UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA
CIVIL MINUTES – GENERAL

Case No.	**EDCV 16-1097-VAP (JEMx)**	Date	August 22, 2018
Title	***Prime Healthcare Servs., et al. v. Humana Ins. Co.***		

Present: The Honorable	VIRGINIA A. PHILLIPS, CHIEF UNITED STATES DISTRICT JUDGE

BEATRICE HERRERA	Not Reported
Deputy Clerk	Court Reporter

Attorney(s) Present for Plaintiff(s):	Attorney(s) Present for Defendant(s):
None Present	None Present

Proceedings: **MINUTE ORDER DENYING IN PART AND GRANTING IN PART PLAINTIFFS' MOTION FOR SANCTIONS (DOC. NO. 104) (IN CHAMBERS)**

Plaintiffs Prime Healthcare Services, Inc., et al.[1] ("Plaintiffs") filed a Motion for Sanctions under Federal Rule of Civil Procedure 11(b), 28 U.S.C. § 1927, and

[1] The Plaintiffs are: (1) Alvarado Hospital LLC dba Alvarado Hospital Medical Center; (2) Veritas Health Services, Inc. dba Chino Valley Medical Center; (3) Desert Valley Hospital, Inc. dba Desert Valley Hospital; (4) Prime Healthcare Services—Garden Grove, LLC dba Garden Grove Hospital & Medical Center; (5) Prime Healthcare Huntington Beach, LLC dba Huntington Beach Hospital; (6) Prime Healthcare Services—La Palma, LLC dba La Palma Intercommunity Hospital; (7) Prime Healthcare Services—Montclair, LLC dba Montclair Hospital Medical Center; (8) Prime Healthcare Paradise Valley, LLC dba Paradise Valley Hospital; (9) Prime Healthcare Services—San Dimas, LLC dba San Dimas Community Hospital; (10) Prime Healthcare Services—Shasta, LLC dba Shasta Regional Medical Center; (11) Prime Healthcare Services—Sherman Oaks, LLC dba Sherman Oaks Hospital; (12) Prime Healthcare Anaheim, LLC dba West Anaheim Medical Center; (13) Prime Healthcare Services—North Vista, LLC dba North Vista Hospital; (14) Prime Healthcare Services—Reno, LLC dba Saint Mary's Regional Medical Center; (15) Prime Healthcare Services—St. Mary's Passaic, LLC dba St. Mary's General Hospital; (16) Prime Healthcare Services—Garden

Local Rules 11-9 and 83-7 on June 25, 2018. (Doc. No. 104 ("Motion").) Defendant Humana Insurance Company ("Defendant" or "Humana") timely opposed the Motion on July 2, 2018, (Doc. No. 108 ("Opposition")), and Plaintiffs replied on July 18, 2018, (Doc. No. 112). After considering all papers filed in support of and in opposition to Defendant's Motion, as well as arguments advanced at the August 20, 2018 hearing on this Motion, the Court DENIES in part and GRANTS in part the Motion.

I. BACKGROUND

A. Statutory Framework – The Medicare Act

This case concerns Part C of the Medicare Act (the "Act" or "Medicare"). (*See* Doc. No. 89 ("5AC").) Under Part C, Medicare enrollees can receive Medicare benefits through a plan, known as Medicare Advantage ("MA") plans, offered by a Medicare Advantage Organization (individually "MAO," or collectively "MAOs") instead of the government. 42 U.S.C. § 1395w-21, 27. MAOs are private insurance companies, such as Defendant, that contract with the Centers for Medicare and Medicaid Services ("CMS"), an agency within the Department of Health and Human Services ("HHS"), to manage the Medicare benefits of Part C enrollees. *See id.; Tenet Healthsystem GB, Inc. v. Care Improvement Plus South Central Ins. Co.*, 875 F.3d 584, 586 (11th Cir. 2017).

> CMS pays an MAO a fixed amount for each enrollee, per capita (a "capitation"). The MAO then administers Medicare benefits for those enrollees and assumes the risk associated with insuring them. MAOs like Humana are thus responsible for paying covered medical expenses for their enrollees. Part C allows MAOs some flexibility as

City, LLC dba Garden City Hospital; (17) Prime Healthcare Services—Pampa Regional Medical Center, LLC dba Pampa Regional Medical Center; and, (18) Prime Healthcare Foundation, Inc.

> to the design of their MA plans. The MAO is required to provide the benefits covered under Parts A and B to enrollees, but it may also provide additional benefits to its enrollees.

In re Avandia Mktg., 685 F.3d at 357-58 (citing 42 U.S.C. § 1395w–22(a)(1)–(3)).

"MAOs pay third-party healthcare providers to treat enrollees." *Tenet Healthsystem*, 875 F.3d at 587; *see also Prime Healthcare Huntington Beach, LLC v. SCAN Health Plan*, 210 F. Supp. 3d 1225, 1227 (C.D. Cal. 2016) ("*SCAN Health*"). These healthcare providers may be "contract providers" or "noncontract providers." *Tenet Healthsystem*, 875 F.3d at 587-88. Contract providers, also referred to as in-network providers, have express, written contracts with the MAO, whereby the MAO "agrees to pay certain rates for certain categories of treatment." *Id*. at 587 (citing 42 U.S.C. § 1395w-25(b)(4)). "The Medicare Act permits these types of contracts, and provides very few limitations on how they can be drafted." *Id*. Noncontract providers, also referred to as out-of-network providers, seek reimbursement from the MAO after providing services to a Medicare Part C enrollee. *Id*. at 588. Noncontract providers are reimbursed based on rates set by the Medicare Act and related regulations. 42 C.F.R. § 422.214. Plaintiffs here are contract providers.

"Jurisdiction over cases 'arising under' Medicare exists only under 42 U.S.C. § 405(g), which requires an agency decision in advance of judicial review." *Kaiser v. Blue Cross of Calif.*, 347 F.3d 1107, 1111 (9th Cir. 2003) (citing 42 U.S.C. § 405(g)); *see also Do Sung Uhm v. Humana, Inc.*, 620 F.3d 1134, 1140 (9th Cir. 2010) ("The Act's exhaustion requirement, 42 U.S.C. § 405(h), makes judicial review under a related provision, 42 U.S.C. § 405(g), 'the sole avenue for judicial review' for claims ''arising under' the Medicare Act.'" (quoting *Heckler v. Ringer,* 466 U.S. 602, 614–15 (1984))); *Tenet Healthsystem*,

875 F.3d at 587 ("A party may only bring suit in an Article III court to challenge an organization determination once all of the administrative remedies provided by the act and its regulations have been exhausted."). "Federal regulations provide for a separate MAO administrative review process [pursuant to 42 U.S.C. § 405(g)] for MAO benefits determinations (or 'organization determinations')." *SCAN Health*, 210 F. Supp. 3d at 1229 (citing various provision in 42 C.F.R. Ch IV, Subch. B, Pt. 422). "HHS's regulations define potential parties to an 'organization determination' as an 'enrollee,' the 'assignee of an enrollee,' the 'legal representative of a deceased enrollee's estate,' or '[a]ny other provider or entity (other than the MA organization) determined to have an appealable interest in the proceeding.'" *Tenet Healthsystem*, 875 F.3d at 587 (citing 42 C.F.R. § 422.574). Where, as here, a suit is brought against an MAO, 42 U.S.C. § 405(h) "limits this Court's jurisdiction over unexhausted claims to those that do not 'arise under' Medicare." *SCAN Health*, 210 F. Supp. 3d at 1231.

B. Factual and Procedural Background

Plaintiff Prime Healthcare Services, Inc. owns and operates hospitals throughout the country, including the plaintiff-hospitals in this case. (5AC ¶¶ 24-42.) Defendant is a health insurance company and MAO. (*Id*. ¶ 20.) Plaintiffs and Defendant entered into two contracts — one contract is a Letter of Agreement ("LOA") between all Plaintiffs except Garden City Hospital and Defendant, and the other is the "Garden City Agreement," between Plaintiff Garden City Hospital and Defendant — under which Plaintiffs agreed to provide hospital services to Defendant's Medicare Advantage health plan enrollees. (*Id.* ¶¶ 21-22.) In other words, Plaintiffs are Defendant's contract — *i.e.*, in-network — providers. (*Id*.) In the operative complaint, Plaintiffs seek damages for a single claim — breach of written contract — based on allegations that Defendant

underpaid or did not pay at all for services rendered by Plaintiffs to Defendant's enrollees from August 1, 2012 through February 29, 2016. (*Id*. ¶ 23, 64-69.)

Plaintiffs initiated this action on May 26, 2016.[2] (Doc. No. 1.) They filed a First Amended Complaint ("FAC") as a matter of course on August 31, 2016, alleging six claims: (1) breach of written contract; (2) breach of oral contract; (3) breach of implied-in-fact contract; (4) breach of implied covenant of good faith and fair dealing; (5) negligent misrepresentation; and (6) violation of California Unfair Competition Law ("UCL"), Bus. & Prof. Code § 17200. (Doc. No. 19.) Defendant moved to dismiss Plaintiffs' FAC, arguing (1) Plaintiffs' claims were preempted under the Medicare Act as they relate to areas governed by Medicare Advantage standards; (2) the Court did not have jurisdiction over Plaintiffs' claims because Plaintiffs failed to exhaust their administrative remedies; (3) Plaintiffs' negligent misrepresentation claim failed because courts do not recognize a claim for a negligent false promise; and (4) Plaintiffs failed to plead their negligent misrepresentation claim with sufficient particularity to satisfy Rule 9(b). (*See* Doc. No. 22 ("FAC MTD").) The Court dismissed with leave to amend Plaintiffs' FAC based on Defendant's exhaustion argument alone. (*See* Doc. No. 30 ("FAC Order").)

Plaintiffs filed their Second Amended Complaint ("SAC") on November 18, 2016, re-alleging the same claims as those contained in the FAC. (Doc. No. 31.) On December 2, 2016, Defendant moved to dismiss Plaintiffs' SAC on the same grounds as its first motion to dismiss. (Doc. No. 32 ("SAC MTD").) The Court again dismissed Plaintiffs' complaint with leave to amend on the ground that it did

[2] The procedural history of this case is lengthy and known to the parties. The Court discusses it here only insofar as it bears on this Motion.

not have jurisdiction because Plaintiffs had not exhausted their administrative remedies. (Doc. No. 43 ("SAC Order").) The Court also separately considered Defendant's arguments regarding Plaintiffs' inadequate pleading of their negligent misrepresentation claim, and granted Defendant's motion on Rule 12(b)(6) grounds as to this claim only. (*Id*. at 15-18.)

On December 4, 2017, Plaintiffs moved for reconsideration of the Court's order dismissing Plaintiffs' SAC pursuant to Federal Rule of Civil Procedure 60, or, in the alternative, for leave to amend. (Doc. No. 77.)[3] Plaintiffs argued that new evidence warranted the Court's reconsideration because they had sought to pursue the administrative review process Defendant had asserted was mandatory. (*See id*.) In doing so, Plaintiffs obtained evidence showing that, consistent with relevant Medicare laws and regulations, this review process was entirely unavailable to contract providers such as Plaintiffs. (*See id*.) This evidence, submitted again in support of the instant Motion, includes correspondence with a representative of Maximus, the contractor that conducts administrative reviews on behalf of the federal government when an appeal arises from a Medicare Advantage claim. Maximus's representative confirmed that a contract provider had no right to act as the party in an appeal to Maximus, and any payment dispute between a contract provider and a MAO had to be resolved outside of the Medicare appeals process. (Doc. No. 104-1.)

[3] In the intervening period, Plaintiffs filed a Third Amended Complaint ("TAC"), alleging four claims: (1) breach of oral contract; (2) breach of implied-in-fact contract; (3) negligent misrepresentation; and (4) violation of UCL, Bus. & Prof. Code § 17200. (Doc. No. 45.) Defendant filed a motion to dismiss Plaintiffs' negligent misrepresentation claim only, (Doc. No. 46), which the Court granted with prejudice, (Doc. No. 50).

Rather than opposing Plaintiffs' motion, Defendant stipulated to Plaintiffs' filing of their Fourth Amended Complaint ("4AC"). (Doc. No. 78 ("Stipulation").) The Stipulation reads, in part,

> The Court's January 27, 2017 Order (the "[SAC] Order") is superseded to the extent it dismissed Plaintiffs' contracted Medicare claims on the grounds that Plaintiffs failed to exhaust the Medicare appeals process. The Order shall be modified to reflect that this Court has jurisdiction to adjudicate Plaintiffs' claims for the contracted Medicare claims at issue and those claims should not be dismissed at the pleading stage for failure to exhaust the Medicare appeals process, and Plaintiffs should be permitted to reassert these claims in the Fourth Amended Complaint.

(*Id*. ¶ 3.) Further, Defendant agreed that it would not move to dismiss Plaintiffs' 4AC on the basis that any of the contracted Medicare claims are subject to the Medicare exhaustion requirement, and Plaintiffs withdrew their motion for reconsideration. (*Id*. at 1-2.)[4] On January 10, 2018, the Court granted the parties' Stipulation. (Doc. No. 79.)

Since then, in the course of a separate proceeding, Defendant's corporate representatives have testified under oath regarding similar issues to those presented in this action. (Doc. No. 104-2.) In April 2018, Ms. Amy Grimes,

[4] In its order denying Defendant's motion to dismiss Plaintiffs' 5AC, the Court separately confirmed that Plaintiffs' claim is not subject to the exhaustion requirement since the Court has an independent duty to ensure that it has subject matter jurisdiction over an action. (Doc. No. 103 ("5AC Order") at 9 n. 2.) Critical to this analysis is that Plaintiffs are contract providers, and the relevant Medicare regulations do not provide an avenue for contract providers to appeal a determination. (*Id*.); *see also* CMS Pub. 100-16, Medicare Managed Care Manual, Chap. 13 § 70.1 ("Any party to an organization determination . . . i.e., an enrollee, an enrollee's representative or a non-contract physician or provider to the Medicare health plan may request that the determination be reconsidered. However, contract providers do not have appeal rights."). As explained in the 5AC Order, without an opportunity for administrative review, Plaintiffs cannot be subject to the exhaustion requirement. (*Id*.)

Defendant's corporate representative and director of Defendant's operational risk, compliance, and resolution team, testified that Defendant has distinct administrative appeals procedures and departments for claims submitted by contract and non-contract providers, such that contract providers' appeals are not submitted for federal administrative review, but non-contract providers' appeal are so submitted. (Doc. No. 104-2, Ex. B ("Grimes Dep.") at 9:23-10:9, 13:8-14:25, 15:19-16:5, 61:4-19.) Further, she testified that this divided appeals process was Defendant's long-standing practice. (*Id*. at 24:22-25, 61:4-19.)

Another one of Defendant's corporate representatives, Ms. Tanya Anker, who has worked for Defendant for 11 years and ensures processes are followed for contract provider disputes, provided testimony consistent with that of Ms. Grimes. (Doc. No. 104-2, Ex. A ("Anker Dep.").) She testified that she was not aware of any circumstance in which someone in her group would submit a claim to Maximus, and she would expect to be aware if Maximus was involved with contracted providers. (*Id*. at 26:5-8, 29:20-25.)

Based on Defendant's corporate representatives' testimony, correspondence with Maximus's representative, and the Stipulation, Plaintiffs contend that Defendant falsely represented to the Court in this action that: (1) the federal administrative review process was available to contracted providers, specifically Plaintiffs; (2) Plaintiffs had not exhausted this process because they had to submit appeals directly to Maximus, which they had failed to do; (3) Defendant's internal appeals process was not available for contracted Medicare claims; and (4) Defendant could not supplant the federal administrative review process with its own internal process. (Mot. at 14.) Plaintiffs argue that these

misrepresentations provide grounds for sanctions, and thus bring the instant Motion.

II. JUDICIAL NOTICE

Plaintiffs request that the Court take judicial notice of the Declaration of Theresa Smith and the accompanying exhibits, which were previously filed in this action at docket number 77-3. (Doc. No. 105 ("RJN").) Ms. Smith is one of Plaintiffs' representatives who pursues billing issues on behalf of Plaintiffs, and the exhibits attached to her declaration consist of appeals to MAXIMUS, the contractor through which the federal government processes Medicare Part C appeals, and related correspondence. (Doc. No. 77-3.)

Under Federal Rule of Evidence 201(b), a "judicially noticed fact must be one not subject to reasonable dispute in that it is either (1) generally known within the territorial jurisdiction of the trial court, or (2) capable of accurate and ready determination by resort to sources whose accuracy cannot reasonably be questioned." Fed. R. Evid. 201(b). "While the authenticity and existence of a particular order, motion, pleading or judicial proceeding, which is a matter of public record, is judicially noticeable, veracity and validity of its contents (the underlying arguments made by the parties, disputed facts, and conclusions of applicable facts or law) are not." *United States v. Southern California Edison Co.*, 300 F. Supp. 2d 964, 974 (E.D. Cal 2004) (citing *Lee v. City of Los Angeles*, 250 F.3d 668, 690 (9th Cir. 2001)). Plaintiffs seek judicial notice of the contents of the documents. (*See* RJN.) As the contents are not the proper subject of judicial notice, the Court DENIES Plaintiffs' Request.

Further, Plaintiffs indicated that "[the document] is attached primarily for the Court's convenience." (RJN at 3.) No document was attached to Plaintiffs' Request for Judicial Notice. The Court also advises Plaintiffs that they "need not seek judicial notice of documents previously filed in the same case. An accurate citation will suffice." *NovelPoster v. Javitch Canfield Group*, No. 13-CV-05186-WHO, 2014 WL 5594969, at *4 n. 7 (N.D. Cal. Nov. 3, 2014).

III. DISCUSSION

Plaintiffs seek to have the Court sanction Defendant under Federal Rule of Civil Procedure 11(b), 28 U.S.C. § 1927, and Local Rules 11-9 and 83-7. (*See* Mot.) The grounds for sanctions under Local Rules 11-9 and 83-7 and the Court's inherent power are encompassed within Rule 11 and 28 U.S.C. § 1927. *See* C.D. Cal. L.R. 11-9 (giving the Court discretion to issue sanctions where a party files a frivolous motion); C.D. Cal. L.R. 83-7(a) (empowering the Court to issue monetary sanctions for a violation of the Local Rules and upon a finding that the offending party's conduct "was willful, grossly negligent, or reckless"); C.D. Cal. L.R. 83-7(b) (empowering the Court to award costs and attorneys' fees to opposing counsel upon a finding that the offending party acted in bad faith). Thus, the Court does not separately analyze whether sanctions are warranted under the Local Rules. The Court addresses Plaintiffs' arguments for sanctions under Rule 11 and § 1927 in turn.

A. Rule 11

Plaintiffs argue that Defendant's factual representations in support of its exhaustion arguments in the FAC MTD and SAC MTD were false and frivolous, and thus sanctionable under Rule 11.

"Rule 11 imposes a duty on attorneys to certify by their signature that (1) they have read the pleadings or the motions they file and (2) the pleading or motion is 'well-grounded in fact,' has a colorable basis in law, and is not filed for an improper purpose." *Sec. Farms v. Int'l Bhd. of Teamsters, Chauffers, Warehousemen & Helpers*, 124 F.3d 999, 1016 (9th Cir. 1997) (citing Fed. R. Civ. P. 11; *Smith v. Ricks,* 31 F.3d 1478, 1488 (9th Cir.1994)). The Ninth Circuit has explained that "Rule 11 addresses two separate problems: first, the problem of frivolous filings; and second, the problem of misusing judicial procedures as a weapon for personal or economic harassment." *Aetna Life Ins. Co. v. Alla Med. Servs., Inc.*, 855 F.2d 1470, 1475 (9th Cir. 1988) (internal quotation marks omitted). "Although the 'improper purpose' and 'frivolousness' inquiries are separate and distinct, they will often overlap since evidence bearing on frivolousness or non-frivolousness will often be highly probative of purpose." *Townsend v. Holman Consulting Corp.*, 929 F.2d 1358, 1362 (9th Cir. 1990).

A pleading is "frivolous" if it is "*both* baseless and made without a reasonable and competent inquiry." *Id*. (emphasis in original). This determination is made under an objective reasonableness standard and does not require a finding of subjective bad faith. *In re Keegan Mgmt. Co., Sec. Litig.*, 78 F.3d 431, 434 (9th Cir. 1995); *Zaldivar v. City of Los Angeles*, 780 F.2d 825, 831 (9th Cir. 1986), *abrogated on other grounds by Cooter & Gell v. Hartmarx Corp.*, 496 U.S. 384, 399-400 (1990). "An assertion is baseless when it lacks a factual foundation, and a competent attorney could not form a reasonable belief that it is warranted by existing law or a good faith argument for extension, modification, or reversal of existing law." *Altamont Summit Apartments LLC v. Wolff Properties LLC*, No. CV 01-1260-BR, 2002 WL 31971832, at *2 (D. Or. Aug. 21, 2002) (citing *Montrose Chem. Corp. of Cal. v. Am. Motorists Ins. Co.*, 117 F.3d 1128,

1133 (9th Cir. 1997); *Golden Eagle Distrib. Corp. v. Burroughs Corp.*, 801 F.2d 1531, 1538 (9th Cir. 1986)). Some factors courts consider in determining whether a reasonable inquiry was made include: (1) "the knowledge that reasonably could have been acquired at the time the pleading was filed"; (2) "an assessment of the type of claim and the difficulty of acquiring sufficient information"; (3) "an assessment of which party has access to the relevant facts"; and (4) the significance of the frivolous portion in relation to the pleading as a whole. *Townsend*, 929 F.2d at 1364. The Ninth Circuit has emphasized the affirmative duty Rule 11 places on counsel to make further inquiries where necessary to ensure their pleadings are well-grounded in fact, noting that "[c]ounsel . . . may not avoid 'the sting of Rule 11 sanctions by operating under the guise of a pure heart and empty head.'" *Sec. Farms*, 124 F.3d at 1016 (quoting *Smith v. Ricks,* 31 F.3d 1478, 1488 (9th Cir.1994)).

Rule 11 provides specific examples of filings for an "improper purpose" — namely, to harass, cause unnecessary delay, or needlessly increase the cost of litigation. Fed. R. Civ. P. 11(b)(1). The Ninth Circuit has separately addressed when motions may be deemed to have been filed for an improper purpose:

> Although a complaint that is filed for an improper purpose will not be sanctionable unless it is frivolous, [citation omitted] there comes a point when successive motions and papers become so harassing and vexatious that they justify sanctions even if they are not totally frivolous under the standards set forth in our prior cases. If a court finds that a motion or paper, other than a complaint, is filed in the context of a persistent pattern of clearly abusive litigation activity, it will be deemed to have been filed for an improper purpose and sanctionable.

Aetna, 855 F.2d at 1476.

Here, Plaintiffs argue they are entitled to sanctions because Defendant falsely represented: (1) the federal administrative review process was available to contracted providers, specifically Plaintiffs; (2) Plaintiffs had not exhausted this process because they had to submit appeals directly to Maximus, which they had failed to do; (3) Defendant's internal appeals process was not available for contracted Medicare claims; and (4) Defendant could not supplant the federal administrative review process with its own internal process. (Mot. at 14.)

Defendant counters that (1) it did not know whether Plaintiffs were pursuing claims on behalf of enrollees; (2) its motions were not legally baseless because two courts — the Arizona Supreme Court and a federal district court in Florida — had left open the possibility that contract providers would have to exhaust administrative remedies before pursuing a claim against a MAO; and (3) neither Defendant's in-house nor outside counsel knew how Defendant's own appeals process and departments worked — namely, that they were unaware that Defendant's appeals division does not send contracted providers' Medicare Advantage claims to Maximus for review. (Opp'n at 12; Doc. No. 108-1 ("Romano Decl.") ¶¶ 5-6; Doc. No. 108-3 ("Paradis Decl.") ¶¶ 6, 8.) Notably, neither Defendant nor its counsel detail the factual inquiry that in-house or outside counsel made into Defendant's own appeals process, or even state that a reasonable inquiry was made. (*See* Opp'n; Romano Decl.; Paradis Decl.)

Defendant's first argument is unavailing because Plaintiffs' claims have been consistently based on their contracts with Defendant. Nothing in Plaintiffs' complaints or the related motion papers suggest they were pursuing claims on behalf of enrollees, and thus required them to exhaust administrative review.

Defendant's second argument misses the mark because a motion or an argument contained therein can be frivolous if it is *factually* baseless. Here, Defendant's in-house and outside counsel offer no explanation for why they were not aware of Defendant's own long-standing appeals process, nor do they affirm that even inquired into it. Had there been a reasonable inquiry of Defendant's own appeals divisions, counsel would have learned that the process they argued was required of Plaintiffs was not, in fact, available.

Specifically, Defendant stridently argued that Plaintiffs, who are contract providers, had to first comply with Defendant's internal appeal procedures, and then pursue the federal administrative review process. (*See* SAC MTD at 7-9; Doc. No. 37 at 1-6.) Yet, as discussed above, Ms. Grimes and Ms. Anker testified that the federal review process is not available to contract providers. For instance, she testified:

> Q: Are contracted providers' appeals on Medicare Advantage claims ever submitted to the federal contractor for review?
>
> A: It is not part of the process.
>
> Q: Has it ever been part of the process?
>
> A: No.

(Grimes Dep. 13:9-14.) Ms. Grimes further explained that appeals by non-contract providers, members, or beneficiaries would have to be submitted for federal review after Defendant's internal appeals process because Medicare regulations so require it. (*Id*. 13:22-14:25.) Defendant does not contest the accuracy of Ms. Grimes nor Ms. Anker's testimony regarding the structure of Defendant's appeals divisions, the processes they follow, or the consistency of these processes with Medicare law and regulations.

Defendant is not insulated from a finding of a Rule 11 violation simply because Defendant's in-house and outside counsel did not, in fact, know how Defendant's appeals process works. As the Ninth Circuit has made clear, a pure heart and an empty head is not a defense to Rule 11 sanctions. *See Sec. Farms*, 124 F.3d at 1016 (quoting *Smith v. Ricks,* 31 F.3d 1478, 1488 (9th Cir.1994)).

It is objectively unreasonable for Defendant and its counsel to be unaware of Defendant's own long-standing appeals process. They were in place at the time both the FAC MTD and the SAC MTD were filed. Defendant had access to its own corporate representatives who had knowledge of how these processes worked in practice and the reasons underlying them. This issue of exhaustion, while not the entire basis of either motion to dismiss, was critical, as it concerned a threshold question of jurisdiction. After consideration of the *Townsend* factors, the Court finds that Defendant and its in-house and outside counsel did not conduct a reasonable inquiry before making representations to this Court regarding Defendant's internal appeals process and the federal review process available to Plaintiffs.

Accordingly, the Court finds that Defendant violated Rule 11 by making a frivolous argument regarding Plaintiffs' failure to exhaust their administrative remedies in its FAC MTD and SAC MTD.

B. 28 U.S.C. § 1927

Plaintiffs also argue that Defendant acted recklessly and in bad faith, thus warranting sanctions under 28 U.S.C. § 1927. 28 U.S.C. § 1927 provides:

> Any attorney. . . who so multiplies the proceedings in any case unreasonably and vexatiously may be required by the court to satisfy

> personally the excess costs, expenses, and attorneys' fees reasonably incurred because of such conduct.

The statute "applies only to unnecessary filings and tactics once a lawsuit has begun." *In re Keegan,* 78 F.3d at 435.

Unlike sanctions awarded under Rule 11, "section 1927 sanctions must be supported by a finding of subjective bad faith." *Id*. (internal formatting and citations omitted). "Bad faith is present when an attorney knowingly or recklessly raises a frivolous argument, or argues a meritorious claim for the purpose of harassing an opponent." *Id*. (quoting *Estate of Blas v. Winkler,* 792 F.2d 858, 860 (9th Cir.1986)). The Ninth Circuit has emphasized that "[t]he bad faith requirement sets a high threshold." *Primus Auto. Fin. Servs., Inc. v. Batarse*, 115 F.3d 644, 648 (9th Cir. 1997). "Even in a case where the district court described a litigant's arguments as 'totally frivolous,' 'outrageous' and 'inexcusable' and called his behavior 'appalling,' [the Ninth Circuit] nonetheless refused to equate this characterization of conduct as synonymous with a finding of bad faith." *Mendez v. County of San Bernardino,* 540 F.3d 1109, 1132 (9th Cir. 2008), *overruled on other grounds by Arizona v. ASARCO LLC*, 773 F.3d 1050 (9th Cir. 2014). Thus, the trial court is required to make an explicit finding of bad faith before awarding sanctions under § 1927.

Here, Plaintiffs do not present evidence that Defendant or its counsel made these arguments in bad faith. Defendant's outside counsel declares that she and her team understood the relevant case law — which is sparse on the issues — to require exhaustion of the Medicare appeals process. (Romano Decl. ¶¶ 4-6.) They consulted their client contact, Ms. Akure Paradis, who is in-house counsel for Defendant, and provided Ms. Paradis with drafts of the motions to dismiss. (*Id*.) Ms. Paradis did not inform Defendant's outside counsel or her team that

Defendant's appeals group does not send contract providers' appeals to Maximus, nor that Maximus would not accept Plaintiffs' appeals. (*Id*.) Ms. Paradis likewise declares that she did know of Defendant's appeals procedures. (Paradis Decl. ¶¶ 6, 8.) While their failure to make reasonable inquiry of Defendant's internal appeals process constitutes a Rule 11 violation, as discussed above, the Court does not find that this failure merits a finding of bad faith.

Accordingly, the Court DENIES Plaintiffs' request for sanctions under 28 U.S.C. § 1927.

C. Rule 11(c)(2) Safe Harbor Provision

Defendant argues that sanctions cannot be awarded here because Plaintiffs' Motion is untimely. (Opp'n at 13-14.) The only legal basis it provides for this argument is that it should be shielded by Rule 11's safe harbor provision, which provides that a motion for sanctions "must not be filed or be presented to the court if the challenged paper, claim, defense, contention, or denial is withdrawn or appropriately corrected within 21 days after service or within another time the court sets." Fed. R. Civ. P. 11(c)(2). The Advisory Committee Notes describe the purpose of this provision:

> These provisions are intended to provide a type of "safe harbor" against motions under Rule 11 in that a party will not be subject to sanctions on the basis of another party's motion unless, after receiving the motion, it refused to withdraw that position or to acknowledge candidly that it does not currently have evidence to support a specified allegation. Under the former rule, parties were sometimes reluctant to abandon a questionable contention lest that be viewed as evidence of a violation of Rule 11; under the revision, the timely withdrawal of a contention will protect a party against a motion for sanctions.

Fed. R. Civ. P. 11; Adv. Comm. Notes, 1993 Amend.

Defendant cannot invoke the safe harbor provision because it has never candidly acknowledged that it does not have the evidence to support its exhaustion argument. In the Stipulation, Defendant specified that it did not agree with Plaintiffs' arguments in the Motion for Reconsideration, even though it agreed not to move to dismiss Plaintiffs' Fourth Amended Complaint on the basis of failure to meet the exhaustion requirement. Defendant has since contended that the Stipulation should be read narrowly, arguing in a footnote in its Motion to Dismiss Plaintiffs' Fifth Amended Complaint that it "agreed it would not move to dismiss the operative pleadings based on failure to exhaust. [citation omitted] The stipulation did not extend to asserting failure to exhaust administrative remedies as a defense on the merits." (Doc. No. 90-1 at 4 n. 2.) Thus, Defendant has not withdrawn its position that Plaintiffs are subject to an exhaustion requirement, although the Court has independently found that they are not so subject. Accordingly, Defendant cannot invoke the safe harbor provision.

Further, insofar as Defendant argues that Plaintiffs delayed too long in filing this Motion, (Opp'n at 9), the Court disagrees. The crux of Plaintiffs' argument for sanctions is that the testimony of Ms. Grimes and Ms. Anker shows that Defendant had an appeals process for contract providers that did not comport with the representations that Defendant has made in this action, specifically in Defendant's FAC MTD and SAC MTD. Ms. Grimes testified on April 26, 2018, and Ms. Anker testified on May 16, 2018. (*See* Grimes Dep.; Anker Dep.) Plaintiffs met and conferred with Defendant regarding the instant Motion on May 25, 2018, served it on May 29, 2018, and filed it after the 21-day

safe harbor period on June 25, 2018. (Mot. at 4.) Plaintiffs did not unduly delay in the filing of this Motion.

D. Sanctions

Having determined that Defendant violated Rule 11 and cannot invoke Rule 11's safe harbor provision, the Court next considers the appropriate sanction. Plaintiffs request (1) monetary sanctions against Defendant and its counsel for the attorneys' fees for outside legal services related to the motion for reconsideration, pre-filing factual investigation, and the instant Motion; and (2) issue preclusion sanctions prohibiting Defendant from raising any administrative review process, including its own internal appeals process, as a defense in this action. (Mot. 16-18.)

Rule 11(c)(1) provides, "If, after notice and a reasonable opportunity to respond, the court determine that Rule 11(b) has been violated, the court may impose an appropriate sanction on any attorney, law firm, or party that violated the rule or is responsible for the violation." Rule 11(c)(4) then expressly limits the imposition of sanctions "to what suffices to deter repetition of the conduct or comparable conduct by others similarly situated."

Rule 11 also affords the Court wide latitude in determining the appropriate sanction, providing that "[t]he sanction may include nonmonetary directives; an order to pay a penalty into court; or, if imposed on a motion and warranted for effective deterrence, an order directing payment to the movant of part or all of the reasonable attorney's fees and other expenses directly resulting from the violation." Fed. R. Civ. P. 11(c)(4). The Advisory Committee Notes also contemplate issue-related sanctions, such as "dismissal of a claim, preclusion of

a defense, or preparation of amended pleadings." Fed. R. Civ. P. 11; Adv. Comm. Notes, 1993 Amend.

The Court finds that limiting Defendant's defenses is a sufficient sanction here. Defendant already agreed not to move to dismiss Plaintiffs' complaint on exhaustion grounds, and it does not contest that its corporate representatives accurately described its appeals process and the underlying reasons. The Court also separately confirmed the unavailability of the administrative appeal process to contract providers where the dispute arises between the provider and an MAO. Precluding further argument regarding the federal administrative review process as a defense to Plaintiffs' claims is thus consistent with this Court's finding and Defendant's own appeals process. Further, because Defendant failed to conduct a reasonable inquiry into its own appeals process and made factually baseless arguments about the overall process required by Plaintiffs, the Court imposes the following sanction: Defendant will be permitted to present a defense only to the extent necessary to show that exhaustion of its internal appeals process is a precondition for payment under the parties' explicit contract language, but may not argue or present evidence regarding its internal appeals process for any other purpose.

The Court does not find that monetary sanctions against Defendant or its outside counsel are warranted here. While Plaintiffs seek to recover the costs of the motion for reconsideration, as well as the instant motion and pre-investigation, Defendant's Rule 11 violations occurred in its briefing of its motions to dismiss Plaintiffs' FAC and SAC. Thus, it is principally the cost of opposing those motions that could potentially give rise to a sanction of attorneys' fees. The Court finds a monetary award inappropriate here, however, because (1) Plaintiffs

did not request those fees in their moving papers; and (2) Defendant's exhaustion argument, while important, was only one of the arguments it presented in its FAC MTD and SAC MTD. Consequently, Plaintiffs would have incurred the cost of defending against those motions even without the frivolous exhaustion argument. Further, the Court acknowledges that the Stipulation functioned as a partial withdrawal of the offending arguments, diminishing the need for sanctions.

In sum, the Court sanctions Defendant by precluding it from raising as a defense in this action an argument that Plaintiff failed to exhaust either the federal administrative review process or Defendant's internal appeals process, except as necessary to show that exhaustion of the internal appeals process is a precondition for payment under the parties' explicit contract language.

IV. CONCLUSION

For the reasons stated above, the Court GRANTS Plaintiffs' Motion for Sanctions under Rule 11, and DENIES Plaintiffs' Motion for Sanctions under 28 U.S.C. § 1927 and Local Rules 11-9 and 83-7. The Court SANCTIONS Defendant by precluding it from raising as a defense in this action an argument that Plaintiff failed to exhaust either the federal administrative review process or Defendant's internal appeals process, except as necessary to show that exhaustion of the internal appeals process is a precondition for payment under the parties' explicit contract language.

IT IS SO ORDERED.