IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF ALASKA

UNITED STATES OF AMERICA, ex rel. BEN FERRIS, Plaintiff, vs. AFOGNAK NATIVE CORPORATION and ALUTIIQ, LLC, Defendants.	)	No. 3:15-cv-0150-HRH

O R D E R

Motion to Dismiss Relator's Second Amended Complaint

Defendants move to dismiss relator's second amended complaint.[1] Defendants also request that the court take judicial notice of two exhibits offered in support of their motion to dismiss.[2] Defendants' motion to dismiss is opposed.[3] Defendants' request for judicial notice is opposed in part.[4] Oral argument was requested and has been heard.

[1]Docket No. 212.

[2]Docket No. 213.

[3]Docket No. 218.

[4]Docket No. 219.

Background

Relator Ben Ferris was employed by defendant Alutiiq, LLC from March 2008 through March 2014, serving as Alutiiq's Chief Compliance Officer from May 2011 through March 2014.[5] Alutiiq, LLC is a wholly-owned subsidiary of defendant Afognak Native Corporation.

Afognak Native Corporation "participates in the Small Business Association's 8(a) Business Development Program through its wholly-owned subsidiary Alutiiq."[6] "The purpose of the 8(a) Program is to increase federal contracts awarded to small businesses owned by socially and economically disadvantaged individuals." Contract Mgmt., Inc. v. Rumsfeld, 291 F. Supp. 2d 1166, 1170–71 (D. Haw. 2003) (citing 15 U.S.C. § 637(a)). "Under the 8(a) program, a contracting officer awards a contract to the SBA. The SBA then awards a subcontract to a small business owned by socially and economically disadvantaged individual(s)." Id. at 1171 (internal citations omitted).

"Generally, a concern meets the basic requirements for admission to the 8(a) BD program if it is a small business which is unconditionally owned and controlled by one or more socially and economically disadvantaged individuals ... and which demonstrates potential for success." 13 C.F.R. § 124.101. In order to be considered a "small" business, a concern must not exceed a certain size as measured by average annual receipts or number

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[5]July 2, 2015 Declaration of Amy Shimek [etc.] at 2, ¶ 5, Docket No. 154.

[6]Second Amended Complaint [etc.] at 2, ¶ 4, Docket No. 217.

of employees. 13 C.F.R. §§ 124.102(a)(1), 121.103(a)(6), 121.104(a). The size standards vary according to the type of economic activity or industry. 13 C.F.R. § 121.201. Generally, "[i]n determining the concern's size, SBA counts the receipts, employees, or other measure of size of the concern whose size is at issue and all of its domestic and foreign affiliates, regardless of whether the affiliates are organized for profit." 13 C.F.R. § 121.103(a)(6) (emphasis added). "Concerns and entities are affiliates of each other when one controls or has the power to control the other, or a third party or parties controls or has the power to control both. It does not matter whether control is exercised, so long as the power to control exists." 13 C.F.R. § 121.103(a)(1). "Affiliation [may also] arise[] where one or more officers, directors, managing members, or partners who control the board of directors and/or management of one concern also control the board of directors or management of one or more other concerns." 13 C.F.R. § 121.103(e).

"Small business concerns owned and controlled by" Alaska Native Corporations ("ANCs") "are eligible for participation in the 8(a) program...." 13 C.F.R. § 124.109(a). The eligibility requirements for ANCs are different from the requirements for other 8(a) participants. Business concerns that are majority owned by an ANC are deemed economically disadvantaged; therefore, unlike most other 8(a) participants, ANC-owned businesses need not demonstrate economic advantage. 13 C.F.R. § 124.109(a)(4). But, as with other small business concerns, "[a] tribally-owned applicant concern must qualify as a small

business concern.... The particular size standard to be applied is based on the primary industry classification of the applicant concern." 13 C.F.R. § 124.109(c)(2)(i).

> In determining the size of a small business concern owned by a socially and economically disadvantaged Indian tribe (or a wholly owned business entity of such tribe) for either 8(a) BD program entry or contract award, the firm's size 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, unless the Administrator determines that one or more such tribally-owned business concerns have obtained, or are likely to obtain, a substantial unfair competitive advantage within an industry category.

13 C.F.R. § 124.109(c)(2)(iii) (emphasis added). An ANC may enroll multiple business concerns in the 8(a) program as long as for each concern 1) the ANC owns at least 51% of the concern, 2) the concern meets the size requirements for ANC-owned businesses, 3) the concern is "a separate and distinct legal entity organized or chartered by the tribe, or Federal or state authorities[,]" and 4) the ANC controls the "management and daily business operations" of the concern. 13 C.F.R. § 124.109(c)(1), (2)(iii), (3), and (4). But, "[t]he individuals responsible for the management and daily operations of a tribally-owned concern cannot manage more than two [8(a)] Program Participants at the same time." 13 C.F.R. § 124.109(c)(4)(iii). "Officers, board members, and/or tribal leaders may control a holding company overseeing several tribally-owned or ANC–owned companies, provided they do not actually control the day-to-day management of more than two current 8(a) BD Program Participant firms." 13 C.F.R. § 124.109(c)(4)(iii)(B).

A qualifying business concern may participate in the 8(a) program for a term of nine years. 13 C.F.R. § 124.2. A concern that completes its nine-year term is said to "graduate" from the program. It is however possible to "graduate" early if, at any time during the nine-year term, the concern no longer meets the 8(a) program size requirements. 13 C.F.R. § 124.2.

In June 2012, relator became "concern[ed] that Afognak was misrepresenting and falsely certifying that 8(a) entities were bidding on and performing the awarded government contracts because these entities did not actually exist as separate business entities."[7] Relator alleges that Afognak Native Corporation has eight divisions and that "[e]ach division provides separate and unique services to government contractors."[8] Each division is headed by a Senior Vice President.[9] Alutiiq, LLC "has approximately fourteen current and former 8(a) small business subsidiaries[.]"[10] Relator alleges that defendants appoint a General Manager for each of these 8(a) subsidiaries, but that all the General Managers do is "sign some paperwork...."[11] Relator alleges that it is the eight divisions, not the 8(a) subsidiaries, "that submit the bids for government contracts, select the 8(a) entity that will be included in

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[7]Second Amended Complaint at 15, ¶ 39, Docket No. 217.

[8]Id. at 15, ¶ 40.

[9]Id. at 16, ¶ 46.

[10]Id. at 17, ¶ 49.

[11]Id. at 18, ¶¶ 50-51.

the submission and once the contract is awarded, oversee and manage the contract's performance."[12] Relator alleges that "[t]he 8(a) entity is selected not because [it] has some particular expertise that will assist in the performance of the contract; rather it is selected ... because it has a sufficient amount of contract dollars remaining under its [industry] code cap."[13]

Relator commenced this action on May 30, 2013, by filing a complaint under seal in the Northern District of Alabama, in which relator asserted claims against defendants under the False Claims Act (FCA).[14] "[T]he FCA creates liability for any person who, inter alia, '(A) knowingly presents, or causes to be presented, a false or fraudulent claim for payment or approval; [or] (B) knowingly makes, uses, or causes to be made or used, a false record or statement material to a false or fraudulent claim.'" Hooper v. Lockheed Martin Corp., 688 F.3d 1037, 1047 (9th Cir. 2012) (quoting 31 U.S.C. § 3729(a)(1)).

On June 21, 2013, relator filed an amended complaint.[15] On April 3, 2014, after the United States declined to intervene in this action, relator's amended complaint was

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[12]Id. at 19, ¶ 52.

[13]Id. at 19, ¶ 53.

[14]The case was transferred to the District of Alaska on August 25, 2015. Docket No. 104.

[15]Docket No. 6.

unsealed.[16] On September 28, 2016, the court ordered relator to file a second amended complaint in light of the Supreme Court's recent decision in United Health Services v. United States ex rel. Escobar, 136 S. Ct. 1989 (2016) (Escobar I).

Relator timely filed his second amended complaint, in which he asserts causes of action under Section 3729(a)(1)(A) (Count One) and Section 3729(a)(1)(B) (Count Two) of the FCA. Relator alleges that defendants have violated Section 3729(a)(1)(A) by presenting false or fraudulent claims for reimbursement, and relator alleges that defendants violated Section 3729(a)(1)(B by making false certifications in their 8(a) applications and annual reviews.

Defendants now move to dismiss relator's claims.

Discussion

"'To survive a [Rule 12(b)(6)] motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.'" Zixiang Li v. Kerry, 710 F.3d 995, 999 (9th Cir. 2013) (quoting Ashcroft v. Iqbal, 556 U.S. 662, 678 (2009)). "A claim is facially plausible 'when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged.'" Id. (quoting Iqbal, 556 U.S. at 678). "The plausibility standard requires more than the sheer possibility or conceivability that a defendant has acted unlawfully." Id. "'Where a complaint pleads facts that are merely consistent with a

[16]Docket No. 15.

defendant's liability, it stops short of the line between possibility and plausibility of entitlement to relief.'" Id. (quoting Iqbal, 556 U.S. at 678). "[T]he complaint must provide 'more than labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do.'" In re Rigel Pharmaceuticals, Inc. Securities Litig., 697 F.3d 869, 875 (9th Cir. 2012) (quoting Bell Atl. Corp. v. Twombly, 550 U.S. 544, 555 (2007)). "In evaluating a Rule 12(b)(6) motion, the court accepts the complaint's well-pleaded factual allegations as true and draws all reasonable inferences in the light most favorable to the plaintiff." Adams v. U.S. Forest Srvc., 671 F.3d 1138, 1142-43 (9th Cir. 2012).

"The heightened pleading standard of Rule 9(b) governs FCA claims." United States ex rel. Cafasso v. Gen. Dynamics C4 Sys., Inc., 637 F.3d 1047, 1054 (9th Cir. 2011). "Rule 9(b) provides that '[i]n alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake.'" Id. at 1054-44 (quoting Fed. R. Civ. P. 9(b)). "To satisfy Rule 9(b), a pleading must identify 'the who, what, when, where, and how of the misconduct charged,' as well as 'what is false or misleading about [the purportedly fraudulent] statement, and why it is false...." Id. (quoting Ebeid ex rel. United States v. Lungwitz, 616 F.3d 993, 998 (9th Cir. 2010)). "Knowledge, however, may be pled generally." United States v. United Healthcare Ins. Co., 848 F.3d 1161, 1180 (9th Cir. 2016).

> [T]o establish a cause of action under § 3729(a)(1)(A), the United States or relator must prove the following elements: (1) a false or fraudulent claim (2) that was material to the decision-making process (3) which defendant presented, or caused to be presented, to the United States for payment or approval (4) with knowledge that the claim was false or fraudulent.

Hooper, 688 F.3d at 1047. "[T]o establish a cause of action under § 3729(a)(1)(B), the United States or a relator must show that defendants knowingly made, used, or caused to be made or used, a false record or statement material to a false or fraudulent claim." Id. at 1048. Thus, materiality is a required element for both a § 3729(a)(1)(A) claim and a § 3729(a)(1)(B) claim.

Defendants argue that relator has not adequately pled materiality. Defendants argue that relator has not alleged a single violation of the eligibility requirements in 13 C.F.R. § 124.109 for ANCs that was material to the SBA's decision to allow their 8(a) subsidiaries to participate in the 8(a) program.

Relator's claims are based on his allegations that defendants' 8(a) subsidiaries do not actually bid on or do the work on government contracts "because they are not operated as legitimate, independent small business concerns."[17] Rather, relator alleges, defendants' 8(a) subsidiaries exist in name only to serve "as conduits to obtain[] government contracts which would otherwise only be available to qualified 8(a) small business entities."[18] Relator alleges that the General Managers of the 8(a) subsidiaries do not bid on the contracts or oversee the performance of any contract that is awarded.[19] Rather, relator alleges that "[i]t is the Senior Vice Presidents of [the eight] divisions who submit the bids and decide which sham 8(a) will

[17]Relator's Opposition [etc.] at 6, Docket No. 218; Second Amended Complaint at 3, ¶ 5, Docket No. 217.

[18]Second Amended Complaint at 3, ¶ 5, Docket No. 217.

[19]Id.

be included in the paperwork submitted to the government so to qualify for these government contracts."[20]

Thus, relator alleges that defendants have falsely represented and certified that "they were in full compliance with the SBA's 8(a)" program.[21] More specifically, relator alleges that defendants falsely represented and certified that 1) their 8(a) subsidiaries were separate business entities owned by defendants,[22] 2) "that these business entities will pursue contracts that will allow the business to grow, develop, and eventually graduate from the program[;][23] 3) that their 8(a) subsidiaries would and in fact did the required portion of work under each contract,[24] and 4) that the General Managers of each 8(a) subsidiary "devote all the time necessary to the particular entity in order for the 8(a) to achieve its business objectives"[25] and actually "manage[] and oversee[] the 8(a) entities' ... performance of [the] contract[s]."[26] Relator alleges that these misrepresentations are material. Specifically, relator alleges that representations regarding 1) "an 8(a) applicant's status as a 'business concern' – let alone,

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[20]Id.

[21]Id. at 43, ¶ 140, Docket No. 217.

[22]Id. at 43, ¶ 140; 45, ¶ 145.

[23]Id. at 43, ¶ 140; 45, ¶ 146.

[24]Id. at 43, ¶ 140; 45, ¶ 148.

[25]Id. at 43-44, ¶ 140.

[26]Id. at 45, ¶ 147.

a small business concern[,]"[27] 2) "an 8(a) applicant's size[;][28] 3) "an 8(a) applicant's management[,]"[29] and 4) "other 8(a) eligibility criteria ... are material to the government's payment decisions."[30]

"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 I, 136 S. Ct. at 1996. "[M]ateriality "look[s] to the effect on the likely or actual behavior of the recipient of the alleged misrepresentation.'" Id. at 2002 (quoting 26 R. Lord, Williston on Contracts § 69:12, p. 549 (4th ed. 2003)).

> In the context of an FCA claim,
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> > [a] misrepresentation cannot be deemed material merely because the Government designates compliance with a particular statutory, regulatory, or contractual requirement as a condition of payment. Nor is it sufficient for a finding of materiality that the Government would have the option to decline to pay if it knew of the defendant's noncompliance. Materiality, in addition, cannot be found where noncompliance is minor or insubstantial.

Id. at 2003.

> > [P]roof of materiality can include, but is not necessarily limited to, evidence that the defendant knows that the Government consistently refuses to pay claims in the mine run of cases based

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[27]Id. at 38, ¶ 113.

[28]Id. at 38, ¶ 117.

[29]Id. at 39, ¶ 119.

[30]Id. at 40, ¶ 123.

> on noncompliance with the particular statutory, regulatory, or contractual requirement. Conversely, 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. 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 is strong evidence that the requirements are not material.

Id. at 2003-04.

Defendants primarily argue that relator has failed to adequately plead materiality because relator has not alleged that the government has terminated or denied admission[31] to any of defendants' 8(a) participants. "[I]f 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. Defendants argue that the government has known for more than a decade how ANCs are participating in the 8(a) program. In connection with this argument, defendants cite to two reports from the General Accounting Office regarding monitoring and oversight of ANCs' participation in the 8(a) program.[32]

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[31]In the Ninth Circuit, "the distinction between a condition of participation and a condition of payment is one without a difference." United States v. Ctr. for Employment Training, No. 2:13-CV-01697-KJM-KJN, 2016 WL 4210052, at *7 (E.D. Cal. Aug. 9, 2016) (citing United States ex rel. Hendow v Univ. of Phoenix, 461 F.3d 1166, 1176 (9th Cir. 2006)).

[32]Exhibits A and B, Declaration of Angela R. Jones [etc.], Docket No. 214.

Defendants request that the court take judicial notice of these two reports. Courts may take judicial notice of GAO reports. Williams v. Lew, 819 F.3d 466, 473 (D.C. Cir. 2016). Defendants contend that the reports "generally discuss, among other thing, ANCs' 'unique status' in the 8(a) Program and how ANCs use the 8(a) Program."[33] Defendants contend that the reports "show that the government was well aware of how ANCs, such as [d]efendants, operate, including that ANCs often enroll multiple subsidiaries in the 8(a) Program and operate such subsidiaries in distinct ways."[34]

"Documents are judicially noticeable only for the purpose of determining what statements are contained therein, not to prove the truth of the contents or any party's assertion of what the contents mean." United States v. S. California Edison Co., 300 F. Supp. 2d 964, 975 (E.D. Cal. 2004). The court takes judicial notice of the existence, authenticity, and contents of the two GAO reports offered by defendants. However, the court "decline[s] to take judicial notice of the veracity and accuracy of the facts contained within the report[s.]" S.A. v. Patterson Joint Unified Sch. Dist., No. 1:10-CV-00943-OWW, 2010 WL 3069204, at *4 (E.D. Cal. Aug. 2, 2010). As such, the GAO reports add very little to the discussion here because they do not establish that the SBA knew how defendants had organized their 8(a) subsidiaries.

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[33]Request for Judicial Notice [etc.] at 3, Docket No. 213.

[34]Id.

But even if the GAO reports do not show that the government knew how defendants and their subsidiaries were participating in the 8(a) program, which they do not, defendants argue that there can be no dispute that the government was aware of the specific allegations that relator has raised since May 2013, when relator filed his original complaint. Thus, defendants argue that the government has been aware of relator's allegations for almost four years but has continued to allow defendants' 8(a) subsidiaries to participate in the program and has continued to award 8(a) contracts to defendants' 8(a) subsidiaries. Defendants contend that relator has not alleged one single instance of the SBA refusing to pay a claim by one their subsidiaries since the government became aware of relator's allegations. Rather, relator has alleged that defendants' 8(a) subsidiaries continue to participate in the 8(a) program.[35] Defendants argue that the SBA had more than enough information to act on relator's allegations and had a number of remedies at its disposal, such as an eligibility review, 13 C.F.R. § 124.112(c), or suspension or termination. 13 C.F.R. § 124.303, 124.305. But instead the SBA has taken no action, which defendants insist is fatal to relator's claims.

First of all, "[w]hile the Supreme Court observed that '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,' the Court did not state that such knowledge is dispositive.'" United States ex rel. Escobar v. Universal Health

[35]See, e.g., Second Amended Complaint [etc.] at 35, ¶ 101, Docket No. 217 ("All of the government contracts awarded to the 8(a) subsidiaries ... from 2007 to present are tainted by this fraud").

Servs., Inc., 842 F.3d 103, 110 (1st Cir. 2016) (Escobar II) (quoting Escobar I, 136 S. Ct. at 2003-04); see also, United States ex rel. Campie v. Gilead Scis., Inc., 862 F.3d 890, 906 (9th Cir. 2017) ("as argued by Gilead itself, there are many reasons the FDA may choose not to withdraw a drug approval, unrelated to the concern that the government paid out billions of dollars for nonconforming and adulterated drugs"); United States ex rel. Harrison v. Westinghouse Savannah River Co., 352 F.3d 908, 917 (4th Cir. 2003) ("we can foresee instances in which a government entity might choose to continue funding the contract despite earlier wrongdoing by the contractor"); United States ex rel. Am. Sys. Consulting, Inc. v. ManTech Advanced Sys. Int'l, Case No. 14–3269, 2015 WL 410272, at *7 (6th Cir. Feb. 2, 2015) ("[w]hen the government discovers misrepresentations made during contract formation, a subsequent decision not to terminate may weigh against a finding of materiality, but it is not always dispositive").

Secondly, while there is no dispute that relator filed his qui tam complaint with the Department of Justice over four years ago, there is nothing in what is currently before the court that shows that the Department of Justice shared the information in relator's complaint with the SBA. Granted, "[a] plaintiff in an qui tam FCA action must first file his complaint under seal so the government can discreetly investigate and decide whether to intervene." United States ex rel. McCurdy v. Gen. Dynamics Nat'l Steel & Shipbuilding, No. 07CV982 BTM CAB, 2010 WL 1608411, at *1 (S.D. Cal. Apr. 20, 2010) (citing 31 U.S.C. § 3730(b)).

And, the court assumes an investigation of relator's allegations would have involved the SBA, but that is an assumption and nothing more.

Campie, 862 F.3d 890, is instructive on this issue. There, the relators alleged that Gilead had "made false statements about its compliance with Food and Drug Administration (FDA) regulations regarding certain HIV drugs, resulting in the receipt of billions of dollars from the government." Id. at 895. "Gilead [argued] that because the government continued to pay for the medications after it knew of the FDA violations, those violations were not material to its payment decision." Id. at 906. But, because "the parties dispute exactly what the government knew and when, calling into question its 'actual knowledge,'" the court declined to dismiss the relators' complaint on that basis. Id. at 906-07. The court explained that the questions of what the government knew and when it knew it were "matters of proof, not legal grounds to dismiss relators' complaint." Id. at 907. Similarly here, the question of what the SBA knew when is a matter of proof that cannot be resolved on the instant motion to dismiss. The crux of relator's allegations is that defendants misrepresented that their 8(a) subsidiaries were actually small business concerns, which would mean that the 8(a) subsidiaries were never eligible to participate in the 8(a) program. There is no question that misrepresentations about whether a business concern is actually a small business concern are material because being a small business concern is a "core" or "basic" requirement that goes to the "very essence" of the 8(a) program. See Escobar II, 842 F.3d at 110 (quoting Escobar I, 136 S. Ct. at 2003 n.5) ("Materiality is more likely to be found where the information at

issue goes 'to the very essence of the bargain'"). Relator has plausibly alleged that if the SBA knew that defendants' 8(a) subsidiaries existed on paper only as he alleges, the SBA would not have allowed them to participate in the 8(a) program. These allegations are sufficient to defeat defendants' motion to dismiss, which is based solely on the contention that relator has not adequately pled materiality.

Conclusion

Defendants motion for judicial notice[36] is granted in part and denied in part. Defendants' motion to dismiss[37] is denied. Defendants shall answer relator's second amended complaint on or before September 1, 2017.

DATED at Anchorage, Alaska, this 11th day of August, 2017.

/s/ H. Russel Holland
United States District Judge

[36]Docket No. 213.

[37]Docket No. 212.