New York Law Journal
SERVING THE BENCH AND BAR SINCE 1888
WWW.NYLJ.COM
An ALM Publication
VOLUME 255—NO. 37
FRIDAY, FEBRUARY 26, 2016

Federal Civil Enforcement

Expert Analysis

Supreme Court to Review Theory Of Implied False Claims Act Liability

By **Richard Strassberg**

And **William Harrington**

The False Claims Act (FCA) has served a vital role in protecting the federal purse: Its provision for treble damages and whistleblower rewards creates a powerful incentive to ensure that private parties that enter into contracts with the government deliver the goods or services they promised to provide. But more troubling to some has been the effort to infer that the government contracts include promises to comply with additional requirements, even when no such promises were expressed, and use the FCA to police these broader sets of implied legal obligations. In such cases, the government or whistleblowers contend that the contractor implicitly certified compliance with applicable legal provisions, and they seek to use the FCA to penalize non-compliance. To critics of such theories, the FCA can become a net sweeping in conduct far beyond that intended by Congress, and creating litigation even where Congress or state legislatures deliberately refrained from creating private rights of action in favor of specialized regulatory regimes.

A circuit split has grown along the question of whether the FCA should apply to such cases. Late in 2015, the Supreme Court agreed to hear a case that challenges the viability of the implied false certification theory, *Universal Health Services v. ex rel. Escobar*, No. 15-7 (cert. granted Dec. 4, 2015).[1]

Theories of Falsity

At the heart of the FCA is the government's obligation to prove that a defendant made a false claim or statement to the federal government in connection with a request for payment for goods provided or services rendered to the government. Over the course of the FCA's history, the government has pursued an expanding range of FCA cases, reliant on the Supreme Court's pronouncement that the FCA "was intended to reach all types of fraud, without qualification, that might result in financial loss to the government." *United States v. Neifert-White*, 390 U.S. 228, 232 (1968).

RICHARD STRASSBERG *and* WILLIAM HARRINGTON *are partners at Goodwin Procter, and are based in the New York office.*

The government has pursued FCA cases based on claims or statements that were factually false (an incorrect description of goods or services provided, or a request for payment for goods or services never provided), legally false (a false certification of compliance with a federal statute, regulation or contractual term), or fraudulently induced (claims that are neither factually false nor legally false, but were submitted to the government pursuant to contracts obtained by fraud). See *United States ex rel. Marcus v. Hess*, 317 U.S. 537, 542-43 (1943) (explaining fraudulent inducement); *Mikes v. Strauss*, 274 F.3d 687, 697 (2d Cir. 2001) (explaining factual and legal falsity).

> To some, the False Claims Act can become a net sweeping in conduct far beyond that intended by Congress.

Within the concept of legal falsity, the government has pursued two potential theories: express legal falsity and implied legal falsity, also known as implied false certification. Under an express legal falsity theory, the government alleges that the defendant falsely certified its compliance with some law or regulation on the face of the submitted claim. Under a theory of implied legal falsity, the government argues that the act of submitting a claim constitutes certification of compliance with government laws or regulations, even if the claim itself is silent as to compliance. The theory of implied false certification has been further separated by the courts, with certain jurisdictions, such as the U.S. Court of Appeals for the Second Circuit, imposing liability only where compliance with the law or regulation at issue is expressly required in order to obtain payment.

Other jurisdictions have found FCA liability under an implied false certification theory, even where compliance with the statute or regulation at issue is not expressly stated to be a condition of payment by the government.

An example drawn from the Second Circuit's leading implied false certification case, *Mikes v. Strauss*, can help illustrate the various theories of FCA liability. In *Mikes*, a doctor claimed that her former medical partners violated the FCA when they submitted Medicare reimbursement forms for spirometry procedures,[2] even though the procedures were allegedly not performed in accordance with the relevant standard of care. 274 F.3d at 696. Here is how the allegations in *Mikes* would play out under each theory of FCA liability:

A. If the reimbursement forms—i.e., the claims—sought repayment for spirometry procedures that were not actually performed, this would have been a factual falsity.

B. If the claims explicitly stated, on the face of the reimbursement forms, that the spirometry procedures were performed in accordance with the relevant standard of care, this would have been an express legal falsity.

C. However, as happened in *Mikes*, the challenged claims, on their face, were silent as to whether the spirometry procedures were performed in accordance with the relevant standard of care, which made *Mikes* an implied false certification case. Id. at 699.

D. *Mikes* further turned on whether compliance with the relevant standard of care was required in order for the government to provide payment for the procedures, or whether compliance with the standard of care was merely a condition of participation in the Medicare program. Ultimately, the Second Circuit, reluctant to impose the "federalization of medical malpractice" that it feared would result from an expansive interpretation of the implied certification theory of FCA liability in the health care context, noted that "courts are not the best forum to resolve medical issues concerning levels of care." Id. at 700. The court ultimately held that compliance with the standard of care was a requirement of participation in the Medicare program, and not a condition of payment, and therefore found no FCA violation. Id. at 702.

'Escobar'

In *Universal Health Services v. ex.rel Escobar*, the Supreme Court will weigh in on both the viability of the implied legal falsity theory of FCA liability itself, as well as whether the theory should be limited to instances where payment on the claim is expressly conditioned on compliance with the statute, regulation or contractual term at issue.

Escobar is an FCA case brought by two relators—the parents of a teenage girl who died of a seizure shortly after being treated at a mental health clinic owned by the petitioner. Relators allege that petitioner violated the FCA by seeking Medicaid reimbursement for the services provided to their daughter even though: (1) the staff members were not supervised as required under Medicaid regulations; and (2) the clinic was operating in violation of other Medicaid staffing-related regulations because it did not employ a board-certified psychiatrist and a licensed psychologist. However, both parties agree that the claims for reimbursement submitted to Medicaid did not contain express certifications of compliance with either the supervision or staffing regulations, placing the case squarely within the realm of the implied certification theory of legal falsity.

Petitioner is arguing that nowhere in the applicable regulations was compliance with either the supervision or staffing regulations expressly stated to be a condition of payment by Medicaid; but relators disagree, stating that the U.S. Court of Appeals for the First Circuit found that compliance with the supervision regulation was, in fact, an express condition of payment.

The court granted certiorari on two questions, namely:

> 1. Whether the "implied certification" theory of legal falsity under the FCA—applied by the First Circuit below but recently rejected by the Seventh Circuit—is viable; [and]
> 2. [W]hether a government contractor's reimbursement claim can be legally "false" under that theory if the provider failed to comply with a statute, regulation, or contractual provision that does not state that it is a condition of payment, as held by the First, Fourth, and D.C. Circuits; or whether liability for a legally "false" reimbursement claim requires that the statute, regulation, or contractual provision expressly state that it is a condition of payment, as held by the Second and Sixth Circuits.

Escobar, Cert. Petition at ii.

Petitioner argues that to allow FCA cases to proceed on the implied false certification theory is the equivalent of "effectively impos[ing] a fiduciary obligation on every individual or business that submits claims to the government." *Escobar*, Petitioner's Br. at 33. The FCA imposes liability on any person who presents, or causes to be presented, "a false or fraudulent claim for payment" to the government. 31 U.S.C. §3729(a)(1)(A). According to petitioner, the FCA's use of the term "false" corresponds to the factual falsity theory of FCA liability, whereas the statute's use of the term "fraudulent" corresponds to the legal falsity theory. *Escobar,* Petitioner's Br. at 29.

Petitioner argues that the term "fraudulent" in the FCA should have the same meaning as in the common law, and that the common law "has never understood the act of seeking payment under a contract as giving rise to a duty of disclosure." Id. at 32. Therefore, flows petitioner's argument, the act of submitting a claim to the government for services provided imposes no duty on the part of the contractor to disclose whether or not he has complied with each and every term of the contract pursuant to which he is seeking payment. To hold otherwise would effectively impose a fiduciary duty on the contractor that is not contemplated by the FCA.

With respect to the second question presented for Supreme Court review, petitioner argues that "if the implied-certification theory is not restricted to cases in which compliance is a pre-condition to payment, it will transform the FCA from a remedy targeting intentional fraud against the government into an all-purpose remedy for virtually every violation of a federal statute, regulation, or contractual requirement." Id. at 43.

Where the government has demonstrated that it can distinguish between conditions of payment and mere conditions of participation (since some statutory, regulatory, and contractual obligations expressly state that compliance is a requirement for payment), FCA liability—and the heavy financial and reputational penalties that go along with it—should not be imposed for violations of conditions of participation.

In 'Escobar,' the Supreme Court will weigh in on both the viability of the implied legal falsity theory of FCA liability itself, as well as whether the theory should be limited to instances where payment on the claim is expressly conditioned on compliance with the statute, regulation or contractual term at issue.

Respondents' brief on the merits is due to be filed on or before Feb. 25, 2016, but they are expected to rely on the First Circuit's finding that "[c]ompliance with the [staffing regulations allegedly violated by petitioner] is a condition of payment." *United States v. Universal Health Services*, 780 F.3d 504, 517 (1st Cir. 2015). In reaching that conclusion, the First Circuit avoided addressing the viability of the implied false certification theory directly, noting that "[t]h[e] circuit recently has eschewed distinctions between factually and legally false claims, and those between implied and express certification theories," in favor of "ask[ing] simply whether the defendant, in submitting a claim for reimbursement, knowingly misrepresented compliance with a material precondition of payment" which, the court noted, "need not be expressly designated" as such. Id. at 512.

Implications

The Second Circuit has em-braced the implied legal falsity theory, but only in the limited circumstances in which compliance is expressly stated as a requirement of payment. In *Mikes*, the Second Circuit announced: "We join the Fourth, Fifth, Ninth, and District of Columbia Circuits in ruling that a claim under the [FCA] is legally false only where a party certifies compliance with a statute or regulation as a condition to governmental payment." 274 F.3d at 697.

Effectively, the Second Circuit's existing jurisprudence supports respondents on the first question (general challenge to the implied legal falsity theory), and petitioner on the second (limitation of the theory to implied certifications of compliance with expressly stated conditions of payment).

Escobar therefore threatens to upset the rule in this circuit and indeed the scope of FCA litigation nationwide. On the one hand, should the Supreme Court agree that the implied legal falsity theory takes FCA liability too far and essentially imposes one-sided fiduciary obligations on any contractor that provides goods or services to the federal government, the scope of FCA liability in the Second Circuit will be curtailed. But *Escobar* also presents an opportunity for the court to increase the types of FCA cases viable in this circuit by rendering viable an implied false certification case even where the statute, regulation, or contractual provision at issue does not expressly require compliance for payment.

1. Co-author William Harrington filed an amicus brief in the matter. See *Escobar,* Brief for the General Pharmaceutical Association as Amicus Curie Supporting petitioner (filed Jan. 26, 2016).
2. Spirometry is an pulmonary function test used to detect lung diseases.