Advocate'sEDGE

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January/February 2014

Diagnosing health care fraud

What employers need to know

According to the Centers for Medicare and Medicaid Services, national health care spending reached $2.7 trillion in 2011 — and is projected to increase at an average rate of 6.2% annually through 2015. With so much money running through the health care system, it's no surprise that some medical providers are practicing fraud. There are several schemes that could affect your clients — both insurers and noninsurance companies that self-insure.

5 FRAUDS TO WATCH FOR

Public and private health insurers, including self-insured employers, are vulnerable to the following types of fraud:

1. Services not rendered. Insurers must be vigilant about providers who bill for services never actually rendered, or for providers who bill for physician services that were rendered by someone other than a physician. For example, a sports medicine office could bill at a doctor's rate for services that were in fact provided by a physical therapist. And identity theft could lead to an insurer paying for services that were rendered, but not to the insured individual.

2. Unnecessary services rendered. Providers could also bill for services that were rendered but were unnecessary. And in other cases, they could bill for services, supported by false diagnoses, that were invented to justify costly tests and procedures. For example, a patient diagnosed with pneumonia would certainly be expected to run up more charges than would one with a common cold. Imaging is another area ripe for abuse. Was that head CT scan really indicated by the patient's symptoms or complaints? Nerve-conduction and other diagnostic testing often is used to pad bills, too.

3. Upcoding. This occurs when a provider codes the minor service provided as a more pricey service on the bill. This scheme typically requires the use of a more serious diagnosis code that would be consistent with the false procedure.

4. Noncovered charges billed as covered charges. When physicians provide treatments or perform tests or procedures that aren't covered under a patient's policy, they may bill them as something the policy *does* cover. For example, instead of billing for an experimental treatment, the doctor bills for a treatment approved for coverage. This scheme is common with cosmetic procedures, such as when a medically unnecessary nose job is billed as repair of a deviated septum.

5. Unbundling. Unbundling is another popular scheme, although it may become less common as health care payment models change to encourage bundled pricing. In the meantime, a provider might bill an insurer with a comprehensive code for a procedure and then also charge each step of the procedure separately.

RED FLAGS

Health care provider fraud frequently is betrayed by certain red flags. Typically, fraud experts look closely at providers that:

- Bill for treatment on consecutive dates of service for minor injuries,
- Administer tests or treatments at a far higher rate than similar providers do,
- Prescribe certain drugs at a higher rate than other providers do,
- See a large number of nonlocal patients,
- Unbundle lab tests,
- Work with attorneys who have a history of questionable claims, or
- Pay agents for referrals.

When reviewing data about specific providers, experts consider such items as total amount billed, total number of patients, average billing amounts per patient, average visits per patient and average medical tests per patient.

> *Health care providers could bill for services, supported by false diagnoses, that were invented to justify costly tests and procedures.*

PRESCRIPTION FOR DETECTION

If a client suspects health care provider fraud, call a fraud expert for assistance. These professionals are equipped to audit suspicious claims — even those using new fraud schemes — with a variety of analytic techniques. That's important, given how quickly the U.S. health care system is changing.

Patent infringement damages

Court tosses expert's reasonable royalty testimony

Calculating damages in patent infringement cases continues to pose a challenge, with expert testimony on the matter coming under heavy *Daubert* scrutiny. In a recent case, *Brandeis University, et al, v. Keebler Co., et al*, Judge Posner of the Seventh Circuit Court of Appeals (sitting by designation in a federal district court) excluded most of an expert's proposed damages testimony — despite finding her "highly qualified" and competent to estimate reasonable royalties.

TESTIMONY STARTS TO MELT

The case involved patents for a type of margarine that doesn't contain trans-fats. The plaintiffs alleged that the Keebler Company's cookie, cookie dough, and reduced-fat biscuit and crescent roll products infringed the patents. At issue was the reasonable royalty Keebler would have paid the licensor if it had negotiated a license before it started using the infringing product rather than risk being sued.

EXPERT NEEDED MORE COOKS IN THE KITCHEN

The plaintiffs' expert in *Brandeis University, et al, v. Keebler Co, et al* (see main article) ran into trouble because she didn't make proper use of the input of other types of experts. The damages expert testified that no cheap and satisfactory substitute to the patented margarine existed. She also testified that, to avoid both trans-fats and use of an infringing margarine, Keebler would have had to consider the possible effects of substituting a noninfringing margarine (which could cause sogginess) on consumer demand.

But the expert, an economist, wasn't an expert on consumer demand for cookies, and she failed to consult with a sales or marketing expert. She did consult with a biochemist specializing in food, but he wasn't a food scientist. Judge Posner also faulted her for not consulting an industrial baker on the sogginess issue. He ruled that the damages expert couldn't rely on the biochemist for the conclusion that no noninfringing alternatives were available that would cost Keebler less than a "hefty royalty to the plaintiffs."

Posner stated that Keebler wouldn't have paid a royalty higher than the cost of switching to a noninfringing substitute for the plaintiffs' margarine or otherwise reworking its manufacturing process to avoid making the infringing margarine. He rejected the plaintiffs' expert's conclusion that no noninfringing alternatives to the patented margarine could be found. (See "Expert needed more cooks in the kitchen" above.) But he also explained that the lack of a perfect substitute by itself wouldn't allow the estimation of a reasonable royalty. That royalty would depend on the cost — in higher production expenses and loss of business to competitors — of the best imperfect substitute, and the expert offered no evidence on either cost.

Instead, the expert based her calculation of a maximum reasonable royalty on the company's maximum profits that she deemed at risk if Keebler didn't obtain a license. Therefore, she relied on three "comparable" licenses to project that maximum amount of profits that Keebler put at risk by failing to obtain a license.

ONE PASSES TASTE TEST

The court rejected the expert's reliance on two of the licenses out of hand. One of the licenses resulted from the settlement of a patent infringement suit. Posner found that licensee "wholly dissimilar to Keebler." The licensee makes just two allegedly infringing cookies, and they were alleged to infringe a patent different from the one infringed by Keebler.

The second license was also granted in settlement of litigation. The stated payment for the license was a one-time payment, but it appeared to have been returned to the licensee as consulting fees over the next few months. In addition, the settlement provided for changing a strategic partnership between the licensee and a subsidiary of the licensor. In return for those benefits, the licensor agreed to dismiss its lawsuit and grant a license.

Posner noted that the expert had made no attempt to value any individual component of the complex settlement agreement that produced the second license. Therefore, she couldn't "responsibly" value the patent license itself.

Only the third license came close to passing muster. Like Keebler, the licensee was a large food conglomerate that makes baked goods alleged to infringe, permitting an inference that Keebler would have paid as much as the licensee. Yet Posner questioned the expert's "pure conjecture" that the license represented the minimum royalty the licensor would accept. Changes since that license was negotiated in 2005 would drive the licensor to insist on a higher royalty.

HOW THE COOKIE CRUMBLED

Ultimately, Judge Posner found that the plaintiffs' expert had failed to use a reasonable methodology to calculate the damages by reference to two of the licenses; calculate the profits at risk; or assess the cost of noninfringing alternatives. However, he allowed her to testify on the third license — which remained a "possible basis" for estimating a reasonable royalty — and on general principles of patent damages.

What prevents an equitable divorce?

In divorce cases, courts try to split assets equitably between the spouses. But the parties sometimes make a court's job difficult by hiding assets or even by performing their own valuations. Hiring an experienced financial expert to accurately appraise assets is the key to a fair settlement.

INFORMATION ACCESS BLOCKED

One common roadblock to an equitable asset split is inadequate discovery. When divorcing spouses own a business, it's usually their biggest, most illiquid asset. But a spouse who controls a business often is reluctant to release certain information, such as financial statements, tax returns, business plans, contracts and marketing materials.

Some divorcing spouses may be unscrupulous and actually hide assets or income. Others may simply argue that giving an appraiser access to this information breaches the company's security and interrupts business operations.

When valuing a business, an appraiser needs access to information that's known only to insiders. Involve your financial expert early on to improve the scope of discovery. Ask him or her for a comprehensive list of documents and procedures needed to complete the job.

SPECTER OF FRAUD

Sometimes spouses hide assets in anticipation of an impending divorce. Or a business owner might delay reporting income or overstate expenses until his or her divorce is settled.

For example, Mrs. Murdoch opened a bank account under her adult daughter's name and set aside $100,000 over two years. She suspected Mr. Murdoch was being unfaithful, and she wanted to squirrel away some funds in case he left her. But the $100,000 legitimately belongs in the Murdochs' joint marital estate — regardless of which spouse might be in the wrong.

If you or a client suspects that the other spouse is concealing assets or income, the scope of an assignment may need to be expanded to investigate financial misstatement and asset misappropriation. Financial experts in divorce proceedings often have forensic accounting backgrounds, so be sure to tap into their fraud expertise.

PROBLEMS OF SUBJECTIVITY

Divorce cases are fraught with subjective issues. For example, it may be unclear whether discounts for lack of control and marketability, which are common in Tax Court cases, apply in divorces. Other relevant issues that might apply when appraising a business include the appropriate standard of value, the appraisal date, and local courts' treatment of buy-sell agreements and goodwill.

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While it's necessary to look at applicable case law in the appropriate state, an understanding of legal precedent in *other* jurisdictions can be helpful, too. Family courts sometimes consider cases in other states — or even U.S. Tax Court cases — especially if the state hasn't ruled on a similar case or if state case law is contradictory.

The parties also might argue whether it's appropriate to subtract built-in capital gains tax liabilities when the marital estate includes C corporation stock. In a volatile economy, parties might argue over whether the filing date or the court date is the more appropriate "as of" date for valuing stock, retirement accounts and other marital assets.

Such points of contention can slow down divorce cases and add an element of uncertainty to court-imposed settlements, especially since judges may differ in their interpretations of these issues. Often the parties are better off negotiating their own out-of-court settlements.

DON'T DIY

As tempted as your client might be to perform a do-it-yourself (DIY) assessment of assets in a misguided attempt to save money, don't let him or her do it. Professional appraisers use sophisticated methods to value assets, particularly businesses. Such methods might include the adjusted book value, guideline public company, merger and acquisition, capitalization of earnings and discounted cash flow methods. These proven techniques are preferred by courts.

On the other hand, shortcuts, such as industry rules of thumb, net book value or buy-sell formulas, are likely to be found wanting. And attempts to fraudulently hide or misrepresent assets could lead to additional legal trouble that will make the original divorce action seem like a walk in the park.

Extraordinary circumstances: DLOM allowed in forced buyout

When closely held businesses are appraised, professional valuators often apply a discount for lack of marketability (DLOM). However, in forced-buyout situations, DLOMs are generally only applied under extraordinary circumstances (although such applications vary by jurisdiction). The New Jersey Court of Appeals found such circumstances in *Wisniewski v. Walsh*, an unpublished shareholder oppression case.

SIBLINGS GO TO COURT

The case involved various disputes among three siblings who were equal owners in a closely held corporation. In 1995, Patricia Wisniewski sued her brothers Norbert and Frank over the company's acquisition of certain property. Then, in 1996, Norbert filed a complaint against Patricia and Frank, alleging their attempts to oust him from the company made him an oppressed shareholder. Patricia counterclaimed, alleging *she* was the oppressed shareholder.

In 2001, the trial court found that Norbert was the oppressing shareholder and that his actions harmed the other shareholders. It ordered Norbert to sell his interest back to the company (or to his siblings) at fair value. Norbert's interest was eventually valued at $32.2 million. Both Norbert and Patricia appealed. Patricia argued, among other things, that the trial court should have applied a DLOM when valuing Norbert's interest.

EXTRAORDINARY CIRCUMSTANCES

The court of appeals agreed with Patricia. It noted, however, that in forced-buyout situations a DLOM is only applicable under extraordinary circumstances. Otherwise, minority shareholders might be deprived of the full proportionate value of their shares, and majority shareholders might be allowed to buy out minority interests at bargain prices.

The court acknowledged that Norbert was a minority shareholder and, in fact, his actions didn't actually harm the company. Nonetheless, the court stated that "Norbert should not be rewarded when his conduct not only harmed the other shareholders but necessitated this forced buyout."

The court explained that, if the oppressed shareholder were ordered to buy out the oppressor at a value without any DLOM, the innocent party would be forced inequitably to shoulder the entire burden of the asset's illiquidity. The oppressing shareholder, whose unlawful behavior caused the forced sale, would have received the undiscounted proportional value of his share. Meanwhile, the oppressed shareholder would be forced to accept a discounted price in any future sale to a third party.

A POSSIBILITY

While the appellate court remanded for application of a DLOM, the value wouldn't necessarily be reduced. The court recognized the possibility that the DLOM might already have been embedded in the discount rate used in the discounted cash flow (DCF) valuation the trial court adopted. Absent a clear understanding of whether a DLOM was implicitly applied via the DCF valuation approach, the court of appeals concluded that the trial judge should reconsider the award by applying an appropriate DLOM.

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