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EXPERT ANALYSIS

FCA Implied Certification and Materiality: Bad News, Good News

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In False Claims Act litigation — an enforcement area that has netted the federal government a whopping average $4 billion annually since 2010 — the theory of implied certification has been hotly contested for several years.

Now, the Supreme Court has shed some light on the issue while raising some additional questions — all of which will affect contractors, health care providers, and any institutions accepting federal dollars.

Traditionally, FCA liability has stemmed from claims that are factually false — for example, when a contractor or provider overbills or invoices for services that weren't delivered.

The implied certification theory extends liability to claims that are not inaccurate on their face but are false in a legal sense — when, for example, a contractor fails to satisfy an underlying contractual term or regulatory provision.

By submitting a claim for payment to the government, the theory says, the contractor is implying that it has complied with certain underlying legal, contractual, or regulatory requirements.

The contractor is liable under the FCA if the government would not have paid that claim had it known that the provider had not fulfilled the underlying obligations.

In recent years, the implied certification theory has created a significant split among circuit courts. By early 2016, two federal circuit courts of appeals had rejected the theory altogether. Eight others, however, had accepted it, though they adopted varying requirements in applying it.

Some circuits said that the underlying provision in question had to expressly be a condition for payment for an implied certification theory under the FCA to hold water.

Other circuits used a broader standard, saying that liability extended to cases where the contractor had simply failed to disclose any violations of underlying provisions that were material to the government's decision to pay.

Under that standard, a contractor, health care provider, or other recipient of federal funds could potentially run into trouble for violating any one of countless regulations or terms of an agreement.

The Supreme Court addressed the issue in *Universal Health Services, Inc. v. U.S. ex rel. Escobar* in June 2016, saying that the implied certification theory was indeed valid.

That the Court upheld the theory makes it likely that we'll see more litigation surrounding implied certification claims and expands the realm of liability and risk for government contractors.

However, this is one of those decisions that has something for everyone, and there is some potentially good news for defendants, as well.

Traditionally, FCA liability has stemmed from claims that are factually false — for example, when a contractor or provider overbills or invoices for services that weren't delivered.

The equation's penalty side

Under the False Claims Act, defendants face statutory penalties for submitting false claims — regardless of whether there has been any actual damage to the government. For more than a decade, those penalties have been set at $5,500 to $11,000 for each false claim submitted, based on the discretion of the court.

In June 2016, however, the Department of Justice published adjusted civil monetary penalties for the FCA; the new amounts ranged from $10,781 to $21,563 — nearly double what they had been.

Those penalties can add up quickly. Many contractors submit hundreds or thousands of invoices over the life of a program. For health care providers, that number may reach into the tens of thousands.

If each invoice is determined to be a false claim, you can see how quickly statutory penalties can multiply into hundreds of millions of dollars in exposure.

Now, in one fell swoop, those penalties have been doubled, and the ranges will continue to be adjusted upward annually.

While the new penalty amounts are not, for the most part, retroactive, they provide strong incentives for the government and whistleblowers alike.

Even in a case where there was little or no damage to the government, the potential for a huge recovery on penalties alone can make it worth bringing an action. And, that gives plaintiffs considerably more settlement leverage.

When the amount of penalties awarded grossly exceeds any actual damages, defendants may contest the penalties as violating the Eighth Amendment's Excessive Fines clause.

Such challenges, while rarely successful, will likely become more frequent as the higher penalty ranges are applied.

With the onset of penalties at nearly double the prior amounts, it is inevitable that we are going to see more cases in which the fines are vastly disproportionate to the actual damages. That means more Eighth Amendment challenges in this consequential area of the FCA, and perhaps with better results for defendants."

While allowing for implied certification claims, the Court also seemingly tightened the standard for determining whether a violation was material to the government's decision about whether to pay a claim.

Among other things, the Court said that the government had to do more than simply assert after the fact that a defendant's failure to comply was material to its decision to pay or that the government had the right to decline payment.

Instead, the burden is on the government to demonstrate that it would not have paid.

The Court also said that a requirement should be considered material if a reasonable person would attach importance to it in deciding whether to pay the claim, even if that requirement is not expressly characterized this way in the agreement or relevant regulations.

For example, if a contractor were supplying watches, it would know that they should keep time, regardless of whether a provision specifically says so.

On the other hand, the Court said that the government could not demonstrate materiality by simply inserting a blanket requirement conditioning payment on compliance with every provision in a contract.

The decision instead leaves it to the district court to conduct a rule-of-reason type analysis.

The FCA itself defines "material" as "having a natural tendency to influence, or be capable of influencing, the payment or receipt of money or property."

However, that was widely agreed to be a very weak standard, because it didn't really require any delving into the actual facts, even at the summary judgment stage.

It was basically asking, *could* this particular noncompliance have affected payment? It was not asking whether it was likely to affect payment or even did it actually do so.

With *Universal Health Services*, the Court said that the materiality standard under the FCA should be considered a rigorous standard. That opens the door to introducing actual evidence, maybe even beyond the contract at issue.

What's the history here? Does the government routinely pay claims in similar contexts, even when they know that this kind of noncompliance with underlying requirements is occurring? If so, that could undercut materiality for purposes of FCA liability.

Such questions promise to be something of a battleground in the near future.

We are going to see a lot of litigation around this as parties dispute the importance of regulatory and contractual provisions, leaving the courts struggling to apply the Supreme Court's opinion on materiality going forward.

That's starting to happen, and some recent circuit and district court decisions alike have already pointed in different directions.

It may take another trip to the Supreme Court to clarify its own ruling on materiality. In the meantime, there is plenty of room for disagreement on a case-by-case basis.

All of this will only add more litigation to the steadily growing number of FCA cases.

Recoveries have been growing — and so has executive risk, thanks in part to the Department of Justice's Yates Memo, issued late in 2015, which emphasizes individual accountability when looking at corporate fraud.

There's a directive under the memo that calls for corporate misconduct investigations, such as for FCA violations, to focus on both civil and criminal liability of any individuals that may have been involved.

More and more, we are seeing high-stakes, bet-the-company types of cases — but that also means more cases are going to trial, with companies fighting back, sometimes all the way to the Supreme Court.

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