Portfolio Media. Inc. | 111 West 19th Street, 5th Floor | New York, NY 10011 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Revisiting Bishop In Light Of Escobar

By **Andrew Schilling and Megan Whitehill**

Law360, New York (September 1, 2017, 12:42 PM EDT) --

Andrew Schilling

Megan Whitehill

Last year, the Second Circuit Court of Appeals in New York handed the banking industry some much-needed ammunition to fight back against False Claims Act suits premised on broad certifications of compliance.[1] Specifically, in Bishop v. Wells Fargo & Co.,[2] the court affirmed the dismissal of a declined qui tam suit in which the relators had alleged that the defendant banks were not in compliance with federal banking laws and regulations when they borrowed money at favorable rates from the Fed's discount window. In the absence of a specific, factually false statement or claim made by the banks, the relators resorted to theories of "legally false" express and implied certifications, arguing that requesting loans from the Fed while operating out of compliance with the federal banking laws was enough to impose FCA liability. The court expressed reluctance, however, to allow self-interested whistleblowers to police the highly regulated banking industry, concerned that endorsing the relators' broad theories, at least in this context, could discourage banks from accessing the discount window.

The banks' victory was short-lived, however. Eight months later, the U.S. Supreme Court vacated the Second Circuit's decision in Bishop and sent it back to the circuit for further consideration in light of the Supreme Court's intervening decision in Universal Health Services Inc. v. United States ex rel. Escobar, 136 S. Ct. 1989 (2016). The Second Circuit is now poised to decide whether Escobar allows these relators to pursue these banks for FCA liability for requesting government funds while allegedly operating out of compliance with federal banking laws. The outcome of the case will be closely watched.

United States ex rel. Bishop v. State of New York

In Bishop, the relators had alleged that, when two banks attempted to borrow money from the Federal Reserve's discount window, they made false statements by broadly representing and warranting, in their lending agreement with the Fed, that they were not in violation of "any laws or regulations" relating to the lending agreement. That agreement provided that each bank was "deemed" to have made that representation each time it requested an advance from the government. Relators alleged that, in fact, the banks were not operating in compliance with all banking laws or regulations during that time frame, and, therefore, that they were deemed to have made a false representation every time they

sought federal funds. Relators sought nearly $900 billion in treble damages and civil penalties.

The government apparently didn't think much of the case and declined to intervene. Undaunted, the relators proceeded on their own. The district court dismissed the case, and the relators appealed.

The Second Circuit's Decision

In its May 5, 2016, decision, the Second Circuit upheld the district court's decision to dismiss the case. In the process, it handed a much-needed win to the financial services industry by rejecting FCA liability premised on allegedly false general compliance certifications.

The Second Circuit's decision in Bishop relied heavily on the circuit's 2001 decision in Mikes v. Strauss.[3] In Mikes, the court imposed strict limits on liability for claims of "legal falsity," expressing concern that, without such limits, relators could use the FCA to impose liability for mere regulatory noncompliance. Cabining exposure for express false certification liability, Mikes held that such a claim requires the plaintiff to show that the defendant expressly certified compliance with a "particular" statute, regulation or contractual term; general compliance certifications were not enough.[4] Mikes also placed limits on implied certification liability, under which FCA liability can occur even in the absence of an express false statement if, by merely requesting payment, the defendant can be said to have made an implied certification of compliance with a requirement on which payment is conditioned. To establish implied certification liability, Mikes held, the plaintiff must show that the defendant failed to comply with a regulation that expressly required compliance as a "condition to payment."[5]

Applying Mikes, the court in Bishop found that the relators failed both requirements. First, the court held that the relators' express certification theory failed because the relators were relying on the broad certification contained in the lending agreement stating that the banks were in compliance with "any laws or regulations" that could have an adverse impact on the lending agreement.[6] While the court recognized that false certifications of compliance can sometimes give rise to FCA liability, it observed that it had not previously addressed "how narrow a certification of compliance must be to constitute an express false claim."[7] Without defining the precise contours of such a claim, the court found this particular certification too broad to satisfy the particularity requirement of Mikes, observing that "[t]he universe of potentially applicable laws or regulations is vast."[8]

Second, the court held that the relators' implied certification theory failed because relators had not identified noncompliance with a "condition to payment."[9] Although the relators had argued that the banks' alleged noncompliance was "material" and went to the "heart of the bargain" with the government, the court declined to adopt a "heart of the bargain" test for implied certification liability.[10] The court also rejected the relators' argument that the "condition to payment" limitation on the implied certification theory — under which the regulation at issue must explicitly condition payment of the claim on compliance — did not apply outside the health care context, as at least two other courts had held.[11] Accordingly, the court affirmed the district court's decision dismissing the case.

The Supreme Court's Decision in Escobar

One month later, the Supreme Court announced its landmark decision in Escobar. In Escobar, the court for the first time addressed the controversial implied certification theory. In a victory of sorts for the government and relators, the court held that FCA liability could indeed be premised upon an implied certification of compliance, at least where two conditions are met: "[F]irst, the claim does not merely

request payment, but also makes specific representations about the goods or services provided; and second, the defendants' failure to disclose noncompliance with material statutory, regulatory, or contractual requirements makes those representations misleading half-truths."[12]

Significantly, the court explicitly rejected the limitation imposed by courts such as Mikes that the noncompliance relate to an express "condition of payment." As the court explained, "[w]hat matters is not the label the Government attaches to a requirement, but whether the defendant knowingly violated a requirement that the defendant knows is material to the Government's payment decision."[13]

While the Supreme Court's sustaining the implied certification theory represented a victory for the government and relators, Escobar certainly did not embrace broad False Claims Act liability for mere regulatory noncompliance. To the contrary, the court in Escobar appeared to go out of its way to impose significant limitations on the false certification theory.

For starters, the court reinforced the well-settled principle that the "False Claims Act is not 'an all-purpose antifraud statute, or a vehicle for punishing garden variety breaches of contract or regulatory violations."[14] Separately, it "emphasized" that "the False Claims Act is not a means of imposing treble damages and other penalties for insignificant regulatory or contractual violations."[15] While the court opened the door to implied certification claims under limited circumstances, it also explicitly addressed the concerns expressed by the defendants about potentially "open-ended liability."

On that score, the court handed a significant victory to defendants in False Claims Act cases by announcing that courts should strictly enforce the act's materiality and scienter requirements. Specifically, the court observed that the act's "materiality" requirement was a "demanding one" and that the scienter requirement is likewise a "rigorous" one.[16] On an issue likely to be of particular relevance to the panel that will reconsider Bishop, the court strongly signaled that cases based on broad certifications of compliance would not survive the heightened materiality standard it had announced, observing that "if the Government required contractors to aver their compliance with the entire U.S. Code and Code of Federal Regulations, then under this view, failing to mention noncompliance with any of those requirements would always be material. *The False Claims Act does not adopt such an extraordinarily expansive view of liability*."[17] The court remanded the case for further proceedings consistent with its opinion.

What Escobar Means for Bishop

At the Second Circuit's invitation, the parties in Bishop have submitted supplemental briefing to address the impact of Escobar on the panel's prior opinion. Recognizing the potential significance of the case, amicus briefs have been filed by the Chamber of Commerce and the Clearing House Association (in support of the defendants), Taxpayers Against Fraud Education Fund (in support of the relators), and the U.S. Department of Justice (in support of "neither party").

While all parties and their amici recognize that Escobar rewrote the standards for assessing an implied certification case, the parties dispute Escobar's impact on the Bishop panel's rejection of the relators' express certification theory. As the defendants and their amici point out, the Supreme Court in Escobar addressed the issue of implied certification liability only; it did not purport to address express certification liability. In the defendants' view, the Mikes "particularity" requirement in express certification cases survived Escobar, and Mikes continues to preclude express certification liability based on general compliance certifications. Not surprisingly, the relators and their amici (and the government) disagree.

According to the Justice Department, the Mikes requirement that plaintiffs show that the defendant certified compliance with a "particular" statute, regulation or contractual requirement was an "atextual, policy-driven understanding of falsity" that "does not survive Escobar."[18] Significantly, however, the government recognized that Escobar hardly embraced liability for broad compliance certifications. Rather, as the Justice Department explained, the breadth of the certification remains relevant; but after Escobar, the government said, it is relevant to the elements of "materiality" and "scienter" rather than the element of "falsity." As the government explained: "Thus, in some cases, the breadth of a certification might bear on whether or not the violation was material to the government's decision to pay. It could also potentially be relevant to a determination of whether the defendant knew that its certification was false."[19] The government ultimately declined to take a position on the merits of the relators' claims, including whether the court should affirm the district court's judgment on the element of falsity.

Conclusion

If the Second Circuit panel that reconsiders Bishop follows the road map outlined by the Justice Department's amicus brief, it will still consider the breadth of the express certifications at issue to be a critical weakness of the relator's case. But this time around, whether that weakness is fatal may turn not on whether such a general compliance certification can ever be false, but rather on whether the relator has plausibly alleged that the banks knew that the falsity of that statement would be material, and whether it was material, to the Fed's lending decision. As the Supreme Court in Escobar appeared to signal, it is hard to see how such a broad statement of compliance with "all laws and regulations" could ever meet the heightened materiality and scienter standards. Given the relative weakness of the relators' case and the legitimate policy concerns expressed by the Bishop panel about imposing FCA liability on these facts, it therefore seems unlikely that a reconsideration of the case in light of Escobar will change the outcome.

Whatever the outcome, the Second Circuit's upcoming decision in Bishop will be closely watched, and it could turn out to be the circuit's most significant False Claims Act decision since Mikes.

Andrew W. Schilling is a partner at Buckley Sandler LLP and leader of the firm's False Claims Act and FIRREA practice. He is a former assistant U.S. attorney and chief of the Civil Division at the U.S. Attorney's Office for the Southern District of New York.

Megan E. Whitehill is an associate in the firm's New York office.

[1] See A. Schilling, "A False Claims Act Win For the Banks," Law360 (May 11, 2016).

[2] 823 F.3d 35 (2d Cir. 2016).

[3] 274 F.3d 687 (2d Cir. 2001).

[4] Id. at 698.

[5] Id. at 699-700.

[6] Bishop, 823 F.3d at 44-45.

[7] Id. at 44.

[8] Id. at 45.

[9] Id. at 48-49.

[10] Id. at 48.

[11] Id. at 49 (citing U.S. ex rel. Hendow v. Univ. of Phoenix, 461 F.3d 1166, 1177 (9th Cir. 2006); U.S. ex rel. Feldman v. City of New York, 808 F. Supp. 2d 641, 653-54 (S.D.N.Y. 2011)).

[12] Escobar, 136 S. Ct. at 2001.

[13] Id. at 1996.

[14] Id. at 2003 (quoting Allison Engine, 553 U.S. 662, 672 (2008)).

[15] Id. at 2004.

[16] Id. at 2002-03.

[17] Id. at 2004 (emphasis added).

[18] Brief for the United States as Amicus Curiae Supporting Neither Party, Bishop v. Wells Fargo & Co., 15-2449 (filed June 6, 2017), at 12.

[19] Id. at 14.
