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First Circuit on Escobar Remand: Relators' Allegations of Regulatory Violations Sufficiently Material to State Claim Under FCA

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On remand from the ***Supreme Court's Escobar*** decision, the ***First Circuit*** holds that ***Universal Health Services' (UHS)*** alleged failure to adequately staff its facilities in compliance with Massachusetts health care regulations is sufficiently material to survive UHS's motion to dismiss. The decision is not a complete surprise, but is nevertheless noteworthy because it reflects the First Circuit's treatment of the matter following one of the most important Supreme Court FCA decisions in recent history.

We have written about *Escobar* extensively earlier this year and invite you to review our coverage of the oral argument, the decision and our review of the government's materiality arguments following the decision. In short, *Escobar* upheld the viability of the implied false certification theory, under which a claim for payment can be false without an express certification, but because of a lack of compliance with a statute, regulation, or contractual provision. The Court further clarified how the materiality element of FCA liability is applied to this theory.

Escobar was not the best or most representative test case for defendants hoping the Supreme Court would one day narrow or eliminate the implied certification theory that they believed had gone too far in characterizing garden-variety breaches of

contract or noncompliance as fraudulent actions triggering FCA liability. *Escobar* involved allegations that UHS had knowingly hired unqualified and unlicensed personnel who caused the death of the relators' child after the personnel allegedly received National Provider Identification numbers corresponding to inflated levels of expertise. The relators argued these actions violated Massachusetts health care regulations that triggered FCA liability.

One of the silver linings of *Escobar* was its treatment of "government knowledge." UHS argued that if the government knows of an alleged statutory, regulatory, or contractual violation, and pays the claim anyway, then the violation could not possibly have been material to the government's decision to pay. Although the Supreme Court did not adopt a *per se* defense regarding this type of government knowledge, it did agree that such knowledge would be highly relevant: "if the Government pays a particular claim in full despite its actual knowledge that certain requirements were violated, that is very strong evidence that those requirements are not material."

On remand, the First Circuit was sympathetic to the relators' case, finding the allegations could be material to the government's decision to pay claims. As the First Circuit put it: "At the core of the MassHealth regulatory program in this area of medicine is the expectation that mental health services are to be performed by licensed professionals, not charlatans." Then paying homage to the FCA's genesis in the Civil War, during which the Army was provided defective military supplies from some unscrupulous contractors, the First Circuit wrote "UHS's violations in the instant case are as central to the bargain as the United States ordering and paying for a shipment of guns, only to later discover that the guns were incapable of firing."

Under these alleged facts and circumstances, the First Circuit was not persuaded by UHS's government knowledge argument. The First Circuit downplayed the argument in this particular case on the ground that the government did not discover the extent of the allegations until long after the litigation was filed—"mere [government] awareness of allegations concerning noncompliance with regulations is different from *knowledge of actual noncompliance*." Without evidence of knowledge of actual noncompliance, the First Circuit was not prepared to dismiss the matter at the motion to dismiss stage of the litigation.

The *Escobar* case on remand is just one more example of how the lower courts are starting to grapple with the Supreme Court's recent guidance regarding materiality as applied in the implied certification context. A number of courts, including the First Circuit, are even adding their own follow-on clarifications. A sampling of recent decisions shows that *Escobar* will not be a panacea for resolving FCA actions predicated on implied certification theory. *Compare United States ex rel. Nelson v. Sanford-Brown, Ltd.*, No. 14-2506, 2016 WL 6205746 (7th Cir. Oct. 24, 2016) (applying *Escobar*, finding defendants made no representations in connection with claims for payment, much less false or misleading representations, and finding that relator offered "no evidence that the government's decision to pay [the defendants] would likely or actually have been different had it known of [the defendant's] alleged noncompliance with [government] regulations."); *United States ex rel. Lee v. N. Adult Daily Health Care Ctr.*, No. 13-CV-4933, 2016 WL 4703653 (E.D.N.Y. Sept. 7, 2016) (finding that the relator had not shown the government would have withheld payment

if it knew of the defendant's noncompliance with DOH regulations governing day care center), *with Scott Rose v. Stephens Institute*, No. 09-CV-5966, 2016 WL 5076214 (N.D. Cal. Sept. 20, 2016) (applying *Escobar*, finding that government's decision to not take action against a defendant despite its awareness of allegations in the case to be "not terribly relevant to materiality"); *United States ex rel. Williams v. City of Brockton*, No. 12-CV-12193, 2016 WL 4179863 (D. Mass. Aug. 5, 2016) (finding in favor of the relators, noting that "the government consistently refuses to pay claims in the mine run of cases based on noncompliance" with the so-called "non-supplanting rules" which governed the City's compliance with the Department of Justice's COPS program). *See also City of Chicago v. Purdue Pharma L.P.*, No. 14-CV-4361, 2016 WL 5477522 (N.D. Ill. Sept. 29, 2016) (dismissing a relator's implied certification claim, noting that the City continues to pay for claims based on the companies' alleged misrepresentations, but granted leave to the City to replead consistent with the standards set forth in *Escobar*). The only certainty post-*Escobar* seems to be that litigants and the courts will continue to battle over this controversial FCA theory of liability.