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PRATT'S
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EDITOR'S NOTE: SUPPLY CHAIN INTEGRITY

Victoria Prussen Spears

**U.S. GOVERNMENT'S INCREASED EFFORTS
IN SUPPLY CHAIN INTEGRITY**

Michael F. Mason, Robert Taylor,
Stacy Hadeka, Michael J. Scheimer,
William T. Kirkwood, and
Rebecca H. Umhofer

**NINTH CIRCUIT'S ROSE DECISION COULD
BE A THORN IN THE SIDE OF RELATORS
(AT LEAST FOR NOW)**

William S.W. Chang, Brian Tully McLaughlin,
Gail D. Zirkelbach, Jason M. Crawford,
Mana Elihu Lombardo, and Sarah A. Hill

**NINTH CIRCUIT FOLLOWS ESCOBAR AND
FINDS LACK OF MATERIALITY WHERE
GOVERNMENT CONTINUED TO PAY**

Craig D. Margolis, Tirzah S. Lollar,
and Michael E. Samuels

**UNTIMELY PHYSICIAN CERTIFICATIONS
FOR MEDICARE HOME CARE CLAIMS
- ARGUABLY A TECHNICALITY -
VULNERABLE TO FALSE CLAIMS ACT
ALLEGATIONS, SIXTH CIRCUIT FINDS**

Brian T. McGovern and Jared Facher

**DISTRICT COURT FINDS FCA COMPLAINT
FAILS TO SATISFY MATERIALITY
REQUIREMENT AND REJECTS
CLAIMS BASED ON ALLEGED TAA
NONCOMPLIANCE**

Paul R. Hurst, Thomas P. Barletta,
and Kendall R. Enyard

**IS THE PENDULUM SWINGING ON AGENCY
AND GOVERNMENT CONTRACTOR
COOPERATION? COMMENTS FROM
THE DEPARTMENT OF DEFENSE -
AND RECENT GOOD FAITH AND FAIR
DEALING DECISIONS - POINT TO
IMPROVED CONTRACTOR/GOVERNMENT
RELATIONSHIPS**

Michael R. Rizzo, Glenn Sweatt,
and Kevin Massoudi

**SOMETIMES LESS THAN COMPLETE
INFORMATION IS ENOUGH, BUT DON'T
COUNT ON IT**

Eric Whytsell

PRATT'S GOVERNMENT CONTRACTING LAW REPORT

VOLUME 4

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Editor's Note: Supply Chain Integrity

Victoria Prussen Spears

395

U.S. Government's Increased Efforts in Supply Chain Integrity

Michael F. Mason, Robert Taylor, Stacy Hadeka, Michael J. Scheimer,
William T. Kirkwood, and Rebecca H. Umhofer

398

**Ninth Circuit's *Rose* Decision Could Be a Thorn in the Side of Relators
(At Least for Now)**

William S.W. Chang, Brian Tully McLaughlin, Gail D. Zirkelbach,
Jason M. Crawford, Mana Elihu Lombardo, and Sarah A. Hill

405

**Ninth Circuit Follows *Escobar* and Finds Lack of Materiality Where Government
Continued to Pay**

Craig D. Margolis, Tirzah S. Lollar, and Michael E. Samuels

409

**Untimely Physician Certification for Medicare Home Care Claims—Arguably a
Technicality—Vulnerable to False Claims Act Allegations, Sixth Circuit Finds**

Brian T. McGovern and Jared Facher

412

**District Court Finds FCA Complaint Fails to Satisfy Materiality Requirement
and Rejects Claims Based on Alleged TAA Noncompliance**

Paul R. Hurst, Thomas P. Barletta, and Kendall R. Enyard

418

**Is the Pendulum Swinging on Agency and Government Contractor Cooperation?
Comments from the Department of Defense—And Recent Good Faith and Fair
Dealing Decisions—Point to Improved Contractor/Government Relationships**

Michael R. Rizzo, Glenn Sweatt, and Kevin Massoudi

423

Sometimes Less Than Complete Information Is Enough, But Don't Count on It

Eric Whytsell

427

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Ninth Circuit’s *Rose* Decision Could Be a Thorn in the Side of Relators (At Least for Now)

By **William S.W. Chang, Brian Tully McLaughlin, Gail D. Zirkelbach, Jason M. Crawford, Mana Elihu Lombardo, and Sarah A. Hill***

Recently, in United States ex rel. Rose, et al. v. Stephens Institute, the U.S. Court of Appeals for the Ninth Circuit held that Escobar’s two-part test is mandatory in all implied certification cases under the False Claims Act. The authors of this article explain the decision and why this issue may be an appealing candidate for en banc or even U.S. Supreme Court review.

In *Universal Health Services, Inc. v. United States ex rel. Escobar*,¹ the U.S. Supreme Court held that an implied false certification can be a basis for False Claims Act (“FCA”) liability, “at least where two conditions are satisfied:” (1) the claim makes specific representations about the goods or services provided and (2) the defendant’s failure to disclose noncompliance with material statutory, regulatory, or contractual requirements makes those representations misleading half-truths.²

Since *Escobar*, lower courts have split on whether that two-part test was necessary—or merely sufficient—for establishing such FCA liability.³ Recently, in *United States ex rel. Rose, et al. v. Stephens Institute*, the U.S. Court of Appeals for the Ninth Circuit joined the U.S. Court of Appeals for the Seventh Circuit and held that *Escobar*’s two-part test is mandatory in all implied certification

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¹ 136 S.Ct. 1989 (2016).

² Emphasis added.

³ Compare, e.g., *U.S. v. Sanford-Brown, Ltd.*, 840 F.3d 445, 447 (7th Cir. 2016) (holding that an implied certification claim must satisfy both conditions described in *Escobar*); with, e.g., *United States v. Triple Canopy, Inc.*, 857 F.3d 174, 178 n.3 (4th Cir. 2017) (stating that it had “already answered” the question “left open” in *Escobar* by “holding that the Government pleads a false claim when it alleges a request for payment under a contract where the contractor withheld information about its noncompliance with material contractual requirements.”); *U.S. ex rel. Panarello v. Kaplan Early Learning Co.*, No. 11-cv-00353, 2016 U.S. Dist. LEXIS 158193, at *13 (W.D.N.Y. Nov. 14, 2016) (“The fact that *Escobar* clarified ‘some’ of the circumstances creating implied false certification liability suggests that compliance with the conditions it discussed is not necessarily a prerequisite to implied false certification liability in every case.”).

cases under the FCA. That holding is welcome news to defendants at large. But the same cannot be said for the defendant in *Rose*, as the court affirmed the district court's denial of its motion for summary judgment, ruling that there was sufficient evidence for a jury to find that the two-part test had been met and that the noncompliance at issue was material to the government's payment decision.

BACKGROUND

In *Rose*, former admissions representatives alleged that the Stephens Institute (DBA Academy of Art University) violated the incentive compensation ban in its program participation agreement ("PPA") with the Department of Education. According to the relators, the University did so by paying bonuses up to \$30,000 to recruiters for enrolling higher numbers of students.

The district court denied the University's summary judgment motion on May 4, 2016. After the U.S. Supreme Court decided *Escobar* just one month later, the University sought reconsideration. The district court declined to reconsider its ruling, but it certified several questions concerning *Escobar's* impact for interlocutory appeal.

ESCOBAR'S TWO-PART TEST

In deciding whether the two conditions described in *Escobar* are mandatory for establishing a false claim based on implied certification, the *Rose* panel contended with both the Supreme Court's decision and Ninth Circuit precedent. Prior to *Escobar*, the Ninth Circuit had recognized the implied certification theory of FCA liability in *Ebeid ex rel. United States v. Lungwitz*.⁴ *Ebeid* permitted implied certification claims when (1) the defendant explicitly undertook to comply with a law, rule, or regulation that is implicated in submitting a claim for payment; (2) the defendant submitted the claim; and (3) the defendant did not comply with that law, rule, or regulation. *Ebeid* did not require that a claim for payment contain a "specific representation" that was misleading due to a failure to disclose a violation.

The *Rose* panel questioned whether *Escobar* itself necessarily overruled *Ebeid*. But in the panel's view, two prior Ninth Circuit decisions applying *Escobar* had fatally undermined *Ebeid*. First, in *United States ex rel. Kelly v. Serco, Inc.*, the panel applied only the two-part test from *Escobar*—and not the more relaxed *Ebeid* standard—in holding that the plaintiff's implied false-certification claim failed.⁵ Second, in *United States ex rel. Campie v. Gilead Sciences, Inc.*, the panel

⁴ 616 F.3d 993 (9th Cir. 2010).

⁵ 846 F.3d 325, 332 (9th Cir. 2017).

held that *Escobar's* two conditions must be satisfied to give rise to an implied certification claim.⁶

Ultimately, the *Rose* panel concluded that it was bound by *Serco* and *Campie*; hence, *Escobar's* two-part test was mandatory. During oral argument in *Rose*, however, one of the judges suggested that the Ninth Circuit may need to resolve the issue *en banc*. The *Rose* opinion repeated that sentiment, noting that the panel was constrained “unless and until our court, *en banc*, interprets *Escobar* differently.”

The panel concluded that the evidence was sufficient to create an issue of material fact as to whether the University's actions met the two *Escobar* requirements. In a loan School Certification form, the University had certified that the student applying for federal aid was an “eligible borrower” and was “accepted for enrollment in an eligible program.” Because the University did not disclose its violation of the incentive compensation ban, the panel explained that the certification could be considered a “misleading half-truth.”

MATERIALITY

The *Rose* panel then split 2-1 on whether the alleged false certification was material under *Escobar*. The majority concluded that a reasonable trier of fact could find that the violation was material because “the Department's payment was conditioned on compliance with the incentive compensation ban, because of the Department's past enforcement activities [against schools for violations of the incentive compensation ban], and because of the substantial size of the forbidden incentive payments.”

Judge N.R. Smith dissented. He emphasized that *Escobar* requires a “rigorous” and “demanding” inquiry into the government's “likely or actual behavior” to determine whether the alleged misrepresentation was important to its decision to pay (or not). Because the majority relied on evidence of how the government *generally* enforces the incentive compensation ban—and not how the government would respond to the specific incentive compensation ban violations alleged—Judge Smith opined that the only real evidence supporting materiality was the fact that payment was conditioned on compliance with the ban. According to Judge Smith, that was not dispositive under *Escobar*.

LOOKING AHEAD

The relators in *Rose* had argued that the two conditions described in *Escobar* were merely one way to establish implied certification liability. The Department of Justice (“DOJ”) supported the relators' position as *amicus curiae*. In the

⁶ 862 F.3d 890, 901–03 (9th Cir. 2017).

DOJ's view, "loose language" from other courts characterizing the two conditions "as necessary rather than merely sufficient" should not limit the implied certification theory to cases where the alleged false claim makes "specific representations."

In contrast to *Rose*, courts, including the U.S. Court of Appeals for the Fourth Circuit in *Triple Canopy*, have endorsed that more expansive view of the implied certification theory. Given the amount of leeway that *Escobar* leaves for interpreting the scope of implied certification liability, the conflicting interpretations from lower courts, and the implicit invitation from the *Rose* panel, this issue may be an appealing candidate for *en banc* or even Supreme Court review.

For now, the *Rose* decision is good news for those facing implied certification claims. By holding that the two conditions expressly mentioned in *Escobar* are necessary for establishing liability under a false certification theory, the *Rose* decision curtails *Escobar's* open-ended statement that implied certification liability exists *at least* in those circumstances.