

## ALERTS

## Physicians Agreements May Cost South Carolina Hospital More Than \$237.5 Million

### HEALTH CARE CLIENT UPDATE

10.2013

The District Court in *United States ex rel. Drakeford v. Tuomey Healthcare Sys., Inc.*, ordered Tuomey Healthcare System, Inc. ("Tuomey") to pay \$237.5 million in damages and penalties, which is more than Tuomey's revenue last year. No. 3:05-2858-MBS (D.S.C. Sept. 30, 2013). In this case, which has spanned nearly eight years and two trials, the jury found that Tuomey violated the Stark Law and the False Claims Act by entering into contracts with outside physicians to provide surgery exclusively in its facilities and pay bonuses for productivity. The week prior to the Court's order, Tuomey's President and CEO, Jay Cox, announced he was leaving the hospital he had run for 23 years. Gregg Martin, Tuomey's Executive Vice President and COO, will also be departing the hospital. Tuomey has appealed to the Fourth Circuit.

#### Background

In 2003, when physicians at a gastroenterology practice told Tuomey, a hospital in Sumter, South Carolina, they wanted to perform outpatient surgical procedures in their own offices rather than at the hospital, Tuomey made them an offer. Tuomey and 19 physicians agreed to sign a 10-year contract to do outpatient surgeries only at Tuomey hospital facilities. This arrangement included part-time employment agreements that paid each physician a base salary that fluctuated based on Tuomey's net cash collections for the outpatient procedures, as well as potential bonuses based on Tuomey's collections. Physicians were also barred from competing with Tuomey after the contract expired.

Dr. Michael Drakeford refused to enter into a similar agreement with Tuomey, and the orthopedic surgeon subsequently filed a *qui tam* lawsuit against Tuomey in 2005 alleging violations of Section 1877 of the Social Security Act (42 U.S.C. 1395nnn), commonly referred to as the Stark Law. When enacted in 1989, the Stark Law applied only to physician referrals for clinical laboratory services. Congress has expanded the Stark Law on several occasions to include additional services covered by Medicare. Dr. Drakeford alleged that Tuomey paid the physicians an average of more than 30 percent above the fees collected, including fees collected from Medicare.

The U.S. Department of Justice intervened in 2007 and asserted Stark Law and False Claims Act violations against Tuomey. The False Claims Act provides a cause of action against federal contractors, including hospitals paid by Medicare, who defraud the Government. The Act provides that "[a]ny person who . . . knowingly presents, or causes to be presented, to an officer or employee of the United States Government . . . a false or fraudulent claim for payment or approval . . . is liable to the United States Government for a civil penalty of not less than [\$5,500] and not more than [\$11,000], plus 3 times the amount of damages which the Government sustains because of the act of that person . . ." 31 U.S.C. § 3723(a); 28 C.F.R. § 85.3(a)(9).

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The DOJ claimed that the number and value of the referrals the specialists generated for Tuomey affected their compensation. As a result, the related reimbursement claims for these referrals submitted to Medicare violated the Stark Law and the False Claims Act.

In response to these complaints, among other defenses, Tuomey alleged that it relied on the advice of counsel from two separate law firms for the belief that the employment contracts were permissible. Tuomey also received input regarding the part-time employment agreements from a former Inspector General of the Department of Health and Human Services and a fair market value opinion Cejka Consulting, a physician and health care recruiting and consulting firm.

### The Trials

The first trial took place in the District Court of South Carolina in 2010. The jury found that Tuomey violated the Stark Law, but not the False Claims Act. The District Court vacated the jury's verdict on the False Claims Act and entered judgment against Tuomey for more than \$44 million on equitable claims. On appeal, the Fourth Circuit concluded that when the District Court set aside the jury's Stark Law verdict and granted the DOJ a new trial on the False Claims Act claims, the jury's verdict regarding the Stark Law issue became a legal nullity. In remanding the case, the Fourth Circuit provided guidance on legal issues the Court believed were necessary for a resolution before the District Court. The Fourth Circuit noted that even where the referring physician performed the procedure, "for example, in the case of an inpatient surgery, there would be a referral of the technical component of the surgical service[,]” which it would be impermissible for Tuomey to compensate the referring physician for as part of the employment contracts. *U.S. ex. rel. Drakeford v. Tuomey Healthcare System, Inc.*, 675 F.3d 394, 406 (4th Cir. 2012). The Fourth Circuit further stated that physician compensation arrangements that take future referrals into account could violate the Stark Law. The Court reasoned that "if a hospital provides fixed compensation to a physician that is not based solely on the value of the services the physician is expected to perform, but also takes into account additional revenue the hospital anticipates will result from the physician's referrals, that such compensation by necessity takes into account the volume or value of such referrals." *Tuomey Healthcare System*, 675 F.3d at 409.

The second Tuomey trial lasted over a month in the District Court of South Carolina. On May 8, 2013, the jury found that Tuomey's compensation arrangements with the referring physicians violated both the Stark Law and the False Claims Act. The jury found that Tuomey submitted more than 21,000 false claims to Medicare which the Government provided reimbursement of more than \$39 million. The Government sought more than \$235 million in treble damages and penalties, which it explained to be the minimum recovery for Tuomey's violation of the False Claims Act. The Government indicated it intends to file a separate motion addressing its causes of action for payments made by mistake and unjust enrichment, which resulted in a judgment of more than \$44 million from the District Court after the first trial.

### Impact of Tuomey

The DOJ's interpretation of the Stark Law and the False Claims Act as confirmed by the large jury award and the much larger court-ordered penalties will most certainly have repercussions on the healthcare industry and reshape how physicians and hospitals contract for services.

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This very costly result came about not as the result of Tuomey overbilling the Government or billing the Government for services that were never performed. Instead, Tuomey knowingly submitted Medicare claims for services that were rendered pursuant to an agreement that a jury found to be a prohibited referral arrangement.

*Tuomey* makes clear that the Government will scrutinize compensation agreements between a physician and hospital. At a minimum, when hospitals and physicians negotiate compensation agreements for referrals, referrals of designated health services payable by Medicare cannot be part of those agreements. Hospitals need to carefully scrutinize their agreements to make sure that physicians are paid for the fair market value of their services and they need to consider the risks of including non-compete provisions in their employment agreements. Hospitals should also diligently investigate issues raised by potential whistleblowers that, if ignored, may result in significant litigation exposure.

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