MEMORANDUM

TO: HEALTH CARE CLIENTS

DATE: July 16, 2004

RE: Not-For-Profit Hospital Class Action Lawsuits Filed

I. INTRODUCTION

Beginning in mid-June 2004, the Scruggs Law Firm, a well-known plaintiff’s class action firm that made its name in tobacco litigation, and a consortium of additional local law firms, filed class action lawsuits in federal district courts against some of the largest not-for-profit hospitals and hospital systems in the United States. The plaintiffs are uninsured patients who as consumers allege that these hospitals and systems have harmed them by violating implied and/or express promises, consumer protection laws, federal tax law, the federal Emergency Medical Treatment and Labor Act (“EMTALA”), and state laws governing contracts and charitable trusts, among other violations. Currently, lawsuits have been filed in 17 states\(^1\) against approximately 30 health systems and hospitals. The plaintiffs’ law firms have indicated that additional proposed class actions likely will be filed, and the firms have established an online “litigation site” (http://www.nfplitigation.com), which among other things solicits information to identify potential additional class representatives.

II. CLASS ACTION COMPLAINTS

On June 16, 2004, four similar proposed class action lawsuits were filed in federal district courts in Florida, Illinois, Minnesota, and Ohio against four health systems and hospitals. The proposed plaintiff class consists of uninsured patients of the named hospitals. The plaintiffs seek monetary damages and injunctive and other equitable relief against the defendant systems and hospitals.

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\(^1\) These states include: Alabama; Arizona; California; Colorado; Florida; Georgia; Illinois; Louisiana; Minnesota; Mississippi; Missouri; New Jersey; New York; Ohio; Oklahoma; Tennessee; and Texas.
Substantively similar proposed class action complaints have since been filed against not-for-profit hospitals and systems in several waves, most recently on July 15, 2004.

Generally, the plaintiffs assert that the defendants have engaged in a pattern and practice of charging uninsured patients significantly more for health care services than they charge insured patients. Moreover, the plaintiffs allege that the defendants pursue aggressive collection techniques against uninsured patients resulting in lawsuits, judgments, garnishments, property seizures, and personal bankruptcies. Many of the complaints allege that the defendants require uninsured patients to sign contracts promising to pay defendants in full for all charges as a condition to admission into their hospitals or emergency rooms, and also assert that the defendants allow certain affiliated non-charitable groups to derive a profit from the defendants’ operations. As a result of unpaid taxes and income from their “for profit operations,” the class action complaints assert that the defendants have amassed millions of dollars in cash and marketable securities while neglecting to provide charitable care to the uninsured. Several of the complaints also name the American Hospital Association (“AHA”) as a conspirator based upon the trade association’s advice and assistance to the defendants regarding hospital operations generally, and billing and collection practices concerning the uninsured in particular.

The complaints allege causes of action based on the defendants’ federal tax exempt status as charitable institutions pursuant to 26 U.S.C. § 501(c)(3), which requires them to operate “exclusively” in furtherance of a charitable purpose, with no part of their operations (either directly or indirectly) attributable to any non-charitable commercial purpose, and with no portion of the defendants’ earnings inuring to the benefit of any private individual or entity by accepting this favorable tax exemption. The complaints assert that, by reason of their tax-exempt status, the defendants have explicitly and/or implicitly agreed to: (1) operate exclusively for charitable purposes; (2) provide affordable care to all their patients; (3) charge their uninsured patients rates for health care services that are reasonable and not higher than rates charged to their insured patients; (4) utilize their net revenues and assets to provide affordable health care to their uninsured patients; (5) not pursue outstanding health care debt from their uninsured patients through aggressive and unreasonable collection efforts; and (6) provide an emergency room open to all without regard to their ability to pay for such health care services.

Premised on the theory that the uninsured patients are express and/or implied intended third party beneficiaries of the defendants’ agreement with the United States, the complaints assert causes of action for breach of contract, breach of the duties of good faith and fair dealing, and breach of charitable trust and unjust enrichment. Additionally, many of the complaints allege violations of EMTALA, civil conspiracy, and several state law specific violations of consumer protection and other laws.
III. SIGNIFICANCE OF LAWSUITS

These lawsuits include some creative and novel theories and cover a broad range of legal issues and subjects. By characterizing the cases as class actions and bringing actions in many jurisdictions across the nation, plaintiffs’ counsel attempt to utilize techniques commonly employed in consumer class action litigation to place overwhelming pressure upon the defendants. It may not be a coincidence that the lawsuits were filed about the same time as hearings were being held on Capitol Hill on the charity care practices of not-for-profit hospitals, and on the heels of the oddly defensive reaction of federal agencies’ to the AHA’s request for clarification of federal regulations relating to hospital billing and collection practices.²

The breadth and scope of the proposed class actions, which seek to hold not-for-profit hospitals responsible for national problems surrounding the treatment and billing of the poor and uninsured, could have a major impact upon not-for-profit health systems and hospitals throughout the United States. We expect that plaintiffs’ counsel will push very hard for prompt certification of the purported plaintiff classes in an effort to generate leverage in the hope of forcing a major settlement involving substantial damages and accompanying policy changes.

There are a variety of defenses that are available to the defendants in these cases. As with other large consumer litigation, the most important phase of the litigation is likely the beginning -- where defendants will have the opportunity to contest plaintiffs’ efforts to obtain class treatment of their claims. In this regard, plaintiffs will be required to show that they represent a well-defined class with common claims and injuries. However, individual hospital policies regarding charity care and admissions are likely to vary widely and be individually distinct. Similarly, the claims of loss and damages for individual plaintiffs likely will involve very different issues, facts, and circumstances that are not easily subject to adjudication in the form of a class-action.

The cases also present an important question of whether the plaintiffs even have standing to assert the claims being raised. Thus courts will have to determine whether a not-for-profit hospital’s charitable obligation affords individuals a right of action to challenge alleged short-comings. Substantively, the complaints raise novel theories, and perhaps misstate the law, regarding a not-for-profit entity’s

obligations under section 501(c)(3) of the Internal Revenue Code. For example, most practitioners do not think of a grant of tax exemption as creating a contract between the IRS and the exempt entity. Further, courts have long held, and the IRS agrees, that in the context of section 501(c)(3) the term “exclusively” means “substantially.” Moreover, in recent years the IRS has focused not on some vague notion of “charity,” but on the benefit an exempt hospital affords to the community it serves to determine whether its activities are charitable enough to merit exempt status under section 501(c)(3). Courts will be asked to decide whether a hospital’s charitable contribution or “community benefit” is satisfied given the alleged facts.

Given the potential exposure raised by these lawsuits, any named defendant will want to give them their most serious attention. In order to be successful, it is imperative that defendants in these lawsuits plan and coordinate their responses at the very outset of the litigation. This is particularly so with regard to their efforts to challenge plaintiffs’ attempts to certify a plaintiff-class and thereby gain leverage against defendants.

Obviously, selection of defense counsel is crucial for the defendant not-for-profit hospitals, which have not historically been targeted in this type of litigation. Counsel must have experience in developing appropriate strategies for this type of case, an understanding of the procedural rules that can be employed in defending class-claims, and the capacity to manage and coordinate defense strategies in conjunction with counsel for other named defendants. In this regard, legal counsel should have substantial class action expertise as well as intimate familiarity with the hospital industry and knowledge in the substantive areas of law relevant to the complaints. Proficiency in the requirements on organizations that are exempt from federal and state tax, and that are subject to government health program payment and fraud and abuse rules, will be invaluable.

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If you would like to discuss these developments and their implications, please contact Linda A. Baumann (lbaumann@reedsmith.com, 202/414-9488), Donald J. Bouey (dbouey@reedsmith.com, 415/659-5972), Andrea M. Kahn-Kothmann (akahn-kothmann@reedsmith.com, 215/851-8106), Julia Krebs-Markrich (jkrebs-markrich@reedsmith.com), Karl A. Thallner, Jr. (kthallner@reedsmith.com, 215/851-8171), or any other Reed Smith attorney with whom you work.

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