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Supreme Court Oral Arguments in *Escobar* Indicate Evolving Meaning of Materiality, But Not Its Importance



BY JACK PIROZZOLO, SCOTT D. STEIN AND BRENNA JENNY

After years of litigants urging the Supreme Court to impose order on diverse lower court approaches to the scope of liability under the False Claims Act (''FCA''), the Court finally agreed this year to consider the viability of the implied certification theory. *See Universal Health Services v. United States ex rel. Escobar*.

Under the implied certification theory, a contractor who submits a claim for reimbursement is deemed to certify implicitly that it has complied with all material statutory, regulatory and contractual requirements. Failure to comply with those requirements, even though the contractor has not expressly represented that it has complied, can therefore trigger liability under the FCA.

Circuits have disagreed over whether such a theory is valid, and even those circuits that have held the theory to be valid have, in turn, disagreed over how it should be applied.

Jack Pirozzolo, a partner in Sidley Austin LLP's Boston office, focuses his practice on white collar criminal defense, securities enforcement, internal corporate investigations and complex civil litigation. Scott Stein is a partner in the firm's Chicago office and focuses on complex health-care civil litigation, with a special emphasis on False Claims Act and antitrust litigation. Brenna Jenny is an associate in the firm's Washington office, with a practice focused on health-care litigation and white collar government litigation and investigations.

At the heart of the disagreement among the circuits are competing views over the circumstances under which a violation of a law, contract term, or applicable regulation can be considered ''fraudulent'' as that term is used in the FCA.

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As the circuit split evidences, courts have had trouble defining the appropriate boundary between a simple breach of contract and fraud in the context of the FCA.

Not surprisingly, the oral arguments on April 19 revealed the Justices to be struggling with where to draw the line. The questions from the Court suggest that many of the Justices are focused on orienting the implied certification theory around concepts relating to the underlying substance of a contractor's agreement with the government.

This questioning revealed, however, how difficult it will be for the Court to articulate an appropriate framework for the implied certification theory that will provide both the government and contractors with sufficient clarity and predictability as to the circumstances under which the fraud provisions of the FCA will apply.

Barring a ruling that the implied certification theory is invalid (which seems unlikely based on the questions at oral argument), there will remain considerable risk that contractors will be subjected to a fact-intensive *ex post* judicial inquiry over the impact of alleged viola-

tions of the myriad laws, contract provisions, and regulations applicable to their conduct.

In addressing the question of what should be considered ''fraudulent'' under the FCA, petitioner Universal Health Services (''UHS'') argued for a narrower, common-law based approach to the meaning of ''fraudulent.''

At common law, non-disclosure of a fact (*i.e.*, the trigger for exposure under the implied certification theory) is only fraudulent where there is a duty to speak.

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Justices Kagan and Sotomayor seemed skeptical of this approach, expressing concern that it would protect companies providing goods substantially different than those for which the government had contracted.

Justice Sotomayor appeared particularly dubious of UHS's argument for a narrow construction, discussing a hypothetical in which a contractor provided to the government guns that did not shoot. Justice Sotomayor was openly dismissive of UHS's position that, although providing guns that did not shoot to the government might be a material breach of contract, even a material breach of contract is not necessarily the same as a ''fraudulent'' claim.

Although UHS's position was grounded in long recognized principles of tort law, Justice Sotomayor said that she was having a ''very hard time'' understanding how those circumstances would not be a fraud.

In contrast, respondent Escobar (the relator in the underlying *qui tam* suit) urged the Court to rely on contract law and hold that a claim for payment is fraudulent if the claimant violated any material term of the arrangement.

The government advanced an even more expansive standard. It maintained that a request for payment would be fraudulent if the government were entitled to withhold even partial (as opposed to full) payment as a result of a violated term.

Chief Justice Roberts posited a hypothetical in which a government contract included ''all these health services,'' as well as a requirement that staplers be purchased in the United States. Under this hypothetical, the contractor complied with all terms except for the ''buy America'' term.

Chief Justice Roberts seemed incredulous when the government took the position that the contractor's failure to purchase American-made staplers could create FCA liability.

This exchange highlighted one of the major concerns over the government's view of the implied certification theory—the prospect of uncertain and boundless liability for government contractors, particularly for those contractors providing goods and services in areas with numerous and complex contracts and regulations, such as health care and defense.

The tenor of the exchange during oral arguments suggests that the Court may fashion a framework in which liability under the FCA will turn less on what is stated in a particular claim for payment and more on the degree to which the substance of the goods and services meets the expectations of the government payer.

Justices Kagan and Sotomayor seemed willing to embrace the framework advanced by Escobar and the government as an intuitive means to impose FCA liability. Indeed, they may view the conceptual space between UHS's ''facts basic to the transaction'' and Escobar's ''material'' terms of a contract as a small gap to bridge.

But to aggregate at least five votes, those justices willing to accept a more flexible concept of materiality may have to cede to language firming up the definition.

Chief Justice Roberts and Justice Breyer seemed genuinely concerned over how to impose limitations on the potential scope of FCA liability and provide adequate notice to contractors. Justice Kennedy, too, seemed at least open to the idea of ''a very strict standard of materiality.''

While setting a strict standard for materiality would provide some helpful guidance to contractors, as UHS pointed out in its rebuttal argument, orienting the inquiry around the concept of materiality may not provide contractors with sufficient notice and predictability.

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Indeed, UHS noted that the regulation the First Circuit identified as the relevant regulation triggering liability in this case was identified for the first time when the case was on appeal. The relator did not cite the regulation in the complaint; nor did the federal or state government seek repayment based on the allegations.

Chief Justice Roberts pressed Escobar over whether a facts and circumstances approach to materiality offers adequate notice to potential defendants given the ''thousands of pages of regulations under Medicaid or Medicare programs.'' Escobar seemingly brushed aside the need for notice.

On the one hand, truly meaningful notice in the form of enumerating the government's material terms would, Escobar warned, create a ''roadmap for fraud.'' Yet other potential avenues for technical notice, such as a general ''compliance with all laws'' certification or ap-

  HFRA ISSN 1092-1079

pending regulations to a contract, are not worthwhile according to Escobar because they do not provide meaningful notice.

There is some tension in Escobar's position. Escobar insisted on one hand that companies will be protected from inappropriate FCA liability because relators must prove defendants knew a term was material, yet at the same time, Escobar maintained that the government should not disclose what is material.

This approach would make it difficult for contractors to know of the government's material terms, despite Escobar's insistence that scienter would be a sturdy safeguard against unwarranted FCA liability.

The defense bar has consistently raised the same point regarding the lack of meaningful notice provided by certifications that the contractor has ''complied with all laws,'' and during oral arguments, Justice Breyer seemed inclined to agree. Yet the unpredictability of a materiality standard could have unexpected consequences in the form of greater reliance on these provisions, through use of the express certification theory of liability.

Some but not all courts have ruled that a wide array of regulatory violations render a signatory's representation of ''compliance with all laws'' an express false certification.

The government may decide to avoid its own litigation risk under a materiality inquiry by increasing the use of these catch-all certifications. If courts continue to be receptive to the contention that the violation of *any* law creates an express false certification, this could result in greater FCA exposure.

This is so because, whereas a regulatory violation would need to be material in order to create a ''fraudulent'' claim, at least in some courts, if a claim form includes a catch-all compliance statement—in essence rendering *any* violation of any law ''material''—only a relator's imagination would limit the types of regulatory violations that could create a false claim.

Finally, even if the Court tightens up the concept of materiality, the inquiry remains an incredibly fact-intensive one. Realistically, many litigants may struggle to defeat even frivolous suits at the motion to dismiss stage.

Although relators and the government often point to the FCA's scienter requirement as a safeguard against meritless cases, scienter in the FCA context appears to have had less bite as a filter early in litigation than it has in other contexts.

It remains to be seen whether the Court will provide companies with enough guidance and fair notice to allow them to adjust their compliance programs to respond to government priorities.

The extent to which the implied certification theory has resulted in significantly increased exposure was a point of dispute during the oral arguments. UHS and supportive *amici* maintained that the theory has contributed to the explosion in *qui tam* suits in recent years.

During oral arguments, Escobar dismissed these concerns, citing an *amicus* brief filed by Professor David Engstrom, whose research concluded that the number of *qui tam* filings did not increase in circuits following their adoption of the implied certification theory.

Assuming this conclusion about raw numbers is accurate, it ignores other adverse consequences flowing from implied certification's malleability, such as whether a higher percentage of FCA suits now move to active discovery.

A number of pending suits invoking the implied certification theory have been stayed pending the Court's opinion.

Beyond the decision's impact on these matters, it remains to be seen whether the Court will provide companies with enough guidance and fair notice to allow them to adjust their compliance programs to respond to government priorities.