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HEALTH LAW CHECKUP

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Fourth Circuit Discusses Stark Issues in Remand of *Tuomey* \$45 Million Stark Verdict

By Eric L. Kintner

On March 30, 2012, a three-judge panel for the United States Court of Appeals for the Fourth Circuit unanimously agreed to vacate a \$44.9 million judgment against Tuomey Healthcare System, Inc. for Stark law violations, holding that the federal district court had violated Tuomey's Seventh Amendment right to a jury trial and remanding the case. In remanding the case, however, two of the three panel judges took the opportunity to discuss certain Stark law issues that were likely to reoccur on appeal. The court's discussion provides some guidance for structuring Stark-applicable physician compensation arrangements going forward, especially in light of the government's positions in this case.

Background

During 2005 and 2006, Tuomey entered into part-time employment arrangements with 19 specialist physicians. These contracts arose because several specialty groups were considering performing outpatient surgical procedures in their offices rather than at Tuomey's facilities. The contracts required that the physicians perform outpatient surgical procedures only at Tuomey's facilities and to reassign to Tuomey all amounts paid by third party payors, including Medicare and Medicaid. Tuomey agreed to pay each physician a compensation package that consisted of: (i) a "tiered" base salary, whereby each physician would earn a base salary of \$5,000 for up to \$185,000 in personally performed services, with an additional \$5,000 for each additional \$25,000 in personally performed services, (ii) a productivity bonus equal to 80 percent of the net collections, and (iii) up to an additional 7 percent incentive bonus for meeting certain quality measures. These physicians were also provided with a benefits package many considered consistent with full-time employment. The employment agreements included a 10-year term and provided that the physician would not compete with Tuomey within a 30-mile area during the employment term and for two years thereafter.



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In 2005, Dr. Michael Drakeford, an orthopedic surgeon on the Tuomey medical staff, who did not enter into one of these part-time employment arrangements, filed a *qui tam* action against Tuomey alleging violations of the federal False Claims Act (FCA). In 2007, the U.S. government intervened in the case. The government alleged that these compensation arrangements violated the Stark law because they were above fair market value and took into account the volume or value of referrals. The government sought treble damages under the FCA and further asserted equitable claims premised on violations of the Stark law. In 2010, a jury returned a verdict finding that while Tuomey had not violated the FCA, the hospital had violated the Stark law. The district court, however, set aside the jury verdict and ordered a new trial on the government's FCA claim. At the same time, the district court granted judgment on the government's equitable claims and awarded damages in the amount of \$44,888,651, plus pre- and post-judgment interest.

Stark Issues

The Stark law prohibits a physician from making a referral for the furnishing of designated health services payable under Medicare to an entity with which the physician has a financial relationship, unless an exception is met. In the *Tuomey* case, the parties agreed that, if Stark applied, the physician compensation relationship should be analyzed as an "indirect compensation arrangement." An indirect compensation relationship is defined as a compensation relationship in which the referring physician's aggregate compensation "varies with, or takes into account, the volume or value of referrals or other business" generated between the parties.

The government alleged that the arrangements constituted an indirect compensation arrangement but did not satisfy the indirect compensation arrangement exception because the compensation took into account the volume or value of referrals. Specifically, the government asserted that the physician compensation for personally performed services simultaneously generated a technical component for such services for the hospital, and the physician compensation included a portion of this anticipated technical component. The government noted that the total compensation paid to the physicians (salary and benefits) would likely exceed 100 percent of the value of the physician's professional fee collections. The government's case was also supported by a trial record that evidenced Tuomey executives discussing how the hospital wanted to share revenues with physicians that would otherwise compete with the hospital, and that the hospital could lose money on the proposed employment agreements because the hospital had other sources of revenue.

In its analysis of the Stark issues, the Fourth Circuit addressed two specific issues:

1. Does a hospital's technical component fee that arises from the physician's personally performed services constitute a "referral" for purposes of Stark?
2. Do the physician compensation arrangements implicate Stark's "volume or value" standards by taking into account anticipated referrals?

On the first issue, Tuomey had argued that since the physicians were only paid for personally performed services, there was no "referral," and,

therefore, there was no indirect compensation arrangement for purposes of Stark. The Fourth Circuit disagreed, holding that the technical component fee received by the hospital did constitute a referral for purposes of Stark. The court cited supporting language in the preamble to Stark's "Phase I" regulations that, in the context of inpatient and outpatient hospital services, referral includes a technical component generated in connection with a physician's personally performed services.

On the second issue, Tuomey had argued that the physicians were only paid for their personally performed services and, therefore, the court should not inquire as to whether the parties considered future referrals when deciding to enter into the contracts. The court rejected this position, reasoning that compensation arrangements that take into account anticipated referrals do implicate the volume or value standard under Stark. The court also noted that Stark's "fair market value" definition requires that the compensation not be determined in a manner that takes into account the volume or value of anticipated referrals. The court held that the issue for the jury to decide is "whether the contracts, on their face, took into account the value or volume of anticipated referrals." If so, the court noted that the jury would need to further determine whether the aggregate physician compensation was nevertheless lawful because it satisfied the indirect compensation arrangement exception under Stark.

Practical Considerations

Although the Fourth Circuit decided to remand the case for a re-trial, the court's discussion of Stark raises several issues for health care providers when structuring their compensation arrangements with referring physicians.

- The Fourth Circuit's interpretation that physician compensation for personally performed services, if such services simultaneously generate a technical fee for the hospital, implicates the Stark law could have a big impact on how physician compensation arrangements are structured. To the extent that physician compensation is based on the personally performed services, *Tuomey* suggests that consideration be given to the extent personally performed services generate a corresponding technical component fee for the health care provider.
- It seems possible that the government's decision to intervene in this case was helped, in part, by certain "bad facts" for Tuomey, including the presence of "part time" employees being paid "full time" salary and benefits; a "tiered" base salary structure; a total compensation package that was more than the value of the professional fees collected; and Tuomey executives rationalizing how the hospital could lose money on these employment agreements and still make money. When considering the business and financial ramifications of physician compensation arrangements, health care providers would be wise to consider the "commercial reasonableness" of the transaction and how the compensation package might look to a future *qui tam* plaintiff, a government prosecutor and a trial of fact.
- Even in Stark cases where violations are based on strict liability, the Fourth Circuit's decisions highlights the fact that the parties' "intent" in structuring a deal can still play a role in determining whether a violation occurred. Indeed, in a footnote to the opinion, the Fourth Circuit panel agreed with another court that "intent alone does not create a violation"

under Stark. However, the court went on to note that this precedent “does not aid Tuomey if the jury determines that the contracts took into account the volume or value of anticipated referrals.” These statements seem designed to encourage the jury (and future *qui tam* plaintiffs and government prosecutors) to question the intent behind these types of compensation provisions.

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