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The Implications of Escobar that You May Have Missed

From the Experts

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The U.S. Supreme Court's ruling last term in *Universal Health Services Inc. v. United States ex rel. Escobar* received a lot of attention because of its implications for False Claims Act (FCA) litigation. Many commentators have focused on the court's materiality holding: that the alleged failure to disclose a statutory, regulatory or contractual violation must be "material to the Government's payment decision." This was, indeed, a significant limitation in several respects. The court made clear not only that materiality is a demanding standard, but also that lower courts may consider the absence of sufficiently plausible and particularized materiality allegations as grounds for dismissal at the motion to dismiss stage, rather than a jury question.

U.S. Supreme Court.

Photo: Diego M. Radzinschi/ALM

But another aspect of the *Escobar* decision has received comparatively less attention. The *Escobar* court also focused on an important aspect of implied false certification cases: the "specific representations about the goods or services provided" that contractors make when entering into a contract or submitting claims for payment.

Before we explain why we believe this aspect of the ruling was so important, we need to go back and provide some background on the FCA. It actually has quite a history.

The History of the FCA

During the Civil War, unscrupulous contractors sold Union forces guns that would not shoot, rotted ship hulls painted to appear new, and even the same mule over and over again. To add insult to injury, the federal government lacked a law that would punish the fraudsters. Enter the FCA, sometimes referred to as "Lincoln's Law," which imposes civil and criminal liability on those who submit a false or fraudulent claim to the government.

One unique aspect of the FCA is its qui tam provisions, which authorize private whistleblowers, called "relators," to file lawsuits on behalf of the government. "Qui tam" comes from the Latin phrase "qui tam pro domino rege quam pro se ipso in hac parte sequitur," which means the person "who brings this lawsuit for the king as well as for himself." In return, relators can receive a share of the recovery—in effect, acting as private bounty hunters for the government fisc. If the government declines to intervene in these qui tam cases, the FCA authorizes relators to prosecute the litigation directly. In such cases, relators historically have a lower success rate, but if they do prevail on their own, the relators may receive a higher percentage of the recovery.

The financial stakes in FCA cases can be enormous. The FCA imposes treble damages plus statutory fines for each false claim. As government contracts have become ever-larger and seemingly ever-present, so too has the potential liability under the FCA. According to one group, the top 100 civil FCA recoveries range from $100 million to $2 billion. Private relators may receive a statutory bounty of up to 30 percent, and the median relator recovery is over $100,000.

The last half-century has seen a steady increase in these lawsuits. Whereas the overwhelming majority of FCA litigation used to be initiated directly by the government, today the opposite is true. In 2015 alone, over 600 qui tam lawsuits were filed by private whistleblowers, compared with roughly 100 by the U.S. government. Moreover, qui tam litigation has expanded far from the FCA's roots in military procurement into industries like health care, telecommunications, education and mortgage lending that have become increasingly entwined with the government. As an illustration, in 2015, over 400 qui tam lawsuits were filed against health care defendants, compared with 34 against defense contractors.

Changes in the Law

At the same time, the theories of FCA liability advanced by both private relators and the government have expanded. In recent years, courts have been asked to extend the FCA to situations that look less like the outright frauds of the Civil War era and more like allegations of breach of contract or strict liability. One such example is what has become known as the "implied false certification" theory, which posits that simply by submitting a claim for payment to the government, a contractor is impliedly certifying its compliance with a host of other statutory, regulatory and contractual provisions that might be applicable to the transaction. Under this theory, a contractor that fails to disclose that it has purportedly not complied with some statutory, regulatory or contractual requirement has committed a fraud-by-omission based upon its "implied certification" that it had met such requirements.

As an oft-used example, imagine that a doctor buys a Chinese-made stapler, notwithstanding a regulation requiring Medicare and Medicaid providers to buy staplers made in the U.S. The doctor then files various claims under Medicare and Medicaid for legitimate services rendered to her patients at the correct amount.

Until recently, a relator might have attempted to invoke the implied false certification theory to argue that those claims were fraudulent because every time the doctor submitted a claim, she was impliedly certifying that she had complied with all rules and regulations, including the stapler regulation. In a real-world example, an FCA defendant that had sold explosives to the government was required to stand trial, not because it was alleged to have sold shoddy products, but rather because it was alleged to have failed to disclose purported violations of environmental and occupational safety regulations with which it had also agreed to comply. *See U.S. ex rel. Holder v. Special Devices Inc.*, 296 F. Supp. 2d 1167 (C.D. Cal. 2003).

The aggressive interpretation of the implied false certification theory imposed a significant liability risk for any company dealing with the government. To put this in context, health care providers are subject to as many as 130,000 pages of rules and regulations. A standard Department of Defense contract includes boilerplate language requiring compliance with dozens of statutes and regulations and often includes an even broader catch-all promise to "comply with all applicable federal, state and local laws." For government contractors, the implied false certification theory, left unchecked, conceivably turned every potential violation of a federal statute, regulation or contractual provision into a potential FCA claim.

Where Escobar Fits In

In *Escobar*, the Supreme Court held that the implied false certification theory is in some circumstances a viable theory under the FCA. During oral argument in the case, however, it was clear that the justices were concerned with placing reasonable limits on implied false certification claims and not, as Justice Stephen Breyer put it, making contractors responsible, under penalty of treble damages, "for having complied with every one of 40,000 regulations, the size of the room, size of the table," or, in Justice Elena Kagan's words, "every jot and tittle of the contract." And in its unanimous opinion, the court established several key boundaries.

The court limited its holding to cases where the alleged failure to disclose a statutory, regulatory, or contractual violation would render the contractor's specific "representations misleading with respect to the goods or services provided." Thus, to support an implied false certification claim, the alleged misrepresentation-by-omission must relate to specific representations that were made about the good or service provided and the alleged omission must make those specific representations misleading or fraudulent. The court noted, for example, that the petitioner was alleged to have submitted claims using payment codes that identified various mental health services, while failing to disclose its alleged violations of licensing requirements that, if true, would have made its use of the billing codes misleading. In other words, the petitioner was alleged to have billed the government for services that it did not provide based on the billing codes that it used.

Importantly, in reaching its holding, the court expressly declined to adopt the theory of "automatic implied certification" advanced by the relators and the government: that "all claims for payment implicitly represent that the billing party is legally entitled to payment." Instead, the court required a nexus between the alleged omissions and specific representations made concerning the contracted-for goods or services. If lower courts faithfully follow this approach, it will be a significant additional limitation on the reach of the implied certification theory, resulting in the dismissal of qui tam lawsuits that are premised on alleged violations that do not directly relate to a contractor's statements regarding its goods or services. One would expect, for example, that a lawsuit like Holder might come out differently under *Escobar*, because it is difficult to see how purported violations of environmental or workplace safety regulations would render a contractor's representations about its explosives misleading.

By limiting its holding in this manner, the Supreme Court has hopefully returned the FCA to its roots as a means to combat fraud in which the government does not receive the good or service for which it bargained, rather than an enforcement tool to police every governmental rule and regulation that might apply to a contractor. As the court reiterated in *Escobar*, "The False Claims Act is not 'an all-purpose antifraud statute,' or a vehicle for punishing garden-variety breaches of contract or regulatory violations." As Justice Kagan commented at oral argument, what matters is "that the guns shoot, that the boots can be worn, that the food can be eaten." In light of *Escobar*, it is critical for courts to ensure that the implied certification theory is not misapplied to expand liability into conduct that is far afield from a traditional false claim. By focusing on alleged representations and omissions that are squarely related to the goods or services provided, the Supreme Court has given lower federal courts the guidance to do just that.

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