

THE ESCOBAR CASE: SOME PRACTICAL IMPLICATIONS

By Robert L. Vogel and Andrew H. Miller
August 2016

INTRODUCTION

In *United Health Services, Inc. v. United States ex rel. Escobar*, 136 S. Ct. 1989 (2016) (“*Escobar*”), the United States Supreme Court addressed two questions that have arisen in the context of litigation under the False Claims Act (“FCA”), 31 U.S.C. §§ 3729 *et seq.* The first question was whether the so-called “implied false certification” theory of liability is a valid basis of liability under the FCA. Under this theory, when someone submits a claim for payment of government funds for the rendering of goods or services, the claimant “impliedly certifies” that the goods or services were rendered in compliance with applicable legal requirements (whether statutory, regulatory, or contractual). The second question the Court addressed was whether, assuming there could be liability based on “implied false certification,” such liability could only be premised on noncompliance with a legal requirement that was expressly designated as a condition of payment.

The Court answered the first question by holding that, “at least in certain circumstances, the implied false certification theory can be a basis for liability. Specifically, liability can attach when the defendant submits a claim for payment that makes specific representations about the goods or services provided, but knowingly fails to disclose the defendant’s noncompliance with a statutory, regulatory, or contractual requirement. In these circumstances, liability may attach if the omission renders those representations misleading.” *Escobar*, 136 S. Ct. at 1995. The Court answered the second question by stating that “liability for failing to disclose violations of legal requirements does not turn upon whether those requirements were expressly designated as

conditions of payment.” *Id.* at 1996. The Court further stated, “What matters is not the label the Government attaches to a requirement, but whether the defendant knowingly violated a requirement that the defendant knows is material to the Government’s payment decision.” *Id.*

This paper will discuss the Court’s holdings in *Escobar*, its discussion of the issue of materiality, and the practical implications that one can expect from the Court’s decision.

I. The *Escobar* Court Held That a “False Implied Certification” Can Be a Basis for Liability Under the False Claims Act.

In *Escobar*, the relator’s complaint alleged that the defendant had submitted claims for payment using payment codes that corresponded to specific counseling services – individual therapy, family therapy, preventive medication counseling, and other types of treatment. In their claims, the defendant included National Provider Identification numbers corresponding to specific job titles, such as “social worker.” While using these payment codes and identification numbers, the defendant failed to disclose that the providers rendering the treatment did not have the qualifications which, under state law, persons using those job titles are required to have. *Id.* at 2000.

The Court held that a defendant can be liable for violating the FCA under the “implied false certification” theory, “at least where two conditions are satisfied: first, the claims 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.” *Id.* at 2001.

The Court’s use of the qualifier “at least where two conditions are satisfied” indicates that the Court was describing circumstances that were *sufficient* for a finding of liability, but that the

Court was not holding that these circumstances were *necessary* for a finding of liability. The Court's use of the words "at least" implies that there might be other circumstances, in addition to those enumerated by the Court, in which the implied certification theory can be a basis of liability.

If there were any doubt as to the limited nature of the Court's holding, the Court clarified its position when it addressed the difference between the parties' positions. The Court observed: "[The Government and *qui tam* relator] contend that every submission of a claim for payment implicitly represents that the claimant is legally entitled to payment, and that failing to disclose violations of material legal requirements renders the claim misleading. [The respondent], on the other hand, argues that submitting a claim involves no representations," and that "nondisclosure of legal violations is not actionable absent a special duty ... to exercise reasonable care to disclose the matter in question, which it says is lacking in Government contracting." *Id.* at 1999-2000 (internal quotation marks omitted).

In response to these arguments, the Court stated: "*We need not resolve whether all claims for payment implicitly represent that the billing party is legally entitled to payment.* The claims in this case do more than merely demand payment. They fall squarely within the rule that half-truths – representations that state the truth only so far as it goes, while omitting critical qualifying information – can be actionable misrepresentations." *Id.* at 2000 (emphasis added). In short, the Court left open the question of whether a person who knowingly failed to disclose its noncompliance with a material obligation could be liable simply for submitting a claim for payment *without* making any specific representations about the goods or services provided.

II. The Court Held that Liability for “Implied False Certification” Does Not Depend On Whether a Provision Was Expressly Designated as a “Condition of Payment.”

After holding that a defendant can be liable for a “false implied certification,” the *Escobar* Court addressed a second question raised in the petition for *certiorari*: whether, for the violation of a statutory, regulatory, or contract provision to be the basis of FCA liability, the provision had to be expressly designated as a “condition of payment.” The Court said “no.” *Id.* at 2001. The Court held that the question of whether the provision was designated as a condition of payment could be relevant to the ultimate question of whether a violation of that provision was “material,” but it was not necessarily dispositive. *Id.*

In other words, there could be some situations where, notwithstanding the designation of a provision as a “condition of payment,” a violation would not be material. Likewise, there could be situations where, although the provision had not been designated as a condition of payment, a violation of that provision was nonetheless material to the payment decision.

In discussing this point, the Court addressed – and rejected – a distinction that had been made by several lower courts prior to *Escobar*. Before *Escobar*, a number of lower courts had decided that, to be liable under the FCA for an “implied false certification,” the defendant had to violate a provision that was considered a “condition of payment,” rather than a “condition of participation.” In other words, some lower courts had held that if a defendant misrepresented facts pertaining to whether the defendant was eligible to participate in a particular federal program, the misrepresentation as to eligibility did not mean that the defendant’s subsequent claims for payments under that program were “false.” See, e.g., *United States v. Sanford-Brown, Ltd.*, 788 F.3d 696, 712 (7th Cir. 2015). What mattered, according to these lower courts, was whether the defendant misrepresented its compliance with provisions that were designated as

“conditions of payment.” The *Escobar* Court indicated that this distinction created “arbitrariness.” *Escobar*, 136 S. Ct. at 2002.

III. The *Escobar* Court Sought to Clarify the Standard for “Materiality.”

After holding that the key question in “implied false certification” cases is whether the defendant’s non-disclosure concerned the violation of a provision that was “material” to the payment decision, the *Escobar* Court sought to “clarify how that materiality requirement should be enforced.” *Id.* at 2002. The Court noted that Section 3729(b)(4) of the FCA defines “materiality” as follows: “[T]he term ‘material’ means having a natural tendency to influence, or be capable of influencing, the payment or receipt of money or property.” *Id.* The Court further noted that this statutory definition of “material” was taken directly from Supreme Court case law, and that it descended from “common-law antecedents.” *Id.*

The Court then held: “We need not decide whether §3729(a)(1)(A)’s materiality requirement is governed by §3729(b)(4) or derived directly from the common law. Under any understanding of the concept, materiality ‘look[s] to the effect on the likely or actual behavior of the recipient of the alleged misrepresentation.’” *Id.*, citing 26 R. Lord, *Williston on Contracts* §69:12, p. 549 (4th ed. 2003) (Williston).

Drawing on the standards of “materiality” set forth in the Restatement (Second) of Torts, § 538, and the Restatement (Second) of Contracts, § 162(2), the Court held that the violation of a specific statute, regulation, or contract provision is “material” if (1) a reasonable person would have attached importance to it making a payment decision, *or* (2) the particular decision-maker was known to attach importance to the matter, even if a reasonable person would not. *See Escobar*, 136 S. Ct. at 2002-03.

Significantly, the *Escobar* Court eschewed the notion that there is any categorical rule or test to determine the “materiality” of a statement or omission. Quoting from *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 29 (2011), the *Escobar* Court stated that “materiality cannot rest on ‘a single fact or occurrence as always determinative.’” *Escobar*, 136 S. Ct. at 2001.

Instead of trying to enunciate a fixed legal rule to determine “materiality” in broad categories of cases, the Court held that this determination required a broad examination of the circumstances in the particular case. Ultimately, the court or jury would have to determine, based on all the available evidence, whether a “reasonable person” would have found the violation of the provision to be material to the payment decision, or, if not, whether the defendant knew that the particular decision-maker did in fact attach importance to the provision. *Id.* at 2002-03.

The Court went on to discuss the relevance of several specific factors to the decision on materiality. The Court declared unequivocally that materiality “cannot be found where noncompliance is minor or insubstantial.” *Id.* at 2003. The Court further noted that it was not “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.*

The Court then addressed some factors which could be viewed as evidence that a provision was material: “[W]hen evaluating materiality under the False Claims Act, the Government’s decision to expressly identify a provision as a condition of payment is relevant, but not automatically dispositive. Likewise, proof of materiality can include, but is not necessarily limited to, evidence that the defendant knows that the Government consistently

refuses to pay claims in the mine run of cases based on noncompliance with the particular statutory, regulatory, or contractual requirement.” *Id.*

Finally, the Court addressed some factors that could be viewed as evidence that a provision was not material. The Court wrote: “[I]f 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. Or, if the Government regularly pays a particular type of claim in full despite actual knowledge that certain requirements were violated, and has signaled no change in position, that is strong evidence that the requirements are not material. *Id.* at 2003-04.

In three separate places, the *Escobar* Court cited approvingly to *Junius Construction Corporation v. Cohen*, 257 N.Y. 393 (1931) (“*Junius*”), an opinion written by Chief Judge (and future Supreme Court Justice) Benjamin Cardozo of the New York Court of Appeals. *See Escobar*, 136 S. Ct. at 2000, 2003 n. 5, 2003. *Junius* involved a real estate transaction where the buyer sought to purchase a plot of land on which to build a factory. Prior to closing, the seller disclosed that there were plans to condemn and build roads around two edges of the property, but failed to disclose that there was also a plan to condemn and build a road right through the heart of the property (which would have rendered it impossible to build the factory). In ruling for the buyer, Chief Judge Cardozo pointed out that the seller’s misrepresentation concerned a matter that “went to the very essence of the bargain.” 257 N.Y. at 400. *See Escobar*, 136 S. Ct. at 2003 n. 5 (citing *Junius*).

IV. The Practical Impact of the *Escobar* Decision.

The Court recognized that its holding would result in a fact-based inquiry to determine materiality, and that this would inevitably raise questions over how trial courts should apply the Court's materiality standard when considering pre-trial motions, such as a motion to dismiss or a motion for summary judgment. Accordingly, the Court included a footnote that said: "We reject [the defendant's] assertion that materiality is too fact intensive for courts to dismiss False Claims Act cases on a motion to dismiss or at summary judgment. And False Claims Act plaintiffs must also plead their claims with plausibility and particularity under Federal Rules of Civil Procedure 8 and 9(b) by, for instance, pleading facts to support allegations of materiality." *Id.* at 2004 n. 6.

What, then, is a plaintiff supposed to plead as to the element of "materiality" in order to state a plausible claim for relief and to satisfy Rule 9(b)'s "pleading with particularity" requirement? Although defendants can be expected to point to the Court's discussion of materiality and argue that the various circumstances that the Court discussed should be treated as dispositive one way or the other, the Court indicated that while those circumstances have evidentiary value, no single factor (with the exception of "minor or insubstantial" noncompliance") is to be treated as dispositive. Instead, the trial court (or the jury) must ultimately determine, considering all the circumstances, whether (1) a "reasonable person" would have considered an undisclosed breach of a provision to be material to the payment decision, or (2) the defendant knew that the person responsible for the payment decision attached importance to compliance with the provision in question. *See id.* at 2002-03.

Although there might be various other ways to satisfy this burden of pleading, one way a plaintiff should be able to satisfy this burden is by pleading that the provision at issue was an important part of the bargain between the payer and the claimant. *See id.* at 2003 n. 5 (citing

Junius). Since the price of a good or service is nearly always at the “essence of the bargain,” an allegation that the defendant failed to disclose noncompliance with a requirement that could affect the price – for example, the failure to disclose collusive bidding, or the failure to disclose discount or rebate practices that the Government demands to know about – should be sufficient to satisfy the “materiality” element at the pleading stage. Likewise, under the “reasonable person” standard, if the plaintiff can present proof that the defendant failed to disclose noncompliance with a requirement that could affect the price, the plaintiff should be able to withstand a motion for summary judgment.

Alternatively, a plaintiff could plead facts (or, in response to a motion for summary judgment, introduce evidence) indicating that the defendant knew that the particular payer, whether reasonable or not, placed some importance on the defendant’s compliance with the provision at issue. *See id.* at 2003. This may be important in cases where defendants have misrepresented compliance with provisions that do not affect either the price or quality of goods or services, but instead, are relevant to the defendants’ eligibility to receive government contracts or participate in government programs. If a plaintiff can show that the defendant had reason to believe that procurement officials placed some importance on the eligibility provision, then the defendant’s failure to disclose a violation of that provision would be material.