

[Securities Regulation Daily Wrap Up, FRAUD AND MANIPULATION—M.D. Tenn.: Claims that medical provider illegally boosted Medicare revenues dismissed as time-barred, \(Jun. 17, 2016\)](#)

Securities Regulation Daily Wrap Up

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By [Kevin Kulling, J.D.](#)

A federal court has dismissed an amended complaint brought by investors in Community Health Systems Inc., which alleged that the health provider fraudulently admitted patients for treatment in order to boost Medicare revenues. The court held that the amended complaint did not include matters that related back to the original complaint and the new allegations fell outside the statute of limitations period ([Norfolk County Retirement System v. Community Health Systems, Inc.](#), June 16, 2016, Sharp, K.).

Community Health Systems. Known as CHS, Community Health Systems operated and leased more than 130 acute care hospitals in non-urban markets in 29 states. CHS provided both inpatient admission and outpatient observation services. However, its use of observational status prior to 2011 was less than half the national average rate for United States hospitals. Plaintiff Norfolk County Retirement System claimed that the observational status statistics were due to CHS's intentional plan to boost Medicare revenues by admitting patients for inpatient service when all that was medically required was outpatient observation.

Takeover target. After being made the subject of a hostile takeover attempt by CHS, another medical provider, Tenet Healthcare Corp., sued CHS in April 2011. That suit became the basis for the action brought by Norfolk County after the complaint publicly revealed that CHS's successful track record of increasing revenues at acquired hospitals was attributable to improper and unsustainable admission practices, according to the complaint.

Complaints. The initial complaint against CHS was filed on May 9, 2011. It was amended on July 13, 2012, and again on October 15, 2015, the last of which raised new allegations about misrepresentations.

Time-barred. The court noted that the statute of limitations required that the claim be brought not later than the earlier of two years after discovery of facts constituting the violation or five years after such violation. CHS contended that the investors were on notice of the alleged new claim concerning an October 2011 corrective disclosure when the plaintiff filed its consolidated class action complaint in 2012. However, they waited until the filing of the first amended complaint on October 15, 2015, to raise the claim.

Regarding the plaintiff's argument that the claim related back to the initial complaint, the court said that relation back is only appropriate if an amended complaint asserts a claim arising out of the same conduct, transaction, or occurrence that was already pleaded or attempted to be pleaded.

Many of the alleged misrepresentations were included in the company's financial results for the third quarter of 2011. While the complaint alleged material misrepresentations were made in each of its released financial results from the second quarter of 2006 to the fourth quarter of 2010, there was no mention made of the third quarter of 2011, the court said. The consolidated class action alleged that the class action was precipitated by disclosures made in April 2011 by Tenet that caused CHS stock to immediately plummet.

Allegations of the post-Tenet conduct constituted an entirely new securities fraud claim, the court said. It alleged a different fraud and alleged corrective disclosure that expanded the size of the putative class, extended the class period and added hundreds of millions of dollars in potential damages.

Fraud elements. The court did find that the complaint stated the elements of a securities fraud claim, despite the statutory bar. A reasonable investor could find it important that the business model would likely collapse. The

court agreed that investors had adequately stated material misrepresentations and identified a strong inference of scienter.

The case is [No. 3:11-00433](#).

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Companies: Norfolk County Retirement System; General Retirement System of the City of Detroit; NYC Funds; Community Health Systems, Inc.

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