

Litigation Alert

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Appellate Court Expands Liability Under California False Claims Act

A California appellate court recently lowered the bar for bringing California False Claims Act (CFCA) actions against government contractors and potentially eliminated key defenses to such actions. In *San Francisco Unified School District ex. rel. Contreras v. First Student, Inc.*, No. A136986, Cal. Court App. (1st Dist. Mar. 11, 2014), the court held that “a vendor impliedly certifies compliance with express contractual requirements when it bills a public agency for providing goods or services.” In other words, the mere submission of an invoice exposes a government contractor to CFCA liability if it knowingly breached a material contract term. The court’s holding arguably eliminates a common defense to such actions – that absent certification of compliance, contractual breaches do not give rise to CFCA liability. The court’s holding has significant implications for government contractors because, unlike ordinary contract actions, which give rise to compensatory damages, the CFCA permits the recovery of civil penalties up to \$11,000 per alleged false claim and treble damages. Moreover, because every invoice submitted amounts to a false claim, even if the invoice does not itself contain any false statement, the penalties can be astronomical.

The court also relaxed the materiality requirement, finding that the government’s failure to treat the falsity as a material breach does not preclude a CFCA claim. The court’s holding significantly reduces a government contractor’s chance of defeating such actions at the summary judgment stage by presenting evidence that the alleged breach was not material because the government entity knew about it and did nothing. As discussed below, the *Contreras* court found that the government entity’s response (which fell far short of terminating the contract or stopping payments) could nonetheless support a finding that the breach was material.

In *Contreras*, the *qui tam* plaintiffs sued First Student, Inc., a company that had contracted with the San Francisco Unified School District (“District”) to provide bus transportation services. The plaintiffs allege that the defendant failed to maintain its buses as required under the contract and submitted claims for payment to the District when defendant knew that it was in breach of the contract. The contract required the defendant to “(1) provide school buses meeting state and federal standards relating to pupil transportation; (2) maintain its buses in ‘excellent mechanical condition and appearance’ and replace all vehicles ‘which are deemed to be unfit for providing the required service’; (3) provide buses meeting or exceeding state and federal safety standards; and (4) employ a ‘Fleet Maintenance Supervisor’ to ‘establish and maintain a complete and effective preventative maintenance program with complete and accurate records on each vehicle.’” The District agreed to pay the defendant on a monthly basis. The contract provided that the District could terminate the contract immediately if the defendant failed or refused to perform any act required under the contract.

The defendant moved for summary judgment, and, in their opposition, the plaintiffs presented evidence that the “defendant committed numerous violations of the maintenance requirements, including among other things: (1) disregarding a 45–day inspection requirement; (2) operating buses with defective brake linings; and (3) placing buses into service with dangerously low tire tread.” The plaintiff also presented evidence that the defendant met with District officials in September 2011 and assured the District that it was meeting its contractual obligations and all laws relating to student transportation. The defendant also agreed to establish a reporting process and provide the District a monthly report on the 45-day inspection program.

However, in November 2011, the District received a report which it believed indicated that defendant had operated 31 vehicles out of compliance, and wrote a letter to the defendant requesting that defendant immediately remove those vehicles from service. The District did not withhold payment or cancel the contract. In fact, the undisputed evidence showed that the District consistently paid the defendant’s invoices, even after the plaintiffs filed suit. The defendant also presented evidence showing that the California Highway Patrol had inspected its facilities and vehicles to annual inspections to ensure compliance with federal and state laws, including the 45-day inspection requirement. The trial court granted summary judgment in favor of the defendant, concluding that no reasonable trier of fact could find that the defendant’s alleged false implied certifications were material or that defendant acted with the requisite scienter. The appellate court reversed.

The appellate court first noted that, four years ago, it had reversed the trial court’s dismissal of plaintiff’s implied certification claim, and had rejected the defendant’s argument that it was immune from liability under the CFCA because its invoices did not expressly certify compliance and the contract did not condition payment on certification of compliance. The appellate court summarized its prior holding:

We concluded defendant’s invoices were “claims” within the meaning of the CFCA; the invoices did not need to contain an expressly false statement to be actionable; and defendant’s requests for payment under the Contract included “an implied certification of compliance with contractual requirements that, if false and fraudulent, can form the basis for a CFCA action.”

Although the appellate court had reinstated the plaintiff’s implied certification claim, it had also recognized that CFCA liability hinges on whether the implied certification with the breached provision was material to the District’s decision to pay the claim and whether the defendant had the requisite knowledge of the alleged falsity of the implied certification.

The appellate court then considered whether the trial court properly granted summary judgment based on these elements, and concluded that it did not. The defendant argued that the breach was material as a matter of law because the District knew about it and continued to make payments, but the court rejected this argument for several reasons. First, there was no evidence that the District knew about the alleged breach. It only knew about the plaintiff’s allegations, which the defendant denied.

Second, even if the District had been aware of the alleged breach, the District’s failure to terminate the contract or stop payments would not be dispositive because “the materiality determination turns on

whether the alleged false statement was such that it had a natural tendency to influence or was capable of influencing government action.” Applying this standard, the appellate court concluded that there was a triable issue as to materiality. It noted that the District’s response could support numerous favorable inferences including “a judgment that plaintiffs’ claims should be resolved in the present action at minimal cost to the District;” “acceptance of defendant’s representations of compliance, the expense and difficulty of investigating the allegations of wrongdoing, fear of litigation with defendant, or concerns about the possibility of disrupting services;” or “a judgment that, regardless of whatever past maintenance problems existed, defendant is now complying with its contractual obligations.”

Finally, the appellate court held that the plaintiffs presented sufficient evidence to support an inference that defendant acted in reckless disregard of the truth of its implied certifications of compliance with the contract. The court noted that the plaintiffs presented evidence of widespread maintenance failures and that the defendant failed to comply with its own policies requiring regular audits that could have disclosed these maintenance failures.

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