Federal Court invalidates marketing agreement

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When is a percentage-based commission an illegal kickback? A recent ruling by the U.S. Court of Appeals for the Tenth Circuit suggests that common practices in health care marketing may be illegal and unenforceable.

As in the case of a handful of earlier rulings, this decision arose from a private dispute among the parties, not from a government enforcement action or whistleblower case. An Oklahoma durable medical equipment company, Joint Technology Inc., had retained an independent contractor, Gary Weaver, as a marketing agent under an agreement which paid him a percentage of the company's collections from business he generated. His duties involved making marketing calls on potential referring physicians, but there were no allegations that he offered or paid the physicians any improper amounts to induce their referrals.

The agreement between Weaver and Joint Technology included exclusivity and nonsolicitation provisions. After Weaver terminated his agreement, Joint Technology alleged that he violated those terms and brought suit to enforce the agreement. In his defense, Weaver asserted that the agreement was void because it violated the federal Anti-Kickback Statute (AKS). Joint Technology countered that the agreement was valid because Weaver was a "bona fide employee" and therefore the arrangement met the employment exception under the AKS. This was a risky strategy for the company since the agreement clearly identified Weaver as an independent contractor, no taxes had been withheld from his pay and he did not qualify for the company's employee benefit programs.

In January 2013, the U.S. District Court for the Western District of Oklahoma ruled in favor of Weaver and granted his motion for summary judgment as to Joint's claims for breach of exclusivity, breach of non-solicitation covenant prior to termination, and breach of non-solicitation covenant after termination. The court applied a narrow definition of "employee" and noted that the AKS does not prohibit "any amount paid by an employer to an employee (who has a bona fide employment relationship with such employer) for employment in the provision of covered items or services." The court also noted the fact that the Tenth Circuit has adopted the "one purpose" test (that originated in our own Third Circuit) which holds that "a person who offers or pays remuneration to another person violates the Act so long as one purpose of the offer or payment is to induce Medicare or Medicaid patient referrals." There was no discussion of whether the commissions paid to Weaver as sales agent were intended to induce "referrals" as generally understood under the AKS to involve payments or benefits to physicians and other health care providers who directly refer patients for services covered by Medicare or Medicaid.

On appeal, the Tenth Circuit agreed with the lower court and ruled that Joint Technology could not enforce its restrictions on Weaver. Its May 28, 2014, opinion again focused on Weaver's status as an independent contractor and Joint Technology's failure to convince the court that he should be treated as an employee. The appellate court even granted Weaver's motion for sanctions against the DME company for double costs and attorneys' fees because their appeal was deemed "frivolous," i.e., the result was obvious or the appellant's arguments of error were wholly without merit.

This ruling is a classic example of the legal cliché "bad cases make bad law." By relying solely on Weaver's employment status, Joint Technology missed the opportunity to raise other possible flaws in Weaver's case that may have affected the outcome, specifically the "intent" element. Both the lower court and the appellate opinions suggest that any variable compensation to a non-employee based on sales automatically violates the AKS. In fact,

an AKS violation requires evidence that at least one party intended to induce the referral of a Medicare or Medicaid reimbursable service or item by giving the other party something of value.

The Office of Inspector General analyzed percentage-based commissions in Advisory Opinion 98-10, in which they noted:

"[A]ny compensation arrangement between a Seller and an independent sales agent for the purpose of selling health care items or services that are directly or indirectly reimbursable by a Federal health care program potentially implicates the anti-kickback statute, irrespective of the methodology used to compensate the agent. Moreover, because such agents are independent contractors, they are less accountable to the Seller than an employee. . . For these reasons, this Office has a longstanding concern with independent sales agency arrangements. . . .

"In reviewing sales arrangements that do not fit in the personal services and management contracts safe harbor, this Office has identified several characteristics of arrangements among Sellers, sales agents, and purchasers that appear to be associated with an increased potential for program abuse, particularly overutilization and excessive program costs. These suspect characteristics include, but are not limited to:

- compensation based on percentage of sales;
- direct billing of a Federal health care program by the Seller for the item or service sold by the sales agent;
- direct contact between the sales agent and physicians in a position to order items or services that are then paid for by a Federal health care program;
- direct contact between the sales agent and Federal health care program beneficiaries;
- use of sales agents who are health care professionals or persons in a similar position to exert undue influence on purchasers or patients; or
- marketing of items or services that are separately reimbursable by a Federal health care program (e.g., items or services not bundled with other items or services covered by a DRG payment), whether on the basis of charges or costs.

"[T]he more factors that are present, the greater the scrutiny we ordinarily will give an arrangement. Of course, in all cases the statute is not violated unless the parties have the requisite intent to induce referrals."

In the facts presented to the OIG which resulted in this advisory opinion, the seller did not bill any payer for the items being sold, and there was no contact between the sales agent and patients or physicians. Unlike DME, the items supplied were not separately reimbursable by government programs. Under this analysis, the Joint Technology/Weaver deal would still be suspect, because Weaver did meet with physicians and the DME was separately reimbursable.

So far, the only cases challenging percentage-based marketing fees have arisen from one party's attempt to invalidate the arrangements, itself a risky strategy that in essence involves admitting to participating in a criminal scheme. That may explain why such cases have been infrequent. Regardless, marketing arrangements involving commissions that vary with the value or volume of government-reimbursed business should be approached with caution.

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