

Escobar in Action: Physician-owners' fraud claims against hospital defeated in Fifth Circuit appeal for lack of materiality

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Following the passage of the Affordable Care Act (“ACA”), which placed new limits on physician-owned hospitals, St. Luke’s Health System (“System”) took action to change one of its hospital’s ownership structures through a buy-out of the physicians’ partnership interests pursuant to the Texas Securities Act (“TSA”). The TSA allows rescission for the original price paid for a security, plus interest, in exchange for a release of potential liability under TSA. Three of the physician-owners, who resisted the System’s attempt to rescind their ownership interests, sued the System and other defendants in connection with the buy-out alleging state-law violations and violations of the Anti-Kickback Statute (“AKS”), 42 U.S.C. § 1320a-7b(b), the Stark Law, 42 U.S.C. § 1395nn, and by extension, the False Claims Act (“FCA”), 31 U.S.C. § 3729-3733. The district court dismissed the federal claims with prejudice. *U.S. ex rel. Patel v. Catholic Health Initiatives*, 312 F. Supp. 3d 584 (S.D. Tex. 2018). Relying heavily on the district court’s lengthy and thorough decision, the United States Court of Appeals for the Fifth Circuit affirmed in a nonprecedential decision. *U.S. ex rel. Patel v. Catholic Health Initiatives*, 2019 U.S. App. LEXIS 34741 (5th Cir. Nov. 20, 2019) (*per curiam*).

The physician Relators first alleged that the process by which the physician-owners were bought out under the TSA resulted in payments to the physician-owners substantially above market value of their stakes in the hospital. According to the Relators, these high prices were set with the intent by the System of maintaining referral relationships with those physicians, in violation of the AKS and Stark Law.

The Relators’ second alleged scheme concerned the System’s false representations to federal and state health care programs about the true ownership of the hospital. The Relators alleged that despite their retained ownership in the hospital after the partial buyout process, the System began representing to the government that the partnership was defunct and that a different entity owned the hospital. According to the Relators, this rendered the System’s representations factually false, leading to violations of both the FCA and the Texas Medicaid Fraud Prevention Act.

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Ultimately, the district court reasoned that while the Relators “might well have had legitimate grievances” and that the complaint had “an abundance of detail,” the claims “[did] not add up to liability under the [FCA]” because “the [FCA] ‘is not an all-purpose antifraud statute or a vehicle for punishing garden-variety breaches of contract or regulatory violations.’” *U.S. ex rel. Patel*, 312 F. Supp. 3d at 589 (quoting *Univ. Health Servs., Inc. v. U.S. ex rel. Escobar*, 136 S. Ct. 1989 2003 (2016)). “More is needed to establish that false or fraudulent claims have been made on the government.” *Id.*

The Fifth Circuit affirmed, rejecting the Relators’ AKS and Stark Law claims because the System “had a reasonable basis to utilize the TSA approach” to try to comply with the ACA, “and nothing ties the allegedly high payment for physician shares to any inducement or referrals.” *U.S. ex rel. Patel*, 2019 U.S. App. LEXIS 34741, at *5.

In affirming the dismissal of the FCA claims, and rather than relying on the district court’s analysis of whether the ownership representations were factually or legally false, the Fifth Circuit “conclude[d] that the alleged falsity, under the circumstances of this case, was not material.” *Id.* at *8. Because “[n]othing in Relators’ filings suggests that that the government would stop the flow of funds to this hospital if it knew the truth of its ownership,” and because “the System has continued to submit claims and receive reimbursement, even after a court determined that the entity designated as owner of the [h]ospital was not really the owner,” the Fifth Circuit found the alleged falsity immaterial. *Id.* at *9-10. “This suggests that the government does not care who the ‘rightful’ owner of the hospital is, and Relators have not alleged facts to the contrary.” *Id.* at *10.

The case is another example of *Escobar* in action, and a reminder that FCA claims, even if very detailed with allegations of breaches of contract and regulatory violations, are unlikely to survive a motion to dismiss unless the materiality of the false claims can be established.