

# Universal Health Services, Inc. v. Escobar

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## WHY IT MADE THE LIST

*Escobar*<sup>1</sup> made this year's list because it addressed the reach of one of the government's most powerful enforcement tools, the federal False Claims Act (FCA). The FCA imposes civil penalties and treble damages for knowingly presenting "false" claims for payment to federal government programs, including Medicare and Medicaid. Because the statute is not explicit about what constitutes a false claim, courts have long struggled to articulate the limits of liability under the FCA.

The Supreme Court granted certiorari in *Escobar* to resolve conflict in the lower courts about the implied false certification theory of FCA liability. According to that theory, a defendant violates the FCA if it submits a claim that implicitly certifies compliance with a statutory, regulatory, or contractual requirement that the defendant has failed to satisfy. In a unanimous decision, *Escobar* held that the implied false certification theory is a valid basis for FCA liability, at least in some circumstances, provided that the requirement at issue was material to the government's payment decision.

*Escobar*'s approval of the implied false certification theory was a victory for whistleblowers and the Department of Justice but not a complete one. The Supreme Court cautioned that the materiality requirement must be applied rigorously by the lower courts and may bar FCA claims even at the pleading stage.

Already, courts are wrestling with how to apply the standards that *Escobar* announced. The decision is sure to have a profound impact on implied false certification cases in 2017 and beyond.

## DISCUSSION

### *Background*

Julio Escobar and Carmen Correa were the parents of Yarushka Rivera, a teenager who received mental health care from Arbor Counseling Services through the Massachusetts Medicaid program. *Escobar*, 136 S. Ct. at 1997. Arbor is owned and operated by a subsidiary of Universal Health Services. After five years of intermittent

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<sup>1</sup> Universal Health Services, Inc. v. United States *ex rel.* Escobar, 136 S. Ct. 1989 (2016).

counseling, providers at Arbor diagnosed Rivera with bipolar disorder and prescribed medication for her treatment. She experienced an adverse reaction to the medication, suffered multiple seizures, and died. *Id.*

Soon after Rivera's death, her parents learned that many of Arbor's providers, including those who had diagnosed Rivera and prescribed her medication, were not licensed doctors and did not have the authority to counsel patients or write prescriptions. *Id.* They were also largely unsupervised despite state regulations detailing supervision requirements for unlicensed staff. *Id.* at 1198.

Rivera's parents filed a qui tam action against Universal Health Services based on an implied false certification theory. They alleged that Universal Health Services, acting through Arbor, submitted claims to Medicaid that were false because they included payment and provider codes that implicitly certified that Arbor's staff had qualifications they lacked. The complaint alleged that Medicaid would not have reimbursed the claims had it been aware that the providers were unlicensed, unqualified, and unsupervised staff members who were counseling patients and prescribing medication in violation of Medicaid regulations. *Id.* at 1997-98.

The district court dismissed the complaint. It construed First Circuit precedent as holding that a defendant can be liable under the FCA only for misrepresenting its compliance with an express condition of payment under the relevant government program. It held that Escobar failed to state a claim because the regulations that Arbor allegedly violated were conditions of participation in the state Medicaid program but not conditions of payment. *Id.*

The First Circuit reversed. It held that the submission of any claim implicitly certifies that the billing party complies with all relevant program requirements. It determined that a defendant can violate the FCA by falsely certifying compliance with a requirement that is not expressly designated as a condition of payment. Based on its interpretation of the state Medicaid regulations, the First Circuit held that compliance with the regulations was a condition of payment and could support the FCA claims alleged. *Id.*

### *The Circuit Split*

Just months after the First Circuit issued its decision in *Escobar*, the Seventh Circuit issued a decision that flatly rejected the First Circuit's view. In *United States v. Sanford Brown Ltd.*, the Seventh Circuit held that the FCA "is simply not the proper mechanism" to enforce compliance with statutes, regulations, or contractual provisions that may apply to participation in an agency's programs because the agency itself is in the best position to assess and adjudicate compliance. 788 F.3d 696, 712 (7th Cir. 2015). The Seventh Circuit's opinion not only conflicted with the First Circuit's decision in *Escobar* but also the views expressed by most other circuit courts.

Among the circuits that recognized implied false certification, there was disagreement about the scope of liability. The Second and Sixth circuits imposed liability only if the government expressly conditioned payment on the defendant's compliance with the requirement at issue. *Escobar*, 136 S.Ct. at 1998. But like the First Circuit, the Fourth Circuit and the D.C. Circuit were willing to extend liability beyond expressly designated conditions of payment. *Id.*

The Supreme Court granted certiorari in *Escobar* to clarify both the viability and the scope of the implied false certification theory of FCA liability.

### *The Supreme Court's Opinion*

The Supreme Court began by holding that, “at least in certain circumstances, the implied false certification theory can be a basis for liability” under the FCA. *Id.* at 1995. The Court reached its conclusion by determining that the FCA incorporates the common-law understanding of fraud, which encompasses misrepresentations by omissions and misleading half-truths. It explained that Arbor submitted claims that included codes corresponding with certain counseling services and job titles; those codes constituted specific representations that were misleading in context because they implied that the providers had qualifications they lacked. *Id.* at 1999-2000.

The Court declined to reach the broader question of whether every claim for payment implicitly represents compliance with legal requirements even absent a specific misrepresentation. It held that the implied false certification theory is viable “at least” in cases where two conditions are met: “[1] first, the claim does not merely request payment, but also makes specific representations about the goods or services provided; and [2] second, the defendant’s failure to disclose noncompliance with material statutory, regulatory, or contractual requirements make those representations misleading half-truths.” *Id.* at 2001.

The Court went on to hold that defendants can be liable under the FCA for failing to disclose their noncompliance with a legal requirement regardless of whether that requirement is an express condition of payment. But the FCA is not “an all-purpose antifraud statute or a vehicle for punishing garden-variety breaches of contract or regulatory violations.” *Id.* (quotation and citation omitted). The essential question is whether compliance is material to the government’s decision to pay the claim. *Id.* at 2001-02.

The materiality requirement is “rigorous” and “demanding,” the Court explained. *Id.* at 2002-03. Whether compliance is an express condition of payment is relevant to materiality but not dispositive. The government’s payment practices are also relevant. If the defendant knows that the government “consistently refuses” to pay claims based on noncompliance with a particular requirement, that is evidence of materiality. *Id.* at 2003-04. Conversely, if the government pays a claim knowing that the billing party is not complying with a particular requirement, or routinely pays a type of claim knowing that particular requirements have not been met, that is “very strong evidence” against materiality. *Id.*

With this guidance, the Court vacated the First Circuit’s opinion and remanded it for further consideration consistent with its holdings.

### **IMPACT OF THE CASE**

*Escobar* had an immediate impact in the lower courts. The decision ended debate about the viability of the implied false certification theory but sparked new debates that are likely to continue for years to come.

Courts are already struggling with whether the two conditions for liability articulated in *Escobar* are absolute and exclusive requirements for an implied false certification claim. Some courts have suggested that *Escobar* established a mandatory two-part test; the defendant must have (1) made a specific representation about the goods or services provided, and (2) failed to disclose noncompliance with material

requirements such that the representation was misleading.<sup>2</sup> Other courts have held that *Escobar*'s conditions are sufficient but not necessary to state a claim.<sup>3</sup> Recognizing the difficulty of the issue, a federal district court in California has certified the question to the Ninth Circuit for interlocutory consideration. *See* *Rose v. Stephens Institute*, No. 16-8-167 (9th Cir. Nov. 7, 2016). On the other side of the country, a magistrate judge in New York has recommended certification of the question to the Second Circuit. *United States ex rel. Panarello v. Kaplan Early Learning Co.*, No. 11-cv-00353 (W.D.N.Y. Nov. 14, 2016). Meanwhile, litigants face considerable uncertainty in implied false certification cases that do not satisfy *Escobar*'s conditions.

*Escobar* has also created uncertainty about how courts should weigh the government's payment practices in the materiality analysis. Evidence that the government paid claims despite actual knowledge of the defendant's non-compliance has proven important in several appellate cases affirming summary judgment for defendants in implied false certification decisions since *Escobar*.<sup>4</sup> For example, in *United States ex rel. McBride et al. v. Halliburton Co.*, 848 F.3d 1027 (D.C. Cir. 2017), the court affirmed summary judgment for defendants and explained that it could not "ignore what actually occurred" in that case, which was that the government had investigated the allegations against the defendant and continued to pay claims. *Id.* The court's analysis reflects that *Escobar* reinforced a strong defense based on government inaction in the face of actual knowledge of non-compliance.

That said, the First Circuit gave little attention to the government's payment practices when it considered *Escobar* on remand. The First Circuit focused instead on state regulations indicating that licensing and supervision requirements were conditions of payment. The court concluded that those regulations were "central[]" to the state's contractual relationships with providers. *United States ex rel. Escobar v. Universal Health Servs.*, 842 F.3d 103, 110 (1st Cir. Mass. 2016). Because it considered the regulations at issue essential to the regulatory framework, the court

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<sup>2</sup> *See, e.g.*, *United States v. Sanford-Brown, Ltd.*, 840 F.3d 445 (7th Cir. 2016) (affirming summary judgment for the defendant after concluding that neither of *Escobar*'s conditions were satisfied); *United States ex rel. Kelly v. Serco*, 846 F.3d 325 (9th Cir. 2016) (same); *United States ex rel. Tessler v. City of N.Y.*, 2016 U.S. Dist. LEXIS 174013, at \*12 (S.D.N.Y. Dec. 16, 2016) (concluding that relators "must show" that the alleged false claim makes specific representations); *United States ex rel. Handal v. Cent. for Empl. Training*, 2016 U.S. Dist. LEXIS 105158, at \*12 (E.D. Cal. Aug. 8, 2016) ("To establish implied false certification, a plaintiff must show [*Escobar*'s two conditions] . . ."); *United States ex rel. Doe v. Health First, Inc.*, 2016 U.S. Dist. LEXIS 95987, at \*8 (M.D. Fla. July 22, 2016) ("[*Escobar*'s] two conditions must exist to impose liability . . ."); *United States ex rel. Creighton v. Beauty Basics Inc.*, No. 2:13-CV-1989-VEH, 2016 U.S. Dist. LEXIS 83573, at \*9 (N.D. Ala. June 28, 2016) ("[T]he plaintiff must allege [*Escobar*'s two conditions].").

<sup>3</sup> *See, e.g.*, *United States ex rel. Panarello v. Kaplan Early Learning Co.*, No. 11-cv-00353, 2016 U.S. Dist. LEXIS 158193, at \*13 (W.D.N.Y. Nov. 14, 2016) ("The fact that *Escobar* clarified 'some' of the circumstances creating implied false certification liability suggests that compliance with the conditions it discussed is not necessarily a prerequisite to implied false certification liability in every case."); *Rose v. Stephens Institute*, 2016 U.S. Dist. LEXIS 128269, at \*13 (N.D. Cal. Sept. 20, 2016) ("[Defendant] is incorrect as a matter of law that *Escobar* established a rigid 'two-part test' for falsity that applies to every single implied false certification claim."); *United States ex rel. Landis v. Tailwind Sports Corp.*, 2017 U.S. Dist. LEXIS 19623, at \*\*36-37 (D.D.C. Feb. 3, 2017) (concluding that a request for payment can be the basis of an implied false certification claim even absent a specific misrepresentation).

<sup>4</sup> *See also* *United States ex rel. Searle v. DRS C3 & Aviation Co.*, No. 15-2442 (4th Cir. Feb. 23, 2017) (unpublished) (affirming summary judgment for defendants based in part on declarations from government officials that undercut allegations of materiality); *U.S. ex rel. Kelly v. Serco, Inc.*, 856 F.3d 325 (9th Cir. 2016) (affirming summary judgment for defendants based partly on evidence that the government knew of alleged violations and did not require the defendant to change its conduct).

held that the complaint alleged material misrepresentations. In so holding, the court gave little weight to the defendant’s argument that the misrepresentations could not have been material because the government continued to pay claims even after it became aware of non-compliance. In the First Circuit’s view, the allegations showed only that the government had notice of complaints against the defendant, not knowledge of actual non-compliance. *Id.* at 112.

The First Circuit’s decision on remand raises the question of how courts will evaluate implied false certification cases at the pleading stage. At a minimum, bare-bones allegations of materiality should not suffice. For example, in *United States ex rel. Dresser v. Qualium Corp.*, 2016 U.S. Dist. LEXIS 93248 (N.D. Cal. July 18, 2016), the court held that a complaint must not only allege that misrepresentations were material but also explain why. *Id.* at \*20. That said, courts have accepted allegations of materiality based on a requirement’s centrality to the regulatory framework rather than the government’s actual payment practices. *See, e.g.*, *United States v. Planned Parenthood of the Heartland, Inc.*, 2016 U.S. Dist. LEXIS 181100, at \*32 (S.D. Iowa, June 21, 2016) (citing *Escobar* and concluding that compliance with licensing and prescribing requirements was material largely because the requirements were at “the heart” of the prescription medication regulation).

Direct allegations that the government continued to pay claims after becoming aware of the defendant’s non-compliance may support dismissal at the pleading stage. For example, in *City of Chicago v. Purdue Pharma*, 2016 U.S. Dist. LEXIS 134752 (N.D. Ill. Sept. 29, 2016), the City of Chicago alleged that the pharmaceutical company defendants engaged in deceptive marketing practices that caused doctors to submit claims that were allegedly false because they represented that opioids were medically necessary to treat chronic pain. But the City further alleged that it “continues to pay the claims that would not be paid but for defendants’ illegal business practices.” *Id.* at \*52. Citing *Escobar*, the court held that the City’s allegation of continued payment was inconsistent with its assertion that the alleged misrepresentations were material.

Like *Dresser* and *City of Chicago*, many of the complaints dismissed based on *Escobar* were filed before the Supreme Court issued its decision. It seems likely that whistleblowers will learn from post-*Escobar* dismissals and soon become adept at alleging materiality with *Escobar*’s standards in mind.

Not surprisingly, the government has resisted the suggestion that payment of a claim despite actual knowledge of non-compliance indicates that an alleged misrepresentation is immaterial. The Department of Justice and U.S. Attorneys offices have expressed their views in many post-*Escobar* briefs and statements of interest. In general, they have argued that *Escobar* did not establish a heightened materiality standard; instead, determining materiality requires a multi-factor analysis; and although payment practices may be considered in the analysis, a decision to pay claims even with actual knowledge of non-compliance should not always undermine a finding of materiality.<sup>5</sup>

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<sup>5</sup> *See, e.g.*, Br. for the U.S. as Amicus Curiae Supporting Appellant, *United States ex rel. Escobar v. Universal Health Servs.*, No. 14-1423 (1st Cir. Aug. 22, 2016); Br. for the U.S. as Amicus Curiae Supporting Appellant, *United States ex rel. Miller v. Weston Educational d/b/a Heritage College*, No. 14-1760 (8th Cir. Sept. 14, 2016); Statement of Interest, *United States ex rel. Zayas v. AstraZeneca Biopharm, Inc.*, No. 14-cv-1718 (E.D.N.Y. Aug. 8, 2016); Statement of Interest, *United States ex rel., Herman v. Coloplast Corp.*, No. 11-cv-12131 (D. Mass. Aug. 19, 2016).

As courts and litigants wrestle with *Escobar*'s materiality standard, the decision's emphasis on the government's payment practices is bound to shape discovery strategy in implied false certification cases. The government may find it difficult to avoid having its agents testify in FCA cases because those who handle claims for payment may be the most qualified to speak to the government's practices. For example, in *United States ex rel. Ribik v. HC ManorCare, Inc.*, No. 09-cv-13 (E.D. Va. Feb. 3, 2017) a district court denied the Department of Justice's motion to quash subpoenas to Medicare Administrative Contractors because the court concluded that the defendant had the right to "explore whether the four contractors actually processed claims in the manner asserted as correct by the plaintiff." *Id.*

*Escobar*'s focus on actual payment practices could also subject drug and medical device manufacturers to more non-party subpoenas from those in their industries facing FCA claims based on implied false certification allegations. Defendants may increasingly take the position that they are entitled to obtain discovery from their competitors to establish that the government routinely pays claims despite non-compliance with particular requirements within their industries.

Another potentially significant question is what impact *Escobar* will have in cases involving allegations of off-label promotion. One such case is currently unfolding in a California federal court. *United States ex rel. Brown v. Celgene Corp.*,<sup>6</sup> involves allegations that Celgene violated the FCA by causing pharmacies to submit claims for medication prescribed off-label. 2016 U.S. Dist. LEXIS 180628 (C.D. Cal. 2016). The implied false certification theory is that claims for off-label uses of the drugs at issue were false because they were allegedly not reimbursable under Medicare. *Id.* at 10.

Relying in part on *Escobar*, Celgene moved for summary judgment. It argued that *Escobar* precluded liability because the allegedly false claims did not include specific representations; they were simply claims presented for payment. Celgene also offered robust evidence that the government knowingly reimburses off-label prescriptions; knowingly reimbursed off-label prescriptions for the particular drugs at issue; and continued to reimburse claims for off-label uses of those drugs after the case was filed. *Id.* at \*\*37-41.

The district court largely rejected Celgene's arguments based on *Escobar*. It concluded that *Escobar* did not foreclose the possibility that an implied false certification case could proceed absent specific representations. The court also concluded that even if the government reimbursed some claims knowing that they were for off-label uses, it did not necessarily pay particular claims at issue with actual knowledge as to those claims. *See id.* Celgene has since moved for reconsideration and certification of questions for interlocutory consideration; its motion was still pending when this article went to print.

*Celgene* is one of several post-*Escobar* cases worth watching for those in the drug and medical device industries. Because the Supreme Court's opinion raised as many questions as it answered, *Escobar* will have a significant impact on implied false certification cases in 2017 and beyond.

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<sup>6</sup> Sidley Austin is counsel to Celgene in this matter.