

HEALTH LAW UPDATE

November 2005

Healthcare Construction An Ounce of Prevention is Worth a Pound of Cure

By Aileen M. Leipprandt

Considering a renovation, expansion, or new facility? From the inception of the project, it is crucial to develop a master plan and an interdisciplinary team of staff and industry professionals to maximize your objectives and minimize risks associated with development, design and construction. Consider the following concept to completion checklist.

✓ **Feasibility Study.** Begin with the basics—what are your needs? Develop a master plan for expansion that includes an analysis of the current facility and key facility infrastructure. Explore all alternatives, including whether another site is necessary or whether an expansion to the existing site is the best solution. Prioritize and define expectations for expansion and consider what will drive the project's design – the patient care market you hope to maintain and/or expand, the patient care model, cost, security, staff safety, technology, sustainable construction (sometimes called “green” building), and maximizing patient and operational flows and systems (sometimes called “lean” thinking).

✓ **Equipment Assessment.** Assess key medical equipment, including the age, condition and repair record of existing medical equipment. Consider the major pieces of equipment that will be necessary to equip new areas and how to purchase that equipment such as through properly structured competitive bidding or well-drafted purchase orders.

✓ **Financing.** Nothing can stop a project faster than a lack of funding. Develop a strategic capital spending plan, including debt financing options, future debt capacity and the legal structure of such debt. Determine how to pay for the project and develop adequate contingencies. Consider whether there are any federal or state government initiatives available as a source of funding.

✓ **Compliance Issues.** Consider health and safety of patients during the project, including an Infection Control Risk Assessment and a HIPAA privacy assessment. Are you partnering with experts who understand applicable Life Safety Code provisions? Consider what certificate of need (“CON”) approval is required and plan

INTRODUCING YOUR HEALTHCARE INDUSTRY TEAM

At Smith Haughey, we don't just know the law, we pride ourselves on also knowing the nature of our client's business. Our 11 health law attorneys have almost 150 years of collective experience. But our Healthcare Industry Team is not only comprised of health law attorneys. It also includes business, employment, tax, construction, and workers' compensation attorneys who have extensive experience in representing healthcare institutions and professionals. For our clients, that means we can serve almost any legal need while being sensitive to the industry trends, regulations, and issues.

Our team members, who are listed at the back, speak at leading healthcare industry conferences. We sit on the boards of principal industry organizations. And we represent many of the top healthcare institutions in the state.

We realize that our clients view a legal matter as a business problem. We are sensitive to the issues affecting healthcare providers, and we work to tailor solutions with their business goals in mind. Please keep us in mind for all your legal needs.

www.shrr.com

ahead so that potential uncertainty of the CON process does not derail the project after other significant expenditures have been made.

✓ ***Project Delivery Structure.***

There are several different methods by which the construction project can be delivered, including design-bid-build, construction management, and design build. Make sure to understand the strengths and weaknesses of the various methods and the role of the owner, architect, contractor or construction manager in each delivery method. Consider a construction professional sensitive and appropriate to your particular healthcare environment. It may be an architect for the design-bid-build method, or a contractor for the construction management or design build method.

✓ ***RFPs and Contracts.***

Consider soliciting from the construction professional a Request for Proposal (RFP) to compare various proposals. A well-drafted RFP and detailed RFP response will provide significant insight into the capability, qualifications and client service philosophy of the construction professional. Likewise, consider the assistance of legal counsel in drafting and negotiating these important contracts, so that the contracts are properly coordinated and accurately reflect the division of responsibility of all parties.

✓ ***Design Development.***

Once the construction professional has been selected, that leader will work to move the project from the feasibility stage to conceptual or schematic design

phase where the project concept is defined, including scope, scale, functional layout of the project and other key objectives. This process may also involve development of key systems such as structural, mechanical and electrical. The project will continue to move through a more intensive design development stage. It is critical that key members of the team, including the owner's representative, participate fully for a shared responsibility in balancing the health care delivery goals with the capital spending plan.

✓ ***Construction Document Development.***

When the design phase has concluded, construction documents detailing the design will be prepared for project bidding and actual construction. Take time to thoroughly review these drawings, specifications, and other documents. Ask questions at this time to avoid costly changes in the project later.

✓ ***Bidding.*** Depending upon the project delivery method selected, you may be involved in selecting or approving subcontractors. Select a construction professional who will provide quality work, strong, responsive management, and who has a demonstrated track record of completing projects on time and within budget. Likewise, a reputation for responsive and efficient post construction warranty service is essential. Consider a prequalification procedure for subcontractors, particularly in specific, technical areas of expertise, such as security and technology.

✓ ***Actual Construction.*** The dust is flying and so are the

dollars. Prepare yourself for changes in the project as changes are inevitable and sometimes necessary to keep the project within budget and on time. Unexpected conditions may be encountered such as unforeseen underground conditions, unavailable materials, or a change in rules or regulations affecting the project. Some cost overruns cannot be financed and therefore must be managed tightly. Not only is maintaining the overall budget crucial, construction scheduling and completion are just as vital. A missed completion date can affect the project financing and cause loss of revenue. Consider incentive and liquidated damage provisions in the construction contract to award early project completion and compensate for delays. Does specialized equipment require specialized installation? Consider the need to coordinate high tech equipment installation with the various contractors early in the process.

✓ ***Completion.*** As the project nears completion, you will participate in a "punch list" review, a process whereby a detailed assessment of the construction is performed and defects or incomplete items are identified for contractor attention. The contract will certainly require the delivery of all product manuals, maintenance materials and warranties. Be sure to receive these crucial items and any necessary training. Further, consider a contractual requirement that the construction professional complete a one-year, post-construction inspection and repair of defects or deficiencies.

(continued...)

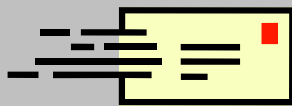
✓ *Small But Not Insignificant.* Perhaps you are considering minor deferred maintenance for which financing or significant project planning is unnecessary. Regardless of the size of the project, do not overlook the importance of the contract securing such work. For instance, consider indemnification provisions and additional insured provisions for all construction projects, large and small. Confirm that the

contractor is licensed and insured and require that the contractor's subcontractors are as well. Confirm that the contractor understands the particular health and safety issues associated with working in or around a healthcare facility. Even the smallest dollar project can result in major headaches if proper legal protections are not in place.

Whether expanding an existing facility, building a new campus

from scratch, or acquiring land for future expansion, a thoughtful plan will serve you well. After all, an ounce of prevention is worth a pound of cure.

Aileen Leipprandt practices construction law and commercial litigation and serves as a member of the healthcare industry team. She can be reached directly at 616.458.5298 or aleipprandt@shrr.com.



Be the First to Know

Sign Up for Electronic Newsletters and Legal Alerts

If you prefer to receive our Newsletters and Legal Alerts via email, please contact Lisa Young at lyoung@shrr.com or 616.458.3636 to sign up for the electronic version.

Michigan's Uniform Anatomical Gift Law: *Respect the Donor's Wishes*

By Scott D. Harvey

Michigan affords an individual who is at least 18 years of age and of sound mind the ability to make a gift of all or a part of his or her body, to be effective upon his or her death, pursuant to Michigan's Uniform Anatomical Gift Law ("UAGL"). The UAGL affords an individual the ability to express such a gift in his or her will, or in a document of gift other than a will, such as a driver's license or a Uniform Donor Card.

While the UAGL contemplates "first person consent" (i.e., that an individual's valid expression of a gift of all or a part of his or her body contained in a will or other document can only be revoked by that individual), in practice, upon the death of the donor, many health care institutions seek consent of the donor's family before harvesting the organs or other body parts gifted by the donor. Oftentimes, unless the family consents to such harvesting, the institution will not harvest the organs or other body parts

gifted by the donor. Some argue that this practice, while being respectful of the family's wishes, frustrates the intent of the donor who freely and voluntarily made this gift.

Responding to this practice, the Michigan Legislature recently passed an amendment to the UAGL, which became effective on September 29, 2005. Significantly, the amendment adds a subsection to the UAGL that provides the following:

(7) “A gift of all or a physical part of a donor’s body made by will as authorized by subsection (1) or by a document of gift other than a will as authorized by subsection (2) is not revocable after the death of the donor regardless of the expressed desires of the deceased donor’s next of kin who may oppose the donor’s organ, tissue, or eye donation.” MCL 333.10104(7).

While the concept of “first person consent” was implicit in the UAGL prior to this amendment, this amendment makes it clear that a donor’s valid expression of a gift of all or a part of his or her body contained in a will or other

document is to be respected regardless of the contrary expressions from the donor’s family upon his or her death. Clearly, this amendment is an attempt by the Legislature to remedy what many view as the frustration of the donor’s intent by his or her family upon the donor’s death. It can also be seen as an attempt to help remedy the problem of an increasing number of persons in need of an organ transplant and a decreasing number of available organs.

What does this amendment to the UAGL mean for health care institutions? First, such institutions should inform their relevant health care personnel of this change in the law as soon as possible. Second, such

institutions need not and in fact *should not* seek the consent of the donor’s family to act upon his or her validly expressed gift of an organ or other body part. While it is certainly acceptable and good practice to inform the donor’s family of their loved one’s gift of an organ or other body part, such institutions must respect and act in accordance with a donor’s valid expression of such a gift, despite any protestations to the contrary from the donor’s family.

Scott D. Harvey specializes in nonprofit law, business law and estate planning. He is a member of the healthcare industry team and can be reached at 231.486.4545, or at sharvey@shrr.com.

Proposed Regulations Offer Guidance on Revocation of Tax Exempt Status *Significant Changes on the Horizon*

By Ann-Mary Petroskey

Excess benefit transactions can cause the loss of an organization’s tax exempt status. But this status also can be revoked by the IRS if the organization is seen as operating for private rather than public benefit.

On September 9, 2005, the Treasury Department and the IRS issued proposed regulations that would amend the existing regulations. The proposed changes would provide guidance on avoiding the revocation of the tax-exempt status in instances of an organization that engages in one or more “excess benefit

transactions” and also if they do not.

The proposed regulations provide examples to consider. These examples illustrate certain activities furthering a private rather than a public interest that can jeopardize exemption, including those involving

1. non-economic benefits,
2. payments that are reasonable, and
3. transactions that would not otherwise constitute an excess benefit transaction under IRC § 4958.

None of the examples provided involve unreasonable economic benefit to insiders and, therefore, do not involve excess benefit transactions.

The proposed regulations clarify that the imposition of intermediate sanctions for excess benefit transactions by the IRS do not preclude the IRS denying or revoking the tax-exempt status of an organization. Instead the proposed regulations indicate that the IRS will apply a facts and circumstances test in determining whether to continue to recognize the tax-exempt status of an IRC § 501(c)(3)

organization that engages in one or more excess benefit transactions that violate the prohibition on inurement.

In doing so, the IRS will consider all relevant facts and circumstances, including, but not limited to, the following:

(1) The size and scope of the organization's regular and ongoing activities that further exempt purposes before and after the excess benefit transaction or transactions occurred;

(2) The size and scope of the excess benefit transaction or transactions (collectively, if more than one) in relation to the size and scope of the organization's regular and ongoing activities that further exempt purposes;

(3) Whether the organization has been involved in repeated excess benefit transactions;

(4) Whether the organization has implemented safeguards that are reasonably calculated to prevent future violations; and

(5) Whether the excess benefit transaction has been corrected, or the organization has made good faith efforts to seek correction from the disqualified persons who benefited from the excess benefit transaction.

The proposed regulations provide that all factors will be considered in combination with each other and that, depending on the particular situation, the IRS may assign greater or lesser weight to some factors than to others. Simply correcting the excess benefit transaction after the IRS has discovered the transactions is never a sufficient basis for maintaining exemption.

However, the regulations make it clear that an organization that has implemented safeguards to detect and prevent excess benefit transactions, and takes actions to discover and correct such transactions, is less likely to have its tax exemption status revoked by the IRS—even in the face of substantial excess benefit transactions. Accordingly, under the proposed regulations, organizations should take specific steps to guard against the revocation of its tax-exempt status.

The proposed regulations illuminate current IRS thinking on the question of when revocation of exemption is warranted on account of private inurement. Exempt organizations that discover they have engaged in inurement transactions would be well advised to consider the adoption of safeguards to prevent reoccurrence, and taking other corrective action consistent with the proposed regulations.

New Changes to Watch For

New efforts by the IRS in ensuring compliance are presently being implemented in revised Forms 1023, the application for tax exempt status and Form 990, the annual tax return of an exempt organization. The IRS has indicated that significant modifications to Form 990 may be expected soon, aimed at ensuring that proper disclosure of compensation arrangements are made on an annual basis.

Organizations should also be on the watch for significant legislative activity. While Congress has been sidetracked by disaster relief efforts, major

reform of the entire tax exempt sector is foreseeable. The House Ways and Means and Finance Committees held hearings on the issue in 2004 and the Joint Committee on Taxation released a similar study in January 2005.

Of greatest concern is the potential repeal of the “rebuttable presumption” standard on excess benefit transactions. Also discussed was a five year review of exempt status, application of the private foundation rules to public charities, establishment of federal standards on conversions, giving the state the authority to pursue violations, and enhanced reporting and disclosures. While these developments are still in the discussion stage, it may be a question of “when” not “if” on many of these areas. Keep alert for these potentially major impact changes!

Ann-Mary Petroskey practices tax law, business law and estate planning, and serves as a healthcare industry team member. She can be reached directly at 517.318.5659 or apetroskey@shrr.com.

Any tax advice contained in this article was not intended or written by the author to be used and it cannot be used by any taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer. Any tax advice contained in this article was written to support the promotion or marketing (as defined by IRS Circular 230) of the transactions or matters addressed by such advice. Before using any tax advice contained in this article, a taxpayer should seek specific tax advice based on the taxpayer's particular circumstances.

**SMITH HAUGHEY RICE & ROEGGE'S
HEALTHCARE INDUSTRY TEAM**



Veronica A. Marsich, Chair
734.913.6662



William W. Jack, Jr.
616.458.6243



William R. Jewell
616.458.8203



R. Jay Hardin
231.486.4534



Robert C. Stone
616.458.3622



Richard C. Kraus
517.318.5653



Christopher R. Genther
616.458.0222



Aileen M. Leipprandt
616.458.5298



Jane C. Hofmeyer
616.458.5388



Rachel Brochert Roe
231.486.4503



Kirk W. Morgan
616.458.3319



Ashley W. Taylor
734.913.6907



Billee Lightvoet Ward
616.458.5454



Cara L. Nieboer
616.458.0437



Shawn C. Worden
231.486.4505



Scott D. Harvey
231.486.4545



Amanda K. Coulter
734.913.5517