# For Liability for Implied Fraud Under the False Claims Act, Materiality Is the Key

Legal Alert
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The June 16, 2016, US Supreme Court decision in *Universal Health Services v. Escobar* provides fresh guidance on what constitutes "implied certification" liability under the False Claims Act (FCA). The Court addressed the tricky issue of a contractor's "implied fraud" when the contractor seeks payment for goods or services provided under a federal contract when the contractor fails to comply with laws, regulations, or contract rules. It addresses the question: if a contractor submits a claim for payment knowing that the contractor is out of compliance with a particular statutory, regulatory, or contractual requirement, is the contractor defrauding the Government or is the contractor simply guilty of a contract violation? The answer is important, because the FCA imposes severe penalties and triple damages for fraudulent conduct, and an FCA violation can lead to debarment. Thus, it is critical to know whether a contractor's failure to disclose its own noncompliance in connection with a payment request is a fraudulent misrepresentation, sufficient to make the contractor liable under the FCA. The Court said yes – but only when the noncompliance is material. This seems like a commonsense approach, but one that will cause much debate about what is "material." In *Universal Health Services*, a contractor (Universal) provided clinical services covered by Medicaid and Medicare. It submitted invoices (claims) for such services, which the programs paid. However, many of the clinicians who provided the services did not have required qualifications. In the lawsuit that followed, the issue was whether Universal's invoices contained implied certifications that the contractor had complied with all applicable regulations (including the requirement that the clinicians had the required qualifications) while performing the services. By submitting invoices for services performed by unqualified people, did the contractor commit implied fraud on the Government? The Supreme Court ruled that an implied certification theory can lead

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to liability under the FCA, if 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." In such case, liability may attach if the omission renders those representations misleading." However, a misrepresentation about compliance with such a requirement "must be material to the Government's payment decision" in order to be actionable under the FCA." The Court ruled that implied certification can be a basis for liability when two conditions are met: (1) the claim does not merely request a payment, but also makes specific representations about the goods or services provided; and (2) the contractor's failure to disclose noncompliance with material statutory, regulatory, or contractual requirements makes representations misleading half-truths.

What is material? The Court says the standard is demanding and must be applied rigorously. Its opinion provides some guidance:

Materiality cannot be found where noncompliance is minor or insubstantial.

The FCA is not a vehicle for punishing garden-variety breaches of contract or regulatory violations. It is not an all-purpose antifraud statute.

Not every violation is material: a statutory, regulatory, or contractual violation is not material simply because a contractor knows the Government would be entitled to refuse payment were it aware of the violation.

An express condition of payment incorporated in the contract may be, but is not always, material. The Government's decision to identify a provision as a condition of payment is relevant, but not automatically dispositive.

A contract provision that is not an express condition may still be material.

If the Government consistently refuses to pay claims based on noncompliance with a particular statutory, regulatory, or contractual requirement, then that is evidence that the requirement is material.

If the Government regularly pays claims despite knowledge of noncompliance with particular statutory, regulatory, or contractual requirements, then that is evidence the requirements are not material.

In short, the Court's ruling seems to be a welcome restriction on the Government's apparent desire for what the Court calls an "extraordinarily expansive view" of FCA liability. However, the analysis of materiality seems very fact-intensive and will likely take many cases to generate real-world examples of material violations.

**Please call John Knab, Ben Lambiotte, or other GSB government contracting attorneys if you have any questions or need any guidance or assistance on providing goods and services to the Government.**