

AN A.S. PRATT PUBLICATION
SEPTEMBER 2019
VOL. 5 • NO. 9

PRATT'S
**GOVERNMENT
CONTRACTING
LAW**
REPORT



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EDITOR'S NOTE: LESSONS

Victoria Prussen Spears

**THREE YEARS AFTER ESCOBAR: LESSONS
LEARNED REGARDING PLAINTIFFS'
EFFORTS TO NEUTRALIZE ESCOBAR
AND OPPORTUNITIES THIS PRACTICE
RAISES FOR DEFENDANTS**

Robert S. Salcido

**SUPREME COURT RULES THAT EXTENDED
10-YEAR FCA LIMITATIONS PROVISION
APPLIES TO QUI TAM RELATORS IN
NONINTERVENED CASES, LEAVES OTHER
QUESTIONS UNANSWERED**

Douglas W. Baruch, Jennifer M. Wollenberg,
John T. Boese, and Kayla Stachniak Kaplan

**FEDERAL CYBERSECURITY REGULATIONS
POSE NEW FCA RISK TO DEFENSE
CONTRACTORS**

Daniel P. Graham, Caroline Colpoys, and
Peter T. Thomas

IN THE COURTS

Steven A. Meyerowitz

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NUMBER 9

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Editor's Note: Lessons

Victoria Prussen Spears

275

Three Years After *Escobar*: Lessons Learned Regarding Plaintiffs' Efforts to Neutralize Escobar and Opportunities This Practice Raises for Defendants

Robert S. Salcido

277

Supreme Court Rules That Extended 10-Year FCA Limitations Provision Applies to *Qui Tam* Relators in Nonintervened Cases, Leaves Other Questions Unanswered

Douglas W. Baruch, Jennifer M. Wollenberg, John T. Boese, and Kayla Stachniak Kaplan

291

Federal Cybersecurity Regulations Pose New FCA Risk to Defense Contractors

Daniel P. Graham, Caroline Colpoys, and Peter T. Thomas

295

In the Courts

Steven A. Meyerowitz

298

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Library of Congress Card Number:

ISBN: 978-1-6328-2705-0 (print)

Cite this publication as:

[author name], [article title], [vol. no.] PRATT’S GOVERNMENT CONTRACTING LAW REPORT [page number] (LexisNexis A.S. Pratt).

Michelle E. Litteken, GAO Holds NASA Exceeded Its Discretion in Protest of FSS Task Order, 1 PRATT’S GOVERNMENT CONTRACTING LAW REPORT 30 (LexisNexis A.S. Pratt)

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Three Years After *Escobar*: Lessons Learned Regarding Plaintiffs' Efforts to Neutralize *Escobar* and Opportunities This Practice Raises for Defendants

By Robert S. Salcido*

This article contains a detailed discussion of Escobar and how it transformed, both doctrinally and conceptually, the False Claims Act ("FCA") and established the foundation for today's FCA litigation practices. Also discussed is the method plaintiffs have undertaken to combat Escobar defenses through the use of public records and government enforcement practices. Finally, addressed is the opportunity Escobar has provided defendants to persuade the government to dismiss meritless FCA actions.

Approximately three years ago, a unanimous U.S. Supreme Court decided *Universal Health Servs. v. United States ex rel. Escobar*.¹ It is arguably the most influential False Claims Act ("FCA") decision since Congress' 1986 FCA amendments.

In *Escobar*, the Court reset the FCA's trajectory. The Court transformed the FCA from a statute that was primarily invoked to police garden-variety regulatory and contractual disputes to a statute that can only be successfully invoked when a knowingly false statement has an actual impact, rather than a merely theoretical impact, on the government's determination to pay a claim.²

The Court effected this transformation by rejecting a strict objective materiality test to one that focuses on the government's actual conduct in

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¹ 136 S. Ct. 1989 (2016).

² Before *Escobar* courts distinguished between regulatory violations that were conditions of participation and conditions of payment to assess whether the defendant violated the FCA. See Robert Salcido, When a Violation of a Rule or Regulation Becomes an FCA Violation: Understanding the Distinction Between Conditions of Payment and Conditions of Participation, (Oct. 1, 2015) <https://www.akingump.com/images/content/3/8/v4/38183/When-a-Violation-of-a-Rule-or-Regulation-Becomes-an-FCA-Violatio.pdf>. Under this framework, the defendant's violation was a condition of payment if the government's rule merely stated that it was a condition of payment, notwithstanding the government's actual conduct. The Supreme Court, in *Escobar*, expressly rejected this approach.

determining to pay claims. To ensure that the FCA is maintained within its proper scope, the Court also pointed out that the FCA is not “an all-purpose antifraud statute” or a “vehicle for punishing garden-variety breaches of contract or regulatory violations.”³

Escobar had an immediate impact on FCA case law. One effect was that it played an important part in the reversal of \$1 billion worth of judgments in FCA lawsuits.⁴ Another effect is that *Escobar* resulted in the dismissal of several FCA cases where it was clear that the government either believed that the product or service it purchased complied with law or was aware of regulatory or contractual imperfections but nonetheless addressed the deficiency through remedies other than the denial of payment.⁵

³ *Id.* at 2003.

⁴ See *United States ex rel. Harman v. Trinity Indus., Inc.*, 872 F.3d 645 (5th Cir. 2017); *United States ex rel. Ruckh v. Salus Rehab, LLC*, 304 F. Supp. 3d 1258 (M.D. Fla. 2018). The firm represented the defendants in these two lawsuits where more than \$1 billion in judgments were collectively reversed.

⁵ *United States ex rel. Abbott v. BP Explorations & Prod.*, 851 F.3d 384, 387–88 (5th Cir. 2017) (noting *Escobar* “debunked the notion that a Governmental designation of compliance as a condition of payment by itself is sufficient to prove materiality” and finding that notwithstanding a government official’s testimony that platform would not be approved had defendant not certified its compliance with government regulations, materiality was not found because government report found no violation and found no grounds to suspend defendant’s operations); *United States ex rel. Kelly v. Serco, Inc.*, 846 F.3d 325, 333–34 (9th Cir. 2017) (under the “demanding standard required for materiality under the FCA, the government’s acceptance of [defendant’s] reports” and payment “despite their non-compliance” demonstrated that no reasonable jury could return a verdict for relator); *United States ex rel. D’Agostino v. EV3, Inc.*, 845 F.3d 1, 7 (1st Cir. 2016) (“[T]he FCA requires that the fraudulent misrepresentation be material to the government’s payment decision itself The fact that CMS has not denied reimbursement . . . in the wake of [relator’s] allegations casts serious doubt on the materiality of the fraudulent representations that [relator] alleges.”) (citing *Escobar*). Nor can a relator demonstrate materiality by showing that the government merely has the option to deny payment. See, e.g., *Coyne v. Amgen, Inc.*, 717 Fed. Appx. 26, 29 (2d Cir. 2017) (finding that relator could not state a cause of action when he relied upon a conclusory assertion that the alleged misrepresentation was material to the government’s determination to pay because it is not sufficient for a finding of materiality that the government would have the option to decline to pay if it knew of defendant’s noncompliance, but instead “the complaint must present concrete allegations from which the court may draw the reasonable inference that the misrepresentations . . . caused the Government to make the reimbursement decision”); *United States ex rel. McBride v. Halliburton Co.*, 848 F.3d 1027, 1033–34 (D.C. Cir. 2017) (rejecting the relator’s “far-too-attenuated supposition that the Government *might* have had the ‘option to decline to pay’” because it does not satisfy *Escobar*’s “rigorous” and “demanding” materiality standard). See also *United States ex rel. Harman v. Trinity Indus.*, 872 F.3d 645, 663 (5th Cir. 2017) (finding that “though not dispositive, continued payment by the federal government after it learns of the

But after these early dismissals, several noteworthy developments have occurred. One is that FCA plaintiffs have developed a counter-strategy to blunt the impact of *Escobar*. To neutralize *Escobar* plaintiffs have mined public records—e.g., government reports, Corporate Integrity Agreements (“CIAs”), settlement agreements, voluntary disclosures—to identify repayments that companies have submitted to the government to demonstrate that the defendant’s purported violation would affect the government’s payment determination.

Additionally, government agencies, now understanding that their payment practices will be evidence in future FCA actions, have seemingly become more aggressive in insisting upon repayment of claims rather than imposing a lesser sanction.⁶ This is detrimental for industry because not only is it more frequently asked to remit purported overpayments, but when it does remit payments, at nuisance value, for trivial violations of rules or contracts, the government and relators use such repayment as evidence that everyone in industry “knew” that such violations are indeed material to the government’s payment determination in subsequent FCA actions.

Another development stemming from *Escobar*’s focus on the government’s actual conduct which has been beneficial to industry is that the government, being burdened by the real costs associated with inquiries into its payment practices during FCA litigation, has become more receptive to moving to dismiss relators’ meritless actions. To provide a framework identifying lawsuits particularly ripe for dismissal, the Department of Justice (“DOJ”) has issued the Granston Memorandum identifying several factors it will take into account when evaluating whether to seek the dismissal of a *qui tam* action.⁷

Set forth below is a detailed discussion of *Escobar* and how it transformed, both doctrinally and conceptually, the FCA and established the foundation for today’s FCA litigation practices. Also discussed is the method plaintiffs have undertaken to combat *Escobar* defenses through the use of public records and government enforcement practices. Finally, addressed is the opportunity *Escobar* has provided defendants to persuade the government to dismiss meritless FCA actions.

alleged fraud substantially increases the burden on the relator in establishing materiality”).

⁶ The stakes are high for the government in light of *Escobar*. If the government does not recover payment and imposes some lesser sanction, it will have difficulty prevailing in any subsequent FCA action alleging the same type of misconduct.

⁷ Memorandum from Michael D. Granston, Dir., Commercial Litig. Branch, Fraud Section to Attorneys, Commercial Litig. Branch, Fraud Section at 5 (Jan. 10, 2018) (hereinafter “DOJ Granston Memorandum.”) For a description of the Granston Memorandum, see <https://www.akingump.com/en/news-insights/department-of-justice-memorandum-provides-guidance-for.html>.

ESCOBAR TRANSFORMED FCA JURISPRUDENCE

Escobar was transformative in a couple of significant respects. First, before *Escobar* several courts applied a strict objective materiality test and ruled that the actual behavior of government employees was not relevant to the materiality analysis.⁸ Moreover a number of courts ruled that a government's representation

⁸ See, e.g., *United States ex rel. Feldman v. Van Gorp*, 697 F.3d 78, 95–96 (2d Cir. 2012) (concluding “that the test of materiality in the case before us is objective—asking what would have influenced the judgment of a reasonable reviewing official—rather than subjective—asking whether it influenced the judgment of a reviewer of a proposal in the case at hand” and noting that to “decide otherwise—that materiality must be established in each case based on the testimony of a decisionmaker—would subvert the remedial purpose of the FCA. The resolution of each case would depend on whether such a decision maker could be identified and located, and whether that particular person would have treated the claims as material, regardless of whether they were one of several individuals charged with evaluating the claims at issue”); *United States ex rel. Harrison v. Westinghouse Savannah River Co.*, 352 F.3d 908, 916–17 (4th Cir. 2003) (“[c]ourts give effect to the FCA by holding a party liable if the false statement it makes in an attempt to obtain government funding has a natural tendency to influence or is capable of influencing the government’s funding decision, not whether it actually influenced the government not to pay a particular claim.”) (citation omitted); *United States ex rel. Anti-Discrimination Ctr. of Metro New York v. Westchester Cnty.*, 06 Civ. 2860, 2009 U.S. Dist. LEXIS 14399 at *62 (S.D.N.Y. Feb. 24, 2009) (rejecting defendant’s contention that because agency had reviewed its submissions and continued funding that its submissions could not be “material” to payment because “an individual government employee’s decision to approve or continue such funding, even with full access to all relevant information or knowledge of the falsity of the applicants certification does not demonstrate that the falsity was not material. After all, the FCA is intended to police the integrity of those claims submitted to the government for payment, and the materiality of statements made in those claims is tested as of the time of submission to the government and in the context of the regulatory requirements. Thus, the assertion that certain HUD bureaucrats reviewed the [defendant’s] submissions and continued to grant the [defendant] funding cannot somehow make the false . . . certification immaterial, where the funding was explicitly conditioned on certifications”) (footnote omitted); *United States v. President and Fellows of Harvard Coll.*, 323 F. Supp. 2d 151, 186 (D. Mass. 2004) (finding that the government’s burden to establish materiality is that the false statement has a natural tendency to influence agency action or is capable of influencing agency action and that “[e]vidence of the government’s actual conduct is less useful for FCA purposes than evidence of the government’s legal rights. I decline to adopt rules of law that would enable the government to determine materiality by its reaction to either a violation of the [regulations], or a failure to submit properly signed financial forms. Materiality must turn on how [the government] was authorized to respond to such failures, or else violation of identical provisions in separate case could have different materiality results based on the predilections of particular program or accounting staff”).

The Supreme Court, in *Escobar*, appropriately rejected the position these courts articulated. The rejection was appropriate because the actual conduct of the government’s expert agency administrators in determining whether violations of their rules should be remedied by an overpayment or some lesser sanction is far superior in assessing the actual materiality of a claim

that compliance with a rule or regulation was a condition of payment was dispositive of materiality notwithstanding the government's actual behavior.⁹

Escobar reversed this vast body of FCA case law. First, it ruled that the actual behavior of the government can, and should, be reviewed because “materiality look[s] to the effect on the likely or actual behavior of the recipient of the alleged misrepresentation.”¹⁰ To translate this principle into practice, the Court examined two scenarios. One is when the government pays a particular claim in full despite its actual knowledge that certain requirements were violated. The

than the assessment of a trial court judge who is otherwise unfamiliar with the operational needs and practices of the government program.

⁹ *United States ex rel. Escobar v. Universal Health Servs., Inc.*, 780 F.3d 504, 514 (1st Cir. 2015) (finding that compliance with rules governing adequate supervision was a condition of payment because the regulations explicitly condition reimbursement on the supervision and the condition of payment was “material” because there was “repeated references to supervision throughout the regulatory scheme”), *vacated and remanded*, 136 S. Ct. 1989 (2016); *Mikes v. Straus*, 274 F.3d 687, 697 (2d Cir. 2001) (finding that where plaintiff did not submit a factually false claim or submit an expressly false certification, that liability would only attach where “the underlying statute or regulation upon which the plaintiff relies expressly states the provider must comply in order to be paid”) (*abrogated by Universal Health Servs., Inc. v. United States ex rel. Escobar*, 136 S. Ct. 1989 (2016)); *United States ex rel. Acad. Health Ctr. v. Hyperion Found., Inc.*, No. 3:10-CV-552, 2014 U.S. Dist. LEXIS 93185, at *116-19 (S.D. Miss. July 9, 2014) (finding that failure to disclose that a person with a control interest of an entity participating in federal health care program is excluded is a condition of payment citing regulation that provides “No payment will be made by Medicare, Medicaid or any of the other Federal health care programs for any item or service furnished, on or after the effective date of the notice period, by an excluded individual or entity or at the medical direction . . . of a physician or other authorized individual who is excluded when the person furnishing such item or service knew or had reason to know of the exclusion”) (citation omitted); *United States ex rel. Kappenman v. Compassionate Care Hospice of the Midwest, L.L.C.*, No. 09-4039, 2012 U.S. Dist. LEXIS 23020 at *13-14 (D.S.D. Feb. 23, 2012) (“The Medicare statute specifically requires that ‘no payment may be made under part A or part B of this subchapter for any expenses incurred for items or services in the case of hospice care, which are not reasonable and necessary for the palliation or management of terminal illness This section is an express condition of payment that links ‘each Medicare payment to the requirement that the particular item or service be ‘reasonable and necessary’ ”) (Citations omitted.); *United States ex rel. Spay v. CVS Caremark Corp.*, 09-4672, 2012 U.S. Dist. LEXIS 180602, at *53, *61 (E.D. Pa. Dec. 20, 2012) (finding that where regulation makes pharmacy benefit manager certify to the accuracy, completeness, and truthfulness of data and “acknowledge that the claims data will be used for the purposes of obtaining Federal reimbursement,” the certification operated as a “condition of payment”).

¹⁰ 136 S. Ct. at 2002 (alterations, internal quotation marks, and citation omitted); *see also United States ex rel. Bishop v. Wells Fargo & Co.*, 870 F.3d 104, 107 (2d Cir. 2017). For example, materiality can include “evidence that the defendant knows that the Government consistently refuses to pay claims in the mine run of cases based on noncompliance with the particular statutory, regulatory, or contractual requirement.” 136 S. Ct. at 2003.

Court concluded that when this occurs that the government's payment "is very strong evidence that these requirements are not material."¹¹ A second is when the government generally, as a matter of course, in administration of the government's program or contract, pays a particular *type* of claim despite its knowledge that certain requirements were violated, and has signaled no change in position, the government's conduct under these circumstances "is strong evidence that the requirements are not material."¹² Moreover, the Court, on two separate occasions, to ensure that its mandate is clear that it is the government's actual behavior that matters, rejected the government's position regarding materiality that materiality can be established if the government merely would have the option to decline to pay if it knew of the defendant's noncompliance.¹³

Additionally, the Court specifically rejected the government's contention that it could, by a swipe of the pin, designate compliance with a rule as material by characterizing it as a condition of payment, by pointing out that a "misrepresentation cannot be deemed material merely because the Government designates compliance with a particular statutory, regulatory, or contractual require-

¹¹ 136 S. Ct. at 2003–04 (if "the Government pays a particular claim in full despite its actual knowledge that certain requirements were violated, that is very strong evidence that these requirements are not material"). Of course, this situation would arise in many *qui tam* actions post-filing because the relator must produce "substantially all material evidence and information the person possesses" at the time of filing the action. See 31 U.S.C. § 3730(b)(2). Thus, if the government pays actual claims at this point, that "is very strong evidence" that the alleged breach is not material.

¹² 136 S. Ct. at 2003–04 (if "the Government regularly pays a particular type of claim in full despite actual knowledge that certain requirements were violated, and has signaled no change in position, that is strong evidence that the requirements are not material.").

¹³ *Id.* at 2004 ("These rules lead us to disagree with the Government's and First Circuit's view of materiality: that any statutory, regulatory, or contractual violation is material so long as the defendant knows that the Government would be entitled to refuse payment were it aware of the violation"); *id.* at 2003 ("Nor is it sufficient for a finding of materiality that the Government would have the option to decline to pay if it knew of the defendant's noncompliance"). The Escobar Court rejected the government's position that "any statutory, regulatory, or contractual violation is material so long as the defendant knows that the Government would be entitled to refuse payment were it aware of the violation." *Id.* at 2004. The Court explained 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." *Id.* at 1996. That is because, if the "Government required contractors to aver their compliance with the entire U.S. Code and Code of Federal Regulations, then under this view, failing to mention noncompliance with any of those requirements would always be material," but the "False Claims Act does not adopt such an extraordinarily expansive view of liability." *Id.* at 2004.

ment as a condition of payment.”¹⁴ Indeed, to make this point unmistakable, the court referenced, in its relatively short opinion, on four separate occasions that the designation of compliance as a condition of payment does not establish FCA materiality.¹⁵ The Court’s emphasis on this point was likely driven by its recognition that otherwise the “Government might respond by designating every legal requirement an express condition of payment.”¹⁶

Escobar not only eradicated doctrines that resulted in an overly expansive FCA interpretation—that is, rejecting a purely objective materiality test (without assessing the government’s actual conduct) and the government’s ability to designate a breach of a rule or contract as a condition of payment, and hence material (again without assessing the government’s actual conduct)—but also the conceptual underpinnings of those doctrines. For example, before *Escobar*, lower courts frequently cited to *United States v. Neifert-White Co.*’s statement that the FCA reaches “all fraudulent attempts to cause the Government to pay out sums of money” as the Supreme Court’s endorsement of a broad construction of the FCA.¹⁷

In *Escobar*, the Court carefully described the FCA’s limited scope and that it is not to have an expansive, but a restrictive, application. First, reaffirming its prior ruling in *Allison Engine Co. v. United States ex rel. Sanders*,¹⁸ that Court proclaimed that the FCA is not “an all-purpose antifraud statute.”¹⁹ The Court apparently believed it necessary to remind lower courts and the public that general allegations of a fraudulent scheme is insufficient unless the plaintiff can actually link that alleged conduct to specific claims that are presented to the government for payment and it is only that linkage that establishes FCA liability.²⁰

¹⁴ 136 S. Ct. at 2003.

¹⁵ See *id.* at 1996 (“What 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”); *id.* at 2001 (“Whether a provision is labeled a condition of payment is relevant to but not dispositive of the materiality inquiry”); *id.* (“But, as discussed below . . . , statutory, regulatory, and contractual requirements are not automatically material, even if they are labeled conditions of payment”); *id.* at 2003 (“A misrepresentation cannot be deemed material merely because the Government designates compliance with a particular statutory, regulatory, or contractual requirement as a condition of payment”).

¹⁶ *Id.* at 2002.

¹⁷ 390 U.S. 228, 233 (1968).

¹⁸ 553 U.S. 662 (2008).

¹⁹ 136 S. Ct. at 2003.

²⁰ Of course, if the FCA were merely a general antifraud statute, there would be no

Second, the Court declared that the FCA is not a “vehicle for punishing garden-variety breaches of contract or regulatory violations.”²¹ The Court apparently believed it necessary to remind courts and the public that the FCA does not apply regarding ambiguous contractual or regulatory provisions where reasonable persons may disagree or to contractual or regulatory breaches that are immaterial to any rational determination to pay. Indeed, to ensure that no one could mistake its meaning, the Court “(e)mphasize[d]” on two other occasions that “the False Claims Act is not a means of imposing treble damages and other penalties for insignificant regulatory or contractual violations.”²²

Third, the Court, in *Escobar* underscored the “rigorous” nature of the FCA materiality element and to ensure no mistake was made as to its intent that lower courts apply a “rigorous” and “demanding” standard in light of prior lower court rulings, the Court used the word “rigorous” or “demanding” in its opinion to describe the FCA’s materiality element on four separate occasions.²³

Fourth, the Court, repeating its conclusion in *Vermont Agency of Natural Resources v. Unites ex rel. Stevens*,²⁴ pointed out that FCA liability—treble damages and civil penalties—is “essentially punitive in nature.”²⁵ Courts historically have emphasized the FCA penal effects to limit FCA liability.²⁶

requirement to link the purported fraud to specific claims. Instead, rather than creating a general antifraud statute, Congress elected to specify in the FCA, seven separate categories of wrongdoing where false statements or fraudulent conduct must be linked to specific “claims” or “obligations” (defined terms in the FCA) related to governmental funds or property. See 31 U.S.C. § 3729(a)(1)(A)-(G).

²¹ 136 S. Ct. at 2003.

²² See 136 S. Ct. at 2004 (“We emphasize . . . that the False Claims Act is not a means of imposing treble damages and other penalties for *insignificant regulatory or contractual violations*”) (emphasis supplied); *id.* at 2003 (“Materiality, in addition, *cannot be found where noncompliance is minor or insubstantial*”) (emphasis supplied).

²³ *Id.* at 1996 (“We clarify below how that *rigorous* materiality requirement should be enforced”) (emphasis supplied); *id.* at 2002 (“Those requirements [the FCA’s materiality and scienter requirements] are *rigorous*”) (emphasis supplied); *id.* at 2003 (“The materiality standard is *demanding*”) (emphasis supplied); *Id.* at 2004, n. 6 (“The standard for materiality that we have outlined is a familiar and *rigorous* one”) (emphasis supplied).

²⁴ 529 U.S. 765, 784 (2000).

²⁵ 136 S. Ct. at 1996.

²⁶ The Court’s pronouncement regarding the punitive aspects of the FCA’s damage provision will likely influence how other issues under the FCA are decided including how broadly FCA liability should apply. See, e.g., *United States ex rel. Weinberger v. Equifax*, 557 F.2d 456, 460 (5th Cir. 1977) (“The penal nature of the statute requires careful scrutiny to see if the alleged misconduct violates the statute”); *United States ex rel. Pogue v. Am. Healthcorp, Inc.*, 914 F. Supp. 1507, 1511 (M.D. Tenn. 1996)(Because of possible penal application of statute, “a number of

PLAINTIFF'S EFFORTS TO COMBAT *ESCOBAR* DEFENSES

Given the fact, as the Supreme Court announced in *Escobar*, that the FCA looks to what the government actually does, courts have rejected FCA actions when the evidence reveals that the government does not typically reject payment on the defendants' claims based upon the alleged infraction. Thus, where the defendant can show that the government has reviewed the same subject matter either directly, as to the defendant's own practices, or indirectly, such as reviewing the practices of others as reflected in Government Accountability Office ("GAO"), Office of Inspector General ("OIG") or agency reports, the defendant can prevail.

But what has also developed, post-*Escobar*, is that relators have persuaded some courts that the opposite should also be true—that is, if public records show that defendants typically remit overpayments to the government, they contend that evidence is sufficient to raise a triable issue of fact that the alleged infraction is, indeed, material to the government's payment decision.

As recent cases reflect, courts have found that repayments reflected in GAO reports, CIAs, voluntary disclosures and the government's prior enforcement practices against other entities as probative evidence that the alleged infraction the defendant committed was material in subsequent FCA lawsuits:

- In *United States ex rel. Rose v. Stephens Inst.*, the Court found that because GAO reports revealed that the government at times recouped

courts have denied application of the False Claims Act in particular situations, although a claimant has engaged in fraudulent conduct"). Additionally, one district court declined to apply the general rule regarding vicarious liability because it ruled that the FCA was being applied in a punitive fashion. See *United States v. S. Md. Home Health Servs.*, 95 F. Supp. 2d 465 (D. Md. 2000). Finally, the court's pronouncement could influence whether the relator's *qui tam* action survives after the relator's death. See, e.g., *United States ex rel. Harrington v. Sisters of Providence*, 209 F. Supp. 2d 1085 (D. Ore. 2002) (dismissing relator's action after his death because penal actions do not survive a party's death and the relator did not allege that he suffered substantial harm such that his recovery would be remedial rather than penal). See generally *Ruckh*, 304 F. Supp. at 1263 (noting that *Escobar* underscores the rigorous application of the FCA materiality and scienter requirements "by acknowledging the 'essentially punitive' effects of the False Claims Act's remedial mechanism: treble damages plus civil penalties 'of up to \$10,000 per false claim.' 136 S. Ct. at 1996. Treble damages plus \$11,000 (after adjusting for inflation) per false claim is not a remedy lawfully imposed on a supplier who delivers substantially compliant goods or services that are received and accepted by a government with knowledge of, or with indifference toward, some immaterial, formalistic, or technical non-compliance. At an irreducible and necessary minimum, the 'essentially punitive' False Claims Act requires proof that a vendor committed some non-compliance that resulted in a material deviation in the value received and requires proof that the deviation would materially and adversely affect the buyer's willingness to pay.").

“many millions of dollars” from schools that engaged in the same type of misconduct the relator alleged, “a reasonable trier of fact could find that Defendant’s violations of the incentive compensation bar were material.”²⁷

- In *United States ex rel. Emanuele v. Medicor Assocs.*, the Court ruled that the Stark law in writing requirement is not “minor or insubstantial” and compliance with the in writing requirement goes to the very “essence of the bargain” and hence is material under *Escobar* and noted that in “the absence of any evidence to the contrary,” a factor weighing slightly in favor of materiality was that the relator “pointed to public records suggesting that health care providers have paid penalties after self-reporting similar violations on at least nine occasions since 2009.”²⁸
- In *United States v. Teva Pharms. USA, Inc.*, the Court found that a reasonable jury could find that alleged Anti-Kickback Statute (“AKS”) violations regarding defendant’s payment to physicians to speak at programs were material because the government has pursued FCA cases against pharmaceutical companies on the basis of AKS violations arising in connection with their speaker programs (as revealed in several CIAs other companies executed) and the government has criminally prosecuted pharmaceutical companies for AKS violations.²⁹
- In *United States ex rel. Lemon v. Nurses To Go, Inc.*, the Court found that relators raised a reasonable inference that the government would deny payment if it knew about defendants’ alleged violations regarding hospice certifications when “[r]elators alleged that the U.S. Department of Health and Human Service’s Office of Inspector General has taken criminal and civil enforcement actions against other hospice providers that submitted bills for ineligible services or patients, including situations where the provider failed to conduct appropriate certifications.”³⁰

The use of repayments in this fashion place defendants in a bind. Frequently defendants will settle at nuisance value or resolve particular payment disputes

²⁷ 909 F.3d 1012, 1021–22 (9th Cir. 2018).

²⁸ 242 F. Supp. 3d 409, 431–32 (W.D. Pa., 2017).

²⁹ No. 13 Civ. 3702, 2019 U.S. Dist. LEXIS 35148, at *93–94, *101–03 (S.D.N.Y. Feb. 27, 2019).

³⁰ No. 18-20326, 2019 U.S. App. LEXIS 13634, at *13–14 (5th Cir. May 7, 2019). Similarly, in the post-*Escobar* world, to plead materiality adequately, the government, in its FCA Complaints, will point to prior enforcement actions it has pursued and settled, as evidence that the alleged regulatory or contractual breach was material to its determination to pay. *See, e.g.*, Complaint in Intervention, *United States ex rel. Longo v. Wheeling Hosp.*, No. 17-1654, ¶¶ 160–167 (W.D. Pa. Mar. 25, 2019) (pointing to several FCA actions alleging a violation of

because the costs of litigating the matter against the government will exceed the costs of settlement. For example, take the following examples, which entities in the healthcare industry may confront:

- Medicare Administrative Contractor, or agent, claims a particular service is not medically necessary or that the claim is upcoded. Healthcare provider disagrees.
- Employee contends that physician's medical directorship agreement is not appropriately documented, but hospital believes sufficient related communications exist to satisfy the Stark law, but agrees to submit voluntary disclosure to foreclose any future dispute.
- Hospital nurse fails to renew license for a limited period and state contends hospital has received a Medicaid overpayment related to any Medicaid patient who received services from the nurse during the period of licensure nonrenewal and threatens FCA litigation. Hospital considers whether to repay a relatively small overpayment the state offers to compromise or fight in litigation.³¹

The healthcare industry is heavily regulated with multiple payors making multiple demands for payments upon audits. When the dollar amount in dispute is small, it is frequently tempting to resolve the dispute by paying the trivial amount demanded. But today, in the post-*Escobar* world, one must be mindful of not setting a negative precedent with the repayment. If the practice in dispute involves a recurring matter—the validity of a frequently used service; the use of a billing code; the qualifications of a care provider—the entity must carefully assess whether the short-term gain of settling is outweighed by the trap

the AKS and Stark law to plead that such violations are material to the government's determination to pay).

³¹ Indeed, regarding the nurse example above, the firm represented a hospital system under these circumstances. Unbeknownst to the hospital, the nurse neglected to renew her license for a year. Although the nurse's services were supervised by licensed physicians in a licensed hospital and the government conceded that the nurse was otherwise appropriately trained and qualified to be a nurse, all services were medically necessary and appropriately coded and all services to patients satisfied the standard of care, the state asserted that the hospital breached the FCA and, as to the materiality of the implied representation that all health care professionals were appropriately licensed, the state pointed out that it had extracted several settlements from other hospitals under the same circumstances. The state offered to settle at a relatively trivial amount or it threatened to file an FCA action. Ultimately, fearing the precedent that would occur if it settled, the hospital refused the state's offer and the state filed an FCA action. But after the hospital filed its motion to dismiss, the state elected to voluntarily dismiss its lawsuit. As a result of *Escobar* and its aftermath, all entities, considering repayment, will also have to consider whether the short-term gain of settlement and repayment exceeds the long-term cost of setting a precedent that the conduct should be resolved as an overpayment.

it may be setting for itself in some subsequent, large FCA investigation when it will want to contend that a breach of the government standard would not result in an overpayment. As the case law demonstrates, such repayments will be used to demonstrate that the entity has reason to believe that the perceived regulatory infractions are material to the government's payment determination and, to the extent settlement is captured in some public repository, used as evidence that others in industry would know that the same type of breach is material to the government's determination to pay.

OPPORTUNITIES *ESCOBAR* PRESENTS TO GAIN DISMISSAL UNDER GRANSTON MEMORANDUM

As noted, pre-*Escobar*, a strict objective materiality test was generally employed in FCA cases. Under the condition of payment versus condition of participation framework courts used to assess FCA liability, the Court frequently reviewed the governing regulation or contract and, applying an objective standard, assessed what a reasonable government employee would do in light of the alleged falsehood.

During this period, in nonintervened cases, discovery against the government was infrequent. First, the government claimed in nonintervened cases that it is not a party so any discovery against it had to be sought under cumbersome, time-consuming regulations that place limitation on access to government records and testimony.³² Second, both relators and defendants realized that seeking information, particularly testimony, from the government was a high-risk endeavor. Usually, the government will not proffer, in advance, what its employee will state under oath so, by seeking testimony, both the relator and the defendant risk obtaining testimony that undermines its case.

Now, under the post-*Escobar* regime—which focuses not on what a theoretical, reasonable government employee does but what government employees actually do—inquiries of government practices are, of necessity, frequent. But this places intense pressure on the government. Rather than spending time prosecuting cases, it now must function as an information gatherer for third parties (relators and defendants) in nonintervened cases.

³² When the government declines to intervene, courts ruled that the government is not subject to party discovery under the Federal Rules of Civil Procedure. See *United States ex rel. Farrell v. SKF, USA, Inc.*, 32 F. Supp. 2d 617, 618 (W.D.N.Y. 1999) (ruling that where the government did not intervene in the action it is not subject to discovery demands as a party because otherwise its election not to participate “would be thwarted since the government counsel would have to expend government resources to respond to discovery requests from hundreds of private suits”) (footnote omitted); cf. *United States ex rel. Lamers v. City of Green Bay, Wis.*, 924 F. Supp. 96, 98 (E.D. Wis. 1996) (where government does not intervene, then matter should be treated as one between private litigants).

In part, as a reaction to the increased demand for government information and documents, the government promulgated the Granston Memorandum setting forth seven factors the government takes into account in assessing whether to seek dismissal of a *qui tam* action. These factors are tailored toward:

- (1) Curbing Meritless Qui Tam Actions;
- (2) Preventing Parasitic or Opportunistic Qui Tam Claims;
- (3) Preventing Interference with Agency Policies and Programs;
- (4) Controlling Litigation Brought on Behalf of the United States;
- (5) Safeguarding Classified Information and National Security Interests;
- (6) Preserving Government Resources; and
- (7) Addressing Egregious Procedural Errors.³³

One of the factors the Memorandum takes into account in seeking dismissal is preserving government resources, such as the high costs associated with monitoring or participating in extensive litigation. The government has successfully invoked this ground to obtain dismissal of a number of post-*Escobar qui tam* lawsuits.³⁴

Additionally, not captured in the case law is the significant number of cases in which the government has persuaded relators not to pursue their action

³³ Memorandum from Michael D. Granston, Dir., Commercial Litig. Branch, Fraud Section to Attorneys, Commercial Litig. Branch, Fraud Section (Jan. 10, 2018).

³⁴ See, e.g., *United States v EMD Serono, Inc.*, No. 16-5594, 2019 U.S. Dist. LEXIS 57150, at *11, 14 (E.D. Pa. Apr. 3, 2019) (noting that the government satisfies the rational relationship test where the case lacks sufficient factual and legal support and where the government also maintains that the relators' allegations "conflict with important policy and enforcement prerogatives of the federal government's healthcare programs" because the government concluded that educational programs, informational support, medication instruction, and nurse access and support are not "remuneration" and are programs that are "appropriate and beneficial to the federal health programs and their beneficiaries" and concluding that like "any other plaintiff in a civil case, the government has the option to end litigation it determines is too expensive or not beneficial") (footnote omitted); *United States ex rel. Sibley v. Delta Reg'l Med. Ctr.*, No. 4:17-cv-000053-GHR-RP, 2019 U.S. Dist. LEXIS 48150, at *21–22 (N.D. Miss. Mar. 21, 2019) (finding government had rational basis to seek dismissal because dismissal "would conserve government resources" because the government would need to monitor the case, and "the government will also be required to bear discovery burdens and costs if litigation on these claims continues"); *United States v. Webster Univ.*, No. 3:15-cv-03530, 2018 U.S. Dis. LEXIS 133488, at *5 (D.S.C. Aug. 8, 2018) (finding the government has set forth sufficient grounds in asserting that "dismissal will further its interest in preserving scarce resources by avoiding the time and expense necessary to monitor" the action and the relator sets forth no evidence that the government decision is "fraudulent, arbitrary and capricious, or illegal"). There is a circuit split regarding the standard a court would apply to the government's motion.

under threat that the government may seek dismissal if the relator elects to proceed with its meritless lawsuit.

This presents a significant opportunity for a defendant ensnarled in FCA litigation to approach the DOJ and present all the reasons why it is in the government's interest to seek dismissal, including the substantial cost to be imposed when relators and defendants are compelled to inquire into the government's oversight of the program relevant to the relator's complaint.

CONCLUSION

Escobar's transformation of the FCA presents risks and opportunities to those who do business with the government. One risk is that if companies pay even a nuisance value amount, FCA plaintiffs will contend that the payment establishes that the company knew that such infractions are material to the government and will also use that repayment against other companies as proof that such violations are material to the government. One opportunity is that companies embroiled in meritless *qui tam* lawsuits now have a better chance of persuading the government to move to dismiss the lawsuit inasmuch as the government, during the course of discovery, and not simply the defendant, will have to incur wasteful costs as a result of the relator's meritless lawsuit.