Sweeping Changes to New Jersey’s “Codey Law”

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Governor Jon S. Corzine signed into law Senate Bill 787\(^1\) on March 21, 2009, significantly amending New Jersey’s physician self-referral law, known as “the Codey Law” for its sponsor, state Senator Richard J. Codey.\(^2\) The adoption of Senate Bill 787 is intended to provide guidance concerning the scope of physician investment in and referrals to ambulatory surgery centers. In so doing, S787 makes considerable changes to the way ambulatory surgery centers will be owned and regulated in New Jersey, with the ultimate effect of “leveling the playing field” between freestanding and hospital-based surgery centers. S787 also removes statutory exceptions for physician self-referrals for lithotripsy and radiation therapy services, which have been in the Codey Law since 1991.

Background

The Codey Law was enacted in 1989 as New Jersey’s version of the federal Stark Law, intended to eliminate financial incentives to physicians and other practitioners licensed by the New Jersey Board of Medical Examiners (BME) to refer their patients to entities in which they held any financial interest. Unlike the Stark Law, the Codey Law contains a general prohibition on a practitioner’s referral of all patients, not just Medicare and Medicaid patients, for “health care services” in which the practitioner or an immediate family member has a “significant beneficial interest” (which means any financial interest).\(^3\) In 1991, a grandfather clause was enacted, exempting referrals by practitioners to health care services in which they had an ownership interest prior to July 31, 1991.\(^4\) Health care services covered by the Codey Law include ambulatory surgery services.\(^5\)

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2. N.J.S.A. 45:9-22.4 et seq.
3. “Significant beneficial interest” means any financial interest except the ownership of a building wherein space is leased at prevailing rates under a straight lease agreement or any interest in publicly traded securities. N.J.S.A. 45:9-22.4; N.J.A.C. 13:55-6.17.
The 1991 amendments to the Codey Law provided a number of statutory exceptions to the self-referral prohibitions. The first exception, known informally as the "extension of practice" exception, applies to referrals for a health care service that is provided at the practitioner’s medical office and for which the patient is billed directly by the practitioner.6 The other exceptions to the referral prohibition are for radiation therapy pursuant to an oncological protocol, lithotripsy and renal dialysis.7

Since the enactment of the Codey Law, ambulatory surgery centers, imaging centers and other free standing facilities organized as physician-owned ventures or joint ventures between physicians and a hospital (or hospital affiliate) have proliferated in New Jersey under the extension of practice exception. This exception has been broadly interpreted based on a 1997 advisory letter from the BME, determining that referral of patients to a surgical center owned by a hospital and physicians in which referring surgeons performed procedures on their patients was integral to the surgeons’ medical practice and could be viewed as an extension of that practice, falling within a permitted exception to the self-referral prohibitions in the Codey Law. Physician investment in freestanding facilities has occurred for years in New Jersey under the extension of practice exception, where physician-investors perform services at the facility on the patients they refer, physician-investors do not refer patients they will not treat at the facility, and the facility’s bills disclose the name of the referring physician and the fact that the physician has an investment interest in the facility.

This widespread practice was placed in jeopardy in November 2007, when New Jersey Superior Court Judge Contillo ruled in Garcia v. Health Net of New Jersey that it was a violation of the Codey Law for physicians to send their patients to an ambulatory surgery center where physician-investors personally performed their procedures.8 Garcia involved a payment dispute between Health Net and a group of physicians and their affiliated surgery center. The physicians owned varying percentages of the surgery center and referred medically appropriate candidates to it. Health Net provided insurance coverage to the physicians’ patients at their private practices, but the physician-owned surgery center was not within Health Net’s network. Health Net claimed that the physicians’ referrals to their surgery center were prohibited by the Codey Law so that the surgery center’s reimbursement claims to Health Net were unlawful and in violation of New Jersey insurance fraud laws.

The court rejected the surgery center’s reliance on the 1997 BME advisory letter that the surgery center was an extension of the physicians’ medical practice, noting that the facility was separate from and at a different location from the other medical offices maintained by the physicians, the physicians did not control the personnel, and different bills were generated for the professional services rendered and for the facility fees. In addition, the 1997 advisory letter was specific to a joint venture between physicians and a hospital. The court concluded that “the language of the statute is plain and simple, and can yield no other conclusion but that the defendant-doctors’ referrals of their private patients to the ambulatory surgical center, in which each of them has a significant

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7 N.J.S.A. 45:9-22.5(c)(2).
beneficial interest, runs afoul of the Codey Law ban on such referrals.” While the court held that the physicians did not knowingly violate the Codey Law and thus were not liable to Health Net for damages or penalties, this decision left that possibility open for the future if the physicians (or other similarly situated investors) continued to own and operate a freestanding surgery center in a manner now deemed to be a violation of the Codey Law. 9

Given the prevalence of physician-owned surgery centers in New Jersey, the Garcia decision caused an outcry in the medical community and prompted the BME to pursue an emergency rule clarifying, with certain conditions, that a practitioner’s medical office includes a practice site at which ambulatory surgery and/or special surgical procedures integrally related to a practitioner’s field of practice are performed, thus allowing physician ownership in ambulatory surgery centers and referrals of patients to such centers for procedures performed by them to continue. The State Attorney General, however, directed that the rule proposed by the BME be voted upon in accordance with normal rule making procedures. The proposed rule was not formally introduced or adopted, and both houses of the state legislature became involved by proposing legislation to address these issues. In his own words, Senator Codey introduced S787 in January 2008 as a compromise “[t]o remedy the situation,” not having “foresee[n] the proliferation of ambulatory surgery centers over the next 15 or so years [since enactment of the Codey Law].”10 Governor Corzine signed S787 into law last month.

Changes to Codey Law Statutory Exceptions

S787 has left intact (with slight language changes) the extension of practice exception, which allows a physician to refer patients for medical treatment or a procedure provided at the physician’s medical office, and for which the patient is billed directly by the physician or his medical practice. Referring physicians will be required to make written disclosure to patients in a form to be prescribed by future BME regulations, including informing patients whether the referral will be reimbursed on an out-of-network basis. Significantly, however, the extension of practice exception will no longer apply to referrals of patients for ambulatory surgery or procedures requiring anesthesia performed at surgical practices or ambulatory care centers. S787 sets forth other requirements for ambulatory surgery self-referrals.

In addition, effective March 22, 2010, S787 removes the Codey Law exceptions for self-referrals to radiation therapy pursuant to an oncological protocol and lithotripsy services that were added in 1991 (leaving unchanged the statutory exception for physician self-referrals for renal dialysis). Only practitioners who can satisfy the extension of practice exception, as “plainly read” by the Garcia court, or who currently have, or will have by March 22, 2010, a financial interest in radiation therapy or lithotripsy services, will be permitted to continue to refer patients to those services, as long as they disclose to patients that they have a financial interest in the referred services.

9 A second, unreported case also rejected application of the extension of practice exception to an ambulatory surgery center not physically located at the referring physician’s medical office, owned by a different entity and billed in a different name. Endo Surgi Center, P.C. v. Liberty Mutual Insurance Company, Letter Opinion of Hon. Ross R. Anzaldi, Docket No. UNN-L-0228-06 (March 26, 2008).
10 Richard J. Codey, Point of View, MD Advisor, Spring 2008, at 36.
Impact on Ambulatory Surgery Referrals

Starting March 22, 2010, practitioners will be permitted to refer patients only to registered and accredited surgical practices or licensed and accredited ambulatory care facilities for ambulatory surgery or procedures requiring anesthesia and if the following conditions are met: (1) the practitioner with the financial interest refers the patient and also personally performs the procedure; (2) the practitioner’s financial interest in and remuneration from the surgical practice or facility is not related to the volume of patients referred by the practitioner; (3) all clinical decisions are made by practitioners and in the best interest of patients; (4) before or at the time of referral, each patient is given prior written notice that the referring practitioner has a financial interest in the surgical practice and/or facility; and (5) before or at the time of referral, the patient is informed in writing whether reimbursement for any services or facility fees will be at an out-of-network level. S787 calls for the BME to issue regulations concerning the written disclosure form to be furnished to patients.

Referrals to existing single operating room surgical practices and licensed surgery centers that were made before March 21, 2009, are deemed to be compliant with the Codey Law if the physician personally performed the procedure. Referrals to existing surgical practices and licensed surgery centers that are made between March 21, 2009, and March 21, 2010, will be deemed to be compliant with the Codey Law if the physician personally performs the procedure and discloses to the patient in writing at or before the time of referral that the physician has a financial interest in the practice or facility. This one-year grace period is intended to give surgical practices time to meet new requirements for registration with the Department of Health and Senior Services (DHSS), including certification by the Centers for Medicare and Medicaid Services (CMS) or a CMS-recognized accrediting body, and for licensed surgery centers similarly to obtain ambulatory care accreditation. Surgical practices are also required to make certain annual reports to DHSS, including information about patients by payment source. These registration and accreditation requirements were made in response to concerns in the hospital community that the regulation of physician-owned surgical practices by the BME was not nearly as burdensome as the regulation of hospital-owned surgery centers regulated by the DHSS. These changes are also consistent with recommendations contained in the 2008 final report of the Reinhardt Commission that DHSS should be responsible for licensure of all surgical facilities, including single operating room practices, and that all surgical facilities meet nationally recognized accreditation status.

Limits on New Surgical Facilities

Significantly, S787 also restricts the future development of ambulatory surgery centers, in favor of hospitals. Effective immediately, DHSS will not register a new surgical practice or license a new surgery center except for: (1) single room surgical practices; (2) facilities

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A surgical practice is a structure or suite of rooms that has no more than one operating room and at least one or more post-anesthesia care units or a dedicated recovery room, and is established by a physician or physician practice solely for such entity’s private medical practice. N.J.S.A. 45:9-22.6(4)b.
owned jointly with a New Jersey general hospital; (3) facilities owned by a hospital or medical school; (4) licensed facilities and registered surgical practices with respect to certain transfers of ownership or relocations approved by the Commissioner of DHSS; or (5) a proposed surgical practice or facility that files its plans and specifications with the Department of Community Affairs or the municipality in which the surgical practice or facility will be located within six months, i.e., by September 17, 2009.  

Conclusion

With the law’s limitations on who may own new surgical facilities, S787 is expected to curb the ability of physicians to own and operate new surgery centers unless structured as a joint venture with a hospital or unless a physician-owned entity already has plans underway and appropriate filings can be made before the six-month window closes on September 17, 2009.

Clearly, S787 prescribes the permitted scope of physician investment in and referrals to surgery facilities and in so doing has removed the uncertainty generated by the Garcia case. S787 imposes strict conditions on how such referrals are to be made and to whom they may be made, without the benefit of the extension of practice exception. Existing surgical practices and facilities will need to meet new registration and/or accreditation requirements within the next year. They should also assess whether surgeries performed before March 21, 2009, were by the referring surgeon as required by S787, and they will need to ensure that during the one-year grace period expiring on March 21, 2010, that referring physicians perform procedures on their patients and disclose their financial interests as required by S787.

Now that the application of the extension of practice exception to surgery self-referrals has been rejected by the Garcia court and a special exception for surgery self-referrals has been created by S787, the future of the extension practice exception for other services is in question. The extension of practice exception may not be as broadly interpreted as it was before the Garcia decision, and physicians and other practitioners planning to invest in and refer patients to freestanding facilities providing imaging, physical therapy, lithotripsy, radiation therapy or other health care services will need to proceed with caution.

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12 Surgical practices that were not operating on March 21, 2009, but which file their plans and other required documents with the appropriate municipality by September 17, 2009, must register with DHSS before they commence services.