

Litigation Alert

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Summary and Significance of the Supreme Court's Decision in *Escobar*

Yesterday, Justice Thomas, writing for a unanimous Court in *Universal Health Services, Inc. v. United States ex rel. Escobar*, examined the circumstances under which an “implied false certification” can trigger liability under the False Claims Act (FCA) and clarified how the FCA materiality requirement should be enforced.

In construing the FCA, the Court reaffirmed its prior ruling in *Allison Engine Co. v. United States ex rel. Sanders*, that the FCA is not “an all-purpose antifraud statute” or a “vehicle for punishing garden-variety breaches of contract or regulatory violations.” Indeed, the Court took the opportunity to “emphasize” that “the False Claims Act is not a means of imposing treble damages and other penalties for insignificant regulatory or contractual violations.”

By expressly repudiating FCA liability based solely on a breach of a broad certification, such as averring compliance with the entire U.S. Code and Code of Federal Regulations, the Court's decision will be instrumental in curtailing efforts to advance expansive theories of FCA liability.

A. Summary: The Supreme Court Finds Implied Certification Theory Viable Only IN Limited Situations

The Court granted certiorari to resolve the scope and validity of the implied false certification theory of liability. Under an implied false certification theory, a defendant can be liable for submitting a “false or fraudulent” claim, even when the defendant's claim for payment is literally true and accurate, if the defendant violated some statutory, regulatory or contractual provision and compliance with that provision was a precondition to government payment. Appellate courts had split three ways on this issue: (1) one circuit rejected this theory, finding that only an express falsehood on a claim form can render a claim “false or fraudulent”; (2) other circuits permitted the theory but only if the relevant statute, regulation, or contract expressly stated that compliance with the rule was a condition of payment; and (3) other courts applied the theory regardless of whether the relevant statute, regulation or contract specifically designated compliance with the relevant provision to be an express condition of payment as long as compliance with the relevant provision was in fact a condition of payment.

The Court rejected all three of these approaches. Specifically, it found that the precise label that the government affixes to the relevant statute, regulation, or contract – such as, compliance is a “condition of payment” – is not determinative regarding whether the statute, regulation, or contract is material. Instead, the Court ruled that an implied certification theory can be a basis for FCA liability only if two conditions are satisfied: (1) “the claim does not merely request payment, *but also makes specific representations about*

the goods and services provided’ (emphasis supplied); **and** (2) the defendant failed to disclose its noncompliance with a provision that is “material” to the government’s decision to pay.

Condition 1: Specific representations about the goods and services provided

Before the Court’s ruling, the precise debate regarding the application of the implied false certification theory was whether a submitted “claim” can be “false,” although its representations are literally true, because of some violation of law or contract that is not expressly referenced on the claim form. Providing some guidance for future cases, the Court held that submitting claims for payment using payment codes that corresponded to specific counseling services is equivalent to a representation that these services had been provided in accordance with applicable law. The Court also held that submitting Medicaid reimbursement claims using National Provider Identification numbers is equivalent to a representation that the services were provided by properly trained and licensed employees. “By using payment and other codes that conveyed this information without disclosing Arbour’s many violations of basic staff and licensing requirements for mental health facilities, Universal Health’s claims constituted misrepresentations.”

The issue not addressed, however, is the extent to which non-compliance with rules and regulations that are not directly linked to specific codes and factual representations on the claim form may result in FCA liability based upon an implied false certification theory. Indeed, by specifically linking the relevant law breached to specific codes used on the claim form, the Court seemingly adopted the narrowest interpretation of an implied false certification theory by essentially asserting that the claim form itself must be expressly false (not impliedly false) because the code used did not accurately correspond to law (for example, a social worker’s service is billed when the person is not a licensed social worker under law).

Condition 2: Materiality

After addressing the viability of implied false certification theories, the Court turned to the FCA’s materiality element. The Court emphasized that the FCA’s materiality requirement is “rigorous” and “demanding.” The Court identified a number of factors that may be relevant to materiality: (1) the provision is labeled a condition of payment, although, as noted below, this is not “dispositive”; (2) there exists “evidence that the defendant knows that the Government consistently refuses to pay claims in the mine run of cases based on noncompliance with the particular statutory, regulatory, or contractual requirement”; and (3) a “reasonable person” would realize the importance of the provision, and thus failing to “appreciate the materiality of that condition would amount to ‘deliberate ignorance’ or ‘reckless disregard’ of the ‘truth or falsity of the information’ even if the Government did not spell this out.”

However, the Court also identified a number of limiting factors regarding materiality: (1) “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”; (2) “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”; (3) “Materiality . . . cannot be found where noncompliance is minor or insubstantial”; (4) “if the Government pays a particular claim in full despite its actual knowledge that certain requirements were violated, that is very strong evidence that these requirements are not material”;

(5) and “if 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.”

B. Significance: *Escobar* May Make it Easier to Dismiss FCA Suits at the Summary Judgment Stage

The Supreme Court’s decision will have a significant impact on FCA jurisprudence. Under current case law, FCA liability frequently turns on whether courts label a violation of law to be a “condition of participation” (a breach of law or contract that is typically addressed through administrative remedies, such as corrective action plans, education, or the imposition of civil penalties), which does not result in FCA liability, or a “condition of payment” (a breach of law or contract that results in the denial of payment) which does result in FCA liability.¹ To address this trend in case law and expand the scope of FCA liability, the government increasingly has required those who do business with the government to execute broad certifications stating that, in submitting a claim, they are representing that they have complied with all governmental rules and regulations, and this compliance is an express condition of payment.

The Supreme Court’s holding on the rigors of the materiality element, and its decision to remand the case for a more stringent application of the materiality standard, will have a significant impact on FCA jurisprudence. Specifically, the Court noted that it disagreed with the government’s view of materiality “that any statutory, regulatory, or contractual violation is material so long as the defendant knows the Government would be entitled to refuse payment were it aware of the violation.” Likewise, the Court rejected the view that if the “Government required contractors to aver their compliance with the entire U.S. Code and Code of Federal Regulations, then under this view, failing to mention noncompliance with any of those requirements would always be material” because the “False Claims Act does not adopt such an extraordinarily expansive view of liability.”

Additionally, the Court’s decision will facilitate the defendant’s ability to prevail on a motion to dismiss under Fed. R. Civ. P. 9(b), 12(b)(6) and at the summary judgment stage. Specifically, the Court underscored that FCA plaintiffs must “plead their claims with plausibility and particularity under Federal Rules of Civil Procedure 8 and 9(b),” and the Court specifically rejected Universal Health’s “assertion that materiality is too fact intensive for courts to dismiss FCA cases on a motion to dismiss or at summary judgment.” As a result, defendants will be positioned in FCA actions to compel FCA plaintiffs to assert plausible and specific materiality claims in their complaints to surmount Rules 12(b)(6) and 9(b). And even where FCA plaintiffs do specifically aver such materiality claims, defendants will be able to prevail on summary judgment on the issue of materiality if the undisputed facts show that the noncompliance

¹ The underlying logic of this distinction is that the FCA is intended to protect the federal fisc. If a violation of law would not alter the government’s payment on the claim, then, by definition, it is not actionable under the FCA because the violation has no impact on the federal treasury. Alternatively, if the violation would result automatically in denial of payment, then it directly impacts the federal fisc and is precisely the type of violation the FCA was intended to address if the defendant “knowingly” breached the law.

with a statutory, regulatory, or contractual requirement was insignificant or was otherwise not likely to have induced the Government not to pay the claim.

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