

BASS BERRY SIMS

INSIDE

THE FCA



In *Escobar*, Supreme Court Endorses, but “Materially” Refines, Implied Certification Theory of False Claims Act Liability

John Eason

On June 16, 2016, the U.S. Supreme Court issued its much-anticipated opinion in [Universal Health Services, Inc. v. United States ex rel. Escobar](#) regarding the implied certification theory of False Claims Act (FCA) liability. The Court’s unanimous opinion, drafted by Justice Clarence Thomas, is significant in three respects, detailed further below: (1) the Court ruled that, in certain circumstances, the implied certification theory can be a basis for FCA liability; (2) the Court held that an express condition of payment in a statutory regulatory, or contractual requirement is relevant—but “not automatically dispositive”—in determining FCA liability; and (3) the Court clarified how the FCA’s materiality requirement should be enforced by lower courts addressing FCA suits premised on an implied false certification theory.

Background

In *Escobar*, the relators alleged that Universal Health Services (UHS) violated the FCA by submitting claims for services provided at a Massachusetts mental health clinic that failed to comply with several Medicaid regulations related to staff licensure and supervision. The relators alleged that although UHS did not expressly certify compliance with these regulations in submitting claims for payment, it impliedly certified such compliance, and by failing to disclose noncompliance with these material regulations, the claims were rendered “false or fraudulent” under § 3729(a)(1)(A) of the FCA. In 2014, the U.S. District Court for the District of Massachusetts granted UHS’ motion to dismiss because it concluded the regulations at issue were conditions of participation in the Massachusetts Medicaid program, not conditions of payment, and thus could not form the basis for a theory of implied false certification.

The U.S. Court of Appeals for the First Circuit reversed that ruling, disagreeing with the district court’s reading of the regulations and finding that “the provisions at issue clearly impose conditions of payment.” The First Circuit explained that a condition of payment need not be expressly designated and that whether a regulatory requirement is a condition of payment is “a fact-intensive and context-specific inquiry, involving a close reading of the foundational documents, or statutes and regulations, at issue.”

The Supreme Court granted *certiorari* to address two questions: (1) whether the implied certification theory under the FCA is viable and (2) if so, whether liability under the theory requires that the underlying statute, regulation or contractual provision *expressly* state that it is a condition of payment. These questions aimed to address a split in the circuit courts of appeal regarding the implied certification theory, as the Seventh Circuit rejected the theory entirely; some circuits limited its scope to legal requirements expressly designated as conditions of payments; and other circuits, including the First Circuit, endorsed a broader view of the theory.

Viability of Implied Certification Theory

The Court first held that the implied certification theory can be a basis for FCA liability when (1) the defendant submits a claim that “does not merely request payment, but also makes specific representations about the goods or services provided,” and (2) “the defendant’s failure to disclose noncompliance with material statutory, regulatory, or contractual requirements makes those representations half-truths.” In other words, when “a defendant makes representations in submitting a claim but omits its violations of statutory, regulatory, or contractual requirements, those omissions can be a basis for liability if they render the defendant’s representations misleading with respect to the goods or services provided.”

In this case, the Court found that the relators pleaded actionable misrepresentations because the claims at issue did “more than merely demand payment,” by making specific representations, while “omitting critical qualifying information.” Specifically, the claims for payment “us[ed] payment codes that corresponded to specific counseling services” and “National Provider Identification numbers corresponding to specific job titles.” “[T]hese representations were misleading in context,” because they conveyed to the reader that the mental health clinic’s personnel had certain training, experience and qualifications required by Medicaid regulations—which allegedly was not the case.

Notably, although the Court declined to resolve whether all claims for payment included a specific representation(s) about the goods or services provided, *Escobar* suggests that the implied certification theory would not apply to a bill or invoice with sparse information only requesting payment, without any specific representations. In addition, the Court’s holding—that an omission of legal violations must make a claim’s specific representations misleading—indicates that, for the implied certification theory to be viable, the alleged legal violation must be tethered to the specific representations made in the submitted claim.

Relevance of Designation as Express Condition of Payment

The *Escobar* Court next addressed whether FCA liability for failing to disclose violations of legal requirements only attaches when those requirements were expressly designated as conditions of payment. The Court concluded that the FCA does not include such a restriction on liability, holding that “[w]hether a provision is labeled a condition of payment is relevant to but not dispositive of the materiality inquiry.” In reaching this conclusion, the Court noted that the proposed restriction is not supported by the statutory text, the common law meaning of fraud, or the materiality and scienter elements of the FCA. Regarding scienter, the Court explained that a defendant (1) “can have ‘actual knowledge’ that a condition is material without the Government expressly calling it a condition of payment;” and (2) can act with “deliberate ignorance” or “reckless disregard” of the “truth or falsity of the information”—for purposes of FCA liability—by “fail[ing] to appreciate the materiality of [a] condition,” “even if the Government did not spell this out.” As to UHS’ concerns about fair notice and open-ended liability without such a restriction on liability, the Court said those concerns “can be effectively addressed through strict enforcement of the [FCA]’s materiality and scienter requirements.”

Contours of “Demanding” Materiality Requirement

Finally, the Court turned to “clarify[ing]” how the materiality requirement should be strictly enforced. Most significantly, the Court rejected the government’s and First Circuit’s “extraordinarily expansive view” of materiality—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. Instead, the Court explained that “under any understanding of [materiality]”—whether arising from common law or the FCA’s text—the materiality requirement focuses on whether knowledge of noncompliance would effect “the *likely or actual* behavior of the recipient of the alleged misrepresentation,” not simply on whether the recipient’s behavior *could* have been effected. The Court emphasized that an endorsement of the government’s or First Circuit’s position would entirely ignore the course of action between the parties, for example, whether the government “routinely pays claims despite” being aware of the noncompliance.

The materiality requirement, the Court observed, is “demanding” and “rigorous,” and safeguards defendants from FCA liability for “garden-variety breaches of contract or regulatory violations.” To further delineate when the nondisclosure of a legal violation is material, the Court offered the following evidentiary guideposts:

- It is not “sufficient for a finding of materiality” that the government “would have had the option to decline to pay if it knew of the defendant’s noncompliance.”
- The government’s decision to “expressly identify a provision as a condition of payment is relevant, but not automatically dispositive” of the materiality inquiry.
- It is “evidence” of materiality “that the defendant knows that the Government consistently refuses to pay claims in the mine run of cases based on noncompliance” with a requirement.
- It is “[v]ery strong evidence” of immateriality “if the Government pays a particular claim in full despite its actual knowledge that certain requirements were violated.”
- It is “[s]trong evidence” of immateriality “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.”
- Materiality “cannot be found where noncompliance is minor or insubstantial.” As support for this point, the Court cited two cases where the alleged misrepresentations were found to violate the FCA because the receiving party would not have entered into the relevant contract had it known of the undisclosed noncompliance.

Addressing UHS' concern that materiality is "too fact intensive for courts to dismiss [FCA] cases on a motion to dismiss or at summary judgment," the Court indicated that lack of materiality remains a basis for dismissal, noting that relators and the government still must plead their claims with plausibility and particularly under Federal Rules of Civil Procedure 8 and 9(b), "by, for instance, pleading facts to support allegations of materiality."

Concluding Thoughts

Escobar is unlikely to narrow the potential scope of FCA liability for government contractors. Healthcare providers, in particular, who must comply with myriad byzantine rules and regulations, hoped that the Court would reject the implied certification theory or at least require any underlying legal requirement to be expressly designated as a condition of payment, as a means of curbing and/or clearly outlining the parameters of FCA liability.

However, the Court's opinion does arm defendants with several new arguments regarding when a misrepresentation has occurred and whether a misrepresentation is material under the FCA, as the Court's newly articulated materiality standard puts the focus on whether the government in fact would refuse payment or exit a contract as a result of a legal, regulatory or contractual violation - not whether it hypothetically could do so. Additionally, the Court's "demanding" materiality standard could be applied to express, as well as implied, false certification theories of liability.

Escobar is certainly a seminal shift for FCA litigants, but its full import will not become apparent until lower courts begin applying its framework, particularly at the pleading stage. A notable bellwether, in fact, may be *Escobar* itself, when the district court rules on UHS' motion to dismiss after the case is remanded. The complaint in *Escobar* alleged that after receiving complaints about the mental health clinic's regulatory violations, the state investigated the clinic and made specific findings that it was in violation of a number of regulations. As a result, the state allegedly placed a clinical director on a two-year period of supervised probation and assessed a small fine against another staff member. If the state did not cancel its contract with the clinic or demand repayment of claims for services tied to the regulatory violations, UHS may be able to win on remand.