Hogan Lovells

False Claims Act Guide

2020 and the road ahead

Table of Contents

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Executive summary

Notwithstanding the unprecedented business disruptions caused by the COVID-19 pandemic and the immense human and financial toll it has taken, the United States Department of Justice (DOJ) continued a sustained program of enforcement of the False Claims Act (FCA) in 2020.

These efforts produced both significant judicial decisions on issues of increasing importance in FCA jurisprudence and the recovery of substantial damages and penalties in settlements under the Act.

In particular, the health care sector continued to see nine-figure FCA settlements stemming from Anti-Kickback Statute violations and billing for medically unnecessary services, but the year also saw substantial FCA settlements as part of the government's priority in combatting the opioid epidemic. With the DOJ's recent directive to U.S. Attorneys to prioritize the investigation of coronavirus-related fraud, the unprecedented amount of federal stimulus payments, and the commencement of a new presidential administration, FCA enforcement and compliance issues will continue to be important considerations for businesses in all sectors of the economy. We hope this guide provides a helpful overview of the most significant FCA developments over the last year and a glimpse of potential areas for further development in 2021.

Guide sections

We begin our 2020 review with what has been foremost on so many minds this year—the COVID-19 pandemic. The Coronavirus Aid, Relief, and Economic Security Act (CARES Act) authorized more than $2 trillion in COVID-19 relief. The acceptance of relief funds under the CARES Act, however, raises potential enforcement risks for aid recipients. We explore those risks in various sectors of the U.S. economy.

Next, we turn to the aftermath of the 2016 *Escobar* decision, and the continued case law development of what the Supreme Court emphasized is the Act's "demanding" and "rigorous" materiality requirement. This year, lower courts continued to develop standards to determine what types of misrepresentations or omissions are sufficiently material to justify the imposition of treble damages and penalties under the FCA. We discuss the evolving understanding of this important opinion.

We next focus on the financial institution sector, which has seen a slowdown in reliance on the FCA to enforce Federal Housing Administration regulations. At the same time, however, financial institutions have distributed hundreds of billions of dollars in loans under the CARES Act, creating new FCA risks for lenders. We explore the scope of those risks to businesses participating in these lending programs.

In addition, 2020 saw a deepening circuit split over a long-disputed question of whether and when a scientific, clinical, or medical opinion can be "false" and thus serve as a predicate for FCA liability. We explore recent decisions by the Third and Ninth Circuits, which mark a sharp contrast against the Eleventh Circuit's 2019 *United States v. AseraCare Inc.* decision and we look ahead to the ramifications these decisions could have across industries, particularly if the Supreme Court grants the petition for a writ of certiorari filed in the Third Circuit case.

We next turn to the Seventh Circuit, which introduced a third standard to be applied when DOJ seeks to dismiss a suit filed under the qui tam provisions of the FCA. Until recently, courts had lined up in one of two camps on the government's dismissal power under Section 3730(c)(2)(A) of the Act. We consider the implications of this new approach, which affords the government a largely unfettered right to intervene and dismiss a qui tam complaint over the relator's objection during the early stages of litigation.

Finally, we look to the higher education sector, where DOJ has used the FCA for years to enforce the so-called "incentive payment ban," prohibiting institutions that receive federal student financial aid funds from paying incentive compensation for student recruitment services. We discuss the changing regulatory landscape, as various safe harbors have come and gone. In particular, we consider recent FCA settlements and congressional attention, which have raised questions about the continued viability of the "bundled services" exception.

The CARES Act serves up COVID-19 relief funds along with potential risks and defenses

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act), authorized more than $2 trillion in federal loans, grants, and other financial assistance focused on COVID-19 relief. The CARES Act cast a wide net, including authorizing direct cash payments to individuals, loans to small businesses, advanced payments to healthcare providers, healthcare sector relief funds, and spending flexibility to certain federal contractors.[1] Receipt of CARES Act funds was not without strings attached, usually in the form of various certifications regarding eligibility and/or how the funds would be used. Those certifications can be open to interpretation and/or require compliance obligations that early signs indicate are proving difficult to meet. As a result, CARES Act recipients face False Claims Act (FCA) risk under, among others, express false or implied false certification theories. We discuss below some of these risks in various sectors of the U.S. economy.

The Paycheck Protection Program & Main Street Lending Program

The Paycheck Protection Program (PPP) is a primary CARES Act relief program. The PPP provides small businesses with loans for payroll and certain non-payroll business expenses, and offers loan forgiveness to borrowers who meet employee retention requirements and can show that the funds were used for eligible expenses during a "covered period" of up to 24 weeks from the date of loan origination (but not extending beyond December 31, 2020).[2]

The PPP has a number of eligibility requirements regarding the type of organization that can apply.[3] Borrowers must make numerous certifications, including that the "uncertainty of current economic conditions" makes the loans "necessary" to support "ongoing operations," representations that the costs covered by the loan are eligible payroll and non-payroll costs, and that the borrower does not have

[1] Public Law No. 116-136.

[2] U.S. Small Business Administration, *Paycheck Protection Program*, https://www.sba.gov/funding-programs/loans/coronavirus-relief-options/paycheck-protection-program (last visited Nov. 18, 2020).

[3] *See* 15 U.S.C. §636(a)(36)(D)(i); 13 C.F.R. § 121.301(a)(2).

other pending PPP loans, or has not received duplicative PPP loans. There is also a detailed loan necessity questionnaire for loans of more than $2 million, the accuracy of which must be certified. Finally, there are certifications required for loan forgiveness requests and lenders may also face FCA risk on the basis that they were reckless in making loans[4] to businesses that they knew or should have known were ineligible or unduly risky recipients.

If accurate, public reporting has already identified numerous types of PPP loans that could be subject to FCA enforcement, ranging from borrowers who received funds for businesses that were purportedly not in existence and operating as of February 15, 2020 (the date at which eligible small businesses must have been operating), to those who inflated payroll costs or used loan funds to pay personal and non-business expenses.

The Main Street Lending Program is another form of CARES Act support with FCA risk. Here, borrowers certify that the loan is "necessary," that the borrower will "make reasonable efforts to maintain" payroll and retain employees, and that the funds will not be used to repay other loans. There are additional requirements for borrowers with 500-10,000 employees, including requirements regarding not offshoring or outsourcing jobs. Lenders also make certifications under this program, including that the funds will not be used to address prior loans from the lender to the borrower.

[4] *See* 15 U.S.C. §636(a)(36)(G)(i); 13 C.F.R. § 121.301(a)(2).

Public Health and Social Services Emergency Fund

The CARES Act and related legislation also appropriated funds to reimburse eligible healthcare providers for healthcare related expenses or lost revenues attributable to COVID-19 through the HHS-administered Provider Relief Fund (PRF).

All facilities and providers that received Medicare fee-for-service (FFS) reimbursements in 2019 are eligible for PRF funds as long as they continued providing medical services after January 31, 2020 and have not had Medicare billing privileges revoked.[5] Providers that ceased operation as a result of COVID-19 are still eligible to receive PRF funds if they provide proof of diagnoses, testing, or care for individuals with possible or actual cases of COVID-19.

Under Phase 1, all eligible providers automatically received PRF funds, which meant that rejecting CARES Act funding required affirmatively returning the funds to HHS. The funds were deemed accepted through an attestation or non-action after 90 days. HHS created an application and attestation portal through which eligible providers could confirm they will comply with all terms and conditions of PRF, which included representations that the provider:[6]

- Provided diagnosis, testing, or care for actual or possible COVID-19 patients on or after January 31, 2020. For purposes of this requirement, HHS broadly views every patient as a possible case of COVID-19.
- Will use the payment to prevent, prepare for, and respond to coronavirus, and reimburse healthcare-related expenses or lost revenues attributable to coronavirus. Certain types of healthcare-related expenses cannot be paid using these funds (e.g. executive compensation). These expenses or lost revenues must exceed the total payments received under PRF. Lost revenues cannot exceed the difference of 2019 and 2020 actual patient care revenues.
- Will not use the payment for expenses or losses that have been or will be reimbursed from other sources (e.g. payments cannot be used for expenses otherwise reimbursable through Medicare).
- Consent to public disclosure of the payment.

Providers receiving more than $10,000 of PRF funds will be required to report the use of these funds by February 15, 2021 or July 31, 2021 (for providers that did not expend all funds prior to December 31, 2020).[7] Providers receiving $500,000 or more will be required to complete more detailed reports. HHS has stated that PRF recipients providing inaccurate information will be subject to payment recoupment and other legal actions, presumably including FCA claims through false or implied certification theories.[8]

Section 3610 of the CARES Act

For government contractors, Section 3610 of the CARES Act allows federal agencies, at their discretion, to modify the terms of existing contracts or other agreements to reimburse any paid leave, including sick leave, which a contractor provides to keep its employees in a ready state.[9] Each agency can issue its own guidance regarding what certifications are required and what costs can be billed.

In general, eligible contractors are those with employees who cannot perform work on a government-owned, government-leased, contractor-owned, or contractor-leased facility or site due to closure or other restrictions related to COVID-19. Additionally, these contractors' employees must also be unable to telework because their duties cannot be performed remotely.

As a representative example, the Department of Defense (DoD) issued a new cost principle, DFARS 231.205-79, under which contractors can only seek reimbursements if they make the following representations, among others:

- The contractor can support all claimed costs with appropriate documentation.
- The contractor identifies other relief funds claimed or received related to COVID-19 (e.g. PPP loans).
- The contractor affirms it has not and will not pursue reimbursement elsewhere for the same costs accounted for under their Section 3610 request.

FCA risk under Section 3610 may arise due to the prohibition on double payments to cover the same costs and ambiguous documentation requirements. For example, what sort of documentation supports an inability to work remotely? Likewise, DoD requires that the government receive a credit or reduction in billing for any PPP loans or loan payments that are forgiven if PPP credits are allocable as costs allowed under a contract.

5 U.S. Dep't of Health and Human Servs., CARES Act Provider Relief Fund: For Providers, https://www.hhs.gov/coronavirus/cares-act-provider-relief-fund/for-providers/index.html (last visited Nov. 20, 2020).

6 Full list of terms and conditions for each type of payment under PRF is available on the HHS website. *See U.S. Dep't of Health and Human Servs., CARES Act Provider Relief Fund: For Providers, Terms and Conditions*, https://www.hhs.gov/coronavirus/cares-act-provider-relief-fund/for-providers/index.html#terms-and-conditions (last visited Nov. 20, 2020).

7 *See* U.S. Dep't of Health and Human Servs., *Reporting Requirement and Auditing*, https://www.hhs.gov/coronavirus/cares-act-provider-relief-fund/reporting-auditing/index.html (last visited Nov. 20, 2020).

8 *See* U.S. Dep't of Health and Human Servs., *Reporting Requirement and Auditing*, https://www.hhs.gov/coronavirus/cares-act-provider-relief-fund/reporting-auditing/index.html (last visited Nov. 20, 2020).

9 *See* Public Law 116–136, div. A, title III, §3610.

Looking ahead

There was significant FCA enforcement activity after the 2008 financial crisis and its associated relief efforts and we may well see a similar uptick in FCA activity in 2021 related to CARES Act funding. The CARES Act itself was a hastily written statute that lacks clarity with respect to its requirements. In addition, the need to distribute funds quickly meant that agencies had little time to offer guidance. When they did so, it often took the form of FAQs or other similar informal sub-regulatory guidance. While the climate in which CARES Act funds were dispersed created risk, it may also contribute to defenses of FCA claims. For example, CARES Act certifications may in some cases be sufficiently ambiguous so as to undermine efforts to establish scienter. Similarly, guidance evolved over time, and that fluidity alone may give rise to defenses. And, in some areas, defendants may try to advance a public disclosure bar defense based on databases offering detailed information about CARES Act funding recipients. Ultimately, while we can expect to see CARES Act-related FCA activity, the statute and its implementing guidance can be expected to offer several avenues of defense.

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Evolving application of materiality standard continues to shape FCA litigation

An important element of liability under the False Claims Act (FCA) is proof that an alleged misrepresentation is material to the government's payment decision. In its 2016 decision in *Universal Health Services, Inc. v. United States ex rel. Escobar,* the Supreme Court emphasized that the FCA's materiality requirement is "demanding" and "rigorous."[1] Although the Court offered examples of how to evaluate materiality, it did not articulate clear standards for what constitutes a materially false misrepresentation. As decisions from the past year illustrate, lower courts are continuing to develop standards for analyzing and deciding this issue in the wake of the *Escobar* decision.

Courts generally apply demanding materiality requirement at all stages of litigation

Consistent with Escobar, courts have dismissed complaints that make only conclusory allegations of materiality. Generalized allegations that a government payment is conditioned upon compliance with a statutory, regulatory or contractual requirement is insufficient; instead, courts have required relators to include specific factual allegations demonstrating how a false representation of compliance actually affected, or was likely to affect, the government's decision to make payment to the defendant.

For example, the Fifth Circuit in *United States ex rel. Porter v. Magnolia Health Plan, Inc.* affirmed the dismissal of a complaint alleging a Medicaid contractor violated the FCA by using licensed professional nurses for jobs that required registered nurses (RNs), concluding the relator failed to allege that such staffing practices would have impacted Medicaid payment decisions.[2] The court found that underlying contracts did not require services be performed by an RN, and even if state law required the use of RNs, "broad boilerplate language generally requiring a contractor to follow all laws" in the contracts was "too general" to support a finding of materiality.[3]

In contrast to recent cases dismissing (or affirming the dismissal of) FCA claims on materiality grounds, the Second Circuit recently held the demanding materiality standard was met in *United States v. Strock,* which involved set aside contracts for service-disabled, veteran-owned small businesses (SDVOSBs).[4] The government alleged the defendant was not eligible for the set aside contracts it won and never would have won the contracts had it not falsely claimed to be an SDVOSB.[5] The district court granted the motion to dismiss, holding that the government must sufficiently allege that the defendant's SDVOSB status was material to its decision to pay the defendant's claims, not just to its decision to award the defendant SDVOSB contracts.[6] The Second Circuit disagreed, holding that, "at least in fraudulent inducement cases, the government's 'payment decision' under Escobar encompasses both its decision to award a contract and its ultimate decision to pay under that contract."[7]

The rigorous materiality requirement is also enforced at summary judgment. The Tenth Circuit in *United States ex rel. Janssen v. Lawrence Memorial Hospital* affirmed summary judgment for a hospital accused of defrauding Medicare. The qui tam relator alleged that the hospital misreported patient arrival times to gain additional Medicare reimbursement and falsely certified compliance with a provision of the Deficit Reduction Act to obtain a $5 million payment awarded to hospitals that trained employees on the provisions of the FCA.[8] The court emphasized the need under *Escobar* to analyze the effect on the likely or actual behavior of the *recipient* of the alleged misrepresentation, rather than focusing on how a "reasonable person" might have behaved.[9] Applying that standard, the court found materiality lacking.[10] Despite evidence the defendant had knowingly falsified patient arrival times, the court found that the alleged falsification affected only a "subset of a subset" of data reported under certain inpatient and outpatient quality reporting programs, such that the relator failed to demonstrate the falsified data ultimately impacted Medicare reimbursement.[11] The Tenth Circuit dispensed with the relator's allegations related to compliance certifications as "precisely the type of garden-variety compliance issues" that "did not translate into FCA liability."[12]

1 *Universal Health Servs., Inc. v. United States ex rel. Escobar (Escobar),* 136 S. Ct. 1989, 2003, 2004 n.6 (2016).
2 *United States ex rel. Porter v. Magnolia Health Plan, Inc.,* 810 F. App'x 237, 238, 242 (5th Cir. 2020).
3 *Id.* at 242.
4 *United States v. Strock,* No. 19-4331, 2020 WL 7062274 (2d Cir. Dec. 3, 2020).
5 *Id.* at *1.
6 *United States v. Strock,* No. 15-CV-0887-FPG, 2019 WL 4640687, at *8 (W.D.N.Y. Sept. 24, 2019), *aff'd in part, vacated in part, rev'd in part,* No. 19-4331, 2020 WL 7062274 (2d Cir. Dec. 3, 2020).
7 Strock, 2020 WL 7062274, at *6.
8 United States ex rel. Janssen v. Lawrence Memorial Hospital, 949 F.3d 533, 535 (10th Cir. 2020).
9 Id. at 541.
10 Id. at 545–46.
11 Id. at 538, 543–44.
12 Id. at 545.

Finally, the Eleventh Circuit in *Ruckh v. Salus Rehab., LLC* affirmed the district court's grant of judgment as a matter of law in favor of defendants on a subset of the relator's claims, while reversing on the other, showing that Escobar materiality can also meaningfully limit the reach of the FCA after trial.[13] On the relator's Medicaid claims alleging defendants submitted false claims to Medicaid based on a failure to maintain care plans, the court held that "scant" evidence supported relator's claim that completing care plans was a condition of payment under the applicable regulations.[14] By contrast, the relator's Medicare claims that the defendants defrauded Medicare by "upcoding" and "ramping" were material. Although the district court found "an entire absence of evidence" of materiality for those claims, the Eleventh Circuit concluded there was "plain and obvious materiality" because the defendants' claims indicated that defendants provided more services than they actually delivered, which translated into larger payments than they were truly owed.[15] Consequently, the Eleventh Circuit reversed the district court as to the relator's Medicare claims and concluded evidence of materiality supported a jury verdict of $85 million, or $255 million when trebled, down from the original $348 million entered following the jury verdict.[16]

Courts continue to cite government inaction as probative evidence of immateriality

A number of courts have continued to endorse the proposition that government inaction, after learning of alleged fraud, demonstrates a lack of materiality. In so ruling, courts have confirmed the need for FCA defendants to focus on government knowledge, and to obtain discovery on the government's awareness of allegations of misconduct.

For instance, the Fifth Circuit in *Porter* noted the government took no action after the relator informed the relevant agency and local U.S. Attorney's Office of the underlying allegations several years before filing suit, as part of its justification for affirming dismissal of the complaint.[17] The court noted that the agency continued to pay the company and renewed its contract multiple times, even after the relator's suit was unsealed.[18]

In *Janssen*, the Tenth Circuit emphasized that the Centers for Medicare and Medicaid Services (CMS) investigated the relator's central allegations, did nothing in response, and continued to pay the hospital's Medicare claims.[19] Although CMS may not have independently verified the alleged noncompliance – and thus may not have had "actual knowledge" of the alleged infractions – the court concluded that CMS's "inaction in the face of detailed allegations from a former employee suggests immateriality."[20] Thus, the court focused on the government's awareness of *allegations*, rather than actual *knowledge* of noncompliance. The court specifically acknowledged that the First Circuit, in *Escobar* on remand, held that "awareness of allegations concerning noncompliance with regulations is different from knowledge of actual noncompliance,"[21] but it distinguished that holding based on the different procedural posture: *Escobar* arose on a motion to dismiss while the disposition in *Janssen* came on a motion for summary judgment.[22] Additionally, the Tenth Circuit said it gave "little weight" to the Department of Justice's decision to decline to intervene in the suit, reasoning that to do otherwise would "undermine the purposes of the FCA."[23]

The Eleventh Circuit in *Ruckh* acknowledged evidence that defendants had self-disclosed certain deficiencies in care plans that served as the basis for the relator's allegations to state Medicaid officials – citing to a lack of evidence that the state had refused reimbursement or sought recoupment – in concluding the materiality standard had not been satisfied.[24]

13 Ruckh v. Salus Rehab., LLC, 963 F.3d 1089, 1109 (11th Cir. 2020).

14 Id.

15 *Id. at 1104–05.*

16 *Id. at 1094, 1111.*

17 *Porter, 810 F. App'x at 238, 242.*

18 *Id.*

19 *Janssen, 949 F.3d at 542.*

20 *Id.*

21 *Id.*

22 *Id. at 542 n.13*

23 *Id. at 542 n. 12. Other courts, however, have concluded that the government's decision to decline to intervene in a* qui tam *suit may be relevant to the materiality analysis. See, e.g., Polansky v. Exec. Health Res., Inc., 422 F. Supp. 3d 916, 938 (E.D. Pa. 2019) (noting that the government's actions in the litigation – "declining to intervene and moving for dismissal" – were "probative of the lack of materiality of [the relator's] claims").*

24 ?

Courts have begun to apply *Escobar's* materiality guidance in the criminal context

As anticipated, the Supreme Court's guidance on materiality in Escobar have taken root in the criminal context, as prosecutors, defendants, and courts look to the real-world impact of criminal defendants' alleged fraud on the government.

For example, in *United States v. Clark*, one defendant, after being convicted of multiple counts of fraud for obtaining Small Business Administration set-aside contracts under false pretenses, moved for judgment of acquittal notwithstanding the verdict. The district court granted the motion as to four counts related to the submission of false claims.[25] Citing the "rigorous" *Escobar* materiality standard, the court concluded the evidence was insufficient to establish a false material fact.[26] In particular, the court concluded that a failure to disclose to the government certain details regarding the extent of the defendant's involvement in projects involving other entities was immaterial, and that even if those facts had been disclosed to the government, it "may still have paid" on the invoices.[27]

Looking ahead

Going forward, we anticipate courts will continue to enforce the materiality requirement to limit attempts to use the FCA as an "all-purpose antifraud statute" or "vehicle for punishing garden-variety breaches of contract or regulatory violations."[28] Just as relators will seek to frame allegations and develop evidence of materiality consistent with these requirements, so too should FCA defendants actively seek evidence of government knowledge of the underlying allegations of fraud, as well as other evidence of immateriality, as central components of a potential defense. Time will tell whether the different standards applied by federal courts in determining materiality will converge or, instead, continue to give rise to different approaches for analyzing this fact-intensive issue.

[25] *United States v. Clark, No. 1:19-CR-148, 2020 WL 830057, at *1, 10–12 (N.D. Ohio Feb. 20, 2020) (the court dismissed three counts of submitting false claims in violation of 18 U.S.C. § 287 and one count of conspiracy to submit false claims in violation of 18 U.S.C. § 286).*

[26] *Id. at *10–11.*

[27] Id.

[28] Escobar, 136 S. Ct. at 2003.

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False Claims Act risk for lenders: Will risk from the PPP program rival that of federally-insured mortgage programs?

Financial institutions settled several False Claims Act (FCA) cases involving allegations they failed to comply with Federal Housing Administration (FHA) rules regulating federally-insured mortgage programs in 2020. But, reliance on the FCA to enforce FHA regulations appears to have slowed just as financial institutions' role in distributing more than $522 billion in Paycheck Protection Program (PPP) loans and another $3.7 billion in the Main Street Lending Program (MSLP) loans have created new FCA risk for lenders.

Recent developments in FHA enforcement

Until recently, FCA enforcement actions were the primary tool employed by the United States Department of Justice (DOJ) to punish lenders that failed to comply with the rules and standards regulating FHA mortgage loan programs. From 2009 through 2016 alone, DOJ recovered more than $7 billion in FCA settlements and judgments relating to housing and financial fraud.[1] This risk, along with a lack of transparency in the program's standards, had the effect of deterring lenders from originating FHA-insured loans.[2] Thus, in October 2019, in an effort to encourage lenders to once again participate in FHA lending programs, DOJ and the Department of Housing and Urban Development (HUD) issued a Memorandum of Understanding (MOU) outlining a new joint approach to FCA enforcement.[3] The MOU announced that FHA lending requirements would be enforced primarily through HUD's administrative proceedings process, but cautioned that DOJ and HUD would continue to coordinate to determine whether the facts and circumstances of certain defects in FHA-insured mortgage loans warrant enforcement through the FCA. The MOU also prescribed new standards for when HUD may refer a matter for FCA enforcement and set forth guidelines on how HUD and DOJ will cooperate during the investigative, litigation and settlement phases of FCA matters.

1 *U.S. Dep't of Justice, Fact Sheet: Significant False Claims Act Settlements & Judgments, Fiscal Years 2009-2016, available at https://www.justice.gov/opa/press-release/file/918366/download.*

2 U.S. Dep't of Treasury, A Financial System that Creates Economic Opportunities: Nonbank Financials, Fintech, and Innovation, Updating Activity-Specific Regulations, Lending and Servicing, at p. 10 (July 2018), available at https://home.treasury.gov/sites/default/files/2018-07/A-Financial-System-that-Creates-Economic-Opportunities---Nonbank-Financi....pdf.

3 U.S. Dep't of Housing and Urban Dev., Memorandum of Understanding Between the Department of Housing and Urban Development and the Department of Justice, Inter-Agency Coordination of Civil Actions Under the False Claims Act Against Participants in FHA Single Family Mortgage Insurance Programs (Oct. 29, 2019), available at https://www.hud.gov/sites/dfiles/SFH/documents/sfh_HUD_DOJ_MOU_10_28_19.pdf.

Following issuance of the MOU, DOJ settled a number of significant FCA matters that had been pending prior to October 2019.[4] However, consistent with the MOU's new approach to FCA enforcement, DOJ has only announced the filing of one new FCA lawsuit against a financial institution for originating unqualified FHA-insured loans since October 2019. In September 2020, the government commenced a civil action against Nutter Home Loans f/k/a James B. Nutter & Co. for allegedly forging certifications and using unqualified underwriters to approve reverse mortgage loans under the FHA-insured Home Equity Conversion Mortgage program.[5] We expect DOJ's more reserved approach to employing the FCA to enforce HUD regulations to continue into 2021. However, the change in political leadership at DOJ and FHA could bring modifications to the MOU and shape enforcement priorities.

4 Recent settlements include a March 2020 settlement with Finance America Reverse, which agreed to pay $2.47 million to resolve allegations that it violated the FCA by knowingly originating hundreds of FHA-insured loans that failed to meet the program's requirements. *See* U.S. Dep't of Justice, *Finance of America Reverse Agrees to Pay $2.47 Million to Resolve Alleged Liability for FHA-Insured Reverse Mortgage Lending Violations*, (Mar. 31, 2020), available at https://www.justice.gov/opa/pr/finance-america-reverse-agrees-pay-247-million-resolve-alleged-liability-fha-insured-reverse. Similarly, in April 2020, DOJ announced that Guaranteed Rate, Inc. agreed to pay $15.06 million to settle FCA claims that it knowingly violated material program requirements when originating FHA-insured loans. *See* U.S. Dep't of Justice, *Guaranteed Rate to Pay $15 Million to Resolve Allegations It Knowingly Caused False Claims to Government Mortgage Loan Programs*, (Apr. 29, 2020), available at https://www.justice.gov/opa/pr/guaranteed-rate-pay-15-million-resolve-allegations-it-knowingly-caused-false-claims. And, in October 2020, DOJ announced that Guild Mortgage Company agreed to pay $24.9 million to settle similar FCA claims. *See* U.S. Dep't of Justice, *Guild Mortgage Company to Pay $24.9 Million to Resolve Allegations it Knowingly Caused False Claims for Federal Mortgage Insurance*, (Oct. 28, 2020), available at https://www.justice.gov/opa/pr/guild-mortgage-company-pay-249-million-resolve-allegations-it-knowingly-caused-false-claims.

5 U.S. Dep't of Justice, *United States Files Complaint Against Nutter Home Loans for Forging Certifications and Using Unqualified Underwriters to Approve Government-Insured Reverse Mortgages*, (Sept. 25, 2020), available at https://www.justice.gov/opa/pr/united-states-files-complaint-against-nutter-home-loans-forging-certifications-and-using.

New FCA risk posed by Paycheck Protection Program and Main Street Lending Program

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act), which aimed to address the troubling economic impact of the COVID-19 pandemic, was signed into law on March 27, 2020, and established the PPP and the MSLP programs.[6]

Under the PPP, small businesses may obtain low interest rate loans – which may be eligible for forgiveness – to cover payroll costs, rent, and other overhead expenses. The Small Business Administration (SBA) is responsible for administering the program: authorizing lenders to distribute PPP loans and reimbursing the lenders for forgiven amounts. As of August 8, 2020, when the program closed, 5,460 lenders had participated in the program, issuing 5,212,128 loans, totaling $525,012,124.[7] The MSLP which, in contrast, is administered by the Federal Reserve, aims to make lending available to small and medium-sized for-profit businesses and nonprofit organizations. The MSLP, which does not provide for loan forgiveness, has been much less popular than the PPP and has distributed 400 loans totaling $3.7 billion as of October 30, 2020.[8]

The extent of FCA risk that accompanies participation in the PPP and MSLP is not yet clear. As noted above, prior to issuance of the MOU between DOJ and HUD, DOJ had long used the FCA as a vehicle to punish lenders that violate FHA-program requirements.[9] Absent similar MOUs between DOJ and the SBA and DOJ and the Federal Reserve, it is unclear whether DOJ will aggressively employ the FCA against lenders that violate rules regulating the PPP and MSLP. DOJ's commitment to enforcement actions against perpetrators of COVID-19-related fraud has been clear since the beginning of the pandemic when DOJ took steps to collect and share tips with other federal agencies, appointed a Coronavirus Fraud Coordinator in each judicial district, and appointed numerous state-wide and regional COVID-19 fraud task forces.[10] However, there are other indications that FCA enforcement against financial institutions related to participation in the PPP and MSLP may not rival the pre-MOU level of FCA enforcement in federally-insured mortgage programs.

6 *See* U.S. Small Bus. Admin., Interim Final Rule, *Paycheck Protection Program*, 13 C.F.R. Part 120, 85 Fed. Reg. 20811 (Apr. 15, 2020), available at https://www.sba.gov/sites/default/files/2020-04/PPP%20Interim%20Final%20Rule_0.pdf. *See* also Press Release, *Board of Governors of the Federal Reserve System, Federal Board Adjusts Terms Of Main Street Lending Program To Better Target Support To Smaller Business That Employ Millions Of Workers And Are Facing Continued Revenue Shortfalls Due To The Pandemic* (Oct. 30, 2020), available at https://www.federalreserve.gov/newsevents/pressreleases/monetary20201030a.htm.

7 U.S. Small Bus. Admin., *Paycheck Protection Program (PPP) Report*, Approvals through 08/08/2020, available at https://www.sba.gov/sites/default/files/2020-08/PPP_Report%20-%202020-08-10-508.pdf.

8 *Board of Governors of the Federal Reserve System*, https://www.federalreserve.gov/newsevents/pressreleases/monetary20201030a.htm

9 U.S. Dep't of Justice, *Deputy Associate Attorney General Stephen Cox Provides Keynote Remarks at the 2020 Advanced Forum on False Claims and* Qui Tam *Enforcement* (Jan. 27, 2020), available at https://www.justice.gov/opa/speech/deputy-associate-attorney-general-stephen-cox-provides-keynote-remarks-2020-advanced.

10 U.S. Dep't of Justice, *Department of Justice is Combatting COVID-19 Fraud But Reminds the Public to Remain Vigilant*, (Oct. 15, 2020) available at https://www.justice.gov/opa/pr/department-justice-combatting-covid-19-fraud-reminds-public-remain-vigilant.

First, the SBA's PPP rules permit lenders to largely rely on borrowers' representations and certifications at the initial application and loan forgiveness stages. The SBA has indicated it will "hold harmless any lender that relies on such borrower documents and attestation from a borrower"[11] Lenders must, however, confirm that borrowers have submitted proper documentation. It's thus possible lenders could face significant FCA risk if they ignore red flags of fraud by borrowers, fail to collect required documentation, or fail to comply with anti-money laundering rules, which PPP rules specify all lenders must have in place. Lenders under the MSLP must conduct an assessment of a potential borrower's financial condition and apply their own underwriting standards. However, the Federal Reserve's FAQs note that lenders may rely on the borrower's certifications of eligibility and compliance with program requirements, and are not expected to independently verify the certifications or monitor ongoing compliance, but should notify the Federal Reserve Bank of Boston if they become aware that a borrower "made a material misstatement or otherwise breached a covenant during the term" of a MSLP loan.[12]

Looking forward

The DOJ-HUD MOU appears to have slowed the torrent of FCA cases in the mortgage industry, but the scope of new FCA risk facing financial institutions as a result of participation in the PPP and the MSLP programs is still unclear. Agency rules regulating these programs do not directly address DOJ enforcement policies. Absent a MOU or other clear policy statement from DOJ, we will have to continue to monitor DOJ's actions in 2021 to discern the degree to which DOJ will use the FCA as a vehicle for policing PPP and MSLP lending.

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11 13 C.F.R. Part 120, 85 Fed. Reg. 20811 (Apr. 15, 2020), available at https://www.financialservicesperspectives.com/wp-content/uploads/sites/6/2020/05/Sup-Materials.Blog_.FSP_.-PPP-IFRN-FINAL.-GPremo-SCox.-May-2020.pdf

12 Board of Governors of the Federal Reserve System, *Main Street Lending Program Frequently Asked Questions (FAQs) For-Profit Frequently Asked Questions* (November 25, 2020) (PDF), at p. 46, available at https://www.federalreserve.gov/monetarypolicy/mainstreetlending.htm.

Deepening circuit split about falsity of medical opinions invites a Supreme Court decision

In 2020, federal appellate courts continued to grapple with the long-disputed question of whether and when a scientific, clinical, or medical opinion can be "false" and thus serve as a predicate for False Claims Act (FCA) liability.

FCA defendants were hopeful in the wake of the 2019 ruling of the Eleventh Circuit Court of Appeals in *United States v. AseraCare, Inc.*,[1] which held that in the context of hospice reimbursement, a "reasonable difference of opinion among physicians" as to a medical provider's judgment regarding hospice eligibility could not, on its own, satisfy the element of falsity for FCA[2] purposes. The Eleventh Circuit held that so long as the clinical judgment is "properly formed and sincerely held," a different physician disagreeing with the judgment does not make the judgment false for purposes of the FCA. Instead, additional evidence of objective falsity is required, such as proof that the certifying physician did not examine the underlying medical records or did not subjectively believe in the certification they made, or expert testimony showing that no reasonable physician could have concluded that a patient was terminally ill (and thus eligible for hospice reimbursement) given the relevant medical records.[3]

Defendants rightfully saw the ruling as narrowing the scope of FCA liability, and hoped it would be a bellwether indicating the path for other courts to follow. However, in 2020, both the Third and Ninth Circuits weighed in and held that differences in clinical opinions regarding medical necessity can form the basis of FCA violations. While it may be possible to reconcile the circuit court opinions, the continued upheaval over this aspect of FCA liability suggests a circuit split has developed. Not surprisingly, the Supreme Court has been asked to settle this critical question.

United States ex rel. Druding v. Care Alternatives

First, on March 4, 2020, in *United States ex rel. Druding v. Care Alternatives, Inc.*, the Third Circuit Court of Appeals determined that a dispute between physician experts, even without additional indicia of "objective falsity," was enough to create a triable issue of fact for the jury and defeat the defendants' motion for summary judgment.[4] In doing so, the Third Circuit expressly disagreed with the Eleventh Circuit.

1 938 F.3d 1278 (11th Cir. 2019).

2 *Id.* at 1297.

3 *Id.*

4 *United States ex rel. Druding v. Care Alts.*, 952 F.3d 89, 96 (3d Cir. 2020).

Like the relators in *AseraCare*, the qui tam relators in *Care Alternatives* alleged that Care Alternatives, a hospice care provider, submitted false claims for reimbursement to Medicare and Medicaid by certifying patients as eligible for the hospice benefit when they were not. Relators, who were former employees, relied solely on testimony from a medical expert who reviewed a sample of patient records and determined that certain certifications were not adequately supported by the underlying medical records, a conclusion with which Care Alternatives' own medical expert disagreed.

In September 2018, using reasoning parallel to the Eleventh Circuit's in *AseraCare*, the district court granted the defendants' motion for summary judgment, finding the relators had not adduced sufficient evidence to show objective falsity.[5]

The Third Circuit reversed, holding there are circumstances in which an opinion may be considered "false," and that a reasonable difference of opinion among medical experts was sufficient to establish a triable issue as to falsity. The Third Circuit found that by employing the "objective falsehood" standard, the district court and the Eleventh Circuit in *AseraCare* conflated falsity with scienter, which, under the plain language of the FCA, is a separate and distinct element of an FCA claim.[6] According to the Third Circuit, the subjectivity of a medical opinion is relevant not to falsity, but to proving scienter – *i.e.*, that the false determination regarding the patient's prognosis was made *knowingly*, which in turn "helps to limit the possibility that hospice providers would be exposed to liability under the FCA any time the Government could find an expert who disagreed with the certifying physician's prognosis."[7]

The Third Circuit, which has embraced the theory that a claim of falsity can arise either "when the facts contained within the claim are untrue" (objective falsity), or when a certification does not comply with relevant regulatory requirements (legal falsity), found that the district court (and the *AseraCare* court) overlooked how a disagreement between medical experts can be used as evidence of legal falsity, because it can demonstrate that the required clinical information and other documentation did not support the certification.

5 *Druding v. Care Alts., Inc.*, 346 F. Supp. 3d 669, 685 (D.N.J. 2018).

6 *United States ex rel. Druding v. Care Alts.*, 952 F.3d 89, 96 (3d Cir. 2020).

7 *Id.* (citing United States ex rel. Polukoff v. St. Mark's Hosp., 895 F.3d 730, 743 (10th Cir. 2018)).

Winter ex rel. United States v. Gardens Regional Hospital and Medical Center

On March 23, 2020, just weeks after the Third Circuit's Care Alternatives decision, the Ninth Circuit Court of Appeals stepped into the fray and reached a similar conclusion, albeit outside the hospice care context. In *Winter ex rel. United States v. Gardens Regional Hospital and Medical Center*, the Ninth Circuit held that "objective falsity" is not required for FCA claims. In *Winter*, the relator, a former hospital employee, contended the defendants had falsely certified that patients' inpatient hospitalizations were medically necessary, based on statistical evidence showing a pattern of admissions of patients from a particular nursing home who did not meet admissions criteria, allegations of pressure by management to increase hospital admissions, and other circumstantial evidence. The district court granted defendants' motion to dismiss, stating "a plaintiff must show that a defendant knowingly made an objectively false representation" because "subjective medical opinions . . . cannot be proven to be objectively false."

The Ninth Circuit reversed, holding that Congress did not limit the FCA to "objective falsity" or carve out an exception for clinical judgments. In concluding a certification of medical necessity can be false, the court pointed to circumstances where the physician's opinion is not honestly held or is based on false underlying facts.

The Ninth Circuit (in contrast to the Third Circuit) carefully harmonized its holding with that of the Eleventh Circuit in *AseraCare*. The Ninth Circuit pointed out that the *AseraCare* opinion was limited to physicians' determinations regarding hospice eligibility and did not necessarily extend to certifications of medical necessity in other contexts subject to different regulatory regimes. The court further noted that the Eleventh Circuit was not asked to consider whether a medical opinion could ever be false or fraudulent, but instead answered the narrower question regarding whether reasonable disagreement between medical experts, without more, was enough to prove falsity at the summary judgment stage.

Perhaps the most important distinction between *Winter* and *AseraCare* is that the *Winter* disposition came at the pleading stage, and the relator at least alleged more than a mere disagreement in medical judgment, including that the defendants were manipulating hospital admission decisions (facts which would indeed be capable of objective proof).

Finally, the Ninth Circuit emphasized that "after alleging a false statement, a plaintiff must still establish scienter" in order to succeed in establishing a claim under the FCA. The court reminded the district court, however, that scienter need not be pleaded with particularity under Rule 9(b) of the Federal Rules of Civil Procedure.

8 *Winter ex rel. United States v. Gardens Reg'l Hosp. & Med. Ctr., Inc.*, 953 F.3d 1108 (9th Cir. 2020).
9 *Id.* at 1113.
10 *Id.* at 1118-19.
11 *Id.* at 1118.
12 *Id.* at 1122.

Will the Supreme Court get involved?

On September 16, 2020, Care Alternatives filed a petition for writ of certiorari in the U.S. Supreme Court, seeking review of the Third Circuit's decision, and in particular "[w]hether a physician's honestly held clinical judgment regarding hospice certification can be 'false' under the [FCA] based solely on a reasonable difference of opinion among physicians."[13] The petition argued that the split between the Third and Eleventh Circuits is "stark" and "outcome-determinative," and "exacerbates the broader disarray among the courts of appeals regarding when an opinion, including physicians' clinical judgments, can be 'false' under the FCA."

Given the division between the Third and Eleventh Circuits in near-identical cases, and the importance of the question raised, there is a reasonable chance that the Supreme Court could grant certiorari in *Care Alternatives*. The Supreme Court has requested a response to the petition in Care Alternatives, and will likely decide whether to grant the petition sometime in early 2021. If the Supreme Court takes up the case and ultimately sides with the Third Circuit, it could make it easier for the government or a relator to survive summary judgment in FCA cases involving clinical opinions. Conversely, if the Supreme Court adopts the Eleventh Circuit's approach, it could make it easier for defendants to obtain summary judgment in FCA actions. For further analysis of these issues, the Chamber of Commerce's **amicus brief** in *Care Alternatives* provides an in-depth look at the circuit split and policy concerns.

13 Petition for Writ of Certiorari, *Care Alts. v. United States, et al. ex rel. Druding, et al.*, No. 20-371 (Sept. 16, 2020).

Looking ahead

The decisions by the Third and Ninth Circuits in *Care Alternatives* and *Winter* may lead defendants to focus or reframe arguments on the scienter element of the FCA in cases premised on allegations regarding a lack of medical necessity underlying submitted claims. Unfortunately, because scienter may be alleged generally at the pleading stage and can also be difficult to disprove indisputably at summary judgment, these cases may further limit FCA defendants' chances of obtaining dismissal prior to trial and result in an unwelcome choice between litigating through discovery or even a trial, or settling.

At a higher level, the issue of whether subjective opinions can create FCA liability is not limited to the health care setting. It can arise in many other professions and industries. With approximately $4 trillion in government assistance being disbursed in 2020 to combat the effects of the COVID-19 pandemic, the stakes for potential exposure under the FCA could not be higher.

As the pandemic continues to disrupt business operations around the world, a decision in *Care Alternatives* could have significant ramifications for any business that availed itself of government assistance. Specifically, as discussed in detail in The CARES Act serves up COVID-19 relief funds along with potential risks and defenses [link to other article], businesses that received forgivable loans through the Paycheck Protection Program (PPP) were required to certify that "[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations" of their business. If the Supreme Court affirms the Third Circuit's decision in *Care Alternatives*, businesses facing FCA claims that allege they falsely certified necessity may find it more difficult to obtain an early disposition. With more than 5.2 million businesses having received PPP loans and over $525 billion in loan disbursements, it is clear why the Supreme Court's handling of the certiorari petition in *Care Alternatives* will continue to draw significant interest.

[14] Small Business Administration, *SBA Form 2483, Paycheck Protection Program Borrower Application Form* (Apr. 2020), available at https://www.sba.gov/sites/default/files/2020-04/PPP-Borrower-Application-Form-Fill-able.pdf.

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The *CIMZNHCA* decision: A third standard for DOJ dismissals

During the past year, there have been additional developments in case law concerning the standard to be applied when the United States Department of Justice (DOJ) seeks to dismiss a suit filed under the qui tam provisions of the False Claims Act (FCA). Until recently, courts had lined up in one of two camps on the government's dismissal power under Section 3730(c)(2)(A) of the Act. On August 17, 2020, the U.S. Court of Appeals for the Seventh Circuit added yet a third standard for evaluating government motions to dismiss when DOJ has declined to intervene in United States ex rel. *CIMZNHCA, LLC v. UCB, Inc.,*[1] *(CIMZNHCA)*.

Background

Section (c)(2)(A) of the FCA provides that DOJ may dismiss qui tam actions "notwithstanding the objections of the person initiating the action if the person has been notified by the government of the filing of the motion and the court has provided the person with an opportunity for a hearing on the motion."[2] Following the release of the so-called Granston Memo in 2018,[3] DOJ has exercised its authority to dismiss under Section (c)(2)(A) with greater frequency than in the past, leading to an uptick in litigation under that provision.

Prior to *CIMZNHCA*, some courts followed the approach taken by the Ninth Circuit in *United States ex rel. Sequoia Orange Co. v. Baird-Neece Packing Corp.* in assessing government motions to dismiss.[4] Under the *Sequoia Orange* test, the government must first identify a "valid government purpose" and then show "a rational relation between dismissal and accomplishment of the purpose."[5] Once the government makes this showing, the burden shifts to the relator to show that "dismissal is fraudulent, arbitrary and capricious, or illegal."[6] Other courts have followed the D.C. Circuit's standard in *Swift v. United States*,[7] which holds that the government has "an unfettered right" to dismiss.

1 970 F.3d 835 (7th Cir. 2020).

2 31 U.S.C. § 3730(c)(2)(A).

3 This was later incorporated into the Justice Manual. See Memorandum from Michael D. Granston, Dir. Com. Lit. Branch, Fraud Section, U.S. Dep't of Justice, to Att'ys in the Com. Lit. Branch, Fraud Section and Assistant U.S. Att'ys Handling False Claims Act Cases, *Factors for Evaluating Dismissal Pursuant to 31 U.S.C. 3730(c)(2)(A)* (Jan. 10, 2018), available at https://assets.documentcloud.org/documents/4358602/Memo-for-Evaluating-Dismissal-Pursuant-to-31-U-S.pdf; Justice Manual, § 4-4.111 – DOJ Dismissal of a Civil Qui Tam Action, available at https://www.justice.gov/jm/jm-4-4000-commercial-litigation#4-4.111.

4 151 F.3d 1139 (9th Cir. 1998).

5 *Id.* at 1145.

6 *Id.*

7 318 F.3d 250, 252 (D.C. Cir. 2003).

The *CIMZNHCA* Decision

The Seventh Circuit opinion in *CIMZNHCA* is the latest word on the issue. CIMZNHCA was one of eleven FCA suits filed by the same relators in different jurisdictions, alleging essentially identical violations of the FCA arising from alleged violations of the Anti-Kickback Statute.[8] DOJ declined to intervene in the qui tam action and moved to dismiss the suit in the U.S. District Court for the Southern District of Illinois. The district court adopted the Ninth Circuit rule, applying a standard akin to the "arbitrary and capricious" standard found in administrative law, and denied dismissal.[9] The government appealed the district court's decision, which stands as only one of two occasions when a court has denied a dismissal request by DOJ since the Granston Memo was issued.[10]

Jurisdiction

On appeal, the Seventh Circuit first had to overcome an objection to the exercise of appellate jurisdiction. The relator argued that the appeal should be dismissed because denial of a motion to dismiss is neither a final appealable order, nor reviewable under the collateral order doctrine.[11] The Ninth Circuit had recently adopted this position in *United States v. Academy Mortgage Corp.*, in which it held that a district court order denying the government's dismissal motion under Section 3730(c)(2)(A) was not an appealable collateral order.[12] The relator further argued that the FCA required the government affirmatively to intervene[13] before exercising any right under Section 3730(c)(2), because, as a non-party, the government has no basis for moving to dismiss. The court acknowledged this limitation, but concluded it could construe the government's motion to dismiss as impliedly incorporating a motion to intervene, and then construed the district court's order as a denial of the government's motion to intervene, which is appealable.[14] Having found jurisdiction, the court went on to address the substance of the appeal.

8 42 U.S.C. § 1320a-7b(b).

9 *United States ex rel. CIMZNHCA, LLC v. UCB, Inc.*, No. 17-CV-765-SMY-MAB, 2019 WL 1598109 (S.D. Ill. Apr. 15, 2019).

10 *See United States v. Academy Mortgage Corp.*, No. 16-cv-02120-EMC, 2018 WL 3208157, at *2-3 (N.D. Cal. June 29, 2018), appeal dismissed, 968 F.3d 996 (9th Cir. 2020).

11 The collateral order doctrine permits appellate review of a narrow set of prejudgment orders that are collateral to the merits of an action, but too important to be denied immediate review.

12 968 F.3d 996, at 1002-10 (9th Cir. 2020) (declining to expand the collateral order doctrine to encompass the government's appeal of the district court's denial of its motion to dismiss).

13 The court read the FCA "to require the government to intervene as a party before exercising its right to dismiss under § 3730(c)(2)(A)" and concluded you should "treat the government's motion to dismiss as a motion both to intervene and to dismiss." *CIMZNHCA LLC*, 970 F.3d at 842, 843; see also *Swift*, 318 F.3d at 252 ("[I]f there were such a requirement, we could construe the government's motion to dismiss as including a motion to intervene.").

14 *See, e.g., United States ex rel. Eisenstein v. City of New York*, 556 U.S. 928, 931 n.2 (2009).

Creation of a third standard

On the merits, the Seventh Circuit rejected the *Sequoia Orange* test as too rigorous, and the *Swift* test as too lax.[15] It instead purported to draw the applicable standard from Federal Rule of Civil Procedure 41(a). Rule 41(a)(1)(A)(i) provides that "the plaintiff may dismiss an action" by serving a notice of dismissal any time "before the opposing party serves either an answer or a motion for summary judgment." Unless the notice states otherwise, dismissal is without prejudice.[16] This right is "absolute" according to the Seventh Circuit. "In other words, once a valid Rule 41(a)(1) notice has been served, 'the case [is] gone; no action remain[s] for the district judge to take.'"[17]

However, Rule 41(a) by its plain terms allows only "the plaintiff" to dismiss, not an intervenor-plaintiff like the government. In addressing this point, the Seventh Circuit reasoned the government,[18] as intervenor-plaintiff, could dismiss because the provisions of Rule 41(a) are "[s]ubject to … *any applicable federal statute,*" which in this case sweeps in the provisions of the FCA.[19] Turning to Section 3730(c)(2)(A) of the FCA, the court observed that "[t]he Government may dismiss the action" without the relator's consent if the relator receives notice and opportunity to be heard.[20] This unrestricted procedural right afforded to the government is the only authorized statutory deviation from Rule 41. Construing Rule 41 and Section 3730(c)(2)(A) together, the Seventh Circuit held that once the required notice and hearing have taken place before an Answer or Motion for Summary Judgment is served, the case could be dismissed.

The Seventh Circuit recognized that its conclusion may seem counterintuitive (i.e., that after notice and a hearing a case is summarily dismissed), but noted that in some cases (unlike the one at issue here) the conditions of Rule 41(a)(1) may not apply. For example, if the litigation has progressed beyond the filing of an Answer or Motion for Summary Judgment, Rule 41(a)(2) would apply and would add an additional condition on top of the notice and hearing requirement for government dismissal—*i.e.*, a "court order, on terms that the court considers proper."[21] In this instance, a required hearing under Section 3730(c)(2)(A) could serve as an opportunity for the relator to air what terms of dismissal, if any, it believes are proper.[22]

15 *CIMZNHCA*, 970 F.3d at 839 (The Seventh Circuit noted, however, that its position lay much nearer to the *Swift* approach than *Sequoia Orange*).

16 Fed. R. Civ. P. 41(a)(1)(B).

17 *CIMZNHCA*, 970 F.3d at 849.

18 Fed. R. Civ. P. 41(a)(1)(A).

19 *Id.*

20 31 U.S.C. § 3730(c)(2)(A).

21 Fed. R. Civ. P. 41(a)(2).

22 *CIMZNHCA*, 970 F.3d at 850-51 ("Thus, if the government's chance to serve notice of dismissal has passed, see Fed. R. Civ. P. 41(a)(1)(A)(i), and the relator by hypothesis refuses to agree to dismissal, see Fed. R. Civ. P. 41(a)(1)(A)(ii), then a hearing under § 3730(c)(2)(A) could serve to air what terms of dismissal are 'proper.'").

Looking ahead

The new approach proffered by the Seventh Circuit appears to provide further latitude to courts to dismiss qui tam actions that should be welcomed by both DOJ and defendants. The *CIMZNHCA* decision affords the government a largely unfettered right to intervene and dismiss over the relator's objection during the early stages of litigation. This will likely serve to reinforce DOJ's increased cadence for seeking dismissal of qui tam actions under the Granston Memo.

As DOJ continues to seek dismissal of qui tam suits, parties should continue to monitor developments in this area, and consider the approach that will likely be applied by a court assessing a motion by the government to dismiss. The increased exercise of DOJ's dismissal authority may well lead to additional disputes over the correct standard of review for Section 3730(c)(2)(A) dismissal, and, indeed, several circuit courts of appeal are currently reviewing district court decisions to grant a government motion to dismiss, affording more circuits an opportunity to weigh in on the appropriate standard for a government motion to dismiss. Most recently on December 1, 2020, the Second Circuit upheld a government motion to dismiss, determining that even under the strictest test, the relator could not prove the government's dismissal was unreasonable.

In short, there now exist three different approaches to DOJ dismissals under the FCA, and there is an opportunity for yet additional splits, or Supreme Court review. The Supreme Court may find it more attractive to address the deepening split after declining to review this topic in April 2020. From a legislative perspective, the topic of DOJ dismissals has also caught the attention of Senator Charles Grassley, who has announced plans to introduce legislation to address perceived flaws in DOJ's dismissal authority.

23 *See Borzilleri, v. Bayer AG*, case number 20-1066, in the U.S. Court of Appeals for the First Circuit; Polansky. v. Exec. Health Res. Inc., case number 19-3810 in the U.S. Court of Appeals for the Third Circuit; and USA ex rel. Health Choice Alliance LLC v. Eli Lilly & Co. Inc., case number 19-40906, in the U.S. Court of Appeals for the Fifth Circuit.

24 *United States ex rel. Borzilleri v. AbbVie, Inc.*, No. 19-2947-CV, 2020 WL 7039048 (2d Cir. Dec. 1, 2020).

On April 6, 2020, the Supreme Court denied a petition for certiorari that could have provided an opportunity for the Court to clarify the standard for DOJ dismissal. *See U.S. ex rel. Schneider v. JPMorgan Chase Bank NA*, No. 19-678 in the Supreme Court of the United States.

26 Prepared Floor Remarks by U.S. Senator Chuck Grassley of Iowa, *Celebrating Whistleblower Appreciation Day* (July 30, 2020), available at https://www.grassley.senate.gov/news/news-releases/grassley-celebrating-whistle-blower-appreciation-day

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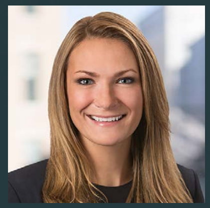

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Recent developments in False Claims Act enforcement of the incentive payment ban in higher education

The United States Department of Justice (DOJ) has used the False Claims Act (FCA) for years to enforce the so-called "incentive payment ban" in higher education. This provision forbids institutions that receive federal student financial aid funds from paying incentive compensation for student recruitment services. The FCA has been an effective enforcement tool in this arena because institutions must certify that they are complying with the incentive payment ban when they participate in the federal student financial aid programs. If an institution is later found to have been making prohibited incentive payments to persons or entities for student recruitment, then the government – or a relator suing on its behalf – may claim the funds were obtained by falsely certifying compliance.

As we discuss further below, the regulatory landscape concerning the incentive payment ban has changed over the years, as various "safe harbors" have come and gone. One such safe harbor, the so-called "bundled services" exception, still exists in the form of sub-regulatory guidance, and has contributed to the growth of online program management companies (OPMs). When higher education institutions decide to establish online programs, they often engage OPMs to handle technology development and support, marketing, and recruitment and enrollment services, among other things.[1] Relying on the "bundled services" exception, institutions often pay OPMs a share of tuition derived from the online programs.

Recently, some members of Congress have raised questions regarding the legal defensibility of the "bundled services" exception, and a recent FCA case suggests DOJ might not consider it a valid defense in an FCA suit.

Background

Title IV of the Higher Education Act of 1965 (HEA) authorizes the student financial aid programs (Title IV Programs) to provide financial assistance to students in higher education.[2] In the late 1980s and early 1990s, there were reports of abuse by for-profit

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1 *See* Margaret Mattes, *The Private Side of Public Higher Education, The Century Foundation* (Aug. 7, 2017), available at https://tcf.org/content/report/private-side-public-higher-education/?session=1.

2 20 U.S.C. §§ 1070 et seq.

colleges that participated in the Title IV Programs, "ranging from the enrollment of prisoners to the falsification of records and signing up of nonexistent students to pad enrollments."[3] In 1991, a Senate investigation found that the federal student loan program, "particularly as it relates to proprietary schools, is riddled with fraud, waste, and abuse."[4] In response, Congress adopted a number of reforms, including the incentive payment ban.

To be eligible to participate in the Title IV Programs, a higher education institution must enter into a "program participation agreement" with the U.S. Department of Education (the Department) in which it certifies its compliance with a long list of rules. One of those rules[5] is the incentive payment ban, which forbids institutions that receive Title IV funds from paying an employee or third party "any commission, bonus, or other incentive payment based directly or indirectly on success in securing enrollments or financial aid" if the employee or third party performs any student recruitment or admissions activities or makes decisions about the award of financial aid.[6]

In the late 1990s and early 2000s, "improper recruiter compensation among for-profit schools was a hot topic."[7] In 2002, after some backlash over its recent enforcement activity, the Department took a new approach to the incentive payment ban.[8] Specifically, the Department adopted new safe harbors, including the first iteration of the "bundled services" exception, which allowed "[p]ayments to third parties, including tuition sharing arrangements, that deliver various services to the institution, even if one of the services involves recruiting or admission activities or the awarding of Title IV, HEA program funds."[9]

In 2010, the Department rescinded the safe harbors regulation, including the section about bundled services.[10] However, on March 17, 2011, the Department published guidance that left open the door for certain third party entities, such as

3 David Whitman, *When President George H. S. Bush 'Cracked Down' on Abuses at For-Profit Colleges, The Century Foundation* (Mar. 9, 2017), available at https://tcf.org/content/report/president-george-h-w-bush-cracked-abuses-profit-colleges/?session=1 (quoting Bruce N. Chaloux, "State Oversight of the Proprietary Sector," *in Community Colleges and Proprietary Schools: Conflict or Convergence? New Directions for Community Colleges 91* (Fall 1995): 89) (internal quotation marks omitted).

4 *Abuses in Federal Student Aid Programs: Report Made by the Permanent Subcommittee on Investigations of the Committee on Governmental Affairs United States Senate*, S. Rep. No. Senate-R-102-58, at 6 (May 17, 1991), available at https://files.eric.ed.gov/fulltext/ED332631.pdf.

5 See 20 U.S.C. § 1094(a).

6 *Id.* § 1094(a)(20).

7 *See* Gretchen Morgenson, *A Whistle Was Blown on ITT; 17 Years Later, It Collapsed, N.Y. Times* (Oct. 21, 2016), available at https://www.nytimes.com/2016/10/23/business/a-whistle-was-blown-on-itt-17-years-later-it-collapsed.html?_r=0

8 *See id.*

9 34 C.F.R. 668.14(b)(22)(ii)(L).

10 75 FR 66832.

OPMs, to earn a share of tuition in exchange for providing institutions with a bundle of services, including student recruitment services.[11] The sub-regulatory guidance stated, "[T]he Department does not consider payment based on the amount of tuition generated by an institution to violate the incentive payment ban if that payment compensates an unaffiliated third party that provides a set of services that may include recruitment services."[12] The Department explained that the independence of the third party entity would provide a safeguard against previously-seen abuses: "When the institution determines the number of enrollments and hires an unaffiliated third party to provide bundled services that include recruitment, payment based on the amount of tuition generated does not incentivize the recruiting as it does when the recruiter is determining the enrollment numbers and there is essentially no limitation on enrollment."[13]

11 Letter from Edward Ochoa, U.S. Dep't of Educ., Assistant Sec'y of Educ. For Postsecondary Educ., to Colleague, *Implementation of Program Integrity Regulations*, at p. 11 (Mar. 17, 2011) available at http://ifap.ed.gov/sites/default/files/attachments/dpcletters/GEN1105.pdf.

12 *Id.*

13 *Id.*

Recent FCA settlements involve the bundled services exception

On October 19, 2020, San Diego Christian College (SDCC) reached a settlement with DOJ over allegations in an FCA qui tam complaint that it unlawfully compensated a now-defunct OPM, Joined, Inc. (Joined), based on its success in recruiting students for enrollment.[14] According to the complaint, SDCC and two other schools that have also entered into settlements, North Greenville University (NGU) and Oral Roberts University (ORU), certified their compliance with the incentive payment ban through execution of a program participation agreement in order to receive Title IV funds.[15] They then allegedly violated the ban by entering into tuition-sharing agreements with Joined, which was affiliated with NGU and "engage[d] primarily in recruiting and enrolling college students" for the defendants. The complaint alleged defendants'[16] claims for federal student financial aid funds violated the FCA because they arose from false certifications of compliance with the ban.[17]

The relator argued the bundled services exception was not available to the defendants. He would not "concede that such an exception, mentioned in neither statute nor regulation, exists or is consistent with congressional intent."[18] Additionally, the relator argued, even if the exception does exist, the defendants would not qualify for the exception for two reasons. First, NGU allegedly held a 33% ownership interest in Joined, which meant that Joined was not an "unaffiliated third party." Second, "the *majority* of the services Joined provided to Defendants involved recruitment, enrollment, and re-enrollment."[19] Notably, however, the bundled services exception, as conveyed in the Department's 2011 guidance, requires that the third party entity in this context provide "a set of services that may include recruitment services."[20] Nothing in the guidance indicates that a bundle of services would not qualify for the exception if recruiting constitutes a "majority" of the total services provided.

14 Press Release, U.S. Dep't of Justice, *California University To Pay $225,000 For Allegedly Violating Ban On Incentive Compensation* (Oct. 19, 2020), available at https://www.justice.gov/opa/pr/california-university-pay-225000-allegedly-violating-ban-incentive-compensation.

15 *See* Complaint, ¶¶ 25-32, *United States ex rel. Shoe v. San Diego Christian Coll.*, No. 6:16-cv-01570 (D.S.C.), Docket No. 1..

16 *Id.* ¶ 1.

17 *Id.* ¶ 23.

18 *Id.* ¶ 38 n.1.

19 *Id.* ¶ 21.

20 Letter from Edward Ochoa, U.S. Dep't of Educ., Assistant Sec'y of Educ. for Postsecondary Educ., to Colleague, *Implementation of Program Integrity Regulations*, at p. 11 (Mar. 17, 2011) available at http://ifap.ed.gov/sites/default/files/attachments/dpcletters/GEN1105.pdf.

Members of Congress question the legality of the bundled services exception

Consumer advocates have been questioning the legality of the bundled services exception for several years, and recently lawmakers started asking questions as well. On January 23, 2020, Senators Elizabeth Warren and Sherrod Brown sent letters to five of the largest OPMs "to express concern about reports of [their] business practices" and to inquire about their "use of federal student aid funds in the administration of OPM services to institutions of higher education that participate in federal student aid programs."[21] The Senators went on to say: "Today, OPM contracts often stipulate that the college or university must share 50% or more of any resulting tuition revenue from students with the OPM. Because these agreements often delegate recruitment responsibilities to the OPM, this tuition-sharing arrangement may violate federal law, which prohibits paying commissions for recruiting and enrolling new students." Finally, they questioned whether the Department's 2011 guidance "is consistent with the text of the Higher Education Act." To consider fully the legality of "bundled services" agreements, the Senators requested that the OPMs provide information and documents, including copies of contracts with Title IV higher education institutions and evidence of compliance "with the incentive compensation provision of the HEA and/or the ED guidance on incentive compensation issued on March 17, 2011."[22]

Looking ahead

The recent settlements and congressional attention demonstrate that the incentive payment ban continues to be an area of enforcement risk, with possible increased scrutiny and regulatory developments under the Biden Administration. Activity in this area warrants ongoing monitoring.

21 Letters from Elizabeth Warren and Sherrod Brown, U.S. Sens. to OPMs, at p. 1 (Jan. 23, 2020) available at https://www.warren.senate.gov/imo/media/doc/Letters%20to%20multiple%20orgs.%20re%20OPM%20Business%20practices.pdf.

22 *Id.* at p. 4.

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Looking ahead

While we are still enduring the effects of a global pandemic, a new presidential administration has been sworn in, and there are plans for trillions of dollars in new federal spending to prop up the economy and battle the COVID-19 virus. We expect all of this to have an effect on the enforcement priorities of the Department of Justice in the new year. The following are several areas where close scrutiny of False Claims Act litigation is warranted in 2021.

COVID-19 stimulus spending

First, companies that availed themselves of the largess bestowed by the Federal Government in response to the COVID-19 pandemic should understand that aggressive anti-fraud enforcement by the Department of Justice has always followed hard upon periods of dramatically increased federal spending. DOJ and qui tam relators have always had a knack for knowing how to "follow the money." Wars, natural catastrophes, and financial crises have often triggered large emergency outlays for defense, disaster relief, or economic stimulus. In the past, such spending has ushered in a period of aggressive prosecution by DOJ and relators of civil suits to recover funds wrongfully obtained from the government by fraud and false claims. The titanic spending bills passed in response to the COVID-19 pandemic create equally enormous opportunities for FCA enforcement. We can expect DOJ to make the investigation and prosecution of fraud schemes related to COVID-19 stimulus bills a high priority in 2021.

At the same time, the manner in which stimulus funding was disbursed may make successful suits more difficult. Vague certification requirements and ambiguous agency guidance promulgated in haste may create insuperable obstacles to demonstrating that beneficiaries of the various stimulus programs knowingly defrauded the government. While we should expect to see active FCA enforcement related to COVID-19 funding, the stimulus legislation and weak implementing guidance can be expected to offer several avenues of defense.

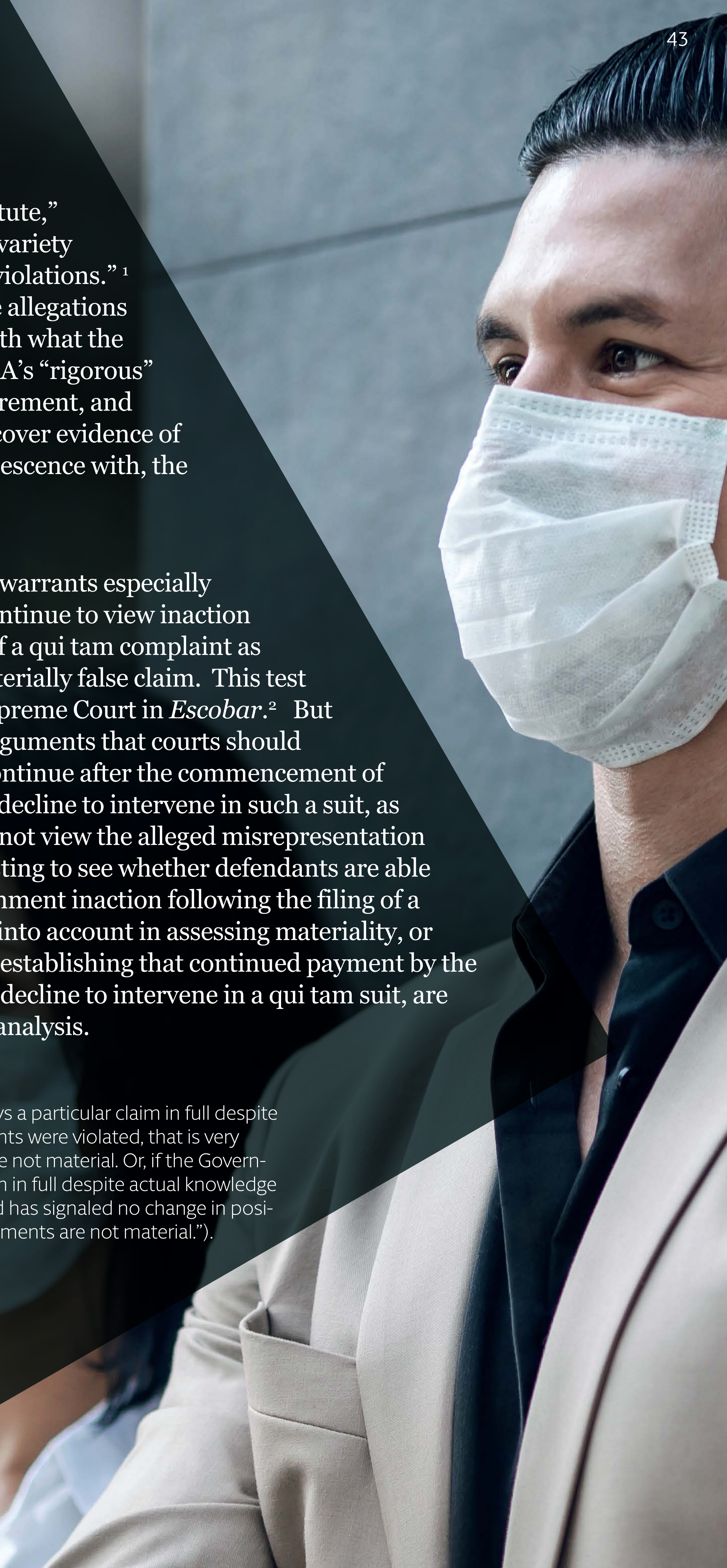
Materiality

In the four years that have passed since the Supreme Court decided *Escobar*, materiality has become the dominant theme in motions to dismiss and motions for summary judgment. Look for continued development of materiality case law in the lower courts, as they grapple with the Supreme Court's instruction that the FCA "is not an all-purpose antifraud statute," or "a vehicle for punishing garden-variety breaches of contract or regulatory violations." [1] DOJ and relators will seek to frame allegations and develop evidence consistent with what the Supreme Court described as the FCA's "rigorous" and "demanding" materiality requirement, and defendants will actively seek to discover evidence of government knowledge of, or acquiescence with, the allegedly wrongful conduct.

[1] *Universal Health Services, Inc. v. United States ex rel. Escobar,* 136 S. Ct. 1989, 2001 (2016).

One thread in the materiality cases warrants especially close study: Whether courts will continue to view inaction by the government after the filing of a qui tam complaint as demonstrating the absence of a materially false claim. This test of materiality was invited by the Supreme Court in *Escobar*.[2] But DOJ has objected vociferously to arguments that courts should consider program payments that continue after the commencement of a qui tam suit, or DOJ's decision to decline to intervene in such a suit, as evidence that the government does not view the alleged misrepresentation as materially false. It will be interesting to see whether defendants are able to persuade more courts that government inaction following the filing of a qui tam complaint should be taken into account in assessing materiality, or whether DOJ ultimately prevails in establishing that continued payment by the government, and DOJ's decision to decline to intervene in a qui tam suit, are wholly irrelevant to the materiality analysis.

[2] *See id.* at 2003-04. ("[I]f 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. Or, 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.").



Government motions to dismiss declined qui tam suits

Since the promulgation of the so-called Granston Memorandum, DOJ has taken a somewhat more active posture in seeking to dismiss declined qui tam suits, and the courts have demonstrated that they are not likely to impose significant barriers to dismissal by the government where it seeks to invoke its right to do so under the FCA. The Granston Memorandum provided defendants with a detailed checklist of the factors that DOJ will consider in determining whether to file a motion to dismiss a declined case, and defendants have actively solicited government motions to dismiss in cases of questionable merit. It remains to be seen whether DOJ will increasingly exercise the dismissal power, or whether the change of presidential administration portends a less energetic use of DOJ's rights under 31 U.S.C. § 3730(c)(2)(A).

In addition, there are now three different approaches to DOJ dismissals under the FCA, and there are additional cases winding their way through the courts that could create additional splits, or prompt Supreme Court review to settle, once-and-for-all, the standard that must be met by the government when it seeks dismissal. The Supreme Court has shown a perennial interest in FCA jurisprudence, and the Circuit split over the dismissal standard is one conflict that could prompt the Court to accept a petition for a writ of certiorari.

Agency subregulatory guidance as the basis for enforcement

One of the hallmarks of the Trump administration was an effort to reduce regulatory burdens on business. That policy was reflected in the enforcement priorities of DOJ. In a memorandum signed by then-Attorney General Jeff Sessions on November 16, 2017, DOJ made a deliberate decision to move away from reliance on Executive Branch agency guidance that is not subjected to the rigors of the notice-and-comment rulemaking process. The memorandum prohibited DOJ components from issuing guidance documents that purport to create rights or obligations binding on persons or entities outside the Executive Branch, and barred line attorneys from using such guidance to coerce "persons or entities outside the federal government into taking any action or refraining from taking any action beyond what is required by the terms of the applicable statute or regulation."

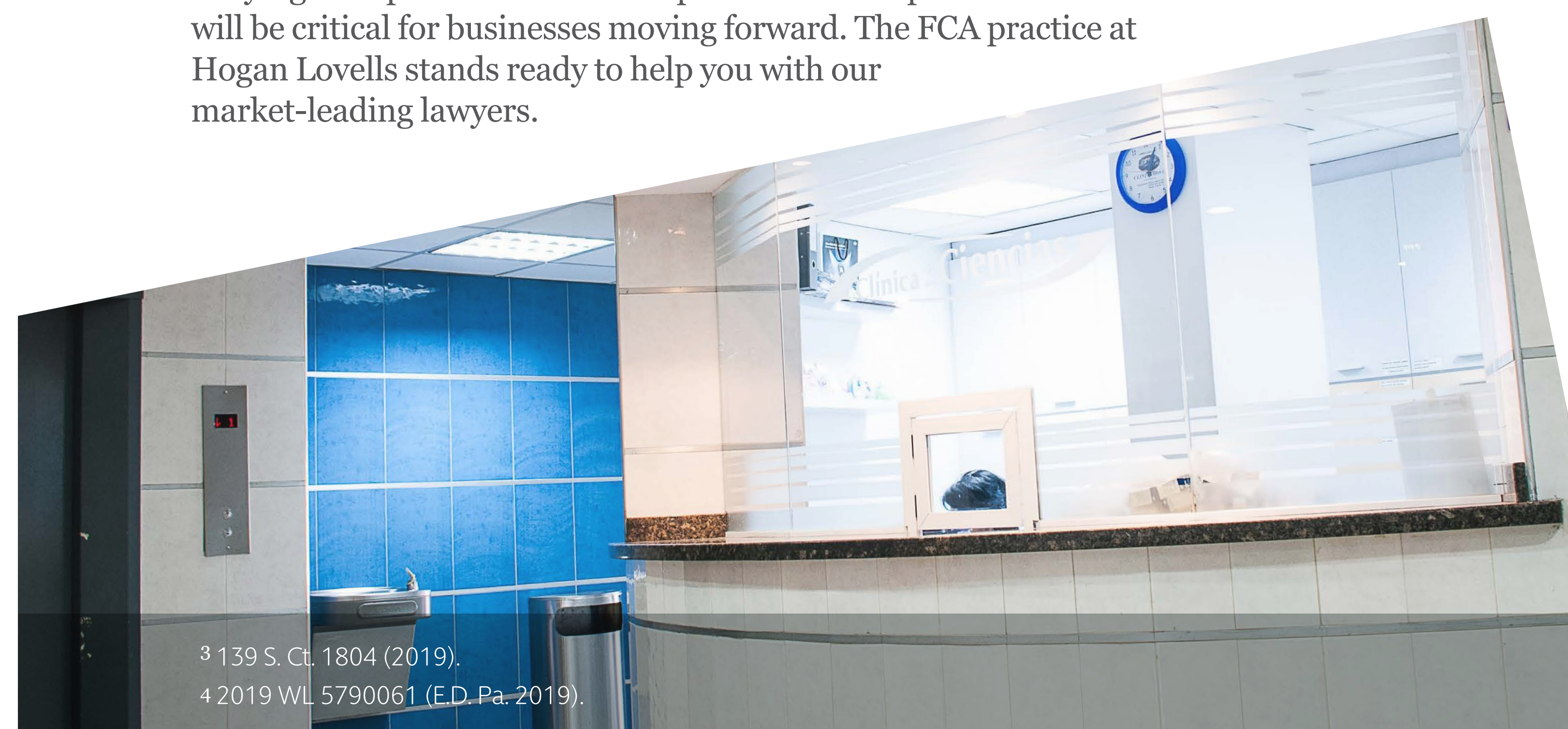
In January 2018, then-Associate Attorney General Rachel Brand issued a memorandum applying these same principles to affirmative civil enforcement cases. While the Sessions memorandum barred the use of guidance documents promulgated by DOJ, the Brand memorandum extended the prohibitions to all agency guidance documents, barring DOJ from using "its enforcement authority to effectively convert agency guidance documents into binding rules." These policies were formally adopted as part of the Justice Manual in December 2018.

While the Brand memorandum and the provisions of the Justice Manual include exceptions for use in a number of circumstances (most notably, agency subregulatory guidance can always be used to establish scienter, notice, knowledge and mens rea, and proof of mental state is an element of every FCA case), the decision by DOJ to eschew reliance on such guidance documents reflects a view that Executive Branch agencies promulgate too many informal interpretations of Congressional enactments and regulate excessively through informal means.

The Supreme Court weighed in on this issue in 2019, holding, in *Azar v. Allina Health Services*,[3] that a Medicare policy dictating the manner of making payments to disproportionate share hospitals had to be vacated because it was not promulgated through the notice-and-comment process dictated by law. A district court subsequently applied the same logic to justify dismissal of an FCA complaint. Seizing upon the analysis in *Azar v Allina Health Services*, the court in *Polansky v. Exec. Health Res., Inc.*[4] held that allegations of Medicare fraud based on the failure to comply with informal guidance issued by the Centers for Medicare and Medicaid Services (CMS) about how hospitals may determine inpatient status were untenable as false claims under the FCA because the purported falsity was based on sub-regulatory guidance that CMS had adopted without going through the rigor of a formal rulemaking process.

It will be interesting to see whether DOJ will, under a new presidential administration, retreat from its assault on agency subregulatory guidance, or whether other courts will follow the path laid out in *Allina* and *Polansky* to block the use of informal agency policies as the basis for FCA enforcement.

Staying on top of these and other potential developments in FCA enforcement will be critical for businesses moving forward. The FCA practice at Hogan Lovells stands ready to help you with our market-leading lawyers.



3 139 S. Ct. 1804 (2019).
4 2019 WL 5790061 (E.D. Pa. 2019).

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