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False Claims Act

Supreme Court Denies Blackstone's Petition On Legal Falsity Under The False Claims Act



BY JOSEPH BERGER

The Supreme Court passed up the opportunity to decide controversial issues surrounding the judge-made liability theory of legal falsity under the False Claims Act, denying the petition for *certiorari* in December 2011 in the case of *Blackstone Medical, Inc. v. United States ex rel. Hutcheson*.¹ Now that the Supreme Court has denied this petition, unless it accepts a similar appeal in the future, it will be up to the lower courts to enforce boundaries and limitations on the common law theory, under the diverging tests for legal falsity created and defined by the various courts of appeals. Defendants will continue to confront increasing litigation risks posed by these diverging tests in the various circuits, while defending themselves in venues chosen by plaintiffs.

¹ 80 U.S.L.W. 3136, 2011 WL 3841712 (U.S. Dec. 5, 2011) (No. 11-269).

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The *Blackstone* appeal resulted from a decision of the U.S. Court of Appeals for the First Circuit that reversed a decision of the Massachusetts district court dismissing legal claims based on legal falsity theories. According to the petitioner Blackstone Medical, its petition presented the Court “with an opportunity to dispel the persistent confusion among federal circuits when addressing the so-called ‘legal falsity’ theory of false claims jurisprudence.” The petition also, said Blackstone, sought “to restore the reasonable limitation, true to the statute’s terms, that FCA actions involve *claims* that are *false* – not merely acts that are wrongful.”² According to Blackstone, the First Circuit’s “unapologetically radical extension of the FCA’s scope transforms the statute into a remedy for virtually all instances of noncompliance with a federal statute, regulation, rule, contractual term, or program requirement[.]” Petition at 35.

The National Defense Industrial Association (NDIA) stated that the First Circuit decision “presents a severe threat to the law and practice of federal government contracting.”³ According to the NDIA *amicus* brief sup-

² Petition for a Writ of *Certiorari* at 4, *Blackstone Med., Inc. v. United States ex rel. Hutcheson*, No. 11-269 (U.S. Aug. 30, 2011) (“Petition”).

³ Brief of the National Defense Industrial Association as *Amicus Curiae* Supporting Petitioner at 13, *Blackstone Med., Inc. v. United States ex rel. Hutcheson*, No. 11-269 (U.S. Sept. 30, 2011) (“NDIA Brief”).

porting Blackstone's petition, the First Circuit decision bypassed reasonable limits on contractor liability and "improperly conflate[s] contractual and FCA remedial schemes, to the substantial detriment of predictable and effective defense contracting." NDIA Br. at 2. NDIA stated that the First Circuit's decision "exacerbates a broad and entrenched" circuit split on a matter of "critical importance to thousands of government contractors nationwide." *Id.* at 3.

The First Circuit's reasoning has been referred to elsewhere as the theory of implied certification, although the First Circuit declined to employ that terminology. Decisions endorsing the implied certification theory in the government contracts setting have typically blurred (or abandoned) the line between remedies for fraud and for contractual disputes, and for violations of laws or regulations that provide their own independent remedies. While some court decisions have allowed potential liability for representations not expressly set forth by the defendant, and allowed relators to base their lawsuits upon statutes and regulations outside the FCA (31 U.S.C. §§ 3729-3733), or upon the contract provisions agreed between the contracting parties, other decisions have refused to do so (including those of at least three circuits). The *amicus* NDIA wrote that the false certification theory may be the most "significant current legal battleground" in FCA litigation and that the decision at issue is "the most aggressive application yet of this already controversial legal doctrine." NDIA Br. at 3.

In 2010, there were decisions on implied certification or legal falsity issued by the U.S. Courts of Appeals for the District of Columbia, Second, Fourth, Fifth, Ninth and Tenth Circuits. In 2011, there were notable decisions by at least the First, Third, and Seventh. As stated in Blackstone's petition and the *amicus* briefs, the approaches and standards applied by the various circuits have varied widely or diverged in subtle ways, creating "the current jumble of legal-falsity standards." Petition at 15. The Fourth, Fifth, and Seventh Circuits have rejected, questioned, or declined allegations of implied certification. *Id.* at 18, 20.⁴ Under the Second Circuit standard, a claim is impliedly false only where an underlying statute or regulation expressly mandates that the party comply with specified obligations as a precondition of payment. *Id.* at 15-16. Other circuits have encompassed contractual provisions as a basis for implied certification. *Id.* at 11. Several circuits have to various extents distinguished between statutes and regulations governing participation in a federal program and those that govern payments (*id.* at 17-22), while one has adopted a conflicting test (*id.* at 24-25). The Ninth has focused on whether an entity has previously undertaken to expressly comply with a law, rule or regulation. *Id.* at 23. The D.C. and First Circuits have adopted the most flexible and expansive standards yet, narrowing the few limitations on the common law theory. *See id.* at 25-26.

Decisions of the First Circuit

The First Circuit's Chief Judge Lynch expanded the implied certification theory, though not by that name, in

⁴ *See United States ex rel. Yannacopoulos v. Gen. Dynamics*, 652 F.3d 818, 824 n.4 (7th Cir. 2011); *Harrison v. Westinghouse Savannah River Co.*, 176 F.3d 776, 786 n.8 (4th Cir. 1999); *United States ex rel. Marcy v. Rowan Cos.*, 520 F.3d 384, 389 (5th Cir. 2008).

United States ex rel. Hutcheson v. Blackstone Medical, Inc., where Hutcheson alleged a "kickback scheme to induce physicians to use [Blackstone's] medical devices in spinal surgeries." 647 F.3d 377, 378 (1st Cir. 2011), *cert. denied*, 80 U.S.L.W. 3136 (U.S. Dec. 5, 2011). As noted by the Petition, Blackstone markets and distributes spinal implant products to hospitals, but does not submit claims for payment to private insurance companies or the Medicare program. Petition at 9. Hutcheson alleged that Blackstone paid unlawful remuneration to physicians to induce them to use Blackstone devices and that, as a result, claims by physicians for their services and by hospitals for reimbursement to Medicare were false. *Id.* The United States did not intervene as a plaintiff.

The district court held that Hutcheson's allegations did not state a claim under the FCA for purposes of Rule 12(b)(6),⁵ and the First Circuit reversed this decision. Chief Judge Lynch rejected the distinctions between factually and legally false or fraudulent claims, and between express and implied certification, which he noted had emerged in the circuit case law beginning in 1999. *Blackstone*, 647 F.3d at 385. The First Circuit decision stated that the text of the FCA does not refer to "factually false" or "legally false" claims, nor to "express certification" or "implied certification." *Id.*

According to the First Circuit, the district court decision under review held "both that implied conditions of payment can only be found in statutes and regulations, and that these sources must expressly state the obligation." *Id.* at 386. The appellate court rejected these requirements in favor of a broader and more expansive standard. The First Circuit stated that "other means exist to cabin the breadth of the phrase 'false or fraudulent' as used in the FCA. The text of the FCA and our case law make clear that liability cannot arise under the FCA unless a defendant acted knowingly and the claim's defect is material." *Id.* at 388.

As a second ground of reversal, the First Circuit held that Hutcheson's allegations could encompass claims submitted by hospitals even though the allegations concerned payments to doctors. Blackstone argued that "when a submitting entity expressly represents its own legal compliance, its representations cannot encompass a precondition of payment applicable to non-submitting entities." *Id.* at 389. Blackstone further argued that "a hospital's truthful certification" could not be rendered false "by the acts of an unrelated third party somewhere in the supply chain." But the First Circuit found that "[t]he categorical limitation Blackstone advances does not appear in the text of the statute and is inconsistent with both the statutory text and binding case law." *Id.*

The First Circuit then turned to the question of whether Hutcheson's complaint identified a materially false or fraudulent claim. Hutcheson and Blackstone argued as to whether compliance with the Medicare Anti-Kickback Statute, 42 U.S.C. § 1320a-7b, was, without more, a precondition of Medicare payment. The Circuit stated that "[w]e need not address this dispute, as we hold that the Provider Agreement and Hospital Cost Report forms identified in Hutcheson's complaint are sufficient to support her claim." *Blackstone*, 647 F.3d at

⁵ *United States ex rel. Hutcheson v. Blackstone Med., Inc.*, 694 F. Supp. 2d 48, 67 (D. Mass. 2010), *rev'd*, 647 F.3d 377 (1st Cir. 2011), *cert. denied*, 80 U.S.L.W. 3136 (U.S. Dec. 5, 2011).

392.⁶ The court, however, was ambiguous in its reasoning as to legal falsity and whether the representations were express or implied:

[T]he claims presented to the government in this case, as alleged, represented that there had been compliance with a material precondition of payment that had not been met. We do not categorize this representation as one of law or fact, nor do we categorize it as either express or implied. We also do not address whether this representation constituted a “certification” within the meaning of case law from beyond this circuit. These formal categories, as we have discussed, are nowhere mentioned in the statute.

Id. The First Circuit found that the allegations of misrepresentation were sufficient to state a claim that the hospital and physician claims for payment were false or fraudulent. *Id.* at 393. Judge Lynch wrote that this holding was “consistent with those of other courts that have found claims false or fraudulent for non-compliance with a contract term,” but that “we are not creating a rule that non-compliance with a contractual condition is any more necessary to establish that a claim is false or fraudulent than non-compliance with an express statute or regulation, or an express misrepresentation on a form submitted with payment.” *Id.* at 393-34. The court then held that the alleged misrepresentation was material, for purposes of the motion to dismiss. *Id.* at 395.

Although this decision was in the Medicare context, its holding presents an amorphous, porous, and malleable standard for analyzing allegations of noncompliance with a contractual condition at the motion to dismiss stage, which (as does the holding by the D.C. Circuit in *SAIC*)⁷ promotes the increasing risk for government contractors that plaintiffs may more easily convert issues of contractual compliance, administration or breach into allegations of FCA violations.

Following its decision in *Blackstone*, in *New York v. Amgen Inc.*, 652 F.3d 103 (1st Cir. 2011), the First Circuit reached a similar holding as applied to multiple state false claims acts, which the circuit construed consistently with the federal FCA. Chief Judge Lynch examined the preconditions of payment recognized under seven state Medicaid programs and found that the plaintiffs demonstrated that statutes and regulations, or provider agreements, in six of the seven states established that claims affected by payments alleged to be kickbacks were not eligible for Medicaid payment. The circuit reversed the district court’s dismissal of the plaintiffs’ claims under the state FCAs in six of seven states. *Id.* at 112-15, 116.

Amgen, like *Blackstone*, petitioned to the Supreme Court,⁸ and Amgen filed an *amicus* brief supporting *Blackstone*’s petition.⁹ However, in late October 2011, Amgen announced a broad settlement in principle with

the United States that could resolve Amgen’s litigation.¹⁰

Blackstone’s Petition

Blackstone argued that while the courts of appeals have developed several conflicting frameworks for evaluating legal falsity theories of liability, the First Circuit rejected all of the existing standards and created its own. *Petition at i.* The questions presented were therefore:

1. Whether an allegation that a defendant has committed a statutory violation renders a claim submitted by an unrelated party “legally false” for purposes of the FCA, where no statute or regulation expressly conditions payment of the unrelated party’s claim on the defendant’s compliance.

2. Whether and when a private citizen is authorized to use a “legally false” theory under the FCA as a generalized enforcement mechanism for statutes, regulations, contractual obligations, or other program requirements that are not otherwise privately enforceable.

Id. *Blackstone* argued that the First Circuit’s decision exacerbates a circuit split over the scope of the legally false theory of liability; that each circuit has adopted its own framework for when a relator can pursue allegations of legally false claims; and that the circuit split leads to different outcomes on the same facts. *Id.* at iii. Discussing the “rapidly expanding” number of FCA *qui tam* cases premised on a theory of legal falsity, *Blackstone* argued that the First Circuit created a “particularly expansive variant of ‘legal falsity’ test”:

After the First Circuit’s decision, a relator’s allegations that claims are “legally false” state a cause of action under the FCA anytime a relator alleges that wrongful conduct occurred somewhere in a chain of transactions among various entities, one of which ultimately submitted a claim—even if the claim itself contains no false statement about the allegedly wrongful conduct and even if no statute or regulation conditions payment of a claim on such compliance.

Id. at 3. According to the *amicus* U.S. Chamber of Commerce, this case presented a “deep and mature” circuit split and the First Circuit’s standard deprives companies of “fair notice of what constitutes a false claim.”¹¹ The *amicus* NDIA wrote that the current state of uncertainty in the law creates a “patchwork of inconsistent standards.” NDIA Br. at 3. NDIA said the Supreme Court’s intervention was critical because FCA plaintiffs can choose to sue in any district, giving them the ability to forum shop in the First Circuit for its “low barrier to FCA liability.” *Id.* NDIA noted that while the decision involved potential liability of the petitioner in the Medicare context, it necessarily could impose an ex-

⁶ Huteson argued that the forms made clear that compliance with the AKS was a precondition of Medicare payment. *Blackstone* argued that they did not identify this precondition with sufficient specificity. With respect to the hospitals, *Blackstone* argued that the forms “did not create an express or implied representation that anyone other than the submitting hospital had complied with the AKS.” 647 F.3d at 392.

⁷ *United States v. Science Applications Intern. Corp.* (SAIC), 626 F.3d 1257 (D.C. Cir. 2010).

⁸ Petition Writ of Certiorari, *Amgen Inc. v. New York*, No. 11-363 (U.S. Sept. 19, 2011).

⁹ Brief of Amgen Inc. as *Amicus Curiae* in support of Petitioner, *Blackstone Med., Inc. v. United States ex rel. Susan Huteson*, No. 11-269 (U.S. Sept. 30, 2011).

¹⁰ According to *The New York Times*, “Amgen said it had reached an agreement in principle to settle criminal and civil investigations that had been under way for several years by the United States attorney offices in Brooklyn and Seattle. The company said a settlement, which it expected to be concluded in three to four months, would also resolve state Medicaid investigations and 10 whistleblower lawsuits.” Andrew Pollack, *Amgen to Pay \$780 Million to Settle Suits on Its Sales*, N.Y. Times, Oct. 24, 2011. Amgen’s petition remained on the Supreme Court docket.

¹¹ Brief of the Chamber of Commerce of the United States of America and the Pharmaceutical Research and Manufacturers of America as *Amici Curiae* Supporting Petitioner at i, *Blackstone Med., Inc. v. United States ex rel. Huteson*, No. 11-269 (U.S. Sept. 30, 2011).

pansive potential liability on government contractors. *Id.* at 3-4. NDIA explained:

The First Circuit's approach, especially if applied to today's massive and complex defense contracting arrangements, would expose contractors . . . to an unwarranted and unreasonable risk of protracted litigation for alleged lapses in contractual compliance that they would not reasonably expect to lead to FCA liability. Broadly permitting contract claims to be enforced through *qui tam* actions would also transfer, to individual relators, contract enforcement decisions that are best left to the contracting parties and the potentially more tailored remedies available under federal government contracting law. The government's cost of procuring defense material and services inevitably will rise if the Act is permitted to exceed its bounds in this way.

Id. at 4. As noted by the Blackstone Petition, the First Circuit rejected the holdings of other circuits that implied false certification claims should be limited to those conditions expressly set forth in a statute or regulation. Petition at 13. According to the Petition, the First Circuit's interpretation of the implied certification theory "expands the theory to the greatest degree yet":

On its face, it authorizes private citizens to sue and recover damages based on any knowing violation of any contractual or program requirements, even if those violations are unknown to the entity filing the claim, and even if the entity's statements as to its own compliance are quite truthful. That approach conflicts in a number of significant respects with other circuits' interpretations of the FCA.

Id. at 14-15. The Petition went on to summarize the "current jumble of legal-falsity standards" in the various circuits. *Id.* at 15-26. At the conclusion, the Petition stated:

It should be clear . . . that the current interplay among the circuits is not a shallow split, nor is it a passing jurisdictional phase. Every circuit has staked out at least some ground on the issue of "legally false" FCA claims and their parameters, and the circuits are not so much split as they are splintered.

Id. at 30. The Petition argued that under the current state of the law, relators can bypass the government's administrative procedures and "circumvent those own enforcement mechanisms by converting every administrative peccadillo into an FCA action carrying with it the specter of staggering liability and enormous settlement pressure." *Id.* at 31. The Petition pointed out that the "looming threat of financial ruin is even further exacerbated in the context of the 'legally false' theory of FCA liability, because relators wielding the theory often assert that some sort of noncompliance renders every claim connected to the defendant, often over many

years, 'false,' and therefore subject to a treble damages recovery." *Id.* at 33.

Conclusion

In its *amicus* brief, the NDIA also pointed out that the First Circuit has previously recognized that contract interpretation "must be based largely on a standard of objective reasonableness rather than purely subjective belief," and that "a party cannot transmogrify a provision that, from an objective standpoint, has only marginal significance into one of central salience by the simple expedient of saying in retrospect that [the party] believed it to be very important." NDIA Br. at 10-11, quoting *Gibson v. City of Cranston*, 37 F.3d 731, 737 (1st Cir. 1994).

In this terminology of the First Circuit, implied certification or legal falsity, taken to its fullest extent, might be described as the "transmogrification" of all potential violations of contractual, regulatory and statutory provisions (hundreds or more in connection with any one government contract or program) into potential FCA liability with treble damages; or the transmogrification of the FCA into an all-encompassing remedy for all those possible violations.

Yet while many of the recent appellate decisions have allowed the implied certification theory to proceed at the motion to dismiss stage, the theory has not seen as much success at the summary judgment or trial stage, and remains subject to necessary and appropriate defenses (including, but not limited to, *scienter*, materiality, government knowledge or approval, and limited or lack of damages). Weaknesses in a plaintiff's case may materialize during the discovery phase. Complaints that succeed at the motion to dismiss stage may not prove meritorious at the summary judgment stage. Nevertheless, regardless of the underlying merits and appropriate remedies, the risks and settlement pressures remain enormous under the expanding precedent of the courts of appeals, which has resulted in numerous settlements, uncertain standards in the evolving case law, and the appeal for intervention to the Supreme Court. Although the Court apparently decided that *Blackstone* was not a suitable vehicle for review, it will likely have more opportunities to address issues concerning implied certification and legal falsity in the future.

Now that the Supreme Court has declined the petition of *Blackstone*, it remains to be seen what further standards may develop in the circuits and how new and existing standards set by the circuits will be applied by the trial courts, and what limitations and boundaries they will impose. In the meantime, the battles over implied certification and legal falsity will continue, and defendants must adapt to the evolving case law of the courts of appeals.