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Applying *Escobar*—Decisions on Materiality, Falsity and Other Issues

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An active year has produced insight into how lower courts will apply the U.S. Supreme Court's decision upholding implied certification liability under the False Claims Act (FCA) in *Universal Health Services v. United States ex rel. Escobar*, 136 S. Ct. 1989, 2016 BL 192168 (2016). This article reviews recent FCA decisions on questions of materiality, falsity and other FCA concerns.

Materiality Requires a Holistic Approach

Escobar emphasized that the materiality inquiry (i.e., whether the alleged misrepresentation was material to the government's payment decision) is a ''demanding'' one. Upon remand, the First Circuit determined the language used by the Supreme Court ''makes clear that courts are to conduct a holistic approach to determining materiality in connection with a payment decision, with no one factor being necessarily dispositive.'' *United States ex rel. Escobar v. Universal Health Servs.*, 842 F.3d 103, 2016 BL 390617 (1st Cir. 2016).

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Key *Escobar* Takeaways

Based on a year's worth of decisions:

- Holistic analysis of three factors is a favored test for establishing materiality.
- It is unresolved whether two conditions for implied certification must be satisfied.
- Dismissal is likely when payments continue after actual knowledge of alleged fraud.
- Dismissal is less likely when conduct such as altered invoices is alleged.
- Determining what is central to a regulatory program is a case by case analysis.
- *Escobar* will be adopted by states and municipalities.

Applying this holistic approach, the First Circuit had ''little difficulty in concluding that Relators have sufficiently alleged that UHS's misrepresentations were material,'' by focusing on three factors: (1) whether regulatory compliance was a condition of payment (the relators alleged that it was); (2) the centrality of the requirement in the regulatory program (the court found that the centrality of the licensing and supervision requirements in the MassHealth regulatory program was ''strong evidence that a failure to comply with the regulations would be 'sufficiently important to influence the behavior' of the government in deciding whether to pay the claims''); and (3) whether the government paid claims despite actual knowledge that certain requirements were violated (there was no evidence in the record that MassHealth paid the claims at issue despite knowing of the violations, although the court acknowledged that such information could come to light during discovery).

A district court in the First Circuit applied these three factors earlier this year and determined that the relator's complaint was sufficient to survive a motion to dismiss. *United States ex rel. Worthy v. E. Me. Healthcare Sys.*, 2017 BL 13956, No. 2:14-cv-00184 (D. Me. Jan. 18, 2017). The defendants argued that Medicare's Three-Day and Same-Day rules could not be preconditions of payment because they were not expressly labeled as

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such in the regulations. The court noted that *Escobar* addressed this exact issue, and that ''[w]hat matters is not the label the Government attaches to a requirement, but whether the defendant knowingly violated a requirement that the defendant knows is material to the Government's payment decision.'' When deciding whether the two rules were designated as conditions of payment, the court found the regulations suggest that, under certain circumstances, CMS has the discretion to deny payment for a misrepresentation of the Three-Day Rule. However, the court deemed this to be insufficient for a finding of materiality under *Escobar* because the regulations did not suggest that noncompliance with the Same-Day Rule could result in a denial of payment. Regarding the centrality of the requirements and the government's actual behavior with respect to these Rules, the relator alleged that the defendant made changes and created dummy accounts in order to get claims paid in violation of the billing rules and to conceal certain payments. The court found that such ''allegations at least make it plausible that CMS would not have paid the Defendants had it known that Defendants misrepresented their compliance with the Rules, and that the Defendants were aware of this fact.'' Finally, the court noted that, in the past, the government has taken action to prevent the type of alleged conduct at issue and has warned that duplicate billing may lead to a fraud investigation.

Another First Circuit district court applying the three factors concluded that failure to disclose noncompliance with federal civil rights law was material. *United States ex rel. Williams v. City of Brockton*, 2016 BL 429782, No. 12-cv-12193 (D. Mass. Dec. 23, 2016). First, compliance was an express condition of payment: the DOJ required applicants and grantees of the program at issue to promise they would not engage in future discrimination, and one form expressly designated an applicant's representations about its compliance as ''material representations of fact upon which reliance will be placed when the [DOJ] determines to award the covered grant.'' Moving to centrality, the court found ''the centrality of racially-neutral and nondiscriminatory policing to the COPS program is strong evidence that a grantee's non-compliance would have the tendency to influence the DOJ's decision to award the grant.'' The ''[d]efendants' alleged pattern and practice of discrimination of minorities through their policing techniques, suppression of complaints, and employment practices would directly subvert the COPS program's goal of promoting community-based approaches to law enforcement.'' Finally, the court discounted defendants' argument that the DOJ continued to award grants to the city in 2011, even though lawsuits against the city alleging civil rights violations were filed before 2009. The court found that the complaint was ''void of any allegation that the DOJ had actual knowledge that these requirements were violated.'' In addition, even if the DOJ did have such knowledge, that knowledge was not ''determinative in the court's holistic review of materiality.''

A district court in the Third Circuit also applied the three ''*Escobar* factors,'' and concluded that the alleged violations were material. *United States ex rel. Emanuele v. Medicor Assocs.*, 2017 BL 80113, No. 10-cv-245 (W.D. Pa. Mar. 15, 2017). First, the court found that the Stark Act ''expressly prohibits Medicare from paying claims that do not satisfy each of its requirements.'' Second, the writing requirement was not ''minor or insubstantial'' but instead went to the very '' 'essence of the bargain' between the government and healthcare providers with respect to Stark Act compliance.'' Finally, while there was no evidence to suggest that the government consistently refuses to pay claims based on Stark Act non-compliance, public records suggested that healthcare providers have paid penalties after self-reporting similar violations.

a) Evaluating Whether the Requirement Is Central in the Regulatory Program Many courts have taken a ''common sense'' approach to the centrality factor. For example, a court in the Eastern District of Virginia found that billing codes and job titles in the defendant's invoices ''specifically represent[ed] to the government that defendant's [personnel] had fulfilled the weapons qualifications requirement.'' *United States ex rel. Beauchamp v. Academi Training Ctr., Inc.*, 2016 BL 399529, No. 1:11-cv-371 (E.D. Va. Nov. 30, 2016). The court concluded that ''it strains credulity to argue that the government's payment decision would not have been affected had the government known that the [personnel] responsible for protecting U.S. officials in Afghanistan had not fulfilled the weapons qualifications requirement.'' The relators alleged that the contract repeatedly stated that personnel had to train with and requalify on certain firearms, and that a failure to do so would require them to be shipped back home, ''indicating that the weapons qualifications requirement is central to the contract.''

In another case, *United States ex rel. Miller v. Weston Educ., Inc.*, 840 F.3d 494, 2016 BL 347571 (8th Cir. 2016), relators claimed that the defendant fraudulently induced the Department of Education to provide funds by falsely promising to keep accurate student records. The Eighth Circuit found that the ''significance of the requirement and the government's acts show that the recordkeeping promise was material.'' A ''reasonable person would attach importance to a promise to do what is necessary to ensure funds go where they are supposed to go.'' The government's behavior confirmed for the court that the government ''cares about the promise at issue: ''The DOE relies on school-maintained records to monitor regulatory compliance. When colleges do not adhere to this promise, there are consequences. ... [T]he DOE sometimes terminates otherwise eligible institutions for falsifying student attendance and grade records.''

The relator in *United States v. Planned Parenthood of the Heartland, Inc.*, 2016 BL 437746, No. 4:11-cv-00129 (S.D. Iowa June 21, 2016), claimed that the defendants violated a regulation by dispensing certain medications without or prior to a physician's order. The court concluded that compliance with this regulation would be material to the government's decision to reimburse the claim, finding ''the circumstances of the requirement sufficient to suggest that Medicaid would not reimburse the cost of a drug that was prescribed absent authority from a legitimate prescribing source.'' The ''condition in question–that a drug be prescribed by a qualified practitioner–represents the heart of prescription medication regulation.''

b) Continued Payment Points to Nonmateriality Multiple opinions relied upon the third factor when dismissing complaints. As *Escobar* taught, when the government ''regularly pays a particular type of claim in full despite actual knowledge that certain requirements were vio-

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lated, and has signaled no change in position, that is strong evidence that the requirements are not material.'' *Escobar*, 136 S. Ct. at 2004. Even though this is not dispositive, courts have followed this guidepost, questioning materiality when government agencies indeed continued to pay claims despite awareness of potential misrepresentations. *See, e.g., United States ex rel Petratos v. Genentech, Inc.*, 2017 BL 143769, No. 15-3805, (3d Cir. May 1, 2017) (relator conceded that the regulators deemed the violations to be ''insubstantial''); *Abbott v. BP Exploration & Prod.*, 851 F.3d 384, 2017 BL 78754 (5th Cir. 2017) (finding that the Department of Interior's decision to allow drilling to continue even after a ''substantial investigation'' into the plaintiff's allegations was strong evidence that the requirements at issue were not material); *D'Agostino v. ev3, Inc.*, 845 F.3d 1, 2016 BL 429304 (1st Cir. 2016) (finding that the ''fact that CMS has not denied reimbursement for Onyx in wake of D'Agostino's allegations casts serious doubt on the materiality of the fraudulent representations that D'Agostino alleges''); *United States ex rel. McBride v. Halliburton Co.*, 848 F.3d 1027, 2017 BL 48645 (D.C. Cir. Feb. 17, 2017) (the Defense Contract Audit Agency investigated the relator's allegations without disallowing any charged costs, and the defendant continued to receive an award fee for exceptional performance even after the government learned of the allegations; per *Escobar*, this was ''very strong evidence'' that the requirements were not material); *United States ex rel. Kolchinsky v. Moody's Corp.*, 2017 BL 64605, No. 12-cv-1399 (S.D.N.Y. Mar. 2, 2017) (explaining that ''credible public reports of inaccuracies'' in the defendant's ratings led to inquiries by the government, but the government ''nonetheless continued to pay [the defendant] for its credit-ratings products each year'').

A defendant's success when arguing for dismissal because of continued payment appears to hinge on the government's actual knowledge of violations. *United States ex rel. Williams v. City of Brockton*, *supra*; *see also United States v. Public Warehousing Co.*, 2017 BL 82441, No. 1:05-cv-2968 (N.D. Ga. Mar. 16, 2017) (''[J]ust because one agency within the vast bureaucracy of the federal government has knowledge of a contractor's wrongdoing does not mean that the Defendants have a 'government knowledge' defense,'' and relator's complaint did not put the ''government'' on notice.); *United States v. Celgene Corp.*, 2016 BL 437201, No. 10-cv-03165-GHK (C.D. Cal. Dec. 28, 2016) (expert testimony that CMS continued to reimburse for medications since initiation of the case was insufficient to show that CMS knowingly paid claims for off-label usage because, even if CMS knew after the case was initiated, that incoming claims for the drugs ''included claims that failed to meet the medical acceptance requirement, it does not follow that CMS had actual knowledge that particular claims were noncompliant and reimbursed them anyway'').

c) Materiality May Be Indicated by Defendants' Behavior or Knowledge Independent of whether a defendant's allegedly fraudulent behavior signals its awareness of materiality, a defendant's knowledge regarding a certain requirement may establish materiality. *See United States v. Savannah River Nuclear Sols., LLC*, 2016 BL 405132, No. 1:16-cv-00825 (D.S.C. Dec. 6, 2016) (''[C]ommon sense suggests that the alleged unallowability of the challenged costs would influence the DOE's decision to pay them, and Defendants' alleged conduct in covering up the costs suggests that they would be material to the DOE.''). The court in *United States v. Luce*, 2016 BL 391783, No. 11-cv-05158 (N.D. Ill. Nov. 23, 2016), found that the defendant, ''as an attorney who had formerly worked at the SEC. . . had reason to know the government attaches importance to criminal history in determining its course of action.'' In *Luce*, the defendant founded a mortgage company that served as a loan correspondent for HUD; but, even though he had been indicted for violations unrelated to operations of the mortgage company, he continued to sign certain forms for the company, which included a false criminal history certification. The court noted that *Escobar* explained that ''materiality may be based on either objective or subjective knowledge of the importance attached to the representation by the recipient.''

d) The FCA May Not Be Appropriate for Addressing Quality of Care Standards The relator in *Planned Parenthood of the Heartland, Inc., supra,* claimed that the defendant failed to provide a comprehensive medical exam prior to prescribing certain medication. The court declined ''to extend the implied certification theory so far as to allow an FCA *qui tam* plaintiff to challenge a medical practice as subjective, personal, and individualized as the type of examination a woman should undergo before obtaining contraception.'' The court concluded that the ''purpose of the FCA is to combat fraud, not to impose quality of care standards in the medical field,'' and dismissed that portion of the relator's count based on a failure to provide a certain quality of care. Similarly, the court in *United States ex rel. George v. Fresenius Med. Care Holdings Inc.*, 2016 BL 316039, No. 2:12-cv-00877 (N.D. Ala. Sept. 26, 2016), held that not all deviations from medical treatment are ''material'' under *Escobar*. The court found that although Medicare does not ask providers to submit information on the duration of the dialysis treatments at issue, ''it is an inherent assumption underpinning the dialysis reimbursement scheme that a patient receives treatment of a sufficient duration so that the significant benefits of dialysis are realized.'' Even if treatment times are shortened, a claim must identify how the dialysis was incomplete; otherwise, a court cannot determine whether the reimbursements for such treatments omitted information that would have been material to the government's decision to pay.

What Constitutes Falsity—The Next Question for the Supreme Court?

One unsettled question is whether *Escobar* set forth two requirements for establishing implied certification liability. In *Escobar*, the Supreme Court held that ''implied certification theory can be a basis for liability, at least where two conditions are satisfied: first, the claim does not merely request payment, but also makes specific representations about the goods or services provided; and second, the defendant's failure to disclose noncompliance with material statutory, regulatory, or contractual requirements makes those representations misleading half-truths.'' 136 S. Ct. at 2001.

Many courts have treated these two conditions as a mandatory two-part requirement. *See, e.g., United States v. Crumb*, 2016 BL 274925, No. 15-0655 (S.D. Ala. Aug. 23, 2016) (finding that the complaint satisfied ''both prongs'' of the *Escobar* standard); *United States*

ex rel Doe v. Health First, Inc., 2016 BL 236651, No. 6:14-cv-501 (M.D. Fla. July 22, 2016) (noting that, in *Escobar*, the ''Supreme Court explained that two conditions must exist to impose liability'' under the implied certification theory).

Other courts have held that the two conditions are suggestions, not conditions. In *United States ex rel. Panarello v. Kaplan Early Learning Co.*, 2016 BL 380480, No. 11-cv-00353 (W.D.N.Y. Nov. 14, 2016), the court found that the defendant's invoices did not contain ''specific representations about the goods or services provided.'' However, the court agreed with both the relator and the government that *Escobar* ''cannot be read to impose the 'specific representations' requirement in every case.''

A court in the Northern District of California has certified the question to the Ninth Circuit ''[b]ecause of the uncertainty about this issue in the district courts'' and because ''clarity on the appropriate standard . . . would materially advance the resolution of this litigation.'' *Rose v. Stephens Inst.*, 2016 BL 360745, No. 09-cv-05966 (N.D. Cal. Oct. 28, 2016). The district court held that ''*Escobar* did not establish a rigid two-part test for falsity that must be met in in every single implied certification case.'' *Rose v. Stephens Inst.*, 2016 BL 309863, No. 09-cv-05966 (N.D. Cal. Sept. 20, 2016). The court noted that the Supreme Court's statement that FCA liability attaches '' 'at least where two conditions are satisfied' . . . must be read in context.'' It continued that the Supreme Court ''explicitly prefaced its holding by making clear'' that it did not need to resolve whether all claims for payment implicitly represent that the billing party is legally entitled to payment; the ''at least'' language indicated that it did not need to decide that question at that time because the particular claim in *Escobar* contained specific representations that were misleading half-truths.

A decision from the Central District of California appears to agree with the reasoning in *Rose*, disagreeing with a defendant's argument that the relator could not proceed on an implied certification theory because she could not satisfy the two conditions mentioned in *Escobar*. *United States v. Celgene Corp.*, *supra*. The court held that the defendant misread *Escobar*, which ''explicitly declined to 'resolve whether all claims for payment implicitly represent that the billing party is legally entitled to payment.' '' Moreover, the court noted, the two conditions were ''not intended to describe the outer reaches of FCA liability.'' Therefore, the court concluded, *Escobar* ''leaves undisturbed cases in this circuit and elsewhere holding that a claim is 'false' if it is statutorily ineligible for reimbursement.''

A decision from the U.S. District Court for the District of Columbia differed from *Rose*, holding that the D.C. Circuit had previously settled the question. The defendant in *United States ex rel. Landis v. Tailwind Sports Corp.*, 2017 BL 42444, No. 1:10-cv-00976, claimed that *Escobar* did not control the case because the defendant's invoices made no specific representations about the services provided and therefore failed ''to satisfy either of the two conditions for liability identified by the Supreme Court.'' The court disagreed, noting that ''the D.C. Circuit has spoken on the question the Supreme Court declined to resolve.'' The D.C. Circuit's 2010 decision in *United States v. SAIC*, 2010 BL 287300, held that ''a claim for payment need not include 'express contractual language specifically linking compliance to eligibility for payment.' Rather, all the government must show is 'that the contractor withheld information about its noncompliance with material contractual requirements.' '' The court denied the defendant's motion for summary judgment because the government offered evidence that the defendant ''withheld information about the team's doping and use of PEDs and that the anti-doping provisions of the sponsorship agreements were material to USPS's decision to continue the sponsorship and make payments under the agreements.''

Escobar Applied to State and Municipal Laws

As expected, other jurisdictions are adopting the analysis of *Escobar*. *See e.g., N.J. ex rel. Santiago v. Haig's Serv. Corp.*, 2016 BL 274959, No. 12-4797 (D.N.J. Aug. 24, 2016) (applying *Escobar* to the New Jersey False Claims Act, the court held that the relators ''failed to demonstrate a statutory or contractual requirement to submit certified payrolls with claims for payment, violating which would result in an implied false certification''); *City of Chicago v. Purdue Pharma L.P.*, 2016 BL 322789, No. 14-cv-4361 (N.D. Ill. Sept. 29, 2016) (applying *Escobar* to Chicago's False Statement Act and False Claims Act, the court agreed with the defendants who argued that the misrepresentations were not material as the plaintiff continued to pay the false claims); *Johnson v. District of Columbia*, 144 A.3d 1120, 2016 BL 259430 (D.C. 2016) (applying *Escobar* to the District of Columbia's False Claims Act, and finding that false records and statements ''knowingly intended to conceal the misallocation of funds'' were ''undoubtedly'' material).

Key Takeaways

Based on a year's worth of decisions, it appears that holistic analysis of three *Escobar* factors is a favored test for establishing materiality, but that the question of whether two conditions for implied certification must be satisfied remains unresolved. Courts are likely to dismiss claims when payments continue after actual knowledge of alleged fraud, but less likely to do so when conduct such as altered invoices is alleged. It seems clear that determining what is central to a regulatory program will require a case by case analysis. Finally, *Escobar* is likely to be applied in cases involving states and municipalities.

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