When Are Omissions Material?: Implied Certification Claims and the False Claims Act

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Last term, the United States Supreme Court decided *Universal Health Services v. United States ex rel. Escobar,* 136 S. Ct. 1989 (2016), settling a circuit split that had developed regarding the validity and proper application of the implied false certification theory, which has become common to lawsuits brought pursuant to the False Claims Act. *See* 31 U.S.C. § 3729(a)(1)(A). Rejecting both the petitioner's and the respondent's arguments, while simultaneously choosing not to adopt any of three competing circuit interpretations, the Court held that liability may attach where a claim is grounded on the allegation that a defendant has failed to disclose violations of legal requirements that may or may not have been designated as conditions of payment. In so holding, the Court articulated a new application of the implied false certification theory of liability, which, in light of its flexibility and new approach, will likely generate a hotbed of FCA litigation for years to come.

The False Claims Act

The False Claims Act dates back to the Civil War era, when Congress decided that it needed to enact legislation designed to punish contractors taking advantage of the Union coffers during a time of war by fraudulently billing the government for goods or services provided (or, sometimes, not). *See United States v. Bornstein*, 423 U.S. 303, 309 (1976). To address this problem, Congress generated a statutory scheme under which violators could be subjected to civil and criminal liability, including double damages, forfeiture, and imprisonment. At present, violators may be subject to liability for false claims, which include "direct requests to the government for payment as well as reimbursements requests made to the recipients of federal funds under federal benefits programs." *Escobar,* 136 S. Ct. at 358 (citing 31 U.S.C. § 3729(b)(2)(A). In addition to allowing suits by the government, the Act contains a qui tam provision that allows "whistleblower suits" to be brought in the name of and on behalf of the federal government by private individuals. 31 U.S.C. § 3730. Under this provision, the government has an opportunity to investigate, intervene, and pursue the claim, or it may choose to abstain in which case a relator can continue prosecuting the claim at their own cost. If the government chooses not to pursue the claim, the individual is entitled to 25-30% of any judgment or settlement. 31 U.S.C. § 3730(d)(1). If, on the other hand, the government prosecutes the claim, the amount to which the individual relator is entitled is capped between 15 and 25%. 31 U.S.C. § 3730(d)(2). The Act also authorizes an award of specific civil penalties and treble damages upon proof that the defendant has committed certain enumerated acts of wrongdoing under 31 U.S.C. § 3729(a). Accordingly, prosecution of a False Claims Act claim for an individual relator or relators is potentially quite lucrative.

The False Claims Act clearly incentivizes individuals who are aware of fraud against the government to report that fraud so that the government investigates and protects the public coffers – something the government encourages. These same incentives (treble damages and per-claim civil penalties) often encourage defendants to settle with the government or the relator, because rolling the dice becomes a much riskier gamble without much of a corresponding upside once suspicion is aroused. Whether the extent of that encouragement is commendable or grounds for overzealous citizen policing is a debate for a different day. Nevertheless, it is fair to say that False Claims Act lawsuits will continue to require vigilance for any government contractor or entity that receives federal funds for goods and services, like healthcare providers who accept Medicaid funding, especially following *Escobar.*

Universal Health Services v. United States ex rel. Escobar

In *Escobar,* two relators brought a False Claims Act claim against Universal Health Services ("UHS"), the parent company of a mental health facility at which relators' teenage child – a Medicaid recipient – received treatment and counseling. The lawsuit developed after the teenager experienced a seizure and died following her use of a medicine that employees at the mental health facility had prescribed to her. Following her death, relators discovered that the employees who treated their daughter were not licensed, were not authorized to prescribe medications, and were unaccredited. They failed to disclose these discrepancies, however, when submitting reimbursement claims to the government under Massachusetts' Medicaid program. 136 S. Ct. at 1997-98.

Armed with this knowledge, relators filed a *qui tam* lawsuit in federal court, alleging that UHS had defrauded the government by submitting Medicaid claims that did not disclose violations of the Massachusetts Medicaid regulations regarding staff qualifications and licensing – a claim clearly grounded on a theory of implied certification. This theory of liability is grounded on the noting that when a company submits a reimbursement claim to the government, it "impliedly certifies compliance with all conditions of payment. But if that claim fails to disclose [a] violation of a material statutory, regulatory, or contractual requirement, the defendant has made a misrepresentation that renders the claim 'false or fraudulent' under [the False Claims Act]." 136 S. Ct. at 1995. In *Escobar,* relators were unsuccessful in convincing the federal district court that this was a cognizable theory on the facts presented. Specifically, the United States District Court for the District of Massachusetts granted UHS's motion to dismiss for failure to state a claim, finding that relators' had not stated a valid implied certification claim because none of the regulations about which they complained violated any condition of payment of the outstanding Medicaid claims. 2014 U.S. Dist. LEXIS 40098 (D. Mass. Mar. 26, 2014). On appeal, the First Circuit Court of Appeals reversed, holding that relators had stated a valid False Claims Act claim under the implied certification theory because every reimbursement submission impliedly certifies that the entity requesting reimbursement has complied with all relevant regulations such that it is entitled to payment under the federal program. 780 F.3d 504 (1st Cir. 2015).

UHS sought review of this issue in the United States Supreme Court, which granted *certiorari* to resolve a circuit split "over the validity and scope of the implied false certification theory of liability." 136 S. Ct. at 1998. To this point, three Courts of Appeals had handled the implied certification theory in three differing ways, generating confusion among the lower courts. The Seventh Circuit had entirely rejected the implied certification theory, "reasoning that only express (or affirmative) falsehoods can render a claim 'false or fraudulent' under [the Act]." Id. at 1998-99 (citing *United States v. Sanford-Brown, Ltd.,* 788 F.3d 696 (7th Cir. 2015)). Meanwhile, the Second Circuit has limited liability under the theory to provisions "expressly designated conditions of payment," id. at 1999 (citing *Mikes v. Straus,* 274 F.3d 687 (2d Cir. 2011)), while the D.C. Circuit has concluded that liability could attach regardless of whether conditions of payment were "expressly designated as such," *id.* (citing *United States v. Science Applications Int'l Corp.,* 626 F.3d 1257 (D.C. Dir. 2010)).

The Supreme Court plowed new ground on the issue, holding that the implied false certification theory can, in some circumstances, serve as a basis for liability under the False Claims Act. The Court looked first looked to the language of the Act itself to determine whether an omission, like a lack of staff qualifications and licensing, could ever serve as a basis of liability. *Id.* at 1999. Finding that the statute imposes liability on "any person who . . . knowingly presents, or causes to be presented, a false or fraudulent claim for payment or approval" to the government, the Court concluded that Congress intended to incorporate common-law fraud principles, which do not distinguish between misrepresentations by omission and express misrepresentations of fact. *Id.* (quoting 31 U.S.C. § 3729(a)(1)(A)). Thus, the Court held, "the 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." *Id.* at 2001.

Next, the Court held that liability for nondisclosure is not limited to those conditions of payment that are "expressly designated" as such. *Id.* At first glance, this appears to present an opportunity for *qui tam* litigants to expand the reach of the False Claims Act to a new set of defendants. Indeed, this is an argument that UHS presented to the Court in asserting a need to cabin liability and provide defendants with fair notice of what may cause an infraction of the False Claims Act. The Court plainly dismissed this argument, concluding that notions of policy "cannot supersede the clear statutory text." Id. at 2002 (citing *Kloeckner v. Solis,* 133 S. Ct. 596 at n.4 (2012). In further response to UHS's argument, the Court noted that "concerns about fair notice and open-ended liability can be effectively addressed through strict enforcement of the Act's materiality and scienter requirements." *Id.* (internal quotation omitted).

The Court's last, and most interesting, holding in *Escobar* is its articulation of the "materiality" requirement under the False Claims Act. *Id.* at 2003 (noting that the "material standard is demanding"). The Court held that not every violation of a governmental requirement will give rise to liability, even if done knowingly or intentionally. Rather, "[w]hat matters is . . . whether the defendant knowingly violated a requirement that the defendant knows is material to the Government's payment decision." *Id.* at 1996. Past practice and knowledge about the types of claims the government has reimbursed, and the circumstances under which they were paid, is relevant to this analysis. *Id.* at 2003.

Further limiting the potentially unlimited liability that could result from its holding, the Court went on to determine: 1) it is relevant, but not dispositive of the materiality analysis, that the government has identified a particular provision as a condition of payment, 2) materiality will not lie solely because the government could withhold payment because of noncompliance, and 3) materiality will not be found where the issue involves a minor infraction or insubstantial noncompliance. *Id.* at 2003-04. In other words, while these are factors that future courts and litigants should look to for guidance, they are not dispositive to the materiality analysis.

***Escobar's* Practical Effect**

The Court’s cornerstone instruction in *Escobar* advises practitioners to proceed on any inquiry of materiality in a holistic manner as it relates to the payment decision at issue; no single factor is automatically dispositive of whether liability will attach under the False Claims Act’s implied certification theory. Accordingly, litigants should look not only to the specific facts of the transaction or reimbursement request at issue, but also the effect that the transaction or request *would have had* if the government was aware of some aspect of the defendants’ noncompliance.

There are any number of factual scenarios that may generate claims for liability under the False Claims Act, and the implied certification theory as defined in *Escobar* provides yet another avenue for creative *qui tam* relators to pursue. It also provides an avenue for creative lawyering on behalf of defendants whose activities may generate heightened scrutiny under the Court’s analysis. In particular, the materiality analysis required under *Escobar* provides fertile ground for novel argument as to the actual or anticipated effect of a defendant’s purported omissions and the government’s knowledge of and response to those alleged omissions. Honesty, of course, is the best policy when it comes to anything submitted to the government, but one never knows which facts a *qui tam* relator may seek to exploit in light of the potentially lucrative private cause of action afforded by the False Claims Act. At the end of the day, *Escobar* requires relevant and “strong” evidence of materiality such that this should always be a key focus of any defense to an implied certification claim brought pursuant to the False Claims Act.