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Medi-Cal Fraud Probe Could Reach \$1 Billion

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A giant rip-off of the California Medi-Cal system, centered in Armenian immigrant neighborhoods of Los Angeles, may total more than \$1 billion when it is finally unraveled, making it one of the largest frauds against a state in American history, federal investigators report.

FBI and California officials, in a task force set up by Gov. Gray Davis, allege massive criminal activity by storefront businesses that sent millions of dollars in phony claims to the state medical poverty program for crutches, adult diapers, prescriptions and other supplies and services.

The addresses in the federal government's indictments read like a road map of Los Angeles County—Van Nuys, Burbank, North Hollywood, Sherman Oaks, Reseda, Northridge, Glendale, Montebello and Pasadena. The only charges not involving Los Angeles businesses cite two medical equipment suppliers in Westminster in Orange County.

Investigators believe the hub of the criminal activity is the San Fernando Valley, where medical supply stores catering almost exclusively to Medi-Cal have become as numerous as hamburger joints and fried chicken emporiums.

Charges for false billings have been lodged against 64 businesses and their owners; 35 have pleaded guilty and the rest are pending.

Penalties have included fines and prison terms ranging from 10 months to three years. The government's cases have been so strong that no one has yet contested the charges in a trial. An additional 300 businesses are under investigation. Most of those charged have Armenian surnames.

The probe has shaken Armenian communities, prompting charges of "witch hunt" and "state terrorism" from lawyers representing some of those accused.

“There is great fear in the Armenian community,” said attorney Pat Hooper. “They don’t know how to react to this. What we are troubled by is the tactics that are being used and the presumption that everyone who is an Armenian must be doing something illegal.”

Federal prosecutors in the U.S. attorney’s office in Sacramento dismiss Hooper’s accusations as rubbish, saying that fraud is driving the investigation; not ethnicity. “We are taking down any fraud we find regardless of race, creed, color or nationality,” said Dan Linhardt, chief of the white collar fraud unit. “I don’t care if you’re a five-headed Martian; we’re going to prosecute.”

For several years under the administration of Gov. Pete Wilson, the fraud operations went unaddressed despite alarming increases in claims, especially for medical equipment. In fiscal year 1996 the state spent \$173.4 million for Medi-Cal supplies. By 1998 expenditures had soared to \$258.4 million, nearly a 50% jump.

At the same time, auditors in Controller Kathleen Connell’s office were alerting state officials to an abrupt increase in its fraud findings. But it wasn’t until the FBI opened an investigation a year and a half ago that it became apparent fraud had permeated entire sectors of California’s vast Medi-Cal program.

“It’s historic, and I think it is every bit as large as the fraud that was uncovered in the 1980s at the [U.S.] Department of Defense,” said James J. Wedick Jr., who is supervising an FBI corruption squad based in Sacramento.

Benefits Intended for the Poor

An FBI informant described for The Times how the fraud rings work. He said loose government regulation makes it so easy for unscrupulous operators to steal that “it was like Bank of America held an open house at every branch and told people to help yourself to all the cash they had.”

The vortex of the criminal activity is Medi-Cal, California’s name for Medicaid, the vast federal-state effort to provide health care for the poor. In California, it serves 5 million people at an annual cost of about \$18 billion, and prides itself on its ability to pay claims quickly so no one is denied care because of government sloppiness.

To establish a business, scam artists first apply for a Medi-Cal provider number, which entitles them to receive state payments and which, until a very recent crackdown, could be easily obtained.

Then, from black marketeers known as “cappers,” they purchase lists containing hundreds of recipient numbers. Cappers steal the numbers from doctors’ offices or buy them off the street, sometimes from the homeless. He remembers one capper who dated a nurse just so he could get access to Medi-Cal numbers in her patient files.

Once in business, fraud operators begin billing Medi-Cal electronically, asking reimbursement for thousands of dollars in supplies they claimed to have provided poor patients. In reality there were never any supplies and never any patients. Some operators, he said, pulled in as much as \$500,000 a month in illegal payments.

Some of the operators didn’t even bother to open a store. Alan Cates, the state auditor who uncovered the fraud and took it to the FBI, remembers when he went to check out some businesses that were billing Medi-Cal he found only a mailbox or a vacant lot.

Under FBI scrutiny are the parts of Medi-Cal that provide medical supplies, laboratory work, pharmaceuticals and nonemergency medical transportation to recipients who are not part of a managed care system. Mostly independent operators, the providers bill the state electronically, outlining on claims the names of each recipient, their Medi-Cal number, and the goods or services they have been provided.

Connell, the state controller, said the proliferation of medical supply stores was the first tip-off that something had gone awry in California’s Medi-Cal program.

“It’s as if there were weekend classes in how to set up this kind of fraud activity,” she said. “It expanded almost exponentially.”

On Magnolia Boulevard in Burbank, medical supply stores open and close almost overnight. On the other side of the Hollywood Hills, just blocks from the Walk of Fame, Hollywood and Sunset boulevards have become a mecca for medical supply stores. In Eagle Rock, along a faded two-mile strip of Colorado Boulevard, eight new medical supply stores sprang up within a year, nestled among dry cleaners, palm readers and doughnut shops.

The Eagle Rock stores alone have billed the state for more than \$2 million.

Their arrival sparked a complaint to state Sen. Adam Schiff (D-Burbank) from the local Chamber of Commerce, whose members worried that their community of 25,000 didn’t have enough disabled poor people to support them.

“We used to have one company in Eagle Rock,” said Bob Russell, a chamber member who has operated a medical supply business in neighboring Pasadena for 22 years. “That’s all the community can support.”

At least half of the Eagle Rock medical shops have become the subject of FBI investigations or been cited in controller's audits for improper billings. One, Shield Medical Supply, closed after the FBI asked state officials to stop all payments until an investigation could be completed.

Neighbors said they couldn't remember seeing any customers going in and out of the store. Yet state records show that Medi-Cal paid it \$1.1 million for supplies last year—its first year in business.

Out of curiosity, Russell said, he walked into the store once and found only a small amount of stock, covered with dust. But the income the store claimed from Medi-Cal, he said, was far more than he earned in his own well-stocked business that has been building a customer base for more than two decades.

The FBI informant, who says death threats have been made against him and asked not to be identified, said family relationships provide the core of most fraud operations. Word of the opportunity to make easy bucks spreads to one family member who gets involved in the scam and then sets up a brother, sister or father in the same operation. Some extended families, may eventually own 10 or 15 stores.

In its investigation of the scandal, the FBI has employed new techniques that allow it to bring charges quickly so cases can be wrapped up in months rather than years, as was typical for health care fraud prosecutions in the past.

"We simply follow the money," said Wedick. Billings to Medi-Cal are compared with purchases of inventory. If banking transactions and invoices show that a business hasn't bought enough supplies to match its Medi-Cal claims, fraud is assumed. Often the investigation of a medical supply store leads to scrutiny of wholesalers suspected of providing false invoices in return for kickbacks.

When investigations are completed, incentives are offered to store owners to encourage capitulation. Those who plead guilty early in the process get shorter sentences, as do those who identify other fraudulent operators. As a result, U.S. Attorney Paul Seave, who is based in Sacramento, has been able to file an extraordinarily large number of cases in an unusually short length of time.

"We are trying to get a big number of cases as fast as we can because we think that's the best way to stop this," Linhardt said.

Making Claims Look Legitimate

Typical of the schemes uncovered in the investigation was the case involving Ashot Art Avetissian, the owner of Delta Medical Wholesale in Sherman Oaks, who has been charged with aiding and abetting a fraud cartel that bilked Medi-Cal out of \$1.2 million.

Federal prosecutors said Avetissian, who is awaiting sentencing, provided phony invoices to stores that used them to back up fraudulent Medi-Cal claims. To make it look legitimate, the stores would send him a check for the total amount of the invoice. Avetissian, court documents said, would convert the check to cash, keep 5% to 25% as his fee and return the rest to the store owner.

Oganes Ekizyan, owner of Zorri Medical Supply in Altadena, was accused of a similar scheme. Documents said wholesalers would send him invoices, which he would pay in full by check. The wholesalers would then cash the check, keep 15% to 25% and send the remainder back to Ekizyan.

The invoices were used to support phony Medi-Cal billings of \$883,000, court records show. Ekizyan is also awaiting sentencing.

But the FBI's success at uncovering fraud has produced a backlash in the Armenian community, where some lawyers complain that federal investigators are only targeting immigrants.

"I've had clients that were actually stone-cold innocent who were drawn into this only because their name ends in i-a-n," said attorney Mark Geragos.

He said immigrants may be an easy target because they often succumb quickly to FBI pressure. "Most of them are so afraid," Geragos said. "A lot of them have had experiences with the KGB."

Hooper said some of the FBI cases may be tainted because they relied heavily on audits performed by the controller's office. A recent federal court ruling found that Connell had no authority to audit Medi-Cal cases.

"She has no business investigating, auditing or reviewing Medi-Cal claims," he said.

Connell takes the position that the court decision applies only to one case, and said the state will appeal it. In the meantime, she said, her office has continued to participate in the probe.

"It's our contention that this judge's ruling is fundamentally flawed," she said. "I think this issue is far too important for there to be jurisdictional combat."