

U.S. Supreme Court Decision May Insulate a Remote Material Supplier Making No Representations Regarding Commercially Useful Function Requirements

By: James D. Fullerton

We reported earlier [here](#), that a national supplier of construction materials (Supplier) had agreed to pay a fine of \$4,945,000 to the United States for participating in transactions in which a certified Disadvantaged Business Enterprise (DBE) acted "merely as a pass through" and did not perform a "commercially useful function" under U.S. Department of Transportation (DOT) regulations on DBE participation goals.

There was no "court decision" in this case, since it resulted in a settlement agreement. This was not a legal precedent and we do not know how a court would have ruled on these facts. The settlement agreement did not use the term "implied certification," although the United States did state that the Supplier did violate the U.S. False Claims Act. However, the prosecutor must have been operating on the theory that the Supplier's invoices impliedly certified that the transaction complied with all statutory, regulatory or contractual requirements, including the DBE Commercially Useful Function requirements. According to this implied certification theory, when a claim for payment fails to disclose a violation of a material statutory, regulatory, or contractual requirement, this is a misrepresentation that renders the claim "false or fraudulent" under the False Claims Act.

A new U.S. Supreme Court decision casts doubt on whether courts would agree with the United States' position in that \$4,945,000 penalty case. Prosecutors will need to decide whether to conduct a similar investigation or prosecution in the future. A full copy of the opinion can be seen [here](#): *Universal Health Servs. v. United States ex rel. Escobar*, 136 S. Ct. 1989, 195 L. Ed. 2d 348 (U.S. 2016), decided June 16, 2016.

The Supreme Court decided that:

[L]iability can attach when the defendant submits a claim for payment that makes specific representations about the goods or services provided, but knowingly fails to disclose the defendant's noncompliance with a statutory, regulatory, or contractual requirement. In these circumstances, liability may attach if the omission renders those representations misleading.

The defendant in *Universal Health Servs.* submitted mental health service invoices for Medicaid reimbursement. Those invoices contained codes signifying that the services were provided by properly licensed mental health professionals, which was false.

If we look only at the quoted language from the Supreme Court, we would decide that False Claim Act violations can occur only if there is a claim for payment that makes *specific representations*, but the claimant knowingly fails to disclose noncompliance with a statutory, regulatory, or contractual requirements, which render *those representations misleading*.

The settlement agreement in the \$4,945,000 construction material supplier case confirmed that the Supplier "did not contract directly with a government entity for any of the federally-funded contracts."

Neither did the Supplier "certify -nor was it required to certify -to any government entity that it had or would comply with DBE regulations in connection with those contracts and projects."

"[The DBE] collected invoices from [the Supplier]; transferred the information from those invoices to [the DBE's] own invoices and added a markup; and passed [the DBE] invoices on to the prime contractors. *The prime contractors* then represented falsely to federal, state and/or local contract-letting authorities that [the DBE] supplied materials that, in reality, [the Supplier] supplied. In this connection, [the Supplier's] conduct *enabled various prime contractors to certify falsely* that materials were supplied by [the DBE] when the parties -i.e. [the Supplier, the DBE], and the prime contractors - knew that was not the case, resulting in the submission to government entities of false or fraudulent claims for payment from federal funds." The invoices from the Supplier contained no representation or discussion of DBE regulations or whether the DBE had performed a Commercially Useful Function. These invoices presumably only described the materials furnished.

It is possible that *Universal Health Servs.* means that this conduct can no longer constitute a False Claims Act violation. However, life is never that simple in the legal business. The Supreme Court also stated in the *Universal Health Servs.* case that

We need not resolve whether all claims for payment implicitly represent that the billing party is legally entitled to payment. The claims in this case do more than merely demand payment. They fall squarely within the rule that half-truths-representations that state the truth only so far as it goes, while omitting critical qualifying information-can be actionable misrepresentations.

In other words, the claimant in *Universal Health Servs.* made *specific representations AND knowingly* failed to disclose noncompliance with a statutory, regulatory, or contractual requirement, *which rendered those representations misleading.* Therefore the U.S. Supreme Court did not have to decide whether ALL claims for payment implicitly represent that the billing party is legally entitled to payment.

The *Universal Health Servs.* case certainly implies that a construction material supplier that did not contract directly with a government entity and did not certify or make any statement regarding compliance with DBE regulations cannot be liable for a False Claims Act violation. However, the door is still cracked open for this argument.

James D. Fullerton
Fullerton & Knowles, P.C.
12642 Chapel Rd.
Clifton, VA 20124
[\(703\) 818-2600](tel:(703)818-2600), Ext. # 205
fax [\(703\) 818-2602](tel:(703)818-2602)
JFullerton@FullertonLaw.com
Cell Phone [703-517-0457](tel:703-517-0457) Ext. #205