UNFAVORABLE

OIG WATCH

11-03

Turn-key pharmacy management for entity owned by LTC facilities that control referrals

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What OIG Said

OIG said a management arrangement where the manager provides everything and the "owners" just refer business looks like an improper vehicle to pay for referrals, regardless of fair market value claims.

- An LTC pharmacy proposed to provide complete turn-key management for a new pharmacy owned by LTC facility operators: all personnel, day-to-day operations, space, billing, inventory, everything except the DEA license, in exchange for $1.25 per script plus direct costs.

- OIG said this is a suspect contractual joint venture where one party (the pharmacy) expands into a new line by contracting substantially all operations to an existing provider, with the "owners" receiving profits as remuneration for their referrals while bearing minimal actual business risk.

- Even though the requestor claimed management fees would be "fair market value," OIG concluded the structure itself posed significant risk because aggregate payments would vary with referral volume from the LTC facility owners, as would the owners' income.

- OIG stated this arrangement appears designed to permit the pharmacy to do indirectly what it cannot do directly: pay the LTC facility owners a share of profits from their pharmaceutical referrals.

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Diligence Checklist

What you need to be ready to show in diligence

- ✓ Prove the "owner" entities have legitimate operational involvement beyond just referring business, they must bear real financial risk, contribute meaningful capital, and participate in actual business decisions, not just collect profits.
- ✓ Show that management fees are fixed in advance for a defined term and not structured to vary directly with the volume or value of referrals from investor-owners (per-script or percentage-based fees tied to referrals are problematic).
- ✓ Document that the joint venture serves a legitimate business purpose beyond creating a vehicle to reward referral sources, the structure must make commercial sense independent of the referral relationship.
- ✓ Have a third-party fair market value opinion supporting both the management fee structure and the economic terms of the joint venture, demonstrating that owner returns are proportionate to actual capital at risk and involvement.
- ✓ Keep owner-referrer investment and revenue from owner-referrers under safe harbor thresholds (40% for both), or demonstrate substantial safeguards if you exceed those limits.

If your management company provides substantially all operations for an entity owned by your referral sources, this is exactly the profile OIG called a suspect contractual joint venture, claiming FMV won't overcome structural problems.

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Structure not diligence-ready?

Cabra Consulting helps healthcare organizations make sure compensation and transaction structures are independently valued, clearly scoped, and defensible in diligence.

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