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HEALTH CARE LAW

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Distributor's Right to Reimbursement

A manufacturer may be forced to repay a distributor for legal expenses it has caused

It should come as no surprise to any practitioner that the manufacturers of health care equipment, like manufacturers in other fields, use a nationwide network of distributors to sell their products. There are special considerations attendant to the health care industry, however, that may not be found in other industries, and likewise, may seriously affect the rights and legal obligations of the distributor. For instance, the manufacturer is bound to adhere to Medicare and Medicaid rules for billing purposes and reimbursement regulations.

In a recent case, *Bachs Home Health Care Supply v. Abbott Laboratories, Inc.*, Superior Court of New Jersey, Law Division, Warren County, Case No. L-408-06, a manufacturer of enteral nutrition infusion pumps entered into an "Always Lease" with its distributors. The manufacturer supplied its distributors with pumps at no additional charge, in exchange for an agreement to buy a predetermined amount of pump sets. The manufacturer then told its sales force, which in turn told its distributors, that the distributors could bill Medicare and Medicaid for the pump sets as well as for the enteral infusion pump. The manufacturer sold a pump and pump set as one unit at one price, but the distributors were instructed to bill Medicare and Medicaid for each

item separately so that the distributor received two payments from Medicare and Medicaid: for the pump as well as the pump set. The structure of the bundled transaction made it difficult for Medicare and Medicaid to discern the true and reasonable charges associated with the equipment.

Using terms such as "signing bonuses," "conversion fees," "standardization fees," "education grants" and like elusive and deceptive terms, the manufacturer offered up-front payments, incentives and discounts to those distributors that would sign on to purchase the "bundled" sets for ultimate use by Medicare and Medicaid beneficiaries.

Eventually an investigation was conducted by the U.S. Department of Health and Human Services, under the direction of the Office of Inspector General. As a result of the investigation, and the possibility of facing criminal charges, the manufacturer entered into a settlement agreement and agreed to pay over \$382 million in fines and penalties to the United States and an additional \$17 million to a number of state governments to avoid further prosecution. This company also entered into what is known as a Corporate Integrity Agreement, (CIA), which contains the language of settlement as well as prohi-

bitions against future like activity.

A condition of the CIA was that the manufacturer cooperate with the states that chose to initiate investigations to determine if local distributors double billed the states' Medicaid programs. The New Jersey Medicaid Fraud Control Unit, in the Attorney General's Office, commenced investigations and subpoenaed records from local distributors.

Bachs Home Health Care Supply, a local distributor in New Jersey, obtained its supply of pumps and pump sets from the manufacturer and did not participate in any of the monetary incentive programs offered by the manufacturer, other than the bundled arrangement. The manufacturer insisted that if the distributor wanted to distribute its products, that the distributor was required to enter into the "Always Lease," thereby receiving the bundled products at one price. As a result of the investigation by the State of New Jersey, the distributor incurred significant legal fees and expenses exculpating itself from the state's accusations. Upon receiving a complete exoneration of any knowledge and/or complicity in the fraud scheme, the distributor contacted the manufacturer and asked to be reimbursed for the expenses incurred in the investigation that originated because of its conduct. The manufacturer rejected such a request. *Bachs Home Health Care Supply* filed suit for reimbursement. The follow-

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ing legal issue was presented: Does a durable medical equipment distributor have the right to be reimbursed by a manufacturer for the legal fees it expends defending itself against a state's allegations of fraud that originated from fraud committed by the manufacturer? In New Jersey the answer appears to be "Yes."

In support of the cause of action, the plaintiff distributor preliminarily relied on rules established in this state, allowing a party to be indemnified for legal costs that were caused by the actions of another party. The investigation for which the plaintiff incurred legal fees was a direct result of the criminal activities of the manufacturer, which prompted the State of New Jersey to expand the investigation to determine what violations of the law, if any, occurred in New Jersey. The investigation and resultant legal fees expended by plaintiff had nothing to do with any activities of the plaintiff, but were solely based upon the manufacturer's activities, while plaintiff was simply a distributor of its products.

The *Restatement of Torts* long ago stated this principle:

One who through the tort of another has been required to act in the protection of his interests by bringing or defending an action against a third person is entitled to recover reasonable compensation for loss of time, attorney fees and other expenditures thereby suffered or incurred in the earlier action. *Restatement, Torts 2d, § 914 (2)*.

The parameters require that the plaintiff establish that the plaintiff was involved in a legal dispute because of a breach of contract by the defendant, or because of the defendant's tortious conduct; that the litigation was with a third party (here the State of New Jersey); that the attorney fees were incurred in the third-party litigation; that the fees incurred were the natural and necessary consequences of the defendant's actions.

In *Jugan v. Friedman*, 275 N.J. Super. 556 (App. Div. 1994), the court reaffirmed this principle. In *Jugan*, a creditor had sued a judgment debtor, his wife and children for participating in

alleged fraudulent transactions to prevent the collection of the judgment. The court held that the debtor's interference with the creditor's efforts to collect on the judgment was an independent act, for which the creditor would be permitted to collect attorney's fees incurred, caused by the actions of the debtor. While the defendant would not be ordinarily liable for attorney's fees in the original action, his tortious conduct led to additional legal actions with third parties, and therefore the additional costs and attorney's fees were permitted to be assessed against him.

The *Jugan* case relied on those principles of damages long established in New Jersey in the matter of *Feldmesser v. Lemberger*, 16 Gummere 184 (N.J. E&A 1925), 127 A. 815. The Court could not be clearer in enunciating the principles that still remain the law of this state:

The defendant by his wrongful act started a train of circumstances which entailed the losses which the plaintiffs sustained. These losses, arising, not by reason of the contract, but by reason of the defendant's deceit and fraud, were incurred by the plaintiffs in the enforcement of the contract which they believed to be honest and fair. It is not important that these losses were incurred through the media of litigation to enforce the contract. It is sufficient if they flow naturally and directly from the wrongful act or are within the contemplation of the offending person at the time the wrong is committed.

In *Feldmesser*, the plaintiffs were induced to sign a contract for the purchase of land as a result of a fraud perpetrated by the defendant, who represented that he was the owner of the property. He was not, and the plaintiffs sued the actual owner to compel specific performance of the contract. The plaintiffs were not successful in compelling the sale of the land to them. The plaintiffs then sued the defendant for the costs and attorney's fees incurred in the other litigation.

Among the most cited cases in New

Jersey that have applied this rule without wavering from its original pronouncement and that as contained in the *Restatement*, are *Dorofee v. Planning Board of Pennsauken*, 187 N.J. Super. 141 (App. Div. 1982); and *Verhagen v. Platt*, 1 N.J. 85 (1948); *Lash v. Lopez*, 169 N.J. 20 (2001). Each of these cases has repeatedly maintained the principles set forth above.

Similarly, in *Bachs Home Health Care Supply*, the manufacturer, through its conduct, "started a train of circumstances" that eventually led to the actions of the State of New Jersey conducting a parallel investigation into its actions here, and was the cause of the expenses and fees incurred by the plaintiff, through no fault of its own. Clearly, a jury might reasonably conclude that such a result was a foreseeable consequence of the manufacturer's violations of the law.

One of the more novel and interesting defenses raised by the manufacturer in *Bachs Home Health Care Supply*, on its unsuccessful motion to dismiss under R.4:6-2(e), was the proposition that if this claim were allowed to stand it would "release the floodgates" for other similarly situated plaintiffs to seek indemnification. Such a proposition has no basis in law as a legal defense.

Traditionally, local distributors of medical equipment have considered themselves insulated from the wrongdoing of their manufacturers. If a manufacturer got into legal trouble that impacted the distributor, the distributor simply switched and bought its products from another manufacturer. Recent consolidation of manufacturers in the health care industry has, unfortunately, reduced this traditional option for distributors. In addition, switching to other manufacturers has not insulated distributors from the defense expenses associated with increased federal and state investigations of manufacturers. The case discussed above — which reached a confidential settlement prior to verdict — illustrates what is not a unique problem. Most distributors acquiesce to the manufacturer's denial and write it off as a business expense. Distributors need to recognize, however, that they do have rights and should consider seeking reimbursement of legitimate expenses that arise out of the wrongful conduct of the manufacturer who has created the problem. ■