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Supreme Court Holds "Implied Certification" a Valid Theory under the False Claims Act But Establishes a Strong New Defense for Defendants

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Today the Supreme Court of the United States announced its decision in *Universal Health Services v. United States ex rel. Escobar*, confirming the validity and defining the scope of the "implied certification" theory of liability under the False Claims Act (FCA). Writing for a unanimous Court, Justice Thomas found that submitting a claim for payment implies compliance with statutory, regulatory, or contractual requirements that are material to specific representations made in the claim for payment. On that basis, failure to disclose violations of such requirements can become violations of the FCA. The Court's ruling will have enormous ramifications for contractors who do business with the United States, as well as all those in the telecommunications, healthcare, and pharmaceutical industries that participate in government programs.

At issue in *Universal Health Services* is what it means for a claim to be "false or fraudulent" under the FCA. Specifically, the Court addressed the question of whether and under what circumstances a contractor that has failed to comply with a legal or contractual obligation can become liable for violating the FCA just by submitting a claim for payment. This is referred to as an "implied certification" theory because it allows a contractor to be held liable even if it has not made any express certifications when submitting a claim for payment to the government. The theory has been criticized because it risks sweeping any contractual or regulatory violation into the punitive regime of the FCA, which is supposed to be about fraud and not breach of contract. The controversial nature of the implied

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certification theory created a circuit split, which led to the Supreme Court granting *certiorari* in *Universal Health Services*.

In *Universal Health Services*, the *qui tam* relators filed a complaint alleging that a mental health clinic in Massachusetts was operating and submitting claims for payment under Medicaid with staff who were not qualified and who were not supervised in accordance with Massachusetts regulations. Relators were parents of a teenager who died as a result of a medication she was given at the clinic. The clinic had never certified to the federal government that it was complying with these regulations, so there was no specific misstatement in connection with the Medicaid payments. Nonetheless, the First Circuit found that the relators had stated a claim under the False Claims Act and that, by submitting claims for payment, the defendant had "implicitly communicated that it had conformed to the relevant program requirements, such that it was entitled to payment."

The Supreme Court granted *certiorari* to address two questions: (1) whether the implied certification theory is a valid theory of liability under the FCA; and (2) if so, whether a contractor can be held liable for submitting a false claim if the statute or regulation it is accused of violating does not expressly state that it is a condition of payment.

The Supreme Court held that the FCA, which prohibits "false or fraudulent claims," encompasses misleading omissions when "they render the defendant's representations misleading with respect to the goods or services provided." The opinion is essentially affirmed, but redefined, the implied certification theory of the FCA.

The Court looked to the common law definitions of fraud to guide its interpretation of the FCA, finding that the general rules regarding fraudulent omissions are applicable to the FCA. The Court said that the claims at issue in *Universal Health Services* "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." Because the clinic's claims for payment referred to specific payment codes stating that individual therapy, family therapy, and other types of treatment had been provided, failure to disclose violations of "core Massachusetts Medicaid requirements" related to those services constituted a fraudulent omission.

The Court went on to say that implied certification can be a basis for liability under the FCA "at least where two conditions are satisfied: first, the claim does not merely request payment, but also makes specific representations about the goods or services provided; and second, the defendant's failure to disclose noncompliance with material statutory, regulatory, or contractual requirements makes those representations misleading half-truths."

The Court went on to say that the violated provision does not have to be a condition of payment to be material. Many U.S. Circuit Courts of Appeals have found that implied certifications only create liability if the violated contract term or regulation was a pre-requisite to payment. The Court eschewed this framework, stating that nothing in the text of the FCA, or general common-law fraud, limits fraudulent omissions to those items identified by the other party as a condition of payment. The Court rejected arguments by *Universal*

Health Services that the "condition of payment" requirement is necessary to provide fair notice to defendants and cabin the expansive theory, saying "policy arguments cannot supersede the clear statutory text." The Court also said that any concerns about the expansiveness of the theory can be addressed through the FCA's materiality and scienter requirements, which it described as "rigorous."

The Court went on to elaborate on how the materiality standard should be enforced. The FCA statute itself defines 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). Many lower courts have understood this language to create a fairly low standard under which any noncompliance on which the government could potentially withhold payment becomes a "material" violation.

Not so, according to the Court. The Court said the statutory definition is consonant with general common-law fraud and contract standards of materiality, which is "demanding" and looks to the effect on the likely or actual behavior of the recipient of the alleged misrepresentation. Where noncompliance is minor or insubstantial the violation is not material, and whether the government has identified a provision as a condition of payment is relevant but not dispositive to the materiality inquiry. The defendant's knowledge and the government's behavior will be key here, as the Court found that "proof of materiality can include, but is not necessarily limited to, evidence that the defendant knows that the government consistently refuses to pay claims in the mine run of cases based on noncompliance with the particular statutory, regulatory ,or contractual requirement." Similarly, if the government knows about a violation and pays anyway or has a general practice of doing so and has not changed its policy, then that is "very strong evidence that those requirements are not material."

The Court's framework, which differs substantially from those used by lower courts in the past, will shift both the litigation and compliance landscape for anyone doing business with the federal government.

On the one hand, the opinion expands the FCA beyond specific misrepresentations, which will make it easier for *qui tam* relators and the government to bring suit. Many circuits had not adopted the implied certification theory at all, and now it will be universally recognized along the lines of the Supreme Court's opinion. However, the Court cabined the theory in ways that will keep every contract and regulatory violation from becoming a FCA suit. In order to protect against a new wave of litigation, anyone submitting a claim for payment to the government will need to be mindful of the specific language of the representations made in the claim. Where it is generic and does not describe what the claim for payment is for, implied certification may not be a concern because the Court confined the theory to omissions that relate to a specific statement in the claim for payment. However, where a claim for payment describes the good or service provided, any undisclosed contract or regulatory violation related to that representation could be fair game for FCA liability.

The Court's opinion will be particularly challenging for those submitting claims for payment under government health care programs. The Court's analysis treated the payment codes for the therapy services as affirmative representations such that failing to disclose non-compliance with the related regulations was misleading. This creates a serious risk that violation of Medicare and Medicaid rules creates FCA liability, as payment codes

are a routine part of claims for payment under those programs.

However, the Court's opinion also contains language that will help defendants ward off FCA suits even beyond cases based on an implied certification theory. The Court reaffirmed that the scienter and materiality requirements are "rigorous" and should be "strictly enforced," a reminder to lower courts that don't always take a hard look at FCA allegations. The Court also made clear that insignificant regulatory or contractual violations should not fall under the FCA rubric. Under the Court's opinion, a mere potential for the government to refuse payment is insufficient to show materiality. The Court also noted in a footnote that plaintiffs needed to plead materiality "with plausibility and particularity under Federal Rules of Civil Procedure 8 and 9(b)," inviting motions to dismiss related to this new materiality standard.

In addition, the Court indicated that payment by the government, despite knowledge of a violation, is "strong evidence" that a violation is not material. Before today, the so-called "government knowledge defense" was considered under the scienter prong of the FCA, and government awareness of a misstatement or violation was considered to negate the "knowing" submission of a false claim. Now government knowledge would seem to be relevant to the new materiality requirement, as a government decision to pay when it had actual knowledge of the violation is "strong evidence" that the term is immaterial.

The Court's opinion will also likely transform discovery in FCA cases. The court indicated that government practice surrounding a type of regulatory or contractual violation shows whether it is material, saying: "proof of materiality can include... evidence that the defendant knows that the Government consistently refuses to pay claims in the mine run of cases based on noncompliance with the particular statutory, regulatory, or contractual requirement. 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." In order to litigate this issue, parties are going to have to obtain discovery about how the government treats similar types of violations, an ancillary inquiry that could become a headache for the government. It could allow defendants to request documents and issue interrogatories related to completely different contracts—or agencies—to ascertain some kind of pattern regarding how the government treats a particular issue.

While the Court's opinion will have immediate effect, the full impact of today's decision may not be known for some time as lower courts interpret the new standards announced today.

Wiley Rein will host a complimentary webinar on June 28, 2016 at 12:00 p.m. EDT to discuss this ruling. Click here to register.