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Supreme Court Upholds Implied Certification Liability, While Emphasizing Materiality Requirement

By Jonathan G. Cedarbaum, Karen F. Green, David W. Ogden, and Matthew Guarnieri*

In a unanimous decision, the U.S. Supreme Court recently upheld the "implied certification" theory of liability under the False Claims Act, while emphasizing that only material misrepresentations are actionable. In this article, the authors explain the decision and discuss the implications for future False Claims Act cases.

In *Universal Health Services v. United States ex rel. Escobar*, the U.S. Supreme Court unanimously upheld the "implied certification" theory of liability under the False Claims Act ("FCA"), while emphasizing that only material misrepresentations are actionable.[1] In particular, the Court held that liability can attach if 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," which the defendant "knows is material to the Government's payment decision."[2]

BACKGROUND

The FCA prohibits the submission of a "false or fraudulent" claim for payment to the government, or a "false record or statement material" to such a false or fraudulent claim.[3] Prior to *Universal Health Services*, a majority of the

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[1] 136 S. Ct. 1989 (2016).

[2] *Id.* at 1995–96.

[3] 31 U.S.C. § 3729(a)(1)(A), (B).

federal courts of appeals had held that a claim could be false or fraudulent by implication, under an implied certification theory, even though the claim itself contained no misrepresentations. In particular, several courts had accepted the theory that submitting a claim for payment is itself an implied certification that the party seeking payment is entitled to be paid—*i.e.*, that the party has complied with all the requirements for payment set by statute, regulation, or contract.

For example, in this case the FCA relators are the parents of a teenager who died of a seizure after being treated by allegedly unlicensed and unsupervised staff at a provider of mental health services. The premise of their claim is that because the provider allegedly failed to hire and supervise its staff properly, in violation of state regulations, its submission of reimbursement claims to the Massachusetts Medicaid agency violated both the FCA and a state–law counterpart.

The district court dismissed the action. Drawing a distinction between conditions of payment and conditions of participation, the court held that only non-compliance with statutory or regulatory conditions of payment could render a contractor's claims for payment actionably false. The conditions at issue in this case, the district court held, were conditions of the defendant's participation in the relevant program, not conditions for receiving payments.

The U.S. Court of Appeals for the First Circuit reversed, holding that "any payment/participation distinction is not relevant here," because "the provisions at issue in this case clearly impose conditions of payment."[4] In a footnote, the court observed that "[a]lthough the record is silent as to whether [the mental health center] explicitly represented that it was in compliance with conditions of payment when it sought reimbursement from" the state Medicaid agency, the First Circuit has "not required such 'express certification' in order to state a claim under the FCA."[5]

Universal Health Services, the owner of the mental health center, petitioned for certiorari, and the Supreme Court granted on two questions: (1) "[w]hether the 'implied certification' theory of legal falsity under the FCA—applied by the First Circuit below but recently rejected by the Seventh Circuit—is viable"; and (2) if so, "whether a government contractor's reimbursement claim can be legally 'false' under [the implied certification] theory if the provider failed to comply with a statute, regulation, or contractual provision that does not state

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[4] *United States ex rel. Escobar v. Universal Health Servs., Inc.*, 780 F.3d 504, 513 (1st Cir. 2015).

[5] *Id.* at 514 n.14.

that it is a condition of payment, as held by the First, Fourth, and D.C. Circuit; 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, as held by the Second and Sixth Circuits."

THE SUPREME COURT'S DECISION

In a unanimous opinion by Justice Thomas, the Court first held that implied certification is a viable theory of FCA liability: "[T]he implied certification theory can be a basis for liability, at least where two conditions are satisfied: first, the claim does not merely request payment, but also makes specific representations about goods provided; and second, the defendant's failure to disclose noncompliance with material statutory, regulatory, or contractual requirements makes those representations misleading half-truths."[6] The Court also held that "liability for failing to disclose violations of legal requirements does not turn upon whether those requirements were expressly designated as conditions of payment," as some Circuits had held.[7] Rather, "[w]hat matters is not the label the Government attaches to a requirement, but whether the defendant knowingly violated a requirement that the defendant knows is material to the Government's payment decision."[8]

On the first point—the viability of implied certification—the Court reasoned that Congress intended to incorporate the common law meaning of the terms "false" and "fraudulent" in the FCA. At common law, fraud encompassed not only express misrepresentations but also certain "half-truths," or representations "that state the truth only so far as it goes, while omitting critical qualifying information."[9] The Court held that the FCA incorporates that common law concept. Thus, when a claim "makes specific representations about the goods or services provided," it can be considered fraudulent if "the defendant's failure to disclose noncompliance with material statutory, regulatory, or contractual requirements makes those misrepresentations misleading half-truths."[10] For example, in this case the defendant submitted claims for reimbursement that used billing codes that corresponded to specific counseling services. Using such codes was, in the Court's view, a specific representation that

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[6] 136 S. Ct. at 2001.

[7] *Id.* at 1996.

[8] *Id.*

[9] *Id.* at 2000.

[10] *Id.* at 2001. The Court declined to resolve "whether all claims for payment implicitly represent that the billing party is legally entitled to payment." *Id.* at 2000.

the defendant had provided the services corresponding to the codes—a representation that could be considered "fraudulent" under the FCA, given the defendant's alleged violation of various regulations governing those services.

On the second point—whether a condition of payment must be expressly designated as such in order for noncompliance with it to give rise to implied certification liability—the Court rejected both parties' positions in favor of a renewed emphasis on materiality. Whether the requirement is designated as an express condition of payment is relevant to materiality, but not dispositive. The fact that the government designates a particular requirement as a precondition of payment is not sufficient, in and of itself, to render the requirement material. Nor is it sufficient that the government would have been legally entitled not to pay the claim had it known of the violation. Courts should also consider other evidence on the issue of materiality, such as whether the government has consistently refused to pay claims for noncompliance with the particular requirement at issue in the past, and whether the government in fact paid a particular claim despite actual knowledge that the payee had not complied with the requirement at issue.

In language defendants will no doubt emphasize in future cases, the Court described two prior examples of material misrepresentations in seemingly strong parenthetical language:

> *See United States ex rel. Marcus v. Hess*, 317 U. S. 537, 543 (1943) (contractors' misrepresentation that they satisfied a noncollusive bidding requirement for federal program contracts violated the False Claims Act because "[t]he government's *money would never have been placed in the joint fund for payment to respondents had its agents known the bids were collusive*"); *see also Junius Constr.*, 257 N. Y., at 400, 178 N. E., at 674 (an undisclosed fact was material because "*[n]o one can say with reason that the plaintiff would have signed this contract if informed of the likelihood*" of the undisclosed fact).[11]

IMPLICATIONS FOR FUTURE FCA CASES

The implied certification theory is now firmly established in the law. In those Circuits that had previously declined to permit FCA claims based on implied certification theories, such as the U.S. Court of Appeals for the Seventh Circuit, the door is now open for FCA relators and the government to pursue such claims. The decision also abrogates the rule in some Circuits, including the U.S. Court of Appeals for the Second Circuit, that implied certification liability

[11] *Id.* at 2003 (emphases added).

could lie only for noncompliance with expressly designated conditions of payment. In both respects, the decision expands the scope of potential FCA liability.

That said, the decision also contains language that may serve to limit the expansive theories of implied certification advanced by some FCA relators and the government. The Court emphasized that materiality is a "rigorous" and "demanding" standard, and one that cannot be met if "noncompliance is minor or insubstantial."[12] The Court also stated that the defendant must know that a particular requirement is material to the government before FCA liability will attach. Finally, the Court explained in a footnote that an FCA plaintiff must plead a plausible basis for materiality to withstand dismissal, expressly "rejecting . . . [the] assertion that materiality is too fact intensive for courts to dismiss False Claims Act cases on a motion to dismiss."[13]

PhRMA, AdvaMed, and other *amici* had argued that stricter enforcement of the FCA's "materiality" standard might not be enough to cabin the expansive theories of FCA liability advanced in some implied certification cases, in part because some courts had accepted the government's own *post hoc* representation that particular requirements were material. The Court did not directly address those concerns, but its renewed emphasis on a "rigorous" materiality standard may do so. The Court explained, for example, that "evidence that the defendant knows that the Government consistently refuses to pay claims in the mine run of cases based on noncompliance" might show materiality; conversely, "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."[14] Materiality, the Court stressed, is a "demanding standard" that looks to the effect on the likely or actual behavior of the recipient of the alleged misrepresentation.

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[12] *Id.* at 2003. The FCA itself expressly requires "materiality" for only a subset of possible violations, and it defines "materiality" in a way that some lower courts had construed to be less rigorous than the standard articulated by the Court in *Universal Health Services*. *See* 31 U.S.C. § 3729(b)(4) ("the term 'material' means having a natural tendency to influence, or be capable of influencing, the payment or receipt of money or property"). The Court confirmed that materiality is an element of all FCA claims sounding in fraud, and that, "[u]nder any understanding of the concept," materiality is a "demanding" standard. 136 S. Ct. at 2002, 2003.

[13] *Id.* at 2004 n. 6.

[14] *Id.* at 2003–04.