sections 1877(e)(1)(A)(vi), 1877(e)(1)(B)(vi), and 1877(b)(4) of the Act, we are proposing to clarify that percentage compensation arrangements: (1) may be used only for paying

for personally performed physician services; and (2) must be based on the revenues directly resulting from the physician services rather than based on some other factor such as a percentage of the savings by a hospital department (which is not directly or indirectly related to the physician services provided).

9. Stand in the Shoes

Commenters to the Phase I final rule with comment period proposed that we permit physicians to stand in the shoes of their group practices, thereby requiring analysis of certain indirect compensation arrangements as direct compensation arrangements. In the Phase II interim final rule, we solicited comments on this issue, and we may be addressing this issue in an upcoming final rule. In this proposed rule, we are focusing on the DHS entity side of physician-DHS entity financial relationships. We propose to amend §411.354(c) to provide that, where a DHS entity owns or controls an entity to which a physician refers Medicare patients for DHS, the DHS entity would stand in the shoes of the entity that it owns or controls and would be deemed to have the same compensation arrangements with the same parties and on the same terms as does the entity that it owns or controls. For example, a hospital would stand in the shoes of a medical foundation that it owns or