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HEALTH LAW

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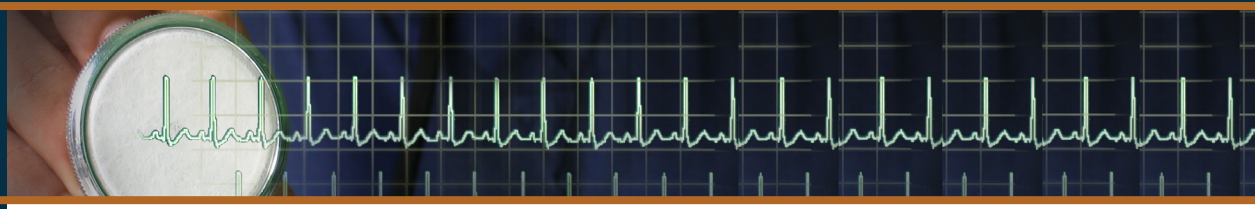

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Lessons Learned from *U.S. ex rel., Drakeford v. Tuomey Healthcare System, Inc.*

Approximately 10 years ago, Tuomey Healthcare System, Inc. ("Tuomey"), a hospital located in Sumter, South Carolina, entered into exclusive part-time employment negotiations with 19 of its affiliated specialist physicians (among them surgeons, gastroenterologists, obstetricians/gynecologists and ophthalmologists) to prevent these physicians from moving their outpatient business out of Tuomey's ambulatory surgery center and into lower cost competing locations, some of which would be owned by the physicians themselves. Each of these physicians except for one, an orthopedic surgeon who subsequently became the Relator (i.e. "whistleblower") in the Federal Government's case against Tuomey, agreed to enter into exclusive part-time employment agreements with Tuomey and thus, keep all of their outpatient business at Tuomey in exchange for very favorable compensation arrangements.

At issue in this case was the compensation that Toumey agreed to pay the physicians pursuant to their exclusive part-time employment agreements. Specifically, Tuomey agreed to pay each physician 131% of their net revenues collected (or 31% over the amount that the physicians actually generated in revenues) in return for their services and a non-compete agreement. While some of the physicians were eager to accept the terms of the proposal, the orthopedic surgeon or Relator sought his own legal counsel to confirm the legality of the arrangement and was advised by his counsel that the proposed employment agreement violated the Stark Law.[1]

In an effort to address the orthopedic surgeon's concerns, Tuomey agreed to jointly hire a second attorney with the orthopedic surgeon for the purpose of providing an independent third-party legal opinion of the proposed part-time exclusive employment agreement. However, when the jointly engaged attorney found the proposed employment agreement to be problematic because it had the effect of locking in the orthopedic surgeon's referrals (by

1 Section 1877 of the Social Security Act, 42 U.S.C. §1395nn (the "Stark Law").

way of a non-compete) and provided compensation in excess of fair market value, Tuomey disengaged from the attorney and advised him not to put his opinion in writing.

Thereafter, Tuomey sought legal review of the proposed employment agreement from another law firm. Tuomey's new counsel, relying on the fair market value opinion of Tuomey's expert (who advised that paying the physicians 131% of their net revenues was fair market value compensation), advised Tuomey that the compensation was unlikely to violate the Stark Law, provided, (i) the employment agreements allowed the physicians to not be restricted in honoring the patient's choice (even though Tuomey was the only hospital in the area); and (ii) the physicians were compensated on the basis of revenue generated rather than procedures performed. Notwithstanding the new opinion, the orthopedic surgeon was not convinced of its legality and attempted to bring his concerns to Tuomey's board of directors. However, Tuomey effectively made it impossible for the orthopedic surgeon to communicate his concerns to the board.

Subsequent to that event, the orthopedic surgeon related the matter to the Federal Government, which also concluded that the Tuomey employment agreements exceeded fair market value, were commercially unreasonable and took into account the volume or value of referrals all in contravention of the Stark Law.[2] The Federal Government brought suit against Tuomey. See, U.S. ex rel., Drakeford v. Tuomey Healthcare System, Inc. After ten years of litigation, involving two jury trials and appellate review by the 4th Circuit Court of Appeals, the Federal Government finally received a significant jury verdict on May 8, 2013, finding Tuomey liable for violating the Stark Law and the False Claims Act. As a result of that decision, Tuomey now faces potential liability in excess of $350,000,000.

If we look at the Federal Government's complaint, the dicta of the 4th Circuit and the jury verdict itself, there are lessons to be learned from Tuomey that can shed some light on what is otherwise a very nuanced and complex Stark Law. The following sets forth our take aways:

- The underlying facts relating to a compensation relationship between a physician and hospital will be closely scrutinized by the Federal Government and hence, the written document setting forth the arrangement will not be viewed in a vacuum if the arrangement itself does not meet all of the requirements of the Stark Law's enumerated exceptions to prohibited referrals. Thus, if the negotiations and discussions between

2 The United States sought relief for the alleged Stark Law violations under the False Claims Act. See, 31 U.S.C. §§3729-33.

the parties represent an intent to induce or reward the volume or value of referrals, those facts will become relevant when and if the arrangement is investigated;

- Take little comfort in an expert opinion on fair market value if the expert does not do his or her homework, does not have the necessary competencies to understand the Stark Law and is simply willing to give the customer whatever they are looking for rather than a careful analysis under the applicable law. Simply put, you cannot buy yourself an insurance policy against Stark Law liability if you have not complied with the Stark Law in the first instance; and

- Although a physician who initiates a service that he or she performs is not a referral, in the context of inpatient and outpatient hospital services, a referral will be considered to have occurred if the physician employee initiates a technical component or facility fee in connection with his or her service.[3]

At the end of the day, if a physician is compensated fair market value for the services that he or she provides and the arrangement is commercially reasonable (i.e. but for the referrals, it still makes business sense to enter into the arrangement with the physician), then hospitals will have little to worry about. Nevertheless, all should take note and consider the lessons to be learned from Tuomey.

If you have any questions, please contact any member of our Health Law Practice Group listed on the first page of this alert.

3 When a physician initiates a service and personally performs it, that action does not constitute a referral under the Stark Law. See, 42 U.S.C. § 1395nn(h)(5); 42 C.F.R. § 411.351.

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