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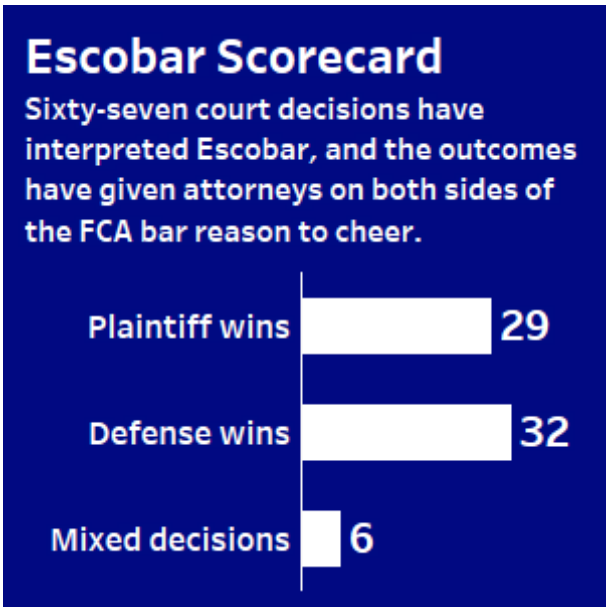
One Year Later, Escobar Is Roiling FCA Landscape

By **Jeff Overley**

Law360, New York (June 16, 2017, 4:06 PM EDT) -- It's been one year since the U.S. Supreme Court's Escobar decision rocked the world of False Claims Act litigation, forcing lawyers and judges to wrestle with an intricate new approach to fraud cases with very big bucks on the line. Here, Law360 surveys the biggest debates that are raging and the fights that are ahead.

Dead Heat on Decisions

At least 67 court rulings have interpreted Universal Health Services v. Escobar during the past year. Remarkably, whistleblowers and government contractors have each prevailed in about half the rulings.



The dead heat so far mostly validates **the original views** of how Escobar would affect FCA cases: Whistleblowers benefited from the Supreme Court's endorsement of the "implied certification" theory of fraud, and government contractors benefited from what the Supreme Court called a "demanding" standard for whether compliance failings are "material" under the FCA.

"It's like a Christmas tree where there's something for everybody," said Robert Rhoad, a partner at Sheppard Mullin Richter & Hampton LLP.

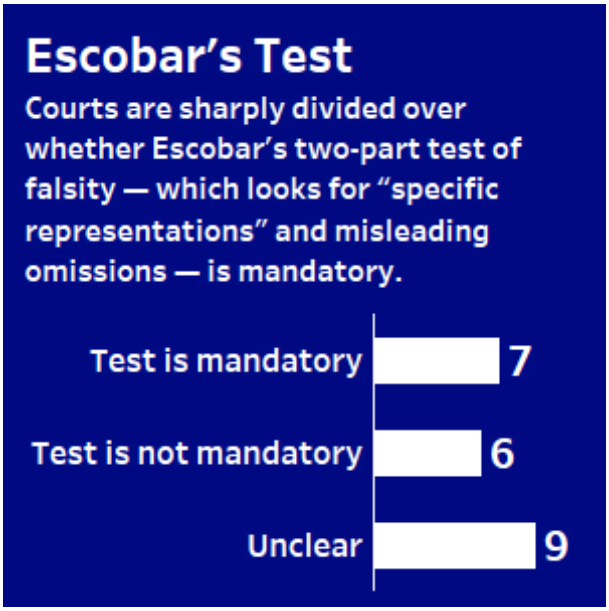
But whether things will stay balanced is hard to predict. Although many courts have weighed in, their rulings have often been incremental and fact-specific. And some questions that have divided the courts will eventually have to be resolved authoritatively in favor of one side or the other.

"There's only been a few circuit courts that have really looked at this closely. I think the district courts are scattered," Rhoad said. "I think what's most important on a forward-looking basis is to see what circuit courts do. … And I think we'll learn a lot more in the next year."

Test Splits Courts

Perhaps the most clear-cut disagreement about Escobar is whether its two-part test for falsity is mandatory. The test looks for "specific representations" about goods provided and for misleading omissions about adherence to regulations.

A Law360 analysis found that at least 22 courts have made some sort of statement about whether FCA suits must pass the test. Seven of the courts have found it mandatory, six have found it optional, and nine have issued ambiguous rulings.



Defense lawyers insist that Escobar's test is compulsory, arguing that implied certification cases would otherwise be unconstrained by any reasonable boundaries.

"There needs to be a two-part test because otherwise, if there doesn't have to be a representation that was false or misleading, I think then the analysis gets to never-never land," said Laurence Freedman of Mintz Levin Cohn Ferris Glovsky and Popeo PC.

But plaintiffs lawyers warn that the test, if always required, would let government contractors hide behind invoices that obviously billed for specific services but technically didn't say so.

"It's a kind of important issue because in a lot of modern contracting cases, you won't have those sorts of descriptions," said Harry Litman, of counsel at Constantine Cannon LLP. "You'll just have indecipherable numbers and 80 pages of bills."

All eyes are on a case called Rose v. Stephens Institute at the Ninth Circuit, which has agreed to decide **whether the test must be satisfied**.

Intervention Gains Meaning

An intriguing development in Escobar's aftermath is the willingness of some courts to gauge materiality by looking at whether the U.S. Department of Justice intervened in an FCA case. Although DOJ intervention decisions are often viewed as tacit commentary on a case's merits, some courts — and even the DOJ itself — have recently made the decisions an explicit factor.

For example, the Fourth Circuit in Badr v. Triple Canopy noted that the government "immediately intervened" in an FCA case, calling the move "evidence that Triple Canopy's falsehood affected the government's decision to pay." In addition, the Third Circuit in Petratos v. Genentech wrote that a failure to report safety data was perhaps unimportant because "the Department of Justice has taken no action against Genentech and declined to intervene in this suit."

Strikingly, the DOJ has hopped on the bandwagon as well. In an FCA suit against hospice chain Caris Healthcare LP, the government cited its own intervention as evidence of materiality, sparking **a backlash from Caris**.

"The degree to which the government strains to satisfy the demanding materiality requirement is particularly apparent when it alleges that its own intervention decision in this case makes the alleged noncompliance material," Caris wrote. "That the government would rely on this allegation in an effort to plead materiality is simply remarkable and undoubtedly not what the Supreme Court envisioned in Escobar."

Rhoad called the development "provocative" and summed it up this way: "The argument is that, 'Gee, government, if you knew all of the facts, you had the opportunity to investigate … and you chose not to proceed with the case. Isn't that evidence of materiality?'"

"I don't think it's ever going to be something that's black and white," Rhoad added. "But I certainly think that the nonintervention decision should be evidence or at least should be considered as part of that calculus."

'Holistic Approach' Rises

Thomas Zeno
Squire Patton Boggs

“They came up with this holistic idea of the three tests for materiality, and that seems to be catching on. That's going to be the way this is interpreted.

If one decision stands out in Escobar’s aftermath, it is probably how Escobar was **decided on remand** at the First Circuit. There, judges took a “holistic approach” to assessing whether violations were material to government reimbursement. Specifically, the First Circuit examined three questions: whether compliance was a condition of payment, whether compliance went to the “very essence of the bargain” and whether the government paid claims despite knowledge of noncompliance.

“My sense is that the remand back to the circuit court has sorted out a lot,” said Thomas Zeno, of counsel at Squire Patton Boggs LLP. “They came up with this holistic idea of the three tests for materiality, and that seems to be catching on. That's going to be the way this is interpreted."

At least six courts, including four outside the First Circuit, have explicitly applied the “holistic approach” in subsequent rulings, court records show.

Zeno described the holistic approach as a broad balancing test in which courts collect lots of evidence and then see which way it leans.

“They don’t say any one of the three factors is more important," he said. "They just say, ‘These are the things we're looking at, and then we'll weigh it out at the end.’”

Government Knowledge Is Key

Of the holistic approach’s three factors, the issue of government knowledge has perhaps received the most attention. According to Escobar, if the government keeps paying when aware of noncompliance, that is “very strong evidence” that noncompliance wasn’t material. Now, a key debate centers on whether the government may have good reasons for continuing to pay claims despite being aware of compliance miscues.

In one important ruling, a California federal judge preserved a suit accusing Celgene Corp. of illicit off-label promotion. The court first made clear that continued reimbursement doesn’t negate materiality, writing, “The fact that the government sometimes exercises its discretion to excuse noncompliance with a requirement does not establish that the requirement is immaterial as a matter of law.”

The court also said that the U.S. Food and Drug Administration’s general awareness of off-label uses does not mean that Medicare knew about specific billing claims for off-label uses; therefore, reimbursement for such claims doesn’t necessarily negate materiality.

Litman said that defenses premised on government knowledge will likely need to show that the specific government workers responsible for reimbursement had knowledge of wrongdoing but still didn’t deny payment.

"It's a big government there, and one side isn't necessarily going to shut down the other side," Litman said.

Constantine Cannon partner Mary Inman added that the government's continued reimbursement may be sensible even when compliance is lacking because denying payment might cut off essential goods or services.

"There can be many reasons why the government would continue to pay," Inman said.

Litigants are also sparring over whether mere allegations of wrongdoing — as opposed to concrete evidence — are sufficient to make the government aware of noncompliance. As one example, the First Circuit looked at allegations that a medical device maker committed fraud to win product approval. The court ruled that Medicare's failure to deny reimbursement for the device six years after a whistleblower alleged fraud "casts serious doubt on the materiality of the fraudulent representations."

Rick Morgan, a whistleblower lawyer at Morgan Verkamp LLC, said that defense lawyers have attempted to run wild with Escobar's language about government knowledge and that courts will hopefully hit the brakes.

"To me, it's been way overblown because my filing a complaint does not put the government on notice that fraud has occurred. It puts the government on notice of an allegation," Morgan said. "And I think that in early cases, the defense bar sought to turn that into much more than could be read into it. But it's still going to take some clarification."

Centrality Examined

Escobar also teed up debates about when compliance is "so central" to the goods or services provided that it is an essential factor in government reimbursement. It's a somewhat subjective standard on which courts have differed.

For example, in a decision granting partial summary judgment for the government, a D.C. federal judge ruled in U.S. v. Dynamic Visions that a "plan of care" document was a "central condition" to Medicaid reimbursement for a home health provider. By contrast, a Georgia federal judge ruled in S.E. Carpenters Regional Council v. Fulton County that alleged failures by construction companies to pay prevailing wages didn't go to the heart of the contract. The failures therefore weren't material.

Attorneys say that there doesn't appear to be any crystal-clear checklist so far for gauging centrality and that outcomes will likely be very fact-specific.

"Coming up with an objective standard there is difficult. It's a little bit like, you know it when you see it — that it's either central or it's not," Zeno said. "That's going to be in the judgment of the trial court or the appellate court or whoever gets it."

Lines Drawn

The Escobar opinion, which dealt with allegedly shoddy mental health care, ended by emphasizing that the FCA "is not a means of [punishing] insignificant regulatory or contractual violations. The opinion noted that "this case centers on allegations of fraud, not medical malpractice."

George H. King
Retired Federal Judge

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The fact that the government sometimes exercises its discretion to excuse noncompliance with a requirement does not establish that the requirement is immaterial.

Some courts have latched onto those closing remarks to reject FCA allegations involving subpar medical treatment. For example, an Alabama federal judge wrote in George v. Fresenius Medical Care that “not all deviations from medical treatment are material under Escobar.” Elsewhere, an Iowa federal judge in Thayer v. Planned Parenthood cited Escobar when writing that “the FCA is not the appropriate avenue of redress when a plaintiff merely disagrees with the course of medical treatment administered by a defendant.”

Defense attorneys are cheering those rulings, saying they prevent the implied certification theory from being wielded to nitpick every less than perfect instance of medical care.

“I would like to see courts really emphasize that implied false certification is not meant to be a

broad bucket for quality-of-care cases," Freedman said.

Zeno added, "Courts are going to be very careful to weigh in that a doctor's decision to do X versus Y is going to equal falsity, as opposed to just a difference of opinion about quality of care."

Materiality Changes Debated

Lawyers and judges are also split on whether Escobar merely clarified the FCA's materiality component or instead interpreted it in a new manner that holds plaintiffs to a higher standard.

The Third Circuit's Petratos ruling recognized a "heightened materiality standard" after Escobar. However, a Pennsylvania judge ruled in Oberg v. Pennsylvania Higher Education Assistance Agency that Escobar "certainly provided guidance" but that "this guidance did not constitute a departure from already existing law."

And the DOJ, in an amicus brief at the First Circuit, asserted that "the Supreme Court did not purport to impose a heightened test for materiality."

Congress in 2009 **codified the materiality standard** in the FCA and defined it more liberally than many courts had previously done, allowing it to cover anything "capable of influencing" government reimbursement. Rhoad suggested that Escobar reminded judges to ask hard questions about whether something is truly material, despite the FCA's seemingly low bar.

"In my view, what the court did is they basically reinjected back into the False Claims Act a materiality standard," Rhoad said.

But Morgan described things more modestly, arguing that Escobar simply laid out basic principles without ever criticizing the FCA's definition of materiality.

There is "nothing in it we view as a massive game-changer in terms of, 'Oh, my God, what used to be material no longer is,'" Morgan said.

--Additional reporting by Daniel Wilson. Editing by Christine Chun.
