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Supreme Court Decision Changes Landscape for False Claims Act Litigation

By Ty Howard, Brad Robertson, and Travis Lloyd

The False Claims Act (FCA) is the federal government's chief weapon to combat false or fraudulent claims made to the government and has resulted in billions of dollars of recoveries. In recent years, broad interpretation of the Act has left the financial services industry and other regulated companies grappling with how to manage their risk of FCA liability. On June 16, the U.S. Supreme Court entered the fray, issuing a much-anticipated decision that significantly changes the landscape of FCA litigation—for both the government and defendants.

In *Universal Health Services v. United States ex rel. Escobar*, a unanimous Court validated the controversial "implied certification" theory of FCA liability. According to that theory, when a defendant submits a claim for payment to the government, it impliedly certifies compliance with various regulatory, statutory, and contractual requirements that otherwise apply to it. The theory holds that noncompliance with one of those separate requirements renders the claim "false" even if the defendant provided the government the good or service it bargained for.

Although the Court upheld the implied certification theory, it limited it. The decision does not provide a bright-line rule—as advocated by the defense—to delineate which statutes, regulations, and contractual provisions may form the basis for FCA liability if violated. Instead, it focused on "materiality," a legal concept that essentially asks whether something would have mattered to or influenced the other party. Here, the Court provided a heightened standard of materiality that looks to the likely or actual behavior of the government if it knew of the violation. Ultimately, while it will take time for the full impact of the decision to be realized, the limits placed on the implied certification theory by the *Escobar* decision may provide useful tools to the financial industry in defending against FCA claims.

Background

The case arose from treatment by unlicensed and unsupervised personnel at a mental health clinic. The relator alleged that the claims the clinic submitted for these services were false and subject to FCA liability because the clinic, through the act of submitting the claims, impliedly certified that it was in compliance with all conditions of payment, including state Medicaid requirements regarding licensing and supervision. While the district court found that none of the regulations alleged to have been violated were conditions of payment, the First Circuit reversed, finding that conditions of payment do not have to be expressly identified as such. The Supreme Court then granted certiorari to address (1) whether the implied certification theory of legal falsity under the FCA is viable, and (2) if so, whether liability under the implied certification theory requires

that the underlying statute, regulation, or contractual provision expressly state that it is a condition of payment.

Implied Certification Theory—Upheld but Limited

Writing for the Court, Justice Thomas upheld the implied certification theory of liability under the FCA, but under limited circumstances. Implied certification may apply only when a claim makes specific representations about the good or service (as opposed to merely requesting payment) and the failure to disclose certain noncompliance makes those specific representations "misleading half-truths." The Court found that this standard was satisfied in *Escobar*, where the clinic's claims included payment codes for specific types of treatment and other codes that corresponded to specific job titles. In this situation, the claims constituted misrepresentations because these codes wrongly implied that the personnel providing the services had the specialized training, experience, and qualifications required by regulation.

Importance of Materiality

But not all misrepresentations regarding compliance are subject to FCA liability. The Court emphasized that only misrepresentations that are material to the government's payment decision are actionable under the statute. In so holding, the Court flatly rejected the argument that whether a requirement is expressly labeled a condition of payment is dispositive of the issue and undercut the long-standing distinction used in some circuits between conditions of payment and conditions of participation.

In that regard, the Court announced the most significant aspect of its decision—a new, rigorous materiality standard to be imposed on the government and qui tam plaintiffs. Escobar states that FCA materiality is based on the "likely or actual behavior of the recipient of the alleged misrepresentation" rather than merely whether the government "would be entitled to refuse payment were it aware of the violation." The Court explained that the materiality bar was high and not easily met:

> The materiality standard is demanding. The False Claims Act is not "an all-purpose antifraud statute" or a vehicle for punishing garden-variety breaches of contract or regulatory violations. A misrepresentation cannot be deemed material merely because the Government designates compliance with a particular statutory, regulatory, or contractual requirement as a condition of payment. Nor is it 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. Materiality, in addition, cannot be found where noncompliance is minor or insubstantial.

The Court also emphasized that materiality turned on substance, not mere labels:

> In sum, when 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. Conversely, if the Govern¬ment 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.

Of Staplers and Liability Theories—The Fallout of a Hypothetical?

The heightened standard of materiality may be to some extent in response to the government's inability at oral argument to provide a satisfying response to a hypothetical scenario in which the government contracted for health services and required

the provider to use American-made staplers. At argument, the government indicated that the use of foreign-made staplers would entitle the government to withhold payment and could be the basis for FCA liability. Justice Thomas addressed this hypothetical directly in the opinion, stating "if the Government required contractors to aver their compliance with the entire U.S. Code and Code of Federal Regulations, then under this view, failing to mention noncompliance with any of those requirements would always be material." In the words of the Court, "[t]he False Claims Act does not adopt such an extraordinarily expansive view of liability."

Conclusion

Although the Court's decision may be construed as a government win because it upholds the implied certification theory, *Escobar* may ultimately prove a hollow victory. While it will take time to see how the opinion plays out in lower courts, its limitations on when implied certification theory can apply and the bolstering of the materiality requirement may hamper the government's most expansive use of the theory and create a higher bar for qui tam plaintiffs to clear before FCA liability can apply, both of which will be welcome news to financial institutions and others that do business with the federal government.

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Government Imposes Cybersecurity Responsibilities on Bank Boards and CEOs

By Brian Malcom

Concerns about cybersecurity are here to stay. The federal government is keenly aware of the threat, due to some recent large-scale breaches receiving a significant amount of attention in the press. Following these breaches, the government issued new regulations and legislation designed to enhance and ensure cybersecurity for financial institutions. Consequently, bank directors and officers face more pressure to pay attention to and take action with respect to cybersecurity.

One way the government is signaling that it will become more active in regulating cybersecurity is through the issuance of guidelines. The Cybersecurity Assessment Tool, issued by the Federal Financial Institutions Examination Council (FFIEC) in June 2015, contains such guidelines. A copy of the Cybersecurity Assessment Tool is available at: https://www.ffiec.gov/cyberassessmenttool.htm. This site contains the following message from the FFIEC:

> *In light of the increasing volume and sophistication of cyber threats, the Federal Financial Institutions Examination Council (FFIEC) developed the Cybersecurity Assessment Tool (Assessment) to help institutions identify their risks and determine their cybersecurity preparedness. The assessment provides a repeatable and measurable process for financial institutions to measure their cybersecurity preparedness over time.*
>
> *The following resources can help management and directors of financial institutions understand supervisory expectations, increase awareness of cybersecurity risks, and assess and mitigate the risks facing their institutions.*

Thus, the goal of the assessment is to outline the government's expectations for bank management and directors in auditing and mitigating their institution's cybersecurity.

The FFIEC also provides an overview of the assessment for CEOs and directors of financial institutions. This overview outlines the government's expectations for the CEO and the separate expectations for the board of directors in mitigating cybersecurity threats. Those are, as follows. The role of the chief executive officer (CEO), with management's support, may include the responsibility to do the following:

- Develop a plan to conduct the assessment.
- Lead employee efforts during the assessment to facilitate timely responses from across the institution.