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White Collar Watch

An eye on whistleblowers, false claims and compliance

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Conditions of participation vs. conditions of payment – a recent trend in False Claims Act cases

By Jennifer L. Beidel

IN BRIEF

- **Recently, several courts have dismissed False Claims Act suits after determining that the allegations involved "conditions of participation" rather than "conditions of payment" and therefore did not involve "false" claims for purposes of the False Claims Act.**
- **Although the distinction between "conditions of payment" and "conditions of participation" is fact-specific and better defined in some jurisdictions than in others, defendants facing a False Claims Act lawsuit should consider whether an argument that the allegations are mere conditions of participation could prove a successful defense.**

Recently, several courts have dismissed False Claims Act suits on the basis that the allegations involved conditions of participation, rather than conditions of payment. The rationale of these courts is that a claim for payment is only "false" for purposes of the False Claims Act when the alleged misconduct involves compliance with statutes or regulations that are a condition of governmental *payment* of that claim. When, instead, the alleged misconduct involves compliance with statutes or regulations that are conditions of *participation* in a federal health care program, there is no false claim for payment that can be regulated by the False Claims Act. For defendants facing False Claims Act allegations, then, arguing that the allegations involve conditions of participation could prove a valid defense in some cases.

Two recent decisions – *United States ex rel. Fox Rx Inc. v. Omnicare Inc.* and *United States ex rel. Escobar v. Universal Health Services Inc.* – illustrate this trend.

***United States ex rel. Fox Rx Inc. v. Omnicare Inc.*, Civ. A. No. 12cv275 (DLC) (S.D.N.Y.)**

On August 12, 2014, the U.S. District Court for the Southern District of New York dismissed a False Claims Act suit against three pharmacies and a pharmacy benefits administrator. The defendants provide pharmacy services to long-term care facilities and dispense drugs to 1.4 million facility residents. The suit was brought by Fox Rx, Inc., which sponsored prescription drug plans pursuant to the Medicare Part D prescription drug benefit program.

Sponsors, like Fox, contract with Medicare to administer prescription drug plans; they work with pharmacies to provide the needed drugs to their enrolled beneficiaries. When a prescription is filled, the pharmacy presents a claim to Fox, which, in turn, notifies Medicare and Medicaid. Fox alleges that for some of these filled prescriptions, the defendant pharmacies (1) failed to substitute generic drugs for brand names in states that mandate such substitution, and (2) dispensed drugs beyond the national drug code termination date in states that prohibit dispensing drugs after their shelf-life expiration dates. Fox's theory for a False Claims Act suit, then, was that the defendants had falsely indicated that the dispensed drugs were "covered" by Medicare and had overcharged Medicare and Medicaid, as a result.

The court viewed the allegations as conditions of participation that could not support a False Claims Act theory. The court reasoned that the regulations at issue were "'irrelevant' to the Government's disbursement decisions" and that no other regulations or statutes conditioned reimbursement on the substitution of generic drugs or on national drug code termination dates.

***United States ex rel. Escobar v. Universal Health Services Inc.*, Civ. A. No. 11-11170-DPW (D. Mass.)**

In March 2014, the U.S. District Court for the District of Massachusetts dismissed a False Claims Act lawsuit brought by two individuals, Carmen Correa and Julio Escobar, who alleged that the defendant had provided their daughter with mental health services conducted by unlicensed counselors. Correa and Escobar's theory was that the defendant's claims for government reimbursement of these mental health services were false because the defendant was "systematically violating" state health regulations.

The court scrutinized the regulations cited by Correa and Escobar and concluded that they failed to establish that the claims at issue were "false" because the allegations involved conditions of participation, rather than conditions of payment. In other words, the False Claims Act is designed to police financial fraud on the government; without such fraud, the False Claims Act is not an appropriate mechanism for policing general regulatory compliance.

Recently, however, the Massachusetts Attorney General filed an amicus brief asking the First Circuit to reverse the lower court's decision. In the Attorney General's view, the lower court too rigidly applied the distinction between conditions of participation and conditions of payment. The Attorney General seeks additional "clarity regarding the legal test for ascertaining when a claim can be considered 'false.'"

Whether the First Circuit will reverse in the Correa and Escobar case remains an open question. Additionally, the distinction between conditions of payment and conditions of participation is fact-specific and better defined in some jurisdictions than in others. Nonetheless, a defendant facing a False Claims Act lawsuit should consider whether an argument that the allegations are mere conditions of participation could prove a successful defense.

SEC gives first whistleblower award to audit and compliance employee

By Nicholas J. Nastasi and Marisa R. De Feo

IN BRIEF

- **The Securities and Exchange Commission awarded $300,000 to a whistleblower who performed audit and compliance functions at a company.**

The Securities and Exchange Commission has underscored the importance of a timely response to internal reports of wrongdoing by awarding $300,000 to a whistleblower who was an audit and compliance employee. This award sets a new precedent that may cause an increase in the number of audit and compliance employee whistleblowers complaints.

Generally, SEC regulations preclude whistleblower awards to employees whose principal duties involve compliance or internal audit responsibilities. 17 C.F.R. § 240.21F-4(b)(4)(iii)(B). There is, however, an exception to this rule where the employee first reports the alleged violation internally and then waits at least 120 days before reporting it to the SEC. 17 C.F.R. §

240.21F-4(b)(4)(v)(C). The SEC's whistleblower program rewards high-quality, original information that results in an SEC enforcement action with sanctions exceeding $1 million. Awards can range from 10 percent to 30 percent of the amount recovered by the SEC. The statute is specifically designed to provide employees with a financial incentive to report wrongdoing to the SEC.

The whistleblower program requires the SEC to protect the confidentiality of whistleblowers and prohibits the disclosure of any information that may directly or indirectly reveal their identity. However, it has been reported that the SEC mistakenly released (and later redacted) a reference number that disclosed the identity of the whistleblower who received this award. That case, captioned *SEC v. Phillip J. DeZwirek,* Civil Action No. 134-CIV-6135 (S.D.N.Y.), involved an audit and compliance employee who internally reported concerns to appropriate personnel, including a supervisor. The complaint alleged that the company failed to take action within 120 days, and subsequently, the employee reported the same information to the SEC. The SEC initiated an action against DeZwirek, the former chairman and CEO of the company, charging him with insider trading and numerous other securities violations. Ultimately, the SEC awarded the whistleblower $300,000 – 20 percent of the $1.5 million monetary sanctions it collected in the DeZwirek case – on August 29, 2014.

Sean McKessy, chief of the SEC's Office of the Whistleblower, said "[i]ndividuals who perform internal audit, compliance, and legal functions for companies are on the front lines in the battle against fraud and corruption. They often are privy to the very kinds of specific, timely, and credible information that can prevent an imminent fraud or stop an ongoing one." Because audit and compliance employees are viewed this way by the SEC, it is imperative internal complaints be addressed immediately and well before the expiration of the 120-day limitation.

Whistleblower verdict upheld against Chicago State University

By Christopher R. Hall and Brittany E. McCabe

A Cook County judge recently upheld the verdict in a whistleblower case against Chicago State University. In February 2014, former university employee James Crowley told a jury that Chicago State fired him after he reported misconduct by the school's leadership. Chicago State countered that it terminated Crowley for "improper financial dealings and misuse of university resources." The jury found for Crowley and the judge ordered the university to pay Crowley more than $3 million and to reinstate him.

This judgment is the first under the Illinois state ethics act whistleblower provision. The act provides guidelines and protections for public employees who report potential violations of the ethical guidelines.

Chicago State appealed the verdict in the circuit court on several grounds: (a) the jury foreman had not disclosed that a relative of a Chicago State University trustee had sued him in a wrongful termination case; (b) the damages were excessive; and (c) the university could not reinstate Crowley because Crowley would displace other employees.

The judge questioned the jury foreman and found that the foreman had not intentionally concealed his prior lawsuit. That experience also had not significantly influenced the jury's quick deliberations. The judge further found that Illinois' history of public corruption made the award of more than $3 million necessary even though taxpayers and students eventually bear the expense. The judge emphasized that the public can hold the responsible officials accountable and deter future misconduct. Finally, the judge was not moved by the administrative obstacles the university asserted would make reinstatement difficult. Chicago State had tried to destroy Crowley's career opportunities and reputation. The university will have to pay lost compensation from the date of the decision until any appeals are resolved if it chooses not to reinstate Crowley.

The judge's decision sends a signal to non-profit institutions and government agencies that whistleblower protection schemes apply equally to public and private organizations. This case also sets a precedent for the imposition of increased damages to deter retaliation.

FYI

U.S. Attorney General Holder calls for higher Wall Street whistleblower awards

In a speech at New York University School of Law on September 17, 2014, U.S. Attorney General Eric Holder called on Congress to consider several proposals to assist the government in prosecuting financial fraud. Specifically, Holder proposed that the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA), which currently caps the amount an individual whistleblower can receive for referring a matter to the Securities and Exchange Commission for investigation at $1.6 million, be amended to allow larger whistleblower awards – similar to those under the False Claims Act, which allows for recovery of up to one third of the funds recovered by the government. Holder argued that $1.6 million is a "paltry sum in an industry in which, last year, the collective bonus pool rose above $26 billion" and is "unlikely to induce an employee to risk his or her lucrative career in the financial sector." Holder also proposed that FBI resources, which have significantly shifted toward counter-terrorism efforts since the 9/11 attacks, be increased to keep pace with white-collar investigations. The full speech can be found at http://tinyurl.com/k6jrcas.

DOJ Criminal Division increasing review of False Claims Act lawsuits

On September 17, 2014, Assistant Attorney General Leslie R. Caldwell announced that the Criminal Division of the Department of Justice recently implemented a new procedure whereby it now reviews all False Claims Act lawsuits for criminal conduct as a matter of course. Under the new procedure, the Civil Division shares all new *qui tam* complaints with the Criminal Division as soon as the cases are filed. Previously, the Civil Division forwarded complaints to the Criminal Division only where they believed the particular circumstances warranted a criminal review. Caldwell also encouraged relators and their counsel to "consider reaching out to criminal authorities" even when they are only "thinking of filing a *qui tam* case that alleges conduct that potentially could be criminal." The Criminal Division's increased scrutiny of *qui tam* lawsuits will likely lead to a greater number of parallel civil and criminal investigations and may very well give civil prosecutors and relators' counsel greater leverage in negotiations with False Claims Act defendants. The full speech can be found at http://tinyurl.com/oh874ka.

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