

# THE EMERGENCE OF PHYSICIAN-OWNED SPECIALTY HOSPITALS

By

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There are over 6,000 hospitals in the United States today. The overwhelming majority of hospitals comprising this figure are general hospitals that provide care for a full range of medical conditions. While large general hospitals offering acute care services, specialized units for rehabilitation, skilled nursing, intensive care, and other levels of care may represent the traditional notion of a hospital, a sizeable number of hospitals throughout the country operate for the purpose of providing care to a select type of patient. In recent years, the health care facility landscape has increasingly expanded to include smaller hospitals that specialize in treating a particular disease or condition, such as cancer or rehabilitation, or focus on one type of patient, such as children or the elderly. Many of these hospitals are physician-owned in varying degrees. A number have been developed to compete with local full-service hospitals for patients, while others are joint ventures between groups of physicians and a larger general hospital in the community.

## **The Evolution of Specialty Hospitals**

The concept of a hospital functioning to specifically provide care for only a select patient population is not a recent innovation. Some specialty hospitals, especially those dedicated to children's health, have long been

a standard in most large communities. However, one of the emerging trends within the hospital industry is the proliferation of smaller, physician-owned hospitals that focus on treating a particular disease or condition that was historically treated at general hospitals. Health care facilities with a specialized focus have now expanded to include:

- Orthopedic Hospitals;
- Cancer Hospitals;
- Heart Hospitals;
- Rehabilitation Hospitals;
- Psychiatric Hospitals;
- Respiratory Care Hospitals;
- Eye and Ear Hospitals;
- Women's Hospital's; and
- Maternity Hospitals.

It has been estimated that the number of specialty care hospitals has more than doubled in the past decade. Heart hospitals, cancer hospitals, and orthopedic hospitals, particularly, have been developed throughout the country in recent years. A significant fraction of this trend that is gaining momentum is the development of specialty surgical hospitals as an outgrowth of ambulatory surgical centers.

The new model of specialty care hospital that has emerged in the past few years is characterized by a relatively small facility, ranging in size from 15-70 beds, that provides

amenities not seen often in the traditional general hospital. Many of the newest specialty hospitals offer lavish furnishings often reserved for upscale hotels such as leather furniture, fine artwork, fresh-cut flowers, and flat-screen televisions in each patient room. The narrow clinical focus and state-of-the-art settings of these hospitals has led many to classify such facilities as “boutique” hospitals.

### **State Licensing of Specialty Hospitals**

Specialty hospitals have gained prominence primarily in states that do not require hospitals to obtain a “certificate of need” from a state agency in order to begin operations. Under the certificate of need process, new facilities must establish a case for the community’s need for the type of services that will be provided at a proposed site. Over half of states maintain a certificate of need process in various forms, although a number have recently abandoned or modified their processes to provide for a less regulated marketplace. Due to the burdensome and often costly nature of the certificate of need process, as well as possible opposition from area hospitals, specialty care hospitals are most likely to develop in those states, such as California and Oklahoma which do not perform a need review for new hospitals. Although data verifying the prominence of specialty hospitals in states lacking a certificate of need process is not available, industry

experts agree that development is more far more likely in states that do not require potential providers to undergo this often burdensome process.

Specialty hospitals are typically licensed as acute care hospitals by State Health Departments. However, many states have separate licensing categories for hospitals limiting their services to one category of care, such as rehabilitation, orthopedics, psychiatry, and other specialized facilities. Under state licensing standards, a specialty hospital may be required to provide many of the same ancillary services associated with larger, general hospitals. Depending on state regulations, a specialty hospital may be required to directly provide laboratory, physical therapy, radiology, pharmacy and emergency services. In some states, a specialty care hospital would be required to operate a full-time emergency room. However, in most states many of these services can be outsourced.

### **Efficient, Quality Care**

Many believe that specialty hospitals can be profitable while providing exceptional care at competitive prices. With a limited focus, specialty hospitals may have the ability to create a niche and develop reputations as centers of excellence for specific clinical conditions. By dedicating all of their resources towards one type of care, such as cardiology or orthopedics, specialty

hospitals are often in a position to offer the most advanced equipment and technology in that field. "Single-minded, single-focused" is the essence of the specialty hospital, says Don Burman, Chief Executive Officer of the Orthopedic Hospital of Oklahoma, a 27-bed, physician-owned specialty orthopedic hospital in Tulsa, Oklahoma. Proponents claim that quality of care is improved by concentrating on a particular type of patient. "A patient receives a higher level of care when the entire hospital- from physicians, nurses, and management to the physical design and equipment at the facility- is focused specifically on the type of care that the patient requires", according to Burman.

Furthermore, according to proponents, these facilities are able to manage their resources more efficiently than larger hospitals that provide a wide array of services for a broad range of conditions and diseases. Operational processes and costs can be streamlined, thus providing a competitive advantage over general acute care hospitals that incur the high fixed costs associated with delivering care for all of the areas health care needs.

The trend towards specialty hospitals has not been embraced by everyone in the health care arena. Critics are concerned that specialty hospitals will challenge the financial health of general hospitals in the community by competing for some of the highest paying procedures. Others claim that the smaller facilities cannot provide the comprehensive care offered by full-service hospitals because they

often lack many important supplementary services.

### **Physician Owned and Operated**

A common theme in the proliferation of specialty hospitals, regardless of whether they concentrate on orthopedics, cardiology, cancer or any other particular area, is physician ownership in the facilities. Some specialty hospitals are owned completely by doctors, others share ownership through joint ventures with acute care hospitals. Many independent specialty hospitals utilize management companies for administrative activities while maintaining complete control over clinical care.

Physician ownership in health care facilities is not a revolutionary concept. In the late 1980s and 90s, stories of failed physician-owned full-service hospitals were common. However, specialty hospitals, with their narrowed focus and lower overhead costs, offer physicians an opportunity to once again take greater control over the hospital environment without facing the complexity of management challenges posed by full-service hospitals. The attraction to physician ownership in a specialty hospital is primarily an issue of control. Physician owners can be involved at all stages, from the design of the facility to major decisions regarding strategic issues affecting operations. Physician-owners at specialty hospitals have the opportunity to control scheduling, purchasing, and to dictate what types of procedures will be offered in the facility.

The Stark Act is a major consideration with respect to the ownership structure of a specialty hospital. Under the Stark Act, physicians are prohibited from referring Medicare patients for certain “designated health services”, including all inpatient and outpatient hospital services, to entities in which the physician has an ownership or other financial interest. However, physicians can maintain ownership in a specialty hospital under what is commonly termed the “whole hospital” exception. The whole hospital exception acts to permit physician ownership in a specialty hospital where the referring physician has an ownership in the entire hospital (and not a subdivision of the hospital) and the referring physician is authorized to perform services at the hospital.

Under the whole hospital exception, a specialty hospital can be owned by physicians and avoid running afoul of Stark laws. However, on July 12, 2001, Congressmen Stark of California and Kleczka of Wisconsin introduced the Hospital Investment Act of 2001 which would amend current Stark law to require that ownership interests offered to physician investors be “purchased on terms generally available to the

public at the time.” In a press release, Congressman Stark makes clear that the new law is intended to respond to increased physician ownership in specialty hospitals and their possible impact on full-service hospitals. The fate of this bill, which is uncertain at this time, could have an impact on the continued trend towards development of physician-owned specialty hospitals.

### Looking Forward

New laws may alter the emerging model of specialty care hospital. Nonetheless, the concept of a “single-focused” facility has changed the traditional view of a hospital. Patient outcomes and satisfaction with such facilities, as well as their ongoing effect on community hospitals, will sharply influence the prevalence and structure of the specialty hospital of the future. However, the concept of the state-of-the-art facility focused on a single patient type, whether owned by general hospitals, physicians, the public, or some combination of all three, is likely to be a permanent part of the hospital landscape.

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