Client Alert

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Universal Health: The Supreme Court Approves Implied Certification; Focus on Materiality Provides a Mixed Blessing to Defendants in False Claims Act Cases

By Demme Doufekias and Catherine Chapple

On June 16, 2016, a unanimous Supreme Court blessed the implied false certification theory of False Claims Act (FCA) liability, resolving a circuit split on the theory's legitimacy. The Court held that implied certification will succeed as a theory of liability where (1) the claim makes specific representations about the goods and services being provided and (2) the defendant's failure to disclose noncompliance with material statutory, regulatory, or contractual requirements makes those misrepresentations misleading. The Court then provided guidance on the appropriate materiality standard, which will most certainly dominate FCA litigation in the coming years.

Although the *Universal Health* decision on its face appears to be a victory for relators, potential FCA defendants can take some heart in the Court's analysis. In shifting the focus to the facts and circumstances surrounding a misrepresentation, rather than regulatory and contractual strictures, the Court stressed that the materiality standard is "demanding," and that the FCA is not an "all-purpose" antifraud statute, or a vehicle for punishing "garden-variety breaches of contract or regulatory violations."[1] By rejecting an expansive theory of materiality in favor of this common sense, fact-based approach, *Universal Health* becomes a tool for imposing liability only when the violation at issue actually matters to the government.

As a result of how the Court framed its analysis in *Universal Health*, going forward the emphasis in FCA cases will likely be on the facts of each violation, rather than on the wording of relevant statutes, regulations, or contracts, as it has been in the past. This is a mixed blessing. Although this fact-based approach could give defendants more flexibility and opportunity to demonstrate that an alleged violation is not material and, therefore, not actionable, it also will make it more difficult for defendants to prevail on this theory at the dismissal stage, where one must take the plaintiff's allegations as true. Every FCA plaintiff will plead, with facial plausibility, that what allegedly was not done was material, making it difficult to prevail on a motion to dismiss. Similarly, although defendants still will have the option of summary judgment, in most courts this means first engaging in protracted and expensive discovery, after which there likely will remain a factual dispute.

[1] *Id.* at 12.

THE *QUI TAM* CASE

The case, *Universal Health Services, Inc. v. Escobar*, was brought by the parents of a Massachusetts Medicaid beneficiary. The couple's teenage daughter, Yarushka Rivera, received counseling services at Arbour Counseling Services (Arbour), a satellite mental health facility owned and operated by a subsidiary of Universal Health Services (Universal Health). Yarushka was treated by a number of individuals who purported to be licensed mental health professionals. She was diagnosed with bipolar disorder and prescribed medication to which she had an adverse reaction that ultimately resulted in her death.

The relators, Yarushka's parents, filed the *qui tam* case after discovering that few Arbour employees were actually licensed to provide mental health counseling, to provide counseling without supervision, or to prescribe medications; of the five professionals that treated Yarushka, only one was properly licensed. The relators alleged that Universal Health violated the FCA under an implied false certification theory of liability by submitting reimbursement claims that made representations about the specific services provided by specific types of professionals, but failing to disclose regulatory violations pertaining to staff qualifications and licensing requirements. In essence, the relators argued that Medicaid would not have reimbursed the claims had it known that it was billed for mental health services that were performed by unlicensed and unsupervised staff.

The United States declined to intervene and the district court dismissed the relators' complaint, finding that the Massachusetts regulations at issue did not explicitly state that the regulations were conditions of payment.[2] Relators appealed and the First Circuit reversed,[3] holding that any undisclosed violation of a precondition of payment (whether or not expressly identified as such a precondition) renders a claim "false or fraudulent." The First Circuit further held that the regulations themselves provided conclusive evidence that compliance was a material condition of payment because the regulations expressly required facilities to adequately supervise staff as a condition of payment.

In an opinion by Justice Thomas, the Supreme Court approved implied false certification as a basis for FCA liability where a defendant fails to disclose noncompliance with material statutory, regulatory, or contractual requirements that ultimately misleads the Government with respect to the goods or services for which it is paying. *Universal Health Servs., Inc. v. United States*, No. 15-7, 2016 WL 3317565, at *2 (U.S. June 16, 2016). This misrepresentation must be material to the Government's payment decision in order to be actionable. The Court clarified that the standard is not whether the government would be *entitled* to refuse payment but rather whether the government likely would have refused to pay had it known the violation had occurred. Although finding for the relators, the Court's holding expressly rejected the First Circuit's and Government's expansive theory of materiality in favor of a more exacting standard.

[2] *United States. ex rel. Escobar v. Universal Health Servs., Inc.*, No. CIV.A. 11-11170-DPW, 2014 WL 1271757, at *1 (D. Mass. Mar. 26, 2014), *aff'd in part, rev'd in part sub nom. United States v. Universal Health Servs., Inc.*, 780 F.3d 504 (1st Cir. 2015), *cert. granted in part*, 136 S. Ct. 582, 193 L. Ed. 2d 465 (2015), *and vacated and remanded*, No. 15-7, 2016 WL 3317565 (U.S. June 16, 2016).

[3] *United States v. Universal Health Servs., Inc.*, 780 F.3d 504 (1st Cir.), *cert. granted in part*, 136 S. Ct. 582, 193 L. Ed. 2d 465 (2015), *and vacated and remanded*, No. 15-7, 2016 WL 3317565 (U.S. June 16, 2016).

WHAT DOES *UNIVERSAL HEALTH* MEAN FOR MATERIALITY UNDER THE FCA?

Materiality Pre-*Universal Health*

Prior to the Court's ruling in *Universal Health*, courts uniformly held that FCA liability required that the violation of a statutory, regulatory, or contractual obligation must be material to the government's decision to pay the claim. Nevertheless, in practice, these courts applied different standards to what constituted materiality.

Historically, courts held that "materiality" involved an actual prerequisite to payment such that an inaccuracy in a statement or claim would be considered "false" only if the government would not have paid the claim if it knew of the inaccuracy—a standard to which courts must return in the wake of the Supreme Court's opinion. More recently, the government argued that the inaccuracy is material, and thus false, if it has a "natural tendency" to influence the government.[4] Under this standard, which several circuits – including the First Circuit – adopted (and the Supreme Court has now rejected), an inaccuracy could be considered material if it was deemed capable of influencing payment, even if the government would have paid the claim regardless of the alleged inaccuracy.[5]

Alternatively, other circuits, (including the Second, Fourth, Fifth, Sixth, Seventh, Ninth, and Eleventh), adopted a "natural tendency test" for materiality, which focused on the potential effect of the false statement when it is made rather than on the false statement's actual effect after it is discovered.[6] Not surprisingly, further variation developed in how courts applied this "natural tendency" test.[7]

Finally, the Eighth Circuit adopted a more stringent "outcome materiality" test, which required a showing that the alleged fraudulent actions had "the purpose and effect" of causing the Government to pay out money it is not obligated to pay, or intentionally depriving the United States of money it is lawfully due.[8] Applying this test, the Eighth Circuit held that where the plaintiff cannot show that the government agency would have acted differently had it known of the omission, "there is no false claim because [the agency's action] would have occurred regardless of [the defendant's] actions."[9]

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[4] *E.g.*, *United States v. Southland Mgmt. Corp.*, 326 F.3d 669, 679 (5th Cir. 2003); *United States v. Rogan*, 517 F.3d 449 (7th Cir. 2008).

[5] *Id.*

[6] *E.g.*, *U.S. ex rel. Feldman v. van Gorp*, 697 F.3d 78, 95 (2d Cir. 2012) (defining materiality as the natural tendency to influence or be capable of influencing the payment or receipt of money or property and is an objective test that does not depend upon whether an individual officer relied on the misrepresentation); *United States v. Triple Canopy, Inc.*, 775 F.3d 628 (4th Cir. 2015) (materiality turns on the potential effect of the statement when it is made, not on the actual effect when it is discovered); *United States ex rel Longhi v. Lithium Power Techs.*, Inc., 575 F.3d 458, 470 (5th Cir. 2009); *U.S. ex rel. A+ Homecare, Inc. v. Medshares Mgmt. Grp., Inc.*, 400 F.3d 428, 445-46 (6th Cir. 2005) ("natural tendency" test focuses on the potential, not actual, effect of the false statement when it is made) (citations omitted); *U.S. ex rel. Matheny v. Medco Health Solutions, Inc.*, 671 F.3d 1217, 1228–29 (11th Cir. 2012) (misrepresentation material under 'natural tendency' test because government unable to identify excess payments).

[7] For example, the Fourth Circuit took a different approach than the Seventh Circuit to the precondition of payment rubric, applying a standard of materiality that was somewhat vague. 775 F.3d at 638.

[8] *Costner v. URS Consultants, Inc.*, 153 F.3d 667, 677 (8th Cir.1998); *see also United States ex rel. Miller v. Weston Educ., Inc.*, 784 F.3d 1198, 1207 (8th Cir. 2015) ("Materiality requires a causal link between the false statement or record and the Government's payment of a false claim. . . . The FCA is concerned about regulatory noncompliance only if it causes the government to pay money.") (citations omitted).

[9] *Rabushka ex rel. United States v. Crane Co.*, 122 F.3d 559, 563 (8th Cir.1997), *cert. denied*, 523 U.S. 1040 (1998).

The Supreme Court's Analysis of Materiality

The Supreme Court has now expressly rejected the First Circuit's broad view of materiality by clarifying that the materiality standard is not whether the government has an entitlement to refuse payment, but rather whether the government would have been likely to refuse payment if it knew about the violation. The Court's approach turns the materiality focus away from the specific contractual, statutory, or regulatory language at issue and instead emphasizes a factual inquiry as to whether the government would have refused payment had it known of the particular violation at issue. In other words, the standard articulated by the Supreme Court asks whether the violation would have had a real-world impact on whether the government would pay for the good or service had it known of the violation. Thus, materiality "look[s] to the effect on the likely or actual behavior of the recipient of the alleged misrepresentation."[10]

As a result, not every undisclosed violation of an express condition of payment automatically triggers liability; whether a provision is labeled a condition of payment is relevant to, but not dispositive of, the materiality inquiry. Even if such a violation occurs, defendants can now argue that the violation is not material if, for example, the government knew of the violation and paid regardless, or has done so in other similar situations. The Court also emphasized 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. Nor can materiality be found where noncompliance is minor or insubstantial.

Although the Court upheld the implied certification theory of FCA liability, which most practitioners in this area expected to survive in some form, it has done so by turning the focus of how FCA liability is analyzed upon the question of materiality. This approach requires an analysis of the specific violation being alleged and its actual impact because, as the Court made clear in its ruling yesterday, "the False Claims Act is not a means of imposing treble damages and other penalties for insignificant regulatory or contractual violations." The Court seems to believe that this more-stringent materiality standard will do much to curb the excessive use of the FCA by the government against private parties. Indeed, in a footnote it claims that materiality is not "too fact intensive for courts to dismiss False Claims Act cases on a motion to dismiss or at summary judgment."[11] But the reality of litigating an FCA case remains; at the motion to dismiss stage, a plaintiff's allegations that the violations are material are taken as true and, by summary judgment stage, defendants have already spent significant amounts of time and money on discovery.

[10] *Universal Health Servs., Inc. v. United States*, No. 15-7, 2016 WL 3317565, at *11 (U.S. June 16, 2016)

[11] *Id.* at n.6.

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