Corporate Healthcare Transactions: Avoiding Crimes, Dismissals and Embarrassment

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The Nassau Lawyer, April 2002

In today's complex legal healthcare world, it has become increasingly more important for lawyers in one practice group to consult with specialists in other areas of the law to ensure that all of the legal implications of a client's particular situation are understood and properly addressed. A recent decision of the Supreme Court, New York County, is a perfect example of the importance of coordinating the specialties of a law firm's different practice groups in analyzing and implementing a comprehensive legal plan that is best suited to protect the client. As explained below, effective use of corporate, healthcare, litigation and criminal practitioners could have avoided a very costly, embarrassing ? and criminally and professionally volatile ? situation.

In *Donovan v.Rothman,* [1] the Court's decision on a motion for summary judgment was one part of a lengthy, on-going dispute between shareholder-physicians of a radiology practice. The case involved a shareholder derivative action brought by shareholders of LH Radiologists, P.C. (the "P.C."). The individual plaintiffs were radiologists from the staff of Lenox Hill Hospital ("Lenox Hill"). They intended for the P.C. to contract directly with Lenox Hill to provide radiology services within the hospital. The P.C. would, in turn, employ the physicians who actually rendered those services and the P.C. would bill patients and third party payors directly for such services. Instead of being employed by Lenox Hill, the radiologists would be shareholders/employees of the P.C. Defendant Lewis Rothman, who was Director of Radiology at Lenox Hill, became the President of the P.C.

In 1987, Rothman, acting on behalf of the P.C., entered into a "fee for services agreement," whereby the P.C. would bill patients directly for services. He also entered into a separate "supplemental agreement" with Lenox Hill, whereby the P.C. would forward a portion of the proceeds they received to Lenox Hill, and a fixed percentage of the P.C.'s net collections would be retained by Lenox Hill through its Department of Radiology fund, which was utilized for capital improvements, equipment and other expenditures for the Department. A separate additional percentage of the P.C.'s net collections was also to be paid to the Hospital?s general fund. Pursuant to the "supplemental agreement," the P.C. paid or credited Lenox Hill approximately $3.75 million through Oct. 31, 1998.

The plaintiffs alleged that in 1988, unbeknownst to them, Rothman issued a stock certificate to himself for shares of the P.C., effectively making himself the sole

shareholder, and unilaterally fixed salaries and entered into illegal transactions on behalf of the P.C. After they were granted access to corporate records, the plaintiffs brought this shareholder derivative action against Rothman and another physician concerning unilateral and allegedly illegal conduct referenced herein.

For purposes of this article, we focus specifically on a cause of action by the plaintiffs against Lenox Hill.[2] The plaintiffs alleged that the payments made by the P.C. to Lenox Hill pursuant to the "supplemental agreement" violated the Federal Anti-Kickback Statute.[3] Interestingly, the plaintiffs relied upon this allegation in an attempt to terminate the contract, when they, in fact, had signed the "supplemental agreement" and benefited from its provisions. Indeed, the plaintiffs had been the sole radiologists receiving referrals from Lenox Hill since the "supplemental agreement" went into effect and, as a result, they obtained the benefit of the radiology work. Moreover, the plaintiffs were involved in the payment of a percentage of their net proceeds back to Lenox Hill.

Any time a decision from a judge in a civil litigation suggests, in effect, that the plaintiffs may want to cease being involved in felonious conduct, one should pause to consider the litigation strategy that has gotten them to that point. With proper input among the transactional, healthcare, litigation and criminal defense counsel, the exposure created by the cause of action alleging a violation of the Federal Anti-Kickback Statute may have been avoided. As Justice Cahn points out in his decision, the plaintiffs put themselves "in the untenable position of claiming that their agreement with Lenox Hill is illegal, in that if the monies the corporation paid to Lenox Hill pursuant to the agreement amount to a kick-back in exchange for referrals, the P.C. would also be guilty of violating the [anti-kick-back] Statute, since the corporation offered to pay remuneration for referrals." Justice Cahn therefore neutralized both parties, refusing to allow plaintiffs to recover previous payments they made pursuant to the illegal arrangement, but also declining to permit Lenox Hill from recovering any further payments under the illegal contract.

Generally, there is no private right of action for a litigant to enforce the Anti-Kickback Statute,[4] but the Statute has been used by civil litigants to escape or attack contractual relationships,[5] as the plaintiffs did in Donovan, by arguing that it was an unenforceable illegal arrangement. However, as Justice Cahn noted, "it is well settled that a party to an illegal contract cannot ask a court of law to help him carry out his illegal object, nor can such a person plead or prove in any court a case in which he, as a basis for his claim, must set forth his illegal purposes."[6] In other words, for the plaintiffs to prevail on their claim to recover from Lenox Hill payments made by the P.C. under the "supplemental agreement," the plaintiffs would have had to prove their own involvement in illegal conduct. Thus, Justice Cahn rejected their attempt to recover past payments because that would have rewarded them for entering into a contract they claim to be illegal.

It is questionable how the arrangement in *Donovan* was even entered into in the first place, and, even more troubling, how it landed in court, given the proliferation of investigations into suspect contractual

arrangements such as these and prosecutions of health care fraud over the last several years. For example, in a recent high profile case, the government launched an investigation into a series of consulting contracts entered into by two directors of a nursing home and a hospital.[7] Under the contracts, the owners of nursing homes purportedly provided geriatric-related services to the hospital, such as clinical instruction and staff training. The government, however, argued, and the court agreed, that these consulting contracts were, in fact, disguised kickbacks from the hospital to the nursing home in return for the referral of the nursing home's Medicare patients. The consultants, the hospital President and CEO, as well as a hospital administrator, were convicted after trial. Sentences ranged from 50 to 70 months in jail with fines and restitution from $25,000 to $142,000. The hospital entered a No Contest plea to similar charges and paid a $17.5 million fine.

Likewise, in *United States v. Gerber,*[8] an osteopathic physician was both a hospital staff member and president of Cardio-Med, Inc., a company that provides physicians with diagnostic services. Cardio-Med would bill Medicare for all of its cardiac services, and when payment was received, forward a portion to the referring physician-defendant. The court held that even if the payments were intended to compensate the physician for professional services in connection with the tests performed, one purpose of the payments was clearly to induce referrals by that physician for Medicare patients to use the company's laboratory services, in violation of the Anti-Kickback Statute.

Lessons can be learned from all of this case law. From a transactional perspective, the hospital and physicians could have formulated the essence of their agreement in acceptable, legal ways that would have preserved the intended arrangement and avoided both problems in enforcement and criminal and professional exposure. The first task, therefore, is to make sure that learned counsel familiar with these complex arrangements and the corresponding law be consulted at the drafting stage so that legal and enforceable contracts are written. Moreover, effective and ongoing coordination between lawyers in different specialty areas is critical in ensuring not only the success of any subsequent litigation, but more importantly, preventing collateral issues, including potential criminal prosecution, license revocation and other embarrassment.

1 N.Y.L.J., Jan. 31, 2002, Supreme Court, N.Y. Co., Justice Cahn.

2 Lenox Hill removed the action to U.S. District Court for the Southern District of New York on the grounds that the allegations against Lenox Hill presented a substantial federal question. U.S. District Court Judge Sidney H. Stein, by decision dated July 18, 2000, remanded the action back to Supreme Court, finding that the federal interest in plaintiff's claim for relief against the hospital was too insubstantial to support federal question jurisdiction.

3 42 U.S.C. § 1320a-7b sets forth the criminal penalties for acts involving federal health care programs. Subsection (b)(2) provides:
whoever knowingly and willfully offers or pays any remuneration (including any kick-back, bribe or rebate) directly or indirectly, overtly or covertly, in cash or in kind, to any person to induce such person
(A) to refer an individual to a person for the furnishing or arranging for the furnishing of any item or service for which payment may be made, in whole or in part, under a Federal healthcare program, or
(B) to purchase, lease, order or arrange for or recommend purchasing, leasing, or ordering any good, facility, service, or item for which payment may be made in whole or in part under a Federal healthcare program shall be guilty of a felony upon conviction thereof, shall be fined not more than $25,000 or imprisoned for not more than five years or both.

4 See West Allis Mem. Hosp., Inc. v. Bowen, 852 F.2d 251, 254-55 (7th Cir. 1988).

5 *See Medical Development Network, Inc. v. Professional Respiratory Medical Equipment Services, Inc.,* 673 So.2d 565 (1996).

6 N.Y.L.J., Jan. 31, 2002, Supreme Court, N.Y. Co., Justice Cahn, citing *McConnell v. Commonwealth Pictures Corp.,* 7 NY2d 465, 469 (1960).

7 *United States v. La Hue,* 261 F.3d 993 (10th Cir. 2001), cert. denied, 122 S. Ct. 819 (2002).

8 760 F.2d 68 (3d Cir. 1985).