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The Stark/False Claims Act Booby Trap

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Picture a hospital in a medically underserved area trying to keep its doors open and serve its patients.

Imagine the hospital wants to enter into contracts with physicians as part-time employees of the hospital. To ensure compliance with applicable law, the hospital seeks the advice of its long-time counsel.

After the hospital and its longtime counsel consult with a national consulting firm with expertise in physician compensation and the nation's largest health care firm, the longtime counsel drafts and approves the contracts. One physician (who balked at signing the contract) and the hospital then jointly retain and consult another health-care lawyer who says the contracts raise some red flags.

In-house counsel advises the hospital it can proceed with the contracts. Shortly thereafter, the physician files a whistle-blower lawsuit against the hospital under the False Claims Act, based solely on underlying claimed violations of the Stark law.

There are no allegations that the services were not provided, were not medically necessary or that the government overpaid for the services. Two trials and two appeals later, the hospital now has a judgment against it for over $237 million, large enough to potentially cause it to shut its doors.

One may wonder how that result is beneficial to the patients the hospital serves.

Indeed, as Judge James A. Wynn Jr. noted in his concurring opinion in the recent decision by the U.S. Court of Appeals for the Fourth Circuit upholding the judgment against Tuomey Hospital, ''This case is troubling. It seems as if, even for well-intentioned health-care providers, the Stark Law has become a booby trap rigged with strict liability and potentially ruinous exposure—especially when coupled with the False Claims Act.'' (*United States ex rel. Drakeford v. Tuomey*, 2015 BL 212865, 4th Cir., No. 13-2219, 7/2/15) (26 MCR 859, 7/10/15).

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Stark Law

Designed to prevent physicians from receiving financial benefit from referring patients for certain health services to entities in which the physicians (or family members) have a financial interest and resulting overutilization of services, the Stark law does not provide any civil cause of action at all, no less a whistle-blower cause of action. 42 U.S. C.§ 1395nn.

Instead, the statute includes strict liability nonpayment of claims based on prohibited referrals, as well as potential exclusion and administrative penalties for knowing violations.

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As Judge Wynn so aptly quoted in his concurring opinion, the Stark law is considered by many as ''complicated, confusing and counterintuitive; for producing results that defy common sense and sometimes elevating form over substance.'' Id. at 63, citing Charles B. Oppenheim, The Stark Law: Comprehensive Analysis + Practical Guide 1 (AHLA 5th ed. 2014).

Notwithstanding its complexity and potential traps for the unwary, the government and whistle-blowers are increasingly bootstrapping claimed Stark violations into False Claims Act cases.

False Claims Act

Passed by Congress during the Civil War to attack war profiteering, the False Claims Act (''FCA'') remains the main civil weapon in the government's arsenal, given its combination punch of treble damages and mandatory penalties of $5,500 to $11,000 per claim. 31 U.S.C. § 3729-3733.

The FCA also allows whistle-blowers to file suit and collect up to 30 percent of the government's recovery; the government can intervene and take over the case or allow the whistle-blower to proceed independently. 31 U.S.C. § 3730.

The FCA requires knowing violations, defined as:

1) actual knowledge of the information;

2) deliberate ignorance of the truth or falsity of the information; or

3) reckless disregard of the truth or falsity of the information. 31 U.S.C. § 3729(b)(1)(A).

No specific intent to defraud is required. 31 U.S.C. § 3729(b)(1)(B).

Advice of Counsel

The government's FCA case against Tuomey hinged on proving underlying Stark violations.

Since the alleged false claims were not factually false (there were no allegations that the services were not provided, were not medically necessary, or were billed at a higher reimbursement rate than appropriate), the Court focused on the hospital's knowledge that its claims were allegedly legally false (that is—submitted in violation of the Stark Law).

As the majority opinion states, ''the government needed to show that Tuomey knew that there was a substantial risk that the contract violated the Stark Law, and was nonetheless deliberately ignorant of, or recklessly disregarded that risk.'' Id. at 19.

To defeat the necessary scienter that the hospital knew the claims were legally false under the FCA because they were submitted in violation of Stark, the hospital relied on an advice of counsel defense.

As the Fourth Circuit recognized, a jury can appropriately determine that good faith reliance on legal advice by a lawyer to whom one has made full disclosure of the facts negates the requisite ''guilty mind.'' Id. at 30-31, quoting U.S. v. Painter, 314 F.2d 939, 943 (4th Cir. 1963).

Even if the lawyer's advice turns out later to be wrong, the entities good faith reliance on that advice can still defeat an allegation of a knowing violation of law.

As Judge Wynn stated in his concurring opinion, given the complexities of the Stark law, ''it is easy to see how even diligent counsel could wind up giving clients incorrect advice.'' Id. at 65.

The advice of counsel, particularly the advice of the counsel jointly retained by the hospital and the physician whistle-blower (before he filed suit), became the centerpiece of the government's case against Tuomey and a large part of the Circuit Court's decision.

During the first trial, the district court excluded evidence by that attorney (the ''red flag attorney''), as well as evidence by a hospital executive concerning conversations with in-house counsel which were in turn based on in-house counsel's communications with the red flag attorney.

Although the first jury determined the hospital had violated Stark, it did not find any FCA violations. The district court granted the government's motion for a new trial based solely on error in excluding the testimony of the hospital executive (but not, however, based on exclusion of the red flag attorney's testimony.)

In the second trial, the Court allowed testimony by both the hospital executive and the red flag attorney, resulting in a jury verdict that the hospital had violated both Stark and the FCA by submitting 21,730 false claims with a value of more than $39 million.

On appeal from the Court's entry of judgment for treble damages and penalties of $5,500 per claim totaling over $239 million, the hospital challenged the district court's grant of a new trial and the admission of the red flag attorney's testimony.

Although the Fourth Circuit concluded the district court abused its discretion by granting a new trial based on the exclusion of the hospital executive's testimony, the majority opinion focused instead on the exclusion of the red flag attorney's testimony.

In the eyes of the majority, the testimony of the red flag attorney was not only relevant, but an essential component of the government's evidence on the hospital's scienter and thus, an appropriate basis for granting a new trial. Id. at 19-20.

Turning to the issue of the admissibility of the red flag attorney's testimony, the Court found the hospital had opened the door to such testimony by presenting an advice of counsel defense, which waived the attorney client privilege as to all advice it had received on the legality of the contracts. Id. at 23, n.1, citing Rhone-Poulenc Rorer, Inc. v. Home Indem. Co., 32 F.3d 851,863 (3d Cir. 1994), Accord, Concurring Opinion at 57.

Although the hospital had received advice that the contracts were appropriate, from both outside and in-house counsel, the Fourth Circuit expressed concern that the hospital was cherry picking its legal advice. In the Court's view, evidence that the hospital shopped for legal opinions approving the contracts, while ignoring negative assessments, was sufficient evidence for the jury to find it possessed the requisite intent to violate the FCA. Id. at 29.

So does this mean that an entity that gets one legal opinion at any stage of consultation from either in-house or outside counsel that its conduct might violate Stark or the anti-kickback statute, despite other legal opinions to the contrary, runs the risk of huge potential FCA exposure? At least in the Fourth Circuit it does.

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Damages of $239 Million

In a case with no actual damage to the government, but legal damages for alleged violations of the Stark law and hence, the FCA of approximately $39 million, is a judgment of $239 million constitutional? The Fourth Circuit says it is.

Although Tuomey argued that the measure of damages should be the difference between what the government paid and the value of the services it received (which would result in no actual damages), the Court incorporated Stark's prohibition against government payment for claims in violation of the law.

In the Court's view, because the government was prohibited from paying anything on the claims under Stark, the full amount of each claim was appropriately considered actual damages under the FCA. Id. at 45-46.

This analysis of actual damages then formed the basis for the Court's decision upholding the constitutionality of the total award.

Turning to Tuomey's argument that judgment for over $239 million was unconstitutional under the Excessive Fines clause or Due Process clause, the Court found that although the award was substantial, it was not unconstitutional. Id. at 46.

To reach that conclusion, the Court examined the nature of each element of the damages award—actual damages of $39,313,065 treble damages of $78,626,130 and penalties of $119,515,000—and the ratio between them.

According to the Court, because the prohibition against Excessive Fines and Due Process requirements apply only to punitive damages, not compensatory damages, the $39,313,065 actual damages portion of the award passed constitutional muster. Id. at 46-48, 52.

Of course, such damages were based on the technical Stark violation, not on any real damages the government actually sustained. In the Court's assessment, the $119,515,000 penalties portion of the judgment was punitive, while the additional sum of $78,626,130 for treble damages was part compensatory and part punitive damages.

After assuming relator would receive at least the statutory minimum 15 percent of the treble damages portion of the judgment ($11,793,920), which it categorized as compensatory damages; the Court then allocated the balance of the treble damages of $66,832,210 to the punitive category, resulting in total compensatory damages of $51,106,985 and total punitive damages of $186,347,210. Id. at 52.

Relying on the U.S. Supreme Court's suggestion that although there was no bright line test, ''an award of more than four times the amount of compensatory damages might be close to the line of constitutional impropriety,'' the Court then examined the ratio between its calculated compensatory and punitive damages. Id. at 53, citing State Farm Mut. Auto Ins. Co. v. Campbell, 538 U.S. 416, 425 (2003).

Finding the ratio of 3.6 to 1 below the constitutionally suspect ratio of 4 to 1; the Court therefore concluded the damages award was constitutional.

Had the Court looked at the FCA damages as a technical violation of Stark, however, rather than compensation for losses actually suffered by the Government, it might have reached a different conclusion.

Conclusion

While noting Judge Wynn's concern about the outcome, ''I am troubled by the picture this case paints: an impenetrably complex set of laws and regulations that will result in a likely death sentence for a community hospital in an already medically underserved area,'' the majority left it to Congress ''to consider whether changes to the Stark Law's reach are in order.'' Id. at 62, 53.

Until Congress takes such action to reduce the risk of a Tuomey-sized judgment, consider the following:

- Don't shop for legal opinions.
- When presenting an advice of counsel defense, be prepared to provide all documents relating to communications with and advice by all attorneys (in-house and outside counsel) on the issue.
- If you go to trial, assume the government will press for treble damages and penalties.
- Make sure agreements with physicians serve a legitimate need, are for fair market value and are in writing signed by all parties.
- Check that the work is actually performed before making payment.