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United States

False Claims

In *Universal Health Services, Inc. v. United States ex rel. Escobar*, the U.S. Supreme Court held that the implied false certification theory applies to False Claims Act suits. But Gentry Locke attorneys Cynthia D. Kinser and John R. Thomas Jr. say that the fundamental landscape of FCA litigation wasn't changed. Instead, they say the opinion opened the door to more types of relevant evidence, theories of liability and trials.

Escobar Aftermath: Expanded Liability, Uncertainty and More Trials

BY CYNTHIA D. KINSER AND JOHN R. THOMAS JR.

Legal commentators from a variety of perspectives have heralded the June 2016 decision of the U.S. Supreme Court in *Universal Health Services, Inc. v. United States ex rel. Escobar*, 84 U.S.L.W. 4410, 2016 BL 192168 (U.S. 2016) (''Escobar''), as a game-changing opinion for False Claims Act (''FCA'') litigation.

Relator counsel applauded the acceptance of implied false certification liability and the elimination of an express ''condition of payment'' requirement previously required by some federal circuit courts.

Defense counsel found solace in the seeming strengthening of the materiality requirement.

As the dust settles, however, it is becoming more clear that the fundamental landscape of FCA litigation has not changed.

Rather, the Supreme Court opened the door to more types of relevant evidence and more theories of liability.

The expansion of the factual inquiry in these areas can only mean one thing: more trials.

Overview

The FCA, 31 U.S.C. § § 3729-3733, is the United States' primary statutory tool to combat fraud against the government, and prohibits the submission of a false claim for payment of federal funds.

In an archetypical FCA action, such as the submission of a bill to the government for goods or services never provided, the claim for payment is itself false or fraudulent.

The FCA's development, however, has ushered in a variety of more nuanced theories of liability—one of these is implied false certification.

The implied false certification theory of liability posits that a claim for payment is false if it rests on an implied false representation of compliance with material contractual terms, statutes, regulations, or administrative policies.

For example, when a government contractor submits a claim for payment, it impliedly certifies compliance with relevant contractual, statutory, or regulatory provisions—even if those provisions are not express conditions of payment.

If, however, the contractor has violated a particular requirement and fails to disclose or misrepresents its

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noncompliance in submitting the claim, FCA liability may attach. *See, e.g., United States ex rel. Badr v. Triple Canopy, Inc.*, 775 F.3d 628 (4th Cir. 2015) (alleging that the company submitted false claims to the Government when it billed for guard services and withheld its knowledge that the guards had failed to comply with a marksmanship requirement), *vacated and remanded in light of Escobar*, *Triple Canopy, Inc. v. United States ex rel. Badr*, 84 U.S.L.W. 3701, 2016 BL 204402 (U.S. 2016).

Prior to this summer, federal circuit courts were split about the viability of the implied false certification theory, with the majority of circuits recognizing implied false certification as a valid theory of FCA liability.

In June, the Supreme Court ended the debate over implied false certification with *Escobar*.

The Court held that the implied false certification theory can provide a basis for FCA liability.

The Court's decision broadened the range of instances in which defendants may face FCA liability.

Adopting the implied false certification theory was, in fact, sweeping in favor of the government and relators.

Beyond upholding the theory generally, the Court went so far as to eliminate the ''condition of payment'' limitation that had existed in some circuits.

Despite this clear decision on implied false certification, the Supreme Court sowed a degree of uncertainty on a separate issue: materiality.

Many commentators perceive *Escobar*'s materiality requirement as a more stringent test than was previously used.

The Court, however, was unclear about whether its materiality standard applies to all FCA claims or only to those brought under 31 U.S.C. § 3729(a)(1)(A).

Thus, the decision actually may prove to be the catalyst for more debate about materiality.

But, there can be little doubt that the materiality standard for § 3729(a)(1)(A) claims will require a case-by-case, fact-intensive analysis, resulting in a greater number of cases to be tried.

Escobar

The facts underlying the *Escobar* case are tragic.

In 2009, a young Medicaid patient in Massachusetts died of a seizure while being treated at Universal Health Services, Inc. (''Universal Health'').

As it turned out, the Universal Health staff members caring for the patient were not properly licensed or supervised pursuant to Massachusetts law.

The parents of the deceased brought a *qui tam* action against Universal Health under the implied false certification theory of liability.

They alleged that Universal Health violated the FCA by submitting reimbursement claims under the Medicaid program that included representations about specific medical services and the professionals providing those services.

Universal Health failed, however, to disclose its violations of regulations governing the staff qualifications and licensing requirements for the medical services rendered to the relators' daughter.

The relators alleged that Universal Health defrauded the Medicaid program because the government would not have paid the reimbursement claims if it had known that Universal Health billed for medical services provided in violation of regulatory requirements.

Cynthia Kinser was the first woman Chief Justice of the Supreme Court of Virginia. Her seventeen years of distinguished service to the Court ended with her retirement in 2014. In 2015, she joined Gentry Locke as Senior Counsel, where she focuses on appeals, criminal matters, and government investigations.

John Thomas is a national leader in False Claims Act litigation, where whistleblowers uncover and report fraud against the government. John litigates cases throughout the country involving procurement fraud, health care fraud, medical device fraud, and grant fraud. John is the founder and Chair of the Federal Bar Association Qui Tam Section and a frequent writer and speaker on FCA topics.

The Department of Justice (''DOJ'') did not intervene in the case, and the U.S. district court dismissed the complaint because none of the regulations that Universal Health allegedly violated, with one exception, was a ''condition of payment.'' *United States ex rel. Escobar v. Universal Health Servs., Inc.*, No. 11-11170-DPW, 2014 BL 82774 (D. Mass. Mar. 26, 2014).

The U.S. Court of Appeals for the First Circuit disagreed and reversed in part. *United States ex rel. Escobar v. Universal Health Servs., Inc.*, 780 F.3d 504 (1st Cir. 2015).

The appeals court held that each time Universal Health submitted a claim for reimbursement, it ''implicitly communicated that it had conformed to the relevant program requirements, such that it was entitled to payment.''

Thus, the relevant question was ''whether [Universal Health], in submitting a claim for reimbursement, knowingly misrepresented compliance with a material precondition of payment.''

Noting that ''[p]reconditions of payment, which may be found in sources such as statutes, regulations, and contracts, need not be 'expressly designated,' '' the court concluded that the regulatory provisions at issue ''clearly impose[d] conditions of payment.''

The court further held that the ''express and absolute language of the regulation in question, in conjunction with the repeated references to supervision throughout the regulatory scheme,'' constituted ''dispositive evidence of materiality.''

The Supreme Court granted certiorari to answer two questions: (1) whether the implied false certification theory can be a basis of liability under the FCA; and (2) whether FCA liability attaches only if a defendant fails to disclose its violation of a contractual, statutory, or regulatory provision that the government has expressly designated a ''condition of payment.''

On the first question, the Court held that the implied false certification theory can provide a basis for liability when ''a defendant makes representations in submitting a claim but omits its violations of statutory, regulatory, or contractual requirements.''

If the omissions or ''half-truths'' render the defendant's representations misleading with respect to the goods or services provided, FCA liability may attach.

As to the second question, the Court held that FCA liability ''for failing to disclose violations of legal require-

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ments does not turn upon whether those requirements were expressly designated as conditions of payment.''

Whether a requirement is labeled a condition of payment is relevant, but the dispositive inquiry is ''whether the defendant knowingly violated a requirement that the defendant knows is material to the Government's payment decision.''

Under this standard, a defendant must ''knowingly'' violate a requirement and also ''know'' that the requirement is material.

The Court described two circumstances in which a misrepresentation would be material: (1) when a reasonable person would attach importance to the matter in determining a choice of action or in manifesting assent; or (2) when the defendant knows or has reason to know that the recipient of the representation attaches importance to the matter or that the representation will likely induce the particular recipient to manifest assent.

The first circumstance describes an objective test; whereas, the second employs a subjective determination.

Post-*Escobar* Materiality

The Supreme Court undoubtedly recognized that its adoption of the implied false certification theory expanded the scope of FCA liability.

The Court took pains, therefore, to dispel concerns about fair notice to defendants and open-ended liability by emphasizing that the FCA's scienter and materiality requirements should be strictly enforced.

Its analysis of materiality, however, leaves courts and litigants with much fodder for debate.

Prior to 2009, the FCA did not have an express materiality requirement.

Many courts had found an implied materiality requirement, however, and had employed differing standards of materiality.

In the Fraud Enforcement and Recovery Act of 2009, which amended the FCA, Congress defined the term ''material'' as ''having a natural tendency to influence, or be capable of influencing, the payment or receipt of money or property.'' 31 U.S.C. § 3729(b)(4).

Materiality is now a specific requirement for liability under § § 3729(a)(1)(B) and (G) of the FCA.

Those sections expressly require that a false record or statement be ''material'' to a false claim, or to any obligation to pay money or property to the Government, respectively.

In contrast, § 3729(a)(1)(A) does not contain an explicit materiality requirement.

That section imposes liability on any person who ''knowingly presents, or causes to be presented, a false or fraudulent claim for payment.''

Notably, the Supreme Court's materiality discussion in *Escobar* focused on claims under § 3729(a)(1)(A).

The Court stated that it was not deciding ''**whether § 3729(a)(1)(A)'s materiality requirement** is governed by'' the definition of materiality in § 3729(b)(4) or ''derived directly from the common law.'' (Emphasis added.).

Instead, the Court concluded that materiality under § 3729(a)(1)(A) '' 'look[s] to the effect on the likely or actual behavior of the recipient of the alleged misrepresentation.' '' (quotation omitted).

As to the explicit materiality requirement for claims under § § 3729(a)(1)(B) and (G), the Court did not expressly reject the statutory, objective test.

So, uncertainty about materiality remains.

Will similar yet somewhat different materiality standards apply depending on the sections of the FCA under which claims are brought?

If the Court intended for the materiality requirement in all FCA claims to be judged by its objective/subjective materiality standard in lieu of the statutory, objective test, then the Court judicially amended the FCA.

Despite this confusion, it is clear that for § 3729(a)(1)(A) claims, the materiality of a misrepresentation must now be judged by an objective test and/or a subjective test.

Courts can no longer merely determine whether a particular requirement was likely to influence or was capable of influencing the government's payment decision.

Evidence showing a defendant's knowledge about the materiality of a particular requirement is now relevant.

Likewise, evidence about the government's knowledge that a requirement is being violated and how it handles claims when it has such information is relevant.

For relators and relators' counsel, the subjective test means that facts pled with sufficient particularity and plausibility showing, for instance, that the government routinely refuses to pay claims due to noncompliance with a particular statutory, regulatory, or contractual requirement should withstand motions to dismiss and for summary judgment.

For example, one federal district court recently held that a relator sufficiently pled materiality by alleging that the government had ''with some frequency'' prevented law enforcement agencies from receiving particular grants because the agencies violated certain requirements. *United States ex rel. Williams v. City of Brockton*, Civil Action No. 12-cv-12193-IT, 2016 BL 254889 (D. Mass. Aug. 5, 2016).

Similarly, whether the government has expressly designated a requirement as a condition of payment is relevant along with why the designation was or was not made.

The presence or absence of this designation, however, is not dispositive.

If the government identifies a provision or requirement as a condition of payment but routinely pays claims with full knowledge that the requirement was violated, evidence about why the government paid will be relevant to the materiality analysis.

Courts will seek to answer several factual questions: (1) what exactly did the government know about the violation; (2) was the violation trivial or significant; and (3) was a contract so advantageous to the government that the government decided to pay a false claim rather than contest the violation of a requirement that the government would otherwise view as material.

Clearly, these questions will require a case-by-case, fact-based analysis.

The Supreme Court attempted to alleviate concerns that its fact-intensive materiality test would result in more trials.

The Court asserted that its standard for materiality remained ''familiar and rigorous'' and that plaintiffs must plead claims with plausibility and particularity, including facts to support materiality allegations.

While all these assertions are correct, the Court's test for materiality under § 3729(a)(1)(A), nevertheless, will turn on contested facts that only a fact-finder can resolve.

DOJ expressed its view of the *Escobar* materiality standard in supplemental briefing in *Triple Canopy*, which is currently on remand to the Fourth Circuit in light of *Escobar*.

DOJ stated: ''In short, the Supreme Court did not impose a heightened test for materiality beyond the 'natural tendency' test codified in the [FCA], entrenched in the common law, and applied by this Court and others.'' DOJ Br., p. 12.

As stated in its brief, the government continues to view the materiality test as a comprehensive, commonsense, and objective analysis:

> *Escobar* makes clear that materiality is determined through a holistic assessment of the tendency or capacity of the undisclosed violation to affect the government decision maker. The Court did not impose a new requirement—contrary to both the FCA and the common law—that the United States (or a relator) must demonstrate that the government *would actually* refuse payment.

DOJ Br. p.11 (emphasis in original).

DOJ's position, therefore, is that while *Escobar* undoubtedly opened the door to new types of evidence in the materiality analysis, the standard by which materiality is judged has not changed—and ''common sense materiality'' remains the bar that must be reached.

Conclusion

The Supreme Court's decision in *Escobar* accomplished three things.

First, it increased a defendants' exposure to FCA liability by adopting the implied false certification theory.

Second, the decision created uncertainty about whether materiality for all FCA claims will now be judged by the Court's objective/subjective materiality standard or whether certain claims will continue to be judged under the statutory definition of materiality.

Finally, despite the Court's assertions to the contrary, materiality in § 3729(a)(1)(A) claims will require a fact-intensive, case-by-case analysis, resulting in more trials.

So, the conclusion is—stay tuned for the next chapter of FCA litigation.

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