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What To Expect In Post-Escobar FCA Litigation

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The U.S. Supreme Court's June 16 decision in Universal Health Services Inc. v. U.S. ex rel. Escobar continues to send shockwaves across the landscape of False Claims Act litigation. Earlier this week, the court vacated the judgments in three matters that were pending before it on petitions for certiorari, and remanded the matters for further consideration in light of the new standards enunciated in Escobar. Dozens of pending motions that were stayed before district and appellate courts around the country are being rebriefed. The U.S. Department of Justice, relators' counsel and defense counsel are scrambling to assess existing matters and investigations in light of the Supreme Court's decision. Within the next few weeks, there will be a trickle of lower court decisions applying the principles of Escobar. By the end of the year, the trickle will be a flood. And while the full implications of the decision may be hard to predict, it is possible to identify certain likely repercussions even at this early stage.


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Background: The Court's Decision

In a unanimous decision authored by Justice Clarence Thomas, the Escobar 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. The court explained that the invoices submitted by the defendant in Escobar, a health care provider, 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. 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.

The court also sought to "clarify how [the] materiality requirement should be enforced" in any FCA matter, repeatedly emphasizing that the FCA's materiality standard is "rigorous" and "demanding." While the court did not provide any bright-line rules, it did offer several examples of evidence 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." And significantly, the court highlighted the importance of government

knowledge and course of dealing in assessing materiality, explaining that "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."

Implications of Escobar

Unclear Contours of Implied False Certification Liability

The court's decision in Escobar recognized the availability, at least in certain circumstances, of an implied certification theory of liability. This merely confirms the existing law in many jurisdictions, which has recognized the theory so long as the certification is a material precondition of payment. The court confirmed that a defendant's claim for payment that includes specific misrepresentations and fails to disclose noncompliance with applicable statutory or contractual requirements relating to payment would be actionable.

The decision also confirms that a simple demand for payment, without specific misrepresentations about the contracted-for goods and services, is not actionable under an implied certification theory. Likewise, the opinion does not 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. Indeed, less than a week after Escobar was handed down, litigants in the U.S. District Court for the District of Columbia already were battling over the applicability — or inapplicability — of the court's ruling to a fraudulent inducement case. In short, post-Escobar, lower courts will continue to assess the viability of implied certification claims on a case-by-case basis.

Motions Practice Concerning Materiality Standard

Appropriately, much has been made of Escobar's emphasis on the rigorous showing required to demonstrate materiality. It will be the task of the lower courts to flesh out the meaning of this standard in resolving Rule 12 and Rule 56 motions. In resolving motions to dismiss under Rule 12, district courts will need to enforce the "rigorous" and "demanding" materiality standard by ensuring that complaints provide specificity regarding materiality in order to survive a motion to dismiss. Escobar makes clear that FCA liability is imposed only where a defendant both knowingly violated a requirement and knew (or should have known) that the requirement was material to the government's payment decision. In the past, the government and relators have not always focused on pleading with specificity the defendant's knowledge of materiality, but without specific allegations of such knowledge, future cases will be subject to dismissal at the outset.

The materiality standard in Escobar will also lead to more courts disposing of matters both under Rule 12 and Rule 56, for at least two reasons. First, although courts have recognized that dismissal is appropriate where the defendant can demonstrate government knowledge of the alleged noncompliance at issue, courts typically have viewed such a showing as evidence relevant to the FCA's scienter prong. Many courts have been reluctant to dispose of matters through motions practice on the grounds of scienter, viewing this as a classic question for the jury. Escobar, however, makes clear that government knowledge is relevant not only to scienter, but also to materiality, explaining that government payment notwithstanding knowledge of alleged noncompliance is strong evidence that the noncompliance at issue was not material. This is significant because unlike scienter, materiality is more likely to be viewed as a legal question that is amenable to disposition by the court. Under Escobar, defendants with strong evidence of government knowledge are far more likely to be able to secure an early dismissal.

Second, even where courts have considered government knowledge as grounds for dismissal, they often have required the defendant to demonstrate that it made a full, robust and specific disclosure of the alleged noncompliance, a high standard of proof. Escobar clarifies that such a demanding showing is not required, explaining that as long as a defendant can show that the government had previously paid in full "a particular type of claim" despite knowledge of noncompliance with certain requirements, "that is strong evidence that the requirements are not material." Time will tell how this standard is interpreted by the lower courts, but it is evidently a far more attainable benchmark for defendants.

Expansion of Scope of Discovery

Escobar's emphasis on the actual conduct of the government in considering and paying (or failing to pay) claims as relevant to materiality will likely have a significant impact on the discovery process. By recognizing that the government's payment of a "particular type of claim" can be evidence that a statutory, regulatory, or contractual requirement is not material, the court has clarified that a broad range of government knowledge and conduct is highly relevant to an FCA matter. The course of dealing between the defendant and the government under all of their contractual or programmatic dealings could be relevant and subject to discovery. In addition, the government's treatment of similar "types of claims" submitted by other parties (i.e., trade usage evidence) under other contracts or programs could also be relevant and discoverable.

Expect FCA defendants to seek broad discovery into the government's practices — including communications and payment history — under other contracts and programs involving a similar "type of claim," even where the invoices were submitted by other companies. Again, it will be the job of the district courts to determine the reasonable scope of such discovery requests, but, in the aggregate, the rationale of the Escobar decision will likely lead to broader discovery for FCA defendants if the cases survive an early motion.

Re-Emergence of Common Law

Finally, an important feature of the court's decision 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." The court explained that with limited exceptions (e.g., the FCA's lack of a requirement for a specific intent to defraud), "we presume that Congress retained all other elements of common-law fraud that are consistent with the statutory text because there are no textual indicia to the contrary." Consistent with this presumption, the Escobar court relied liberally on citations to the Restatements of Torts and Contracts, standard treatises such as Williston on Contracts, and a Cardozo opinion from the 1930s. The court even suggested that the term "material," despite being defined in the FCA itself, could be just as reliably interpreted by looking to the common law. See Op. at 14 ("We need not decide whether §3729(a)(1)(A)'s materiality requirement is governed by §3729(b)(4) or derived directly from the common law.").

The court has sent a signal to lower courts and litigants that the contours of liability under the FCA and the meaning of "false, "fraudulent" and "material" should be assessed by looking to these common law sources. Viewing FCA liability through this broader interpretive lens could lead to important shifts in jurisprudence, because courts to date have at times been hesitant to embrace the common law in interpreting the FCA.

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