Whistleblower Defense Alert: Supreme Court Hears Arguments on Implied Certification Theory of FCA Liability

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On Tuesday, the Supreme Court heard oral argument in *Universal Health Services, Inc. v. U.S. ex rel. Escobar*. The questions presented in *Escobar* ask the Court to resolve a circuit split regarding the viability and scope of the implied certification theory of liability under the False Claims Act (FCA). While it is difficult to predict an outcome based on oral argument, it appears that the implied certification theory of liability is here to stay in some form. And, although several Justices expressed support for reasonable limitations on this extremely broad theory of liability, it's not clear what those limitations will entail. The Court expressed little interest in the various tests and limitations employed by the lower courts. Therefore, it is possible, and perhaps even likely, that the Court will articulate a new analytical framework for deciding implied certification cases.

Such a move by the Court would not be unprecedented. In 2008, the Supreme Court in *Allison Engine Co. v. U.S. ex rel. Sanders* (Vorys was counsel for Allison Engine, Co.) considered whether "presentment" of a claim for payment to the government was a prerequisite for liability under the former 31 U.S.C. § 3729(a)(2). Before becoming Chief Justice, John Roberts, in his position as a D.C. Circuit judge, had held that presentment was required; the Sixth Circuit had disagreed. In a unanimous opinion, the Court rejected both absolutes. Instead, the Court articulated a new specific intent requirement—the government or the relator was required to prove "that the defendant intended that the false record or statement be material to the government's decision to pay or approve the false claim." The stated goal of the Court was to prevent the FCA from reaching "well beyond its intended role of combating 'fraud against the government.'"

The Court appears poised to take a similar approach in *Escobar*. The arguments on Tuesday revealed consensus among the Justices that a contractor makes implicit representations of compliance with at least some subset of contractual terms and regulations when it submits claims for payment to the government. The justices agreed implicit representations "that the guns shoot, that the boots can be worn, that the food can be eaten . . . and a doctor's care is a doctor's care" should

be actionable under the FCA if those implicit representations are knowingly false. The difficulty, as Justice Breyer noted is: "how do you distinguish those regulations, [the] breach of which are fraudulent ..., from those that it is not? There are millions of regulations." The questions from the Court largely focused on how to draw this distinction.

Justices Breyer and Kennedy questioned whether the common law requirement of materiality could sufficiently limit the scope of liability under the implied certification theory. Justice Kennedy seemed receptive, noting that "we just can't think about fraud unless we have materiality in some sense. And it could be a very strict standard of materiality." Defense counsel, however, correctly resisted the materiality framework, noting that the FCA has its own definition of "materiality" that is significantly less stringent than the common law definition materiality. Instead, Defense counsel explained that the issues the Court was concerned about—guns that don't shoot and boots that cannot be worn—are encompassed by what the common law refers to as "essentiality" and urged the Court adopt the test set forth in the "Restatement (Second) of Torts, Section 551(2)(b) and (e) and Comments j and k, and Illustrations 3 through 8." Under an "essentiality test," only those contractual terms that go "to the basis, or essence, of the transaction" could support an implied certification claim.[1]

Chief Justice Roberts came the closest to referencing the condition of payment test used by many lower courts to determine which contractual and regulatory violations can support an implied certification claim. He suggested that if the government were required to expressly condition payment on compliance with specific regulations, contractors could evaluate their risk of liability and increase their bids accordingly. Counsel for the relator noted that this solution would not work in the healthcare context, where the government sets the rate and the provider is unable to negotiate a higher price.

Predictably, the relator and the government argued in favor of using materiality to determine whether implied certifications are false or fraudulent under the FCA. Chief Justice Roberts, however, was skeptical of this position and questioned whether a materiality framework would render "every material breach of a contract . . . as false and fraudulent" under the FCA. Counsel for the relator tried to find a limiting principle in the FCA's scienter element, noting that liability under the FCA would not be imposed unless the contractor knew of the particular requirement or regulation, and also knew that the particular requirement or regulation is material to the government's decision to pay. But, this approach would be inconsistent with the government's interpretation of scienter—in litigation, the government always argues that ignorance of a particular requirement is not a defense.

The government tried hard to focus the Court's attention on materiality. The deputy solicitor general argued that "a person who knew himself to be in breach of a nonmaterial term and requested payment anyway wouldn't be making a false claim" and that FCA liability would only arise "if the term that was being breached was material." Chief Justice Roberts expressed doubt about the government's materiality approach. He asked whether the government would be justified in withholding payment if a healthcare provider fully performed its contract for healthcare services but violated a provision requiring the provider to purchase staplers made in America. The deputy solicitor general responded that the government could withhold payment for the staplers, and the claim for payment would be actionable under the FCA. This response seemed to trouble the Justices. The chief justice stated that he doesn't "understand the difference between material and immaterial." Justice Kagan asked for examples of terms that the government would consider immaterial; the government conceded that there were none—in the government's view, there are no wholly immaterial contractual terms or regulations. Justice Breyer also

expressed concern that the government was treating minor contractual breaches as fraud.

The chief justice's stapler hypothetical is reminiscent of *Allison Engine*. At oral arguments in that case, the chief justice illustrated the need for sufficient limitations on FCA liability by asking whether a relator should be able to bring an FCA suit in a situation where the government has provided funding to a state to build a school, and the school's prime contractor hires a painter, who buys paint from a company that purchases chemicals for the paint from a chemical company, and the chemical company fraudulently adds $1 to the cost of the chemicals, resulting in a $1 overcharge to the government. Here, like *Allison Engine*, the chief justice's hypothetical about staplers may have persuaded his fellow Justices that the Court should develop an appropriate test for limiting FCA liability for implied certifications. History suggests that the Court may reach a broad consensus on the appropriate standard for liability. In the last two major FCA cases in which the government and the relator attempted to broaden significantly the scope of FCA liability—*Allison Engine* and *Kellogg Brown & Root Servs., Inc. v. United States ex rel. Carter*—the Court delivered a unanimous decision. It remains to be seen, however, exactly how the Court will limit liability for implied certifications.

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[1] Comment j, in particular, discusses the requirement of "essentiality." fense counseleart of the bargain with thng with, however, was how to impose a limiting principlequired; the Sixth Circuit had dIt notes that "a basic fact is a fact that is assumed by the parties as a basis for the transaction itself. It is a fact that goes to the basis, or essence, of the transaction, and is an important part of the substance of what is bargained for or dealt with. Other facts may serve as important and persuasive inducements to enter into the transaction, but not go to its essence. These facts may be material, but they are not basic." Restatement (Second) of Torts, Section 551, Comment j.