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Supreme Court Accepts Implied False Certification Theory But Erects Substantial Hurdles To Proving Materiality

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Government Contracts, White Collar

In *Universal Health Services Inc. v. U.S. ex rel. Escobar*, No. 15-7 (Slip. Op. June 16, 2016), a unanimous Supreme Court affirmed the viability of the "implied false certification" theory of False Claims Act liability, at least in certain circumstances. This portion of the ruling was not unexpected given the overwhelming acceptance of implied certification among the Circuit courts. But, more importantly, out of concern that the statute be applied too broadly, the Court also explained at length that the "materiality" standard in the statute is a "demanding" one, and set a high bar for the Government and relators to demonstrate materiality of the alleged non-compliance.

I. Background

The False Claims Act ("FCA"), 31 U.S.C. § 3729, *et seq.*, generally prohibits a defendant from "knowingly present[ing], or caus[ing] to be presented, a false or fraudulent claim for payment or approval." 31 U.S.C. § 3729(a)(1)(A). Under an implied certification theory of liability, the submission of a payment request is treated as an implied certification that the person or entity submitting it has complied with all contractual, regulatory, or statutory requirements material to payment. Consequently, should a defendant fail to comply with a material statutory, regulatory, or contract requirement, a subsequent claim for payment may be viewed as "false or fraudulent," exposing the defendant to treble damages and potentially crippling statutory penalties.

Relying on the implied certification theory, the respondents in *Escobar* filed a *qui tam* suit against a healthcare provider, alleging that it violated the FCA when it submitted claims for payment for services but failed to disclose that it had violated Massachusetts Medicaid regulations regarding staff qualifications and licenses for such services. Op. at 5–6. The respondents argued that the failure to meet these qualification and licensing requirements was material because Medicare would not have paid for the services had the state been aware of the healthcare provider's alleged noncompliance. Op. at 6. The District Court rejected the respondents' implied certification theory. *Id.* However, the First Circuit reversed, explaining that the submission of a claim implies compliance with relevant regulations and, therefore, can lead to FCA liability if the party does not disclose failure to satisfy a material condition of payment. Op. at 6–7.

II. Case Analysis

A. Viability of Implied Certification Theory

The Court, in a unanimous decision authored by Justice Thomas, affirmed the viability of the implied certification theory at least in certain circumstances. Specifically, the Court held that a defendant can face FCA liability under an implied certification theory where two conditions are satisfied:

1. The claim asserts a request for payment and makes specific representations about the goods or services provided, *and*
2. The failure to disclose noncompliance with material statutory, regulatory, or contractual requirements makes those representations misleading half-truths.

Op. at 11. The Court explained that the invoices submitted by the healthcare provider in the instant case made "specific representations" about the services rendered by utilizing payment codes that corresponded to specific counseling services performed by designated professionals, but failed to disclose that the persons performing these services were untrained and unlicensed. Op. at 9–11. According to the Court, such "half-truths—representations that state the truth only so far as it goes, while omitting critical qualifying information—can be actionable misrepresentations" under an implied certification theory. Op. at 9–10.

The Court's decision is not an endorsement of the implied certification in all circumstances. The Court noted that because "[t]he claims in this case do more than merely demand payment," it "need not resolve whether all claims for payment implicitly represent that the billing party is legally entitled to payment." Op. at 9. Indeed, the Court rejected the Government's suggestion that compliance with a requirement to use American-made staplers, in a contract for health services, could support FCA liability. Op. at 17. The decision thus leaves open the possibility that a simple demand for payment, without specific half-true representations about the contracted-for goods and services, is not actionable under an implied certification theory. Likewise, the opinion does not squarely address the viability of the implied certification theory in cases where a defendant's misrepresentation relates to its eligibility to pursue a contract or to participate in a federal program. In short, the Court's decision does not provide a clear standard as to the outer limits of the implied certification theory, and courts will continue to assess the viability of implied certification claims on a case-by-case basis.

B. Materiality Standard

Escobar also offers a momentous discussion of the FCA's "materiality" standard. First, the Court rejected the argument that the materiality of an undisclosed violation of law, regulation, or contract depends entirely on whether the provision in question was designated by the Government as a "condition of payment." The Court explained that "[w]hether a provision is labeled a condition of payment is relevant to but not dispositive of the materiality inquiry." Op. at 12. Thus, although a defendant theoretically could face implied certification liability even if the provision it violated was *not* expressly designated a condition of payment, "[c]onversely, even when a requirement is expressly designated a condition of payment, not every violation of such a requirement gives rise to liability." *Id.* The ultimate test is not whether the condition of payment is expressly designated as such, but "whether the defendant knowingly violated a requirement *that the defendant knows was material* to the Government's payment decision." Op. at 2 (emphasis added).

Second, the Court then "clarif[ied] how [the FCA] materiality requirement should be enforced" in any FCA matter, whether or not under a false certification theory. Op. at 14. Starting from the baseline principle that any misrepresentation about compliance "must be material to the Government's payment decision in order to be actionable," Op. at 14, the Court repeatedly emphasized that the FCA's materiality standard is "rigorous" and "demanding." Op. at 2, 14, 15, 16. While the Court did not provide any bright-line rules, it did offer several examples of fact patterns that would be highly relevant to materiality. For instance, the Court explained that the FCA is not "a vehicle for punishing garden-variety breaches of contract or regulatory violations" and that "[m]ateriality . . . cannot be found where noncompliance is minor or insubstantial." Op. at 15–16. The Court also noted the importance of Government knowledge and course of dealing in assessing materiality:

> [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.

Op. at 16.

Ultimately, the Court rejected the First Circuit's holding "that any statutory, regulatory or contractual violation is material so long as the defendant knows that the government would be entitled to refuse payment were it aware of the violation." Op. at 17. In short, "[t]he False Claims Act does not adopt such an extraordinarily expansive view of liability." *Id.*

III. Implications

The *Escobar* decision will be analyzed, briefed, and cited for years to come, and its full implications are hard to predict. Here are some initial thoughts.

"Half-True" Claims May Be Actionable. While the outer limits of implied certification remain unclear, the Court suggested that under certain circumstances claims for payment making specific representations while omitting other material facts about noncompliance are actionable. Expect future Government and *qui tam* pleadings to adopt "half-true claim" theories of liability.

The Common Law Counts. An important feature of the Court's decision, which will reverberate in the lower courts for years to come, is that it looked to the substantive common law of torts and contracts to assess whether the conduct in the case constituted an "actionable misrepresentation," citing the Restatements of Torts and Contracts, standard treatises on torts, and a Cardozo opinion from the 1930s. This is a signal to courts and litigants that the contours of liability under the FCA and the meaning of "false and fraudulent" should be assessed by looking to these common law sources. This could lead to important shifts in jurisprudence, because courts to date have not looked to the common law in interpreting the FCA.

"Materiality" Is Not a "Gimme" for the Government. The Government has consistently asserted that materiality standard can be met whenever a violation would have entitled the Government to refuse payment. Emphatically rejecting that standard, the Court made clear that future

inquiries into materiality—including at the motion to dismiss and summary judgment stages—will turn on the allegations and circumstances involved in a particular case. The parties' actual conduct and course of dealing will be critical, and the Government will have difficulty establishing liability where a violation in the past has been ignored when the payment decision is made.

The Government Cannot Legislate Materiality. The Court held that "[a] misrepresentation cannot be deemed material merely because the Government designates compliance with a particular statutory, regulatory, or contractual requirement as a condition of payment." This means that in the future, Congress and agencies will not be able to sidestep the new materiality standard by designating minor or unimportant requirements as conditions of payment.

Defendants' Knowledge of Materiality is Required. The Court stated clearly that for liability to attach, the defendant must both *knowingly* violate a requirement, and also *know* that the requirement was material to the Government's payment decision. In the past, the Government and relators have not focused on establishing the defendant's knowledge of materiality. Without allegations and evidence of such knowledge, future cases will be subject to dismissal or summary judgment.

Expansive Theories of Liability are Disfavored. The Court's decision is rife with language cautioning against overly broad interpretations of the FCA. The lower courts are repeatedly reminded that the standard for materiality is "demanding" and "rigorous"; that there need be "strict enforcement" of the FCA's materiality and scienter requirements; and that the law is not a "vehicle for punishing garden-variety breaches of contract or regulatory violations." These cautionary words should guide the lower courts away from expansionist views of the statute.

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