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FCA's Split Personality Makes Compliance A Moving Target

Law360, New York (September 30, 2015, 10:16 AM ET) --

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The False Claims Act is undergoing an identity crisis, and entities doing business with the government should take notice. Decisions this year by the First, Fourth and Seventh Circuits have magnified a split among the federal appeals courts regarding what conduct actually constitutes a false claim under the FCA. At the center of the circuit split is the theory of implied certification, which posits that a contractor or participant in a federal reimbursement program violates the FCA not only when it knowingly presents a false claim for payment for goods or services, but also when it presents a claim for payment that falsely implies it has satisfied underlying contractual, statutory and regulatory requirements. The problem inherent in the theory of implied certification is defining the behavior that constitutes implied certification.

Whether noncompliance with a contract clause or a statutory or regulatory requirement can be shoehorned into a FCA claim is important for two reasons. First, the implied certification theory gives relators and the government additional bases on which to bring FCA claims, increasing litigation costs for contractors or reimbursement program participants. Second, the damages for an FCA violation can dwarf those for breach of contract. A contractor that violates the FCA is liable for treble damages, for civil penalties of between \$5,000 and \$10,000 for each false claim submitted, and for the plaintiff's costs. The U.S. Supreme Court has characterized the FCA's imposition of treble damages and civil penalties as "essentially punitive in nature," stressing that the higher penalties ensure that "the Government is fully compensated for the costs of corruption," which might otherwise go undetected. United States v. Halper, 490 U.S. 435, 450 (1989). In contrast, it is well established that in an ordinary case, a plaintiff cannot recover punitive damages for a breach of contract.

The Split

The FCA provides that any person who “knowingly presents, or causes to be presented, a false or fraudulent claim for payment or approval” is liable to the government for damages. However, the FCA does not define what makes a claim false or fraudulent. There is no dispute that a claim under the FCA can be stated by alleging either factual falsity — the defendant billed for goods or services not provided — or express certification — the defendant made an express false certification of performance — will survive a motion to dismiss. The question is whether and under what circumstances the FCA applies when a claim for payment is silent as to a legal obligation that should have been satisfied.

The Seventh Circuit’s June 2015 decision in United States v. Sanford-Brown Ltd., Case No. 14-2506 (7th Cir. June 8, 2015), offers an example of the narrowest application of implied certification. In that case, a for-profit educational institution, Sanford-Brown College, entered into a program participation agreement (PPA) with the U.S. Secretary of Education as a part of obtaining federal educational subsidies. The PPA required compliance with a variety of statutory and regulatory regimes, including Title IV of the Higher Education Act. The relator, a former official at the school, alleged that the defendants engaged in recruiting and retention practices that violated Title IV regulations, thereby violating the PPA, rendering the school no longer eligible for any of the subsidies they received. The relator claimed that as a result, Sanford-Brown’s thousands of claims for subsidies were false claims in violation of the FCA. The Seventh Circuit disagreed, determining that satisfaction of the regulations referenced in the PPA were preconditions for participation in the Department of Education program, not preconditions of payment for services delivered under the PPA. Thus, because there was no allegation of fraud in connection with entry into the PPA itself, the school’s Title IV noncompliance could not give rise to a cause of action under the FCA.

The Fourth Circuit, in United States ex rel. Badr v. Triple Canopy Inc., 775 F.3d 628 (4th Cir. 2015), has taken an approach different from the Seventh Circuit’s precondition of payment rubric, following a somewhat vague standard of “materiality.” In that case, the government contracted with Triple Canopy to provide security services at a base in Iraq. The contract included a clause requiring Triple Canopy to ensure that all employees satisfied certain marksmanship requirements. Triple Canopy provided the number of guards required by the contract, but, as it turned out, none were able to meet the marksmanship standards. Supervisors faked scorecards for the guards’ personnel files to cover up their deficiency. Over the course of the one-year contract, Triple Canopy submitted invoices and was paid over $4 million for the guards’ work at the base.

The relator, a medic at the base, initiated a qui tam suit and the government intervened. The district court granted Triple Canopy’s motion to dismiss, concluding that the government had failed to plead a false claim because it had not alleged that Triple Canopy invoiced the government for an incorrect number of guards or billed for a fraudulent amount of money. On appeal, the Fourth Circuit adopted the implied certification theory of liability, holding that “the Government pleads a false claim when it alleges that the contractors, with the requisite scienter, made a request for payment under a contract and withheld information about its noncompliance with material contractual requirements.” With respect to materiality, the Fourth Circuit opined that “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.” 775 F.3d at 638.

Offering a third variation on the theme, the First Circuit, in United States ex rel. Escobar v. Universal Health Services, 780 F.3d 504 (1st Cir. 2105), took the middle ground between the “precondition of payment” and “materiality” tests, announcing, “[w]e ask simply whether the defendant, in submitting a claim for reimbursement, knowingly misrepresented compliance with a material precondition of payment.” The Escobar court found that the relator’s claims squarely alleged the defendant healthcare provider had failed to comply with preconditions of payment, but noted that it “eschewed” distinctions between implied and express certification theories because “they create artificial barriers that obscure and distort [the statute's] requirements.” 780 F.3d at 512. The question whether a given requirement constitutes a precondition to payment is a “fact-intensive and context-specific inquiry,” involving a close reading of the foundational documents, or statutes and regulations, at issue. Id. at 513.

Practical Considerations

Contractors and participants in federal reimbursement programs must now face varying definitions of what conduct will constitute a false claim under the FCA. This obviously increases the challenges for compliance officers as it provides incentives for plaintiffs and relators to bring FCA claims under different theories of liability. The defendant contractor in Triple Canopy has filed a petition for writ of certiorari calling on the U.S. Supreme Court to “resolve this pervasive and irreconcilable split as to the important question of the scope of FCA liability.” Petition for a Writ of Certiorari, U.S. ex rel. Omar Badr v. Triple Canopy, No. 14-1440, 2015 WL 3542745 (U.S. June 5, 2015). So there is some possibility that the Supreme Court will return a measure of uniformity to the FCA arena.

Meanwhile, the employment of the FCA by relators and the government is on the rise. The years 2012 through 2014 saw the three largest annual recoveries ever recorded under the statute (with a record-breaking $5.69 billion recovered in 2014). 2015 figures continue that trend. And, in addition to monetary penalties the U.S. Deparment of Justice announced in September 2014 that its Criminal Division will review all complaints filed under the qui tam provisions of the FCA for possible criminal violations.

Doing business with the government can be lucrative, but it can also be risky. A thorough understanding of FCA standards is necessary in managing that risk.

What can government contractors do? A good first step is to review identify all obligations, whether contractual, regulatory or statutory — even those seemingly tangential to the goods or services being delivered. The next step in an ideal world is to take affirmative steps to assure compliance with each of these requirements. However, as the Seventh Circuit noted in Sanford-Brown, “it would be ... unreasonable for us to hold that an institution’s continued compliance with the thousands of pages of federal statutes and regulations incorporated by reference into the PPA are conditions of payment for purposes of liability under the FCA.” Sanford-Brown at 26. Following a risk-based approach, contractors should first identify the most material requirements to ensure compliance. While the Fourth Circuit’s “common sense” test does not provide rigorous guidance, it does suggest that contractors would do well to think about contracts from the government’s point of view and ask what the government cares about most.

It is also advisable for contractors and other program benefit recipients to perform audits to test compliance. Employee training is also important, as is explicit encouragement to employees to identify gaps in compliance. Management personnel should respond to allegations thoroughly to remedy any identified gaps. This not only helps to avoid compliance failures, but also ensures that employees are compliance partners, rather than future qui tam relators.

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