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False Claims Act

D.C. Circuit Addresses FCA 'Implied Certification' Theory in *United States v. Science Applications Int'l Corp.*



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On December 3, 2010, the U.S. Court of Appeals for the D.C. Circuit issued an opinion with broad implications for the ever-expanding body of False Claims Act case law. First, the three-judge panel that unanimously decided *United States v. Science Applications Int'l Corp (SAIC)* (Slip. Op. No. 09-5385) adopted a relatively broad "implied certification" theory of civil FCA liability for the D.C. Circuit. Second, the court rejected the Government's assertion that a corporate entity can be found to possess the requisite knowledge for an FCA violation on the basis of a "collective knowledge" theory that pools the knowledge of all of the corporate entity's employees. Third, the D.C. Circuit held that the value of goods or services provided under a contract must be considered when assessing FCA damages, rejecting the Government's argument that advisory services found to be tainted by an undisclosed conflict of interest were *per se* valueless.

Background of the Case

The FCA complaint filed by the Department of Justice alleged that SAIC "knowingly" made false implied certifications of compliance with organizational conflict of interest (OCI) provisions in a pair of consulting services contracts with the Nuclear Regulatory Commission (NRC). Those contracts, awarded in 1992 and 1997, required SAIC to engage in a variety of tasks to assist the NRC in developing scientifically based standards for the free release of low-level radioactive material to the private sector for recycling. SAIC had no role in developing policy or recommending rulemaking for the NRC under those contracts.

Among other things, the OCI clause in the NRC contracts limited SAIC's ability to "work for others" during the contract term. SAIC agreed to "forego entering into consulting or other contractual arrangements with any firm or organization," including firms or organizations regulated by the NRC, "the result of which may give rise to a conflict of interest with respect to the work being performed under this contract." The OCI clause also required SAIC to obtain the Contracting Officer's written approval before entering into any such arrangement that "might involve a potential conflict of interest." And, the contract also required SAIC to certify that it had no OCI, and to immediately disclose potential conflicts (including OCI issues) if they were discovered after contract award. SAIC was not required to certify OCI compliance each time it sought payment, and neither the contract OCI clause nor the NRC's OCI regulation conditioned payment on OCI compliance or disclosure. Rather, the contract required SAIC to use pre-printed payment forms which contained no express certifications relating to this issue at all.

While performance was underway, during an open NRC meeting in October 1999, a member of the public alleged that SAIC was in violation of these contractual provisions. The NRC requested information regarding these allegations; SAIC responded by disclosing its existing contracts with two other companies in the nuclear field. After determining that SAIC had violated the conflict-of-interest provisions in its contracts, the NRC terminated SAIC's contracts. Notwithstanding that action, the NRC continued to use the SAIC work product delivered under the contracts. The Government alleged that SAIC's relationships violated the contract OCI provisions, and even though compliance with these provisions was not an express condition of payment, there was sufficient evidence (particularly the *post-hoc* testimony of the contracting officer) for the jury to conclude that compliance was a material provision upon which the Government relied in making payments to SAIC.

In 2005, the Justice Department filed an action against SAIC alleging two claims under 31 U.S.C. §3729 *et seq.*, the

civil FCA statute, and one claim for breach of contract. Five of the six relationships that allegedly should have been disclosed by SAIC involved tangential business relationships between SAIC and companies regulated by DOE – not by NRC. The sixth relationship at issue involved an SAIC employee involved in performance of the 1999 contract who served on the Board of Directors of a recycling company that was essentially "defunct" at the time the 1999 contract was awarded.

The Government's allegations relied on the "implied certification" theory of FCA liability, alleging that SAIC was liable even though its invoices did not certify compliance with the OCI provisions of the pertinent contracts, and compliance with the OCI provisions was not an express condition precedent to payment under the contracts. In *United States v. Science Applications Int'l Corp.*, 555 F. Supp. 2d 40, 49-51 (D.D.C. 2008), the district court denied SAIC's motion for summary judgment and permitted the Government to go forward with this theory of liability. Following a four-week trial, a jury found SAIC liable under the FCA, and also liable for breach of contract. On the breach of contract claim, the jury awarded damages of $78. Based on the court's damages instruction, however, the jury assessed FCA single damages of $1,973,839.61, the full amount of all payments made to SAIC by the Government under the contracts. Pursuant to the FCA, this amount was then trebled. The district court added an additional $577,500 in civil FCA penalties to this amount, plus the breach damages, for total damages of $6,499,096.83.

Following the jury verdict, SAIC moved for judgment as a matter of law or, alternatively, for a new trial, arguing: (1) the Government failed to prove its implied certification theory because the record contained no evidence that payment was expressly conditioned on compliance with the contract's OCI provisions; (2) the evidence precluded the jury from finding SAIC liable because of SAIC's reasonable belief that it had no conflicts as defined by the applicable contractual provisions and regulations; (3) the jury instructions were erroneous and prejudicial, including one instruction that the jury could find that SAIC possessed knowledge based on the "collective knowledge" of its employees; and (4) the Government failed to prove that it had suffered any damages from SAIC's false claims, and that the district court's damages instruction was erroneous and prejudicial. In *United States v. SAIC*, 653 F. Supp. 2d 87 (D.D.C. 2009), the district court rejected each of SAIC's arguments. SAIC appealed.

The D.C. Circuit's Opinion in the SAIC Case

The D.C. Circuit affirmed the judgment on breach of contract but vacated the FCA judgment and remanded the case to the district court for further proceedings. The opinion is very significant for government contractors because of its three central holdings: (1) the D.C. Circuit endorsed the "implied certification" theory of FCA liability and held that an implied false certification is established where the Government shows "that the contractor withheld information about its noncompliance with material contractual requirements;" (2) the court rejected the "collective knowledge" theory of FCA scienter adopted by the district court; and (3) the D.C. Circuit rejected the district court's damages instruction, which precluded the jury from considering the value of services that SAIC had provided to the NRC.

Implied Certification

SAIC argued to the D.C. Circuit that FCA liability based upon a false "implied certification" should attach "only where a statute, regulation, or contractual provision makes compliance with a requirement an express condition precedent to payment." In contrast, the Government asserted that implied certification liability could extend to any situation in which the Government contractor "submit[ed] claims for payment while knowing that it violated contractual provisions that are material to the government's decision to pay." The D.C. Circuit settled on a position closer to the Government's, opining:

[W]e hold that to establish the existence of a "false or fraudulent" claim on the basis of implied certification of a contractual condition, the FCA plaintiff—here the government—must show that the contractor withheld information about its noncompliance with material contractual requirements. The existence of express contractual language specifically linking compliance to eligibility for payment may well constitute dispositive evidence of materiality, but it is not, as SAIC argues, a necessary condition. The plaintiff may establish materiality in other ways, such as through testimony demonstrating that both parties to the contract understood that payment was conditional on compliance with the requirement at issue. (Slip. Op. at 18)

The D.C. Circuit took pains in the opinion to emphasize the importance of the materiality and scienter requirements for FCA liability, stating these principles were important limits on the reach of the "implied certification" theory.

Collective Knowledge

In the district court proceedings, the Government urged the court to adopt a "collective knowledge" approach to the FCA requirement that a contractor "know" its claims or statements are false, through actual knowledge, reckless disregard or deliberate ignorance. The district court agreed and instructed the jury that it must consider "the knowledge possessed by those employees and agents as if it was added together and combined into one collective pool of information."

The D.C. Circuit rejected the lower court's approach, noting that no circuit court in the country had applied this "collective knowledge" theory to the FCA. Citing *United States ex rel. Harrison v. Westinghouse Savannah River Co.,* 352 F.3d 908, 918 n.9 (4th Cir. 2003), the D.C. Circuit found that the collective knowledge theory would allow "a plaintiff to prove scienter by piecing together scraps of 'innocent' knowledge held by various corporate officials, even if those officials never had contact with each other or knew what others were doing in connection with a claim seeking Government funds." The circuit court added that the district court's collective knowledge instruction "allowed the jury to impose liability for what is essentially negligence or mistake by another name." Because of this error by the district

court, the D.C. Circuit vacated the lower court's judgments with respect to the two FCA claims.

FCA Damages

Finally, the D.C. Circuit rejected the district court's FCA damages instruction. The district court directed the jury to determine what the NRC paid to SAIC "over and above what the NRC would have paid had it known of SAIC's organizational conflicts of interest." In making that calculation, however, the jury was instructed *not* to consider the value of the services that SAIC had provided to the NRC under the contract, despite evidence at trial that the NRC had used SAIC's work product after terminating the contract for OCI violations. The D.C. Circuit observed that this instruction "compelled the jury to assess as damages the actual amount of payments the government made to SAIC." Instead, the D.C. Circuit said, damages should be calculated under the long-standing test for damages first articulated in *United States v. Bornstein,* 423 U.S. 303 (1976): "'the difference between the market value of the [product] it received and retained and the market value that the [product] would have had if [it] had been of the specified quality.'"

'Unsettled' Law Regarding Implied Certification Theory as Basis for FCA Liability

As Judge David Tatel noted in his 39-page opinion, circuit law on implied certification theory is "unsettled." Until 2010, "implied false certification" theory was primarily limited to situations in which a government contractor's compliance with a statute, regulation or contract requirement was an *express condition precedent to payment*, and the contractor did not disclose its noncompliance with that requirement. In such cases, courts sometimes judicially implied a false certification of compliance by the contractor. Until 2010, judicial use of the "implied certification" theory was limited. *See, e.g.,* the widely cited decision in *Mikes v. Straus,* 274 F.3d 687, 699-700 (2d Cir. 2001) (false certification theory limited to situations in which "the underlying statutes or regulations upon which the plaintiff relies *expressly* states the provider must comply in order to be paid")(emphasis in original). In the few decisions in which courts framed the issue as a "materiality" or "but-for" test, it was clear that the underlying statute, regulation or contract unequivocally showed that full compliance with the requirement at issue was an express condition precedent to payment, or that a failure to fully comply would undermine the fundamental purpose of the contract. *See, e.g., AbTech Constr., Inc. v. United States*, 31 Fed. Cl. 429, 431 (1994) (contract required that contractor provide certification of SBA §8(a) minority status).

In addition to the D.C. Circuit, four courts of appeal published decisions this year addressing implied certification theory. [1] In three of the four cases, the courts arguably accepted implied certification theory as a basis for FCA liability, but only did so because the statute or regulation at issue expressly stated that compliance with the requirement at issue was a *condition of payment*. In the fourth case, the court appeared to adopt a broad theory of implied certification, similar to that adopted by the D.C. Circuit.

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[1] The Fourth Circuit also addressed the issue, but in an unpublished opinion that is not binding precedent. *See United States ex rel. Godfrey v. KBR Inc.,* 360 Fed. Appx. 407, 2010 WL 55510(4th Cir. 2010). The Fourth Circuit affirmed dismissal of the complaint at issue under Rule 9(b), because the "express or implied" certifications alleged "amount to nothing more than a claim that KBR or the subcontractors breached the terms of their contracts and thus cannot give rise to liability under [the FCA.]" *Id.* at 412.

In the first of these cases, *United States ex rel. Kirk v. Schindler Elevator Corp*., 601 F. 3d 94, 114 (2d Cir. 2010), *cert granted*, 79 U.S.L.W. 3194, (U.S. Sept. 28, 2010) (No. 10-188), the Second Circuit denied a motion to dismiss allegations that the contractor failed to file reports (VETS-100 Reports) required under the Vietnam Era Veterans Readjustment Assistance Act, 38 U.S.C. §4212 (VEVRAA). As the court observed, 31 U.S.C. §1354(a)(1) provides that "no agency may obligate or expend funds" to enter into a VEVRAA contract with a contractor who failed to submit a required report the preceding year. In addition, the court stated, 48 C.F.R. §52.222-38 provides that by submitting an offer for a contract subject to the VEVRAA, the contractor is representing it has submitted the most recent VETS-100 Report. The Second Circuit held that "[b]ecause the statute expressly states that the contractor must have submitted the report in order to be paid, a contractor that requests payment under such a contract 'implicitly certifies compliance" with the VETS-100 reporting requirement." *Id*. at 115. The Second Circuit made it clear that its decision was premised on the test articulated in *Mikes v. Straus*, stating that "[a]n implied false certification takes place where a statute expressly conditions payment on compliance with a given statute or regulation, and the contractor, while failing to comply with the statute or regulation (and while knowing that compliance is required), submits a claim for payment." *Id*. at 114 (emphasis omitted).

Similarly, the Ninth Circuit joined its "sister circuits in recognizing a theory of implied certification under the FCA," but did so in the context of the Stark Act, Medicaid regulations, and home health agency regulations, all of which expressly state that the health care provider must comply with the requirements at issue in order to be paid. [2] *United States ex rel. Ebeid v. Lungwitz,* 616 F.3d 993, 996-98 (9th Cir. 2010), *cert. denied*, 79 U.S.L.W. 3246 (Dec 06, 2010) (No. 10-461). The Ninth Circuit loosely stated its conclusion that "[i]mplied false certification occurs when an entity has previously undertaken to expressly comply with a law, rule, or regulation, and that obligation is implicated by submitting a claim for payment even though a certification of compliance is not required in the process of submitting the claim." *Id*. at 998. It is clear, however, that the facts of the underlying complaint fall squarely within the *Mikes v. Strauss* line of cases, which arise in the unique context of federal health care, where the Government expressly conditions its payments on the provision of medical care and other services which meet a certain standard. The Ninth Circuit also stated that under implied certification theory, "materiality is satisfied … only where compliance is a 'sine qua non of receipt of state funding.'" *Id.* at 997. (citation omitted).

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[2] The Ninth Circuit's cited "sister circuit" cases were all health care cases that adopted the limited implied certification test of *Mikes v. Strauss.* See *Ebeid,* 616 F.3d at ___, citing *United States ex rel. Conner v. Salina Reg'l Health Ctr., Inc.,* 543 F.3d 1211, 1217-18 (10th Cir. 2008); *United States ex rel. McNutt v. Haleyville Med. Supplies, Inc.,* 423 F.3d 1256, 1259 (11th Cir. 2005); and *United States ex rel. Augustine v. Century Health Services, Inc.,* 289 F.3d 409, 415 (6th Cir. 2002).

The Fifth Circuit also has addressed implied certification in a recent case, *United States ex rel. Steury v. Cardinal Health, Inc.*, No. 09-20718 (5th Cir. Nov. 1, 2010). In that case, the court found that the relator had not stated an FCA claim and that, in rejecting relator's claim, it was not necessary for the court to decide whether to adopt the implied certification theory in the Fifth Circuit. *See Steury*, slip op. at 8. However, the court did state that, in order to state a valid FCA claim based on non-compliance with a statute, regulation, or contract provision, a plaintiff would need to show that compliance was a condition of payment. Unlike in *Schindler*, however, the court did not state that payment needed to be "expressly" condition on compliance. Rather, the court indicated that determining whether such compliance was a condition of payment could be a question of fact. *See Steury*, slip op at 10 n.4.

In the fourth and final case, the Tenth Circuit has adopted a seemingly broad theory of implied false certification. In *United States ex rel. Lemmon v. Envirocare of Utah,* 614 F.3d 1163 (10th Cir. 2010), the relator alleged that Envirocare violated "a variety of state and federal regulations" and "in doing so, [Envirocare] violated its contractual obligations to the Government." *Id.* at 1169. The Tenth Circuit stated that "what most clearly differentiates" express false certification claims from implied false certification claims is "whether, through the act of submitting a claim, a payee knowingly and falsely implied that it was entitled to payment." From that premise, the Tenth Circuit reasoned that to state a claim for violation of the FCA based on an implied false certification theory, the plaintiff must show that the government contractor "knowingly submitted legally false requests for payment to the government, that the government paid the requests and that , had the government known of the falsity, it may not have paid." *Id.* at 1169. The Tenth Circuit rejected the district court's holding that the complaint at issue had failed to allege that the regulations "require[d] complete regulatory compliance before certification for payment." *Id.* at 1170. The circuit court stated, "materiality does not require a plaintiff to show conclusively that, were it aware of the falsity, the government would not have paid. Rather it requires only a showing that the government *may* not have paid." *Id.* (emphasis added). The Tenth Circuit thus implicitly applied the FERA test for materiality, "a natural tendency to influence, or be capable of influencing, the payment or receipt of money or property," [3] to find an implied false certification in the contractor's alleged claim for payment.

[3] Fraud Enforcement and Recovery Act of 2009, Pub. L. No. 111-21, 123 Stat. 1617, 31 U.S.C. §3729(b)(4).

Implied certification theory is now recognized in the Second, Sixth, Ninth, Tenth and Eleventh Circuits, although the tests articulated vary somewhat among these courts; the theory is not recognized in the Fifth Circuit. Notwithstanding the Supreme Court's recent decision to deny *certiorari* in *Ebeid*, the *SAIC* decision increases the likelihood that the Supreme Court will hear a case involving the scope of the civil FCA statute in the near future.

Test for Implied False Certification Creates Additional Litigation Risk for Government Contractors

The FCA was never intended to punish every violation of contract, regulation or statute. Unlike other statutory remedies for "knowing" contract violations, the FCA is punitive in nature, imposing treble damages and penalties for "false" claims for payment. While the FCA is broadly construed to reach all types of fraudulent claims to the Government for federal funds, the Supreme Court has made it clear that conduct is actionable under the FCA only where a false statement or claim made for the purpose of obtaining a payment from the Government. *See Allison Engine Co., Inc. v. United States ex rel. Sanders,* 128 S. Ct. 2123, 2126 (2008).

There are two significant risks posed by the expansion of implied certification theory beyond situations in which compliance with a contract term is an express condition precedent to payment. First, in light of the many contract, regulatory and statutory requirements applicable to government contracts, use of "materiality" as the threshold criteria for application of implied certification theory poses significant risk that a contractor's failure to comply with *any* contract requirement, whether or not identified by the contract as a condition of payment. Although the D.C. Circuit contrasts such "material" contract provisions with "provisions that are merely ancillary to the parties' bargain, the *SAIC* opinion provides no framework to distinguish a "material" contract provision from a "minor" or "ancillary" contract provision. While government contract case law dealing with "strict" and "substantial compliance" should not apply in the FCA context, "[t]he government is generally entitled to enforce strict compliance with contract requirements." *See* Nash, Cibinic & Nagle, *Administration of Government Contracts,* p. 815 (4th ed. 2006). Potential FCA plaintiffs and the Justice Department can be expected to argue that few contract provisions are "minor" given the Government's entitlement to "square corners" in contract performance before it is required to make payment.

Second, the test articulated by *SAIC* is subjective and allows for dangerous *post-hoc* evidence. The D.C. Circuit stressed the importance of the "materiality" requirement as a limiting principle on the reach of the "implied certification" theory. But as that term has been widely defined in case law, and now is codified in the 2009 Fraud Enforcement and Recovery Act (FERA), "material" facts are those "having a natural tendency to influence, or be capable of influencing," the contracting officer's payment decision. If a false certification can be implied in the absence of an express contractual condition precedent to that payment decision, materiality becomes a subjective determination that the Contracting Officer can make without the burden of actually withholding payment. Post-hoc evidence is disfavored by courts and administrative tribunals in many contexts. For example, the Government Accountability Office, which regularly adjudicates OCI claims through its jurisdiction to hear contractor bid protests,

affords lesser weight to post hoc OCI determinations "because they constitute reevaluations and redeterminations prepared in the heat of an adversarial process … [and] may not represent the fair and considered judgment of the agency, which is a prerequisite of a rational evaluation." *Boeing Sikorsky Aircraft Support*, B 277263.2, B 277263.3, 97-2 CPD ¶ 91 at 15 (Comp. Gen. Sept. 29, 1997).

If compliance with a particular statute, regulation or contract provision is a true prerequisite to the Government's payment decision, the direct link between the contractor's implied "false statement" and the contracting officer's payment of a voucher should be objectively determinable, by a court, as a matter of law, from the contract, regulation or statute at issue. The D.C. Circuit's statement that "abuse" of a broad interpretation of implied certification theory by the Government and relators can be "effectively addressed through strict enforcement of the Act's materiality and scienter requirements" is cold comfort to government contractors, since those elements of the FCA are issues of fact that often cannot be decided on summary judgment.

For these reasons, the D.C. Circuit's opinion in *United States v. SAIC* will likely be a mixed blessing for government contractors. The decision endorses a broad theory of "implied certification" which could potentially create significant additional liability for government contractors under the civil FCA statute. However, the decision's clear rejection of the "collective knowledge" theory of scienter, and its rejection of the district court's flawed valuation of SAIC's services as *per se* valueless because of the OCI issues, will likely help contractors in future cases. Going forward, this decision (and others embracing the "implied certification" theory) put a higher premium on government contracting compliance, creating the risk for contractors
that any contractual non-compliance could give rise to a civil FCA claim.

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