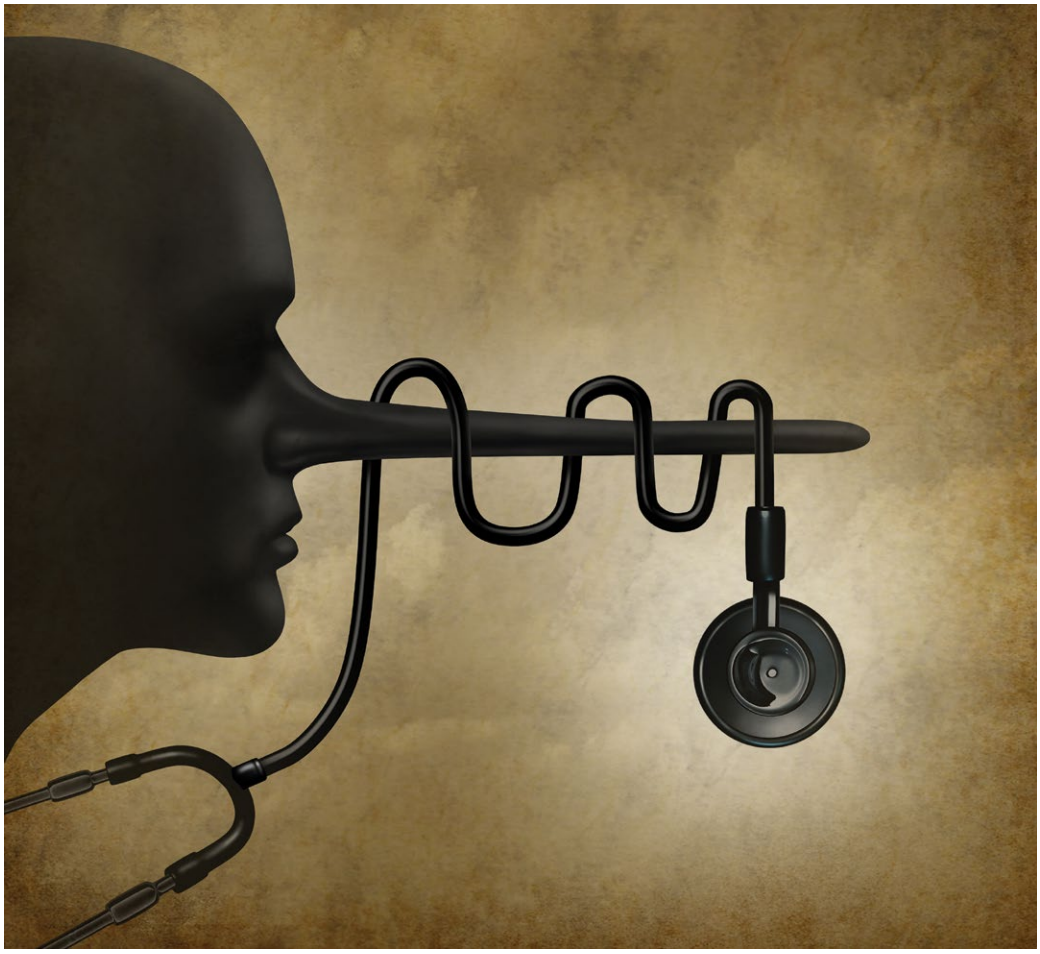
False Claims Act Liability Has a New Implied Certification Standard, or Does It?

by Robert B. Vogel



Suppose a law school wishes to ensure compliance with a school policy that prohibits students from cheating on final exams. As a means of compliance, the law school instructs each student to sign an affidavit at the end of an exam stating that the student did not give or receive help. By signing, the student has *expressly* attested to his honesty. But what if the law school's student handbook states that there shall be no cheating on final exams? Doesn't the law student then, merely by handing in an exam, *impliedly* attest to all of the rules applicable to exam-taking that are found in the handbook?[1]

This vignette exposes one of the central questions that has plagued analysis of the False Claims Act (FCA) in recent years. To succeed in an FCA action, the plaintiff must show by a preponderance of the evidence that the defendant knowingly made a claim that was false or fraudulent while seeking payment or approval from the United States government.[2] Circuit courts have split over whether so-called "implied certification" is a valid means of proving whether a claim is "false or fraudulent." Does

a government contractor impliedly certify compliance with any law or regulation that pertains to the claim that was submitted, just as the law student attests to all the rules in the handbook?

Circuit Courts were split over whether a contractor does impliedly certify compliance with the voluminous statutes and regulations that pertain to his claim. If the court did accept implied certification as a legal theory, then it had to decide how to apply it. One of the critical points of analysis on which the circuits split was whether the false certification was "material" to the government's decision to pay the claim. On June 16, 2016, the United States Supreme Court issued a unanimous decision in *Universal Health Services, Inc. v. United States ex rel. Escobar* upholding the implied certification theory, while imposing what was thought to be a new standard of so-called "materiality."[3] Now that we are a year out from the *Escobar* decision, it is instructive to see how the Circuit Courts of Appeal have applied the *Escobar* standards.

Facts of Escobar

In *Escobar*, a patient, who was a Massachusetts Medicaid beneficiary, received counseling services from a mental health facility owned by Universal Health Services Inc. After the patient died from an adverse reaction to a medication prescribed at the facility, her parents discovered that many of the counselors that had cared for their daughter were unlicensed and unauthorized to prescribe medication without appropriate supervision, which did not exist.[4]

The lawsuit, filed in a district court in the First Circuit, claimed, in part, that submission of claims for the mental health counseling of the patient violated the FCA under implied certification theory. The plaintiffs argued that Universal's submission of Medicaid claims was "false or fraudulent" because utilizing improperly licensed counselors impliedly violated the government's conditions of payment. Despite the fact that the First Circuit had previously recognized implied certification theory and the "conditions of payment" materiality standard, the district court granted Universal's motion to dismiss, finding none of the cited violations as preconditions of payment.[5]

On appeal, the First Circuit reversed the lower court, broadening its own interpretation of materiality and stating: "[O]ur case law makes clear that a healthcare provider's noncompliance with conditions of payment is sufficient to establish the falsity of a claim for reimbursement . . . ." Universal appealed to the Supreme Court.[6]

What is Materiality?

Prior to *Escobar*, if the given circuit accepted implied certification theory, there were generally two standards that were used to assess "materiality": the so-called "prerequisite to payment" test[7] and the "natural tendency to influence" test.[8] The "prerequisite to payment" (or "condition of payment") test made materiality dependent on whether the underlying statute or regulation itself expressly stated that compliance was a condition of payment with which the contractor must comply in order to be paid. Other circuit courts followed the "natural tendency to influence" test employing language from the Fraud Enforcement and Recovery Act of 2009 (FERA), signed by President Obama as an amendment to the FCA, which defined "materiality" as "having a natural tendency to influence, or be capable of influencing, the payment or receipt of money or property."[9] One of the questions now being asked is whether the *Escobar* materiality standard is more well-defined and will be more uniformly applied than the "natural tendency" language of FERA.

What Standard for Materiality Did the Supreme Court Set in Escobar?

In *Escobar*, the Supreme Court validated the existence of the implied certification theory as a whole and attempted to define a "materiality" standard. The Court stated that the "materiality" standard requires that at least two conditions must be satisfied for implied certification theory to apply: "[F]irst, 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 [that were material to the government's payment decision]."[10]

The Court said that it is relevant, although not dispositive, for the noncompliance to technically be a "condition of payment" or have given the government the option to withhold the payment.[11] The Court explained that it would be evidence of materiality if

the contractor knows that the government routinely fails to pay claims when the given provision is violated.[12] Therefore, it seemed from the plain language of the opinion that the misrepresentation must be outcome determinative; if the government had paid earlier claims on the same contract knowing of the noncompliance, then it would be "very strong evidence" that the misrepresentation was not material.[13]

The Court concluded that the First Circuit's view 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 was far too expansive. The Court makes clear that, in order to be material to the government's decision to pay a claim, the violation must be caused by a nondisclosure that lead to it being a half-truth or at least misleading. The case was remanded to the First Circuit for a ruling in keeping with this new standard.[14]

In the immediate aftermath of the *Escobar* decision, there was reason for both FCA plaintiffs and defendants to feel emboldened: implied certification had been upheld as a valid legal theory, but it seemed as if the materiality requirement had been stringently narrowed. Indeed, the Court said that "[t]he materiality standard is demanding" and should be rigorously applied.[15] Noncompliance is not material, said the Court, where it is "minor or insubstantial."[16]

Cases that Have Been Decided Applying the Escobar Standard

Not surprisingly perhaps, interpretations of the Supreme Court's decision in *Escobar* have yielded disparate results, with the district and appeals courts in some cases following *Escobar* and in others continuing to forge their own path.

The most anticipated ruling post-*Escobar* was the First Circuit's decision on the *Escobar* remand. They were now again ruling on the district court's motion to dismiss. A panel of the First Circuit used what they called a "holistic approach" to answer the question of whether the government's decision to pay Universal for mental health counseling from allegedly unqualified individuals was material.[17] The First Circuit said that the plaintiffs had adequately pleaded materiality for the purposes of surviving a motion to dismiss because complying with the regulation in question was, in their opinion, a "condition of payment," and while recognizing that this was not dispositive, it was strong evidence of materiality and the qualifications of the counselors was at the core of the program expectations.[18] These findings are in keeping with the Supreme Court's opinion in *Escobar* and reiterated the First Circuit's own previous decision. The most controversial finding of the First Circuit in this remand was with respect to the "knowledge" that the government must have of the noncompliance before paying a claim. They determined that there was a difference between the knowledge of "the entity paying [the claim]" and other state regulators. The Supreme Court opinion failed to make this distinction, only recognizing the "government's" knowledge more generally.[19] In this case, the court found that there was no evidence that the paying entity, MassHealth, had paid claims despite being aware of violations, but it was clear that other regulators in the state government were aware and did not seek to recoup payment. The court did say that if, upon discovery, it is found that MassHealth knew about the violations and paid, the matter could be reheard in light of this evidence.[20]

In January 2017, the Ninth Circuit affirmed a district court ruling granting summary judgment to a government contractor, SERCO, who was alleged to have violated the FCA by failing to comply with statutory and regulatory law regarding the filing of monthly cost reports.[21] The Ninth Circuit used a straightforward reading of *Escobar* to find that on both prongs the relator had, in the first instance, failed to show that SERCO had impliedly certified "specific representations" about its performance and, secondly, failed to show that compliance with the specific regulation at issue was material to payment and that the government did not rely on the cost reports in deciding whether to pay. The Ninth Circuit concluded that a mere request for payment does not contain representations specific enough to satisfy the pleading requirements in an implied certification case.[22]

Setting up a potential new circuit split, the Fourth Circuit broke ranks with the straightforward reading of *Escobar* by the Ninth Circuit with regard to what a "specific representation" is. In May 2017, the Fourth Circuit found in the case of *United States ex rel. Badr v. Triple Canopy, Inc.*, upon remand from the Supreme Court, that in order to satisfy the first prong of *Escobar*, the defendant was required to disclose its contractual noncompliance in its requests for payments from the government.[23] Triple Canopy had argued that it made no specific representations regarding the marksmanship skill of the guards that it supplied to the government, as was required in its contract, when it requested payment.[24] The question remains open about whether the Fourth Circuit would adopt the First Circuit's approach and reconsider the materiality if the government knew about the poor marksmanship and paid anyway.

Other circuit courts that have decided FCA implied certification cases since *Escobar* included the Seventh Circuit, which had previously rejected the concept of implied certification. In the case before it, a former employee alleged that a for-profit college had violated Title IV Higher Education Act requirements involving recruitment and retention policy. The Seventh Circuit, relying on *Escobar*, decided that the government's decision to pay the college would not have been different had it known of the alleged noncompliance.[25]

The Eighth Circuit decided that if the government had known that a for-profit college was not keeping accurate student records it would not have supplied financial aid funds to the college. Noting that the government had previously terminated colleges from receiving financial aid funds for falsifying records, the Court found that the college's promise to maintain accurate grade and attendance records influenced the government's decision to enter into a contractual relationship with the college.[26]

Conclusion

Relators and the government may now argue that the *Escobar* decision did little to change the definition of "material" as

it was already defined by the FCA under FERA as "having a natural tendency to influence, or be capable of influencing, the payment or receipt of money or property."[27] As expected, the relators and the government will encourage a "holistic approach" that utilizes the materiality factors discussed in *Escobar* as merely guidelines for an overall materiality approach. We can expect defense attorneys to attempt to defeat materiality by submitting evidence that the government knew about the presumed violation and paid anyway. After *Escobar*, we now know that implied certification is here to stay as an FCA theory, and, despite the fact that we have Supreme Court guidelines, how materiality will be proven is still an open question.

Endnotes:

1 This hypothetical is modeled after the one discussed in *United States v. Kellogg Brown & Root Services., Inc. See U.S. v. Kellogg Brown & Root Servs., Inc.*, 800 F. Supp. 2d 143, 154-55 (D.D.C. 2011). It is also found in my law review article that was published in the Liberty University Law Review in the Spring of 2014. At that time, there was a debate about whether the concepts of express and implied certification should be dropped and enveloped into a "materiality" assessment. *See* Robert B. Vogel, M.D., *Implied Certification and Materiality Should be Distinct Elements when Assessing False Claims Act Liability* 8, Liberty U. L. Rev. 449 (2014); *see also* Monica P. Navarro, *Materiality: A Needed Return to Basics in False Claims Act Liability*, 43 U. Mem. L. Rev. 105 (2012).

2 31 U.S.C. § 3729(a)(1)(A)-(G). 31 U.S.C. § 3729(a)(1)(A) says, "knowingly presents, or causes to be presented, a false or fraudulent claim for payment or approval" and § 3729(a)(1)(B) says, "knowingly makes, uses or causes to be made or used, a false . . . or fraudulent claim." 31 U.S.C. § 3729(a)(1)(A-B).

3 *Universal Health Servs., Inc. v. U.S. ex. rel. Escobar*, 136 S. Ct. 1989, 2003-04 (2016).

4 *Id.* at 1997.

5 *Id.* at 1997-98. The Supreme Court opinion cites *United States ex rel. Hutcheson v. Blackstone Medical, Inc.*, 647 F. 3d 377, 385–87 (1st Cir. 2011) as an example of the First Circuit's evaluation of materiality prior to *Escobar*. *Id.* at 1998.

6 U.S. *ex rel. Escobar v. Universal Health Servs.*, 780 F.3d 504, 517 (1st Cir. 2015).

7 This article will not attempt to break down the nuances of the circuit split over the materiality analysis prior to *Escobar*. The "prerequisite to payment" test is best seen in *United States ex rel. Mikes v. Strauss*, 274 F.3d 687 (2d. Cir. 2001). In *Mikes*, the Second Circuit said, "Specifically, implied false certification is appropriately applied only when the underlying statute or regulation upon which the plaintiff relies *expressly* states the provider must comply in order to be paid. *Mikes*, 274 F.3d at 700 (emphasis in original). The Court went on to say that "[l]iability under the Act may properly be found therefore when a defendant submits a claim for reimbursement while knowing – as that term is defined by the Act — that payment expressly is precluded because of some noncompliance by the defendant." *Id.* (citation omitted).

8 31 U.S.C. § 3729(b)(4) (2012).

9 It seems that Congress meant to undercut the strict standard for materiality that circuit courts and the Supreme Court were imposing on the materiality standard in the wake of *Mikes*. *See supra* note 7. The Supreme Court had tightened the standard of materiality when it decided *Allison Engine Co. v. United States ex rel. Sanders*, 128 S. Ct. 2123 (2008). In *Allison*, the Supreme Court said, "What § 3729(a)(2) demands is not proof that the defendant caused a false record or statement to be presented or submitted to the Government but that the defendant made a false record or statement for the purpose of getting 'a false or fraudulent claim paid or approved by the Government.'" *Id.* at 2130. Therefore, a subcontractor violates § 3729(a)(2) if the subcontractor submits a false statement to the prime contractor intending for the statement to be used by the prime contractor to get the Government to pay its claim. *Id.* In announcing the *Escobar* standard, the Supreme Court did little to compare that standard to the standard in *Allison Engine*.

10 *Escobar*, 136 S. Ct. at 2001.

11 *Id.* at 2003-04. "A misrepresentation cannot be deemed material merely because the Government designates compliance with a particular statutory, regulatory, or contractual requirement as a condition of payment. Nor is it sufficient for a finding of materiality that the Government would have the option to decline to pay if it knew of the defendant's noncompliance." *Id.* at 2003.

12 *Id.* at 2003.

13 *Id*

14 *Id.* at 2004

15 *Id.* at 2003

16 *Id.*

17 U.S. *ex rel. Escobar v. Universal Health*, 842 F.3d 103, 109 (1st Cir. 2016).

18 *Id.* at 110-11.

19 *Id.* at 111-12.

20 *Id.* at 112.

21 U.S. *ex rel. Kelly v. Serco, Inc.*, 846 F.3d 325, 328-29 (9th Cir. 2017)

22 *Id.* at 334-35.

23 U.S. *ex. rel. Badr v. Triple Canopy, Inc.*, 857 F.3d 174, 178-79 (4th Cir. 2017

24 *Id.* at 178.

25 U.S. *ex rel. Nelson v. Sanford-Brown*, 840 F.3d 445, 447-48 (7th Cir. 2016).

26 U.S. *ex rel. Miller v. Weston Educ.*, 840 F.3d 494, 503-05 (8th Cir. 2016).

27 31 U.S.C. § 3729(b)(4) (2012).

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