

# Medi-Cal Audits: Physicians Do Have Defenses

by Henry R. Fenton

*The process is costly and burdensome, and could be invalid. Because of possible unfairness to defendants, the courts examine these cases carefully.*

**M**uch media coverage has been provided in the last year to the crisis that exists in California in the Medi-Cal system. Fewer and fewer physicians and other providers of medical and dental services are willing to provide services at the low fees that are now paid for such services — so low that basic services are not available to many impoverished California residents. Physicians who are willing to take Medi-Cal patients do so for a small fraction of the normal and customary fees for services provided by them because that is all that the Department of Health Services will pay.

Compounding the Medi-Cal crisis is what appears to be a systematic effort by the Department of Health Services to drive the remaining physicians who treat Medi-Cal patients out of the Medi-Cal system by subjecting those physicians to the large potential liability and attorney fees resulting from Medi-Cal audits and Medi-Cal auditing procedures. The audits focus upon physicians who are most willing to treat Medi-Cal patients and often result in audit demands in excess of \$100,000.

Recently, the sampling and extrapolation methodology utilized by the Department of Health Services in the course of Medi-Cal audits was subjected to court review in the Los Angeles Superior Court and was determined to be invalid and unlawful. That decision is not yet final and may be appealed by the Department of Health Services. Nonetheless, it is the first court test involving legal issues that arise out of Medi-Cal audits. As a trial court decision, it may not be relied upon as a precedent, but the reasoning of the court is instructive and the logic of the decision may well provide guidance in future legal challenges involving provider audits under the Medi-Cal system.

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## Background

This Superior Court decision involved an underlying set of facts which are typical of other physician audits. After the physician was selected for an audit, an audit team came to his office to review the charts of Medi-Cal patients that he had treated over an extended period of time. After the charts were reviewed, the physician was notified by the Department that he had been overpaid in excess of \$500,000 and that this was determined "by applying the ratio of overpayment found in a random sample to the total Medi-Cal payments you received during the review period." The claim that was made by the Department upon the physician constituted approximately 70% of the total amount of fees that the physician had been paid by the Department of Health Services for treating Medi-Cal patients over a period of years. The physician was given the option of either paying the money to the state or of requesting an administrative hearing to contest the demand.

At the administrative hearing requested by the physician, both the Department and the physician presented evidence in support of their legal positions through their attorneys. The hearing was held before an administrative law judge employed by the Department of Health Services who granted a motion to bifurcate the case and to conduct a separate hearing concerning the validity of the statistical methods utilized by the Department as a first order of business. The reason for the motion was that the very large monetary demand was based upon only a 2% sample of all of the patient charts from which the Department statistically extrapolated to the huge \$500,000 demand. The Department administrative law judge agreed that if the statistical methodology were determined to be invalid, that that could be largely determinative of the entire case. Thus, the hearing was limited to the

Predictably, the Department administrative law judge and the Department, thereafter, ruled in favor of the Department. The court case ensued with an appeal from the decision of the Department.

## Issues involved

At the Superior Court level, there were two major issues involved. First, the physician argued that the sampling and extrapolation methodology utilized by the Department was invalid because it had not been adopted pursuant to the provisions of the Administrative Procedure Act contained within the California Government Code. The second major issue was whether or not the sampling and extrapolation methodology utilized by the Department was statistically valid and reliable.

The California Administrative Procedure Act (APA), Government Code Sections 1134031 through 11356, both define and limit the rule-making authority of the state's administrative agencies. The APA mandates that prior to effectuating a regulation, the adopting agency must provide notice of its proposal to the public and permit comment by interested persons. The purpose of the APA as it relates to agency rule-making is not only to provide a procedure by which people affected may be heard on the merits of proposed rules, but also to ensure compliance with those procedures, *California Optometric Association v. Lackner* 60 Cal. App.3d 500 (1976). Indeed, failure of an agency to follow APA procedures prior to implementing a regulation will render that regulation void and unenforceable, *Armistead v. State Personnel Board*, 22 Cal.3d 198 (1978).

The physician in this case argued that the extrapolation process and statistical sampling methodology utilized by the Department were not adopted pursuant to the APA procedures — they were neither publicly noticed nor were interested persons

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permitted the opportunity to comment. It was contended that the extrapolation and statistical sampling procedure impacted not only on Medi-Cal provider patients but the public as well. It was further noted that many physicians have simply elected not to treat Medi-Cal patients after an audit because large repayment demands make a Medi-Cal practice unfeasible. As a consequence, use of the statistical extrapolator affects the availability of physicians' services to Medi-Cal beneficiaries, making it exactly the kind of rule which should be publicly noticed and subject to comment.

As a result of the Department's failure to abide by APA procedures, a physician group filed a request for regulatory determination with the California Office of Administrative Law in which it asserted that the statistical extrapolation method utilized by the Department was void and unenforceable. The Office of Administrative Law is a separate state agency which exists for the purpose of reviewing agency rule-making actions to determine and, therefore, insure compliance with the APA. On August 6, 1987, the Office of Administrative Law issued 1987 OAL Determination No. 10, in which it found that the statistical sampling and extrapolation process utilized by the Department was subject to the requirements of the APA, that that process was a "regulation" as that term is used in the APA and that, thus, it was invalid and unenforceable unless adopted as a regulation and filed with the Secretary of State in accordance with the APA.

The physician in this case argued to the Superior Court that the Office of Administrative Law is the administrative agency charged by the California Legislature with determining compliance with the APA and although its determinations are not necessarily binding on other state agencies, that the Superior Court should be guided by the interpretation of the California Office of Administrative Law.

The Superior Court agreed and determined that the sampling and extrapolation methodology utilized by the Department was invalid and unenforceable for failing to comply with the APA.

## Statistical issues

To review what occurred at the Department of Health Services level, and typical of the procedure in other audit cases

been paid earlier to the physician. It was claimed that this was a sample of all the Medi-Cal patient records of this physician selected randomly by computer.

The Medi-Cal team concluded that approximately \$12,000 of that \$18,000 sum had been inadequately documented and thus constituted an overpayment. From this claimed \$12,000 overpayment, the Department used statistical formulas and extrapolated from the sample to come up with the claimed overpayment in excess of \$500,000.

After reading the transcript of the administrative hearing before the Department of Health Services, the Superior Court judge determined that the sampling and extrapolation methodology utilized by the Department was statistically invalid and unenforceable. The Court held that the burden of proof was upon the Department to prove the statistical methodology employed by the Department was valid. After reviewing the expert testimony submitted on behalf of the Department and on behalf of the physician, the court concluded that the Department had not met its burden of proof and was convinced by the testimony presented on behalf of the provider-physician that the statistical methods used by the Department were unreliable and invalid.

## Conclusion

The teaching of this recent Superior Court case is that the situation of a provider-physician confronted by a large demand for a payment from the Department of Health Services is not necessarily hopeless. To the contrary, it is likely, based on the views expressed by the Superior Court Judge, that the Department would have to make a strong showing in order to justify a large demand for repayment based upon statistical methodology. Probably, it would also be the view of many other courts confronted with similar situations.

In this particular case, the statistical methods utilized by the Department in treating the patient population of a single physician were found to be invalid and unreliable because they had not been based upon an individualized approach to the Medi-Cal patients actually treated by the physician. It may very well be that the Department bureaucracy cannot provide the kind of individualized statistical approach which would be necessary to provide a fair

have yet to be litigated in the courts which could provide effective defenses in future Medi-Cal audit cases. For example, 1987 OAL Determination No. 10 determined that various Medi-Cal bulletins and pages from the Medi-Cal Provider Manual, which purport to describe the criteria pursuant to which the Department determines whether a physician has appropriately selected the correct RVS code to describe and to bill for the medical services rendered to the patient, are invalid and unenforceable for failure to comply with the Administrative Procedure Act.

It is also true, as the Administrative Law Judge from the Department of Health Services stated in his decision in this case, that "the use of a small random sample to project a large overpayment is inherently suspect." There is, in fact, no California case authority which supports the sampling and extrapolation methodology utilized by the Department in these audit cases, other than a few California cases which have allowed some statistical sampling under very different circumstances. In no California case, however, has a California appellate court authorized the use of statistical sampling as a basis for making a claim for a large amount of money, as is commonly the case in Medi-Cal audits. Where statistical methodology has been allowed, the courts have been careful to state that they will look very carefully at what has been done because of the possibility of substantial unfairness to defendants "which may result from ill-conceived techniques with which the trier of fact is not technically equipped to cope." (*People v. Collins*, 68 Cal.2d 319 (1968).)

It is also worth noting that there is at least one decision from a court outside of California which suggests that the small samples utilized by the Department of Health Services in this case are so small as to constitute a deprivation of due process of law: *Daytona Beach General Hospital Inc. v. Weinberger*, 435 F.Supp. 891 (N.D., Fla. 1977). In that case, the court held that a sample of less than 10% to compute the amount of recoupment due to the Department of Health, Education and Welfare for Medicare overpayments constituted a denial of due process of law.

In sum, Medi-Cal audits continue to be very costly and burdensome to affected physicians. Affected physicians, may well, however, have good legal defenses to the claims