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Supreme Court Endorses "Implied Certification" Theory of Liability Under Federal False Claims Act and Creates New Law as to Materiality of Claims

On Thursday, June 16 the United States Supreme Court decided *Universal Health Services v. United States ex rel. Escobar*.[1] In this unanimous opinion written by Justice Thomas, the Court both endorsed the "implied certification" theory of liability under the False Claims Act ("FCA") and attempted to provide guidance as to the type of regulatory or statutory violations that can trigger such liability. The Court's newly announced reasonableness test for materiality will make it much more difficult for defendants to defeat implied certification FCA cases on preliminary motions. Although the opinion of the Court attempts to limit the reach of the FCA, the landscape for FCA defendants has taken a decided turn for the worse.

Under the "implied certification" theory, a payment request from a government contractor impliedly certifies that the contractor has complied with all legal prerequisites that are material conditions for payment. If the contractor has not complied with these material requirements, the request for payment can be deemed a false claim and result in draconian penalties, such as treble damages and other fines. Although Congress defined materiality in the FCA ("the term 'material' means having a natural tendency to influence, or be capable of influencing, the payment or receipt of money or property"[2]), courts have wrestled with implementing the concept and have often arrived at different answers. In *Universal Health Services*, the Supreme Court endeavored to clarify materiality in the FCA context.

According to the facts alleged in the complaint, Yarushka Rivera was a juvenile patient at a Massachusetts health care facility. She was diagnosed with bipolar disorder and supposedly received various forms of treatment. The requests for payment submitted by the facility to Medicaid contained payment codes and provider identification information that corresponded to services supposedly provided to Ms. Rivera by individuals licensed to perform such services pursuant to Massachusetts Medicaid regulations. The plaintiffs allege that the facility failed to disclose serious violations of Massachusetts Medicaid regulations and the payment requests thus were "false claims." In 2009 Ms. Rivera suffered a seizure and died. She was 17 years old at the time of her death.

The plaintiffs alleged that the requests for payment impliedly certified compliance with the relevant regulations and the case should be permitted to proceed. The district court granted a motion to dismiss on the grounds that, although certain regulations were violated, none of those regulations involved were expressly designated by the government as conditions of payment. The First Circuit reversed because it found that the defendant had knowingly misrepresented compliance with a material precondition of payment — namely, the adequate supervision of facility staff. The Supreme Court granted *certiorari* to provide guidance on two questions. First, is "implied certification" a viable theory under which FCA liability can be imposed? Second, how should courts determine whether a predicate regulatory or statutory violation should be deemed "material" for FCA purposes?

[1] No. 15-7 (U.S. June 16, 2016).

[2] 31 U.S.C. § 3729(b)(4).

The Court wasted no time answering the first question in the affirmative. "We first hold that the implied false certification theory can, at least in some circumstances, provide a basis for liability." The Court found that "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" and that the claims at issue in this case "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." This ruling is a clear victory for plaintiffs and the government. It validates many courts that have recognized the implied certification theory.

The Court's analysis of the "materiality" standard may prove to be an even greater victory for those parties asserting claims. The Court began by noting that "not every undisclosed violation of an express condition of payment automatically triggers liability. Whether a provision is labeled a condition of payment is relevant to but not dispositive of this inquiry." It is clear that the Court feared the government would designate every legal requirement applicable to its contractors as an express, material condition of payment. The Court found that such a designation would be unfair. "(B)illing parties are often subject to thousands of complex statutory and regulatory provisions. Facing False Claims Act liability for violating any of them would hardly help would-be defendants anticipate and prioritize compliance obligations."

The Court then noted that the materiality standard is "demanding." It noted that the False Claims Act "is not an all-purpose, anti-fraud statute" and that materiality "cannot be found where noncompliance is minor or insubstantial." The Court stated that proof of materiality could include "evidence that the defendant knows that the [g]overnment consistently refuses to pay claims in the mine run of cases based on noncompliance with a particular statutory, regulatory, or contractual requirement," but also that "if the [g]overnment regularly pays a particular claim in full despite actual knowledge that certain requirements were violated … it is strong evidence that the requirements are not material." Finally, *Universal Health Services* held that it is insufficient for a finding of materiality "that the [g]overnment would have the option to decline to pay if it knew of the defendant's noncompliance."

On the surface, these points are helpful to defendants in that they purport to limit the reach of the FCA. But the Court introduces an element of subjectivity to the analysis of materiality that creates a potential factual question in every future FCA case. The Court defines something as material "if it concerns a matter to which a ***reasonable person*** would attach importance in determining his or her choice of action with respect to the transaction involved" (emphasis added). Every first-year law student is taught, whether a "reasonable person" would or would not do something is a question of fact.

Courts are not permitted to enter summary judgment if a case contains a genuine dispute of material fact. Since trial courts must now evaluate the materiality of an alleged violation of a statutory, regulatory or contractual requirement under the subjective "reasonable man" standard, it will become more difficult to defeat a case alleging FCA violations using preliminary motions. In contrast, in certain circuits prior to the Court's decision in *Universal Health Services* the materiality question turned on whether or not the alleged noncompliance pertained to an express condition of payment, a legal question that was more readily addressed through preliminary motions.

The holding in *Universal Health Services* cuts across virtually all industries that do business with the federal government. Here are a few examples of the impact of this case:

Health Care:

The distinction between conditions of payment versus conditions of participation has been a hallmark element of analysis of FCA cases arising in the health care industry. *Universal Health Services* eliminates the distinction between these zones of regulatory compliance for purposes of the FCA. This may result in a drastic expansion of allegations that noncompliance with conditions of participation in the

Medicare program and other health care programs gives rise to liability under the FCA through a theory of implied certification. Strict compliance with *all* regulatory requirements of federal health care programs has always been vital for health care providers that participate in such programs and this decision only heightens the importance of such providers' compliance functions. Although the Court emphasized the demanding nature of materiality and the limits of the FCA, until a body of case law is developed as to the bounds of materiality, this decision introduces a significant degree of uncertainty and risk for health care providers and other players in the health care industry.

Financial Transactions:

The decision also raises the ante for financial institutions, an industry that has seen a significant uptick in FCA litigation, largely in the area of lending fraud. Any transaction that involves applications to government-backed loan programs is in play. In particular, representations involving the Department of Housing and Urban Development (HUD) may trigger implied certification liability. Because the Court's opinion encompasses all material violations, the scope of liability for noncompliance with HUD and FHA regulations is potentially extremely broad. Implied certification liability could also extend to alleged schemes to defraud the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) and would target mortgage originators. The increased scope of implied certification liability under *Universal Health Services* will likely incentivize whistleblowers (and the plaintiff's bar) to initiate *qui tam* actions as they will likely perceive that there is now a greater chance of government intervention.

Department of Defense Contractors:

One of most popular theories for asserting *qui tam* actions against defense contractors is improper cost allocation. Government contractors are required to allocate their costs across all of their contracts, whether those contracts are with the government or private parties. Sometimes, however, contractors will improperly shift costs between and among contracts depending on the profit margin of each contract. Just as the improper payment codes submitted by the health care facility formed a basis for possible FCA liability in *Universal Health Services*, improper shifting of costs between contracts may spawn a wave of whistleblower lawsuits on this issue. More than ever, government contractors will be required to keep meticulous records to avoid FCA liability.

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