Plaintiff's lawyers launch 'second offensive'

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Last June, the assault by plaintiffs' lawyers on the tax-exempt status of not-for-profit hospitals was launched in federal courts across the country.


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Throughout last summer, a group of plaintiffs' attorneys, led by Mississippi-based Richard Scruggs, filed a series of class action lawsuits in federal courts against not-for-profit hospitals and hospital systems principally alleging that the billing and collection practices of the hospitals with respect to uninsured patients violated their obligations as tax-exempt organizations.

Scruggs and his colleagues essentially sought to stand in the shoes of the Internal Revenue Service and recover as damages the taxes that the hospitals were not required to pay by virtue of their tax-exempt status under Section 501(c)(3) of the Internal Revenue Code and comparable state and local tax laws.

At the height of the federal litigation, there were 76 cases pending in federal court against not-for-profit hospitals. The plaintiffs' lawyers moved to consolidate all of the federal cases into a single proceeding before a single federal district court judge. That motion was denied last October on the ground that the cases did not present sufficient common issues to merit consolidation. Now, only about four-and-a-half months later, well over half of the federal lawsuits have been dismissed either by the courts or by the plaintiffs' lawyers themselves in the face of a tidal wave of adverse rulings. Additional cases are being dismissed almost every week.

The federal courts have resoundingly rejected plaintiffs' claims premised on federal law and have declined to exercise supplemental jurisdiction over the state law claims that plaintiffs' counsel added to their federal court complaints.

In dismissing a case against Centura Health Corporation, Judge Richard Matsch of the United States District Court for the District of Colorado held that the legal premise underlying plaintiffs' federal claims is "patently untenable" and that "formulating federal health care policy is not a proper function of a [federal] court."

After his principal theories were rebuffed by federal jurists across the nation, Scruggs recently announced a "second offensive" in the not-for-profit hospital litigation. This new "offensive," according to Scruggs, involves the assertion of state law claims against the hospitals in state court actions. Of course, that was the only option available to plaintiffs' counsel in view of the wholesale dismissal of their federal lawsuits.

The state court initiative promised by plaintiffs' counsel is underway. There are approximately 75 state court actions that have been filed to date against not-for-profit hospitals. The principal claims in those actions are based upon the alleged "unreasonableness" of hospital charges with respect to uninsured patients, and pricing and collection activity that allegedly violates state unfair trade practices and consumer protection laws. While Scruggs insists that plaintiffs are not abandoning their federal claims, the battlefield has now clearly shifted from the federal to the state courts. That shift should become even more pronounced in the coming months as additional federal cases are dismissed.

Forcing plaintiffs' counsel to litigate many individual cases in state courts, as opposed to a single consolidated case in federal court, was an important victory for the hospitals. Rather than incur the significant costs required to defend a consolidated action in a remote jurisdiction, hospitals can now defend these lawsuits in the communities they serve. Plaintiffs who paid little or nothing for health care provided to them under charity care policies – the quality of which they do not contest – will have to litigate the merits of their own claims and not be able to ride the coattails of other plaintiffs in other jurisdictions.

It also seems likely that the shift to state law claims will reduce, perhaps significantly, the amount of damages plaintiffs can credibly seek from the defendant hospitals. Now that the claims premised on tax exemption have been rejected, it does not appear that plaintiffs can seek to recover any tax savings arising out of a hospital's not-for-profit status. Instead, plaintiffs' alleged damages appear to be limited to the amounts paid by the plaintiffs in excess of what they contend would have been a "reasonable" charge for the services provided to them.

In view of the fact that many plaintiffs have paid little or nothing toward the cost of the care that was provided to them, the "second offensive" seems to mean significantly reduced exposure for the hospital defendants.

On the other hand, the move to state court may result in increased litigation costs for hospitals. Unlike the novel federal claims plaintiffs' counsel initially asserted, the state-law claims are essentially garden variety claims for breach of contract and violation of consumer protection statutes. At least one state court in Illinois has refused to dismiss claims against Our Lady of the Resurrection Medical Center based upon an alleged breach of the hospital/patient contract and the Illinois Consumer Fraud Act. That decision means the case will proceed to discovery and that the hospital will have to seek judgment from the court at the close of discovery.

Hospitals should be aware that the new state court initiative by plaintiffs' lawyers is not limited to affirmative claims. Plaintiffs' lawyers have begun challenging hospital billing and collection practices in counterclaims filed on behalf of uninsured defendants in state court collection actions. This tactic has been employed in cases that have been filed in several states, including New Hampshire, North Carolina, and Ohio.

The counterclaims are substantially similar to the complaints brought in affirmative cases against hospitals, but sometimes include the additional allegation that the lawsuit itself was part and parcel of the hospital's alleged abusive collection practices.

For example, in *Lakes Region General Hospital v. Rollins*, the counterclaim plaintiff alleges that the collection suit "was brought for purposes of harassment, intimidation and is otherwise violative of the state laws relating to filing of frivolous and improper pleadings."

As hospitals develop and implement their collection policies both internally and as they apply to outside agencies, they should be mindful that a collection action against an uninsured patient could be trigger for a counterclaim against the hospital asserting the same alleged billing and collection misconduct at issue in the "second offensive" announced by Scruggs last month.

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