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FCA Post-Escobar: Implied Certification Debate Will Continue

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Blanca Fromm Young

David J. Feder

The U.S. Supreme Court's acceptance of an implied certification theory of False Claims Act liability in Universal Health Services Inc. v. United States ex rel. Escobar does not end the debate over this controversial theory.

The most significant aspect of the court's much-anticipated decision in Escobar is not that it recognized the implied certification theory per se, but that it placed important limits on its application. The court accepted the theory only in the context of an affirmative representation made by a defendant. And it emphasized that courts must take care to enforce the FCA's materiality and scienter requirements — lest every inadvertent or inconsequential legal, regulatory or contractual violation become the basis for FCA liability and treble damages.

Despite the court's assurances that these issues are amenable to resolution through a Rule 12 or summary judgment motion, it provided only vague guidance to the lower courts. As such, the debate over the boundaries of FCA liability for implied false certifications of compliance with legal or contractual requirements will continue for a long time to come. Until the lower courts refine this theory of liability further, Escobar provides little certainty to the government or to companies that do business with the government.

An Implied False Certification Theory May Be Pursued Subject to "Rigorous" Limitations

The FCA penalizes fraud against the government. It imposes significant penalties and treble damages on any person who commits fraud in connection with requesting federal funds. The "implied certification theory" of liability is that, when someone submits a claim for payment to the government for goods or services, they implicitly represent they have complied with relevant laws, regulations and contractual requirements. Therefore, the theory goes, noncompliance with a relevant statutory, regulatory or contractual requirement makes the claim for payment fraudulent and so actionable under the FCA. In Escobar, the Supreme Court endorsed this theory, but within carefully drawn limits.

First, the court recognized implied certification liability under the FCA only where two conditions are met: (1) the defendant makes a "specific representation" about the goods or services provided to the government; and (2) it fails to disclose non-compliance with a material statutory, regulatory, or contractual requirement and that omission makes the defendant's representation misleading — the paradigmatic "half-truth."

For instance, in Escobar, the court found that the defendant's use of payment codes regarding mental health services for which it sought Medicaid reimbursement was an affirmative representation about the nature of the services and the qualifications of those providing them. And it found that the representation was misleading because the defendant failed to disclose that, contrary to what a reasonable person would assume based on the representations that were made, it did not comply with staff and licensing requirements to provide those types of services. The court left unresolved whether an implied certification claim may proceed where a defendant merely requests payment for goods or services while out of compliance with a relevant requirement. Whether a mere omission regarding the defendant's noncompliance, without some accompanying affirmative representation, would be sufficient to support liability under the FCA is still an open question.

Second, the court emphasized the importance of the FCA's scienter requirement, which it characterized as "rigorous." As the court recognized, "strict enforcement" of the scienter requirement is absolutely necessary so that unintentional infractions are not converted into fraud punishable by treble damages, and so that those who do business with the government have some amount of fair notice about when their conduct may cross the line into territory subjecting them to very substantial liability. Accordingly, the court made clear that under the implied certification theory of liability, it is not enough for the defendant to know that it has violated a legal, regulatory, or contractual requirement. It must also know (or recklessly disregard) that the requirement is material to the government's decision to pay.

Third, the court found that the defendant's noncompliance must be material. While the court described this standard as "demanding" and "rigorous," it provided little concrete guidance as to how this standard should be enforced. The court rejected a bright-line rule for materiality. It found that the government's failure to condition payment on a particular requirement does not necessarily establish that the requirement is immaterial, but it could be relevant. By the same token, a requirement is not necessarily material just because the government has labeled it a condition of payment, or has the option to refuse payment if the requirement is not met, although, again, those facts may be relevant. The government's course of conduct can be relevant, too. If it consistently refuses to pay when the requirement at issue is violated, that is evidence that the requirement is material; and if the government pays knowing full well the requirement is violated, that is evidence of immateriality. The court also emphasized that materiality cannot be found when the noncompliance is "minor or insubstantial."

Uncertainty Remains Regarding the Boundaries of Implied Certification Liability

Although these factors provide some guideposts to the lower courts, the court itself did not apply them to the facts before it. Instead, it remanded the case. So, many questions remain: When does conditioning payment on a statutory, regulatory or contractual requirement establish materiality? How many times must the government refuse payment based on noncompliance before it demonstrates that the requirement is material? What kinds of requirements are minor and insignificant? When is a violation insubstantial? When and under what circumstances does a defendant become aware that a requirement is important to the government? These and other questions are left to the lower courts to decide — and they will vary depending on the facts of each case and the particular regulatory framework that applies to the goods or services at issue.

Of course, there will be no shortage of opportunities for the lower courts to grapple with these questions. The FCA's hefty penalty and treble damages provisions, and the lucrative incentives it provides for private plaintiffs to pursue claims on behalf of the government, assure that the limits of the implied certification theory will be tested by plaintiffs claiming that all manner of statutory, regulatory and contractual violations amount to fraud on the government.

Whether the lower courts will strictly enforce the FCA's rigorous materiality and scienter requirements in implied certification cases remains to be seen. In Escobar, the Supreme Court "reject[ed the …] assertion that materiality is too fact intensive for courts to dismiss False Claims Act cases on a motion to dismiss or at summary judgment." Yet the materiality factors enumerated by the court raise a number of factual questions, and those questions are likely to be hotly contested in many cases.

It will be especially important for courts to enforce materiality requirements from the very outset of a case and hold plaintiffs to their burden of pleading materiality both plausibly under Rule 8 and with particularity as Rule 9(b) requires. Otherwise, the dark shadow of FCA liability will loom large over every one of the thousands of statutory, regulatory and contractual requirements that apply to companies doing business with the government.

—By Blanca Fromm Young and David J. Feder, Munger Tolles & Olson LLP

Blanca Fromm Young is a litigation partner in Munger Tolles' San Francisco office. David Feder is a litigator in the firm's Los Angeles office.

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