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Focus

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FEATURE COMMENT: Spotlight On Timing: The D.C. Circuit Tackles The False Claims Act's Government Action Bar And Materiality Requirement

Last month, in a closely watched case, the D.C. Circuit resolved a dispute about a rarely invoked bar to certain whistleblower actions brought under the False Claims Act. In *U.S. ex rel. Vt. Nat'l Tel. Co. v. Northstar Wireless, LLC*, 34 F.4th 29 (D.C. Cir. 2022), the D.C. Circuit reversed a district court's decision that had held that the so-called "Government action bar" precluded a qui tam action involving allegations similar to those raised in an "administrative civil monetary penalty proceeding." The D.C. Circuit pointed out that to the extent any penalties had been imposed, they were not imposed as part of the administrative proceeding at issue and therefore the bar did not apply.

The court's opinion will likely have a more profound impact because of its discussion of a less closely watched aspect of the case—the meaning of the FCA's requirement that a misrepresentation be "material" to the decisionmaker. On that topic, the court addressed a critical question about the point in time to measure the significance of a representation to the Government, and the court's conclusion is likely to have broad ramifications as courts continue to grapple with the Supreme Court's discussion of materiality in *Universal Health Servs., Inc. v. U.S. ex rel. Escobar*, 579 U.S. 176 (2016).

Background—The Government Action Bar, 31 USCA § 3730(e)(3)—The FCA authorizes a private party, called a "relator," to bring a lawsuit, known as a "qui tam" action, in the name of the Federal Government to remedy fraud against the Government in exchange for a share of the recovery. The Government may join the relator's case, or permit the relator to proceed on their own. The Government also may initiate its own FCA action as part of the Government's broad array of enforcement tools.

To establish a violation of the FCA, the Government or the relator must demonstrate that a statement, record, or claim for payment was materially false. A person or entity found to have violated the FCA is liable for three times the amount of the damages caused by the misrepresentation, as well as penalties. 31 USCA § 3729(a)(1). When Congress amended the FCA in 1986 to enhance the ability of private persons to bring cases in the Government's name, it also enacted certain bars to potentially duplicative and/or parasitic qui tam actions. One such bar, which has come to be known as the "Government action bar," provides that no person may bring a qui tam action that is "based upon allegations or transactions which are the subject of a civil suit or an administrative civil money penalty proceeding in which the Government is already a party." 31 USCA § 3730(e)(3). The FCA does not define either the term "civil suit" or "administrative civil money penalty proceeding," and the legislative history sheds little light on this specific provision. S.Rep.No. 99-345, at 30 (1986).

Unlike some of the other statutory bars to qui tam actions, such as the so-called "first-to-file" and "public disclosure" bars, the Government action bar has received little attention. Only a handful of appellate court decisions have addressed application of § 3730(e)(3). The first to do so was the First Cir-

cuit in *U.S. ex rel. S. Prawer v. Fleet Bank of Maine*, 24 F.3d 320 (1st Cir. 1994), which considered what "allegations or transactions" that are the subject of a Government civil suit should bar a subsequent qui tam action. The FDIC had initiated a collection action against Prawer, in which Prawer raised certain affirmative defenses and counterclaims. Prawer subsequently brought a qui tam action against a bank and its law firm, alleging that they had defrauded the FDIC. The First Circuit reversed the district court's holding that the qui tam action was barred because it addressed allegations that had been raised as defenses in the FDIC's collection action. Noting that "the breadth with which we should read the phrase 'allegations or transactions which are *the subject of* a civil suit' is not readily apparent from the text of the statute," id. at 326, the First Circuit looked to the purposes of the FCA and developed a "host/parasite" test. Under that test, a court asks whether the qui tam allegations received support from the "host" Government suit without providing "any useful or proper return." Id. at 327. The court concluded that the FDIC case did not implicate the bar because it did not involve the entities that were defendants in the qui tam action, which was aimed at remedying something the Government was not yet pursuing.

The Seventh and Eighth Circuits subsequently also addressed the question of when a qui tam action involves "allegation or transactions" that are the subject of a Government proceeding, and concluded that Government proceedings that did not involve fraud claims do not bar subsequent qui tam actions. *Costner v. URS Consultants, Inc.*, 153 F.3d 667 (8th Cir. 1998); *U.S. ex rel. Absher v. Momence Meadows Nursing Center, Inc.*, 764 F.3d 699 (7th Cir. 2014). More recently, the Ninth Circuit held that a dismissed qui tam action in which the Government had intervened was a "civil suit" in which "the Government already is a party" and precluded a subsequent qui tam suit based on allegations or transactions involved in the first qui tam action. *U.S. ex rel. Bennett v. Biotronik, Inc.*, 876 F.3d 1011 (9th Cir. 2017); 60 GC ¶ 15.

While a number of district court decisions have also grappled with the scope of the Government action bar, the case law has remained relatively undeveloped.

***U.S. ex rel. Vermont National Telephone Co. v. Northstar Wireless, LLC* Sheds New Light on the Subject**—Against that backdrop, Vermont National Telephone Co. brought a qui tam action against several telecommunications companies alleging that the defendant companies misrepresented their eligibility for small business discounts when they submitted their applications to participate in Federal Communications Commission auctions for spectrum licenses. The spectrum is a public asset that the FCC allocates through its licensing process and companies use their allocated frequencies to provide television, cell phone and wireless internet service. The FCC encourages diversity of ownership of these licenses by offering discounts, in the form of bidding credits, for certain qualifying small businesses. The application process for the licenses involves two steps. First, an applicant must submit a short-form application establishing qualifications to participate in the auction and to be eligible for bidding credits, and second, winning bidders submit a long-form application establishing qualifications and eligibility. Once the FCC accepts a winning bidder's long-form application, other participants may challenge the award. When a party defaults on paying for an awarded license, the FCC may order a default payment.

Two companies—Northstar and SDI—had filed step one applications claiming eligibility for a 25 percent discount for "very small businesses." They won a large percentage of the available licenses, and were entitled to a discount of $3.3 billion on the amount they had to pay the Government for their winning bids. Several other companies then challenged the awards on the grounds that Northstar and SDI were ineligible for the small business credits because a very large business effectively controlled them and they had failed to disclose material information about that relationship. The FCC ultimately concluded that Northstar and SDI were ineligible for the credits, but that there was no evidence they had attempted to mislead the FCC or that they had not adequately disclosed their relationship with the larger entity. Northstar and SDI then elected to default on their obligation to buy some of the licenses they had won and the FCC ordered that they make default payments.

Vermont National Telephone then brought a qui tam action alleging that Northstar and SDI had submitted false claims to the Government, claiming eligibility for billions in small business credits to which they were not entitled.

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The District Court Decision: The district court held that the Government action bar precluded the qui tam action and that the complaint's allegations failed to meet the FCA's "demanding materiality standard." *U.S. ex rel. Vt. Nat'l Tel. Co. v. Northstar Wireless LLC*, 531 F. Supp. 3d 247, 251, 264–70 (D.D.C. 2021). The court held that the post-auction challenge to the winning bids was an "administrative civil money penalty proceeding" and that the qui tam action was based upon the allegations or transactions that were the subject of that proceeding. The court observed that its conclusion was buttressed by what it perceived to be the purposes of the FCA—namely barring qui tam actions where the Government was capable of bringing the case itself—and that the qui tam action would not provide a "useful return" because the Government had declined to intervene. 531 F. Supp. 3d at 267. The court also held that the complaint did not adequately plead materiality because the FCC withdrew the small business credits for reasons other than the alleged nondisclosure of the companies' relationship to the larger business and therefore the alleged misrepresentation did not affect the Government's "actual" determination of eligibility for small business credits. Id. at 268.

The D.C. Circuit Decision: The D.C. Circuit began its analysis of the Government action bar by considering whether the FCC proceedings even implicated the bar. Noting that the FCA does not define the term "administrative civil money penalty proceeding," the court observed that "to state the obvious, an 'administrative civil money penalty proceeding' is a proceeding in which an administrative agency may impose a civil money penalty."

The court rejected the argument that the imposition of default payments rendered the license proceeding an administrative civil money penalty proceeding even if the payments were considered a "civil penalty" because they are not assessed during the license proceeding and do not flow from it. Rather, the default payments are triggered by a winning bidder's decision not to pay for licenses it won. The court also rejected the defendants' argument that the timing of the penalty award should not matter as penalties are often awarded after the merits of a proceeding are resolved. The court observed that the issue was not the timing of the award, but that the penalties were not an authorized part of a license proceeding. The court also rejected the argument that the bar was implicated because the FCC *could* impose penalties for false or misleading statements in a forfeiture proceeding, as no such proceeding had been initiated. Finally, the court rejected the argument that other types of enforcement, such as ineligibility to participate in future auctions or initiation of criminal proceedings, were relevant because they were not civil monetary penalties. The court concluded that the FCC has no authority to issue civil money penalties during its license proceeding and therefore no "administrative civil money penalty proceeding" was involved. Accordingly, the court did not need to reach the question of whether the allegations or transactions that were the subject of that proceeding were also the subject of the qui tam action.

Turning to materiality, the court cited the FCA's materiality definition—that a misrepresentation is material if it has "'a natural tendency to influence, or be capable of influencing, the payment or receipt of money or property.'" 34 F.4th, at 36 (citing 31 USCA § 3729(b)(4)). The court disagreed with the district court's conclusion that none of the misrepresentations were capable of influencing eligibility for bidding credits, pointing out that if Northstar and SDI had disclosed all their arrangements with the larger entity, which had agreed to purchase their licenses after a five-year non-transfer period, they would have increased their attributable revenue above the cap for "very small business" credits, and failure to disclose an agreement central to their eligibility for the credits was certainly capable of influencing the FCC's eligibility determination.

The court also rejected the companies' argument that because the FCC ultimately denied the bidding credits without regard to the alleged failure to fully disclose the relationship with the larger company, the disclosures would not have changed the FCC's "actual" decision. The court pointed out that the relevant inquiry "focuses on the potential effect of the false statement when it is made" rather than the effect after it is discovered, noting the First, Fourth, Fifth, Sixth, and Ninth Circuits have adopted the same interpretation. If Northstar and SDI had disclosed their alleged agreements at the outset, they would not have been eligible for the bidding credits at all, and therefore the failure to disclose had the potential to affect the FCC's eligibility determination.

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Finally, the court rejected the argument that the Supreme Court's decision in *Escobar,* and the D.C. Circuit's own decision in *U.S. ex rel. McBride v. Halliburton, Co.*, 848 F.3d 1027 (D.C. Cir. 2017); 59 GC ¶ 56, required the court to look to the FCC's "actual" decision to deny bidding credits to assess the materiality of the alleged misrepresentation. The court pointed out that those decisions looked to the Government's " 'actual behavior' only to assess whether the government attaches importance to a particular statutory, regulatory, or contractual requirement." 34 F.4th, at 37. The D.C. Circuit observed that at the motion to dismiss stage there was nothing to suggest that the FCC attached minimal importance to the certification of eligibility requirements. Rather, the complaint alleged the opposite—that the misrepresentation would have precluded participation in the auction. Id.

Implications for the Government Action Bar—The D.C. Circuit's decision is significant for understanding the scope of the Government action bar because of the court's recognition that the provision focuses on the nature of the particular administrative *proceeding* at issue and not simply on whether the administrative agency has monetary and nonmonetary enforcement tools available to it. The court viewed its conclusion as a straightforward application of the statute's text. The district court went astray in separating the individual words that form the single term "administrative civil money penalty proceeding." It had concluded that an administrative proceeding was at issue—a post-auction proceeding—then turned to the similarity of the "nondisclosure" allegations at issue, and then addressed whether the FCC had the capacity to impose penalties.

Although the D.C. Circuit focused on the FCA's text, the result is also supported by the structure and purpose of the provision of preventing duplicative actions to recover for and deter fraud. The bar precludes a qui tam action involving allegations that are already being pursued in the Government's own civil suit or specific types of administrative proceedings. In arriving at the opposite conclusion, the district court's decision took out of context various observations about the purposes of the FCA. For example, the decision states that the qui tam action did not further the FCA's purpose of promoting lawsuits the Government is not equipped to bring on its own. 531 F. Supp. 3d at 267 (citing *U.S. ex rel. Oliver v. Phillip Morris USA Inc.,* 826 F.3d 466, 475 (D.C. Cir. 2016)). Although that is one of the FCA's general purposes, the Government action bar screens out only a narrow set of cases and the FCA contemplates that many suits may go forward without the Government even where the Government is equipped to pursue the case. See, e.g., 31 USCA § 3730(b)(4)(B) (authorizing relator to conduct the action when the Government declines); 31 USCA § 3730(e)(4)(A) (authorizing the Government to veto dismissal of a qui tam case under the public disclosure bar). Drawing from the language of the *Prawer* court's "host/parasite" test, the district court also stated that there would be no "useful return to the Government as a result of this suit" because the Government declined to intervene. 531 F. Supp. 3d at 267 (citing *U.S. ex rel. Alexander v. Dyncorp, Inc.*, 924 F. Supp. 292, 303 (D.D.C. 1996)). But the *Prawer* host/parasite test addresses the similarity of the "allegations or transactions," not whether a case is generally of potential benefit to the Government. Moreover, the Government receives a useful return of at least 70 percent of the recovery in a non-intervened case. 31 USCA § 3730(d)(2).

There are many types of administrative proceedings that address allegations that could potentially overlap with allegations in a qui tam suit, but the D.C. Circuit's decision affirms that the Government action bar is implicated by only a subset of those proceedings. The FCA uses a single phrase "administrative civil money penalty proceeding" to describe the administrative proceedings that implicate the Government action bar and if no such proceeding is involved, then there is no need to evaluate the bar further.

Implications for Materiality—While the decision is important for its analysis of the Government action bar, the opinion's treatment of materiality is likely to have a more significant impact. Following the Supreme Court's decision in *Escobar* and that decision's statement in dicta that the Government's payment of "a particular type of claim in full despite actual knowledge that certain requirements were violated, … is strong evidence that the requirements are not material," 579 U.S. at 195, some courts have placed disproportionate weight on Government conduct when evaluating materiality. While Government payment of a claim after actual knowledge of a violation could support a conclusion that a particular representation was not material,

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the Government's behavior "is relevant only to the extent that it helps answer the ultimate question" of materiality. *Yates v. Pinellas Hematology & Oncology*, 21 F.4th 1288, 1301 (11th Cir. 2021).

In *Vermont National Telephone*, the D.C. Circuit emphasized that the focus of the materiality inquiry is on the potential effect of a statement at the time it is made. While the court cited pre-*Escobar* circuit cases that adopted that interpretation, *Escobar* did not purport to change the standard of materiality, observing that whether using the statutory definition or the common law definition, the definitions are essentially the same. 579 U.S. at 193. Although *Escobar* summarized the definition of materiality as the "effect on the likely *or actual* behavior" of the recipient of the information, id. (emphasis added), the Court did not embrace an "outcome materiality" test, under which a plaintiff must show the Government relied on a misrepresentation. Id. (citing common law definitions of materiality).

The district court in *Vermont National Telephone* had adopted the defendants' argument that the Government does not scrutinize FCC license applications at the stage one application process, so the defendants' alleged failure to disclose required information would not have affected the initial designation of eligibility for credits. But the Government often does not, or cannot, scrutinize the information provided to it, which in part is why applicants are asked to certify the truthfulness of their representations. Cf. *U.S. ex rel. Compton v. Midwest Specialties*, 142 F.3d 296, 302 (6th Cir. 1998) (parties are held to their agreements with the Government under the maxim that "[m]en must turn square corners when they deal with the Government.") (citations omitted). Here, the defendants allegedly certified that they had disclosed all agreements relevant to their status as a very small business entity, while excluding an agreement that rendered them ineligible for the credits. According to the complaint, that misrepresentation rendered them ineligible to participate in the auction. The Government's failure to discover that a person is ineligible to participate in a process does not suggest a misrepresentation lacked the potential to affect the Government's decision.

> A statement or omission is "capable of influencing" a decision even if those who make the decision are negligent and fail to appreciate the statement's significance. … The question is not remotely whether [the defendant] was sure to be caught—though it would have been, had it disclosed the truth … but whether the omission could have influenced the agency's decision.

U.S. v. Rogan, 517 F.3d 449, 452 (7th Cir. 2008). Moreover, participation in a process for which one is ineligible undermines the process itself. Cf. *U.S. ex rel. Longhi v. U.S.,* 575 F.3d 458, 473 (5th Cir. 2009); 51 GC ¶ 277.

As the D.C. Circuit observed, at this stage of the case, the complaint involves only allegations, and development of facts later in the case may shed light on the significance of the alleged misrepresentations. But at the motion to dismiss stage, properly evaluated at the time the alleged misrepresentations were made, they had the potential to affect the Government's decision-making.

The D.C. Circuit's decision in *Vermont National Telephone* brings important clarity to the application of the FCA's Government action bar by looking to the nature of the administrative proceeding at issue, not whether penalties were assessed at some point. More significantly, the decision shines an important spotlight on the point in time that the materiality of a misrepresentation should be evaluated.

This Feature Comment was written for The Government Contractor by* Claire M. Sylvia, *a partner in the law firm of Phillips & Cohen LLP, which represents whistleblowers in False Claims Act cases. www.phillipsandcohen.com. Ms. Sylvia is the author of The False Claims Act: Fraud Against the Government, published by Thomson Reuters.

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