JONES DAY

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COMMENTARY

Fifth Circuit Clarifies Meaning of "False" Claim Under False Claims Act

The recent explosion of cases arising under the False Claims Act ("FCA")[1] certainly has caught the attention of those who do business with the government, whether health care providers, government contractors, or others. Increasingly, *qui tam* relators and the government attempt to assert ever more expansive theories of the FCA's reach and more aggressive theories of the significant damages that are available under the FCA. Those suits, in turn, have forced some courts to wrestle with the distinction between a commonplace breach of contract, on one hand, and a knowing fraud on the government that gives rise to FCA liability, on the other.[2] The recent decision from the U.S. Court of Appeals for the Fifth Circuit in *United States ex rel. Spicer v. Westbrook*, __ F.3d __, 2014 U.S. App. Lexis 8432 (5th Cir. May 5, 2014) addressed that tension, and provides new ammunition to companies seeking to dismiss FCA suits where the complaint fails to plead a false certification of compliance.

Spicer's Factual Background[3]

In January 2007, the United States awarded a contract to Navistar Defense, LLC ("Navistar Defense") to manufacture vehicles designed to transport troops into combat zones, which are known as Mine Resistant Ambush Protected Vehicles ("MRAPs"). The contract incorporated numerous performance standards, including the use of Chemical Agent Resistant Coating ("CARC"). The CARC system included four mandatory steps, including the application of a specific epoxy primer. The contract also incorporated Federal Acquisition Regulation ("FAR") clause 52.246-2, which required Navistar Defense to "provide and maintain an inspection system acceptable to the Government covering supplies under [the] contract" and "tender to the Government for acceptance only supplies that ha[d] been inspected in accordance with the inspection system and ha[d] been found by [Navistar Defense] to be in conformity with the contract requirements." The clause also required Navistar Defense to "prepare records evidencing all inspections made under the system and the outcome."

Navistar Defense subsequently subcontracted with various companies, including Custom Conversions, to apply the CARC to the component parts. But according to allegations by the original relator in the case, Clifford Westbrook,[4] Custom Conversions decided to skip the application of the epoxy primer required by the CARC system. Westbrook claimed he visited Navistar Defense's facility in August 2007, and informed Navistar Defense that the vehicles lacked the proper epoxy primer. Westbrook also alleged that

Navistar Defense employees told him that they knew of the contractor's failure to apply the primer yet continued to subcontract with that company. They ultimately delivered more than 7,000 MRAP vehicles to the United States for payment under the contract.

Based on these allegations, Westbrook filed suit on behalf of the United States under the FCA. Westbrook sued Navistar Defense and Custom Conversions, among others, claiming that the defendants violated various FCA provisions by making false statements to the United States in connection with the delivery of the MRAPs. The United States declined to intervene, and Westbrook proceeded with the *qui tam* suit. After some procedural wrangling, including the filing of an amended complaint and the substitution of the bankruptcy trustee ("Spicer") as relator, the district court granted Navistar Defense's motion to dismiss. Spicer appealed.

At issue on appeal were three of Spicer's claims. First, he claimed Navistar Defense violated § 3729(a)(1)(B) of the FCA by delivering nonconforming MRAPs to the government. Spicer alleged that, pursuant to FAR clause 52.246-2, each delivery constituted a statement that the MRAPs conformed to the contract, and Navistar Defense knowingly made these false statements to get the claim paid. Second, he claimed the invoices submitted by subcontractor Custom Conversions to Navistar Defense resulted in false statements in violation of § 3729(a)(1)(B). Third, Spicer (in a proposed second amended complaint) attempted to assert the same causes of action with greater factual specificity. To cure his apparent failure to identify an express factual statement by Navistar Defense that it had complied with specific contractual requirements, Spicer claimed that Navistar Defense (i) impliedly certified compliance with FAR clause 52.246-2 by submitting claims for payment for the MRAP vehicles, and (ii) violated that clause, including its requirement that Navistar Defense "prepare records evidencing all inspections," by accepting Custom Conversions' allegedly false invoices, among other things.

The Fifth Circuit's Analysis in *Spicer*

On appeal, the Fifth Circuit affirmed dismissal of these claims. The court explained, "The linchpin of an FCA claim resting on a violation of a statute or regulation—here, FAR clause 52.246-2—is the requirement of a certification of compliance" with that statute or regulation.[5] And, as the court made clear, not just any certification of compliance will do; such compliance must be a *precondition of government payment* to give rise to FCA liability. Indeed, "a false certification of compliance, without more, does not give rise to a false claim for payment unless payment is conditioned on compliance."[6] Thus, even if a defendant falsely certified compliance with a contractual or regulatory requirement (in *Spicer*, by allegedly delivering nonconforming goods and failing to perform required inspections), the defendant still could not be liable under the FCA unless compliance with that requirement was a precondition to government payment. If a relator cannot or does not allege such precondition of payment, the case is merely a traditional breach of contract case.

The Fifth Circuit in *Spicer* was careful to make clear that the precondition to payment requirement determines whether a statement is "false or fraudulent" for purposes of the FCA. "Although we have previously indicated that the prerequisite requirement derives from the 'materiality' element of an FCA claim," the court explained, "we have also reasoned, with greater precision, that the term 'material' . . . does not fully encompass the requirement." Instead, the court noted, "the prerequisite requirement has to do with more than just the materiality of a false certification; it ultimately has to do with whether it is fair to find a false certification or false claim for payment in the first place."[7] This analysis helps to clarify an area where courts have used differing reasoning, and lends strong support for the argument that the precondition to payment requirement is not affected by the definition of "materiality" Congress added to the FCA in 2009.[8]

Even more important for companies forced to defend themselves in an FCA case is the Fifth Circuit's application of the precondition to payment requirement. In *Spicer*, the court first examined the complaint and found that "nowhere in the First Amended Complaint does Spicer allege that Navistar

Defense was *required* to certify compliance with FAR clause 52.246-2 in order to receive payment." (emphasis supplied). Thus, Spicer did "not satisfy the prerequisite requirement by invoking" the clause. In addition, the court continued its analysis noting that the contract permitted the United States to "seek a range of remedies in the event of noncompliance," including allowing that the United States "may require or permit correction" and accept the goods. Relying in part on a prior Fifth Circuit decision, the court explained that "the United States' ability to seek a range of remedies in the event of noncompliance suggest[s] that payment was not conditioned on Navistar Defense's certification of compliance."[9] The court in particular appeared swayed, then, by the fact that the United States had a "range of remedies"—and that, under the contract, the United States maintained discretion in choosing which remedy to adopt. As a result, Navistar Defense did not falsely certify compliance with the particular contractual requirement in violation of the FCA.

Finally, the court rejected Spicer's attempt to hold Navistar Defense liable for allegedly false statements its subcontractor had made in invoices it submitted to Navistar Defense. "Nothing in the First Amended Complaint satisfies the prerequisite requirement with respect to these invoices," the court found. Indeed, the relator never alleged "that Navistar Defense actually made a statement to the United States in reliance on those invoices. Nor does Spicer allege that Navistar Defense adopted these invoices and delivered them along with the [vehicles]." Most importantly, the court held that the mere fact that Navistar Defense may have violated FAR clause 52.246-2's inspection and recordkeeping requirements "does not demonstrate [that] Navistar Defense made a false statement to the [government] for purposes of the FCA."[10] The court thus affirmed dismissal of the relator's FCA claims.

Looking Forward

Companies faced with future FCA suits could be well served by the Fifth Circuit's analysis in *Spicer*. Indeed, emphasizing the precondition to payment requirement can prevent aggressive relators and government counsel from turning run-of-the-mill breach of contract claims into punitive FCA suits—where treble damages, punitive damages, civil penalties, and attorney fees may be at stake. The same holds true for regulatory violations that traditionally would be addressed by agencies through the administrative process. And, although the *Spicer* decision may only be binding in the Fifth Circuit, its reasoning is likely to resonate with courts nationwide, as nearly every Circuit Court of Appeals has recognized some variation of a condition of payment requirement in addressing FCA suits. Moreover, where regulatory schemes and government contracts provide the government a range of remedies in the event of noncompliance, *Spicer*'s reasoning will support arguments (both at the motion to dismiss stage and at summary judgment) that noncompliance with those regulatory or contractual requirements alone does not create FCA liability. Thus, the Fifth Circuit's decision provides a valuable tool for companies seeking to dismiss FCA claims.

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Endnotes

1 New *qui tam* FCA cases are growing in number year over year. According to DOJ statistics, 379 cases were filed in 2008, 433 in 2009, 574 in 2010, 635 in 2011, and 652 in 2012. A record number of new cases–753–were filed in 2013. *See* U.S. Dept. of Justice Fraud Statistics Overview (Dec. 23, 2013), available at http://www.justice.gov/civil/docs_forms/C-FRAUDS_FCA_Statistics.pdf

2 *See*, *e.g.*, *United States ex rel. Owens v. First Kuwaiti Gen. Trading & Contracting Co.*, 612 F.3d 724, 726-28 (4th Cir. 2010) (affirming summary judgment in favor of defendant who had allegedly "failed to live up to its contractual obligations" under an embassy construction contract because "Congress crafted the FCA to deal with fraud, not ordinary contractual disputes" and not to "punish honest mistakes or incorrect claims submitted through mere negligence") (internal quotation omitted); *United States v. Sci. Application Int'l Corp.*, 626 F.3d 1257, 1271 (D.C. Cir. 2010) ("Strict enforcement of the FCA's scienter requirement will . . . help to ensure that ordinary breaches of contract are not converted into FCA liability."); *United States ex rel. Steury v. Cardinal Health, Inc.*, 625 F.3d 262, 268 (5th Cir. 2010) (noting that the condition of payment "requirement seeks to maintain a 'crucial distinction' between punitive FCA liability and ordinary breaches of contract"); *United States ex rel. Wilson v. Kellogg Brown & Root, Inc.*, 525 F.3d 370, 373 (4th Cir. 2008) (rejecting a relator's efforts to "shoehorn what is, in essence, a breach of contract action into a claim that is cognizable under the False Claims Act"); *United States v. DRC, Inc.*, 856 F. Supp. 2d 159, 170 (D.D.C. 2012) ("If FCA liability is to be premised on an implied false certification of compliance with contractual term, the term must be clear and unambiguous because FCA liability is not triggered where parties simply disagree about how to interpret ambiguous contract language.") (internal quotation omitted); *United States ex rel. Bender v. N. Am. Telecomms., Inc.*, 750 F. Supp. 2d 1, 10 (D.D.C. 2010) (dismissing FCA complaint alleging that defendant billed for overtime not allowable under Department of Agriculture contract because "[a]t most, these allegations describe a breach of contract claim, for which Plaintiff has no standing under the False Claims Act").

3 The court took these facts from the complaint's allegations, as the case was decided upon a motion to dismiss.

4 Westbrook first filed via his company, Westbrook Navigator. Later, he moved to substitute himself individually as relator, which the district court allowed.

5 *Spicer*, 2014 U.S. App. Lexis 8432, at *28.

6 *Id.* at *29 (quotation omitted).

7 *Id.* at *28-29 (internal quotation omitted).

8 *See* 31 U.S.C. § 3729(b)(4).

9 *Spicer*, 2014 U.S. App. Lexis 8432, at *30-32 (citing *Steury*, 625 F.3d at 270).

10 *Id.* at *32.