

9th Circuit Makes Mandatory Escobar's Implied False Certification Test, But Fails to Faithfully Follow Escobar's Directives

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Key Points

- *Escobar's* two-part implied false certification test is mandatory in the 9th Circuit.
- Though couched as adopting the *Escobar* standard, the 9th Circuit panel's decision may actually undermine *Escobar's* overarching directives.
- The 9th Circuit panel noted that its decision was based on binding precedent and signaled that the holding could be revisited in an *en banc* review.

A three-judge panel of the 9th Circuit ruled that False Claims Act (FCA) plaintiffs must satisfy the two-pronged test for implied false certification claims set out in *Universal Health Services, Inc. v. United States ex rel. Escobar*. Although the panel's ruling on this hotly debated issue is seemingly helpful for FCA defendants, the 9th Circuit's decision may actually undermine the fundamental principles set forth in *Escobar*, allowing garden-variety regulatory breaches to proceed as FCA cases, despite the Supreme Court's instructions to the contrary. Also notable, the panel reached this holding reluctantly based on binding precedent and signaled that the case would be a good candidate for *en banc* review. For these reasons, this case will be closely monitored for further developments and to see how FCA defendants are ultimately impacted as the case law on implied false certification claims post-*Escobar* continues to develop.

Background on *Escobar's* Implied Certification Test and Materiality Standard

In the unanimous landmark *Escobar* decision in June 2016, the U.S. Supreme Court sanctioned the implied false certification theory of FCA liability. Under this theory, a defendant can be liable for knowingly submitting a false or fraudulent claim for payment, even if the claim is factually true and accurate, if the defendant is knowingly not in compliance with an applicable statutory, regulatory or contractual requirement,

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and compliance with the requirement at issue is deemed material to the government's payment decision.

In *Escobar*, the Court made clear that the FCA is not "an all-purpose antifraud statute." The Court further declared that the FCA is not a "vehicle for punishing garden-variety breaches of contract or regulatory violations," and "emphasize[d]" that "the False Claims Act is not a means of imposing treble damages and other penalties for insignificant regulatory or contractual violations." Instead, as one recent court summarized, "*Escobar* assumes and enforces a course of dealing between the government and a supplier of goods or services that rests comfortably on proven and successful principles of exchange—fair value given for fair value received. *Escobar* rejects a system of government traps, zaps, and zingers that permits the government to retain the benefit of a substantially conforming good or service but to recover the price entirely—multiplied by three—because of some immaterial contractual or regulatory non-compliance."

Thus, given its focus on goods or services—and their fair value—that underlie the FCA, the Court, though allowing implied false certification claims to proceed, defined the theory in such a way as to limit its application to specific representations regarding goods or services. Specifically, the Court held that FCA liability can exist under an implied false certification theory where "at least" two conditions are satisfied: (1) the defendant's 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."

This approach, limiting application of the implied false certification theory to specific representations about the goods or services provided, makes sense in that, historically, courts have expressed concern regarding FCA implied false certification theories. This is because, unlike "factual falsity" claims—where the defendant purportedly lies on the claim form itself—or "express false certification" claims—where the defendant certifies to a state of facts that do not exist on the face of the claim form—in implied false certification claims the actual claim form itself is truthful and accurate. This raises concerns of whether the defendant responding to an implied false certification claim actually had fair notice of an alleged FCA breach before suffering the imposition of treble damages and massive civil penalties. It further raises concerns about whether, under these circumstances, the FCA is simply being improperly used as a general antifraud super statute to enforce every other government statute, regulation and standard that is in existence.

Consistent with the limits that it placed on implied false certification claims, the *Escobar* Court provided guidance on how the FCA's materiality requirement should be enforced, and it clarified that the materiality standard is "rigorous" and "demanding." The Court identified a couple of factors that may be relevant to materiality, as well as a number of limiting factors. In sum, the Court shifted the focus away from whether a provision is labeled a condition of payment (this is still relevant, but not dispositive) or whether the government would be entitled to decline to pay, and toward what the government actually did, or would have done, knowing of the alleged noncompliance. Specifically, the Court noted, "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." (Emphasis added.) This rationale supports the principle that the FCA

protects actual government payments and also ensures that relators cannot subvert government programs by contending that specific regulatory violations should be pursued under the FCA's treble damages and civil penalty framework when expert government administrators charged with safeguarding and administering government programs would, in fact, "regularly" treat the infraction in some other, less severe fashion.

The Court's rulings as to implied false certification and materiality protect against the FCA being used, contrary to its intended purpose, as a general antifraud statute that is invoked to police merely garden-variety regulatory or contractual breaches.

United States ex rel. Rose v. Stephens Institute

In *United States ex rel. Rose v. Stephens Institute*, the relators (former admissions representatives of an art university) alleged that the university violated the FCA by paying bonuses to admissions representatives for increasing student enrollment in violation of an incentive compensation ban in its financial aid federal funding agreement. On interlocutory appeal, a 9th Circuit panel considered several questions related to the impact of *Escobar* on 9th Circuit precedent. In particular, the panel addressed whether *Escobar*'s "two conditions" must "always be satisfied" to maintain implied false certification liability under the FCA. Unlike the *Escobar* ruling, which focused on specific representations regarding goods or services, the 9th Circuit explained that it previously allowed a plaintiff to establish falsity by merely pointing to noncompliance with a law, rule or regulation that is somehow necessarily implicated in a defendant's claim for payment. The panel ultimately ruled that FCA plaintiffs "must satisfy *Escobar*'s two conditions to prove falsity."

The 9th Circuit reached this holding reluctantly, explaining that it was bound by its recent post-*Escobar* decisions in *United States ex rel. Kelly v. Serco, Inc.* and *United States ex rel. Campie v. Gilead Sciences, Inc.* More specifically, the 9th Circuit suggested that these cases may have gone too far in making the test mandatory, noting that the *Escobar* Court "did not state that its two conditions were the *only* way to establish liability under an implied false certification theory," but that its own decisions "appear[ed] to *require Escobar*'s two conditions nonetheless."

The 9th Circuit, after clarifying the mandatory nature of the two-prong test to prove falsity, found that the university's action satisfied this test because it (1) "specifically represented that the student applying for federal financial aid [was] an 'eligible borrower' and [was] 'accepted for enrollment in an eligible program'" and (2) "failed to disclose its noncompliance with the incentive compensation ban," and, thus, "those representations could be considered 'misleading half-truths.'" Accordingly, the 9th Circuit found that relators had created a genuine issue of material fact as to falsity.

The 9th Circuit went on to apply the *Escobar* materiality standard, concluding that, although the burden does not shift to the defendant, the university had not established immateriality as a matter of law. The 9th Circuit reached this conclusion based on evidence that (1) payment was conditioned on compliance with the incentive compensation ban (notwithstanding defendant's argument that it was a condition of participation, not a condition of payment); (2) the government "*did* care about violations" because it took various remedial measures short of "limiting, suspending, or terminating schools' access to federal student aid," including recouping money, at

least in some instances, from schools that violated the incentive compensation ban (as reflected in two Government Accountability Office (GAO) reports—although it appears that one GAO report specifically noted that, for 27 of the 32 schools reviewed, the government had either elected to pursue some lesser administrative remedy, such as merely mandating corrective action by requiring the cessation of such payments, and, in only one of the 32 cases, it pursued the same remedy that the relator apparently was pursuing, that is, total recoupment of the claim); and (3) the bonuses at issue were as much as \$23,000, as opposed to “cups of coffee or \$10 gift cards.”

The dissent disagreed on this point, finding that there was “simply no evidence” on “*how* the Government would respond” to the specific alleged violations in question based on “aggregate evidence that the Government cares” and the fact that payment was conditioned on compliance with the incentive compensation ban. As the dissent noted, “caring is not enough” under the *Escobar* materiality standard.

Impact of the *Rose* Holding

The 9th Circuit panel’s holding in *Rose* on the mandatory nature of the implied false certification test, although reluctant, is noteworthy. FCA plaintiffs in the 9th Circuit must now unequivocally demonstrate that they can satisfy *Escobar*’s two-part test when asserting that a claim is impliedly false, in addition to satisfying the “rigorous” and “demanding” materiality element.

However, the panel’s failure to faithfully apply *Escobar*’s overarching mandate to the facts at hand is even more significant. The panel claims to be guided by *Escobar*, but ignores its directives. Namely, as to implied false certification theory, the panel does not address how the alleged falsity (noncompliance with the incentive compensation ban) impacted the services provided (student education). Indeed, the panel does not indicate that the students failed to receive an education, that classes were not held, that the education provided was inadequate, that phantom students were claimed or any other specific representation as to the service provided that would indicate that the government did not receive fair value for the fair value paid. Instead, rather than actually apply *Escobar*’s two-prong implied false certification test, as it represented, it instead appeared to apply the prior test that it purported to reject: that is, that the plaintiff could establish falsity by merely pointing to noncompliance with a law, rule or regulation that is somehow necessarily implicated in a defendant’s claim for payment. As to materiality, although the panel articulated *Escobar*’s materiality test looking to the remedy the government “regularly” pursues based upon the infraction, the court actually appears to have failed to apply that test to its facts because it allowed the relator to pursue a remedy that, according to a GAO report, the government’s expert administrators would not typically pursue in the sound administration of their programs.

As the *Escobar* Court made clear, the FCA should not be used to punish such unrelated garden-variety breaches of contract or regulatory violations. As a result, though cloaked as adoptive of the *Escobar* standard, the panel’s decision may actually undermine *Escobar*. Although *Rose* provides a mandatory implied certification test upon which FCA defendants may rely, this holding may ultimately be overshadowed by the 9th Circuit panel’s misguided application of *Escobar*.