No. 17-15111

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA *ex rel.* SCOTT ROSE; MARY AQUINO; MITCHELL NELSON; LUCY STEARNS,

Plaintiffs-Appellees,

v.

STEPHENS INSTITUTE, DBA Academy of Art University,

Defendant-Appellant.

Appeal from a Decision of the U.S. District Court for the Northern District of California
Case No. 09-cv-05966 (Hamilton, J.)

BRIEF *AMICUS CURIAE* OF THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA IN SUPPORT OF DEFENDANT-APPELLANT

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 26.1 of the Federal Rules of Appellate Procedure, *amicus curiae* the Chamber of Commerce of the United States of America submits the following corporate disclosure statement:

The Chamber of Commerce is a non-profit, non-stock corporation organized under the laws of the District of Columbia. It has no parent corporation, and no company owns 10 percent or more of its stock.

Dated: June 6, 2017

/s/ John P. Elwood

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INTEREST OF *AMICUS CURIAE*[1]

The Chamber of Commerce of the United States of America (the "Chamber") is the world's largest business federation. It represents 300,000 direct members and indirectly represents the interests of more than three million companies and professional organizations of every size, in every industry, from every region of the country. An important function of the Chamber is to represent the interests of its members in matters before Congress, the Executive Branch, and the courts. The Chamber regularly files *amicus curiae* briefs in cases raising issues of concern to the nation's business community, including cases involving the False Claims Act ("FCA").

The Chamber has a strong interest in the questions presented in this case, which are fundamental to the scope of liability under the FCA. The FCA affects businesses from all sectors of the American economy. The Chamber's members, many of which are subject to complex regulatory schemes, have successfully defended scores of FCA cases arising out of government contracts, grants, and program participation in a variety of courts nationwide, including in this Circuit. With increasing frequency in recent years, private relators (only infrequently joined by the government itself) have invoked the "implied false certification"

[1] No counsel for a party authored this brief in whole or in part, and no person other than *amicus curiae*, its members, or its counsel made a monetary contribution for the brief's preparation or submission. All parties have consented to the filing of this brief.

theory in an effort to transform minor deviations from obscure contractual terms or regulations into FCA violations, triggering the Act's "essentially punitive" regime of treble damages and penalties. *Vt. Agency of Nat. Res. v. U.S. ex rel. Stevens*, 529 U.S. 765, 784-85 (2000).

The Supreme Court in *Universal Health Services, Inc. v. United States ex rel. Escobar* held that the implied false certification theory is valid "at least in some circumstances." 136 S. Ct. 1989, 1999 (2016). However, the Court extended the theory only to cases where businesses' claims for payment contain "specific representations about the goods or services provided" that "fail[] to disclose" material violations of relevant laws or contract requirements and thus could be seen as potentially misleading "half-truths." *Id.* at 2000-01. The Court also emphasized that the FCA's "demanding" materiality and scienter requirements provide critical checks on a potentially boundless theory that are necessary to ensure "fair notice" to defendants and guard against "open-ended liability." *Id.* at 2002-03. Rigorous enforcement of these standards is essential to prevent profound harm—not only to educational institutions like appellant Stephens Institute, but also to the myriad businesses, non-profit organizations, and even municipalities and state-affiliated entities that directly or indirectly perform work for the federal government in a broad array of sectors or administer funds through a vast range of federal programs. The Chamber and its members therefore have a substantial

interest in the correct interpretation and application of the FCA's implied false certification doctrine and materiality requirements.

SUMMARY OF ARGUMENT

The district court's application of *Escobar* undermines the Supreme Court's efforts to set reasonable boundaries on the otherwise expansive implied certification theory of liability under the FCA. Where the Supreme Court limited its implied certification decision to cases in which a business made a specific representation that was effectively a misleading half-truth, the district court has opened the door to treating *any* request for payment—no matter what the face of the claim says—as an implied certification of compliance with a host of statutes, regulations, and contractual provisions. And where the Supreme Court imposed a "demanding" materiality standard that turned on whether the government actually and routinely withheld payment for violation of provisions, the district court has applied an amorphous materiality test that looks to whether the government "cared about" the requirement, and which relied upon the government's change in enforcement policy years after the claims at issue. ER11.[2]

The result of the district court's deviations from *Escobar* is that businesses that make claims for payment with the federal government are at risk of being dragged into lengthy and costly litigation, and of being held liable for minor

[2] "ER" refers to Appellant's Excerpts of Record.

violations of minor rules and contract terms, even when the businesses have no notice that they violated any material obligation. These costs are passed on to the government and the taxpayer in the form of higher prices, reduced competition for government work, disruption of agency policies, and actual bills for the legal expenses of defending such cases.

I. *Escobar*'s two-part implied certification test should be rigorously applied. Implied certification cases are particularly troublesome because they require costlier discovery to address basic FCA elements: knowledge, materiality, and damages. Because relators and the Department of Justice often disregard agencies' policy preferences in bringing these implied certification cases, implied certification cases also disrupt the agencies' ability to decide how to apply their own regulations. *Escobar*'s two-part test ensures that only businesses that are put on notice that they are certifying compliance with a particular rule or contract term can be held liable under this disruptive and costly theory.

II. The Supreme Court's "demanding" materiality standard turns on what the government actually treated as material to its decision to pay the contractor at the time of the claim. That means that if the government knew about the allegations but paid anyway, a court should not, as the district court did here, supply hypothesized excuses for the government's failure to withhold payment. Those imagined excuses do not matter under *Escobar*, and complicate the

materiality inquiry unnecessarily because they turn on the government's motivations. *Escobar*'s standard also encourages companies to engage in self-disclosure. Materiality determinations should not be based on after-the-fact changes in agency policies, nor should the standard be watered down by looking to other indicators of a rule's "importance," such as administrative fines and corrective actions. That the agency resorted to those lesser remedies indicates that it did not consider the violation material to payment. Businesses should be able to look to the government's decision to pay in other cases for notice about what the government considers material, and thus learn how to tailor their compliance efforts to what really matters to the government when it decides to pay.

ARGUMENT

I. *Escobar*'s Two-Part Test Should Be Strictly Enforced to Minimize the Systemic Harms of Implied Certification Cases

The Supreme Court in *Escobar* recognized the risks that an expansive implied certification theory poses. *See also U.S. ex rel. Kelly v. Serco, Inc.*, 846 F.3d 325, 332-33 (9th Cir. 2017) (focusing on need for proof of false statements). Those concerns plainly animated the Court's decisions to limit the reach of its implied certification decisions to cases where "two conditions are satisfied: first, the claim does not merely request payment, but also makes specific representations about the goods or services provided; and second, the defendant's failure to disclose noncompliance with material statutory, regulatory, or contractual

requirements makes those representations misleading half-truths." *Escobar*, 136 S. Ct. at 2001; *accord Kelly*, 846 F.3d at 332-33. While the Supreme Court concluded that it "need not resolve whether all claims for payment" contain "implicit[] represent[ations], 136 S. Ct. at 2000, that was not meant to give courts license to disregard *Escobar*'s two-part test, as the district court did below, ER8. Rather, as this Court did in *Kelly*, courts should exercise caution before expanding implied certification beyond *Escobar*'s limited scope, considering the practical impacts of bypassing *Escobar*'s two-part standard.

A. Non-Intervened *Qui Tam* Cases Are Frequently Meritless, but Defense Costs and Potentially Catastrophic Damages Induce Settlements that Encourage Further Lawsuits

The number of new *qui tam* actions filed annually has skyrocketed in recent years. The median number of new *qui tam* suits filed annually has leapt from 395 per year during the decade 2002-2011 to a median of 702 over the past five years. *See* Civil Division, U.S. Dep't of Justice, *Fraud Statistics – Overview: Oct. 1, 1987 - Sept. 30, 2016*, at 1-2 (2016) ("*Fraud Statistics*"), http://goo.gl/LXhywX. Defending FCA cases requires a "tremendous expenditure of time and energy." Todd J. Canni, *Who's Making False Claims, The* Qui Tam *Plaintiff or the Government Contractor? A Proposal to Amend the FCA to Require that All* Qui Tam *Plaintiffs Possess Direct Knowledge*, 37 Pub. Cont. L.J. 1, 11 n.66 (2007). "Pharmaceutical, medical devices, and health care companies" alone "spend

billions each year" dealing with FCA litigation. John T. Bentivoglio et al., *False Claims Act Investigations: Time for a New Approach?*, 3 Fin. Fraud L. Rep. 801, 801 (2011). Discovery imposes heavy burdens on defendants, which can spend hundreds of thousands or even several million dollars fielding discovery demands in a single case.

Although most recoveries in cases brought by relators are small (or nonexistent), the handful of judgments and settlements in non-intervened case that soar to tens or even hundreds of millions of dollars loom large in the minds of business leaders considering whether to do business with the government or settle *qui tam* litigation. *See, e.g.*, Press Release, U.S. Dep't of Justice, Wyeth and Pfizer Agree to Pay $784.6 Million to Resolve Lawsuit Alleging That Wyeth Underpaid Drug Rebates to Medicaid (Apr. 27, 2016), http://goo.gl/bzw8Vg. But cases litigated by relators, as opposed to the government, are rarely meritorious. Non-intervened *qui tam* cases account for only about 4.8% of the dollars returned to government coffers under the FCA over the past 15 years. *See Fraud Statistics*, *supra*, at 1-2. Data obtained from the DOJ pursuant to a Freedom of Information Act ("FOIA") request show that only about 6.5% of non-intervened *qui tam* cases where the government made its intervention decision between DOJ fiscal years 2004 and 2013 had ended in recovery as of late 2014 when the data was gathered; the remaining 2,086 cases had ended in no recovery whatever for the taxpayer. *See*

DOJ FOIA Data Spreadsheet (hosted by Vinson & Elkins, LLP), http://goo.gl/iaOgeG. Of the tiny fraction of those non-intervened cases where there was any recovery, the median recovery during that period was a mere $800,000—probably comparable to (or less than) the litigation costs defendants incurred in those cases. *Id.* That compares to nearly $2.0 million in *qui tam* cases where Department of Justice ("DOJ") intervened. *Id.*

Even these meritless no-recovery cases frequently drag on for years. The DOJ FOIA data show that of the 2,086 declined cases that ended with zero recovery (of which, DOJ provided an election date and case-closing date for 1,805), 278 dragged on for more than three years after the government declined to intervene (which itself often occurs years after the case was initially brought). *Id.* Of those, 110 extended for more than five years after declination, and one case for more than ten years. Those cases represent an unnecessary burden on the court system and an enormous deadweight loss to the economy. *Id.*

Despite the fact that the overwhelming majority of non-intervened cases are meritless, defendants nonetheless face tremendous pressures to settle because the costs of litigating are so high and the potential downside is so great. *See Smith v. Duffey*, 576 F.3d 336, 340 (7th Cir. 2009) (discovery in "complex litigation can be so steep as to coerce a settlement on terms favorable to the plaintiff even when his claim is very weak"); *Int'l Data Bank, Ltd. v. Zepkin*, 812

F.2d 149, 153 (4th Cir. 1987) (danger of settling vexatious nuisance suits increased by the presence of a treble damages provision). The FCA imposes treble damages, 31 U.S.C. § 3729(a), and relators often claim the entire value of a contract or amount billed under it as damages, even if the alleged fraud affected only a small portion of billings. *But cf. U.S. ex rel. Wall v. Circle C Constr., LLC*, 813 F.3d 616, 617-18 (6th Cir. 2016) (rejecting "taint" theory of FCA damages). The FCA also authorizes civil penalties of between $10,957 and $21,916 per false claim for FCA violations after November 1, 2015, 31 U.S.C. § 3729(a); 28 C.F.R. § 85.5, an amount that ratchets up annually even for pending cases, 28 U.S.C. § 2461 note. Relators regularly seek penalties even where the government suffered no actual injury. *E.g.*, *U.S. ex rel. Davis v. District of Columbia*, 679 F.3d 832, 840 (D.C. Cir. 2012). In addition, the FCA authorizes relators to recover attorneys' fees and "reasonable expenses." 31 U.S.C. § 3730(d)(1)-(2).

The burden on businesses that provide the government necessary goods or services is not limited to direct monetary liability. The existence of allegations (no matter how tenuous) that a company "defraud[ed] [the] country sends a message" that is harmful, and "[r]eputation[,] . . . once tarnished, is extremely difficult to restore." Canni, *supra*, at 11; *accord* Sean Elameto, *Guarding the Guardians: Accountability in Qui Tam Litigation Under the Civil False Claims Act*, 41 Pub. Cont. L.J. 813, 824 (2012). For companies that do significant government work,

"the mere presence of allegations of fraud may cause [federal] agencies to question the contractor's business practices." Canni, *supra*, at 11; *U.S. ex rel. Grenadyor v. Ukrainian Vill. Pharmacy, Inc.*, 772 F.3d 1102, 1105-06 (7th Cir. 2014) ("[A] public accusation of fraud can do great damage to a firm . . . ."), *cert. denied*, 136 S. Ct. 49 (2015). A finding of FCA liability can result in suspension and debarment from government contracting, *see* 2 C.F.R. § 180.800—"equivalent to the death penalty" for government contractors. 3 Ralph C. Nash & John Cibinic, *Suspension of Contractors: The Nuclear Sanction*, Nash & Cibinic Rep. ¶ 24, at 4 (Mar. 1989); *see also* 34 C.F.R. § 600.7(a)(3)(ii) (declaring ineligible for funding educational institutions that "[have] been judicially determined to have committed fraud involving title IV, HEA program funds").[3]

FCA allegations also generate ancillary risks regardless of their underlying merit. For instance, FCA allegations can precipitate shareholder derivative suits. *E.g.*, Dani Kass, *Community Health Execs to Pay $60M Over Investor Suits*, Law360 (Jan. 18, 2017), http://goo.gl/1iSLlY. DOJ might also demand individual

[3] In addition, agencies and DOJ, with mixed results, have tried to block businesses' efforts to obtain contractual relief under the Contract Disputes Act in administrative forums by interposing fraud allegations and seeking a stay pending their resolution in district court. *See, e.g.*, R. & R., *United States v. Kellogg Brown & Root Servs., Inc.*, No. 12-cv-4110 (C.D. Ill. Apr. 28, 2017) [Dkt. 157] (denying DOJ's request to enjoin the Armed Services Board of Contract Appeals from hearing a parallel contract case); *Pub. Warehousing Co. K.S.C.*, ASBCA No. 59020 (Jan. 12, 2017) (staying contract case pending resolution of 10-year-old contract fraud criminal case).

employees of the company be given up for prosecution as a condition of settlement. *See* Press Release, U.S. Dep't of Justice, Justice Department Recovers Over $4.7 Billion from False Claims Act Cases in Fiscal Year 2016 (Dec. 14, 2016), http://goo.gl/qc2YTK (noting emphasis on holding individuals liable).

The FCA creates sufficient incentives that marginal or even meritless cases can "be used to extract settlements." Elameto, *supra*, at 824; *accord* Canni, *supra*, at 11-12. The combination of "punitive" liability and the reality that even meritless lawsuits often drag on for years of costly litigation creates intense pressure on defendants to "settl[e] questionable claims." *See AT&T Mobility LLC v. Concepcion*, 563 U.S. 333, 350 (2011). Greater access to litigation financing for *qui tam* actions has thrown even more fuel onto the fire. Note, Mathew Andrews, *The Growth of Litigation Finance in DOJ Whistleblower Suits: Implications and Recommendations*, 123 Yale L.J. 2422 (2014); Donald E. Vinson, *How Litigation Finance Funds Whistleblower Actions*, Law360 (Jan. 5, 2016), http://goo.gl/vM8dba. Thus, the growing number of *qui tam* actions does not demonstrate increased fraud, but rather growing incentives to sue.

B. Unless *Escobar*'s Implied Certification and Materiality Standards Are Strictly Enforced, Contractors Will Be Subject to Punitive FCA Liability and Costly Litigation for Technical Violations of Minor Contractual and Regulatory Provisions

Despite the Supreme Court's caution against misusing the FCA to "punish[] garden-variety breaches of contract or regulatory violations," *Escobar*, 136 S. Ct.

at 2003, relators and DOJ persist in doing just that. Unless *Escobar*'s implied certification and materiality standards are rigorously applied, implied false certification can be read to require essentially 100 percent compliance with a seemingly limitless range of contractual and regulatory provisions—even where the contractor said literally nothing on its invoices that could be read to have misled the government into paying the bill. For instance, in the present case, the defendant's program participation agreement required the defendant to agree to "comply with all statutory provisions of or applicable to Title IV of the HEA, all applicable regulatory provisions prescribed under that statutory authority, and all applicable special arrangements, agreements, and limitations entered into under the authority of statutes applicable to Title IV of the HEA." ER295. Virtually any area of government contracting will involve similarly complex contractual requirements and an overlay of technical regulatory requirements that could subject contractors to hair-trigger lawsuits. Examining two other areas besides education—health care and defense contracting—illustrates how damaging implied certification could be unless courts rigorously enforce *Escobar*'s two-part standard.

Health Care. Health care and pharmaceutical manufacturing are areas rife with complex regulations that may allow relators to second-guess compliance efforts, and the implied certification theory renders the complexity of such programs a potential gold mine for opportunistic relators. Relators in health care

qui tam cases frequently bring claims in cases where health care providers unwittingly ran afoul of complex federal requirements. *See, e.g.*, Joan H. Krause, *"Promises to Keep": Health Care Providers and the Civil False Claims Act*, 23 Cardozo L. Rev. 1363, 1368 (2002). In *U.S. ex rel. Wilkins v. United Health Group, Inc.*, 659 F.3d 295, 307 (3d Cir. 2011), for example, a relator alleged that health care service companies were liable under the FCA because they impliedly certified compliance with Medicare regulations concerning the content of marketing flyers and limiting marketing efforts in a doctor's office waiting room.

The same is true for pharmaceutical manufacturers. For example, one relator alleged that claims for prescription drugs were fraudulent because those pharmaceuticals were repackaged into patient-friendly blister packs at a facility that also processed penicillin, whereas FDA Current Good Manufacturing Practices call for penicillin to be handled at a separate facility. *See U.S. ex rel. Rostholder v. Omnicare, Inc.*, No. 07-cv-1283, 2012 WL 3399789, at *5 (D. Md. Aug. 14, 2012), *aff'd*, 745 F.3d 694 (4th Cir. 2014). Another relator asserted an implied-certification claim based on a pharmacy's alleged sale of medication that had been repackaged and redispensed allegedly without fully complying with a New Jersey Board of Pharmacy regulation. The relator contended that the state regulation permitted redispensing only "[i]f a unit dose packaged medication has been stored in a medication room or secure area in the institution and the

medication seal and control number are intact." *U.S. ex rel. Quinn v. Omnicare Inc.*, 382 F.3d 432, 435, 442 (3d Cir. 2004) (quoting N.J. Admin. Code § 13:39-9.15(a)(2)).

Defense. Logistics Civil Augmentation Program ("LOGCAP") contracts support military operations overseas, and each entails providing a wide range of logistical services such as housing, food, and recreation for America's troops. Those contracts are sprawling and complex, containing (or incorporating by reference) literally *thousands* of terms, both in the base contracts and in the hundreds of individual statements of work and task orders issued under them. The agreements incorporate "a patchwork of other agreements and instruments," including large portions of the two-thousand-page Federal Acquisition Regulation, as well as guidance documents issued by various entities within the Department of Defense. *Carmichael v. Kellogg, Brown & Root Servs., Inc.*, 572 F.3d 1271, 1276 n.2 (11th Cir. 2009). The contract at issue in *Carmichael*, for example, incorporated by reference (among other things) portions of an Army Field Manual. *E.g., id.* (citing Dep't of the Army, *Army Motor Transport Units and Operation*, Field Manual 55-30, http://goo.gl/30UMGH). Another case asserted violations of requirements that "all Electrical work would conform to Army Facilities Component Systems drawings." Compl. ¶ 24, *U.S. ex rel. McLain v. Kellogg Brown & Root Servs., Inc.*, No. 08-cv-499 (E.D. Va. May 16, 2008) [Dkt. 1]. Still

another case alleged the defendant violated record-keeping regulations by recording inaccurate figures for how many individuals used recreation facilities, even though that headcount information had no bearing on the contractor's payments. *U.S. ex rel. McBride v. Halliburton Co.*, 848 F.3d 1027, 1028-29 (D.C. Cir. 2017).

1. Strictly Enforcing *Escobar*'s Two-Part Test Is Necessary to Provide Notice of Punitive FCA Liability and to Make the FCA Administrable

Escobar's two-part test has practical relevance to how contractors submit claims for payments and whether it is even possible for a contractor to submit a truthful claim. The requirement of a specific representation connected to the alleged violation ensures that companies have notice of which contractual and regulatory requirements—among countless requirements—they are representing to have fully satisfied. If a simple invoice for "50 trucks" or "biopsy" can be read to imply a certification that, to use the Supreme Court's hypothetical in *Escobar*, the contractor used American-made staplers, *Escobar*, 136 S. Ct. at 2004; that its third-party cloud computing services vendor fully complied with intricate cyber-security regulations, Dallas Hammer & Evan Bundschuh, *The Rise of Cybersecurity Whistleblowing*, NYU Program on Corporate Compliance & Enforcement (Dec. 29, 2016), http://goo.gl/iJ75Oc; DFARS 252.204-7008 to -7010; or that the contractor has complied with every aspect of the Federal Acquisition Regulation,

Escobar, 136 S. Ct. at 2004, then contractors do not have actual notice of what conduct will expose them to punitive FCA liability. *Escobar* rejected such an outcome. *Id.*

A rule that did not require specific representations would put both contractors and the government in an impossible situation. There is no serious question that the government could not "require[] contractors to aver their compliance with the entire U.S. Code and Code of Federal Regulations," on pain of punitive FCA liability. *Escobar*, 136 S. Ct. at 2004. The Court rejected that argument, stating that the FCA "does not adopt such an extraordinarily expansive view of liability." *Id.* Businesses could try to identify and disclose with each invoice every colorable instance of non-compliance with FAR and other regulatory provisions, the United States Code, agency guidance letters, the contract, and its task orders. As a practical matter, such an effort would prove enormously time-consuming and prohibitively expensive, and that expense would ultimately be borne by the government and the taxpayers. Even if such disclosures were practicable, they would likely yield invoices containing so many disclosures that agencies would be overwhelmed by their volume and would miss material issues.

2. Strictly Enforcing *Escobar*'s Two-Part Test Is Necessary to Keep Discovery Manageable

The technical and complex legal and factual issues involved in showing a knowing and material implied false certification require correspondingly complex

(and thus costly) discovery. The amount and variety of evidence required exceeds the levels called for in traditional FCA cases alleging, for instance, that the guns delivered do not shoot. Instead, these cases require discovery about knowledge, materiality, and damages as they relate to complex contractual and regulatory requirements.

To establish knowledge in implied certification cases, relators must show at a minimum the defendant recklessly disregarded its alleged violation of the relevant rule or contract requirement. *U.S. ex rel. Purcell v. MWI Corp.*, 807 F.3d 281, 287-91 (D.C. Cir. 2015), *cert. denied*, 137 S. Ct. 625 (2017); *Safeco Ins. Co. of Am. v. Burr*, 551 U.S. 47, 69-70 & n.20 (2007). Reckless disregard cannot be shown where the relevant rule is ambiguous and the alleged conduct was not a violation under an objectively reasonable reading of the rule, unless the relator can show the contractor was warned away from its interpretation by the government. *Purcell*, 807 F.3d at 287-91. A relator seeking to prove knowledge in such cases will certainly seek discovery on each aspect of that test.

As for materiality, implied certification cases often demand in-depth discovery to determine whether and when the government learned of the alleged misconduct, whether the government decided to withhold or rescind payment as a result, whether the government in the "mine run of cases" "consistently" and "routinely" "refuses to pay" where similar misconduct is alleged, and whether the

defendant knew that the government refused to pay in other cases where there were violations. *Escobar*, 136 S. Ct. at 2003-04.

Damages in implied certification cases present another source of costly discovery. It is relatively straightforward to price a gun that does not shoot as having almost no value. But it is far less simple to determine the value of (for instance) recreational services allegedly provided with inaccurate usage records, *McBride*, 848 F.3d at 1028-29; jet engines that perform as specified but allegedly had their prices negotiated based on inaccurate data, *United States v. United Techs. Corp.*, 782 F.3d 718, 721-23 (6th Cir. 2015); safe and effective pharmaceuticals manufactured in a factory that allegedly does not meet the latest industry standards, *Rostholder*, 745 F.3d at 698, 701; or, as in this case, students educated at institutions that allegedly paid incentives to employees for attracting students. Valuing the impact of these "deficiencies," if there was any impact at all, will require extensive discovery from the defendant and the government about (for example) prices for similar services on the open market in order to perform a "'comparable sales' analysis[,] [which] has long been and remains the preferred method of establishing 'fair market value.'" *United Techs.*, 782 F.3d. at 731 (quoting *United States v. 103.38 Acres of Land*, 660 F.2d 208, 211 (6th Cir. 1981)).

The end result, once again, is enormous deadweight loss to the economy, as even meritless cases that will end without recovery require years of costly

discovery. The *McBride* case involving allegations of faulty recordkeeping is just one example: Though the relevant contract did not tie compensation to headcounts at facilities, the litigation required the deposition of numerous witnesses and required the defendant to manually scan thousands of pages of records from fifty bases in the middle of a war zone. *See* Reply Mem. in Supp. of Defs.' Bill of Costs at 2-4, *U.S. ex rel. McBride v. Halliburton Co.*, No. 1:05-cv-828 (Nov. 13, 2015) [Dkt. 228]. And in the end, the relator's claims were dismissed on summary judgment. *McBride*, 848 F.3d at 1028-29.

C. Implied Certification Cases Impose Monetary and Policy Costs on the Government and Taxpayers

1. Directly and indirectly, the costs of FCA cases are passed on to contracting agencies—and taxpayers. The risks and costs of litigation may force responsible companies to charge the government higher prices to compensate for far-reaching and potentially catastrophic FCA liability and litigation costs. *Cf. United States v. Data Translation, Inc.*, 984 F.2d 1256, 1262 (1st Cir. 1992) (Breyer, C.J.) ("[S]ignificantly increasing competitive firms' cost of doing federal government business[] could result in the government's being charged higher . . . prices."). Already, the taxpayer bears a significant part of the direct cost of such suits. For instance, cost-based contractors are allowed to pass on to the government 80% of their legal expenses from litigating non-intervened *qui tam* cases when they prevail. FAR 31.205-47(a)(3), (e) .

Some firms may even decline to bid on contracts in the first place if they cannot reasonably anticipate (and price in to their bids) the costs of doing business with the government. *Cf. Tozer v. LTV Corp.*, 792 F.2d 403, 407 (4th Cir. 1986) ("Without the [government contractor] defense [to design-defect claims], military contractors would be discouraged from bidding on essential military projects." (internal quotation marks omitted)). The former head of federal acquisition policy recently noted that potential contractors are wary of "the reputational risk and the very onerous application of [a] remedy for something that is certainly unintentional" when engaging in business with the government. Michael Macagnone, *DOD Buying Group Pushes House Panel for Rules Reform*, Law360 (May 17, 2017), http://goo.gl/TaqwDO; *Initial Findings of the Section 809 Panel: Setting the Path for Streamlining and Improving Defense Acquisition, Hearing Before the H. Comm. on Armed Servs.*, 115th Cong. (May 17, 2017), http://goo.gl/eGYBqn. Others have warned that "[i]t could be almost reckless for a firm to agree" to provide cyber security services that meet "all" regulatory requirements, given the risk of "contractor gotchas" and overzealous enforcement through implied certification suits. Brian D. Miller, *The Hidden Cybersecurity Risk for Federal Contractors*, FCW (Jan. 12, 2016), http://goo.gl/bbHIZA. It is not just a theoretical possibility that people will decline to perform needed services for the government: Doctors have exited Medicare in droves, due in part to

concerns about "fraud" liability based on an auditor's subjective assessment of "deviations" from program requirements. *See* David Hogberg, *The Next Exodus: Primary-Care Physicians and Medicare*, Nat'l Policy Analysis (Aug. 2012), http://goo.gl/9uLxe.

2. Non-intervened FCA actions pursued by self-interested relators impose policy-related costs by disrupting agency priorities and enforcement choices. Relators "pursue different goals and respond to different incentives than do public agencies" and have no "direct accountability" to the public. Jody Freeman, *The Private Role in Public Governance*, 75 N.Y.U. L. Rev. 543, 574 (2000). Regulatory schemes often contain remedies tailored to the particular context. If the government has concerns about compliance with contractual or regulatory requirements, for instance, it can demand information, require a certification of compliance, or exercise inspection rights. *E.g.*, 42 U.S.C. § 1437f(o)(8)(C)-(E) (providing for regular inspections of public housing to ensure continued eligibility for subsidy). The government can also issue notices of corrective action, addressing the issue without resorting to extreme measures that could negatively affect continued performance. *See, e.g., U.S. ex rel. Howard v. Lockheed Martin Corp.*, 14 F. Supp. 3d 982, 1014 (S.D. Ohio 2014) (government issued Corrective Action Requests upon discovering contractual noncompliance). As DOJ itself explained, "it is frequently in the Government's interest, as it would be in the

interest of any contracting party, to avoid excessive concern over minor failings that might threaten a useful course of dealing with the other party," particularly if "the contractor's performance otherwise has been adequate." Constitutionality of the Qui Tam Provisions of the False Claims Act, 13 Op. O.L.C. 207, 220 (1989).

Relators "are motivated primarily by prospects of monetary reward rather than the public good," *Hughes Aircraft Co. v. U.S. ex rel. Schumer*, 520 U.S. 939, 949 (1997), and so have little concern for the important public policy considerations that regulators carefully weigh when administering a complex government program. Although the government may elect to rely on (or even refrain from pursuing) its administrative remedies for regulatory or contract violations, a bounty-hunting relator sees things differently. Focused solely on his own recovery, a relator has no incentive to ignore *any* regulatory or contract violation, no matter how technical; if it might lead to a lucrative payday, a relator will have cause to pursue it.

Heavy-handed use of the *qui tam* procedure is antithetical to the FCA's goals. "[T]he purposes of the FCA [are] not served by imposing liability on honest disagreements, routine adjustments and corrections, and sincere and comparatively minor oversights, particularly when the party invoking [the FCA] is an uninjured third party." *U.S. ex rel. Searle v. DRS Tech. Servs., Inc.*, No. 14-cv-402, 2015 WL 6691973, at *10 (E.D. Va. Nov. 2, 2015) (internal quotation marks omitted),

aff'd, No. 15-2442, 2017 WL 715815 (4th Cir. Feb. 23, 2017). A *qui tam* suit serves no purpose where the government has decided that a regulatory or contractual violation is best addressed through the administrative process. Indeed, such suits can affirmatively undermine regulators' efforts, nullify their decisions to *correct* (rather than penalize) errors, and impose the type of drastic sanctions that regulators deliberately avoided. *See, e.g., U.S. ex rel. Conner v. Salina Reg'l Health Ctr., Inc.*, 543 F.3d 1211, 1220 (10th Cir. 2008) (improper use of *qui tam* suits can "undermine the government's own administrative scheme for ensuring that hospitals remain in compliance and for bringing them back into compliance when they fall short of what the Medicare regulations and statutes require"); *U.S. ex rel. Siewick v. Jamieson Sci. & Eng'g, Inc.*, 214 F.3d 1372, 1378 (D.C. Cir. 2000) (permitting FCA claim based on violation of a statute could "unilaterally divest[] the government of the opportunity to exercise . . . the discretion to accept or disaffirm the contract on the basis of the complex variables reflecting the officials' views of the government's longterm interests"); *U.S. ex rel. Brooks v. Stevens-Henager College*, 174 F. Supp. 3d 1297, 1311 (D. Utah 2016) ("Just as federal courts are ill-equipped to make decisions about medical care standards, courts are equally ill-equipped to determine the proper balance between enhancing access to education by allowing schools to retain eligibility for Title IV funding and adequately enforcing the requirements of program participation." (citations

omitted)); *cf. Rostholder*, 745 F.3d at 702 ("[A]llowing FCA liability based on regulatory non-compliance could 'short-circuit the very remedial process the Government has established to address non-compliance with those regulations.'" (quoting *Wilkins*, 659 F.3d at 310)).

Despite the high cost of these cases to American businesses and to agencies, the government rarely exercises its authority under 31 U.S.C. § 3730(c)(2)(A) to dismiss *qui tam* actions. Instead, the government routinely lets relators "proceed with[] thousands of non-meritorious qui tam suits." Michael Rich, *Prosecutorial Indiscretion: Encouraging the Department of Justice to Rein in Out-of-Control Qui Tam Litigation Under the Civil False Claims Act*, 76 U. Cin. L. Rev. 1233, 1264-65 (2008). Such decisions are ultimately made by DOJ, rather than the affected regulatory agency. *See* 28 C.F.R. §§ 0.45(d), 0.160(d)(2), 0.161 (assigning responsibility to litigate and to settle FCA cases to the DOJ Civil Division). Most often, the government is only too happy to wait it out, reaping the bounty if a defendant elects to settle or the relator is ultimately successful. *Id.* at 1265-66; *accord* David Freeman Engstrom, *Public Regulation of Private Enforcement: Empirical Analysis of DOJ Oversight of Qui Tam Litigation Under the False Claims Act*, 107 Nw. U. L. Rev. 1689, 1717 (2013) (noting that 460-case subsample of *qui tam* actions "revealed exactly *none* in which DOJ exercised its termination authority"). In fact, in some cases, DOJ itself pursues cases where the

contracting agency itself does not believe the case has merit. *See, e.g.*, *United States v. BAE Sys. Tactical Vehicle Sys., LP*, No. 15-cv-12225, 2017 WL 1457493, at *2 (E.D. Mich. Apr. 25, 2017) (noting the Army withdrew underlying contract claim while DOJ persisted in the FCA action). DOJ is thus unlikely to rein in relators (or itself) when there is money on the table—regardless of the wishes of DOJ's client agencies.

II. Materiality Determinations Should Turn on an Agency's Routine Contemporaneous Payment Decisions in Similar Cases, Not Use of Administrative Remedies or the Agency's Later Policies

The Supreme Court made clear in *Escobar* that the focus of materiality is the government's "actual behavior" in cases where it knew of the alleged violation of a law or contract term, *Escobar*, 136 S. Ct. at 2002 (quoting 26 R. Lord, *Williston on Contracts* § 69:12 (4th ed. 2003)), and in particular, payments made in the face of "noncompliance with [a] particular statutory, regulatory, or contractual requirement," *id*. at 2003. When the government "pays a particular claim in full despite its actual knowledge that certain requirements were violated" or "regularly pays a particular type of claim in full despite actual knowledge that certain requirements were violated," "that is strong evidence that the requirements are not material." *Id*. at 2003-04. The district court dramatically weakened *Escobar*'s "demanding" standard and disregarded the specific examples of types of "strong evidence" of whether the alleged conduct was (or was not) material to payment,

instead interpreting a broad range of "corrective actions" to be compelling evidence of materiality. ER11-12. Under the district court's rule, contractors will face substantially the same risk of FCA liability for "garden-variety" immaterial contractual and regulatory violations that they encountered before *Escobar*. 136 S. Ct. at 2003.

1. The district court concluded "that the [Department of Education's] decision not to take action against AAU despite its awareness of the allegations in this case is not terribly relevant to materiality," speculating that there might have been valid reasons for the Department's inaction: it "could well have been based on difficulties of proof or resource constraints, or the fact that the truth of the allegations had yet to be proven." ER10-11. There is no basis for the district court's restrictive materiality test. *Escobar* did not say that courts should look to whether resource constraints or lack of proof were behind the government's payment and non-enforcement decisions: It simply said it was relevant whether the government paid a claim "despite its actual knowledge that certain requirements were violated." 136 S. Ct. at 2003.

That is as it should be. *Every* decision is a product of "resource constraints." Any time the government knows of an alleged violation but decides to pay anyway, that ordinarily reflects "a complicated balancing of a number of factors," such as "whether a violation has occurred, . . . whether agency resources are best

spent on this violation or another, whether the agency is likely to succeed if it acts, whether the particular enforcement action requested best fits the agency's overall policies, and, indeed, whether the agency has enough resources to undertake the action at all." *Heckler v. Chaney*, 470 U.S. 821, 831 (1985). If the government had unlimited personnel and resources, it presumably would enforce every contractual clause and every regulatory provision to the *n*th degree. That the government insists on enforcing a provision despite resource constraints demonstrates it is material. And similarly, the fact that the government invested the resources to obtain necessary proof of particular facts tends to demonstrate that those facts are material. If pleading "resource constraints" were enough to prevent a defendant from defeating materiality, it would essentially render *Escobar*'s observation about the effect of government knowledge a dead letter.

In addition, *Escobar*'s objective rule is a much more straightforward test of materiality than the district court's rule, because all it requires of defendants is to show the government knew about the issues in this case. The district court's analysis, by contrast, would require inquiring into the government's subjective motivations, which would introduce into the materiality determination such "difficulties of proof or resource constraints, or the fact that the truth of the allegations has yet to be proven." ER10. Moreover, because inquiry into the government's motivations would require intrusive discovery into the government's

payment decisions, it is inconsistent with *Escobar*'s express understanding that materiality is an issue that can be resolved on the pleadings. *See Escobar*, 136 S. Ct. at 2004 n.6.

There is another major benefit to closely adhering to a rule that inaction in the face of government knowledge evidences a lack of materiality: It encourages businesses to disclose noncompliance. The FCA gives contractors little benefit for self-disclosure, and if negotiations with DOJ to reach settlement breaks down, businesses can face significant FCA liability despite their efforts. *See* Note, David Farber, *Agency Costs and the False Claims Act*, 83 Fordham L. Rev. 219, 241-42 (2014) ("[T]he FCA whistleblower framework creates incentives to disfavor internal compliance reporting and cooperation . . . ."). However, the prospect that government inaction may be proof of immateriality helps temper the risks of self-disclosure.

2. The district court also relied on the Department of Education's "change in position" after the claims in question here were submitted. ER11. But looking to the rules and agency's practices *at the time the claim was submitted* dovetails with the requirement that the "defendant know[]" the alleged violation is material when it acted. *Escobar*, 136 S. Ct. at 2004. The district court never explained why an agency's later-adopted position is relevant to that inquiry. Moreover, agencies should not be able to retroactively create materiality by changing their practices

after a claim is submitted; indeed, such a position would reward the government for adopting made-for-litigation materiality positions. The revised policies relied upon by the district court below were issued by the government five years after this case was brought. ER11-12; Appellant's Br. 8, 50.

3. The district court also looked to "the government's corrective reforms, fines, and settlement agreements" in other cases, which, according to the district court, indicated that the Department "cared about" ICB violations. ER11-12. But consistent with *Escobar*'s exclusive focus on payment, the materiality should turn on the government's decision to pay or not to pay, not on whether the agency took advantage of other remedies or in some abstract sense the agency "cared about" the regulation or deemed it "important." *Id.* Problems meriting only "garden-variety" administrative remedies such as "corrective reforms" are precisely the sort of minor violations the Supreme Court sought to exclude from the scope of the FCA. *See Escobar*, 136 S. Ct. at 2003. For such claims, the agency has already selected its preferred remedy given the lesser harms the rule was designed to regulate. *See supra* 19-24. Under the district court's rule, if the government consistently imposes a $1 penalty for each non-American stapler a hospital purchases, *see* 136 S. Ct. at 2004, but otherwise pays millions of dollars of reimbursements in full, that minimal enforcement shows the agency "cares about" the regulation and proves it is material to payment.

Moreover, materiality in the "mine run" of cases should be evaluated based on whether the agency "routinely rescinds" payment because only "routine" non-payment ensures "the defendant has 'actual knowledge'" of materiality. *Escobar*, 136 S. Ct. at 2001, 2003. But here, the district court found sporadic, selective enforcement sufficient to qualify as "routine[]" and "consistent[]." ER10-11; Appellant's Br. 44-45, 48-49. But basing materiality on such inconsistent enforcement deprives contractors of notice that a specific issue was material to the government. Depriving businesses of notice about what actually matters to the agency has the side-effect of leading contractors either to fail to focus on what is important, spread their compliance efforts so thinly that they struggle to keep up with every issue, or engage in "over-compliance" at a greater expense to the company and in turn a higher price to the taxpayer. Clear signaling of what provisions are material is key to businesses appropriately calibrating their compliance efforts.

CONCLUSION

For these reasons, and those set forth in appellant's brief, the judgment below should be reversed.

Respectfully submitted.

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CERTIFICATE OF COMPLIANCE

1. This brief complies with the type-volume limitation of Circuit Rule 32-1(a) and Fed. R. App. P. 29(a)(5) because it contains 6,988 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because it has been prepared in a proportionally spaced typeface using Microsoft Word 2010 in Times New Roman 14-point font.

Dated: June 6, 2017

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CERTIFICATE OF SERVICE

I hereby certify that I electronically filed the foregoing Brief *Amicus Curiae* of the Chamber of Commerce of the United States of America with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system on June 6, 2017.

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Dated: June 6, 2017

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