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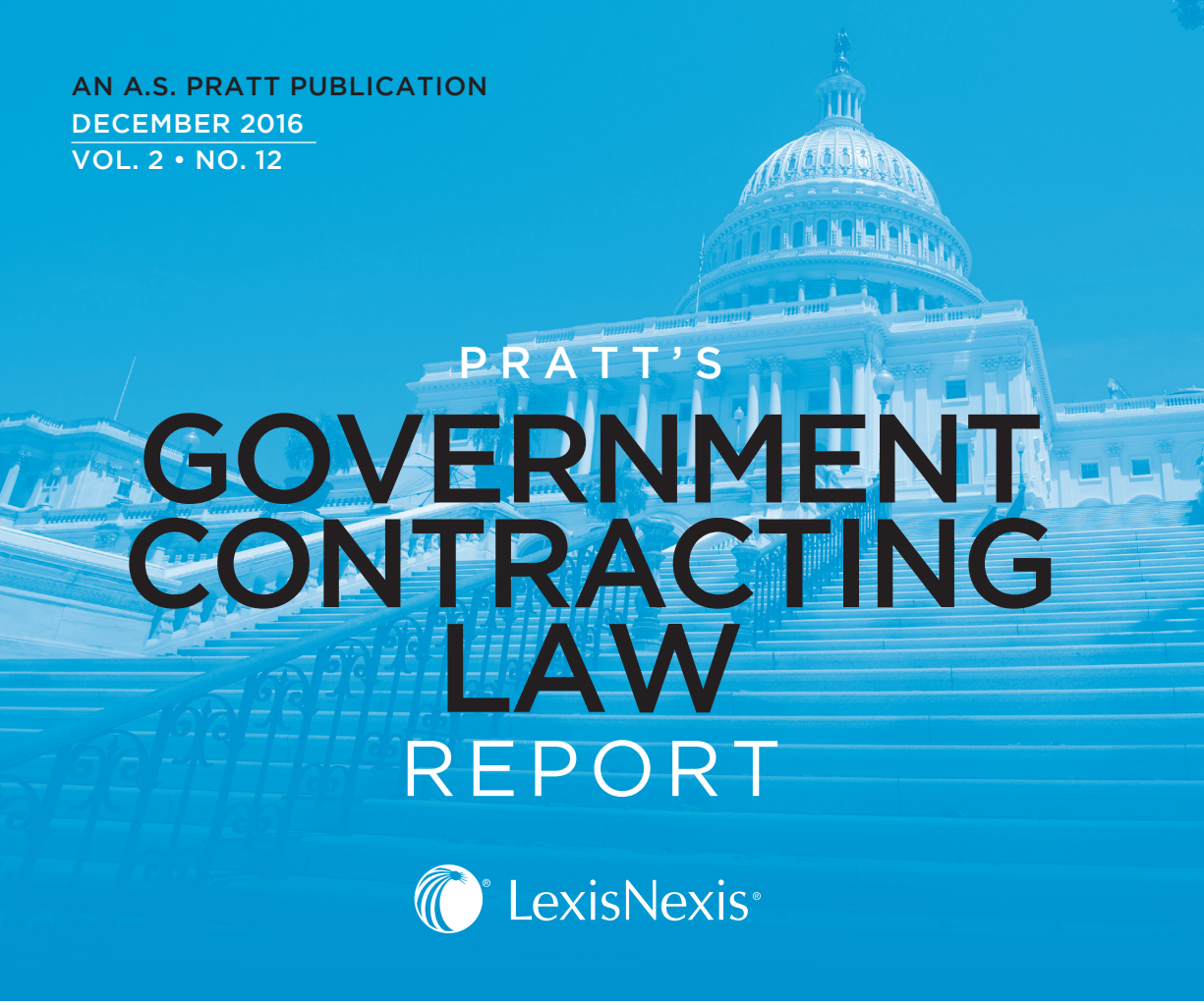

PRATT'S GOVERNMENT CONTRACTING LAW REPORT

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VOLUME 2 **NUMBER 12** **DECEMBER 2016**

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Recent Significant Case Law Developments Regarding What Constitutes a Reckless Interpretation of a Law and When Retention of an Overpayment Violates the False Claims Act

By Robert S. Salcido*

In this article, the author discusses two recent U.S. Court of Appeals for the Eighth Circuit False Claims Act decisions that validate important principles regarding the scope and proper application of the Act.

Among the most important False Claims Act ("FCA") issues to understand in discharging one's obligations to comply with the law is what, if anything, one must do when the underlying regulatory scheme governing payment from the government is ambiguous. For example, if the company simply adopts a reasonable interpretation of the law and seeks payment, will courts, under FCA precedent, find the company liable under the FCA if, upon review, the company's reasonable interpretation is wrong? Under these circumstances, will the company be deemed to have acted with "reckless disregard" in violation of the FCA if there is no official governmental guidance that would have warned the company away from its reasonable interpretation of law?

Another vexing issue is determining when a company has a duty to return an overpayment to the government under the FCA's recently amended reverse false claim provision. For example, does the provision reach merely negligent conduct such that, if a company *unreasonably* interprets an ambiguous law, but does not act fraudulently or recklessly, is the company liable under the FCA for "knowingly and improperly" "avoiding" or "concealing" an obligation to pay if it does not timely investigate and remit an overpayment?

Two recent U.S. Court of Appeals for the Eighth Circuit FCA decisions—*United States ex rel. Estate of Donegan v. Anesthesia Assocs. of Kan. City, PC*[1] and *United States ex rel. Olson v. Fairview Health Servs., of Minn.*[2]—expressly address

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[1] No. 15-2420, 2016 U.S. App. LEXIS 14830 (8th Cir. Aug. 12, 2016).

[2] No. 15-1780, 2016 U.S. App. LEXIS 14491 (8th Cir. Aug. 8, 2016).

these questions, finding that a defendant does not act with reckless disregard when it adopts a reasonable interpretation of an ambiguous law and there is no official governmental guidance that would warn the company away from its reasonable interpretation and that the FCA's reverse false claims provision requires that the defendant act fraudulently and not simply negligently when it makes a mistaken, erroneous construction of law to be held liable under the FCA's overpayment rule.

These decisions validate important principles regarding the scope and proper application of the FCA.

A REASONABLE INTERPRETATION OF LAW DOES NOT RESULT IN AN FCA VIOLATION WHEN THERE IS NO OFFICIAL GOVERNMENTAL GUIDANCE TO WARN DEFENDANT AWAY FROM THAT INTERPRETATION

Recent trending FCA case law demonstrates that courts, over the government's objection, have affirmatively found that the FCA plaintiff cannot satisfy the FCA's knowledge standard when the government or relator announces a novel interpretation of law in the course of FCA litigation for failing to adhere to an interpretation of a rule or regulation that has never been published.

One case that illustrates this principle is the district court's opinion in *United States ex rel. Estate of Donegan v. Anesthesia Assocs. of Kan. City, PC.*[3] Specifically, in *Donegan*, the governing regulation required that the anesthesiologist must personally participate in the most demanding aspects of the anesthesia plan, including, if applicable, emergence, to bill at a higher rate. The district court concluded that the regulation was ambiguous regarding when "emergence" occurs—that is, whether it occurs primarily in the operating room (the relator's position) or whether it extended to the recovery room (the defendant's position). Ultimately, the district court concluded that, because defendant's interpretation of an ambiguous regulation was reasonable and there was no official guidance to warn defendant away from its reasonable interpretation, the relator could not, as a matter of law, satisfy the FCA's scienter standard.

The relator then appealed, and the government, as it had in the district court, objected to the district court ruling, stating that the district court had inappropriately "adopted the sweeping rule that a defendant's reasonable interpretation of an ambiguous regulation precludes FCA liability, regardless of the defendant's state of mind."[4] The relator, as the government has in other

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[3] No. 12-0876, 2015 U.S. Dist. LEXIS 74239 (W.D. Mo. June 9, 2015).

[4] 2016 U.S. App. LEXIS 14830, at *10 (emphasis added).

litigation, also contended that a defendant is liable because a defendant, confronting an ambiguous law, has a duty to seek clarification from government employees or otherwise should be liable under the FCA for acting with reckless disregard of the law.

The Eighth Circuit rejected both positions. The court stated that the principle that a reasonable interpretation of an ambiguous rule precludes FCA scienter is not so "sweeping" simply because "if a Relator (or the United States) produces sufficient evidence of government guidance that 'warn[ed] a regulated defendant away from an otherwise reasonable interpretation,' " summary judgment would not be proper on the issue of FCA scienter.[5] In *Donegan*, however, the FCA plaintiff had failed to submit any relevant evidence that "the government had warned [the defendant] that the agency interpreted [the emergence regulation] differently" and thus, because there had not been sufficient "official government warning," there was not "sufficient evidence of reckless disregard."[6] Additionally, the Eighth Circuit, like the D.C. Circuit in *United States ex rel. Purcell v. MWI Corp.*,[7] specifically rejected the position that the government's failure to promulgate a clear rule or regulation thereby creates a duty on those doing business with the government to inquire into the government's true intent prior to submitting any claim for payment.[8]

Donegan marks the third straight FCA case in which the government has lost in asserting that defendants can be held liable in an FCA case notwithstanding the defendant's reasonable interpretation of an ambiguous rule and the fact that there is no official governmental guidance to warn the defendant away from its reasonable interpretation.[9] The government has been losing because its

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[5] *Id.* (citation omitted).

[6] *Id.* at *11.

[7] 807 F.3d 281 (D.C. Cir. 2015).

[8] *See Donegan*, 2016 U.S. App. LEXIS 14830, at *11 (noting plaintiff "argues that summary judgment was improper because [defendant] had a duty to ask [the Centers for Medicare & Medicaid Services ("CMS")] or its local contractors whether its interpretation of 'emergence' was proper. We disagree. As the agency had not clarified an obvious ambiguity in its Step Three regulations for decades, [defendant's] failure to obtain a legal opinion or prior [CMS] approval cannot support a finding of recklessness") (internal quotation and citation omitted); *see also Purcell*, 807 F.3d at 290 (finding that there was no guidance from the government that would provide the defendant with any "particular reason to formally inquire about" the legality of the commissions paid).

[9] Aside from this case, the D.C. Circuit in *Purcell* and the district court in *Donegan* had expressly rejected the government's position because the position results in an overly expansive interpretation of the FCA. *See Purcell*, 807 F.3d 281 (D.C. Cir. 2015); *Donegan*, 2015 U.S. Dist. LEXIS 74239, at *27–29.

viewpoint—that defendant should have correctly guessed what the government's official position would be if the government were to publish one or else make informal inquiries of government employees—is untenable.

First, the government's viewpoint that the defendant can act with reckless disregard notwithstanding its reasonable interpretation of law when there is no official guidance to warn the defendant away from its interpretation is illogical. If the defendant demonstrates that it, in fact, has a *reasonable* interpretation of law and there is no official guidance that would warn it away from that interpretation, then how could it have behaved recklessly, unless it is charged with the duty of being clairvoyant and actually having the duty to predict what official interpretation the government will promulgate at some future date that may be contrary to defendant's interpretation or be held potentially liable under the FCA? Indeed, this is precisely why the D.C. Circuit rejected the government's position in *Purcell*.[10] There, the defendant learned of the government's official interpretation of a rule only during the course of a "fraud" action—namely, when the government asserted it as part of its FCA action. According to the government, notwithstanding the fact that the defendant formulated a reasonable interpretation of law, it should have instead adhered to the government's unpublished and unknown interpretation that the government only announced at the time it filed its lawsuit.[11] Obviously, the court rejected that position.

Second, contrary to the government's assertion, the government's failure to write a clear rule should not thereby create a duty on the defendant to make informal inquiries of government employees to learn what the government's true intent is regarding the law. Any company that has followed this route can attest that, to the extent any informal answer can be obtained from the government's mid-level managers, the answers are, at times, not based upon evidence, idiosyncratic or simply wrong.[12] And requiring a business to engage in this practice of making informal inquiries—for fear of violating the FCA—does not result in "good" government, but bad government, because this practice is no substitute for notice and comment rulemaking that clearly defines defendants' duties so that they can operate their businesses within the confines of the law.

Finally, frequently in these cases, the government raises a policy argument

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[10] 807 F.3d at 289-90 (D.C. Cir. 2015).

[11] *Id.*

[12] Indeed, the *Olson* case discussed below perfectly illustrates this point. The defendant made multiple inquiries of the government, which resulted in it receiving conflicting guidance from various government employees, which ultimately resulted in FCA litigation.

that the court should find that, notwithstanding the defendant's reasonable interpretation of law and the lack of official governmental guidance, the defendant should potentially be held liable because, otherwise, the defendant will have an "incentive to violate the law" whenever there is an ambiguous law. The government's position is wrong because the government can always enforce the law. If the government believes that the defendant's reasonable interpretation is wrong, the government can always sue to enforce its rights, such as an action for payment by mistake of fact, or unjust enrichment or, if applicable, breach of contract. And, if the government is right and the defendant is wrong, the government should recover. All that is being stated in these cases, as the D.C. Circuit articulated best in *Purcell*, is that, if the government elects to promulgate a vague or general rule, then, under these circumstances, a fraud action under the FCA (with treble damages and substantial civil penalties) "may cease to be an available remedy."[13]

THE FCA'S OVERPAYMENT RULE DOES NOT APPLY TO NEGLIGENT CONDUCT

The government's guidance and court precedent have misconstrued the FCA's plain statutory language regarding what knowledge standard applies in determining whether there is an obligation to repay an overpayment. Both the Centers for Medicare & Medicaid Services ("CMS") and a district court indicated that one could be held liable under the FCA for merely being negligent in failing to report an overpayment.

Significantly, the Eighth Circuit, in *Olson*,[14] has set the record straight that the FCA overpayment obligation extends to only fraudulent, not negligent, conduct. Additionally, CMS has issued a Final Rule clarifying that its regulation does not purport, in any fashion, to interpret the FCA's intent standard, which has been "interpreted by a body of False Claims Act case law."[15] The Eighth

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[13] S*ee Purcell*, 807 F.3d at 291. Indeed, the court's decision is consistent with the principles that the U.S. Supreme Court enunciated in *Universal Health Services, Inc. v. United States ex rel. Escobar*, 136 S. Ct. 1989 (2016). There, the Court emphasized that the FCA is not a "vehicle for punishing garden-variety breaches of contract or regulatory violations." *Id*. at 2003. And, as the Court "emphasize[d]," the "False Claims Act is not a means of imposing treble damages and other penalties for insignificant regulatory or contractual violations." *Id*. at 2004. Here, if the plaintiff's interpretation had prevailed—and defendants are liable for treble damages and substantial civil penalties notwithstanding the defendant's reasonable interpretation of law where there is no authoritative contrary interpretation of the law—then the FCA would be applied to punish "garden-variety breaches of contract or regulatory violations."

[14] No. 15-1780, 2016 U.S. App. LEXIS 14491 (8th Cir. Aug. 8, 2016).

[15] 81 Fed. Reg. 7654 (Feb. 12, 2016).

Circuit's ruling in *Olson* and CMS's statement will help to ensure that the FCA's overpayment rule is confined to only those instances, consistent with congressional intent that a health care business "knowingly and improperly" (as oppose to negligently) retains an overpayment.

The Eighth Circuit's Decision in *Olson*

In *Olson*, the relator alleged that the defendant medical center falsely induced the state Department of Health and Human Services ("DHS") to over reimburse it for services provided to Medicaid patients. The relator worked for the DHS and claimed, that as part of his employment, he drafted a legislative amendment reducing Medicaid expenditures for hospital inpatient services by 10 percent.[16] But, the amendment excluded "children's hospitals" from the reimbursement reduction.[17]

The defendant medical center operated a children's unit that was not licensed as a children's hospital.[18] It believed that the children's unit should be considered a children's hospital, and, hence, the legislative rate reduction did not apply to the unit, and it lobbied state officials accordingly.[19] Although the relator, as the author of the legislation, opposed these efforts, contending that children units were not children hospitals, the state agency disagreed, retroactively exempted the unit and paid the defendant approximately $500,000 to compensate it for prior admissions that had applied the rate reduction.[20]

The relator disagreed with the exemption and persuaded the DHS Commissioner and Office of Inspector General to investigate.[21] The investigation ultimately resulted in the DHS concluding that the relator was correct that the exemption was erroneous and notifying the defendant that it would be issuing a notice of recovery once the overpayment was calculated.[22]

The relator's FCA action alleged that the defendant violated the FCA's reverse false claims provision by "knowingly conceal[ing] an obligation to pay back [Medicaid] monies to the federal and state government, that it knew it illegally received."[23] The relator contended that the legislative language was clear and

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[16] *See* 2016 U.S. App. LEXIS 14491 at *2–3.

[17] *Id.*

[18] *Id.* at *5.

[19] *Id.* at *5–7.

[20] *Id.* at *6–7.

[21] *Id.* at *7.

[22] *Id.* at *8.

[23] *Id.* at *19.

that the defendant knew that the rate reduction was intended to apply to its children's unit.[24] Moreover, the relator contended that the defendant's interpretation of the law was patently unreasonable because it applied the exemption, not just to children treated in the children's unit, but to all inpatients younger than the age of 18 treated elsewhere in the hospital (e.g., birth services to newborns and appendectomies for children, which the relator contended would normally not be provided at children's hospital).[25]

The Eighth Circuit rejected the relator's contention. The court noted that, under the 2009 FCA amendment, the relator must demonstrate that the defendant owed an "obligation," defined as "an established duty, whether or not fixed, arising from an express or implied contractual, grantor-guarantee, or licensor-licensee relationship, from a fee-based or similar relationship, from statute or regulation, or from the retention of any overpayment."[26] The court concluded that the relator failed to demonstrate that the defendant knew that it had an "obligation" to pay back the $500,000 payment that it received. At the time that the DHS issued the defendant's reimbursement, the defendant, according to the court, did not have an obligation to remit the reimbursement back to the government, but, instead, merely had a potential liability and not an established duty.[27]

Significantly, in reaching this conclusion, the court rejected the viewpoint that the FCA's overpayment provision, which does not, by its terms, require falsity or deception, can apply to non-fraudulent conduct. Specifically, the court noted that the absence of terms such as "false" or "fraudulent" is not dispositive of the nature of the conduct prohibited. The court reasoned that the provision in dispute—"knowingly concealing an obligation to pay money to the government"—included fraud because to "conceal is to fail to disclose," and the "*Restatement (Second) of Contracts § 160* treats concealment as equivalent to a misrepresentation."[28] The court also noted that its "understanding comports with the punitive nature of liability that the FCA imposes. Without fraud, punitive damages—a mandatory penalty of up to $10,000 for each claim and treble damages—would seem an unreasonable levy against individuals guilty of

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[24] *Id.* at *19.

[25] *See id.*, at *30 (dissenting opinion).

[26] *Id.* at *19–20 (citation omitted).

[27] The dissenting judge disagreed, asserting that, because the defendant's contention that the exemption from the 10 percent reduction applied to all children, and not just those in the children's unit, its interpretation of an ambiguous regulation was "patently unreasonable," and, hence, it "must have known it was getting overpaid." *Id.* at *30.

[28] *Id.* at *22.

only 'knowingly' receiving an overpayment from the government fisc."[29] Thus, if "there is no allegation of fraudulent conduct under the FCA, then there can be no reverse liability under § 3729(a)(1)(G)."[30]

CMS Overpayment Regulation

CMS had issued a proposed rule that, contrary to the FCA's plain language, appeared to apply the FCA merely to negligent conduct. For example, CMS noted that examples of when a business may fail to discharge its obligation to report an overpayment included "[w]hen *there is reason to suspect* an overpayment, but a provider or supplier fails to make *a reasonable inquiry* into whether an overpayment exists, it may be found to have acted in reckless disregard or deliberate ignorance of any overpayment."[31]

In CMS's final regulation, however, it specifically clarified that the agency had no such intent to address or interpret the application of the FCA's intent standard as courts have developed and applied the FCA's intent standard. Specifically, CMS stated:

> We note that in discussing the standard term "reasonable diligence" in the preamble, we are interpreting the obligation to "report and return the overpayment" that is contained in section 1128J(d) of the Social Security Act. We are not seeking to interpret the terms "knowing" and "knowingly", which are defined in the Civil False Claims Act and have been interpreted by a body of False Claims Act case law.[32]

Instead, CMS clarified that it only sought to elucidate the duty that creates an "obligation" under the FCA and not when one fails to "knowingly and improperly" conceal or avoid that obligation.

> Comment: . . . . Commenters suggested that a failure to report and return an identified overpayment should not lead to reverse FCA liability, unless the provider "knowingly concealed" or "knowingly and improperly avoided" the obligation. Other commenters stated that the proposed rule inappropriately applies the FCA, specifically the "reverse false claims" cause of action, to honest mistakes or inadvertent overpayments.

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[29] *Id.* at *23.

[30] *Id.* at *25.

[31] 77 Fed. Reg. 9179, 9182 (Feb. 16, 2012) (emphasis added). This formulation—on its face—conflates a negligence standard with a reckless disregard and a deliberate ignorance standard and treats each of these standards as if they were merely interchangeable, which is clearly contrary to law.

[32] 81 Fed. Reg. at 7661.

> Response: We are interpreting section 1128J(d) of the Act in this rulemaking, not the FCA. In this rule, our discussion of the FCA is limited to its explicit inclusion in the enforcement provision under section 1128J(d) of the Act, which states that any overpayment retained by a person after the deadline for reporting and returning the overpayment under this rule is an obligation for purposes of the FCA.[33]

Thus, although CMS purports to define what duty a business has to investigate an overpayment, which creates an "obligation" under the FCA, because it does not seek to define when a business is acting with unlawful intent, as set forth in the plain language of the FCA's overpayment regulation, CMS's rule does not ultimately determine whether the defendant breached the FCA. The FCA plaintiff will have to establish that evidence independent of CMS's rule. As a result, CMS's statement will help to ensure that the FCA's overpayment rule is confined to only those instances, consistent with congressional intent, that a health care business "knowingly and improperly" (as opposed to negligently) retains an overpayment.

CONCLUSION

The court's ruling in *Donegan* will help to ensure that businesses that seek to understand the complex maze of health care rules and regulations will not be held liable for their reasonable interpretations of law when there is no official governmental guidance to warn them away from that interpretation. The court's ruling in *Olson* will help to ensure that, when the law, and its potential scope, is ambiguous, a business will not be held to have unlawfully retained an overpayment if the government later disagrees with the business's interpretation of law.

Additionally, these Eighth Circuit cases confirm current FCA trending case law, including the Supreme Court's ruling in *Escobar*, that the FCA should not be applied in "garden-variety" regulatory or contractual disputes, but only when there is fraudulent conduct that warrants the imposition of treble damages and substantial civil penalties.

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[33] *Id.* at 7665.