

Whistleblower suit targets medical product firm

By Barbara L. Jones

bjones@minnlawyer.com

The Department of Veterans Affairs is said, by persons ranging in status from President-elect Donald Trump to a homeless veteran, to be a disaster and the provision of medical services to vets scandalously inadequate.

Illustratively, the medical product company MiMedx, located in Georgia, has been able to “sell” millions of dollars’ worth of products to the VA — and other entities — in a channel-stuffing scheme that bumps up MiMedx’s books at the end of a fiscal quarter when the company counts those deliveries as revenue-realizing events.

That at least is the claim of two former employees, Jess Kruchoski and Luke Tornquist, who claim in a lawsuit filed in U.S. District Court in Minneapolis on Dec. 15 that they were retaliated against and then fired for protesting the channel-stuffing scheme.

Represented by Minneapolis attorneys Clayton Halunen and Stephen Premo, the two former sales representatives allege retaliation in violation of the Dodd-Frank Act, unlawful discharge in violation of Minnesota law, tortious interference with contractual relations and, for Kruchoski, marital and familial status discrimination against the company and its CEO, Parker Petit.



FILE PHOTO: BILL KLOTZ

Clayton Halunen, one of the attorneys representing two former sales representatives for MiMedx, says his firm is gaining a national reputation for False Claims Act and federal whistleblower claims.

MiMedx Group sells Epi-Fix, a wound-care product derived from dehydrated amniotic tissue, as well as other medical products.

Company brought first lawsuits

But MiMedx is not only playing defense. In fact, it has filed four lawsuits against employees, including Kruchoski and Tornquist, in four different states. The lawsuits against Kruchoski and Tornquist, filed on Dec. 13 before the whistleblower suit, allege misappropriation of trade secrets and unlawful competition.

They also allege that the whistleblower claims are false and are made only to allow Kruchoski and Tornquist to avoid their noncompete agreements.

On its website, the company said on Dec. 15 that Kruchoski was fired because he was selling other products not manufactured by MiMedx. It also said Kruchoski and Tornquist wanted the company to waive their noncompete agreements if they left.

On Dec. 27 it announced that its preliminary investigation of the channel-stuffing claims showed no wrongdoing.

The company filed a similar trade secret lawsuit on Dec. 29 in Illinois against

a former vice president of the company and another on Dec. 30 in Texas against an account executive.

The complaints speak for themselves, said Alexandra Haden, general counsel and secretary to the company. The company would not comment any further on pending litigation, she said.

On the company’s website, Petit said, “It is important to note that the two new lawsuits and the recent terminations were not related to allegations made against the Company by Mr. Kruchoski and Mr. Tornquist. The investigations conducted by our Board of Directors and MiMedx management found no merit to the actions

alleged in the lawsuit filed by Messrs. Kruchoski and Tornquist. Nonetheless, when an employee violates the duty of loyalty and contractual obligations by selling competitive products or other products, employment actions must be taken.”

The company was well aware that employees sold products for other companies, Halunen said. “We are not concerned about any legitimate defenses” to the lawsuit, he said. Halunen said he represents other claimants against the company in SEC and OSHA lawsuits as well. Executives at MiMedx are “seasoned players,” he said.

Additionally, the Halunen firm also is investigating whether the company has committed securities fraud and is seeking persons who might have information or be interested in those claims.

Halunen said the firm is expanding this area of its practice as it gains a national reputation for False Claims Act and federal whistleblower claims.

“We represent a lot of executives who come in [after being fired]. The companies have made commitments. They have

to make things happen to make their numbers,” Halunen said. Channel-stuffing is a clearly illegal practice that is so common there is a slang term for it, he said.

Channel-stuffing

According to the complaint, the plaintiffs were top-performing sales employees at the company until they discovered a fraudulent revenue recognition scheme intended to inflate revenue and deceive investors. After they objected to the alleged channel-stuffing scheme they faced retaliation in the forms of threats, intimidation and termination.

The plaintiffs allege that the company entered into a distribution agreement with a Tennessee federal supply contractor called AvKARE which allows it to sell directly to the Department of Veterans Affairs.

MiMedx then sends EpiFix directly to VA hospitals, even if the hospitals do not order it, the complaint says. The sales executives then literally place the EpiFix on the hospital shelves and the company takes the orders as revenue. “The VA doesn’t have a great

inventory system,” Halunen said. The company has other customers as well.

The company then “feathers back” returns from the VA and other places, literally concealing the returned product and/or reporting it in future periods, the complaint states. Many employees have EpiFix returns stored in their homes, Halunen said.

The lawsuit alleges that the company’s revenue-recognition scheme does not meet the conditions for realizing revenue under Generally Accepted Accounting Principles for reasons including the long period where products may be returned. “There is still unpurchased EpiFix product that MiMedx shipped in the first quarter of 2016 that MiMedx recognized as revenue,” the complaint states.

The complaint says Petit routinely ordered the false orders for unpurchased product to recognize the revenue in financial statements. When Kruchoski objected, the director of operations said that Petit had backed his order with a threat to noncompliant employees: “Your ass is grass.”

Shortly thereafter, Kruchoski was denied

a promotion and his subordinate Steve Blocker was promoted over him. An executive vice president told Kruchoski he was not considered for promotion because he was too vocal in his opposition to the channel-stuffing scheme and also because he was a divorced dad. “They said he didn’t have the bandwidth to sell and take care of his children when he needed to,” Halunen said.

In November 2016, Kruchoski and Tornquist submitted a joint report to management and legal counsel about the fraudulent revenue scheme, and the company’s failure to pay commissions on sales.

Blocker allegedly told both men to “think about their families.” The complaint also states that Haden stated in her response to Kruchoski that he had asked the company to assist him in shielding income from his former spouse, which was not true.

The two men supplemented their report with more detail. More retaliation ensued and Petit allegedly stated in a meeting on Dec. 12 that the company was going to hurt the men’s careers and their families. They were fired that evening.