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COMMENTARY

Court of Appeals Affirms $237 Million Judgment Against Community Hospital in False Claims Act Case

Health care providers, government contractors, and others defending investigations and lawsuits under the False Claims Act ("FCA") face many difficult strategic considerations. In cases involving complex underlying regulatory schemes, those decisions become even more critical and can carry severe consequences. The recent decision by the U.S. Court of Appeals for the Fourth Circuit in *U.S. ex rel. Drakeford v. Tuomey*, No. 13-2219, 2015 WL 4036166 (4th Cir. July 2, 2015) affirming the district court's judgment of $237,454,195 illustrates as much, providing a striking example of the drastic liability that can result in FCA cases.

The health care industry and FCA practitioners generally have been closely watching the *Tuomey* case throughout its convoluted history. Although the case has been previously noted for its health care-specific Stark Law issues, the Fourth Circuit decision may prove even more significant for its consideration of several key issues that often arise in FCA cases. First and most significantly, the case adds to an increasing body of law addressing the advice-of-counsel defense, demonstrating the need to weigh the potential risks of invoking such a defense. Second, the decision addresses the extent to which damages calculations can take into account the value of services received by the government (here, health care services rendered to patients referred by certain physicians)—and decides the issue very unfavorably to defendants. Third, addressing the question of whether ambiguity in a statute or regulation can negate FCA liability, the court held that ambiguity was irrelevant to falsity but acknowledged its relevance to a defendant's intent. Finally, the Fourth Circuit considered and rejected the defendant's argument that the total judgment imposed penalties excessive enough to violate constitutional limits, but at the same time set forth a new construct for examining damages and penalties in FCA cases.

Tuomey's Factual and Procedural Background

The FCA claims against Tuomey were based on allegations that, by entering into certain employment relationships with physicians and subsequently billing for Medicare services provided by the hospital to the physicians' patients, the hospital had created a physician self-referral scheme in violation of the "Stark Law." Subject to various statutory and regulatory exceptions, the Stark Law generally prohibits certain financial relationships between physicians and hospitals, restricts physicians from referring patients for

Medicare services to hospitals with whom they have a prohibited financial relationship, and states that Medicare shall not pay for such services.[1]

According to the Fourth Circuit, Tuomey Healthcare Systems, Inc., which operates a nonprofit hospital in a medically underserved area in South Carolina, became concerned in the early 2000s about declining revenues as independent physicians, who had previously performed outpatient surgical procedures at Tuomey, began moving such procedures to their private offices or off-site surgery centers. Allegedly hoping to stem the loss of the associated facility fees—estimated at $8 million to $12 million over 13 years—Tuomey decided to offer part-time employment contracts to community physicians, agreeing to pay direct compensation in exchange for a guarantee that the physicians would perform outpatient surgical procedures exclusively at the hospital during the 10-year contract term. In addition to a guaranteed base salary that would be adjusted annually based on the prior year's collections, the contract provided for productivity and incentive bonuses set at 80 percent of each physician's collections for the year. In drafting these contracts, Tuomey had sought the advice of its long-standing health care counsel, who concluded that the contracts did not give rise to Stark Law compliance concerns. Tuomey also obtained an opinion from a second attorney, a former Inspector General for the U.S. Department of Health and Human Services, that the contracts did not present "significant Stark issues."

Although Tuomey succeeded in reaching agreement with 19 physicians for the part-time employment contracts, it met resistance from Dr. Michael Drakeford, who expressed his concern that the compensation structure violated the Stark Law. In an effort to resolve the issue, Tuomey and Drakeford jointly retained Kevin McAnaney, an attorney with Stark Law expertise who formerly served in the Office of Counsel to the Inspector General of the U.S. Department of Health and Human Services, where he was responsible for drafting many of the Stark Law regulations. Upon McAnaney's determination that the proposed contracts raised significant "red flags" under the Stark Law, appeared to pay physicians above fair market value, and would present an easy case for the government to prosecute, Drakeford declined Tuomey's offer.

In the wake of the advice received from McAnaney, Tuomey sought and received advice that generally approved of the contracts from another attorney at a prominent health care law firm (in addition to the previous advice it had received from McAnaney and two other attorneys). Drakeford, for his part, filed a qui tam complaint under the FCA, alleging that the contracts with the other 19 community physicians violated the Stark Law and that Tuomey had therefore knowingly submitted false claims to the government when it certified Stark Law compliance on Medicare claim forms.

At the first trial in 2010, the jury found that although Tuomey's contracts did in fact violate the Stark Law, Tuomey had not knowingly violated the FCA. Tuomey had argued that it had not known that its claims had been submitted in violation of the Stark Law, so it was not liable under the FCA, and the jury agreed. The government immediately sought a new trial on the FCA claims, arguing that the court had improperly excluded both the testimony of McAnaney and certain other evidence. The district court eventually agreed that it had improperly excluded the other evidence and granted the government's motion for a new trial on the FCA claims.[2]

In contrast to the first trial, the second jury—which, unlike the first jury, heard evidence regarding McAnaney's advice—found in 2013 that Tuomey had violated both the Stark Law and the FCA, and that Tuomey had consequently submitted 21,730 false claims to Medicare totaling $39,919,065. Under the FCA's terms, the district court trebled that figure and added required civil penalties for a total judgment of $237,454,195.

Tuomey appealed, arguing that the district court improperly granted a new trial, that Tuomey was entitled to judgment as a matter of law, that the jury was not properly instructed, and that the damages and penalties awarded against it were improperly calculated and unconstitutional.

1 42 U.S.C. § 1395nn.

2 At the same time, the court entered judgment for the government on equitable claims based on the jury's finding of a Stark Law violation. An initial appeal ensued, and the Fourth Circuit vacated the judgment and remanded for a new trial as to all of the claims, noting that "the jury's finding of a Stark Law violation was a common factual issue necessary to the resolution of both the equitable claims [based on the Stark Law violation] and the FCA claims."

The Fourth Circuit's Analysis in *Tuomey*

Scienter Under the False Claims Act and the Advice-of-Counsel Defense. The Tuomey court's analysis illustrates how FCA cases can often turn on issues of scienter. For FCA liability to attach, a defendant must have acted "knowingly," which includes acting "in reckless disregard of the truth or falsity" of the claim.[3] Mere negligence, however, is insufficient. Reliance upon the advice of counsel thus can serve as a defense for those defendants arguing they have not acted "knowingly."

Tuomey's advice-of-counsel defense played a central role in the Fourth Circuit's affirmance of the district court's decision that a second trial had been necessary. The Fourth Circuit affirmed the grant of a new trial, reasoning that the district court had previously erred by excluding the testimony of attorney Kevin McAnaney regarding his prior advice to Tuomey, including his contention that the agreements could raise "red flags" for the government. McAnaney's testimony, according to the Fourth Circuit, was "relevant, and indeed essential," to proving the scienter element of the FCA claims.[4] "[I]t is difficult to imagine any more probative and compelling evidence regarding Tuomey's intent," the court explained, "than the testimony of a lawyer hired by Tuomey, who was an undisputed subject matter expert on the intricacies of the Stark Law, and who warned Tuomey in graphic detail of the thin legal ice on which it was treading with respect to the employment contracts."[5]

Tuomey's argument that McAnaney's testimony should have been excluded as evidence relating to settlement discussions did not sway the court, which said that McAnaney had been retained to provide advice on the Stark Law implications of the contracts, not to help Tuomey and Drakeford settle a disputed claim. The court further noted that, even if it had found Tuomey's argument persuasive, Tuomey "opened the door" to admission of the testimony when it asserted an advice-of-counsel defense. As discussed at length by Judge Wynn in his concurring opinion, "[w]hen a party raises an advice of counsel defense, … all advice on the pertinent topic becomes fair game."[6]

The court similarly rejected Tuomey's argument that it was entitled to judgment as a matter of law, as sufficient evidentiary support existed for a reasonable jury to find both that the Tuomey contracts violated the Stark Law and that Tuomey had knowingly submitted false claims in violation of the FCA. In making its advice-of-counsel defense, Tuomey asserted that it had relied on its initial counsel's approval of the contracts, along with the generally supportive opinions it had received from its two other counsel. The court nonetheless believed that a reasonable jury could find that Tuomey was "no longer acting in good faith reliance on the advice of its counsel when it refused to give full consideration to McAnaney's negative assessment of the part-time employment contracts and terminated his representation."[7] Indeed, the court noted that, in determining the number of "false" claims at issue, the jury held Tuomey responsible only for those claims submitted after it had terminated McAnaney's representation, suggesting that McAnaney's advice was the critical event following which the jury believed Tuomey had manifested the requisite intent. The court also noted that Tuomey had failed to disclose certain information to the two attorneys who rendered opinions supporting the contracts, and that the jury reasonably could have determined that the information withheld was critical to obtaining reliable advice.[8]

Ultimately, the court's analysis (and the jury's verdict) emphasize the risks inherent in raising the advice-of-counsel defense. To the extent that a defendant sought legal advice in good faith, provided complete facts to its counsel, and then carefully followed counsel's advice, the defendant can establish that it lacked sufficient scienter to be liable under the FCA. The advice-of-counsel defense can apply even where the advice provided by counsel was incorrect, as long as it was provided in good faith and took into consideration all relevant facts and circumstances. Yet by raising the defense, a defendant waives privilege protection over *all* communications with

3 31 U.S.C. § 3729(b)(1).
4 *U.S. ex rel. Drakeford v. Tuomey*, No. 13-2219, 2015 WL 4036166, at *7 (4th Cir. July 2, 2015).
5 *Id.* at *8.
6 *Id.* at *21 (Wynn, J., concurring).
7 *Id.* at *11.

counsel regarding the subject matter, even those communications that are less than helpful. Moreover, the Fourth Circuit opinion makes clear that the completeness of the information provided to the attorney from whom advice is sought will be scrutinized closely and even skeptically by the courts. Under the Fourth Circuit holding, an attempt to prove that the defendant relied in good faith on counsel's advice may inadvertently provide the government with the evidence it needs to show that the defendant at least had reason to suspect that the arrangement may have violated the law and thus that the defendant acted "knowingly" in violation of the FCA.

Objective Falsity. The Tuomey court's opinion also contains notable language for FCA defendants who assert ambiguity in underlying regulatory requirements as a defense. Among its challenges to the district court's jury instructions, Tuomey argued that the district court should have instructed the jury that "claims based on differences of interpretation of disputed legal questions are not false under the FCA." Tuomey's argument relied upon a prior Fourth Circuit case and also has support in case law from other circuits that have recognized the need to avoid finding FCA liability based upon post-hoc interpretations of vague regulatory requirements.[9]

The Fourth Circuit distinguished the *Tuomey* findings from its prior precedent based on the fact that an objective falsehood existed in this case. Because government payment of Tuomey's claims was conditioned on Tuomey's certification of compliance with the Stark Law, the Fourth Circuit reasoned that an "objective inquiry" could be made as to whether Tuomey violated the Stark Law, and thus whether the certifications and claims submitted were "false" for purposes of the FCA. The jury's finding that Tuomey violated the Stark Law meant, according to the Fourth Circuit, that Tuomey's certification that it complied with the Stark Law was "false" and, as a result, that Tuomey's claims were "false." Relying upon what it considered an objective inquiry for the question of falsity, the Fourth Circuit held that Tuomey's subjective view of the contracts' compliance with the Stark Law was relevant instead under the scienter element of the FCA. The Fourth Circuit did not provide any additional analysis, and thus, conclusions are hard to reach. Even so, the *Tuomey* decision calls into question whether claims of ambiguity in the underlying regulatory framework are relevant to scienter—did the defendant knowingly violate that requirement—or instead to the falsity of claims submitted.

Damages. The Tuomey decision also illustrates how the FCA's civil penalties and treble damages provisions can drastically increase the ultimate judgment against a defendant, and how courts may treat such awards moving forward. As alleged by the government, Tuomey paid the physicians approximately $1.5 million to $2 million per year in excess of collections for their professional services. The jury determined that Tuomey had submitted 21,730 false claims to Medicare totaling $39,919,065 in actual damages (based on the Stark Law provision that Medicare shall not pay for services resulting from prohibited referrals). That figure was then trebled pursuant to the FCA's damages provision. In addition, the court assessed the minimum civil penalty required by the statute—$5,500—for each of the false claims. Thus, a finding of less than $40 million in actual damages (based upon claims allegedly rendered problematic by much smaller payments to physicians) resulted in a total judgment of $237,454,195.

No Damages Setoff for Value of Services Actually Provided. Like many other FCA defendants, Tuomey challenged the measure of the actual damages, arguing that the proper measure of such damages should be the difference, if any, between the value of the services actually rendered by Tuomey and the amount that the government ultimately paid for those services. This "setoff" would have effectively eliminated actual damages, as the government did not allege that Tuomey had received payment for services that it did not in fact provide. The court rejected Tuomey's argument, however, stating that the government owed Tuomey nothing for the services provided because "[c]ompliance with the Stark Law is a condition precedent to reimbursement of claims submitted to Medicare." The court reasoned that, regardless of the value of the services Tuomey had rendered to government insureds, the government would not have paid Tuomey's claims had it known that Tuomey was acting in violation of

8 *Id.* at *12.

9 *See U.S. ex rel. Wilson v. Kellogg Brown & Root, Inc.*, 525 F.3d 370, 377 (4th Cir. 2008); *U.S. ex rel. Lamers v. City of Green Bay*, 168 F.3d 1013, 1018 (7th Cir. 1999); *U.S. ex rel. Morton v. A Plus Benefits, Inc.*, 139 F. App'x 980 (10th Cir. 2005).

the Stark Law. Therefore, according to the Fourth Circuit, the government's injury was the full measure of the payments to Tuomey based on the "false" claims, without any consideration of the value of Tuomey's services. The court did not consider the alternative position, advocated by defendants in other cases and adopted by some other courts, that the value of the services received should be subtracted not from the single damages amount but from the trebled amount.

The Fourth Circuit's Constitutional Analysis of the Damages Award. Tuomey also sought to attack the damages award on the grounds that it violated the Fifth Amendment's Due Process Clause and the Eight Amendment's Excessive Fines Clause. Noting that the U.S. Constitution places limits on "punitive" damages, the court held that the damages awarded, though substantial, were within constitutionally permissible limits. To reach this conclusion, the court conducted an analysis to distinguish the amount of the award that the court believed was compensatory from that which it viewed as punitive. While the court quickly distinguished the actual damages, which it characterized as compensatory, from the civil penalty, which it characterized as punitive, it determined that the treble damages component of the award had to be allocated in part to each category. According to the Fourth Circuit, the FCA's treble damages provision in part compensates the government for "costs, delays, and inconveniences occasioned by fraudulent claims" and for the amount that the government must pay to qui tam relators. Therefore, from the trebled damages amount, the court allocated the relator's share—in this case 15 percent, or $11,793,920—as compensatory, while considering the balance to be punitive.

Ultimately, then, the court calculated a total compensatory damages award of $51,106,985, with the remaining $186,347,210 constituting punitive damages, resulting in a punitive-to-compensatory ratio of approximately 3.6 to 1. Noting that the U.S. Supreme Court has not established a bright-line rule and has suggested only that a punitive damages award exceeding four times the amount of compensatory damages "might be close to the line of constitutional impropriety," the court affirmed the entire $237 million award as constitutional.[10]

Looking Forward

The Fourth Circuit's decision in *Tuomey* should give pause to health care providers, government contractors, and all others who do business in any form with the federal government. Even for those who have become slightly numb to the barrage of FCA suits filed over the past several years, examples of jury verdicts and the drastic penalties that can ensue still remain relatively rare. To the extent that many have questioned whether the DOJ would pursue a case to the point of likely shutting down a provider in an underserved community, *Tuomey* demonstrates that it is in fact willing to do so. The *Tuomey* court itself expressed concern over the immense exposure created by the confluence of the FCA and the Stark Law. In his concurrence, Judge Wynn wrote, "to emphasize the troubling 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," noting that, in this arcane area of the law, "even diligent counsel could wind up giving clients incorrect advice." Nonetheless, the court affirmed the $237 million judgment against that community hospital, reasoning that it must fall to Congress, not the courts, to address the troubling complexity and scope of this legal regime.

Although the decision is not binding outside the Fourth Circuit, it emphasizes how FCA defendants throughout the country must consider from the beginning of an investigation how to build all potential defenses, particularly those based upon scienter. As part of that analysis, defendants will need to carefully consider the potential ramifications of raising an advice-of-counsel defense, and diligently weigh all advice that has been provided on the topic to determine what is helpful and what may be harmful. Where advice from counsel was mixed, defendants who choose to rely on an advice-of-counsel defense must be able to clearly demonstrate that they moved forward only after carefully considering *all* of the relevant advice rather than merely "shopping" for a favorable opinion upon which to rest their defense while discounting less-favorable opinions.

10 *Tuomey*, 2015 WL 4036166, at *19. As of July 23, 2015, no petition to seek en banc review has been filed.

Defendants should also take heed of the government's aggressive approach to damages and recognize that, where compliance with a statutory or regulatory provision is a condition of payment, courts may ultimately find that the full amount paid to the defendant constitutes damages even if quality and necessary items or services were provided.

Finally, *Tuomey* offers one approach for how courts may handle the difficult questions concerning the assessment and constitutionality of drastic awards that can essentially cripple defendants. Even if the value of the claims dramatically outstrips the underlying legal violation by the defendant that rendered the claims "false," and even if the penalties imposed based on the number of claims submitted overshadows the value of the claims, the judgment could still satisfy constitutional limitations. Particularly given the relative dearth of case law regarding the constitutionality of FCA awards in particular, the *Tuomey* court's decision may lend itself to further review.

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