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District Court Finds FCA Complaint Fails to Satisfy Materiality Requirement and Rejects Claims Based on Alleged TAA Noncompliance

By Paul R. Hurst, Thomas P. Barletta, and Kendall R. Enyard*

In a recent decision, the U.S. District Court for the District of Columbia dismissed a civil False Claims Act case alleging that the defendants violated the Act by falsely certifying that certain items sold under two General Services Administration Federal Supply Schedule contracts complied with the Trade Agreements Act. The authors of this article discuss the dismissal.

The U.S. District Court for the District of Columbia recently dismissed a civil False Claims Act ("FCA")[1] case which alleged that the defendants violated the FCA by falsely certifying that certain items sold under two General Services Administration ("GSA") Federal Supply Schedule ("FSS") contracts complied with the Trade Agreements Act ("TAA"),[2] and by making open market sales of products sourced from non-TAA countries.[3] The defendants were both distributors of products manufactured by Cisco. The relator was an employee of a Value Added Reseller that partnered with defendants and sold products to the government as an "authorized dealer" under defendants' GSA FSS contracts.

In dismissing the complaint, the court found that the allegations in the complaint regarding defendants' sales of items that were not TAA complaint failed to satisfy the FCA's materiality requirement. The court also held that the complaint failed to state an FCA claim as to certain items on defendants' GSA contracts that were not "end products" and therefore were not subject to the TAA's country of origin rules. Finally, the court held that "open market" items were not subject to the TAA and that open market sales of products from non-TAA countries therefore did not violate the FCA.

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[1] 31 U.S.C. § 3729(a)(1)(A) & (B).

[2] 19 U.S.C. § 2501, *et seq.*

[3] *United States ex rel. Folliard v. Comstor Corp.* ("*Folliard*"), Civ. Action No. 11-731 (BAH) (D.D.C. Mar. 31, 2018).

DEFENDANTS' GSA CONTRACT SALES

"End Products"

The defendants sold two classes of Cisco items under their FSS contracts. The first consisted of items that were "end products" and for which the relator relied primarily on country of origin ("COO") information available through Cisco in alleging that they were not TAA compliant. As to those items, the court found that the defendants' claims for payment included implied certifications of TAA compliance and that the complaint alleged sufficient facts regarding TAA non-compliance to establish, for pleading purposes, that defendants' implied certifications of compliance and their associated claims for payment were false.[4]

However, the court, relying on the U.S. Supreme Court's decision in *Escobar*, found that even if the certifications were false, they were not "material" to the government's decision to pay the contractors so that the complaint therefore failed to state a claim under the FCA.[5] That finding was based on two principal considerations:

First, the government's decision not to intervene in the case after a five year investigation, which included production of documents from defendants pursuant to a civil investigative demand relating to over $123 million in GSA contract sales and production of documents from Cisco regarding the COO of its products.[6] Second, the complaint's failure to allege that the government had consistently refused to pay claims based on TAA non-compliance, and, in particular, its failure to allege that the government, after it became aware of the relator's allegations, took actions against the defendants or steps to cancel the contracts, or even sent notices to the defendants regarding TAA non-compliance.[7] The court also observed that that "[a]ny of those steps by the government could have supported a plausible claim that compliance with

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[4] *See id*. FCA liability can be based on an "implied certification" where a claim for payment "also 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." *Universal Health Servs., Inc. v. United States ex rel. Escobar* ("*Escobar*"), 136 S.Ct. 1989 (2016).

[5] *See* 31 U.S.C. § 3729(b)(4) (defining materiality as "having a natural tendency to influence, or be capable of influencing, the payment or receipt of money or property").

[6] *See Folliard*, *supra* note 3. Folliard was a serial relator and the court also noted that the government had declined to intervene in other FCA cases that had been brought by him.

[7] *See Folliard*, *id*.

regulatory or contractual obligations is material to the government's decision to pay in this case."[8]

In that regard, the court rejected the relator's reliance on a 2006 GSA newsletter that urged contractors to review products on their GSA pricelists for TAA compliance, but also stated that GSA would "work with" contractors to address TAA compliance. The court concluded that the newsletter "show[ed] that the government may continue to make payments even when TAA violations are known."[9] Although outside of the period covered by the allegations in the complaint, in 2016 GSA again reminded contractors that they were responsible for ensuring the accuracy of product information on their GSA price lists; suggested that resellers "may need to confer with the manufacturer, OEM, or wholesaler" about the COO of products on their contracts; and "requested" that all GSA FSS contractors review their contract pricelists to confirm compliance with the TAA and the accuracy of their certifications of TAA compliance. However, unlike the earlier newsletter, the 2016 notice also directed them to delete any non-compliant products from their GSA contracts.

"Configurable Options"

As to the second class of Cisco items, the court essentially found that they were not "end products" and therefore were not subject to the TAA's purchase restriction, which applies to "end products."[10] Cisco described this second set of items as "an item that 'is not orderable by itself and may be considered a configurable option of an end product,' in which 'case, the country of origin of the corresponding end product would apply.' "[11] The court, relying on Cisco's definition, in turn described " 'configurable options' as items that have not yet been 'substantially transformed' into end products and thus need not individually, for the purposes of government procurement, originate in a designated country."[12] Accordingly, the court found that the relator's allegations regarding sales of configurable option items that did not originate from a "designated" (TAA compliant) country were not sufficient to state a claim under the FCA.[13]

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[8] *Id.*

[9] *Id.*

[10] *See* FAR 25.003 (defining "End product" as "those articles, materials, and supplies to be acquired for public use"); *see also* 52.225-5(a).

[11] *Folliard*, *supra* note 3.

[12] *Id.*

[13] *Id.* The court also held that the relator failed to provided facts to support contentions, asserted during briefing on the defendants' motion to dismiss, that the defendants were selling

Open Market Sales

The court also rejected the relator's contention that defendants' sales of "open market" items from non-TAA countries violated the FCA.[14] It noted that those sales "by definition are outside of the FSS contract[s]," and found that the various regulations on which relator relied to support his claim "are silent regarding TAA-compliance for open market items."[15] The court also examined the regulations in FAR 8.402 applicable to open market sales and found that they did not refer to or discuss TAA compliance. Finally, the court also held that since all of the open market sales at issue were below the $191,000 TAA threshold in effect at the time of the sales, the relator failed to "plausibly support" its claim that open market sales of items from non-designated countries violated the FCA.[16]

CONCLUSION

Dismissal of a complaint for failure to state a claim means only that the complaint did not contain sufficient facts to plausibly support an allegation that the defendants violated a statute or other legal requirement—here, the TAA and FCA, and that the plaintiff therefore cannot proceed with its lawsuit. The sufficiency of a complaint is determined in light of the particular factual allegations in each complaint. However, in dismissing the relator's complaint for failure to state a claim in *Folliard*, the district court also made several rulings of broader interest to GSA and other contractors: It held that simply making generalized allegations that a contractor sold end products that were not TAA complaint will not satisfy the FCA's materiality requirement. Rather, a complaint must include facts that plausibly show that any false claims were material to the government's decision to pay those claims and that the government action (or inaction) can affect whether TAA non-compliance was "material." The court also recognized that the TAA applies only to "end products" and that every item sold under a government contract is not necessarily an "end product," and therefore held that a FCA claim cannot be based on an alleged failure to comply with the TAA's COO rules as to items that

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configurable options as standalone products under their FSS contracts and before they were incorporated into end products, and that those items, were never substantially transformed into different articles of commerce for purposes of determining their COO. *See id.*

[14] *Folliard*, *supra* note 3. "Open market" items are items that are not included on a GSA FSS contract but which may be included on an order under a GSA MAS contract sales for "administrative convenience" provided that "[a]ll applicable acquisition regulations pertaining to the purchase of the items not on the Federal Supply Schedule have been followed." FAR 8.402(f).

[15] *Id.*

[16] *Id.*

are not "end products." Finally, it held that open market sales are not subject to the TAA under applicable FAR provisions and that a FCA case therefore could not be based on sales of "open market" end products from non-TAA countries.