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IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF ALASKA

UNITED STATES OF AMERICA *ex. rel.* BEN FERRIS,

Plaintiff,

v.

AFOGNAK NATIVE CORPORATION and ALUTIIQ, LLC,

Defendants.

Case No. 3:15-cv-00150-HRH

DEFENDANTS' REPLY IN SUPPORT OF MOTION TO DISMISS SECOND AMENDED COMPLAINT PURSUANT TO RULES 12(b)(6) AND 9(b)

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I. INTRODUCTION

Defendants showed in their moving papers that Relator's Second Amended Complaint ("SAC") fails to meet the "rigorous" and "demanding" standard for pleading materiality set forth by the United States Supreme Court in *Universal Health Services, Inc. v. United States ex rel. Escobar*, 136 S. Ct. 1989 (2016). That standard requires Relator to plead with particularity "facts that show that the government actually does not pay claims if they involve the statutory violations in question." Order dated Sept. 28, 2016 (Dkt. 201) ("Order") at 8. Relator fails to do so.

Relator claims that the alleged regulatory violations are material because the SBA would likely exclude Defendants' subsidiaries from the 8(a) Business Development ("BD") Program if it knew of them. But we now know exactly what the SBA actually did when informed of the alleged violations—nothing. Rather than exclude Defendants' subsidiaries from the program, the SBA has continued to admit them and to award them contracts—as Relator admits in the Second Amended Complaint—while having full knowledge of the violations alleged by Relator. Under *Escobar*, the SBA's actual conduct constitutes "very strong evidence" of immateriality. Given the absence of contrary facts pled by Relator, the SBA's conduct is fatal to Relator's speculative materiality theory.

Rather than plead the required facts, Relator seeks to supplant the SBA. He asks the Court to ignore the actual decisions made by the SBA (to allow Defendants' subsidiaries to participate in the 8(a) BD Program with full knowledge of the alleged violations) and the actual eligibility rules adopted by the SBA (which treat Alaska Native Corporations ("ANCs") differently from most other program participants), and to find that the SBA likely would exclude Defendants' subsidiaries from the 8(a) BD Program based on violations of SBA rules that he has not pled or that have nothing to do with 8(a) BD Program eligibility. But the False Claims Act does not allow self-serving relators to second-guess the considered decisions and rule-making of government agencies. Relator must plead facts showing a misrepresentation material *to the SBA*.

Because he fails to do so, the Second Amended Complaint should be dismissed.

II. ARGUMENT

A. Relator Must Meet *Escobar*'s Rigorous and Demanding Materiality Standard

Relator concedes that he must meet the materiality requirements established by the Supreme Court in *Escobar*. *See* Opposition (Dkt. 218) ("Opp.") at 12 (acknowledging that *Escobar* establishes the test for determining materiality). Those requirements include the following. First, a misrepresentation about compliance with a statutory, regulatory, or contractual requirement must be material to the government's payment decision in order to be actionable under the False Claims Act. *Escobar*, 136 S. Ct. at 1996. Second, materiality turns on the "effect on the likely or actual behavior of the recipient of the alleged misrepresentation." *Id*. at 2002 (citation omitted).[1] And finally, to satisfy this "rigorous" and "demanding" materiality requirement at the pleading stage, Relator must plead "with plausibility and particularity" facts showing that the alleged regulatory violations were material to a government payment decision. *See id*. at 2004 n.6.

Relator says he meets these requirements because he "plausibly has alleged that Afognak's misrepresentations had a natural tendency to influence the SBA's decision to award its subsidiaries lucrative 8(a) work." Opp. at 12. According to Relator, the SBA likely would have excluded Defendants' subsidiaries from the 8(a) BD Program had it known of the alleged regulatory violations. *See id*. at 15 (claiming that Defendants' subsidiaries "are not 8(a)-eligible" and stating that "the crux of Relator's claim in this action is that Afognak has misrepresented the small business status of its subsidiaries"). Relator's argument cannot withstand scrutiny. Not

[1] The Supreme Court cited various examples to illustrate this holding, including from tort law, contract law, other case law, and secondary sources. *Id.* at 2002-03, 2003 n.5. Relator seizes on one of these examples and makes it the centerpiece of his Opposition. *See* Opp. at 13 (relying on tort law formulation); *see also id.* at 15-19 (purporting to apply tort law formulation). But Relator distorts that example and ignores the Supreme Court's extensive clarification of the materiality standard. In any event, Relator cannot escape the Supreme Court's bedrock holding that "*[u]nder any understanding of the concept*, materiality look[s] to the effect on the likely or actual behavior of the recipient of the alleged misrepresentation." *Id.* at 2002 (emphasis added and citation and internal quotation marks omitted).

only does Relator sell *Escobar* short by ignoring the Supreme Court's extensive clarification of the materiality requirement, Relator ignores the actual decisions made by the SBA, fundamentally mischaracterizes the 8(a) BD Program, and fails to plead any violation of the distinctive eligibility rules that govern ANCs like Defendants.

B. The Actual Decisions Made by the SBA Show That Relator Has Failed to Plead a Material Violation

The Supreme Court took pains in *Escobar* to clarify exactly how the courts should evaluate the materiality of a claimed misrepresentation of regulatory compliance. The Supreme Court held that "[u]nder any understanding of the concept, materiality look[s] to the effect on the likely or actual behavior of the recipient of the alleged misrepresentation." *Escobar*, 136 S. Ct. at 2002 (citation and internal quotations marks omitted). Although no single fact is determinative in every case, the Supreme Court highlighted the pivotal importance of the government's actual payment decisions. A government decision to pay a claim despite actual knowledge of an alleged violation is especially important: "if the Government pays a particular claim in full despite its actual knowledge that certain requirements were violated, that is *very strong evidence* that those requirements are not material." *Id.* at 2003 (emphasis added). Or if the government "regularly pays a particular type of claim in full despite actual knowledge that certain requirements were violated, and has signaled no change in position," that too is "strong evidence that the requirements are not material." *Id*. at 2003-04. Conversely, proof of materiality can include evidence that the defendant knows that the government consistently refuses to pay claims in the mine run of cases based on non-compliance with the particular statutory, regulatory or contractual requirement at issue. *Id.*

Here, the recipient of the alleged misrepresentations was the SBA. Thus, the question is the effect of the alleged misrepresentations of regulatory compliance on the likely or actual conduct of the SBA. The actual decisions made by the SBA affirmatively show that none of the regulatory violations pled by Relator are material. Relator filed his original complaint in May 2013. That complaint set out all the alleged misrepresentations of regulatory compliance: that

Defendants falsely certified that (1) Defendants' 8(a) subsidiaries are separate and distinct small business concerns, (2) Defendants' 8(a) subsidiaries would perform each contract awarded, (3) the general manager assigned to each subsidiary actually manages the daily operations of the subsidiary, and (4) Defendants' 8(a) subsidiaries would pursue contracts that will allow the business to grow, develop, and eventually graduate from the program. Cmplt. Dkt. 1 ¶¶ 113-117 (Count I), 118-23 (Count II); *see also* Opp. at 8.

The SBA has been aware of Relator's allegations for almost four years. Yet Relator has not alleged a single step by the SBA to exclude any of Defendants' 8(a) Participants from the 8(a) BD Program or to deny them contracts on the basis of the alleged violations. Not one. Nor has he pled a single instance in which any government agency has denied Defendants a contract or refused to pay an invoice based on the alleged violations. To the contrary, Relator specifically alleges, and thus admits, that the SBA has continued to allow Defendants' 8(a) Participants to participate in the 8(a) BD Program and to award them contracts right up to the date of the Second Amended Complaint. *See, e.g.*, SAC ¶¶ 101 ("All of the government contracts awarded to the 8(a) subsidiaries . . . from 2007 to the present are tainted by this fraud."), 140 (Count I applies "[f]rom 2007 to the present"), 145 (Count II applies "[f]rom 2007 to the present").[2]

Under *Escobar*, the SBA's actual decisions to allow Defendants' 8(a) Participants to participate in the 8(a) BD Program and to continue to receive contracts under the program—as

[2] As also set forth in Defendants' moving papers, ANC participation in the 8(a) BD Program has been the subject of numerous Congressional investigations and reports, including two Government Accountability Office investigations that explained in 2006 and 2012 how ANCs were organized and operated. *See* Motion at 6-7, 25-26; *see also* U.S. Gov't Accountability Off., GAO-06-399, Contract Management: Increased Use of Alaska Native Corporations' Special 8(a) Provisions Calls for Tailored Oversight 6 (2006) ("2006 GAO Report") ("ANCs are using the congressionally authorized advantages afforded to them, such as ownership of multiple 8(a) subsidiaries, sometimes in diversified lines of business"); U.S. Gov't Accountability Off., GAO-12-84, Federal Contracting: Monitoring and Oversight of Tribal 8(a) Firms Need Attention 39 (2012) ("2012 GAO Report") ("some tribal 8(a) firms operate, in effect, as large businesses due to their parent corporation's backing and relationships with their sister subsidiaries"). As Relator admits, the SBA nonetheless continued to admit ANCs such as Defendants into the 8(a) BD Program; this further evidences the immateriality of Relator's allegations. *See, e.g.*, 2012 GAO Report at 64-70 (SBA detailing special purpose and rules applicable to ANC participation in the 8(a) BD Program).

admitted by Relator—with full knowledge of the alleged violations is "very strong evidence" that Relator has failed to plead a material violation of the 8(a) BD Program rules. Indeed, there can be no better evidence of the effect of the alleged misrepresentations on the SBA's "likely or actual" behavior than the agency's actual response when informed of the alleged violations. Relator's speculative claims that the alleged misrepresentations of regulatory compliance "had a natural tendency to influence" the SBA's decisions cannot survive the SBA's actual conduct to the contrary and the Relator's complete failure to allege to the contrary. Indeed, given Defendants' ongoing participation in the 8(a) BD Program and Relator's failure to plead any other facts showing materiality, the SBA's actual decision to take no action when informed of the alleged misrepresentations is fatal to Relator's claims. To hold otherwise would be inconsistent with the materiality standard set forth in *Escobar* and would upend the 8(a) BD Program by substituting Relator's speculation about how the SBA should act, and his self-serving interpretations of the SBA's rules, for the SBA's actual and informed eligibility decisions.

Relator relies heavily on the First Circuit's decision on remand in *Escobar*, but a more recent decision by the First Circuit is more instructive. *See D'Agostino v. ev3 Inc.*, No. 16-1126, 2016 WL 7422943, --- F.3d ---, (1st Cir. Dec. 23, 2016). In *D'Agostino*, the relator claimed that the defendant had violated the False Claims Act by fraudulently obtaining U.S. Food and Administration ("FDA") approval for a medical device and then submitting claims for payment to the Medicare and Medicaid programs. *Id.* at *4. The relator argued that the alleged misrepresentations to the FDA were material to the government's payment decisions because FDA approval was a precondition to Medicare and Medicaid reimbursement. *Id.* The district court dismissed and the First Circuit affirmed because the government had not taken any action against the defendant in the years since relator had filed the *qui tam* suit. The FDA had not withdrawn its approval or taken any other action, nor had any agency denied payment of any claim. *Id.* at *5. The First Circuit held that the government's inaction precluded relator's claims.

Not only did that inaction cast "serious doubt" on the materiality of the alleged misrepresentations, *id*. at *5 (citing *Escobar*), it broke entirely the causal connection between the alleged misrepresentations and the government's payment decisions. *Id.* at *5-6.

As the First Circuit explained, allowing the relator to proceed where the FDA had not would substitute the judgment of the relator or a jury for that of the FDA, to the detriment of the entire regulatory program: "[t]o rule otherwise would be to turn the FCA into a tool with which a jury of six people could retroactively eliminate the value of FDA approval and effectively require that a product largely be withdrawn from the market even when the FDA itself sees no reason to do so." *Id.* at *6. The court continued: "The FCA exists to protect the government from paying fraudulent claims, not to second-guess agencies' judgments about whether to rescind regulatory rulings." *Id.*; *see also United States ex rel. Campie v. Gilead Scis., Inc.*, No. C-11-0941 EMC, 2015 WL 106255, at *10 (N.D. Cal. Jan. 7, 2015) (declining to second-guess FDA where relator alleged that FDA approval was fraudulently obtained thereby rendering all subsequent Medicare payments false; holding that materiality and causation under the FCA requires that "the alleged fraud be made as part of a claim for payment to the payor agency"). The First Circuit also noted the "[p]ractical problems of proof" that relator's claims would cause, questioning how a relator could prove materiality and causation in the absence of some official agency action. *D'Agostino*, 2016 WL 7422943, at *6 ("These and similar questions all support our position that the absence of some official agency action confirming its position and judgment in accordance with the law renders D'Agostino's fraud-on-the-FDA theory futile.").

So too here. Like the FDA in *D'Agostino*, the SBA has taken no action on Relator's allegations, despite knowing of them for years. As in *D'Agostino*, allowing Relator to pursue his claims in the face of the SBA's decision not to act would substitute Relator's self-serving judgment for the considered actions of the SBA. It would permit Relator to second-guess the SBA. And it would give rise to similarly vexing problems of proof. For example, in the absence of any official SBA action, how would Relator prove that the alleged misrepresentations were

material? Whose views would control? How would one reconcile differing views of individual agency employees? *See id*. at *6. For all these reasons, Relator's attempt to supplant the SBA should be rejected.

Although Relator admits that the SBA has continued to admit Defendants' subsidiaries into the 8(a) BD Program and to award them contracts under the program for almost four years with full knowledge of Relator's allegations, he argues that knowledge of *alleged* noncompliance is different from knowledge of *actual* noncompliance. Opp. at 25. But Relator offers no explanation, and the distinction makes little sense. Relator not only provided the government with his *qui tam* complaint detailing the alleged misrepresentations, he was also required to provide the government with a "written disclosure of s*ubstantially all material evidence and information*" supporting his allegations. 31 U.S.C. § 3730(b)(2) (emphasis added) (relators must serve material evidence disclosure on government). What is the distinction between information about alleged noncompliance and "actual" noncompliance? A confession? A judgment? Where the question is the impact of the alleged misrepresentations on the SBA's "likely or actual" decisions, there is no distinction.

The SBA had more than enough information to act, and a number of remedies available to it, if Relator had pled a material misrepresentation of regulatory compliance. At a minimum, the SBA could have commenced an eligibility review. *See* 13 C.F.R. § 124.112(c) (eligibility review triggered upon receipt of "credible information" of ineligibility). Other remedies available to the SBA include suspension or termination. *See id.* §§ 124.305 (suspension), 124.303 (termination). Yet the SBA has taken no action. Here, as in *D'Agostino* and *Campie*, the government's inaction casts "serious doubt" on the materiality of the alleged misrepresentations and breaks entirely the causal chain between the alleged misrepresentations and the government's payment decisions. *See D'Agostino*, 2016 WL 7422943, at *5-6; *Campie*, 2015 WL 106255, at *10; *see also United States ex rel. Handal v. Ctr. for Emp't Training*, No. 2:13-cv-01697-KJM-KJN, 2016 WL 4210052, at *7 (E.D. Cal. Aug. 9, 2016) ("[i]n assessing the

materiality element, the court looks at whether 'the statutory requirements are causally related [to the government's] decision to pay out money due'") (quoting *United States ex rel. Hendow v. Univ. of Phx.*, 461 F.3d 1166, 1175 (9th Cir. 2006)).[3]

The two cases upon which Relator relies do not support his claim that "actual knowledge" cannot be based on *qui tam* allegations. Opp. at 25-26 (citing *United States ex rel. Escobar v. Universal Health Servs., Inc. (Escobar II)*, 842 F.3d 103 (1st Cir. 2016), and *Rose v. Stephens Inst.*, 09-cv-05966-PJH, 2016 WL 5076214 (N.D. Cal. Sept. 20, 2016)). In the first case, on remand in *Escobar*, the First Circuit held only that "some notice of complaints" to various, unidentified state regulators—but not to the payor agency—*prior* to the filing of the qui tam complaint "is different from actual knowledge of actual noncompliance." *Escobar II*, 842 F.3d at 112. The court expressly noted that there was no evidence that the payor agency "continued to pay claims despite actual knowledge of the violations" after the filing of the *qui tam* complaint because the relators' complaint was based on only those reimbursements "paid up to the filing of this litigation." *Id.* The First Circuit's decision is readily distinguishable from this case.

Similarly, the district court in *Rose* did not find the continued payment of claims after the filing of the *qui tam* complaint "terribly relevant to materiality" because the payor agency had a history of enforcing the regulations at issue against similarly situated defendants, the payor agency's enforcement position changed over time, and the payor agency did not provide its reasons for continued payment. *Rose*, 2016 WL 5076214, at *6. *Rose* is distinguishable because

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[3] As Relator recognizes, causation and materiality are inextricably linked. *See* Opp. at 16 n.20 ("In assessing the materiality element, the court looks at whether 'the statutory requirements are causally related to [the government's] decision to pay out moneys due.") (citing *Hendow*, 461 F.3d 1166) (internal quotation marks omitted). Indeed, the First Circuit in *D'Agostino* concluded that the same factors that negated the causal link between the alleged false representations and subsequent payment "cast[] serious doubt on the materiality" of those representations. *D'Agostino*, 2016 WL 7422943, at *5. This is because it is not sufficient "that the Government would have the option to decline to pay if it knew of the defendant's noncompliance," but rather, to demonstrate that a falsity was material, the falsity must have caused the government to pay a claim it would not otherwise have paid. *Escobar*, 136 S. Ct. at 2003; *see also United States ex rel. Hopper v. Anton*, 91 F.3d 1261, 1267 (9th Cir. 1996) ("[m]ere regulatory violations do not give rise to a viable FCA action"; rather, there must be a link between the false certification of compliance and the payment decision).

Relator has not alleged a single step by the SBA to exclude any of Defendants' 8(a) Participants, or any other similarly-situated ANCs, from the 8(a) BD Program; Relator alleges no change in position of SBA's enforcement of ANC eligibility requirements; and the SBA has provided its reasons for applying special rules of eligibility to ANCs. *See* 2006 and 2012 GAO Reports.

Relator also urges the Court to apply a "holistic approach" to materiality. Opp. at 13-15 (citing *Escobar II*, 842 F.3d at 109-12). Relator does not explain what this means, much less how it salvages his complaint. The First Circuit used the term to signify that "materiality cannot rest on a single fact or occurrence as always determinative." *Escobar II*, 842 F.3d at 109 (citation and internal quotation marks omitted). That unexceptional proposition does nothing to aid Relator because he has not pled any facts plausibly showing materiality. For example, he pleads no facts showing that the SBA has taken any action against Defendants' subsidiaries, that Defendants' subsidiaries have violated any applicable 8(a) BD Program eligibility rules, or even that the SBA has precluded any ANC from the 8(a) BD Program under similar circumstances.

Nor does the First Circuit's decision otherwise help Relator's cause. Following the guidance from the Supreme Court, the First Circuit found that the relator in *Escobar* on remand had pled facts sufficient to meet the materiality requirement for three reasons: (1) the regulations at issue were a condition of payment, (2) relator had pled violations of regulations that went to the "very essence of the bargain," and (3) the claims at issue all occurred before the lawsuit was filed, and there was no evidence that the government knew at that time of the alleged violations. *Escobar II*, 842 F.3d at 110-11. None of those factors apply here. Relator has not pled any violation of any 8(a) BD Program eligibility rules that might be a condition of payment, and, because Relator has not pled any violation of the 8(a) BD Program eligibility rules applicable to ANCs, none of the alleged violations go to the essence of the bargain. Most important, the alleged violations at issue here continued long after the filing of the original complaint, with no allegation by Relator that the SBA took any action despite full knowledge of Relator's allegations.

Finally, Relator argues that "[e]ven if there were evidence that the government had some knowledge of Afognak's violations," to hold that this evidence "in and of itself, establish[es] lack of materiality" would "effectively reinstate the government knowledge defense, which Congress abolished in 1986." Opp. at 27. Relator is wrong. First, the government knowledge defense has not been abolished. *E.g.*, *United States ex rel. Butler v. Hughes Helicopters, Inc.*, 71 F.3d 321, 326 (9th Cir. 1995) (government knowledge is no longer an "automatic bar" to liability, but may preclude liability on a case-by-case basis). Second, under *Escobar*, that the government continues to pay a particular claim or a particular type of claim despite actual knowledge of the alleged wrongdoing is "very strong evidence" of immateriality that the court must consider when evaluating the materiality of the requirements allegedly violated. *Escobar*, 136 S. Ct. at 2003-04. Relator's reliance on authority interpreting the government knowledge defense apart from materiality is thus misplaced. *See* Opp. at 27-28.

C. Relator Fails to Plead Any Violation of the Applicable 8(a) BD Program Rules

Despite Relator's admission that the SBA decided to take no action based on his disclosure of the alleged misrepresentations, Relator argues that the alleged misrepresentations were material to the SBA on the ground that they had "a natural tendency to influence" or were "capable of influencing" the SBA to exclude Defendants' subsidiaries from the 8(a) BD Program. Opp. at 12. Relator relies on three strategies. First, Relator fundamentally mischaracterizes the 8(a) BD Program. Opp. at 2-6. Second, he claims that a reasonable person would attach importance to Defendants' alleged misrepresentations regarding their subsidiaries' "small business status" in deciding whether to allow Defendants' subsidiaries to participate in the 8(a) BD Program. Opp. at 12-17, 19-25. And third, he claims that even if a reasonable person would not attach importance to Defendants' representations regarding their subsidiaries' small business status, Defendants "knew or should have known that they mattered to the government." Opp. at 17-19. All of those arguments fail.

1. Relator Fundamentally Mischaracterizes the 8(a) BD Program

Relator devotes much of his brief to fundamentally mischaracterizing the 8(a) BD Program. The first clue comes on the first page of Relator's Opposition, where he renames the 8(a) BD Program, calling it the "8(a) *Small* Business Development Program." Opp. at 1 (emphasis added). That is not the name of the program. By SBA rule, the name of the program is "the 8(a) Business Development or '8(a) BD' program." 13 C.F.R. § 124.1. No doubt Relator wishes the program were limited to individual small businesses as he defines them, but it is not. At Congress' direction, the program has been broadened to accommodate a number of disadvantaged *groups*, including Alaska Native Corporations, Indian Tribes, and Native Hawaiian Organizations, which (again at Congress' direction) are expressly permitted to enroll multiple subsidiaries in the 8(a) BD Program and do so on terms different from most others. *See, e.g.*, Consolidated Omnibus Budget Reconciliation Act of 1985, Pub. L. No. 99-272, § 18015, 100 Stat. 82, 370-71 (adding Indian Tribes, including ANCs, to list of groups presumed to be socially disadvantaged for purposes of the 8(a) BD Program); Act of Dec. 18, 1971, Pub. L. No. 92-203, 85 Stat. 688, *as amended by* Alaska Native Claims Settlement Act Amendments of 1987, Pub. L. No, 100-241, 101 Stat. 1788 *and by* Alaska Land Status Technical Corrections Act of 1992, Pub. L. No. 102-415, 106 Stat. 2112 (amending the Alaska Native Claims Settlement Act ("ANCSA") to deem all ANCs economically disadvantaged for the purposes of federal programs); 15 U.S.C. § 636(j)(10)(J) (tribes may be "other than small" in 8(a) BD Program in absence of affiliation exemption); 15 U.S.C. § 636(j)(11)(B) (tribes may enroll multiple subsidiaries in 8(a) BD Program). Relator's attempt to rename the program reflects his attempt to read those groups out of the program.

Relator also mischaracterizes the purpose of the 8(a) BD Program, which he says is to "assist eligible small disadvantaged business concerns compete in the American economy through business development." Opp. at 4. While that may be true with respect to individual non-ANC owned businesses, Relator fails to acknowledge that ANC participation in the 8(a) BD

Program "serves a broader purpose than mere business development." Small Business Size Regulations; 8(a) Business Development/Small Business Status Determinations, 76 Fed. Reg. 8222-01, 8234 (Feb. 11, 2011); *see also* 2012 GAO Report at 64 ("The SBA has acknowledged on numerous occasions . . . that tribally-owned companies have a different purpose in the 8(a) program than companies owned by individuals."). The broader purpose is for ANCs to provide benefits to an entire economically and socially disadvantaged community, namely, their Alaska Native shareholders, not just to promote the development of a single business. *See* 13 C.F.R. § 124.604. And the broader purpose applicable to ANCs fulfills the federal government's statutory duty to encourage participation by Alaska Natives through ANCs in America's economy. *See* 15 U.S.C. § 631(f)(2)(A). This broader purpose is reflected in the distinctive rules applicable to ANCs and their subsidiaries.

Finally, and most importantly, Relator simply ignores the distinctive 8(a) BD Program rules for ANCs. Those eligibility rules include: (1) no need to establish economic or social disadvantage because Congress amended ANCSA to provide that all ANCs shall be deemed socially and economically disadvantaged businesses for purposes of government procurement programs, including the 8(a) BD Program, 43 U.S.C. § 1626(e); *see also* 13 C.F.R. § 124.109(a)(4) (same); (2) different size rules, including that the size of an ANC-owned business "shall be determined independently without regard to its affiliation with the tribe … or any other business enterprise owned by the tribe," 13 C.F.R. § 124.109(c)(2); (3) different ownership requirements, namely that the ANC must directly or indirectly own at least 51% of the business, *id.* § 124.109(c)(3); *see also id.* § 124.109(a); and (4) different rules regarding control and management, i.e., that the ANC must control and manage the business, either directly or indirectly, *id.* § 124.109(c)(4); *see also id.* § 124.109(a). To describe the 8(a) BD Program without reference to these distinctive rules mischaracterizes the program by omitting the most relevant aspects of the program for purposes of ANCs like Defendants.

The Court should disregard Relator's mischaracterization of the 8(a) BD Program and

focus instead on the actual rules adopted by the SBA. Doing so shows that Relator has not pled any violation of the program eligibility rules that actually govern an ANC's participation in the 8(a) BD Program.

2. Relator Fails to Plead Any Violation of the Applicable "Small Business Status" Rules

In addition to mischaracterizing the nature and purpose of the 8(a) BD Program, Relator primarily argues that misrepresentations regarding the "small business status" of Defendants' subsidiaries are material because a "reasonable person" would attach importance to them in deciding whether to allow Defendants' 8(a) Participants admission to the 8(a) BD Program. Opp. at 15-17. According to Relator, a violation of the 8(a) BD Program's size standards is material because a business must be small to participate in the 8(a) BD Program, the requirement is "core" to the 8(a) BD Program, and a violation of this requirement is not "minor or insubstantial." *Id.* Relator acknowledges that this is the "crux" of his case. *Id.* at 15.

This argument fails for the simple reason that Relator has not pled any violation of the small business status rules that apply to Defendants and their subsidiaries. Those rules are set forth at 13 C.F.R. § 124.109(c).[4] Relator fails to plead a violation of any of those rules. His arguments to the contrary distort the rules and are without merit.

a. Relator Fails to Plead a Material Misrepresentation Regarding Whether Defendants' 8(a) Participants Are "Separate and Distinct Small Business Concerns"

Relator primarily argues that he has alleged a material misrepresentation regarding whether Defendants' 8(a) Participants are "separate and distinct small business concerns." Opp. at 20-22. This misstates the eligibility rules. The eligibility rules do not require that each of Defendants' 8(a) Participants be a "separate and distinct small business concern." *See* Opp. at 20. Instead, the rules require that each be a "separate and distinct *legal entity*." 13 C.F.R.

[4] Subsection (a) sets forth special eligibility rules governing ANCs. In addition to the rules set forth in subsection (a), ANC-owned businesses are subject to subsections (b) and (c) to the extent consistent with subsection (a). *See* 13 C.F.R. § 124.109(a). Subsection (c), entitled "Business eligibility," sets forth the eligibility rules applicable to ANC-owned businesses, as well as businesses owned by Indian tribes. 13 C.F.R. § 124.109(c).

§ 124.109(c)(1) (emphasis added). The difference is important because there is no dispute that each of Defendants' subsidiaries was a separate and distinct legal entity, namely, a limited liability company.

Rather than pleading facts showing a violation of this requirement, Relator tries to rewrite the rule, arguing that if the rule means what it says, "then it is the 8(a) program that is a sham." Opp. at 21. Once again, Relator is just second-guessing the SBA. The rule as written recognizes the special purposes served by ANC participation in the 8(a) BD Program. ANCs are allowed to enroll multiple businesses in the 8(a) BD Program, and to do so regardless of the size of the ANC or its other subsidiaries, precisely to benefit the ANC (and its shareholders). *See* 13 C.F.R. § 124.604 (discussing benefits obtained "due to the . . . ANC's . . . participation in the 8(a) BD program through one or more firms"). This does not make the 8(a) BD Program a "sham." Rather, it demonstrates that ANC participation in the 8(a) BD Program is working as designed. Nor is it pointless to require that ANCs only enroll separate and distinct legal entities in the program. Among other things, the requirement ensures that the SBA can review and track each entity on a basis similar to other 8(a) participants.

In any event, Relator does not offer a single authority or shred of evidence to support his attempt to rewrite the rule. *See* Opp. at 20-22. The plain language of the rule simply requires that the 8(a) participant be a "separate and distinct legal entity." The term "legal" means "[e]stablished . . . by law." *See* Black's Law Dictionary (10th ed. 2014); *see also* 13 C.F.R. § 124.109(c)(1) (ANC entity must be a "legal business entity" that is "organized or chartered by . . . state authorities"). It defies reason and the plain language of the rule to think that the SBA would impose a whole set of operational controls on 8(a) participants by requiring separate and distinct legal status. Relator does not claim that any of Defendants' 8(a) Participants were not separate and distinct legal entities, and he makes no showing of any basis in the rule to impose the additional requirements he desires. Having failed to plead any plausible violation of the "separate and distinct legal entity" requirement, Relator cannot claim that any such violation

was material to any SBA decision.

b. Relator Fails to Plead a Material Misrepresentation Regarding Whether Defendants' 8(a) Participants Satisfied the Size Limits

It is unclear whether Relator still claims that Defendants' 8(a) Participants violated any 8(a) BD Program size limits. He appears to have dropped this claim, even though it was previously the centerpiece of his case. *Compare* Opp. at 19-25 (no claim to have pled a violation of the size standards), *with* SAC ¶ 117 (claiming that "the materiality of representations regarding an 8(a) applicant's size is evidenced by the fact that the government denies 8(a) applications for business concerns that are 'other than small'"). To the extent any question remains, there is no doubt that Relator has failed to plead a violation of the applicable size rules.

Those rules determine the eligibility of an 8(a) participant for a procurement based on its annual receipts or number of employees, depending on the industry. 13 C.F.R. § 124.109(c)(2); *id.* § 121.101. Relator never alleges that any of Defendants' 8(a) Participants independently exceeded the size limits, whether based on its revenues or number of employees. Moreover, Relator now admits (contrary to his earlier claims) that "the size of an Alaska Native Corporation subsidiary that otherwise is eligible to participate in the 8(a) program 'shall be determined independently without regard to its affiliation with the tribe, any entity of the tribal government, or any other business enterprise owned by the tribe.'" SAC ¶ 112 (quoting 13 C.F.R. § 124.109(c)(2)(iii)). Thus, Relator cannot allege that any of Defendants' 8(a) Participants violated the size standards based on the revenues or number of employees of any of the Participant's sister or parent entities. Having failed to plead any plausible violation of the size limits, Relator cannot claim that any such violation was material to any SBA decision.

c. Relator Fails to Plead a Material Misrepresentation Regarding Whether Defendants' 8(a) Participants Satisfied Self-Performance Requirements

Relator next argues that he has alleged a material misrepresentation regarding whether Defendants' 8(a) subsidiaries "do their own work as separate and distinct small business concerns." Opp. at 22-23. But Relator does not claim that this violated any of the applicable 8(a)

Program eligibility rules set forth in 13 C.F.R. § 124.109. *See id*. Those rules say nothing about ANC-owned entities "do[ing] their own work." *See id.*; *see also* 13 C.F.R. § 124.112(a) ("[s]tandards" for continued eligibility refer back to § 124.109). Sound and fury aside, nothing about these allegations purports to plead a violation of the 8(a) BD Program eligibility rules.

To be sure, in receiving an 8(a) contract, an 8(a) participant must often agree that it will perform a certain portion of the contract with its own employees. 13 C.F.R. § 124.510(b). But the SBA rules specifically provide that compliance with this self-performance requirement is "not a component of size eligibility." *Id.* § 125.6(e)(2). Thus, any alleged failure to meet the self-performance requirements does not render Defendants' 8(a) Participants ineligible for the 8(a) BD Program. Relator's arguments to the contrary simply ignore the plain SBA rules. Moreover, these self-performance requirements are contract specific, and Relator fails to plead any facts showing a single violation of the self-performance requirements in a single specific contract. For these reasons, Relator fails to plead any material violation based on this theory, much less do so with particularity.

Finally, Relator makes much of a single case in which the SBA terminated a non-ANC 8(a) firm for failing to comply with the self-performance requirements because a non-disadvantaged firm performed more than 50% of the 8(a) contract. *See* Opp. at 23 & n.22 (citing *In Re Reality Techs., Inc.*, SBA No. BDPT-488, 2013 WL 2154002, at *1, 6-7 (May 3, 2013)). But that decision says nothing about whether the SBA would be likely to terminate an ANC-owned 8(a) Participant—which is statutorily authorized to be other than small, to operate in the 8(a) Program concurrently with sister companies, and to be commonly managed—for any alleged violation of any self-performance requirements. To the contrary, the SBA has held in applying the affiliation exemption applicable to ANCs under non-8(a) small business programs that an Alutiiq subsidiary permissibly relied on Alutiiq's employees and experience in obtaining a small business contract. *Size Appeal of Alutiiq Int'l Solutions, LLC*, SBA No. SIZ-5098, 2009 WL 5258578, at *7 (Dec. 10, 2009) (finding that an arrangement whereby the Alutiiq subsidiary

relied upon its parent company's employees and experience to obtain the contract did not violate the broad affiliation exemption afforded to ANC entities under Section 121). It would make little sense to allow an Alutiiq subsidiary to rely on Alutiiq's employees to obtain a small business contract, but then penalize the subsidiary by precluding it from using those same employees to perform the contract. *See id*. (reliance on parent company's employees is attributable to the common management by the ANC). This reasoning applies with equal, if not greater, force to contracts awarded in the 8(a) BD Program, because the affiliation exemption is even broader in the 8(a) BD Program. *Compare* 13 C.F.R. § 121.103(b)(2)(ii) (affiliation exemption in non-8(a) small business program) *with id.* § 124.109(c)(iii) (affiliation exemption in 8(a) BD Program).

d. Relator Fails to Plead a Material Misrepresentation Regarding Whether Defendants' 8(a) Participants Satisfy Control and Management Requirements

Relator also argues that he has pled a material misrepresentation regarding whether Defendants' 8(a) subsidiaries are managed as separate and distinct small business concerns. Opp. at 23-24. Again, Relator cannot claim any violation of the applicable 8(a) Program eligibility rules set forth in 13 C.F.R. § 124.109(c). Nothing in those rules requires that an ANC-owned 8(a) Participant be controlled and managed as "a separate and distinct small business concern." 13 C.F.R. § 124.109(c)(4) ("Control and management"). The eligibility rules require only that the ANC control and manage its 8(a) participants through one of a variety of mechanisms, including through a committee, team, or board of directors. *See id.*; *see also* 43 U.S.C. § 1626(e) ("For all purposes of Federal law," all businesses owned, directly or indirectly, by ANCs "shall be considered to be entities owned and controlled by Natives and a minority and economically disadvantaged business enterprise"). Relator pleads no violation of that requirement.

Relator argues that Defendants must be managed by "one or more individuals who possess sufficient management experience . . . ." Opp. at 23. This is an incomplete and misleading quote that omits the relevant parts of 13 C.F.R. § 124.109(c)(4). *See* Opp. at 23-24.

In fact, Section 124.109(c)(4) permits ANCs to manage their 8(a) Participants in multiple ways: "The management and daily business operations of [an ANC-owned] concern must be controlled by the [ANC] through one or more disadvantaged individual members who possess sufficient managerial experience of an extent and complexity needed to run the concern, *or through management as follows*: (A) Management may be provided by committees, teams, or Boards of Directors . . , or (B) Management may be provided by non-tribal members [if SBA determines certain facts]." 13 C.F.R. § 124.109(c)(4) (emphasis added). Read in its entirety, this regulatory provision permits tribes to manage 8(a) Participants in a number of distinctive ways, including by "committees, teams, or Boards of Directors which are controlled by one or more members of an economically disadvantaged tribe." *Id.* § 124.109(c)(4)(i)(A); *see also* SAC, Ex. 5 (identifying management committee of 8(a) Participant). Relator pleads no facts showing that Defendants did not manage their 8(a) Participants in accordance with the rule. As he so often does, Relator simply ignores the actual rules enacted by the SBA.

Relator also argues that he has pled a violation of rules prohibiting the management of an 8(a) Participant from participating in certain outside activities. Opp. at 23-24. Relator relies on a single SBA decision denying 8(a) BD Program admission due to management's outside activities. *Id.* at 24. But there, the applicant was not an ANC and was subject to 13 C.F.R. § 124.104(a)(2), which required that "an individual upon whom 8(a) eligibility was based" manage the 8(a) firm on a "full-time basis." *See* SAC ¶ 122; Motion at 18-19 & n.9.[5] This rule does not apply to ANCs. Instead, the rules actually adopted by the SBA for ANC-owned businesses prohibit managers from engaging outside activities only if they "conflict" with the operation of the 8(a) participant. 13 C.F.R. § 124.109(c)(4)(ii). Relator pleads no fact showing any such conflict.

[5] This requirement is now set forth in 13 C.F.R. § 124.106. Neither former 13 C.F.R. § 124.104 nor current 13 C.F.R. § 124.106 applies to ANCs like Defendants.

e. Relator Fails to Plead a Material Misrepresentation Regarding Whether Defendants' 8(a) Participants Satisfy Growth and Development Requirements

Relator last argues that he has alleged a material misrepresentation regarding growth and development requirements because Defendants' 8(a) Participants misrepresent that they will pursue business in accordance with their business plans. Opp. at 24-25 (arguing that "each entity's business plan is an integral part of its application and annual reviews"). The applicable eligibility rules, however, say nothing about business plans. *See* 13 C.F.R. § 124.109(c); *see also id.* § 124.402 (business plans submitted *after program admission* but before contract award).[6] It is unclear, then, what "growth and development" requirements Relator claims have been violated. The applicable eligibility rules require only that ANC-owned participants demonstrate their "potential for success," which they can do in multiple ways, including through the ANC's "commitment to support the operations of the applicant concern." *Id.* § 124.109(c)(6). Relator has not alleged that Defendants have violated the applicable "potential for success" requirement.

In short, Relator argues that Defendants' 8(a) Participants cannot "grow and develop" because they are "mere conduits" for Afognak. Opp. at 25. But ANC participation in the 8(a) BD Program serves to benefit the ANC's Alaska Native shareholders. *E.g.*, SAC ¶ 11. In order to benefit the ANC's Alaska Native shareholders for longer than nine years (the length of time an 8(a) participant may participate in the 8(a) BD Program), ANCs can create multiple subsidiaries to participate in the 8(a) BD Program concurrently and consecutively. *See* SAC ¶ 48 (ANCs "are permitted to continually create 8(a) business entities"). "Such ownership serves a broader purpose than mere business development" because ANC-owned 8(a) participants are intended to

[6] While business plans must be resubmitted to the SBA when modified, 13 C.F.R. § 124.403, the SBA does not use business plans to determine the continued eligibility of 8(a) participants. Rather, as "part of the final annual review performed by SBA prior to the expiration of a Participant's nine-year program term," the SBA will determine whether the participant met the goals set forth in the business plan to determine whether the participant graduated from the 8(a) BD Program or "merely completed" its program term. *Id.* § 124.112(f). In short, compliance with business plans is not an initial or continued eligibility requirement. *See also id.* § 124.509 (SBA may take remedial steps, including monitoring, to assist 8(a) participant to meet competitive business mix targets).

benefit the ANC through the 8(a) BD Program. Small Business Size Regulations; 8(a) Business Development/Small Disadvantaged Business Status Determinations, 76 Fed. Reg. 8222-01, 8234 (Feb. 11, 2011).[7] For this reason, Relator's reliance on an SBA decision terminating a non-ANC firm for failing to pursue business outside the 8(a) BD Program is misplaced. *See* Opp. at 25.

Relator has failed to plead any facts showing that the government denies applications or refuses to pay ANCs based on any alleged "growth and development" misrepresentation.

3. Defendants Did Not Know or Have Reason to Know that the SBA Attached Importance to Defendants' Alleged Misrepresentations

Relator next argues that, even if a reasonable person would not attach importance to Defendants' alleged misrepresentations regarding the "small business status" of their subsidiaries, the alleged misrepresentations were material because Defendants knew or had reason to know that they mattered to the SBA. Opp. at 17-19. This makes no sense. Participation in the 8(a) BD Program is governed by the eligibility rules for ANCs set forth in 13 C.F.R. § 124.109(c). By definition, Defendants could not "know" or "have to reason to know" that the SBA would exclude a business from the 8(a) BD Program in the absence of a violation of those eligibility rules. As set forth above, Relator pleads no such violation. This argument cannot even get off the ground.

Relator nonetheless argues that Defendants knew or should have known that Defendants' representations regarding their subsidiaries' small business status were important to the SBA for three reasons: (1) Congress adopted the "presumed loss rule"; (2) failure to maintain eligibility could result in termination from the 8(a) BD Program; and (3) the government denies applications for business concerns for various reasons. None of these reasons supports a finding

[7] Relator selectively quotes from the 2012 GAO Report to assert that the "SBA expects that, when it accepts multiple firms under the same tribal entity into the 8(a) program, each firm will operate and grow independently in line with business development purposes of the program," 2012 GAO Report at 36, but this is in the context of a new rule added in 2011 prohibiting the award of successive follow-on sole-source 8(a) contracts to multiple firms owned by the same tribal entity, *id.* "SBA's intention was to address a negative perception that businesses could operate in the 8(a) program in perpetuity by changing their structure or form to continue to perform work as they had under previous contracts." *Id.* Relator does not allege that Defendants violated this rule.

of materiality.

a. The Presumed Loss Rule Does Not Support a Finding of Materiality

Relator first argues that the presumed loss rule demonstrates the materiality of violations of size standards. For all SBA programs, the presumed loss rule, 15 U.S.C. § 632(w) (2010), was implemented to address situations where a business concern receives a contract award "by misrepresenting its small business size or status." Small Business Size and Status Integrity, 78 Fed. Reg. 38811-02, 38111 (June 28, 2013). The presumed loss rule is an evidentiary presumption and says nothing about the eligibility of 8(a) Participants, how they are operated or managed, or how they perform 8(a) work. Because the presumed loss rule applies only to misrepresentations of 8(a) status made in connection with contract procurement, 13 C.F.R. § 124.521(a), Relator's only claims that could arguably give rise to the presumption are those alleging that Defendants' 8(a) Participants operated "as a single, large company" and thus exceeded the size standards to qualify as small. But ANC-owned concerns are exempt from affiliation in the 8(a) BD Program, such that they may be eligible for the 8(a) BD Program even though they are "other than a small business concern" without an affiliation waiver. 15 U.S.C. §§ 636(j)(10)(J)(ii)(I)-(II). And, as discussed above, Relator pleads no violation of the applicable size standards on a stand-alone basis. *See supra* at § C.2.b. Nor does Relator plead any other violation of the 8(a) BD Program eligibility rules for ANCs. Thus, the presumed loss rule does not support materiality of the alleged violations in question.

b. Relator Fails to Plead Facts Demonstrating the SBA Denies Eligibility for ANCs Operated Like Defendants

Relator next argues that Defendants knew or should have known that their alleged misrepresentations were material because Defendants allegedly "received direct notice from the government" that a failure to maintain 8(a) BD Program eligibility could result in termination from the 8(a) BD Program and that 8(a) participants may not share managers and employees. Opp. at 18 (citing SAC ¶¶ 121, 134).

Relator relies on—and mischaracterizes—a single letter from the SBA to Defendants. *Id.*

Specifically, Relator asserts that "the SBA *rejected* at least one Afognak application precisely because it included an intercompany agreement that provided for sharing more than merely 'administrative' services." Opp. at 18 (emphasis added) (citing SAC ¶ 114, which cites SAC, Ex. 12). Far from rejecting the 8(a) application at issue, Exhibit 12 confirms that the SBA simply found the application to be incomplete and requested additional information "since processing cannot begin until a complete application package has been received by SBA." *See* SAC, Ex. 12.[8] In short, Relator has failed to plead materiality of the alleged violations in question.

c. Relator Cites No Examples of the SBA Terminating ANCs for the Alleged Misrepresentations Complained Of

Finally, Relator argues that Defendants knew or should have known that their alleged misrepresentations were material because the SBA denies or terminates 8(a) BD Program participation for a variety of reasons. Opp. at 18-19. But Relator again bases his argument on examples involving non-ANC firms. *See id.* None of the examples Relator pleads involve an ANC because, despite Relator's statement to the contrary, special rules apply to ANCs. *See* Motion at 14-21. As a result, Relator has not pled facts that plausibly allege materiality.

D. Defendants' Motion to Dismiss Relator's First Amended Complaint Does Not Preclude Defendants' Motion to Dismiss Relator's Second Amended Complaint

Relator claims that Defendants are barred from challenging whether he has sufficiently pled a violation of the eligibility rules applicable to ANCs on the ground that these issues were decided by the district court in the Northern District of Alabama when it denied, without explanation, Defendants' motion to dismiss Relator's First Amended Complaint. *See* Opp. at 2. But the Second Amended Complaint differs from the First Amended Complaint in a material respect: Relator now concedes that "the size of an Alaska Native Corporation subsidiary that otherwise is eligible to participate in the 8(a) program 'shall be determined independently without regard to its affiliation with the tribe, any entity of the tribal government, or any other

[8] Exhibit 12 further confirms that the SBA asked about the administrative services that Alutiiq provided its 8(a) applicant, citing 13 C.F.R. § 121.104. But the 8(a) BD Program provides for total exemption from affiliation under 13 C.F.R. § 124.109(c)(2)(iii), and Relator pleads no violation of 13 C.F.R. § 121.104. *See* Motion at 15.

business enterprise owned by the tribe.'" SAC ¶ 112 (quoting 13 C.F.R. § 124.109(c)(2)(iii)). As a result, Relator has dropped his allegations that Defendants violated the size standards applicable to their 8(a) Participants. *See supra* at § C.2.b.

But Relator argued just the opposite when he opposed Defendants' motion to dismiss his First Amended Complaint: "Defendants falsely certified to the government that their 8(a) businesses met industry size standards and were accordingly qualified to participate in the program." Relator's Response in Opposition to Defendants' Motion to Dismiss (Dkt. 43) at 9; *see also id.* at 3 (disputing that "Relators do not allege a size requirement violation"); *id.* at 5 (same); *id.* at 6 ("as pled in the Amended Complaint, . . . they [do not] meet the size standards or management requirements"). The district court in Alabama denied Defendants' motion to dismiss Relator's First Amended Complaint without explaining the basis for its order. *See* Order (Dkt. 48). Thus, given the material change in Relator's allegations that Defendants' violation of size standards rendered their subsidiaries ineligible for the 8(a) BD Program, there is no reason to preclude Defendants from challenging whether Relator has sufficiently pled a violation of the applicable eligibility rules in his Second Amended Complaint. *See, e.g., In re Read-Rite Corp. Sec. Litig.*, No. C 98-20434 JF, 2000 WL 1641275, at *1 (N.D. Cal. Oct. 13, 2000) (considering sufficiency of complaint for a third time after new facts with respect to scienter were alleged in second amended complaint), *aff'd* 335 F.3d 843 (9th Cir. 2003).

E. Further Amendment Cannot Save Relator's Second Amended Complaint

In their Motion, Defendants demonstrated that the Court should deny leave to amend because Relator has already amended his complaint twice, has had ample opportunity to cure the deficiencies in his complaint, and has failed to do so. Motion at 26. Relator offers no argument in opposition and does not request leave to amend.

III. CONCLUSION

For the reasons set forth above and in Defendants' Motion, Defendants respectfully request that the Court dismiss Relator's Second Amended Complaint with prejudice.

Dated: January 24, 2017.

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CERTIFICATE OF SERVICE

I hereby certify that on January 24, 2017, a copy of the foregoing **DEFENDANTS' REPLY IN SUPPORT OF MOTION TO DISMISS SECOND AMENDED COMPLAINT PURSUANT TO RULES 12(b)(6) AND 9(b)** was filed with the Court's electronic filing system which served a copy on all counsel of record.

s/David F. Taylor
David F. Taylor