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Seventh Circuit Emphasizes Limits of Advice-of-Accountants Defense in Affirming Summary Judgment for FCA Defendant

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In *United States ex rel. Horning v. Sheet Metal Workers Int'l Assoc.*, 828 F.3d 587 (7th Cir. 2016), the Seventh Circuit declined to grapple with the implied false certification standard announced by the Supreme Court in *Universal Health Services v. United States ex rel. Escobar*, 136 S.Ct. 1989 (2016), just weeks before. Instead, the court, with a dissent by Judge Posner, upheld a grant of summary judgment for the defendant on knowledge grounds.

Facts

In *Horning*, a union of construction workers brought a False Claims Act suit against Horning Investments ("Horning"), a roofing company hired to perform work at a VA medical center in Dayton, Ohio. The union claimed that Horning had violated the federal Davis-Bacon Act, 40 U.S.C. §§ 3141-43, which requires construction contractors hired by the federal government to pay their workers a "prevailing wage." The prevailing wage, set by U.S. Department of Labor regulations, includes both base wage and fringe benefits components.

As part of its health insurance benefits program, Horning deducted a fixed, hourly fee from all employee paychecks and deposited those funds in a trust, which was then used to pay employee claims. The union claimed that this practice did not provide the full benefit of the deducted funds to each worker, resulting in a fringe benefit rate below the Davis-Bacon Act minimum. Specifically, the union complained, deductions were made (1) without regard for whether the employee had become eligible for insurance benefits after a waiting period upon hiring, and (2) without accounting for the amount of benefits each employee actually used.

As a result of these practices, the union alleged, Horning knowingly made false statements material to claims for payment, in violation of the False Claims Act, 31 U.S.C. § 3729(a)(1)(A), when it submitted payroll reports and applications for payment that contained certifications of compliance with the Davis-Bacon Act.

The Southern District of Indiana granted Horning's motion for summary judgment. The lower court found that Horning lacked knowledge that its statements were false because it had relied on the advice of its accountants in implementing and reporting the deductions in question. Because of this reliance, the court reasoned, the union could not show that Horning had the requisite scienter to make out an FCA claim.

Majority Opinion

In a decision by Chief Judge Wood, joined by Judge Easterbrook, the Seventh Circuit affirmed the grant of summary judgment for Horning. Like the district court, the Seventh Circuit found that the union had failed to raise a genuine question of material fact as to scienter, but it did so under a different rationale, rejecting the lower court's advice-of-accountants holding.

Notably, while the decision came down in the wake of the Supreme Court's opinion in *Escobar*, the majority did not reach the application of *Escobar*'s implied false certification standard to these facts. It observed that the representations made by Horning might rise to the level of "specific representations" that "knowingly fail[] to disclose the defendant's noncompliance with a statutory regulatory, or contractual requirement" such that "the omission renders those representations misleading." *Escobar*, 136 S.Ct. at 1995. The Court noted, however, that the outcome here was "not clear," and it declined to engage in the analysis. 828 F.3d at 592.

Instead, it held that the grant of summary judgment should be affirmed on scienter grounds. In doing so, the court rejected the district court's reliance on Horning's advice-of-accountants defense. The court explained that while such reliance can negate scienter in some cases, Horning had failed to lay the proper evidentiary basis for the defense here. Because Horning had made no showing of the precise facts communicated to (or withheld from) its accountants, or of the exact advice it had received, the district court had no way to determine whether Horning's reliance was reasonable.

Nonetheless, the court held that summary judgment was appropriate because the union had failed to raise a genuine question of fact as to whether Horning knew that its flat, hourly deductions violated the Davis-Bacon Act. As the court explained, nothing in the Act required Horning to calculate the benefits actually used by employees to determine whether the deduction from a given employee's paycheck exceeded the value that employee had received. As a result, Horning did not demonstrate a reckless disregard for the truth of its statements by failing to make such an inquiry.

The court reached a similar conclusion with respect to the deductions for employees not yet eligible for benefits. It noted that Department of Labor regulations permitted employers to make such deductions when required to do so by an insurance plan. Those regulations did not speak, however, to deductions like these, which were instead paid into a trust, and the factual record failed to reveal whether the contributions in this case were in fact contractually required.

The court found that these open questions created sufficient ambiguity to defeat any inference that Horning knew (or acted in deliberate ignorance of whether) it was violating the Act.

Dissent

In dissent, Judge Posner agreed with the majority's advice-of-accountants analysis, but disagreed that no jury question existed on knowledge.

This disagreement primarily hinged on five employees who, based on Judge Posner's view of the record, continued to have deductions taken out of their paychecks after they became eligible for benefits but chose not to enroll. As to these employees, he observed, there could be no ambiguity that the deductions were improper, since no conceivable regulation would permit withholdings from employees who had chosen to opt out of the plan. Horning, as an experienced contractor on Davis-Bacon Act contracts, knew or should have known that these deductions violated the Act.

While the dissent did not fully engage with *Escobar*'s implied false certification analysis, Judge Posner made clear that he viewed these facts as satisfying that standard. With relatively little discussion, he pointed to the company's flat deduction practices, and to evidence that some of these funds had been improperly diverted to Horning's owner and a relative of its general manager. In Judge Posner's view, Horning's failure to disclose this information rendered false its certification that deductions had gone towards insurance benefits.

Implications

On its surface, the underlying labor dispute in *Horning* would appear to be an odd fit for an action under the FCA. The union's decision to proceed through a *qui tam* suit, rather than bringing a direct claim against Horning, may have been motivated in part by doubts about the availability of a private right of action under the Davis-Bacon Act. *See, e.g.*, *Lewis v. Gaylor, Inc.*, 914 F. Supp. 2d 925, 926 (S.D. Ind. 2012) (finding that the Seventh Circuit would likely depart from its earlier precedent and hold that no private right of action exists). This creative use of the statute serves as a reminder to companies receiving federal funds of the wide-ranging and sometimes unexpected ways in which they may be subject to FCA liability. *Horning* is also notable in showing a Seventh Circuit panel split over tackling the implications of Escobar so soon after the opinion issued.

Horning makes another thing clear: The advice-of-accountants defense, and its analogue, the advice-of-counsel defense, can be powerful tools in a defendant's arsenal, but courts are reluctant to apply them unless the defendant

has made fulsome disclosures about the consultations in question. Asserting that outside experts have sanctioned the defendant's conduct may not be sufficient unless the content of those discussions is laid bare.

If you have any questions or would like to discuss the foregoing or any related matter, please contact the Ropes & Gray attorney with whom you regularly work, or an attorney in our False Claims Act practice.