Insights: Alerts

The Supreme Court's Escobar Decision on Implied Certification Liability: The Good, The Bad, & The Ugly for Government Contractors, Health Care Providers, Financial Institutions & Everyone Else Submitting "Claims" to the Government

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On Thursday, June 16, 2016, the United States Supreme Court issued a unanimous opinion finding that implied certifications can form the basis for liability under the False Claims Act (the "FCA"). The press coverage surrounding the case generally described the decision as an "expansion" of FCA liability, one that potentially spells doom for government contractors and other entities routinely submitting claims to the Government, such as health care providers. The decision, however, is not as bad as that press coverage would lead you to believe. In fact, there are a number of holdings in *Escobar* that contractors may ultimately be able to use to *defend against, and even defeat,* liability in False Claims Act cases.

The Ugly: A Quick FCA Primer & Background on the Events Leading Up to Escobar

The False Claims Act is a law that prohibits a party from "knowingly" submitting a "false or fraudulent claim [to the U.S. Government] for payment or approval." A "claim" is a request or demand for payment that ultimately emanates from the federal fisc. "Knowingly" means that a party has "actual knowledge of the information," "acts in deliberate ignorance of the truth or falsity of the information," or "acts in reckless disregard of the truth or falsity of the information." A party submitting a "claim" that violates the False Claims Act can be subject to substantial liability including treble damages and penalties of up to $11,000 per false claim. Falsity can be based either on facts or on the law such as statutory, regulatory, or contractual requirements. *Escobar* involved falsity based on the law.

The facts in the *Escobar* case, as described by the Court, are tragic. The relators bringing the underlying FCA suit against United Health Services ("UHS") had a teenage daughter, Yarushka Rivera, who received benefits from the Massachusetts Medicaid program. In 2004 Ms. Rivera, then 12 years old, began receiving mental health treatment from a United Health Services subsidiary based in Massachusetts. In 2009, a "purported doctor" from that subsidiary diagnosed Ms. Rivera with bipolar disorder and prescribed a drug that gave Ms. Rivera an adverse reaction. Ultimately, Ms. Rivera died in 2009 at the age of 17 from the adverse reaction caused by the medication. Investigations into the subsidiary revealed numerous violations and falsities. The violations included failing to employ personnel with appropriate qualifications and provide supervision. Massachusetts issued a detailed report of the violations and the subsidiary implemented a remedial plan.

Ms. Rivera's parents filed a *qui tam* action as relators against UHS alleging an implied false certification theory of liability. Specifically, the relators alleged that the claims UHS submitted for payment for treating Ms. Rivera were false because they did not disclose to the Government the qualification and supervision problems that UHS knew

about. The trial court dismissed the case explaining that UHS' violations were not "preconditions to payments." On appeal, the United States Court of Appeals for the First Circuit reversed the trial court, explaining that "each time [UHS] submitted a claim, [UHS] implicitly communicated that it had conformed to the relevant program requirements, such that it was entitled to payments." Critical to this underlying case is the fact that the First Circuit was not the only circuit to consider whether implied certifications could form the basis for FCA liability. Several other circuits had considered the issue and came down one of three ways:

1. Allowing the theory of implied false certification but limiting the theory to instances where a requirement was a condition of payment;

2. Allowing the theory of implied false certification regardless of whether the requirement was a condition of payment; or

3. Rejecting the theory all together.

To resolve the split among the Circuit Courts, the Supreme Court granted *certiorari* on two issues:

1. "Whether the 'implied certification' theory of legal falsity under the FCA. . . .is viable;" and

2. "If. . . .viable, whether a Government contractor's reimbursement claim can be legally 'false' under that theory if the provider failed to comply with a statute, regulation, or contractual provision that does not state that it is a condition of payment. . . .; or whether liability for a legally 'false' reimbursement claim requires that the statute, regulation, or contractual provision expressly state that it is a condition of payment. . . ."

The Bad: The Implied Certification Theory of Legal Falsity is Viable

The Court in *Escobar* ruled that the implied false certification theory can in fact form the basis for liability under two conditions: 1. when a party seeking payment "makes specific representations about the goods or services provided", and 2. where the party's "failure to disclose noncompliance with material statutory, regulatory, or contractual requirements makes those representations misleading half-truths." The Court further ruled that companies can be "liable for violating requirements even if they were not expressly designated as conditions of payment." Thus, violating a requirement that is not expressly tied to payment can still render an entity liable under the FCA. This is not, however, the end of the story.

The Good: "Rigorous Materiality Requirement"

Even though the Court accepted the theory of implied false certification in certain conditions, it cautioned that a misrepresentation must be "material" to the Government's payment analysis in order for liability to attach. Specifically, the Court explained that the materiality standard for the FCA is "demanding" and that the FCA is "not 'an all-purpose antifraud statute.'" While the decision does not render a "hard and fast" rule, the Court provided the following guidance when examining materiality:

- First, a misrepresentation is not automatically material just because the Government designates compliance with a particular requirement as a condition of payment;
- Second, just because the Government may have the option to decline payment if it had knowledge of a noncompliance does not automatically result in a finding of materiality;
- Third, materiality does not exist if a noncompliance is minor or insubstantial;
- Fourth, evidence that a defendant knows the Government "consistently refuses to pay claims in the mine run of

cases based on noncompliance with the particular statutory, regulatory, or contractual requirement" can be proof of materiality; and

• Fifth, the Government paying a particular claim in full despite actual knowledge of the violation of requirements is "very strong evidence" that those requirements are not material.

In a footnote, the Court asserts that lower courts can deal with materiality at the motion to dismiss and summary judgment stages. In other words, the question of materiality can be addressed prior to a formal trial on the case, recognizing that many times these questions are factually driven and may nonetheless require a trial.

Looking into the Crystal Ball

The *Escobar* decision provides ammunition to both sides of the "versus" in a FCA case. While guidance is provided, that guidance is open to broad interpretation and applications. The full impact of *Escobar* will be worked out in the trial courts in the coming years. Relators will likely bring more *qui tam* actions and seek to make almost all violations of a statutory, regulatory or contractual requirement "material." Defendants facing false claims allegations based on an implied certification theory will argue about whether the conditions in that specific case have been met and also whether the alleged violations were truly material.

In the wake of *Escobar*, parties that submit claims to the Government should reexamine their internal controls, assess compliance risks based on their organizations and adjust their controls as necessary to prevent and detect instances of material noncompliance with statutory, regulatory or contractual requirements. While *Escobar* may give companies facing FCA allegations a fighting chance, prevention remains the best cure.

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