

Supreme Court Endorses Implied Certification Theory of Liability But Establishes “Demanding” Materiality Standard Under the False Claims Act

Yesterday, the United States Supreme Court decided *Universal Health Services, Inc. v. United States ex rel. Escobar et al.*, holding that the so-called “implied certification” theory is viable under the False Claims Act (“FCA”), but with stricter constraints than had been applied by the courts below (and many others). Drawing on principles of common law fraud, the Court held that a false certification of any kind—express or implied—may subject a defendant to FCA liability *if* the alleged false statement or omission was material to the Government’s payment decision and made with the requisite scienter. Writing for a unanimous Supreme Court, Justice Thomas explained that the “materiality standard [under the FCA] is demanding,” and that it requires more than just that the Government *would be entitled* to refuse payment were it aware of the violation. Though the Court held that liability under an implied certification theory “does not turn upon whether those requirements were expressly designated as conditions of payment,” (Slip Op. at 2) it clarified “not every undisclosed violation of an express condition of payment automatically triggers liability.” Slip Op. at 12. Significantly, the Court emphasized that the Government’s payment of the disputed claim with knowledge of the alleged misrepresentation is “strong evidence” of immateriality. Slip Op. at 16. Moreover, FCA defendants facing the prospect of millions of dollars in discovery costs may take some comfort from the footnote clarification that a case may be dismissed at the pleading stage absent particularized and plausible allegations of materiality. This decision will no doubt inspire more implied certification claims, but many will not withstand the exacting materiality requirement.

Background

In *Escobar*, a teenage beneficiary of Massachusetts’ Medicaid program received services at a mental health facility in Massachusetts, including counseling and medication which were reimbursed by Medicaid. After a purported doctor at the facility diagnosed her with bipolar disorder and prescribed medication to treat her condition, the teenager had an adverse reaction and suffered a seizure. Her condition worsened: she suffered several more seizures and died at age 17. Slip Op. at 4.

After her death, the girl’s parents discovered that few employees at the facility were licensed physicians or counselors. Of the five professionals who had served as counselors to the girl, only one was properly licensed. The practitioner who had diagnosed the girl as bipolar had received her purported Ph.D from an unaccredited Internet college, and the State of Massachusetts had twice rejected her application to be licensed as a psychologist. Likewise, despite claims of being a psychiatrist, the practitioner who prescribed medication to the girl was actually a nurse without authority to prescribe medication absent physician supervision. The clinic’s director helped misrepresent employees’ qualifications, and the facility regularly submitted claims to Medicaid for reimbursement—for many patients—using billing codes reserved for treatment by professionals with qualifications that the staff falsely claimed to have. Slip Op. at 4–5.

An employee at the facility filed a *qui tam* action, alleging that the facility, operated by Universal Health Services, filed “false claims” by submitting claims for Government reimbursement that implicitly certified that its employees had appropriate credentials. The Government declined to intervene, and the district court granted Universal Health’s motion to dismiss, holding that none of the regulations that the facility had violated were conditions of Government payment. Slip Op. at 6. The United States Court of Appeals for the First Circuit reversed in relevant part, holding

that Universal Health had violated Massachusetts Medicaid regulations that “clearly impose conditions of payment” because they identified adequate supervision of unqualified personnel as an “express and absolute” condition of payment. Slip Op. at 7.

The Court’s Analysis

The Supreme Court granted certiorari and vacated the judgment, remanding the case so that the lower courts could, in the first instance, apply the Court’s reasoning. The Court first held that the implied certification theory can subject a defendant to FCA liability when a claim “does not merely request payment, but also makes specific representations about the goods or services provided” and “the defendant’s failure to disclose noncompliance with material statutory, regulatory, or contractual requirements makes those representations misleading half-truths.” Slip Op. at 11.

Second, the Court held that whether a certification is expressly or implicitly designated a condition of payment is not determinative of whether it is material to the Government’s payment decision. Slip Op. at 11–12. Although the Government’s decision to “expressly identify a provision as a condition of payment is relevant, [it is] not automatically dispositive.” Slip Op. at 16. To hold otherwise, the Court reasoned, could result in the Government simply “designating every legal requirement an express condition of payment” (Slip Op. at 13) regardless of whether that provision is material to the Government’s payment decision. Conversely, such a rule could allow a defendant to escape FCA liability where the defendant fails to comply with an obviously material, yet unwritten, condition of goods or services. Slip Op. at 12–13.

Finally, the Court addressed how the materiality requirement of the FCA should be enforced. The Court looked to the materiality requirements in tort and contract law, and held that, under the FCA, “[t]he materiality standard is demanding. The False Claims Act is not an all-purpose antifraud statute, or a vehicle for punishing garden-variety breaches of contract or regulatory violations.” Slip Op. at 15 (internal citations omitted). The Court addressed several circumstances in which a provision is *not* material, and therefore not actionable under the FCA. Specifically, the Court held that a misrepresentation is not material merely because (a) the Government designated compliance with a particular statutory, regulatory, or contractual requirement as a condition of payment, or (b) the Government would have the option to decline to pay if it knew of the defendant’s noncompliance. Slip Op. at 15–16. More is required to prove materiality.

The Court further addressed the issue of “government knowledge,” which has been litigated extensively in lower courts, stating that “if 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.” Slip Op. at 16. In a footnote, the Court also rejected the assertion that materiality is too fact-intensive for courts to dismiss FCA cases before trial, implicitly rejecting several lower court decisions that have held that materiality may not be decided on a motion to dismiss. Slip Op. at 16–17 n.6. The Court explained that “False Claims Act plaintiffs must [] plead their claims with plausibility and particularity under Federal Rules of Civil Procedure 8 and 9(b) by, for instance, pleading facts to support allegations of materiality.” Slip Op. at 16–17 n.6.

Conclusion

The headline of the *Escobar* decision is that the Supreme Court has endorsed the implied certification theory whether or not the false representation was an express condition of payment or condition of eligibility to participate in a Government program. Read more carefully, however, *Escobar* should curtail FCA liability for what can be characterized as insignificant regulatory violations or contractual breaches. The Court’s reasoning suggests that a defendant’s implied certification of compliance with a regulatory or contractual provision is actionable only in narrow circumstances: where that certification “makes specific representations about the goods or services provided” and

the Government would not have paid had it known the facts underlying the misrepresentation. Slip Op. at 11. In cases in which a defendant falsely certifies compliance with a provision that does not affect the characteristics of the goods paid for by the Government—which is a common claim in the ever-expanding field of FCA litigation—*Escobar* strongly suggests that such a case would not subject the defendant to FCA liability. Furthermore, the Court’s pronouncement of a “demanding” materiality standard and its holding that Government knowledge of the defendant’s conduct is “strong evidence” that the underlying provision was immaterial to Government payment will likely result in the dismissal of many current and future FCA suits. We will continue to monitor developments in this area as lower courts apply the Court’s standard.

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