

U.S. Supreme Court Upholds Implied Certification Theory as Basis for FCA Liability But Only in Certain Circumstances

July 21, 2016

The United States Supreme Court recently resolved a circuit split on whether the implied certification theory can be the basis of False Claims Act (“FCA”) liability in *Universal Health Services, Inc. v. United States ex rel Escobar*, 136 S. Ct. 1989 (2016). As many are aware, the FCA imposes significant penalties on parties who submit false or fraudulent claims for payment to the Government. Under the implied certification theory, a party submitting a claim implicitly certifies compliance with all conditions of payment. If the party fails to disclose a violation of a condition of payment, then the omission renders the party’s claim fraudulent or false. Several courts have rejected or limited the applicability of the theory, while others have adopted it.

In its unanimous decision, the Supreme Court determined that the implied certification theory is a viable theory of liability under the FCA in certain circumstances. Central to the Court’s ruling was the conclusion that a nondisclosure must be material to the Government’s decision to make a payment in order for liability to be imposed. As a result, the Court set a “rigorous” and “demanding” standard for establishing FCA liability under the theory, while underscoring the importance for parties subject to the FCA to maintain compliance with rules and regulations governing their business.

Facts of the Case

The *Escobar* case involved a teenage Medicaid patient who had an adverse reaction to medication prescribed at a mental health clinic that resulted in severe seizures and ultimately death. The patient’s parents subsequently learned that few of the clinic’s employees were licensed to provide mental health counseling or were authorized to prescribe medication. The parents filed a *qui tam* suit, alleging that the clinic’s parent corporation, Universal Health Services, Inc., violated the FCA under the implied certification theory. More specifically, the relators claimed that Universal Health, through its subsidiary, submitted Medicaid claims for mental health services performed by unlicensed and unsupervised staff without disclosing that the clinic violated regulations pertaining to staff qualifications and licensing requirements. Because defendant’s claims did not expressly certify that the services provided were in compliance with state regulations, relators’ allegations rested on the theory that Universal Health fraudulently implied regulatory compliance when submitting its claims.

The district court dismissed the relators' action for failure to state a claim. Although recognizing that the First Circuit adopted the implied certification theory, the court observed that the regulations purportedly violated were not a condition of payment necessary to state a FCA claim, but a condition of participation in the Medicaid program. The First Circuit disagreed, finding 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 First Circuit held the regulations at issue were "dispositive evidence of materiality" and therefore the lower court erred in dismissing the FCA cause of action.

Summary of Opinion

Initially, the Supreme Court concluded that the implied certification theory can provide a basis for FCA liability in certain circumstances. When Universal Health submitted its claims, it used specific billing codes and identification numbers to indicate which services were provided and which professionals provided the service. This information implied that the clinic's personnel had the requisite training and qualifications. Because the claims did not disclose that Universal Health had not met staffing and licensing requirements imposed by state regulations, the Court found that Universal Health's claims constituted actionable misrepresentations. Accordingly, the Court held that the implied certification theory can be the basis for FCA liability when two conditions are satisfied: (i) the claim not only requests payment, but also makes specific representations about the goods or services provided; and (ii) the defendant knowingly fails to disclose noncompliance with material statutory, regulatory, or contractual requirements that makes those requirements misleading half-truths.

Next, and arguably favoring FCA defendants, the Supreme Court addressed "materiality" under the FCA. Contrary to what many have assumed, "materiality" is not just what the government might have taken into account in making its payment decisions. Materiality is a "rigorous requirement," said the Supreme Court. It is "demanding" and, moreover, it has to be so because otherwise the FCA would become "a vehicle for punishing garden-variety breaches of contract or regulatory violations." Accordingly, the Court concluded that the materiality standard looks to whether knowledge of the noncompliance would have actually affected the Government's payment decision. If the Government continues to pay a claim, despite knowing that the requirement has been violated, this would constitute strong evidence that the requirement is not material. The Court, however, instructed that the standard is not so fact intensive that materiality could not be addressed at the pleading stage. In coming to its decision, the Court rejected Universal Health's narrow interpretation that a finding of fraudulent or false nondisclosure should be limited to situations where the Government has expressly designated the contractual, statutory, or regulatory requirement as a condition of payment. But on the other hand, the Court tossed out the First Circuit's broader approach that deemed material any violation that the defendant knows would entitle the Government to refuse payment.

Conclusion

Some might say the Court leaves both sides in an FCA case at sea. Not all between-the-lines guarantees of quality of product or accuracy of data will be actionable as implied certifications; not all payment requirements will be sufficiently "material" to indicate that the government, like a common law buyer, has been misled to its detriment in the bargain. Additionally, the opinion may extend beyond just implied false certification cases in light of the Court's elaboration of the materiality standard. Nonetheless, this is a landmark decision and needs to

be studied not only on its own terms, but in the many upcoming judicial opinions that will cite to and struggle with it.

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