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Ninth Circuit Solidifies Mandatory Escobar Test by Denying en banc Rehearing

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On November 24, 2018, the Ninth Circuit denied the Stephens Institute's petition for rehearing *en banc* in *United States ex rel. Rose v. Stephens Institute*, 901 F.3d 1124 (9th Cir. 2018), *reh'g denied*, ---- F.3d ----, 2018 WL 6165627 (Nov. 24, 2018), a False Claims Act case in which the relators alleged an "implied false certification" theory of liability. The decision left in place the panel's holding that the test laid out in *United Health Services v. United States ex rel. Escobar*, is mandatory in False Claims Act cases alleging this theory of liability, supplanting the test previously articulated in *Ebeid ex rel. United States v. Lungwitz*, 616 F.3d 993 (9th Cir. 2010). By declining to elaborate on the differences between *Escobar* and *Ebeid*, the Ninth Circuit left practitioners with little guidance as to what types of allegations would have satisfied *Ebeid*, but will now be barred by *Escobar*.

Background on Implied False Certification Theory

The False Claims Act imposes penalties on entities that defraud the federal government by submitting false claims for payment. Under the "implied false certification" theory of False Claims Act liability, an entity is considered to have defrauded the government if it submits a claim that is accurate on its face, but fails to disclose the entity's violation of a statutory, regulatory, or contractual requirement that is material to the claim. Prior to *Escobar*, not all circuits recognized this theory of liability.

In *Escobar*, however, the Supreme Court held that implied false certification theory could be a basis for False Claims Act liability, and then created a two-part test for falsity and clarified the standard for determining whether misrepresentations about compliance are material. The Court described the falsity prong of the claim as satisfied "at least" when the claim for payment "makes specific representations about the goods or services provided" and "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. The Court expressly noted that it "need not resolve whether all claims for payment implicitly represent that the billing party is legally entitled to payment." *Id*. at 2000. Given the Court's holding that the two conditions of specific representations and failure to disclose noncompliance are sufficient, but not necessarily required, to state a claim under a theory of implied false certification, lower courts subsequently have grappled with whether plaintiffs must always allege facts showing specific representations and noncompliance, or whether plaintiffs could allege other facts to demonstrate falsity, to survive a motion to dismiss their claims under the False Claims Act. *See* Jeff Overley, *One Year Later: Escobar is Roiling FCA Landscape, Law360* (June 16, 2017) (finding at that time that of 22 courts addressing the issue post-*Escobar*, seven held the test is mandatory, six held it optional, and nine made ambiguous rulings).

Implied False Certification Theory in the Ninth Circuit

Prior to the Supreme Court's decision in *Escobar*, the Ninth Circuit used the test it laid out in *Ebeid ex rel. United States v. Lungwitz* when deciding implied false certification cases. Under *Ebeid*, a relator had to show "that (1) the defendant explicitly undertook to comply with a law, rule or regulation that

is implicated in submitting a claim for payment and that (2) claims were submitted (3) even though the defendant was not in compliance with that law, rule or regulation." 616 F.3d at 998.

Indeed the U.S. District Court for the Northern District of California applied *Ebeid* when it first considered the defendant's motion for summary judgment in *United States ex rel. Rose v. Stephens Institute*. In *Rose*, the Stephens Institute entered into a Program Participation Agreement ("PPA") with the Department of Education that required the school to comply with certain regulations, including an incentive compensation ban, to receive federal funding. Relators, former admissions officers, alleged that the school later violated the Department's incentive compensation ban by giving admissions officers salary increases of up to $30,000 in exchange for meeting quantitative enrollment goals. Finding that the relators had raised a triable issue of fact as to whether the school in fact compensated admissions officers solely on the basis of their enrollment numbers, the district court allowed the case to proceed because "each of [the school's] requests for [federal] funds contained an 'implied certification of continued compliance with the incentive ban'" contained in the PPA, thus satisfying *Ebeid*. *Rose v. Stephens Inst.*, No. 09-CV-5966-PJH, 2016 WL 2344225, at *9 (N.D. Cal. May 4, 2016).

The Supreme Court decided *Escobar* less than one month later, prompting the Stephens Institute to move for reconsideration in light of that decision. In denying the school's motion, the district court expressly held that *Escobar* did not establish "a rigid 'two-part test' for falsity that applies to every single implied false certification claim," but nevertheless found that the relators' allegations raised a triable issue of fact under that standard, as well. Specifically, the district court found that the school's failure to disclose its noncompliance with the incentive compensation ban would "render [its] loan forms misleading" because each form represented that the student-borrower is "eligible" and "enrolled in an eligible program," and the school's failure to comply with the ban would have made it ineligible for funding. *Rose v. Stephens Inst.*, No. 09-CV-05966-PJH, 2016 WL 5076214, at *5 (N.D. Cal. Sept. 20, 2016).

The district court subsequently granted an interlocutory appeal of its reconsideration order and simultaneously certified the following question (plus two others) to the Ninth Circuit: "Must the 'two conditions' identified by the Supreme Court in *Escobar* always be satisfied for implied false certification liability under the FCA, or does *Ebeid* 's test for implied false certification remain good law?" *Scott Rose v. Institute*, No. 09-CV-05966-PJH, 2016 WL 6393513 at *4 (N.D. Cal. Oct. 28, 2016).

The Ninth Circuit's Decision in *Rose v. Stephens Institute*

In addressing the district court's certified question, the Ninth Circuit relied on two of its post-*Escobar* rulings that assumed, without deciding, that both prongs of the *Escobar* test were in fact mandatory. In *United States ex rel. Kelly v. Serco, Inc.*, 846 F.3d 325 (9th Cir. 2017), the Ninth Circuit found that the plaintiff's allegations failed to satisfy *Escobar*, but did not even consider whether they otherwise satisfied *Ebeid.* 846 F.3d at 332-333. In *United States ex rel. Campie v. Gilead Sciences, Inc.*, 862 F.3d 890 (9th Cir. 2017), the court made contradictory statements as to whether the *Escobar* falsity test is mandatory, stating both that *Escobar* "clarif[ied] *some* of the circumstances in which the False Claims Act imposes liability," and that "although the implied certification theory can be a basis for liability, two conditions *must* be satisfied." 862 F.3d at 901 (emphases added). Neither opinion commented expressly on whether the *Escobar* conditions were binding on False Claims Act plaintiffs.

Stating that "[w]e are bound by three-judge panel opinions of this court," the Ninth Circuit in *Rose* nevertheless held that relators *must* satisfy both conditions laid out in *Escobar* "unless and until our court, *en banc*, interprets *Escobar* differently." *Rose*, 901 F.3d at 1130. Relying in large part on the district court's reasoning, the court went on to hold that the *Escobar* test was satisfied because the

school had represented on its loan forms that the student-borrowers were “eligible” and “enrolled in an eligible program,” and its failure to disclose its noncompliance with the incentive compensation ban rendered those representations, in the words of *Escobar*, “misleading half-truths.” *Id.* at 1130.

By declining the *Rose* panel’s implicit invitation to reconsider the *Escobar* issue *en banc* – and by finding *Escobar* to be mandatory in a case whose facts also apparently satisfied *Ebeid* –the Ninth Circuit forfeited an opportunity to outline the contours of this new test and explain how it differs, if at all, from the *Ebeid* test that came before it. The court’s assurance that, “[w]ere we analyzing *Escobar* anew, we doubt that the Supreme Court’s decision would require us to overrule *Ebeid*,” provides little guidance as to how *Escobar*’s requirements might differ from *Ebeid*’s. *Rose*, 901 F.3d at 1130. As a result, it remains to be seen how the Ninth Circuit’s application of *Escobar* will differ from its application of *Ebeid*. Additionally, now that the court has concluded that the two-step falsity standard is mandatory to recover under the False Claims Act, it is unclear whether or how that ruling will affect retaliation claims under the False Claims Act, where plaintiffs must demonstrate that they had a reasonable, good faith belief that their employers committed fraud against the government.