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Supreme Court Endorses Implied Certification Theory under False Claims Act—"At least in some circumstances"

On June 16, 2016, the Supreme Court of the United States issued a unanimous opinion addressing the scope and reach of the False Claims Act ("FCA"). *Universal Health Services, Inc. v. United States et al. ex rel. Escobar et al.* resolved longstanding differences among the Courts of Appeal, as to whether implied certification of compliance with statutory, regulatory, or contractual obligations can—"at least in some circumstances"—support FCA liability.

Although the Court recognized implied certification as a theory, the Court also stressed that liability under the FCA for noncompliance is limited and must meet a "rigorous" and "demanding" materiality standard. However, the Court declined to adopt a bright-line rule. Thus, determining what noncompliance may be pursued under the FCA is an exercise that is sure to occupy the attention of courts in cases to come.

History of the Case

The case began with a teenage Medicaid beneficiary who died after receiving mental health treatment from unlicensed and unsupervised professionals employed by a subsidiary of Universal Health Services, Inc. ("Universal"). The beneficiary's parents filed complaints with several Massachusetts agencies, and a *qui tam* action in federal court. Under the FCA, the parents alleged that, when Universal submitted claims to the Massachusetts Medicaid program for reimbursement for the mental health services provided to their child, Universal submitted "false or fraudulent" claims. The parents alleged that compliance with state regulations governing staff qualifications and supervision was a condition of payment that had not been fulfilled.

The District Court granted Universal's motion to dismiss, holding that the parents' complaint failed to allege that compliance with the regulations at issue was a condition of payment by Massachusetts Medicaid.

The parents appealed, and the First Circuit reversed the District Court's decision. The First Circuit, relying on regulatory provisions that had not been part of the proceedings in the District Court, concluded that the supervision standards at issue were "express and absolute" conditions of payment, and provided "dispositive evidence of materiality."

Universal appealed to the Supreme Court, which granted certiorari to consider:

- First, whether the implied certification theory of legal falsity under the FCA is viable.
- Second, if so, whether a provider's claim for reimbursement can be legally "false" under that theory only if the provider fails to disclose a violation of a contractual, statutory, or regulatory provision that the Government has expressly designated a condition of payment.

The Implied Certification Theory Is Viable, "At Least in Some Circumstances"

On the first question, the Court held that the implied certification theory can be a basis for FCA liability, at least when two conditions are satisfied:

i. the claim submitted by the defendant, in addition to requesting payment, "makes specific representations about the goods or services provided," and

ii. "the defendant's failure to disclose noncompliance with material statutory, regulatory, or contractual requirements makes those representations misleading half-truths."

In reaching this conclusion, the Court observed that "half-truths" have long been actionable misrepresentations in common law fraud actions, when they "omit[] critical qualifying information." According to the Court, Universal's claims for Medicaid reimbursement "fall squarely" within this definition of "half-truths" because, through payment and other codes (*e.g.*, staff National Provider Identification numbers), the claims conveyed specific information about the types of services provided and the qualifications of the providers without disclosing the full truth that Universal did not satisfy the basic staff and licensing requirements to provide the services.

We therefore now know that implied certification can be a basis for liability, at least in some cases. However, the Court left many questions. Determining which cases are in and which cases are out is sure to be of significant focus in years ahead.

The Government's Designation of Regulations as Express Conditions of Payment Is Neither Sufficient nor Necessary

On the second question, Universal argued that, if there is to be liability under an implied certification theory, it can be triggered only by violation of a legal standard that is expressly stated to be a condition of payment. The Court disagreed, stating that, "a statement that misleadingly omits critical facts is a misrepresentation irrespective of whether the other party has expressly signaled the importance of the qualifying information."

However, the Court declined to adopt the First Circuit's relator-friendly holding that a violation of an express condition of payment is "dispositive evidence of materiality." Instead, in the Court's view, the fact that a statutory, regulatory, or contractual provision is an express condition of payment is simply one factor relevant to this determination.

"At least in some circumstances" therefore is the subtitle of the Court's decision on the second question, too. Violation of a regulatory requirement that the Government has designated as an express condition of payment sometimes may be grounds for FCA liability, but sometimes may not.

A "Rigorous" and "Demanding" Materiality Requirement: A Gatekeeper for False Claims Act Liability

In its decision, the Court emphasized that materiality under the FCA must be enforced in a manner that is "rigorous" and "demanding," because the FCA "is not an all-purpose antifraud statute . . . or a vehicle for punishing garden-variety breaches of contract or regulatory violations." According to the Court, the materiality analysis must examine the impact of a violation on the Government's actual reimbursement of claims.

To that end, and to ensure that the materiality element plays this gatekeeping role, the opinion addresses how courts should assess materiality.

- First, as described above, the fact that a statutory, regulatory, or contractual provision has been expressly designated a condition of payment is not—on its own—dispositive of materiality.

- Second, the fact that the Government would have a right to refuse payment were it aware of the violation also is insufficient—on its own—to demonstrate materiality.

- Third, the Government's payment of claims knowing of the violation is "strong evidence" that the violation is not material.

- Fourth, materiality "cannot be found where noncompliance is minor or insubstantial."

These guidelines reflect a demanding standard that the Court made clear should be used at Motion to Dismiss and Summary Judgment to dispose of inappropriate claims.

Implications of the Court's Decision

The Court's endorsement of the implied certification theory is a disappointing, though not unexpected, result for health care providers, government contractors, and others who receive federal funding and operate under complex regulatory schemes. However, the Court's strong recognition that the FCA is not a vehicle for pursuing all statutory, regulatory, or contractual noncompliance, coupled with its emphasis on a demanding materiality standard, has established certain specific and important limits to the theory's reach. Companies and individuals who face potential FCA risk should evaluate whether the Court's opinion warrants changes to their compliance strategy.

We will follow closely how *Escobar* is applied by the lower courts. If you have any questions, please contact a member of our False Claims Act practice, or your usual Ropes & Gray advisor.