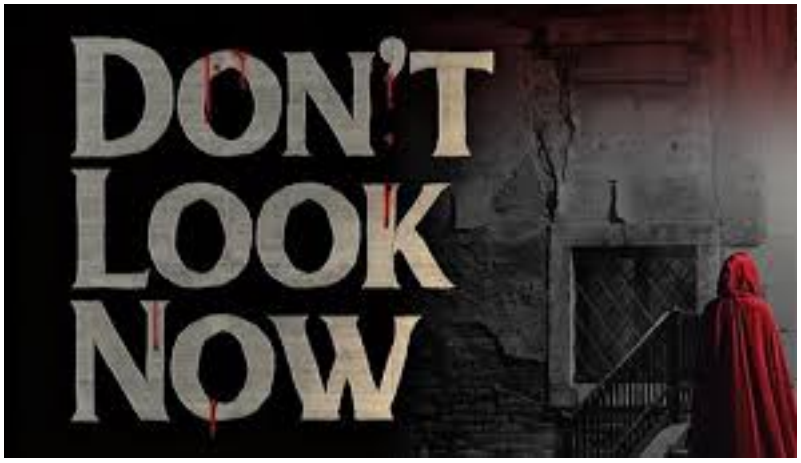


The False Claims Act (which includes both civil and criminal statutes) is one of the biggest sticks wielded by the Federal government against allegations of contractor fraud. Alleged violations can easily lead to multi-million dollar settlements, not to mention large (unallowable) legal bills and huge investments of contractor time and resources. Not really a good thing at all.

Reportedly, 70 percent of all suits under the False Claims Act are filed by whistleblowers, called *qui tam relators*, who are eligible to receive bounties of large percentages of whatever the government collects as a result of the litigation. Your disgruntled employees may become whistleblowers, unless you listen to their concerns and do something about them. Indeed, your company may already be facing a FCA suit and you know nothing about it, because the suits are filed under seal.

Add to this situation the fact that most companies—especially small businesses—really don’t understand how to do a risk analysis that compares the potential FCA liability against the potential profit when they decide to cut corners in the Federal procurement marketplace. We’ve pointed out before just how ill-equipped most business leaders are to decide how much to budget for internal controls and internal audits and contract compliance, simply because they lack information regarding the consequences. Unlike other aspects of the business, they can’t quantify a Return on Investment (ROI) because they lack knowledge and experience in this area.

Examples from this website:

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SAIC **settled** its fraud-related claims for $500 million

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United Technologies Corporation **settled** its export control violation charges for $76 million

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CH2M Hill **settled** its timecard-related fraud charges for $18.5 million

And that's just three of the many examples we have written about. It's a decent rule-of-thumb that any company accused of violations of the FCA is going to be out-of-pocket at least $1 million—no matter what. And if the allegations have merit, that number is going to go up and up and up. Granted, the probability of a FCA suit being filed against your company may be low but the consequences are almost certainly going to be higher than you'd care to think about. Therefore it's imperative to understand the risks when considering how much to invest in fraud prevention. The risks almost always outweigh the cost of anti-fraud activity, which makes such anti-fraud activity a good investment.

That's always been the math, whether your corporate leadership wanted to run the numbers or not.

And all the math just changed, courtesy of the Supreme Court of the United States.

(This is the part where we remind readers that we are not attorneys and any legal analysis we offer is just that of a layperson. If you want legal advice, please go hire a competent government contracts attorney.)

SCOTUS just issued a decision that changes the risk analysis equation. The recent **decision**, captioned *UNIVERSAL HEALTH SERVICES, INC. v. UNITED STATES EX REL. ESCOBAR*, ensures that the probability that you might find yourself the defendant in FCA litigation just increased significantly.

Let's start with the summary of the case—

Yarushka Rivera, a teenage beneficiary of Massachusetts' Medicaid program, received counseling services for several years at Arbour Counseling Services, a satellite mental health facility owned and operated by a subsidiary of petitioner Universal Health Services, Inc. She had an adverse reaction to a medication that a purported doctor at Arbour prescribed after diagnosing her with bipolar disorder. Her condition worsened, and she eventually died of a seizure. Respondents, her mother and stepfather, later discovered that few Arbour employees were actually licensed to provide mental health counseling or authorized to prescribe medications or offer counseling services without supervision. Respondents filed a *qui tam* suit, alleging that Universal Health had violated the False Claims Act (FCA). … Respondents sought to hold Universal Health liable under what is commonly referred to as an 'implied false certification theory of liability,' which treats a payment request as a claimant's implied certification of compliance with relevant statutes, regulations, or contract requirements that are material conditions of payment and treats a failure to disclose a violation as a misrepresentation that renders the claim 'false or fraudulent.' Specifically, respondents alleged, Universal Health (acting through Arbour) defrauded the Medicaid program by submitting reimbursement claims that made representations about the specific services provided by specific types of professionals, but that failed to disclose serious violations of Massachusetts Medicaid regulations pertaining to staff qualifications and licensing requirements for these services. Universal Health thus allegedly defrauded the program because Universal Health knowingly misrepresented its compliance with mental health facility requirements that are so central to the provision of mental health counseling that the Medicaid program would have refused to pay these claims had it known of these violations.

SCOTUS, in a unanimous ruling, held that—

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The implied false certification theory can be a basis for FCA liability when a defendant submitting a claim makes specific representations about the goods or services provided, but fails to disclose non-compliance with material statutory, regulatory, or contractual requirements that make those representations misleading with respect to those goods or

services.

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By submitting claims for payment using payment codes corresponding to specific counseling services, Universal Health represented that it had provided specific types of treatment. And Arbour staff allegedly made further representations by using National Provider Identification numbers corresponding to specific job titles. By conveying this information without disclosing Arbour’s many violations of basic staff and licensing requirements for mental health facilities, Universal Health’s claims constituted misrepresentations.

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A defendant can have ‘actual knowledge’ that a condition is material even if the Government does not expressly call it a condition of payment. What matters is not the label that the Government attaches to a requirement, but whether the defendant knowingly violated a requirement that the defendant knows is material to the Government’s payment decision.

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A misrepresentation about compliance with a statutory, regulatory, or contractual requirement must be material to the Government’s payment decision in order to be actionable under the FCA. The FCA’s materiality requirement is demanding. An undisclosed fact is material if, for instance, ‘[n]o one can say with reason that the plaintiff would have signed this contract if informed of the likelihood’ of the undisclosed fact. … When evaluating the FCA’s materiality requirement, the Government’s decision to expressly identify a provision as a condition of payment is relevant, but not automatically dispositive. A misrepresentation cannot be deemed material merely because the Government designates compliance with a particular requirement as a condition of payment. Nor is the Government’s option to decline to pay if it knew of the defendant’s noncompliance sufficient for a finding of materiality. Materiality also cannot be found where noncompliance is minor or insubstantial. Moreover, if the Government pays a particular claim in full despite its actual knowledge that certain requirements were violated, that is very strong evidence that those requirements are not material. The FCA thus does not support the Government’s and First Circuit’s expansive view that any statutory, regulatory, or contractual violation is material so long as the defendant knows that the Government would be entitled to refuse payment were it aware of the violation.

What does all that mean (to a layperson)?

Well, to some extent the decision is so new that it’s hard to tell how it will impact future litigation. No doubt learned practitioners and law school students are feverishly typing up reviews of the opinion, even as we are feverishly typing up this article. But while the reviews are likely to be mixed, it seems clear that, by accepting some form of the implied certification theory, SCOTUS has expanded the universe of false claims subject to litigation.

SCOTUS held that the implied certification theory can be an accepted basis for a *qui tam* suit when a contractor fails to disclose “non-compliance with material statutory, regulatory, or contractual requirements that make those representations misleading with respect to those goods or services” that constitute the subject of the invoice for which payment is being sought. The opinion spends time discussing how to tell whether a requirement is or is not material, and concludes that a requirement is material if the Government would not have entered into the contract, had it known the contractor would not comply with that particular requirement. Further, SCOTUS held that it was the contractor’s knowledge of the materiality of the non-compliance that mattered, and not the Government’s knowledge.

Accordingly, contractors that fail to comply with *any* statutory, regulatory, or contractual requirement now risk being subject to FCA liability, if it can be alleged that no reasonable party would have entered into the contract had it known that particular requirement would not be complied with. That’s a big deal, in our view.

On the other side of the coin, SCOTUS seemed to have also held that there must be some representation included in or associated with the invoice to create FCA liability. “Materiality also cannot be found where noncompliance is minor or insubstantial.” And that’s good news for contractors, because not every single Section I contract clause is going to be found to be material with respect to invoice submission.

In our view, the issuance of this SCOTUS opinion is a good time to review your government contracts and their terms and conditions, including contract clauses, to see (a) which ones might support a finding that they are material to invoice payment, and (b) which ones you

might not be fully complying with. Where you find an intersection between (a) and (b), we think you have a problem that needs to be fixed soon.