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LEADER (U.S.)

LUCRATIVE OPERATION

How Some Doctors Turn a \$79 Profit From a \$30 Test

Physician Groups Add Markup To Work Done by Others, Despite Ethics Concerns

By DAVID ARMSTRONG Staff Reporter of THE WALL STREET JOURNAL

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After her mother was diagnosed with skin cancer, Lori Hansen went to a local dermatologist in North Carolina to have her skin tested. When she got the results -- with a worrisome mention of "atypical" levels - she was surprised to learn her doctor had sent the samples across the country to California.

Even more surprising: Her doctor stood to make nearly \$200 on the test, she says. Ms. Hansen later learned her skin biopsies weren't abnormal. Also, the California testing center's owner had once directed a lab that the state called a threat to public health.

Arrangements such as the one between Ms. Hansen's North Carolina doctor and the California operation -- sometimes called referral deals -- are common in the more than \$40 billion medical laboratory business.

It works like this: A doctor sends a patient sample to an outside lab for testing. The lab charges the doctor a discounted price -- say, \$30 for a skin biopsy. The doctor then gets reimbursed by the patient's insurer for a much higher amount, say \$100. The difference, \$70, is profit for the doctor.

Typically the doctor doesn't tell the insurer that an outside lab did the work for a steep discount. Insurers could put a stop to the practice by refusing to pay the inflated reimbursement, but they are often unaware of the arrangements.

Critics say referral deals are harmful because doctors have an incentive to send work to the cheapest lab, not necessarily the best one, to maximize their profit margins. Also, by enticing doctors to order many tests, the arrangements drive up the nation's health-care bill.

"Patients should wonder if this dermatologist is doing this biopsy because I need it or he is going to make money from it," says Lisa Lerner, a Boston-area dermatopathologist.

While referral deals aren't new, people in the industry say they have grown rapidly in recent years as doctors seek new sources of income and demand grows for expensive lab work to detect diseases such as prostate cancer. "Five years ago, no one was interested in this," says Bernie Ness, the owner of a laboratory industry consulting firm in Toledo, Ohio. "That has changed dramatically. I get calls every week

from people who want to get in on the billing."

One of the few private insurers to block doctors from profiting on outside lab work is Blue Cross Blue Shield of Georgia. Starting Aug. 1, it required those performing lab tests to do the billing themselves, a practice known as direct billing. That eliminated deals where doctors bill for work they didn't perform. It isn't clear why other insurers don't do the same. Several of the biggest ones declined to comment.

Medicare requires direct billing, as do a few states. In some other states, doctors and local medical societies upset at the prospect of losing revenue have thwarted such legislation. Some doctors still bill Medicare for lab work performed off-site by owning "condo" labs within a larger facility.

The American Medical Association's code of ethics says under the heading of laboratory services that a "physician should not charge a markup, commission, or profit on the services rendered by others." It adds, however, that doctors can levy a processing charge on such services. The AMA code says that a doctor "who chooses a laboratory solely because it provides low-cost laboratory services on which the patient is charged a profit is not acting in the best interest of the patient."

Federal laws broadly prohibit doctors from receiving inducements for referrals or engaging in "self-dealing" -- referring patients for services in which they have a financial interest. Doctors and companies involved in lab referrals say what they do is legal. Companies say they're just offering a service for a price, and that doesn't add up to illegal inducement. In general doctors don't own a stake in the outside labs, which they say clears them of any charge of self-dealing. They say they're entitled to mark up work farmed out to a contractor to cover costs such as billing for the work and delivering results to patients.

Last year, the U.S. attorney in Oklahoma City indicted three former executives of a lab, UroCor Inc. The indictment says UroCor charged discount prices to doctors who turned around and billed private insurance companies at a much higher rate for the lab work. Doctors were charged as little as \$2.75 for a common analysis to detect prostate cancer, called the PSA test, and got reimbursement of \$25 and up, the indictment says. It says the discount was a kickback to induce the doctors to also refer work covered by Medicare, which was billed directly by the lab.

UroCor is now a division of Laboratory Corp. of America Holdings, known as LabCorp. The illegal activity alleged in the indictment occurred before UroCor was sold and none of the three executives named in the indictment still work for UroCor, according to LabCorp. The case is scheduled for trial next June. The executives have denied wrongdoing.

The Oklahoma case is an exception. Most of the referral arrangements never get authorities' attention.

In 2004 LabCorp gave a Tennessee dermatologist a document marked "confidential special client fees." It said LabCorp would charge the doctor \$30 to analyze a skin biopsy. Blue Cross Blue Shield of Tennessee says it reimburses an average of \$109 per biopsy interpretation. That would allow the doctor to realize a profit of 263%. Fees for other lab services on the document allowed for a markup of more than 700%.

LabCorp Executive Vice President Bradford T. Smith says the company has a policy of not discussing specific billing arrangements. He says another case in which a Nashville doctor group was charged only \$17 for a biopsy analysis appears to be an "outlier." That doctor group could yield a profit of more than \$90. About 10% of LabCorp's business comes from "client billing," or arrangements in which LabCorp bills the doctor and the doctor then bills the patient or an insurer, Mr. Smith says.

LabCorp, with sales of \$3 billion last year, is the country's second-largest lab company. The biggest is

Quest Diagnostics Inc. of Lyndhurst, N.J., with revenue of \$5.1 billion last year. Quest says client billing accounts for 6% to 7% of its revenue.

No Choice

At a recent conference of the American Urological Association in San Antonio, doctors took seats at the exhibition booth of Lakewood Pathology Associates of Lakewood, N.J., as the firm touted its "revenue share" model. If urologists send their tests to Lakewood, the company's marketing director said, they could generate up to \$35,000 per year. Lakewood's chief executive, Raza Bokhari, says the lab is careful to obey federal laws barring kickbacks to doctors, in part by making sure that doctors don't get a discount based on the volume of referrals.

Some of the labs engaged in client billing say they have no choice. "A lot of labs do it and if you got out of it the other guys will take you to the cleaners," says Clay Cockerell, a Dallas dermatopathologist who is on the board of Ameripath Inc., a national lab based in Palm Beach Gardens, Fla.

Dr. Cockerell, who is also the president of the American Academy of Dermatology, concedes the practice raises ethical issues. "Is the physician billing for it the one looking at the slide? No," he says. "From that perspective, does it totally pass the smell test? Maybe not."

Several studies have shown physicians are more likely to order services for patients if they have a financial incentive. A 1993 study compared states where doctors are allowed to bill for outside lab work and states where they aren't. It found doctors in the former ordered 28% more tests. The study was conducted by the Center for Health Policy Studies, a consulting group, for the American Clinical Laboratory Association, an industry group.

The study's author, economist Zachary Dyckman, says he would expect the same results today. The extra testing, he says, "appears to be done exclusively to earn more revenue and increase profits."

Ms. Hansen, the North Carolinian who was worried about skin cancer, had her skin biopsies analyzed by National Dermatopathology Laboratory of Lake Balboa, Calif. Ms. Hansen, of Cary, N.C., says she asked a local pathologist, Keith Nance, to review her biopsies after hearing that they were "atypical." Dr. Nance found no abnormalities.

Dr. Nance, who considers client billing unethical and pushed an unsuccessful effort to ban the practice in North Carolina, urged her to report the situation to the state medical board and helped write a complaint. He helped her find out how much the California lab was charging doctors by contacting the lab and pretending to be a potential customer.

In her October 2003 complaint to the medical board, Ms. Hansen cites an email in which National Dermatopathology quoted Dr. Nance a rate of \$35 to analyze a biopsy. Ms. Hansen, who had four biopsies analyzed, says in the complaint that the lab must have charged her dermatologist, William Ketcham, no more than \$140 for her lab work. Insurance records show Dr. Ketcham was paid \$328 for the work by her insurance company.

Dr. Ketcham declined to discuss dollar figures but says his deals with labs are appropriate and don't cost patients anything. He says paperwork is easier when he doesn't have to exchange patient information with the lab. The North Carolina Medical Society has said that "markups are a legitimate business practice" for lab services.

Dr. Ketcham says he has stopped using National Dermatopathology because the state medical board told him he must send his biopsies to pathologists licensed by North Carolina. The board took no disciplinary action against Dr. Ketcham. He now sends his lab work to Dermatopathology Laboratory of Central States in Dayton, Ohio.

Central States won't say what it charges doctors for lab work. But a 2003 fee schedule from the lab states that doctors were charged \$25 for the first biopsy and \$15 for each additional specimen. The same fee schedule indicates that when Central States billed insurers directly for biopsy interpretations it charged a rate of \$95.

The owner of National Dermatopathology Laboratory, Cyrus Milani, was banned from performing certain laboratory work by the state of California in 1989 after state officials accused a lab he directed of operating "in a manner which poses a threat of injury to public health." The state said the lab had an error rate of 21.2%.

Dr. Milani says the charges were "totally false." He acknowledged a settlement barred him from serving as medical director of any lab conducting pap smear tests "for a year or two." California authorities couldn't find a copy of the settlement.

For several years after the ban, Dr. Milani says he had "a very meager income." Even now, he says, his life is one of "simple living." Los Angeles County real-estate records show him as the owner of a home assessed at \$4.1 million on the same street in Bel Air where the actress Elizabeth Taylor lives.

According to a court filing, the pathologist who analyzed Ms. Hansen's biopsies was Hong Li, who worked at National Dermatopathology between July and December 2003. Dr. Milani is suing Dr. Li, accusing her of breaking a one-year employment contract. In the court filing, Dr. Li says her daily volume "far exceeded the generally accepted workload" in her specialty and "directly affected the quality of patient care." She says she quit from fatigue. Dr. Milani says Dr. Li's allegations are false.

Getting Around Medicare Ban

Although Medicare refuses to pay doctors for work performed by others, some companies have figured out a way to let doctors bill Medicare for off-site lab work. It involves doctor groups creating a "condo" or "pod" lab within a building that also houses labs for many other practices. Since the doctors own their "condo" lab, they believe they can bill Medicare for work performed there.

One such facility is operated by Uropath LLC at a medical office building in San Antonio. The door of the building lists the names of 15 urology practices from as far away as Missouri. Inside, there is a long hallway with a series of doors that open into small rooms with labels such as "Lab F -- Urologic Associates of South Texas." Technicians and pathologists in white lab coats move in and out of the small rooms conducting tests.

Each doctor group buys the microscope and other supplies used in its lab. Uropath is paid a management fee by the doctor groups and is reimbursed for rent, personnel costs and other expenses. The doctor groups pay pathologists for their work on a per-case basis. The doctor group does all of the insurance billing, including for patients on Medicare.

The inspector general for the U.S. Department of Health and Human Services evaluated a somewhat different condo arrangement last December. In that case, the lab company provided the pathologists and equipment while receiving a monthly management fee from the referring doctors, who did the billing and

kept any profit. The inspector general said the deal could constitute a violation of antikickback laws since the lab company was giving the doctors an opportunity for near-certain profits in exchange for the business.

A lawyer for Uropath, Greg Cardenas, says the company has carefully constructed its dealings with doctor groups to comply with federal laws including the antikickback law.

Another company offering doctors a chance to profit from lab work for both Medicare and privately insured patients is PathOptions of Hollywood, Fla. It solicited business from Edward Coles, a gastroenterologist in New Braunfels, Texas, saying he could bill insurance companies for four times what tests cost him. A financial "snapshot" attached to the letter claimed Dr. Coles could boost revenue for his small practice by a quarter million dollars. Dr. Coles says the proposal "didn't sound kosher" and he declined to participate.

But dozens of other doctors have signed up with PathOptions, says company co-founder Daniel Karten. Mr. Karten says lawyers have reviewed the company's model to make sure it is legal.

Getting a cut of lab revenue is attractive to gastroenterologists, who specialize in stomach and intestinal diseases. One of their cash cows used to be endoscopy, in which the doctor puts a tube down the patient's throat to examine the digestive tract, but Medicare reimbursement for that procedure fell more than 50% in the five-year period ended in 2002, according to a government study.

At an April 2004 seminar in Knoxville, Tenn., sponsored by the American Society for Gastrointestinal Endoscopy, gastroenterologist Bergein Overholt began with a review of reimbursement cuts before dangling some big numbers in front of the audience.

Dr. Overholt showed how his practice of 12 doctors, Gastrointestinal Associates in Knoxville, netted \$643,000 by sending its lab work to GI Pathology Partners in Memphis, Tenn. According to information presented at the seminar, Dr. Overholt's group paid \$52.55 to GI Pathology Partners for each biopsy the lab examined and then billed insurance companies an average of \$94.55 for the work.

Dr. Overholt has presented the material at similar seminars, including some underwritten by GI Pathology Partners. He says he typically receives a \$1,000 honorarium for such talks. Dr. Overholt was among those who fought a bill in Tennessee last year to ban client billing. The legislature eventually approved a watered-down measure.

In an interview, Dr. Overholt says the \$643,000 figure he cited at the 2004 meeting doesn't include "significant administrative" costs in billing patients and losses from patients who don't pay. He says the profit to his practice from billing on lab work is about 10% to 20%.

GI Pathology Partners says it does work for doctors in 14 states. Pat Dean, a pathologist and lab co-founder, says his company has a "business model of focused, factory efficiency," which along with client billing has "been a real boon for us."

Some doctors who send lab work to Dr. Dean, however, eschew client billing.

"We are a little old-fashioned," says one of them, Michael Freeman of Cape Girardeau, Mo. "It's one of those ethical things. Pat is doing the work. We just assume that Pat does the billing."

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