

KIRKLAND ALERT

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Universal Health Services, Inc. v. United States ex rel. Escobar

On June 16, 2016, the Supreme Court issued its long-awaited decision in *Universal Health Services, Inc. v. United States ex rel. Escobar*, one of the most important False Claims Act cases decided by the Court in recent decades. In an 8-0 decision written by Justice Thomas, the Supreme Court allowed, at least in some circumstances, what has become known as the theory of “implied false certification.” As the Court explained it, under this theory, “when a defendant submits a claim, it impliedly certifies compliance with all conditions of payment,” “[b]ut if that claim fails to disclose the defendant’s violation of a material statutory, regulatory, or contractual requirement . . . the defendant has made a misrepresentation that renders the claim ‘false or fraudulent’” under the False Claims Act. The Supreme Court’s decision provides important guidance on the contours of this theory and the centrality of the False Claims Act’s “materiality” requirement.

Factual Background

The underlying dispute in *Escobar* concerned the Medicaid program, under which medical providers seek reimbursement for the provision of health services to poor and disabled patients. The case was brought by a *qui tam* relator — under the False Claims Act, private plaintiffs can sue on behalf of the United States and obtain part of the recovery, a feature of the Act that makes it a substantial source of potential enforcement risk to businesses. Citing the death of their daughter due to claimed improper mental health treatment and improperly prescribed medication, the plaintiffs alleged that a mental health clinic had submitted false claims for payment by failing to disclose “serious violations of regulations pertaining to staff qualifications and licensing requirements.” According to the plaintiffs, Medicaid would not have reimbursed the health provider “had it known that it was billed for mental health services that were performed by unlicensed and unsupervised staff.” The district court dismissed the suit but the First Circuit reversed, finding that the claim was viable under a theory of implied false certification of a condition of payment. The Supreme Court granted certiorari to review conflicts in the lower courts about the availability and features of this theory.

The Supreme Court’s Opinion: The Truth About Half-Truths

The Supreme Court began its analysis by confirming that the theory of implied false certification is allowed under the False Claims Act. This result, the Court explained, was directed by both the text of the False Claims Act and common law concepts of fraud that underlie it. As the Court held, “[w]hen, as here, a defendant makes representations in submitting a claim but omits its violations of statutory, regulatory, or contractual requirements, those omissions can be a basis for liability if they render the defendant’s representations misleading with respect to the goods or services provided.” In the case at hand, the plaintiffs had stated a claim under the False Claims Act because the defendant had misrepresented the staff’s qualifications

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and billed the government for licensed psychiatrist services that were actually provided by “a nurse who lacked authority to prescribe medications absent supervision.”

The Court next turned to the question of whether “a defendant should face False Claims Act liability only if it fails to disclose the violation of a contractual, statutory, or regulatory provision that the Government expressly designated as a condition of payment.” The Court held that whether such compliance was expressly designated as a condition of payment was relevant, but not dispositive. In other words, False Claims Act liability could potentially lie even if the compliance in question was not an express condition of payment. But, by the same token, a defendant was not necessarily subject to liability simply because compliance with a particular statutory, regulatory, or contractual requirement *was* referenced in the claim documentation as a condition of payment.

Instead, the Supreme Court held, the touchstone should be the Act’s materiality requirement: whether the compliance in question was actually material to the government’s decision to pay. The Supreme Court described the materiality requirement as “demanding” and “rigorous,” explaining that materiality “cannot be found where noncompliance is minor or insubstantial.” Thus, the Court rejected through an analogy the “extraordinarily expansive view of liability” that the government had proposed at oral argument: that “[i]f the Government contracts for health services and adds a requirement that contractors buy American-made staplers, anyone who submits a claim for those services but fails to disclose its use of foreign staplers” is liable under the False Claims Act “irrespective of whether the Government routinely pays claims despite knowing that foreign staplers were used.” While disagreeing with liability in that scenario, the Court used a different example of when a defendant could be liable: “[i]f the Government failed to specify that guns it orders must actually shoot,” a defendant who delivers such defective goods is subject to False Claims Act liability because “a reasonable person would realize the imperative of a functioning firearm.”

Implications

Lower courts and regulated entities will likely be busy for years interpreting the *Escobar* decision. The decision is helpful for False Claims Act defendants when it comes to more technical violations of a government contract. Even if the government designates compliance with a particular statutory, regulatory, or contractual requirement as an express condition of payment, defendants can still argue that the condition was not material enough to give rise to False Claims Act liability. However, defendants have no automatic safe harbor from liability simply because compliance with a particular requirement was not made an express condition of payment.

Everything now turns on the element of “materiality.” Although the term is defined by statute as “having a natural tendency to influence, or be capable of influencing, the payment or receipt of money or property” the Supreme Court described the materiality requirement as “rigorous” and directed the lower courts to enforce it strictly. But because the Supreme Court also clarified that “misrepresentations by omission” may be proven by objective or subjective evidence of falsity, the United States and *qui tam* relators may argue in given cases that materiality is a fact-bound question inappropriate for summary judgment. Nonetheless, *Escobar* clearly indicates that the materiality requirement should have real teeth, expressly “rejecting

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[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.”

In this regard, it is important to note that the Supreme Court also highlighted government knowledge as a potentially key defense: “if the Government pays a particular claim in full despite its actual knowledge that certain requirements were violated, that is very strong evidence that those requirements are not material.” Factual development in litigation, as well as day-to-day compliance efforts, will therefore focus even more frequently on ensuring and proving government knowledge of minor or otherwise inconsequential noncompliance. As a practical matter, however, businesses operate under many different government-funded programs, which the Court admitted “are often subject to thousands of complex statutory and regulatory provisions.” Plaintiffs will thus continue to invoke the False Claims Act, and careful compliance mechanisms and creative defense work will continue to be necessary.

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If you have any questions about the matters addressed in this *Kirkland Alert*, please contact the following Kirkland authors or your regular Kirkland contact.

Daniel Aaron Bress
Kirkland & Ellis LLP
655 Fifteenth Street, N.W.
Washington, D.C. 20005
www.kirkland.com/dbress
+1 202 879 5152

Mike Brock
Kirkland & Ellis LLP
655 Fifteenth Street, N.W.
Washington, D.C. 20005
www.kirkland.com/mbrock
+1 202 879 5991

Henry J. DePippo
Kirkland & Ellis LLP
601 Lexington Avenue
New York, NY 10022
www.kirkland.com/hdepippo
+1 212 446 4780

Mark Filip, P.C.
Kirkland & Ellis LLP
300 North LaSalle
Chicago, IL 60654
www.kirkland.com/mfilip
+1 312 862 2192

Elizabeth S. Hess
Kirkland & Ellis LLP
300 North LaSalle
Chicago, IL 60654
www.kirkland.com/ehess
+1 312 862 3253

Mark Holscher
Kirkland & Ellis LLP
333 South Hope Street
Los Angeles, CA 90071
www.kirkland.com/mholscher
+1 213 680 8190

James F. Hurst, P.C.
Kirkland & Ellis LLP
300 North LaSalle
Chicago, IL 60654
www.kirkland.com/jhurst
+1 312 862 5230

Andrew A. Kassof, P.C.
Kirkland & Ellis LLP
300 North LaSalle
Chicago, IL 60654
www.kirkland.com/akassof
+1 312 862 2474

Brian P. Kavanaugh
Kirkland & Ellis LLP
300 North LaSalle
Chicago, IL 60654
www.kirkland.com/bkavanaugh
+1 312 862 2015

Jennifer Levy
Kirkland & Ellis LLP
655 Fifteenth Street, N.W.
Washington, D.C. 20005
www.kirkland.com/jlevy
+1 202 879 5211

Craig S. Primis, P.C.
Kirkland & Ellis LLP
655 Fifteenth Street, N.W.
Washington, D.C. 20005
www.kirkland.com/cprimis
+1 202 879 5921

Matthew T. Regan, P.C.
Kirkland & Ellis LLP
300 North LaSalle
Chicago, IL 60654
www.kirkland.com/mregan
+1 312 862 2431

Robert S. Ryland
Kirkland & Ellis LLP
655 Fifteenth Street, N.W.
Washington, D.C. 20005
www.kirkland.com/rryland
+1 202 879 5086

Anne M. Sidrys, P.C.
Kirkland & Ellis LLP
300 North LaSalle
Chicago, IL 60654
www.kirkland.com/asidrys
+1 312 862 2448

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