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Practice Update

The High Cost of Paying Physicians for Referrals: Tuomey Healthcare System Faces Penalties of up to $357 Million

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On May 8, 2013, a jury sitting in the U.S. District Court for South Carolina found that Tuomey Healthcare System, Inc. violated the Stark Law and the False Claims Act (FCA) by illegally paying referring physicians. The jury found that Tuomey, a private, nonprofit hospital, submitted for payment to Medicare over 21,000 tainted claims resulting in $39 million in damages. Additionally, Tuomey is potentially liable for treble damages plus a penalty of up to $11,000 per claim under the FCA, which could amount to a total of $357 million. The verdict was issued in a retrial ordered by the United States Court of Appeals for the Fourth Circuit in U.S. ex. rel. Drakeford v. Tuomey Healthcare System, Inc., 675 F.3d 394 (4th Cir. 2012).

The case arose from Tuomey's efforts to prevent its medical staff members from performing outpatient procedures at facilities not owned by the hospital. In 2005 and 2006, Tuomey entered into part-time employment contracts with 19 specialist physicians, all with similar terms. Each contract, which had a 10-year term, provided that the physician was required to perform outpatient procedures at Tuomey Hospital or at facilities owned or operated by it. Tuomey was solely responsible for billing and collections from patients, Medicare and other third-

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party payors for the professional and technical components of the procedures, and the physicians expressly reassigned to Tuomey all benefits payable to the physicians.

Central to the case was the fact that Tuomey paid each physician an annual base salary that fluctuated based on Tuomey's net cash collections for the outpatient procedures. Tuomey further agreed to pay each physician a "productivity bonus" equal to 80 percent of the net collections. In addition, each physician was eligible for an incentive bonus that could total up to 7 percent of the productivity bonus. All parties performed according to the agreements, including Tuomey billing Medicare and other third-party payors for the professional and technical components of the procedures.

Dr. Michael Drakeford, an orthopedic surgeon and the relator in this case, became involved in this matter when Tuomey attempted to negotiate the above arrangement with him. When negotiations failed, Dr. Drakeford filed a qui tam action in 2005. The United States Department of Justice (DOJ) intervened in the case in 2007 and asserted an additional claim for violation of the FCA. DOJ alleged that the physicians' compensation improperly took into account the value or volume of referrals that the physicians generated for Tuomey because it included a portion of the technical component for the outpatient procedures the physicians performed. These illegal compensation arrangements violated the Stark law, resulting in 21,730 improper claims being submitted to Medicare in violation of the False Claims Act. For his efforts in bringing the matter to DOJ's attention, Dr. Drakeford is now likely to recover a significant bounty.

When the case initially went to trial in 2010, the jury found that Tuomey violated the Stark Law, but did not violate the FCA. The trial court set aside the jury's verdict and ordered a new trial on the FCA allegations. The trial court also entered judgment against Tuomey for more than $44 million based on

DOJ's estimate of the value of tainted claims submitted to Medicare.

The case was appealed to the Fourth Circuit, which vacated the $44 million judgment and ordered a new trial on both the Stark Law and FCA allegations. The Fourth Circuit agreed with Tuomey that Tuomey was deprived of its right to trial by jury when the trial court set aside the jury's verdict on the Stark Law allegations and granted the DOJ's motion for a new trial on the FCA allegations because the Stark Law violations were the predicate for the FCA allegations. The Fourth Circuit directed that at the new trial the jury was to determine whether Tuomey's contracts with the physicians took into account the volume or value of referrals in violation of the Stark Law. The Fourth Circuit noted that compensation arrangements that take into account anticipated referrals do implicate the volume or value standard in the Stark Law. It 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 flow from the physician's referrals, that compensation takes into account the volume or value of such referrals.

As noted above, on retrial the jury found that Tuomey violated both the Stark Law and the FCA. After the verdict, the court directed the parties to file their positions on damages and these matters are expected to be the subject of significant litigation in the coming months. It will be interesting to see how much the DOJ seeks in fines and penalties against Tuomey because a judgment close to the statutory maximum of $357 million could put the nonprofit hospital out of business. It remains to be seen whether the judge in the Tuomey case will consider, as the judge in the WakeMed case (U.S. v. WakeMed Health and Hospitals, 5:12-CR-00398-BO, E.D.N.C.) did, the impact of a substantial judgment on the patients and the community served by the hospital.

In light of the Tuomey verdict and case law, hospitals should review their existing compensation arrangements with physicians. Also, going forward, it is clear that hospitals and physicians cannot consider anticipated referrals of designated health services when structuring physician compensation. Physicians should be compensated only for the services they actually provide, i.e., the hospital cannot pay the physicians for the technical component that the procedures performed by the physician generates for the hospital. Adopting a coordinated approach to structuring compensation arrangements, which takes into account the collective knowledge of human resources, compliance and legal counsel, is now more important than ever. In addition to federal prohibitions, parties and their legal counsel should pay special attention to applicable state self-referral or anti-kickback laws when structuring compensation arrangements to avoid potentially disastrous consequences down the road.

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