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### Implied Certification

Relators will want to introduce evidence that the government regularly refuses to pay claims based on statutory, regulatory or contractual noncompliance. Similarly, the defense bar has incentive to use all of the discovery tools at its disposal to show that the government does not view a given requirement as material by showing that the government regularly pays claims in full despite knowing that certain requirements were violated.

## Post-Escobar Application of the Materiality Standard



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**O**n Jan. 26, the Fourth Circuit will hear oral argument in *United States ex rel. Omar Badr v. Triple Canopy*, one of four False Claims Act (FCA) decisions that the Supreme Court vacated and remanded for further consideration in light of the court's June 2016 holding in *Universal Health Servs. v. United States ex rel. Escobar*. All four of the cases — *Universal Health Servs., Inc. v. United States ex rel. Escobar*, 136 S. Ct. 1989, 1995 (2016); *Triple Canopy, Inc. v. United States ex rel. Badr*, 136 S. Ct. 2504 (2016); *United States ex rel. Nelson v. Sanford-Brown, Ltd.*, 136 S. Ct. 2506 (2016); and *Weston Educ., Inc. v. United States ex rel. Miller*, 136 S. Ct. 2505 (2016) — were brought under the implied certification theory of liability, which extends the FCA to situations in which the government pays funds it would not have paid if it had known of a failure to comply with a law, regulation or contractual provision underlying the claim for payment.

In *Escobar*, the court validated the implied certification theory and held that contractors can face FCA li-

ability if they knowingly bill the government while out of compliance with requirements material to the government's decision to pay a claim. Notably, the court decided not to adopt a bright-line rule for determining if a violation is material, instead opting for a rule-of-reason type analysis. Since *Escobar* was decided, three of the four circuits have grappled with the *Escobar* holding and issued decisions in the remanded cases. These early decisions illustrate the expansive nature of the *Escobar* materiality test on both objective and subjective grounds and are an early sign of much litigation to come.

### Living in a Material World After Escobar

Prior to *Escobar*, a number of circuits had held that implied certification liability would attach only if the defendant violated a legal provision that was an express condition of payment. *See, e.g., United States ex rel. Wilkins v. United Health Grp., Inc.*, 659 F.3d 295, 313 (3d Cir. 2011); *United States ex rel. Mikes v. Strauss*, 274 F.3d 687, 700 (2d Cir. 2001). In *Escobar*, the Supreme Court rejected this per se requirement, reason-

ing that a provision's designation as a condition of payment could be relevant, but not dispositive, evidence of materiality. *Escobar*, 136 S. Ct. at 2001.

At the same time, the court recognized that the materiality standard is “demanding” and “rigorous” and “cannot be found where noncompliance is minor or insubstantial” because the FCA is not “a vehicle for punishing garden-variety breaches of contract or regulatory violations.” *Id.* at 2003 (internal citation omitted).

Moreover, the court emphasized that it is not enough for the government to make *post hoc* assertions that a contractor's failure to comply with legal requirements influenced the government's decision to pay. Instead, the misrepresentation of compliance must go to the heart of the contractual bargain. *Id.*

Rather than trying to articulate a bright-line rule for determining materiality, the court set forth a holistic and potentially fact-intensive approach on the grounds that “materiality cannot rest on a single fact or occurrence as always determinative.” *Id.* at 2001 (internal quotations omitted).

While allowing for an objective reasonable-person test, the court also laid out several specific factors that might contribute to determining materiality: “[p]roof of materiality can include, but is not necessarily limited to, evidence that the defendant knows that the Government consistently refuses to pay claims in the mine run of cases based on noncompliance with the particular statutory, regulatory, or contractual requirement. Conversely, 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. Or, if the Government regularly pays a particular type of claim in full despite actual knowledge that certain requirements were violated, and has signaled no change in position, that is strong evidence that the requirements are not material.” *Id.* at 2003-04.

The court's flexible standard affords the lower courts considerable discretion in determining whether the materiality element is satisfied at the motion to dismiss or summary judgment stages, as well as at trial. In practice, the flexibility of the test means that it can be applied in a fashion similar to Justice Potter Stewart's famed standard for determining pornography: “I know it when I see it.” *Jacobellis v. State of Ohio*, 84 S. Ct. 1676, 1683 (1964).

In other words, courts reviewing the allegations pled in the complaint, or the facts in the record, will decide if the government would have acted differently if it had known of the noncompliance based on a judicial “gut check.” The flexible nature of the standard is underscored by the fact that of the three remanded cases that have applied the holding in *Escobar* to date, all three circuits — as described below — arrived at the same decisions they had made prior to the Supreme Court's ruling.

### First Circuit: New Standard, Same Result

In *Escobar*, a case from the First Circuit, relators filed an FCA action after their daughter died of a seizure following treatment by unlicensed and unsupervised counselors at a mental health clinic. Relators alleged that the clinic, owned and operated by United Health Services (UHS), violated the FCA by presenting reimbursement claims to Medicaid without disclosing that it had not complied with Massachusetts' requirements regarding

qualifications of mental health providers. The district court dismissed the relators' complaint and found that the Massachusetts regulations at issue imposed only conditions of participation in the government program, not preconditions to payment as required for FCA liability. *United States ex rel. Escobar v. Universal Health Servs., Inc.*, 2014 WL 1271757 (D. Mass. Mar. 26, 2014).

On appeal, the First Circuit reversed, finding that the regulations at issue were, in fact, conditions of payment. *United States ex rel. Escobar v. Universal Health Servs., Inc.*, 780 F.3d 504 (1st Cir. 2015).

But the Supreme Court rejected the First Circuit's expansive view that any violation is material simply because the contractor knows that the government would be entitled to refuse payment were it aware of the violation. The court vacated the First Circuit's judgment and remanded the case for reconsideration under its newly articulated and more rigorous test for determining whether the defendant's allegedly false claims were material to payment.

On remand, the First Circuit applied the holistic approach for determining materiality laid out by the Supreme Court and articulated three reasons as to why the complaint sufficiently alleged that UHS's use of unlicensed mental health professionals was material to the state when deciding whether to reimburse it for Medicaid claims. First, as found before, relators' complaint alleged that compliance with the regulations at issue was a condition of payment — a relevant, though not dispositive, factor in determining materiality under *Escobar*. Second, the licensing and supervision requirements in the state regulatory program went to the very essence of the bargain of the contractual relationship with UHS. Their centrality within the regulatory scheme was strong evidence that a failure to comply with the regulations would be sufficiently important to influence the behavior of the government in deciding whether to pay the claims. Third, the court found that there was no evidence in the record that Massachusetts paid claims to UHS despite knowing of the violations. *United States ex rel. Escobar v. Universal Health Servs., Inc.*, 842 F.3d 103, 111 (1st Cir. 2016) (internal citation omitted).

Accordingly, the First Circuit reversed the district court's grant of UHS's motion to dismiss — just as it had done prior to the Supreme Court's decision.

### Seventh and Eighth Circuits: Different Schools of Thought?

Both the Seventh and Eighth Circuits have also recently applied the *Escobar* materiality standard in cases that were remanded by the Supreme Court — with *United States ex rel. Nelson v. Sanford-Brown, Ltd.*, 840 F.3d 445 (7th Cir. 2016) and *United States ex rel. Miller v. Weston Educ., Inc.*, 840 F.3d 494 (8th Cir. 2016), respectively.

The cases share similar facts and procedural histories but opposite results. Both cases involved *qui tam* suits brought by former employees who alleged that for-profit colleges inflated student grades and falsified attendance records to keep the students eligible to receive federal financial aid under Title IV of the Higher Education Act. In both cases, the district court had granted summary judgment in favor of the defendant. *United States ex rel. Miller v. Weston Educ., Inc.*, 10 F. Supp. 3d 1046 (W.D. Mo. 2014); *United States ex rel. Nelson*

v. *Sanford-Brown, Ltd.*, 30 F. Supp. 3d 806 (E.D. Wis. 2014).

On appeal, the Seventh Circuit upheld summary judgment. *United States ex rel. Nelson v. Sanford-Brown, Ltd.*, 788 F.3d 696 (7th Cir. 2015).

In contrast, the Eighth Circuit reversed the lower court's summary judgment ruling. *United States ex rel. Miller v. Weston Educ., Inc.*, 784 F.3d 1198 (8th Cir. 2015).

In both cases, the Supreme Court granted certiorari, vacated the judgment, and remanded the case for further consideration in light of *Escobar*.

Despite the factual similarities between the two cases, the Seventh and Eighth Circuits again reached opposite conclusions on remand when applying the *Escobar* materiality standard. In *Weston*, the Eighth Circuit held that defendant's promise to keep accurate grade and attendance records was material in inducing the government to enter into an agreement under the Higher Education Act. The court rejected the defendant's argument that no individual false record caused payment by the government, reasoning instead that the false promise to keep accurate records was material based on the express regulatory conditions of participation, their reasonable importance to payment, and evidence that the government had terminated other institutions that falsified similar records. 840 F.3d at 504.

In contrast, in *Sanford-Brown*, the Seventh Circuit held that the relator had failed to establish the materiality element because — as the *Escobar* court explained — to establish materiality, it is not enough to show that “the Government would have the option to decline to pay if it knew of the defendant's noncompliance.” 840 F.3d at 447.

Rather, “materiality looks to the effect on the likely or actual behavior of the recipient of the alleged misrepresentation.” *Id.*

The Seventh Circuit found that the relator had offered no evidence that the government's decision to pay Sanford-Brown would likely or actually have been different had it known of the alleged noncompliance with Title IV regulations. On the contrary, the record showed that federal agencies had examined Sanford-Brown multiple times and concluded that neither administrative penalties nor termination were warranted. Quoting *Escobar*, the Seventh Circuit reasoned 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.” *Id.*

In short, the Seventh Circuit reasoned that even if false representations had been made, there was no evidence that the government's decision to pay the college would likely have been different had it known of the alleged misrepresentations.

While these contrary decisions may be a product of differences in the record and specific allegations in each case, they are still notable for their differing conclusions as to materiality in the same substantive area.

#### Fourth Circuit: The Gang That Couldn't Shoot Straight

Of the four cases remanded by the Supreme Court, only the *Triple Canopy* case in the Fourth Circuit has yet be decided. In *Triple Canopy*, the relator alleged that a security contractor responsible for ensuring the safety of an air base in a combat zone knowingly em-

ployed guards who allegedly falsified marksmanship scores, and presented claims to the government for payment for those unqualified guards. 775 F.3d 628 (4th Cir. 2015).

The defendant prevailed on a motion to dismiss at the district court after demonstrating that the government failed to plead that it ever reviewed — and therefore ever relied on — the allegedly false scorecards. *United States ex rel. Badr v. Triple Canopy, Inc.*, 950 F. Supp. 2d 888 (E.D. Va. 2013).

The Fourth Circuit reversed, explaining: “Common sense strongly suggests that the Government's decision to pay a contractor for providing base security in an active combat zone would be influenced by knowledge that the guards could not, for lack of a better term, shoot straight ... If Triple Canopy believed that the marksmanship requirement was immaterial to the Government's decision to pay, it was unlikely to orchestrate a scheme to falsify records on multiple occasions.” 775 F.3d at 637–38.

It remains to be seen if the Fourth Circuit will reach a different result after applying *Escobar*, but the standard is certainly flexible enough that the court could reach the same conclusion based on the panel's “common sense” determination that the government would not have paid the defendant if it had known of the marksmanship woes of the contractor's guards.

Moreover, the *Escobar* opinion would appear to support the Fourth Circuit's original holding in *Triple Canopy*. The Supreme Court reasoned that a defendant can have actual knowledge that a condition is material without the government expressly calling it a condition of payment. In fact, the court used as an example a contract for the purchase of guns that did not shoot: “because a reasonable person would realize the imperative of a functioning firearm, a defendant's failure to appreciate the materiality of that condition would amount to ‘deliberate ignorance’ or ‘reckless disregard’ of the ‘truth or falsity of the information’ even if the Government did not spell this out.” 136 S. Ct. at 2001-02.

Given the Fourth Circuit's prior characterization of the materiality in *Triple Canopy* of security guards who could not themselves “shoot straight,” it would not be surprising for the parties to focus on whether the Supreme Court's example provides a useful analogy on remand.

#### Plenty of ‘Material’ for All Sides

When the *Escobar* decision was issued in June, both the relators and defense bars hailed it as a victory. But as the early post-*Escobar* decisions have shown, the decision has been a mixed bag for FCA defendants, the government and *qui tam* relators. In fact, it may be that the decision contains something for everyone when it comes to the materiality element. Going forward, both sides will need to focus on getting evidence of materiality into the record. Relators will want to introduce evidence that the government regularly refuses to pay claims based on statutory, regulatory or contractual noncompliance. Similarly, the defense bar has incentive to use all of the discovery tools at its disposal — including *Touhy* requests — to show that the government does not view a given requirement as material by showing that the government regularly pays claims in full despite knowing that certain requirements were violated.

At the time of the Supreme Court's ruling in *Escobar*, eight of the 13 U.S. courts of appeals had accepted the

implied certification theory in some form, but the approving circuits had articulated varying tests for its applicability. One of the reasons the Supreme Court took up *Escobar* was to address the circuit split. These early post-*Escobar* decisions suggest that while there may be a standard materiality test, its flexible, open-ended nature means that the outcome of its application will not be easy to predict, and it may end up back in front of the Supreme Court for further clarification.

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