Fourth Circuit upholds $237 million judgment against Tuomey Healthcare System

By: Philip Rosenberg and Jason Chimon

On July 2, 2015, the U.S. Court of Appeals for the Fourth Circuit delivered what could be the final note in Tuomey Healthcare System’s (“Tuomey”) decade long battle with the government regarding the legality of certain physician compensation arrangements under the Stark law and False Claims Act. In its opinion, the court affirmed a $237,454,195 lower court judgment against Tuomey for violating the Stark law and False Claims Act. The court’s affirmance serves as a sobering reminder to hospitals and physicians of the staggering liability that could arise from non-compliant compensation arrangements.

The case dates back to 2003, when Tuomey, a nonprofit hospital in rural South Carolina, sought to negotiate part-time employment contracts between its subsidiary LLCs and several local physicians in order to stem Tuomey’s loss of revenue due to the physicians performing surgeries in their own offices or at off-site surgery centers instead of at Tuomey’s hospital. Tuomey eventually entered into arrangements with 19 physicians, but was unable to reach an agreement with one physician. After the negotiations with that physician broke down in 2005, the physician brought suit against Tuomey under the qui tam provisions of the False Claims Act (“FCA”), alleging that the employment contracts violated the Stark law. The United States subsequently intervened in the action.

At the first trial in 2010, a jury found that Tuomey had violated the Stark Law, but not the FCA. The district court then vacated that verdict and granted a new trial on the grounds that the court had erred in excluding deposition testimony. In a second trial in 2013, a jury again found that Tuomey had violated the Stark Law. That jury also found, however, that Tuomey violated the FCA by knowingly submitting false claims to the government for reimbursement in an amount of $39,313,065. The district court then awarded treble damages and penalties, resulting in a judgment of $237,454,195. Tuomey appealed.

In its opinion, the Fourth Circuit affirmed the lower court judgment. While the court’s decision addresses a variety of evidentiary and procedural issues relating to the second trial and the appropriateness of the lower court’s award of treble damages and penalties, one notable takeaway for the health care industry relates to the court’s technical discussion of how the physician compensation arrangements varied with, or took into account, the volume or value of actual or anticipated referrals to Tuomey under the Stark Law.
The physician contracts at issue in the case involved primarily two compensation components: an annual salary based on the amount collected by the physician for services rendered in the prior year and a productivity bonus of 80% of the physicians’ collections that year. The physicians also received benefits, including professional liability coverage and the ability to participate in Tuomey’s health plans. When all was said and done, the physicians received compensation in excess of collections for their professional services, with Tuomey effectively subsidizing the difference.

The government contended that the physician contracts constituted “indirect compensation arrangements” within the meaning of the Stark Law. That was a keystone to the government’s position because the Stark Law bars a physician who has an indirect compensation arrangement with a hospital from referring patients to that hospital (unless the arrangement fits within one of the exceptions under the law). In order to be an indirect compensation arrangement under Stark Law, however, the aggregate compensation paid under the arrangement must, among other things, vary with, or take into account, the volume or value of referrals. At the trial in the lower court, the government argued—and the jury ultimately agreed—that this condition was satisfied because the physician compensation was based on the expectation that the physicians would refer patients to Tuomey. Indeed, the government pointed to testimony by Tuomey’s own chief financial officer expressly acknowledging that Tuomey’s purpose in entering into the physician contracts was to ensure that the physicians refer patients to the hospital so that Tuomey could bill for its facility fees.

In response to the government’s position, Tuomey argued that its underlying purpose in entering into the arrangements with the physicians was beside the point. The only relevant issue, according to Tuomey, was whether the physician contracts on their face violated the Stark Law—which Tuomey claimed was not the case. Tuomey contended that the contracts, by their own terms, were compliant because the contracts tied physician compensation to the collections generated by the physicians’ own services. Tuomey’s reasoning appears to have been based on the fact that the Stark Law does not consider the ordering of services that a physician (or a member of the physician’s group practice) actually performs to be a “referral.” Therefore, the linking of the compensation to physician services meant that the physicians did not receive aggregate compensation based on the volume or value of referrals, as defined under the Stark Law.

The Circuit Court rejected Tuomey’s argument. The court explained that it was appropriate to evaluate the physician compensation arrangement under a broader context that considered the relationship between the physicians’ services and Tuomey’s billing. According to the court, because the physician contracts were based on the notion that the physician would perform their services at Tuomey so that Tuomey, in turn, could bill its facility fee, it was reasonable to conclude that the physicians’ compensation varied with, or took into account, the volume or value of referrals made to Tuomey.

The Tuomey decision means that hospitals must be even more vigilant to maintain Stark compliance. Compensation arrangements should be carefully scrutinized based on the full context underlying the relationship. Hospitals and physicians should be particularly cautious in entering into arrangements where the compensation paid is in excess of the professional fees collected.

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