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Court Deals Government a Blow in Tuomey Hospital Case, But Raises Compliance Bar

The U.S. Court of Appeals for the Fourth Circuit on March 30 threw out the government's landmark Stark and false claims case against Tuomey Healthcare System in Sumter, S.C., which means any new trial must start fresh with all allegations stemming from the hospital's compensation arrangements with physicians.

While Tuomey may be throwing a victory party, lawyers say the decision actually takes a hard line on Stark — saying, for example, that anticipated referrals are just like actual referrals when it comes to compensation — and may raise the stakes for compliance.

The appeals court ruled that after Tuomey's 2010 Stark and false claims trial, the hospital's seventh-amendment right to a jury trial was violated in certain post-trial rulings. The jury had found Tuomey liable for Stark violations but not false claims *(RMC 4/12/10, p. 3).* But then the U.S. District Court judge who oversaw the trial set aside the false claims verdict — giving the government another bite at the apple — while granting the government's request to recover $45 million from Tuomey in Medicare repayment stemming from the Stark noncompliance *(RMC 6/14/10, p. 1).*

The appeals court, however, made it all go away, and the government will have to start over. "The appellate court's reversal of the $45 million judgment against Tuomey is significant to the parties in this litigation, but the potential implications for interpreting Stark in other cases is what makes the Fourth Circuit's opinion so interesting," says Macon, Ga., attorney Alan Rumph, with Smith Hawkins. There is, however, some ambiguity in the court ruling, he says.

The Tuomey Healthcare case captured the attention of the compliance and enforcement world partly because few false claims cases go to trial in the health care industry. The stakes are too high; if the government wins, providers face an $11,000 fine per false claim plus treble damages. Hospitals usually settle, whether or not they think they have wronged Medicare.

For whatever reason, Tuomey went to trial when the government accused it of violating the Stark law and therefore submitting false Medicare claims stemming from allegedly illegal physician relationships. The Stark law forbids Medicare payments to entities for designated health services (DHS), such as inpatient and outpatient services, when patients are referred by physicians who have a financial relationship with the entity, unless an exception applies. For example, the indirect compensation arrangement exception, which figures into the Tuomey case, states that DHS entities may bill Medicare for services referred by physicians who have a financial relationship with the DHS entity as long as the indirect compensation is in writing, at fair-market value, doesn't reflect the volume or value of the physician's referrals and doesn't violate the anti-kickback law.

According to the government, Tuomey signed part-time employment agreements with 18 specialists when it seemed they would shift their outpatient procedures from the hospital to their private practices. Fearing a loss of revenue to the competition, Tuomey offered the physicians 10-year compensation deals, the government alleged. The specialists were required to perform all outpatient procedures at Tuomey Hospital or its other facilities, and were paid an annual base salary that varied according to the net cash collections for outpatient procedures and a productivity bonus equal to 80% of net collections, the court decision states. On top of that, the specialists could earn an incentive bonus worth up to 7% of their productivity bonus. Under the contracts, the specialists reassigned payment to Tuomey, which handled all billing and collections for the professional fee (professional component) and the hospital's facility fee (technical component).

The contracts were brought to the government's attention by orthopedic surgeon Michael Drakeford, who turned down Tuomey's offer and became a whistleblower. The U.S. Attorney's Office for the District of South Carolina took over his false claims lawsuit in 2007. The two sides went to trial and, in a March 2010

verdict, the jury concluded that Tuomey violated the Stark law but not the FCA.

Post-Trial Motions Continued the Drama

But the drama was far from over, thanks to post-trial motions. The federal judge decided he made a mistake in excluding certain government evidence, and therefore ordered a new false claims trial while preserving the Stark win and Tuomey's $45 million debt, which stems from the Stark-related unjust enrichment it allegedly collected in the eyes of the jury.

Tuomey then moved up the food chain to the U.S. Court of Appeals for the Fourth Circuit, where the hospital snatched victory from the jaws of defeat. In a March 30 decision, the appeals court "wiped out the Stark verdict," says Birmingham, Ala., attorney William Horton, with Johnston Barton Proctor & Rose.

It also seized the opportunity to generalize about the application of the Stark law and regulations in ways that have implications for all DHS entities, including hospitals, as they structure financial relationships with physicians.

For one thing, the appeals court emphasized that prohibited referrals under Stark extend to the hospital side of things. Tuomey had argued that Stark was never implicated because the physicians were compensated for services they personally performed at the hospital. While it's true that Stark isn't implicated when physicians perform or provide the services they refer to hospitals with whom they have financial relationships, the professional fee isn't the only service at hand. The hospital also bills Medicare for facility fees, such as X-rays, when physicians perform surgeries there, and those services are DHS, the court ruled.

"We conclude that there was a referral here, consisting of the facility component of the physicians' personally performed services, and the resulting facility fee billed by Tuomey was based upon that component. Thus, the claims for facility fees based on patient referrals were prohibited under the Stark Law if there was a financial relationship within the meaning of the law between the physicians and Tuomey. As such, Tuomey's argument that the physicians were not making referrals — as that term is defined in the Stark Law — pursuant to the contracts fails," the appeals court states.

Beware Compensation for Anticipated Referrals

The appeals court also asserted that Stark would be violated if physician compensation took into consideration the volume or value of physicians' anticipated referrals. Most Stark exceptions state that physician compensation can't vary based on referrals to DHS entities, but the court specified that this applies to future referrals — not just actual referrals.

The appeals court also linked anticipated referrals to fair market value, which is a prerequisite for compliance with Stark exceptions. Stark regulations define "fair market value" partly as compensation that doesn't consider the volume or value of "anticipated or actual referrals." In fact, the court states, when physicians are required to refer patients to a specific place, as is the case with the Tuomey compensation arrangements, there's no Stark violation if certain criteria are met — "one of which is that the physician's compensation must not take into account the volume or value of anticipated referrals," the appeals court notes.

The court's position makes the Stark law tougher to administer, says Los Angeles attorney Brad Tully, with Hooper, Lundy & Bookman. "The court said it's bad if you take into account anticipated referrals in a way that affects physician compensation, but there are a lot of valuation techniques that consider anticipated referrals," he says, such as discounted cash flow methods. The court also seems to imply that it's OK for hospitals to ponder future referrals, as long as their thoughts don't affect how much compensation they pay physicians, Tully says. For example, if an independent expert values a physician's services at $10 to $12 an hour, and the hospital decides first to pay $11 but then bumps it up to $11.50 because it will benefit from the physician's referrals, "the court is saying there's a problem with that" — even though $11.50 falls in the range of fair market value. "This opens up people to being second guessed," Tully says. "As a practical matter, it will be hard for people not to have anticipated referrals affect their valuations."

Rumph and Horton say the opinion sends mixed signals on compensation. The court says at retrial, the jury must decide "whether the contracts, on their face [took anticipated referrals into account]." That implies the process for arriving at compensation is irrelevant, as long as the contract terms don't take referrals into account. "The court sent a mixed signal on this issue," Rumph says.

In light of the decision, Rumph says hospital-physician compensation deals should leave all kinds of referrals out of the equation. He generally recommends that hospitals not pay physicians more than they collect solely from their professional services (as Tuomey contends it did) and that there be a legitimate reason for a hospital experiencing a loss on the physicians' services after associated expenses. For example, a hospital struggling to provide a needed medical service in the community may have to "underwrite a loss" to attract a specialist, "but that is a very different reason for paying the doctor that amount. It's not because they make it up on the facility charge, which may or may not happen," he says.

The decision also sends the message that having an employment relationship with physicians doesn't always insulate hospitals from the Stark law despite the employment exception, Horton says. "The Tuomey case makes it clear that the government can still be concerned with referrals generated by employed physicians. And the court has made it clear there is still a Stark analysis even with employment agreements."

As for Tuomey, it's now up to a South Carolina jury to determine, once again, whether the hospital violated the Stark law and False Claims Act — unless the two sides settle.

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