Client Alert

pillsbury

Corporate Investigations & White Collar Defense

Government Contracts & Disputes

Health Law

June 23, 2016

Supreme Court Validates "Implied Certification" Liability Under False Claims Act

Escobar *Decision Signals Increased Exposure for Government Contractors and Health Care Providers*

By C. Joël Van Over, Alexander B. Ginsberg and Danielle Vrabie

The U.S. Supreme Court issued its decision on June 16, 2016, in Universal Health Services v. United States ex rel. Escobar, *No. 15-7, a case the government contractor and health care communities hoped the Court would use to narrow the scope of liability under the federal False Claims Act (FCA).*[1] *The Court did not oblige. Rather, a unanimous Court held that: (1) "implied certification" is a valid theory of liability under the FCA and (2) FCA liability for failing to disclose violations of legal requirements depends on the "materiality" of those requirements, not on whether those requirements were express conditions of payment. These dual holdings actually* expand *the scope of FCA liability previously recognized in several jurisdictions. In short, the* Escobar *decision is a defeat for companies that sell to or seek reimbursement from the federal government.*

Background

The FCA, the government's favorite enforcement tool against federal contractors, imposes significant financial penalties for "knowingly present[ing], or caus[ing] to be presented, a false or fraudulent claim for payment or approval."[2] The FCA also prohibits contractors from making false statements "material to a false or fraudulent claim."[3] The government and *qui tam* plaintiffs[4] have pursued FCA cases based on both

[1] This Alert is a follow-up to our earlier piece "False Claims Act 'Implied Certification' Update: Supreme Court Oral Argument Forecasts Continued Vitality of Controversial Doctrine" dated May 5, 2016.

[2] 31 U.S.C. § 3729(a)(1)(A). The FCA defines "knowing" to include not only actual knowledge but also "deliberate ignorance" of and "reckless disregard" for the truth and clarifies that "no proof of specific intent to defraud" is required, *Id.* § 3729(b)(1).

[3] 31 U.S.C. § 3729(a)(1)(B).

"factually false" and "legally false" claims, a distinction recognized by several federal appellate courts.[5] The former describes an "incorrect description of goods or services provided or a request for reimbursement for goods or services never provided" while the latter "is predicated upon a false representation of compliance with a federal statute or regulation or a prescribed contractual term."[6] Further, the courts have recognized two types of "legal falsity"—"express" and "implied" false certification.[7]

The FCA has been uniformly understood to create potential liability for a contractor who expressly certifies compliance with certain requirements that are material to payment when in fact the contractor has not complied with such requirements. However, in the years preceding *Escobar*, the federal appellate courts divided regarding FCA liability for implied false certification—or liability where a contractor is out of compliance with a statute, regulation or contract requirement, but the contractor does *not* expressly certify such compliance.

The federal contractor and health care communities long have asserted that implied certification creates undue and unjustified liability—with the potential for the government to escalate minor statutory, regulatory or contractual non-compliances into FCA actions, which expose defendants to tremendous financial penalties including treble damages. Last year, the Seventh Circuit agreed and rejected the theory altogether, finding that it would be "unreasonable for us to hold that an institution's continued compliance with the thousands of pages of federal statutes and regulations incorporated by reference into the [government contract in question] are conditions of payment for purposes of liability under the FCA."[8] However, the Seventh Circuit held the minority view.

The majority of federal appellate courts—including the First, Second, Third, Fourth, Sixth, Ninth, Tenth, Eleventh and D.C. Circuits—had recognized at least some form of implied certification liability, several of them holding that such liability extends to knowing non-compliance with statutory, regulatory or contractual requirements that are clear preconditions of payment. The First and Fourth Circuits, on the other hand, had adopted the broadest view of implied certification liability, holding effectively that *any* knowing, material non-compliance with government regulations or contract requirements potentially gives rise to FCA liability.[9] As a result of this "circuit split," the Supreme Court granted *certiorari* in *Escobar*.

The First Circuit's Decision in *Escobar*

Escobar involved allegations that a mental health clinic violated the FCA by seeking Medicaid reimbursement despite the fact that it failed to comply with certain regulations pertaining to staffing and employee supervision. The claims for reimbursement did not contain express certifications of compliance with the regulations. The claims for reimbursement did, however, employ payment codes corresponding to specific medical services. The First Circuit, reversing the district court's dismissal of the complaint,[10] held

[4] The FCA's *qui tam* provisions feature significant financial incentives for private plaintiffs—known as "relators"—to pursue FCA actions against contractors and health care providers. *See* 31 U.S.C. §§ 3730(b)(1), (d).

[5] *See, e.g., Mikes v. Straus*, 274 F.3d 687, 696 (2d Cir. 2001).

[6] *Id.*

[7] *See, e.g., United States ex rel. Wilkins v. United Health Grp., Inc.,* 659 F.3d 295, 305-06 (3d Cir.2011)

[8] *United States v. Sanford-Brown, Ltd.,* 788 F.3d 696, 711 (7th Cir. 2015), *petition for cert. filed*, No. 15-729 (U.S. Dec. 2, 2015).

[9] *See, e.g., United States ex rel. Badr v. Triple Canopy, Inc.,* 775 F.3d 628, 636-37 (4th Cir. 2015), *petition for cert. filed*, No. 14-1440 (U.S. June 5, 2015) ("[W]e hold that the Government pleads a false claim when it alleges that the contractor, with the requisite scienter, made a request for payment under a contract and 'withheld information about its noncompliance with material contractual requirements.'").

[10] The district court had opined that, although the allegations against the clinic "raise serious questions about the quality of care provided[,] . . . the False Claims Act is not the vehicle to explore those questions." Indeed, the relators in *Escobar* are the parents of a girl who died while in the care of the clinic.

that "alleged noncompliance with regulations pertaining to supervision . . . provided sufficient allegations of falsity to survive a motion to dismiss."[11]

The First Circuit embraced a broad view of implied certification liability, explaining that it determines FCA liability by engaging in a "fact-intensive and context specific inquiry" to determine whether a contractor "knowingly misrepresented compliance with a material precondition of payment," which need not be "expressly designated" as such.[12]

Petitioner Universal Health Services Inc. had asked the Supreme Court to rule that the FCA does not permit liability based on an implied certification theory, "under which claims that contain no affirmative misstatements are deemed to be 'false or fraudulent.'"[13] As an alternative argument, Petitioner asked the Court to hold that any application of implied certification liability must be "limited to circumstances in which a contractor has violated a statutory, regulatory, or contractual provision that is expressly designated as a precondition to payment." Respondents, by contrast, had argued that "[k]nowingly billing the government for services that fail to meet material conditions falls squarely within the scope" of the FCA and that "the relevant payment condition need not bear a formal label as long as it is material and the defendant demands payment while knowingly violating it . . . Nothing in the FCA's text supports restricting it to violations of expressly designated payment conditions."[14] Respondents' arguments largely carried the day.

The Supreme Court's Resolution

Writing for a unanimous Court, Justice Thomas explained that the common-law definition of fraud—applicable to the FCA because the statute does not otherwise define the terms "false" and "fraudulent"—"has long encompassed certain misrepresentations by omission" and includes "more than just claims containing express falsehoods."[15] The Court offered, by way of comparison, a "classic example" of an "actionable half-truth" in contract law: "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."

Given this context, the Court first held that "implied certification theory can be a basis for liability, at least where 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 noncompliance with material statutory, regulatory, or contractual requirements makes those representations misleading half-truths."

Analyzing the facts of *Escobar*, the Court stated that it "need not resolve whether all claims for payment implicitly represent that the billing party is legally entitled to payment. The claims in this case do more than merely demand payment. They fall squarely within the rule that half-truths—representations that state the truth only so far as it goes, while omitting critical qualifying information—can be actionable misrepresentations." Specifically, by submitting claims for payment that used certain payment codes, "Universal Health represented that it had provided individual therapy, family therapy, preventive medication counseling, and other types of treatment." In addition, health care staff "made further representations in submitting Medicaid reimbursement claims by using National Provider Identification numbers corresponding to specific job titles."

[11] *United States ex rel. Escobar v. Universal Health Services Inc.,* 780 F. 3d 504, 514 (1st Cir. 2015), *cert. granted*, No. 15-7 (U.S. Dec. 4, 2015).

[12] *Id.* at 512-13 (internal citations and quotations omitted).

[13] Petitioner's Brief is available here.

[14] Respondents' Brief is available here.

[15] The Supreme Court's decision is available here.

Second, the Court held that nothing in the text of the FCA limits liability to misrepresentations about express conditions of payment. Specifically: "liability for failing to disclose violations of legal requirements does not turn upon whether those requirements were expressly designated as conditions of payment. Defendants can be liable for violating requirements even if they were not expressly designated as conditions of payment." What matters, the Court explained, "is not the label the Government attaches to a requirement, but whether the defendant knowingly violated a requirement that the defendant knows is material to the Government's payment decision." Therefore, "even when a requirement is expressly designated a condition of payment, not every violation of such a requirement gives rise to liability," though such designation might be evidence of materiality. The Court, in turn, cited the common law definition of materiality, under which an issue is material if "a reasonable man would attach importance to [it] in determining his choice of action in the transaction" or "if the defendant knew or had reason to know that the recipient of the representation attaches importance to the specific matter 'in determining his choice of action'."[16]

Ultimately, the Court remanded the case to allow the lower courts to determine whether the relators' complaint properly pleads an FCA violation under the rubric of the Court's decision.

Implications of the Decision

Despite the Court's reassurances that implied certification liability is viable only where "two conditions are satisfied" and that the "materiality standard is demanding," the *Escobar* decision does nothing to curb the scope of the government's enforcement efforts (and relators' claims) under the FCA. Quite the contrary, the decision overrules the several appellate courts that had either rejected or limited the scope of implied certification.

As to the first of these ostensible limiting conditions, the Court stated that implied certification can give rise to FCA liability where "the claim does not merely request payment, but also makes specific representations about the goods or services provided." But this requirement begs the question of what constitutes a "specific representation"—particularly given that implied certification cases generally involve *no* express representations. Indeed, this aspect of the Court's analysis suggests that the Court may have viewed the alleged false claims in *Escobar* as being factually, rather than *legally*, false. In any event, the decision sets the stage for a new line of cases on the issue of what "specific representations" give rise to implied certification liability. The government undoubtedly will argue that the fact of submitting an invoice signifies such a representation.

Second, and similarly, the decision will spark a new series of cases on the issue of materiality. As it has done for years, the government will continue to argue that nearly every statutory, regulatory or contractual non-compliance is material to payment, and the Court's decision does little to deter such conduct. Rather, the *Escobar* decision calls for a fact-intensive inquiry into materiality but provides only sparse and general guidance concerning the scope of such an inquiry. One potential bright spot is the Court's recognition that materiality questions are not too fact intensive for resolution on a motion to dismiss. Indeed, the Court reiterated that under Federal Rules of Civil Procedure 8 and 9(b), plaintiffs must plead plausible and particular facts to support their allegations of materiality. Nonetheless, the time, expense and risk associated with a materiality inquiry may enhance the government's leverage in extracting settlements from companies being investigated for FCA violations.

[16] Certain lower courts have held that materiality under the FCA is a legal issue to be decided by the judge rather than reserved for the jury. *See, e.g., United States ex rel. American Sys. Consulting, Inc. v. ManTech Advanced Sys. Int'l*, 600 Fed. Appx. 969 (6th Cir. 2015). The Supreme Court did not address this issue.

In sum, implied certification is alive and well following the Supreme Court's recent decision and, accordingly, the government's enforcement efforts show no signs of slowing. Until the lower courts have had an opportunity to provide further guidance on "implied certification" in light of *Escobar*, a great deal of uncertainty remains. In the meantime, however, the cost of defending an FCA action, on any theory, will remain high.

If you have any questions about the content of this Alert, please contact the Pillsbury attorney with whom you regularly work, or the attorneys below.

C. Joël Van Over (bio)
Northern Virginia
+1.703.770.7604
joel.vanover@pillsburylaw.com

Alexander B. Ginsberg (bio)
Northern Virginia
+1.703.770.7521
alexander.ginsberg@pillsburylaw.com

Danielle Vrabie (bio)
New York
+1.212.858.1683
danielle.vrabie@pillsburylaw.com

Thomas C. Hill (bio)
Washington, DC
+1.202.663.8073
thomas.hill@pillsburylaw.com

Aaron S. Dyer (bio)
Los Angeles
+1.213.488.7321
aaron.dyer@pillsburylaw.com

Carolina A. Fornos (bio)
New York
+1.212.858.1558
carolina.fornos@pillsburylaw.com

Casey Low (bio)
Austin
+1.512.580.9616
casey.low@pillsburylaw.com

Jeetander T. Dulani (bio)
Washington, DC
+1.202.663.8383
jeetander.dulani@pillsburylaw.com

Pillsbury Winthrop Shaw Pittman LLP is a leading international law firm with offices around the world and a particular focus on the energy & natural resources, financial services, real estate & construction, and technology sectors. Recognized by *Financial Times* as one of the most innovative law firms, Pillsbury and its lawyers are highly regarded for their forward-thinking approach, their enthusiasm for collaborating across disciplines and their unsurpassed commercial awareness.