Last Thursday, in *Universal Health Services, Inc. v. United States ex rel. Escobar*, the U.S. Supreme Court accepted the “implied false certification” theory as a basis for liability under the False Claims Act (the “FCA”). The Court held, however, that the theory only applies where a defendant’s misrepresentation is material to the federal government’s payment decision. This decision resolves a split among the U.S. circuit courts of appeals and did not go as far as many federal contractors had feared. At nearly the same time, however, the U.S. Department of Justice (“DOJ”) signaled an increased commitment to holding individuals accountable in civil FCA cases. Relying on Deputy Attorney General Sally Yates’ policy announcement from last September (known as the “Yates Memo”), a top DOJ official explained that seeking to impose FCA liability on individual (as opposed to corporate) defendants now represented a key component of the DOJ’s FCA enforcement program. Accordingly, executives at companies that receive federal money should understand that, perhaps now more than ever, they may face individual FCA exposure. Both the U.S. Supreme Court decision and the DOJ’s increased focus on individuals represent important developments for such companies and reconfirm that the FCA remains a focus of the DOJ, potential whistleblowers, and the courts. Thus, it is critical for companies and their employees to ensure compliance with the FCA.

1  Supreme Court endorses the “implied false certification” theory, but only where the misrepresentation is material to the government’s payment decision

The FCA imposes liability on persons and companies (usually federal contractors) who defraud governmental programs. The law contains a *qui tam* provision that allows private individuals to file actions on behalf of the government. The DOJ has the option of intervening in such cases. Persons filing under the FCA stand to receive a portion (typically 15–25 percent) of any

recovery. In 2015, whistleblowers filed 638 lawsuits and the DOJ recovered over US$3.5bn, of which whistleblowers were awarded US$597m.

Under the implied false certification theory, when a defendant submits a claim for payment to the federal government, the defendant impliedly certifies compliance with all conditions of payment. According to the theory, a failure to disclose a violation of a material statutory, regulatory, or contractual requirement constitutes a misrepresentation to the government that renders the claim “false or fraudulent” under the FCA. The circuit courts of appeals were split over the implied false certification theory. The Seventh Circuit rejected it altogether after concluding that only express or affirmative falsehoods can render a claim “false or fraudulent” under the FCA. The Second Circuit had accepted the theory, but only in situations where the defendant failed to disclose a violation of an expressly designated condition of payment. Other circuits had held that conditions of payment need not be expressly designated to be a basis for FCA liability.

1.1 Escobar factual background
Yarushka Rivera, a teenage beneficiary of Massachusetts’ Medicaid program, received mental health counseling from a subsidiary of Universal Health Services that received federal funding. In 2009, Rivera suffered a seizure and died due to an adverse reaction to her prescribed medication. Few of the employees who treated her were actually licensed to provide counseling and supervision of the employees was minimal.

Rivera’s parents filed a qui tam suit in federal court alleging that Universal Health violated the FCA under the implied false certification theory of liability. They alleged that Universal Health submitted reimbursement claims that made representations about the specific services provided by specific types of professionals without disclosing serious violations of regulations relating to staff qualifications and licensing requirements for those services, and contended that Medicaid would not have paid the claims had it been aware it was being billed for mental health services performed by unlicensed and unsupervised staff.

The district court granted Universal Health’s motion to dismiss because it found none of the regulations that its subsidiary allegedly violated were conditions of payment. On appeal, the First Circuit Court of Appeals reversed, holding that statutory, regulatory, or contractual requirements can be conditions of payment either by express identification or by implication.

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2 United States v. Sanford Brown, Ltd., 788 F.3d 696, 711-12 (7th Cir. 2015).
3 See, e.g., Mikes v. Straus, 274 F.3d 687, 700 (2d Cir. 2011).
5 For example, the medical professional who diagnosed Rivera with bipolar disorder identified herself as a psychologist with a Ph.D., but she failed to disclose that her degree came from an unaccredited internet college, and that Massachusetts rejected her psychologist licensing application. Likewise, the “psychiatrist” who prescribed medicine to Rivera, was in fact a nurse without authority to prescribe medication absent supervision.
6 The DOJ declined to intervene in Escobar.

U.S. False Claims Act Update: U.S. Supreme Court Affirms Implied Certification Theory of Liability but with Limits, and U.S. Department of Justice Signals Increased Focus on Individual FCA Liability
1.2 Liability under the implied certification theory

On appeal, the Supreme Court held that the implied false certification theory can, “at least in some circumstances,” provide a basis for liability. “When, as in Escobar, a defendant makes representations in submitting a claim but omits its violations of statutory, regulatory, or contractual requirements, those omissions can be a basis for liability if they render the defendant’s representations misleading with respect to the goods or services provided.” In this case, “anyone . . . would [have] probably—but wrongly—conclude[d] that the clinic had complied with core Massachusetts Medicaid requirements.”

Finding nothing in the text of the FCA to limit “false” or “fraudulent” claims to those claims containing express falsehoods, the Court (and parties) all agreed that misrepresentations by omission can give rise to liability. The Court held that the implied certification theory can be a basis for liability, “at least where two conditions are satisfied: first, the claim does not merely request payment, but also makes specific representations about the goods or services provided; and second, the defendant’s failure to disclose noncompliance with material statutory regulatory, or contractual requirements makes those representations misleading half-truths.”

1.3 The misrepresentation, however, must be “material” — a demanding standard

Having determined that Universal Health made misrepresentations, the Court turned to materiality. Under the FCA, a misrepresentation is actionable only when it is material to the government’s payment decision. The Court emphasized that the materiality standard is demanding, and the FCA is “not a means of imposing treble damages and other penalties for insignificant regulatory or contractual violations.”

Universal Health urged the Court to limit liability to instances where the claimant fails to disclose violations of contractual, statutory, or regulatory provisions that the government expressly designates as a condition of payment. But the Court rejected that approach, concluding that “[w]hether a provision is labeled as a condition of payment is relevant to but not dispositive of the materiality inquiry.” Otherwise, the government could require contractors “to aver their compliance with the entire U.S. Code and Code of Federal Regulations, [and then] failing to mention noncompliance with any of those requirements would always be material.” The FCA “does not adopt such an extraordinarily expansive view of liability.”

Materiality instead “look[s] to the effect on the likely or actual behavior of the recipient of the alleged misrepresentation.” Evidence of materiality can include the fact that the government consistently refuses to pay claims involving

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7 The claims submitted by Universal Health “fall squarely within the rule that half-truths—representations that state the truth only so far as it goes, while omitting critical qualifying information—can be actionable misrepresentations.”
noncompliance with a particular statutory, regulatory, or contractual requirement. By comparison, the fact that the government consistently pays particular claims despite knowing that certain requirements were violated can be evidence of immateriality.

The Supreme Court remanded the case to the First Circuit for consideration of whether the plaintiffs pled a FCA violation, noting that this case “centers on allegations of fraud, not medical malpractice.” Accordingly, the question to be answered is whether Universal Health’s misrepresentations relating to mental health facility requirements were so central to the provision of mental health counseling that the Medicaid program “would not have paid these claims had it known of these violations.” The plaintiffs “may well have adequately pleaded a violation,” but the Court left it to the lower courts to resolve the matter in the first instance.

2 DOJ extends its renewed focus on individual accountability to civil FCA cases

Shortly before the Supreme Court announced its decision in Escobar, the DOJ Acting Associate Attorney General, Bill Baer, warned that the DOJ will continue its “commitment to holding individuals accountable for corporate misdeeds” pursuant to the Yates Memo by examining individual liability in the context of civil FCA matters.

In a speech (available here) delivered June 9, 2016, Mr. Baer stressed that the DOJ’s objectives are two-fold: first, “to recoup government money lost to fraudulent schemes,” and second, to “hold accountable those individuals responsible for the misconduct.” He also discussed the implications for companies wishing to cooperate, particularly where a company’s executives may face civil liability.

2.1 Application of the Yates Memo to civil claims under the FCA

Mr. Baer made clear that the Yates Memo “applies with equal force and logic to the department’s civil enforcement” because of the grave and widespread consequences that civil wrongdoing can have on the public. Citing the “waste of taxpayer funds, to the loss of jobs, homes and financial security, to consumer overcharges, to fundamental market dislocations and economic crises,” Mr. Baer urged that individuals who caused and profited from the misconduct be held accountable the same as anyone who violates the law.

“[I]t is department policy to pursue civilly those individuals who are responsible and hold them accountable, in addition to pursuing our civil case against the organization.” As evidence of the extension of the Yates Memo to FCA violations, recent civil DOJ settlements increasingly have included individuals:

> US$1.75m settlement with the owner of Florida-based Recovery Home Care, Mark Conklin, to resolve a lawsuit asserting he violated the FCA by
causing the company to pay kickbacks to doctors who referred Medicare patients for treatment.\(^8\)

> US$10.3m settlement with Maryland-based Dynasplint Systems Inc., a splint supplier company, and its founder and president, George Hepburn, for billing patients in violation of Medicare rules.\(^9\) and

> US$20m settlement with government contractor UFC Aerospace LLC and its former president, Douglas Davis, for falsely certifying the contractor’s status as a female-owned small business in violation of the Small Business Act.\(^10\)

### 2.2 Corporate cooperation and individual liability in resolving FCA cases

#### 2.2.1 A corporate settlement no longer resolves individual liability

Under this new regime, Mr. Baer emphasized that “reaching a resolution with the company does not end our inquiry into whether and which individuals should also be pursued. And you should not assume we will be amenable to releasing individuals from False Claims Act liability when we settle with the organization.”

This may come as a surprise to many companies, and it remains to be seen how strictly this guidance will be applied in practice. Even Mr. Baer acknowledged “this is a departure from past practice, where a settlement would release not only the corporation, but also its individual directors, officers and agents. But it is a change [DOJ] view[s] as necessary to pursue company officials involved in the wrongdoing.”

This could put companies wishing to resolve a case quickly and assure shareholders of the company’s wellbeing in a rather difficult position, as the company assesses how to treat executives who may be under investigation. To be eligible for cooperation credit, companies must “disclose all facts relating to the individuals involved in the wrongdoing, no matter where those individuals fall in the corporate hierarchy.” Otherwise, DOJ “will not credit cooperation.”

The DOJ acknowledges that its approach is to scare company executives into FCA compliance. As Mr. Baer observed from his own experience, “the threat of being named personally, the prospect that a corporate executive will have to pay a sizable civil judgment or even simply be subject to a civil injunction, focuses the

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mind. It sensitizes individuals to the cost of engaging in, or turning a blind eye to, corporate misconduct . . . [and] provides a powerful deterrent against future misconduct."

2.2.2 Guidelines for receiving cooperation credit

Even putting aside individual liability for the moment, the DOJ sets a high bar for companies seeking cooperation credit. According to Mr. Baer, "[c]ooperation is not demonstrated by doing what the law requires, compliance with subpoenas or other lawful demands. Nor is cooperation shown by one-sided presentations and white papers . . . [R]ather, genuine cooperation involves prompt, no slow-walking, and fulsome, no hiding the ball, responses to government requests for information."

At bottom, cooperation requires full disclosure of the facts, including identifying individuals involved and making them available for interviews or depositions. To receive maximum cooperation credit, companies should promptly and voluntarily disclose available information once a violation is discovered and before the government is aware. The DOJ also expects a company’s cooperation to “help us get to the bottom line” in an investigation.

Mr. Baer observed that cooperation credit does not require the company to: conduct internal investigations into conduct unrelated to the FCA issues; waive attorney-client privilege in disclosing relevant factual information; or draw conclusions about the culpability of individuals. In assessing cooperation, Mr. Baer announced that, “we will place great emphasis on the timing, nature and extent of the cooperation, including the quality and completeness of the disclosures we receive and the degree to which it advances the search for truth . . . [w]here a company satisfies the threshold requirement of disclosure as to individuals and otherwise cooperates with the government’s investigation, the department will use its significant enforcement discretion in FCA matters to recognize that cooperation.” While there is no concrete means of calculating the cooperation credit to be awarded, it at least involves disclosing information on “who was involved [in] or sanctioned” the underlying misconduct.

3 Companies doing business with the government should proceed with caution

The Supreme Court’s affirmation of the implied certification theory — even with the demanding materiality standard — and the DOJ’s push to punish individual wrongdoing, will likely make for a more dangerous playing field, especially in those Circuits that previously rejected the implied certification theory or limited its application to cases where defendants failed to disclose a violation of expressly designated conditions of payment. With respect to individuals, corporate executives working for entities doing business with the government should be aware that they may no longer benefit from organizational settlement agreements and that the DOJ may seek to hold them individually accountable as well.
Accordingly, entities doing business with the government should ensure the accuracy of their affirmative representations to the government in connection with claims for payment, and ensure their compliance with other important contractual, statutory, or regulatory requirements related to payment.
U.S False Claims Act Update: U.S. Supreme Court Affirms Implied Certification Theory of Liability But With Limits, and U.S. Department of Justice Signals Increased Focus On Individual FCA Liability

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