COUNTY OF LOS ANGELES

CLAIMS BOARD

500 WEST TEMPLE STREET

LOS ANGELES, CALIFORNIA 90012

April 3, 2006

MEMBERS OF THE BOARD

Maria M. Oms
Auditor-Controller
John F. Krattli
Office of the County Counsel
Rocky Armfield
Chief Administrative Office

Honorable Board of Supervisors
383 Kenneth Hahn Hall of Administration
500 West Temple Street
Los Angeles, California 90012

Re: **County of Los Angeles v. Accordis Inc., et al.**
Los Angeles Superior Court Case No. BC 340 582

Claim of HMS Holding Corp.

Dear Supervisors:

The Claims Board recommends that:

1. The Board authorize settlement of the above-entitled action in the amount of $1,300,000.00 to be paid to the County.

2. The Auditor-Controller be directed to accept payment to implement this settlement for the Department of Health Services.

Enclosed is the settlement request and a summary of the facts of the case.

Return the executed, adopted copy to Georgene Salisbury, Suite 648 Kenneth Hahn Hall of Administration, Extension 4-9910.

Very truly yours,

Maria M. Oms, Chairperson
Los Angeles County Claims Board

MMO:gs

Enclosure

MEMORANDUM

March 9, 2006

TO: THE LOS ANGELES COUNTY CLAIMS BOARD

FROM: ANITA D. LEE
Principal Deputy County Counsel
Health Services Division

RE: **County of Los Angeles v. Accordis Inc., et al.**
Los Angeles Superior Court Case No. BC340582

Claim of HMS Holding Corp.

DATE OF INCIDENT: July 21, 2001 - September 31, 2001
July 1990 - March 2000

AUTHORITY REQUESTED: To accept a settlement amount of $1,300,000

COUNTY DEPARTMENT: Department of Health Services

CLAIMS BOARD ACTION:

☐ Approve ☐ Disapprove ☑ Recommend to Board of Supervisors for Approval

ABSENT, Chief Administrative Office
ROCKY ARMFIELD

John Krattli, County Counsel
JOHN F. KRATTLI

Maria Oms, Auditor-Controller
MARIA M. OMS

on April 3, 2006

HOA.352789.2

SUMMARY

This is a recommendation to settle two matters, a lawsuit and a contract claim, under the terms brokered by a professional mediator. The first is an action brought by the County of Los Angeles against Accordis Inc. (formerly Health Management Systems, Inc.), Accordis Holding Corp., and HMS Holdings Corp. (collectively "Accordis/HMS") relating to these entities' failure to properly submit claims for certain hospital and clinic services provided to Medi-Cal patients enrolled in managed care plans. The second is a claim by HMS Holding Corp. that it was damaged as a result of the County's breach of the covenant of good faith and fair dealing, in that it was forced to defend and settle an action under the federal False Claims Act. Under the proposed settlement:

1. Accordis/HMS would pay the County $1,300,000[1] and the County would dismiss its lawsuit with prejudice; and

2. Accordis/HMS would waive all its rights to pursue any action against the County related to its claim for breach of the covenant of good faith and fair dealing.

County's Complaint Against Accordis/HMS

LEGAL PRINCIPLES

Accordis/HMS had a contractual obligation to submit claims to Medi-Cal on behalf of the County's hospitals and freestanding clinics. Its unexcused failure to do so would constitute a breach of contract, which gives the County a right to damages. To be awarded by a court, such damages must have been reasonably foreseeable by the parties, and the County must have taken appropriate steps to mitigate its loss.

SUMMARY OF FACTS

Under a special Medi-Cal reimbursement system which began July 1, 2000, the County hospitals and clinics were entitled to be paid the difference between the amount they received from Medi-Cal managed care organizations and the actual cost of providing care to Medi-Cal managed care enrollees. To receive such supplemental reimbursement, however, the County had to submit a claim for each outpatient visit it provided to a Medi-Cal managed care enrollee. These claims are generally known as "Gap Claims." It took the State Department of Health Services over a year after the start of the new reimbursement system to

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1 Accordis/HMS has already given the County a credit in the amount of $196,628; thus, the settlement would result in a supplemental payment of $1,103,372.

provide instructions on how to bill the Gap Claims. As a result of this delay, the State Department of Health Services extended the time period usually allowed for the submission of claims to September 31, 2001.

Accordis/HMS contracted with the County to provide Medi-Cal billing services for the County hospitals and clinics, which included billing Gap Claims. However, for various reasons, it failed to submit many of the eligible Gap Claims by the extended deadline set by the State.

In September 2005, the County filed an action against Accordis/HMS for breach of contract, negligent performance of contract and breach of the implied covenant of good faith and fair dealing in connection with its failure to timely file the Gap Claims.

DAMAGES

As a result of Accordis/HMS' failure to submit the Gap Claims, the County estimates that it did not receive approximately $4,500,000 in Medi-Cal reimbursement. This amount was calculated by comparing actual payments determined on the Medi-Cal audited cost reports, with the amounts that would have been recognized on those reports if all of the eligible Gap Claims had been billed timely. Thus, the damage amount calculated by the County takes into consideration the effect of the cost reconciliation process on the amount of its final payment from Medi-Cal.

STATUS OF CASE

Because of the ongoing contractual relationship between the parties, there were significant reasons to try to resolve these two legal disputes. To facilitate a settlement, a mediation with a highly skilled professional mediator was scheduled. Accordis/HMS was given an extension of time in which to respond to the County's complaint until after the mediation occurred. The mediation, which was held on January 31, 2006, resulted in a mediator's proposal, which by February 15, 2006, both Accordis/HMS and the County Department of Health Services agreed to accept. To allow the settlement to be finalized, the County has given Accordis/HMS a further extension of time to respond to the complaint.

Accordis/HMS' Claim Against County

LEGAL PRINCIPLES

Every contract, including those involving governmental entities, may include a covenant of good faith and fair dealing which requires each party to take the steps necessary to allow the other party to fulfill its contractual obligations. Breach of this covenant, like other breaches of contract, gives the non-breaching party a right to damages. To be able to pursue such damages, however, the

plaintiff must make a timely claim to the County, and if that claim is denied, must file a timely complaint in court. In its action, it must demonstrate that the implied covenant applies to the specific factual circumstances, and that the legal obligation reputedly breached was not expressly addressed in the contract. It must also prove a breach of the obligation and then demonstrate that legally recognizable damages were incurred. Legal fees constitute damages only in a very limited number of cases.

SUMMARY OF FACTS

Accordis/HMS' billing contract with the County has been longstanding. During the 1990's, Accordis/HMS submitted claims to Medi-Cal on the County's behalf using default diagnosis codes (i.e. diagnosis codes which were determined independently of a review of patient-specific information). The County was aware of this practice. In 2003, a complaint under the federal False Claims Act was filed against Accordis Inc. (but not the County) in New York by a whistle-blower, asserting that the practice of using default diagnoses was a false claim. Accordis/HMS defended the action and in doing so, incurred approximately $4,000,000 in attorney's fees. Ultimately, Accordis Inc. settled the New York false claims action with the federal government for $1,356,500.

Following the payment of the settlement, HMS Holding Corp. filed a claim against the County for the damages it incurred in defending and settling the New York false claims action. In correspondence with the County, it clarified that its claim was based on the County's alleged breach of the covenant of good faith and fair dealing, which allegedly caused Accordis/HMS to use the default codes when it arguably should not have.

DAMAGES

Accordis/HMS asserts that the damages it incurred in connection with the New York false claims action were approximately $5,356,000. This includes both legal fees and the amount of the settlement.

STATUS OF CASE

The County denied the claim submitted by HMS Holding Corp. on a number of grounds. Part of the claim was denied on September 22, 2005; the remainder was denied on October 14, 2005. Thus, HMS Holding Corp. has until March 22, 2006, to file an action in court. Because the parties are working to towards settlement, the County has agreed to toll HMS Holding Corp.'s time to file an action in Superior Court.

Evaluation of Both the Lawsuit and the Claim

With respect to the complaint related to the Gap Claims, it is clear that Accordis/HMS breached its agreement and damaged the County. However, the proper measure of damages is subject to considerable uncertainty on two grounds. First, Accordis/HMS has forcefully asserted that it could not have reasonably foreseen the full amount claimed by the County, because the County's claim depends on the way Medi-Cal structured the reimbursement calculation in the cost report, and Accordis/HMS had not seen the cost report. Second, there is some question about whether the County took reasonable steps to mitigate its damages, since it did not request the State to accept the late claims or otherwise further extend the billing deadline. While the County has credible responses to each of these points, we believe that there is a significant risk that the County would not recover the full amount of its loss if the case proceeded to trial.

With respect to Accordis/HMS' claim related to the New York action, the County believes that it has numerous defenses; however, defending the matter would be expensive. Moreover, as with all litigation, there is the possibility of an adverse outcome.

Under these circumstances, our office, with the concurrence of the Department of Health Services, is recommending that the proposed settlement be accepted. Although it represents a significant reduction in the County's possible recovery on the Gap Claims lawsuit, there is a real possibility that the full amount of the claimed damages would not be awarded in a final verdict. Additionally, Accordis/HMS' agreement to waive any claims and causes of action which it may have related to the New York case provides genuine value to the County. As noted above, that claim is for approximately $5,356,000, and, under the proposed settlement, Accordis/HMS takes nothing under it. Moreover, settlement at this early stage of the proceeding will likely save over $300,000 dollars in attorney's fees and costs.

APPROVED:

RICHARD K. MASON
Assistant County Counsel
Health Services Division

ADL:vn