Taking Shape: Influential D.C. Circuit Court Continues the Expansion of Escobar's "Materiality" Standard

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In June 2016, the Supreme Court's decision in *Universal Health Services, Inc. v. United States* ex rel. *Escobar* confirmed the viability of the "implied false certification" theory of liability under the False Claims Act (FCA).[1] Thus, when a healthcare provider makes representations in submitting a claim to the government for reimbursement, but fails to mention its violations of statutory, regulatory, or contractual requirements, such omissions can serve as the basis for FCA liability if they render the provider's representations misleading with respect to the goods or services provided. However, in issuing this ruling, the Supreme Court made clear that lower courts should continue to police expansive implied certification theories by strictly enforcing the FCA's "materiality" standard. As such, in the months since the *Escobar* ruling, lower courts have indeed expounded upon the "materiality" standard set forth by the Supreme Court.

Most recently, on February 17, 2017, the D.C. Circuit Court of Appeals – often considered the most influential of the circuit courts – reemphasized key aspects of the *Escobar* court's holding and provided additional guidance as to the applicability of the FCA's "materiality" standard.

Background: *Escobar* Makes "Materiality" Material Again

Prior to the Escobar decision, although a majority of circuit courts had accepted the viability of the implied certification theory, the courts had long been split as to the proper scope of the theory. Specifically, many courts followed the Second Circuit's decision in *Mikes v. Strauss*,[2] which held that implied certification of compliance with a particular statute, regulation, or contractual provision creates a "false or fraudulent" claim for purposes of the FCA only if the government *expressly* conditions payment on such compliance.[3] Others, however, followed the First Circuit's decision in *United States* ex rel. *Hutcheson v. Blackstone*[4] for the proposition that such conditions of payment did not need to be expressly enumerated in the text of a relevant statute, regulation, or contract in order to find that a provider of services to the government had implicitly certified compliance with such statute, regulation, or contractual provision.[5]

The Supreme Court held in *Escobar* that FCA liability for failing to disclose violations of legal requirements does not turn upon whether those requirements were expressly designated as conditions of payment.[6] Instead, such determinations turn upon whether compliance with the relevant statute, regulation, or contractual provision was *material* to the government's decision

1 Universal Health Servs., Inc., v. United States ex rel. Escobar, 136 S.Ct. 1989 (2016).
2 274 F.3d 687 (2d. Cir. 2001)
3 *See id.* at 702; *see also, United States ex rel. Wilkins v. United Health Group, Inc.*, 659 F.3d 295 (3d. Cir. 2011); *Chesbrough v. VPA, P.C.*, 655 F.3d 461, 468 (6th Cir. 2011); *United States ex rel. Conner v. Salina Regional Health Ctr., Inc.*, 543 F.3d 1211, 1221 (10th Cir. 2008) ("Based on the fact that the government has established a detailed administrative mechanism for managing Medicare participation, we are compelled to conclude that although the government considers substantial compliance a condition of ongoing Medicare *participation*, it does not require perfect compliance as an absolute condition to receiving Medicare *payments* for services rendered").
4 647 F.3d 377 (1st Cir. 2011) (expressly acknowledging disagreement with the Second Circuit's holding in *Mikes*).
5 *See id.* at 386-88; *see also United States v. Triple Canopy, Inc.*, 775 F.3d 628, 636 (4th Cir. 2015); *United States v. Science Applications Int'l Corp. (SAIC)*, 626 F.3d 1257 (D.C. Cir. 2010) (noting disagreement with the Second Circuit in *Mikes* and holding that "to establish the existence of a 'false or fraudulent' claim on the basis of implied certification of a contractual condition, the FCA plaintiff – here the government – must show that the contractor withheld information about its noncompliance with material contractual requirements").
6 *Escobar*, 136 S.Ct. at 2001.

to pay.[7] Under the FCA's "materiality" requirement, "statutory, regulatory, and contractual requirements are not automatically material, even if they are labeled conditions of payment."[8]

Importantly, the Court held that materiality "looks to the effect on the likely or actual behavior of the recipient of the alleged misrepresentation."[9] Indeed, it is insufficient for a finding of materiality "that the Government would have the option to decline to pay if it knew of the defendant's noncompliance."[10] Thus, it would not be enough for the government merely to show that, for example, Medicare *could* have denied reimbursements to a healthcare provider if it had known that the provider was not in substantial compliance with a relevant statute, regulation, or contractual provision. Instead, the government must be able to demonstrate that such noncompliance *would have* affected the government's decision to pay.

United States ex rel. McBride v. Halliburton Co.[11]

In the months since the *Escobar* decision, a number of courts deciding FCA cases have cited *Escobar* for the proposition that a defendant's noncompliance with a statute, regulation, or contractual provision was (or was not) material to the government's decision to pay and that the defendant had therefore submitted (or not) an implicitly false claim.

Most recently, on February 17, 2017, the D.C. Circuit Court of Appeals reemphasized two important aspects of the "materiality" standard: (a) "courts should look beyond the express designation of a requirement as a condition of payment to find it material;" and (b) "courts need not opine in the abstract when the record offers insight into the Government's actual payment decisions."[12]

In *McBride*, a former employee of Kellogg Brown & Root Services, Inc. ("KBR," a former subsidiary of Halliburton) asserted FCA violations against KBR for overbilling the government by inflating usage data for recreational services provided to U.S. troops in Iraq.[13] Additionally, the complaint alleged that KBR destroyed sign-in sheets to conceal its falsifying of the usage data.[14] Importantly, before the complaint was filed, the Defense Contract Audit Agency ("DCAA") investigated the plaintiff's allegations, issuing written questions to KBR, interviewing KBR employees, and visiting the base in Fallujah to review records of services provided by KBR.[15] However, DCAA issued no formal findings, and neither DCAA nor any other agency ever disallowed or challenged any amounts billed by KBR for providing these recreational services.[16]

The Court noted that the plaintiff's primary assertion was that "KBR deprived the Government of the opportunity to examine records in order to determine the reasonableness, or allowability of the costs."[17] However, said the Court, such an allegation rested on the assumption that accurate usage data was "relevant to determining the reasonableness of the costs."[18] Yet, as Army employees later testified, such usage data (false or not) "had no bearing on costs billed to the Government, and . . . there was no indication the data affected award fee decisions."[19] Thus, because neither false usage data (which was kept voluntarily by KBR) nor the destruction thereof would have been relevant (much less material) to the government's decision to pay KBR, the Court dismissed the plaintiff's claims.[20]

Importantly, the Court then turned to a statement in an affidavit from a DCAA officer that he "might" have investigated the plaintiff's claims further had he known that KBR had inflated the usage data relating to its recreational services, and that

7 *Id.*
8 *Id.*
9 *Id.* at 2002.
10 *Id.* at 2003.
11 No. 15-7144, 2017 WL 655439 (Feb. 17, 2017).
12 *Id.* at *4.
13 *Id.*
14 *Id.* at *2.
15 *Id.*
16 *Id.*
17 *Id.* at *5.
18 *Id.*
19 *Id.* at *6.
20 *Id.*

"such an investigation 'might' have resulted in some charged costs being disallowed."[21] Expounding on the principles set forth in *Escobar*, the D.C. Circuit quickly laid to rest the plaintiff's assertion that the DCAA officer's statement was "dispositive" to an FCA violation. "At most," said the Court, "the statement amounts to the far-too-attenuated supposition that the Government *might* have had the 'option to decline to pay.'"[22] Moreover, the Court noted that with the "benefit of hindsight," it could not ignore what *actually* occurred – that is, that the DCAA had investigated the plaintiff's allegations and had not disallowed any charges, and continued to pay KBR thereafter.[23]

Conclusion

Given the influence of the D.C. Circuit Court of Appeals, the Court's recent decision in *McBride* will likely serve as highly persuasive authority as lower courts continue to give effect to *Escobar's* "materiality" standard in FCA cases. Pertinently, given the thousands of pages of healthcare regulations potentially applicable to Medicare and Medicaid providers, *McBride's* reaffirmation of the *Escobar* standard could play a significant role. By adding weight to the notion that the government must be able to demonstrate that a defendant's noncompliance *would have* affected the government's decision to pay, the holding in *McBride* may assist in shielding healthcare providers from FCA liability for innocuous regulatory mistakes.

21 *Id.*
22 *Id.* (citing *Escobar*, 136 S.Ct. at 2003) (emphasis in original).
23 Id. (citing *Escobar*, 136 S.Ct. at 2003, for the proposition that "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").

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