

Client Alert

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Universal Health Services v. Escobar

On Thursday of last week, the Supreme Court for the first time addressed the “implied certification” theory of liability under the False Claims Act. The Court ruled unanimously that the theory is valid in certain circumstances. More specifically, the Court held that a defendant may be liable for submitting claims that violate statutory, regulatory, or contractual requirements so long as the violation would have been material to the government’s decision to pay the claim. The Court rejected the dividing line between conditions of payment and conditions of participation as the criterion for when a claim can form the basis for a False Claims Act violation under the implied certification theory. The relevant question, according to the Court, is instead whether the noncompliance is material to the government’s payment decision. As explained below, the Court’s decision will significantly affect qui tam relators, the defense bar, and contractors who participate in federal programs.

Background on the Implied Certification Theory

Enacted during the Civil War to combat fraud by those who supplied goods and services to the Union Army, the False Claims Act imposes liability on whoever “knowingly presents, or causes to be presented, a false or fraudulent claim for payment or approval.” 31 U.S.C. § 3729(a)(1)(A). The FCA also punishes whoever “knowingly makes, uses, or causes to be made or used, a false record or statement material to a false or fraudulent claim.” *Id.* § 3729(a)(1)(B).

A claim can be false or fraudulent in several ways. A quintessential false claim is one that is *factually* false, such as when a contractor misrepresents the goods or services provided or bills for services that were never provided at all. Even a claim that accurately describes the services provided may be *legally* false if the claimant falsely certifies compliance with a statute, regulation, or contract provision.

Legally false certifications may be express or implied. In an *expressly* false certification, a contractor certifies compliance with a statute, regulation, or contract provision on the face of the claim submitted. In an *impliedly* false certification, a claim that is truthful on its face may be construed as false if the claimant violated a separate law or regulation. Before *Escobar*, the implied false certification theory was based on the idea that the act of submitting a claim for reimbursement implies compliance with all federal

rules that affect the claimant's eligibility for payment. In recent years, the implied certification theory has been a source of expanding potential liability for companies that do business with the government.

Before *Escobar*, the courts of appeals were split on whether the implied certification theory was viable at all and, if so, under what circumstances. One court rejected the theory entirely. Others expressed discomfort, noting that the implied certification theory exposes participants in federal programs to unpredictable, broad liability for violating any of thousands of statutes and regulations that may be deemed to be conditions of government payment. These courts and others recognized the implied certification theory in various forms, differing over whether the underlying statute or regulation must say explicitly that it is a condition of government payment or whether the statute or regulation may be deemed to be a condition of payment even without an explicit statement.

Universal Health Services v. Escobar

Universal Health Services v. Escobar involved claims for mental health counseling services that Universal Health submitted to the Massachusetts Medicaid program. Invoking the implied certification theory, the relators alleged that Universal Health "submitted reimbursement claims that made representations about the specific services provided by specific types of professionals, but that failed to disclose serious violations of regulations pertaining to staff qualifications and licensing requirements for these services." Slip Op. 5-6. The First Circuit allowed the claim to proceed, reasoning that the applicable regulations imposed conditions of payment and that Universal Health's compliance was therefore necessarily material to the government's payment decision.

The Supreme Court first addressed when a claim can be deemed false based on noncompliance with a statutory, regulatory, or contractual requirement that is not expressly referenced in the claim. It held "that the implied false certification theory can, at least in some circumstances, provide a basis for liability." *Id.* at 8. "When, as here, 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." *Id.* Although such claims might be truthful on their face, the Court reasoned that "half-truths—representations that state the truth only so far as it goes, while omitting critical qualifying information—can be actionable misrepresentations." *Id.* at 10. The Court, however, did not embrace the sweeping theory that a claim implicitly represents compliance with all statutory, regulatory, and contractual rules that could affect the claimant's eligibility for payment. It held only that a claim will be deemed false when two conditions are satisfied: first, the claim "does not merely request payment, but also makes specific representations about the goods or services provided"; and second, the defendant's failure to disclose its statutory, regulatory, or contractual noncompliance makes the specific representations in the claims "misleading half-truths." *Id.* at 11.

Second, the Court held that noncompliance with a statutory, regulatory, or contractual requirement can render a claim false even if the requirement is not expressly labeled a condition of payment, stating that "the Act does not impose this limit on liability." *Id.* at 12. Instead, the Court emphasized that "a misrepresentation about compliance with a statutory, regulatory, or contractual requirement must be material to the Government's payment decision in order to be actionable." *Id.* at 14 (emphasis added). The Court described the materiality standard as "rigorous" and "demanding" and cautioned that the False Claims Act is not "a vehicle for punishing garden-variety breaches of contract or regulatory violations." *Id.* at 15.

Implications of the Court's Decision

Materiality. The Court's decision appears to raise the bar for the government or qui tam relators to prove materiality. Under the Court's new standard, "[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." *Id.*

Nor is it enough “that the Government would have the option to decline to pay if it knew of the defendant’s noncompliance.” *Id.* at 15-16. In addition, the noncompliance cannot be “minor or insubstantial.” *Id.* at 16.

Instead, proving materiality will typically involve showing that the misrepresentation would “likely . . . induce a reasonable person to manifest his assent.” *Id.* at 15 (citing Restatement (Second) of Contracts 162(2), and Comment c, pp. 439, 441 (1979)). A relator or the government can establish materiality by showing “that the Government consistently refuses to pay claims” based on noncompliance with the requirement at issue or that “a reasonable person would realize” that compliance with that requirement is “imperative” to the government. *Id.* at 13, 16. On the other hand, if the government “regularly” pays claims despite knowing that the requirement was not complied with, that is “strong evidence that the requirements are not material.” *Id.* at 16. Finally, it is not enough that the requirement was material; the defendant must have *known* that the requirement was material in order to meet the intent requirement of the False Claims Act. *Id.* at 2, 12-13. This appears to be a significant departure from how many lower courts have understood materiality.

At the same time, after *Escobar*, defendants could potentially find it harder to get claims dismissed before trial. Many courts treated the question of whether a regulation is a “condition of payment” as a legal question that could be resolved before trial. Defendants will now need to argue instead at the motion to dismiss and summary judgment stages that the alleged noncompliance was not material. The Court’s description of materiality emphasizes facts such as whether the government has a practice of refusing to pay claims in similar cases. But the Court also rejected the idea that “materiality is too fact intensive for courts to dismiss False Claims Act cases on a motion to dismiss or at summary judgment.” *Id.* at 16 n.6. The Court explained that Federal Rules of Civil Procedure 8 and 9(b) requires a False Claims Act complaint to plead materiality with plausibility and particularity. Defendants thus can continue to argue at the motion to dismiss stage that the plaintiff failed to meet this heightened pleading standard. The lower courts will develop a body of materiality law as they apply *Escobar* going forward.

Claim Forms. The Court’s decision may also give FCA defendants an additional argument that the alleged implied certification is not actionable unless it relates to a fact expressly represented on the claim form. The Court did not adopt the government’s broad position that *every* claim for payment contains an implicit representation that the company has complied with *every* statutory, regulatory, and contractual requirement that could possibly affect the company’s legal entitlement to payment. It held instead that the implied certification theory can be a basis for liability so long as “the claim does not merely request payment, but also makes specific representations about the goods or services provided” that are “misleading” in light of the defendant’s noncompliance. *Id.* at 11. That holding is based on the rule that “if the defendant does speak, he must disclose enough to prevent his words from being misleading.” *Id.* at 10 n.3 (quoting Prosser and Keeton on Law of Torts § 106, p. 738 (5th ed. 1984)). In *Escobar*, the Court found that Universal Health’s use of certain codes and provider identification numbers would have led a reasonable reader to conclude that Universal Health had complied with “core Massachusetts Medicaid requirements.” Slip Op. at 11.

In other words, there must be representations in the claim itself that can be characterized as misleading half-truths. But it will not always be easy for a relator or the government to tie a regulatory violation to a particular statement in the claim. After *Escobar*, companies can argue that statements in their claim forms would not have misled a reasonable reader. They can also argue that the supposedly false implied certification on which the FCA action is based has no relationship to any specific representation on the claim form. That argument may generate traction, for example, in cases where there is no strong connection between the alleged statutory, regulatory, or contractual violations and the statements in the claims, or where the violations do not relate to “core” or “basic” requirements. The argument will be particularly useful in cases where the claim forms simply request payment without including any express statements.

Off-Label Promotion. Finally, the Court’s decision may effect more change in the rapidly developing body of off-label promotion jurisprudence. The Department of Justice and relators vigorously pursue companies that advertise

drugs or medical devices for uses that the Food and Drug Administration has not approved. When the government or a relator bases a False Claims Act case on a company's off-label promotion, defendants can use *Escobar* to strengthen their argument that off-label promotion is not material to the government's payment decisions. CMS often pays for drugs and medical devices regardless of whether they are used off-label, suggesting that off-label promotion does not change the government's payment decisions. *Escobar* now confirms that "if 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." Slip Op. at 16.

Escobar may also affect the government's efforts to criminally punish companies who engage in off-label promotion. In response to First Amendment challenges, courts in recent years have rejected the government's efforts to criminally punish companies who speak truthfully about off-label uses of their products. To address those decisions, the government has started urging courts to define "truthful" speech narrowly, and to hold that an otherwise truthful statement is misleading if it omits virtually anything about the product.

In *Escobar*, the Court offered useful guidance about what it means for a statement to be misleading. In particular, the Court defined a "half truth" as a representation that "state[s] the truth only so far as it goes, while omitting *critical* qualifying information." Slip Op. 9-10 (emphasis added). The Court also suggested that a statement is misleading only if it relates to the same subject matter as the omitted information. The Court explained that a "classic example of an actionable half truth in contract law is the seller who reveals that there may be two new roads near a property he is selling, but fails to disclose that a third potential road might bisect the property." *Id.* at 10. In that example, the "enumeration of two streets . . . was a tacit representation that the land to be conveyed was subject to no others." *Id.* (citing *Junius Constr. Co. v. Cohen*, 257 N.Y. 393, 400 (1931) (Cardozo, J.)). Defendants facing off-label promotion investigations and prosecutions will be able to use *Escobar* to counter the government's broad view of misleading speech.

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