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U.S. Supreme Court Implied Certification Case Both Expands and Limits False Claims Act Liability

Court Recognizes Theory but Reaffirms the "Rigorous" Materiality and Scienter Requirements, Making Clear that the FCA is No Remedy for "Minor or Inconsequential" Infractions

By Amy P. Williams, Thomas C. Ryan and Theodore L. Kornobis

The Supreme Court issued a much-anticipated False Claims Act ("FCA") decision yesterday,[1] upholding a theory of liability that has spurred a significant amount of litigation by the government and private relators in recent years. At the same time, the Supreme Court's opinion provides would-be defendants with some helpful ammunition to help curb what many believe has been a severe misuse of the FCA to police relatively minor regulatory and contract violations.

The False Claims Act

The FCA, 31 U.S.C. § 3729 *et seq.*, is a Civil War-era statute that imposes significant penalties on those who defraud the government. As the Supreme Court explained, the statute's focus is on those who knowingly present or directly induce the submission of false or fraudulent claims for payment or approval (including reimbursement requests under federal programs). Among other elements, the current version of the FCA requires that a false claim or statement be made, that it be "material," and that the defendant act "knowingly" (to include actual knowledge, reckless disregard, and deliberate ignorance of the truth).

False claims can take different forms. In a traditional example, a false claim would exist if a medical facility contracts with the government to provide patient treatment, fails to provide any treatment, and nevertheless makes a claim for payment. Similarly, if the facility overcharged the government for the treatment and demanded payment, that could constitute a false claim. What happens, however, if the facility did in fact provide treatment and charged the government the correct amount, but violated some regulatory requirement related to how the treatment was supposed to be provided? Is the claim for payment "false"?

This was the question presented to the Supreme Court in the case of *Universal Health Services, Inc. v. United States ex rel. Escobar*. There, a medical facility allegedly provided therapy services to patients and billed the Medicaid program for those services, but the therapists who provided the services allegedly did not satisfy Medicaid licensing and qualification regulations.

[1] *Universal Health Services, Inc. v. United States ex rel. Escobar*, 579 U.S. ___ (2016), available at http://www.supremecourt.gov/opinions/15pdf/15-7_a074.pdf.

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Implied Certification Theory

These types of cases involve what has become known as the "implied certification" theory of liability, under which a person or entity that submits a claim for payment is deemed to impliedly certify its compliance with a host of legal requirements, which could arise from statute, regulation, or contract.

Critics of the implied certification theory point to the sheer magnitude and complexity of laws, regulations, and contract requirements in the modern regulatory state. Any entity that does virtually any type of business with the federal government is bound to face some type of regulation. Does a claim become false, and thus potentially subject to FCA liability—with its attendant treble damages plus civil monetary penalties—when *any* regulation or contractual term is violated?

Over the past several years, the Department of Justice and private plaintiffs seeking to enforce the FCA have used the implied certification theory to pursue conduct in a variety of heavily regulated industries that involve sometimes thousands of rules and requirements, including financial institutions, government contractors, education providers, and health care facilities.

Prior to the Supreme Court's intervention this week, several (but not all) district and appellate courts had recognized the implied certification theory in at least some situations. Of the courts that accepted the theory, many required that the violated statute, regulation, or contractual term be expressly designated as a condition of payment (i.e. that the regulation states that the government would not pay any claims if it were violated).

The Supreme Court Upholds the Implied Certification Theory

In a unanimous decision, the Supreme Court held that the implied certification theory can be a basis for liability under the FCA. Specifically, the Supreme Court explained, "liability can attach when 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." Further, the Supreme Court held that an implied certification could arise even if compliance with the statute, regulation, or contract term was not in fact expressly designated as a condition of payment (thus removing a key limiting factor for the theory).

The *Escobar* case effectively settles the debate as to whether implied certifications can *ever* be used to establish falsity in a FCA case, and expands the theory's reach to the jurisdiction that had previously rejected it. However, the Supreme Court's opinion does contain a number of helpful points for potential FCA defendants.

The Opinion Provides Important Limitations on Overaggressive FCA Enforcement

First, the opinion appears to cabin the theory's definition, stating that implied certifications can be a basis for liability "at least where two conditions are satisfied." The first condition is that the claim must "not merely request payment, but also makes specific representations about the goods or services provided." The second condition is that the defendant's failure to disclose noncompliance must transform the representations into "misleading half-truths,"

i.e., "representations that state the truth only so far as it goes, while omitting critical qualifying information." The application of these conditions will be heavily litigated in the future. However, it would appear that statutory, regulatory, or contractual violations unrelated to any representations made in a claim for payment would not be "false" and thus could not form the basis of implied certification liability.

Second, the Supreme Court provided substantial explanation as to what it described as the "demanding" materiality standard of the FCA, including:

- The materiality standard helps prevent the FCA from becoming a vehicle to punish "garden-variety breaches of contract or regulatory violations," and is not satisfied where noncompliance is "minor or insubstantial."
- The government cannot create materiality by designating a statutory, regulatory, or contractual requirement as a condition of payment. Moreover, the materiality requirement is not satisfied simply because the government has the *option* to decline to pay the claim if it knew of the noncompliance.
- It would be "strong evidence" against a finding of materiality if the government paid the claim at issue with actual knowledge that the requirements were violated or if the government regularly pays those *types* of claims despite such knowledge (and without signaling any change in position). Conversely, proof of materiality could include evidence that the defendant knows the government consistently refuses to pay claims in analogous cases based on noncompliance with the particular requirement at issue.
- Questions involving materiality (which is a "familiar and rigorous" concept) are appropriate for consideration on a motion to dismiss a complaint (which would be subject to heightened pleading standards for fraud) or at summary judgment.
- Even if materiality were not an express statutory component of the FCA, it would be imposed as part of the statute's common law groundings. This effectively undermines any argument that other fraud subsections of the FCA do not impose a materiality requirement.

Third, the Supreme Court recognized the tremendous amount of complexity involved when dealing with the government today, noting "billing parties are often subject to thousands of complex statutory and regulatory provisions," and imposing FCA liability for violation of every single one of them "would hardly help would-be defendants anticipate and prioritize compliance obligations."

Going Forward

Although the government and relators' bar will likely be cheering the Supreme Court's acceptance and nationwide expansion of the implied certification theory, government contractors and entities that operate in complex regulatory environments also have a good amount to be happy about from the Supreme Court's opinion. The Supreme Court's definition of what could constitute an implied certification and its explanation of what does and does not satisfy the "demanding" materiality requirement may guard against attempts by the Department of Justice or private plaintiffs to use the FCA to "punish[] garden-variety breaches of contract or regulatory violations."

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Those who obtain payment or reimbursement from the government should pay careful attention to the language used when making claims and the actual behavior of the government when such types of claims are made, in order to evaluate how this now-reworked theory of implied certification liability could apply to such claims.

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