

In *Escobar*, Supreme Court Upholds False Claims Act's Implied Certification Theory

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On June 16, 2016, the U.S. Supreme Court in *Universal Health Services v. United States ex rel. Escobar*¹ unanimously upheld the implied certification theory of False Claims Act (FCA) liability. The Court ruled that a party can be liable under the FCA when submitting a claim that makes specific representations about the goods or services provided but knowingly fails to disclose noncompliance with material statutory, regulatory or contractual requirements that makes the representations materially misleading with respect to the goods or services provided. Justice Clarence Thomas delivered the opinion of the Court.

Summary of Opinion

The implied certification theory under the FCA has become one of the primary tools by which the United States and whistleblowers pursue allegedly fraudulent conduct, particularly in the health care and defense industries, where there are myriad statutes and regulations governing underlying contracts. In its broadest context, the implied certification theory allows a plaintiff to bring a FCA claim based on alleged noncompliance with a statute, regulation or contractual provision without having to allege that the defendant explicitly misrepresented its compliance with that particular requirement when submitting a claim to the government for payment. The U.S. Court of Appeals for the 7th Circuit had rejected the theory entirely, others had limited the theory's scope to requirements that were express prerequisites for payment and still others — including the U.S. Court of Appeals for the 1st Circuit — had taken a more expansive view. The Court resolved this circuit split by finding the theory viable and setting out the general requirements that would trigger liability.

In *United States ex rel. Escobar v. Universal Health Services*, the plaintiffs alleged that a health care provider submitted reimbursement claims for counseling and other mental health services but failed to disclose material violations of regulations governing the treating professionals' qualifications and licensing requirements. The district court dismissed the action, holding that the relator had failed to state a claim because the alleged regulatory violations were not an express condition of payment. The 1st Circuit reversed, holding that every submission of a claim implicitly represents compliance with relevant regulations and that any undisclosed violation of a precondition of payment renders a claim false within the meaning of the FCA. In this case, the express language of the regulations established that compliance was a material condition of payment. The Supreme Court reversed and remanded the action for analysis consistent with its requirements for a viable implied certification claim under the FCA.

The Supreme Court held that the implied certification theory can be a basis for liability where at least two conditions are met: (i) the claim for payment must make specific representations about the goods or services provided, and (ii) the party's failure to disclose noncompliance with material statutory, regulatory, or contractual requirements makes those representations misleading half-truths. The Court declined to consider whether all requests for payment imply that the billing party was entitled to payment, because it found the claims at issue in *Escobar* were more than just demands for payment. Specifically, the Court noted that the claims at issue were submitted with payment codes and provider identification numbers that represented that specific types of counseling were performed by providers with specific job titles. The Court found that these representations were misleading because the claims did not disclose that the health care provider had not met the basic staffing and licensing requirements for mental health facilities under state regulations.

¹ No. 13-317, --- S. Ct. --- (June 16, 2016).

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The Court then addressed the proper standard for determining whether noncompliance with a particular requirement was material to the government's decision to pay a claim. The Court adopted a materiality standard narrower than that used by the 1st Circuit, rejecting the theory that it is sufficient to establish the defendant's knowledge that the government would be entitled to refuse to pay if it knew of the violation or nonconformity. The Supreme Court explained that the materiality standard, whether derived from the FCA's statutory definition of materiality or common law, looks to whether knowledge of the noncompliance would have actually affected the government's payment decision, not just whether it could have done so.

Applying this standard, the Court rejected the premise — often argued by FCA defendants and previously adopted by some circuits — that a requirement must be expressly designated as a condition of payment. The Court noted that such a designation may be relevant to the materiality determination but is not “automatically dispositive.” The Court further explained that materiality must be determined by the facts surrounding the payment decision. Evidence that a defendant knows that the government consistently rejected claims when it was aware of noncompliance with the particular requirement would support a finding of materiality, whereas evidence that the government paid a claim (or similar claims) in full despite knowledge of the noncompliance would be strong evidence that the requirements were not material.

Analysis

The Supreme Court has clarified that the implied certification theory may serve as a basis for FCA liability. However, it made clear that this theory may not be expansively asserted in that the

allegations must satisfy both the FCA's materiality and scienter requirements. With respect to materiality, the Court specifically rejected the oft-argued principle “that any statutory regulatory or contractual violation is material so long as the defendant knows that the government would be entitled to refuse payment were it aware of the violation.” The Court found that the “False Claims Act does not adopt such an extraordinarily expansive view of liability.” The Court also reaffirmed the “demanding” nature of the materiality standard and the need to plead the effect of the alleged nonconformance or violation on the government's decision to pay.

Indeed, the materiality standard announced in *Escobar* may prove to be a significant hurdle for the government and relators. The focus going forward will be whether the government would have actually refused to pay the allegedly false claim if it had known of the information allegedly omitted or misrepresented. This standard may make it difficult to pursue an FCA action based on an off-label promotion theory. The government often pays for prescriptions that are known to be off-label, recognizing the discretion of medical professionals to make such judgments. If a defendant can establish a practice by the government in paying claims for such off-label indications, it will be difficult to establish that off-label promotion is material to its decision to pay. Whether there is off-label promotion or not, the medical professional is making the judgment that the prescription is medically necessary.

Although the implied certification theory will continue to provide an independent basis for the government and relators to assert FCA liability, the effect of *Escobar* will not be clear until we see how the courts apply the materiality element. As seen from the above example, however, *Escobar* may prove to be helpful to the defense.

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