LATHAM&WATKINS

Client Alert News Flash

Latham & Watkins Healthcare & Life Sciences, White Collar Defense & Investigations, and Supreme Court & Appellate Practices

June 21, 2016 | Number 1982

SCOTUS Upholds Implied Certification for Some Cases But Imposes "Rigorous Materiality Requirement" for FCA Liability

The decision in* Universal Health *upholds implied certification but strengthens False Claims Act defendants' ability to mount a materiality defense.

On June 16, 2016 the U.S. Supreme Court issued a unanimous decision in *Universal Health Services, Inc. v. United States ex rel. Escobar*, No. 15-7 (U.S., Thomas, J.). As the Justices signaled at oral argument,[1] the Court upheld the "implied certification" theory of liability under the federal False Claims Act (FCA), but rejected the broad scope of the theory applied by the First Circuit and advocated by the relator and the government. Instead, the Court reversed and remanded the First Circuit's judgment with instructions to apply a more "rigorous materiality standard." In this way, the Court adopted a middle-of-the-road approach to the implied certification theory.

The government will likely view this decision as a victory due to the Court's holding that the "implied false certification theory can, at least in some circumstances, provide a basis for liability." At the same time, however, the Court made clear that FCA liability is not as broad as what relators and the government have advocated for years — noting that the FCA is not an "all-purpose antifraud statute" nor "a vehicle for punishing garden-variety breaches of contract or regulatory violations."[2]

Most importantly for FCA defendants, the opinion sets forth a new materiality standard that adds teeth to the relaxed materiality definition enacted in 2009.[3] For example, the Court held that the government's payment of a claim in the face of actual knowledge of noncompliance with a requirement is "very strong evidence that those requirements are not material."[4] The Court further did not confine its "rigorous" materiality standard to the implied certification theory of liability — the new standard now applies across the full spectrum of FCA cases.

Court Upholds Implied Certification Theory and Rejects Prerequisite to Payment Requirement

Relators alleged that a Universal Health Services, Inc. mental health facility was liable under the FCA because the facility misrepresented employees' qualifications and licensing status when obtaining National Provider Identification numbers from the federal government, and then submitted claims for reimbursement under the Medicaid program using payment codes that corresponded with specific job titles. Relators claimed that this constituted a false claim under the "implied certification" theory of FCA liability because, in submitting the claim for reimbursement, Universal Health Services implied that it was in compliance with applicable regulations and failed to disclose the violation of applicable licensing and supervising regulations.

Implied Certification May Trigger Liability in Certain Situations

The Court upheld the viability of the implied certification theory of liability, "at least in certain circumstances." According to the Court, this theory can form a basis of liability under the FCA where (1) "the defendant submits a claim for payment that makes specific representations about the goods or services provided, but knowingly fails to disclose the defendant's noncompliance with a statutory, regulatory, or contractual requirement," and (2) "the omission renders those representations misleading."[5]

However, the Court stopped short of adopting the position advocated by the government and the relator, under which "every submission of a claim for payment implicitly represents that the claimant is legally entitled to payment, and that failing to disclose violations of material legal requirements renders the claim misleading."[6] The Court disagreed with the broad interpretation of implied certification articulated by the First Circuit[7] and advocated by the government[8] and relator.[9] Instead, the Court articulated a much narrower theory of implied certification, holding only that the theory is viable when two conditions are met — "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 noncompliance with material statutory, regulatory or contractual requirements makes those representations misleading half-truths."[10]

The Court declined to address the broader question of whether all claims for payment include a representation that the claimant is entitled to payment because the Court determined that the claims at issue in this case involved "half-truths — representations that state the truth only so far as it goes, while omitting critical qualifying information."[11] By submitting claims with certain payment codes that, in turn, incorporated National Provider Identification numbers corresponding to certain job titles, Universal Health Services represented that it had complied with applicable staffing and licensing requirements to provide the services for which it was seeking reimbursement. The Court shed some additional light on what it meant by its reference to "half-truth" by referencing a "classic example" from contract law in which a seller "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."[12]

Practically speaking, how the new test for implied certification will play out at the district court level remains unclear. Lower courts will likely undertake a closer review of the facts and reach fact-specific holdings as they work to apply this test.

Express Categorization as a Condition of Payment no Longer Required

The Court rejected the dichotomy adopted by several circuits — and urged by Universal Health Services — that the implied certification theory applies only where compliance with the statute, regulation or contractual provision is expressly identified as a condition of payment.[13] Universal Health Services argued that the express condition of payment was an appropriate limitation on FCA liability, particularly where parties are subject to "thousands of complex statutory and regulatory provisions."[14]

The Court held that the FCA "does not impose this limit on liability."[15] The Court instead pointed to the materiality and scienter requirements of the FCA as providing appropriate limitations on "open-ended liability."[16] The Court did note, however, that "the Government's decision to expressly identify a provision as a condition of payment is relevant" to materiality — just "not automatically dispositive."[17]

Court Raises the FCA's Materiality Standard

Justice Thomas' opinion included a lengthy exposition of the FCA's materiality standard. Calling the materiality requirement both "rigorous" and "demanding,"[18] the Court outlined several significant aspects of this requirement that will likely result in a sea-change in how defendants and the government approach this issue in every FCA case, not merely in cases involving implied certification.

Critical for defendants, the Court rejected the government's (and several circuit courts') position that the materiality element is satisfied "so long as the defendant knows that the Government would be entitled to refuse payment were it aware of the violation."[19] In the Court's view, adopting this standard would inappropriately lead to FCA liability even where only minor contract or regulatory violations had occurred. Rebuking this minimal standard for materiality, the Court stated that the FCA "does not adopt such an extraordinarily expansive view of liability."[20]

Instead, the appropriate materiality inquiry is the "'effect on the likely or actual behavior of the recipient of the alleged misrepresentation.'"[21] This test looks beyond what the parties did or did not designate as conditions of payment and instead looks to how the parties are treating contract or regulatory requirements in practice. In other words, the focus of the materiality inquiry is not solely on what the parties agreed to in advance at the time of signing the contract or agreement — the actual decision to pay and the knowledge that the government has at that time are just as, if not more, important.

In outlining the new materiality standard, the Court provided a roadmap for contractors defending against FCA cases where the relator or the government allege noncompliance that is largely immaterial:

- "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."[22]
- "Nor is it sufficient for a finding of materiality that the Government would have the option to decline to pay if it knew of the defendant's noncompliance."[23]
- "Materiality, in addition, cannot be found where noncompliance is minor or insubstantial."[24]
- "[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."[25]
- "[I]f 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.[26]

Moreover, the Court emphasized that such materiality determinations may be made in the early stages of litigation; courts can dismiss FCA cases based on a lack of materiality at either the motion to dismiss or summary judgment stage.[27]

The Court's materiality standard departs from an entire line of cases applying a more relaxed interpretation of materiality that eschews any focus on the government's knowledge or motives at the time of submission and payment of the claim. For example, the standard for materiality which the Fourth Circuit recently enunciated in *United States v. Triple Canopy, Inc.* was to focus on the "potential effect of the false statement when it is made, *not on the actual effect of the false statement when it is discovered.*"[28] Under *Universal Health*, this standard is no longer the law — the actions of the government when it knows of a violation are now directly relevant to the inquiry.[29]

The Court's focus on situations where the government pays claims in full while having actual knowledge that certain requirements were violated will have a profound impact on how government contractors approach FCA litigation. In complex government contract cases, the government is often deeply involved in the contractor's activities and knows a great deal about the compliance of contractors with contract and

regulatory requirements. *Universal Health* now underscores the importance for FCA defendants to understand and leverage the government's understanding and scope of its knowledge at the time it paid the now-disputed claims.

For additional background on the prior decisions by lower courts, the circuit split on the implied certification theory and oral argument before the Supreme Court, please see the April 21, 2016 *Client Alert* SCOTUS Oral Argument Suggests FCA Implied Certification Theory Is Here to Stay – But Perhaps with Limits.

If you have questions about this *Client Alert*, please contact one of the authors listed below or the Latham lawyer with whom you normally consult:

Katherine A. Lauer
katherine.lauer@lw.com
+1.858.523.5451
San Diego

Daniel Meron
daniel.meron@lw.com
+1.202.637.2218
Washington, D.C.

Abid R. Qureshi
abid.qureshi@lw.com
+1.202.637.2240
Washington, D.C.

Anne W. Robinson
anne.robinson@lw.com
+1.202.637.2161
Washington, D.C.

Katherine M. Gigliotti
katherine.gigliotti@lw.com
+1.202.637.1032
Washington, D.C.

Dean W. Baxtresser
dean.baxtresser@lw.com
+1.202.637.2110
Washington, D.C.

You Might Also Be Interested In

SCOTUS Oral Argument Suggests FCA Implied Certification Theory Is Here to Stay – But Perhaps with Limits

AseraCare Ruling: FCA Is Not For Differing Medical Opinions

Fourth Circuit May Address Use of Statistical Sampling in False Claims Act Actions

Significant False Claims Act Amendments Enacted as Part of the Fraud Enforcement and Recovery Act of 2009

Endnotes

[1] April 21, 2016 *Client Alert* SCOTUS Oral Argument Suggests FCA Implied Certification Theory Is Here to Stay – But Perhaps with Limits

[2] *Universal Heath Servs. v. United States ex rel. Escobar*, No. 15-7, slip op. at 15 (S. Ct. June 16, 2016).

[3] *See* 31 U.S.C.A. § 3729(b)(4).

[4] *Universal Health Servs*., slip op. at 16.

[5] *Id*. at 2.

[6] *Id.* at 9.

[7] In its opinion in this case, the First Circuit explained that any knowing misrepresentation of "compliance with a material precondition of payment" was sufficient to trigger FCA liability and that a "material precondition of payment … may be found in sources such as statutes, regulations, and contracts, [and] need not be 'expressly designated.'" *See United States ex rel. Escobar v. Universal Health Servs.*, 780 F.3d 504, 512 (1st Cir. 2015) (citing *United States ex rel. Hutcheson v. Blackstone Med., Inc.*, 647 F.3d 377, 387 – 88 (1st Cir. 2011)*; see also United States v. Triple Canopy, Inc.*, 775 F.3d 628, 636 (4th Cir. 2015) ("[W]e hold that the Government pleads a false claim when it alleges that the contractor … made a request for payment under a contract and withheld information about its noncompliance with material contractual requirements.") (internal citations omitted); *United States v. Sci. Applications Int'l Corp.*, 626 F.3d 1257, 1269 (D.C. Cir. 2010) ("[T]o establish the existence of a 'false or fraudulent' claim on the basis of implied certification of a contractual condition, the FCA plaintiff … must show that the contractor withheld information about its noncompliance with material contractual requirements. The existence of express contractual language specifically linking compliance to eligibility for payment may well constitute dispositive evidence of materiality, but it is not … a necessary condition.").

[8] Brief for the United States as Amicus Curiae at 27-34, *Universal Heath Servs. v. United States ex rel. Escobar*, No. 15-7.

[9] Brief for Respondent at 40-55, *Universal Heath Servs. v. United States ex rel. Escobar*, No. 15-7.

[10] *Universal Heath Servs.*, slip op. at 11.

[11] *Id.* at 9-10.

[12] *Id*. at 10 (citing *Junius Constr. Co. v. Cohen*, 257 N. Y. 393, 400, 178 N. E. 672, 674 (1931)).

[13] This theory had been adopted in the Second, Third, Sixth, Ninth, Tenth and Eleventh Circuits. *See United States ex rel. Mikes v. Straus*, 274 F.3d 687, 699-700 (2d Cir. 2001) (""[I]mplied false certification is appropriately applied only when the underlying statute or regulation … expressly states the provider must comply in order to be paid."); *United States ex rel. Wilkins v. United Health Group, Inc.*, 659 F.3d 295, 307 (3d Cir. 2011) ("Thus, under this theory a plaintiff must show that if the Government had been aware of the defendant's violations of the Medicare laws and regulations that are the bases of a plaintiff's FCA claims, it would not have paid the defendant's claims."); *United States ex rel. Augustine v. Century Health Servs*., 289 F.3d 409, 414 (6th Cir. 2002) ("[L]iability can attach if the claimant violates its continuing duty to comply with the regulations on which payment is conditioned."); *Ebeid v. Lungwitz*, 616 F.3d 993, 996-98 (9th Cir. 2010) (recognizing a theory of implied certification under the FCA, which "occurs when an entity has previously undertaken to expressly comply with a law, rule, or regulation, and that obligation is implicated by submitting a claim for payment even though a certification of compliance is not required in the process of submitting the claim"); *United States ex rel. Conner v. Salina Reg'l Health Ctr., Inc.*, 543 F.3d 1211, 1218 (10th Cir. 2008) ("If a contractor knowingly violates [a prerequisite to the government's payment] while attempting to collect remuneration from the government, he may have submitted an impliedly false claim."); *McNutt ex rel. United States v. Haleyville Med. Supplies, Inc.*, 423 F.3d 1256, 1259 (11th Cir. 2005) ("The violation of the regulations and the corresponding submission of claims for which payment is known by the claimant not to be owed makes the claims false ... ").

[14] *Universal Heath Servs.*, slip op. at 13.

[15] *Id*. at 12.

[16] *Id.* at 13-14.

[17] *Id*. at 16.

[18] *Id.* at 14-15.

[19] *Id.* at 17.

[20] *Id.*

[21] *Id.* at 14 (quoting 26 R. Lord, *Williston on Contracts* §69:12, p. 549 (4th ed. 2003) (Williston)).

[22] *Id.* at 15.

[23] *Id.* at 15-16.

[24] *Id.* at 16.

[25] *Id.*

[26] *Id.*

[27] *Id.* at 16 n.6.

[28] *United States v. Triple Canopy, Inc.*, 775 F.3d 628 (4th Cir. 2015) (quoting *United States ex rel. Harrison v. Westinghouse Savannah River Co.,* 352 F.3d 908, 913 (4th Cir. 2003)) (emphasis in original).

[29] The holding in *Universal Health* also appears to reinforce the line of cases that have taken into account the government's actions and motives when assessing materiality. *See, e.g.*, *United States ex rel. Costner v. United States*, 317 F.3d 883, 888 (8th Cir. 2003) (where the government "undisputably was informed of [defendant's] operational problems from at least three sources, [and] nonetheless continued to approve monthly payments," the court granted summary judgment because the alleged omissions regarding those "operational problems" could not have been material); *United States ex rel. Lamers v. City of Green Bay*, 168 F.3d 1013, 1019-20 (7th Cir. 1999) (where government was "fully apprised" of defendant's technical violations but nevertheless approved a subsequent application, the government's conduct indicated that the alleged misrepresentations were not "material").