False Claim Act Fundamentals

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From Sick Mules to $640 Toilet Seats

No one could have anticipated that one of the most important legal tools for fighting fraud in the U.S. government owes its origin to sick mules. But in fact, the False Claims Act (FCA) was born out of Abraham Lincoln's outrage at defense contractors who sold the Union Army decrepit mules and the same calvary horses several times over.[1] In response, the FCA was passed making it illegal for someone to present false statements in writing to the Federal Government that wrongfully claim money, or wrongfully argue that the government is owed less money.

Nearly 150 years after its passage, the FCA's purpose of encouraging public action against government fraud remains the same. The potency of the FCA has waxed and waned through Congressional amendments seeking to calibrate the balance between encouraging whistle-blowers on the one hand and deterring "parasitic" law suits on the other. In 1943, for example, the FCA was reined in due to perceived abuses. The relator's percentage of the award was reduced and a procedural obstacle was added known as the "public disclosure bar" which prohibits FCA action when the government had prior knowledge of the fraud. As a consequence, government claims were severely curtailed for more than half a century.

More recently, the FCA was revived by an unlikely source - America's arms buildup during the Cold War. Federal money fueled massive defense expenditures providing opportunity for unscrupulous defense contractors to defraud the government. Notorious abuses caught the public's attention - such as the Navy paying $435 for an ordinary claw hammer and $640 for a toilet seat.[2] In the mid 1980's nine out of 10 of the largest defense contractors were under investigation for multiple fraud claims.[3] Congress reacted by strengthening the FCA in 1986. The relator's share was increased, treble damages were allowed, employees

were provided whistle-blower protection, the statute of limitations was extended, and the requisite showing for establishing fraud was reduced.

This has led to the revival of the FCA today. According to the GAO, the government has won recoveries of over $15 billion dollars for the period of 1987 through 2005. Of that, 64 percent, or $9.6 billion, was for recoveries associated with cases filed by whistle-blowers under the FCA.[4]

The FCA practitioner faces unique challenges. A basic understanding of some of the key patterns and dynamics of FCA actions are necessary in evaluating the merits of a potential FCA claim.

The False Claims Act Today

The FCA, codified as 31 U.S.C. §§ 3729 *et seq.*, allows a "private person" to bring a civil action to recover damages to the Government resulting from false or fraudulent claims. Under the federal FCA, such an individual is referred to as the "relator." The action the relator brings is a "qui tam" action which roughly translates as "who as well for the king as for himself sues in this matter."[5] If the relator succeeds in recovering damages on behalf of the Government, the relator is entitled to a reward for his or her efforts, equal to 15% to 30% of the total amount recovered by the Government, plus attorneys' fees and costs. § 3730(d). The percentage depends on whether the government intervenes and the relator's contribution.

Filing Under Seal

One of the more unique attributes of the FCA is that it requires the relator to file their complaint with the court under seal. The complaint is not initially served on the defendants, but must be immediately served on the Attorney General, along with a "written disclosure of substantially all material evidence and information" the relator possesses in support of his or her claims, usually referred to as the "relator's statement." § 3730(b)(2).

The Government then has an initial 60-day period to review the relator's complaint and statement, and determine whether it wants to intervene in the action. *Id.* This investigatory period is often extended for several months, if not years. The complaint remains under seal during this period, and is not served on the defendants.

If the Government elects to intervene in the action, it assumes primary responsibility for prosecuting the action. Importantly, the FCA does not specify the degree to which the government must cooperate with the relator. This stands in contrast to California's False Claims Act which provides "The *qui tam* plaintiff shall have the right to continue as a full party to the action." Cal. Gov Code § 12652(e)(2). Rather, under the federal scheme, Department of Justice (DOJ) attorneys will use their discretion in deciding how much the relator will participate in the case. Generally, this will turn on the amount of information the relator

possesses about the fraud, the degree of experience possessed by the relator's counsel, and interpersonal dynamics between the relator and government lawyers.[6] Often times counsel, and the expertise of the relator, can be critical to the success of the case. Likewise, government involvement can provide resources not otherwise available to the relator such as FBI interviews, wiretaps and reviews of internal government documents. Thus, cultivating a positive relationship with the DOJ is vital to the FCA practitioner. Larger *qui tam* cases are generally handled by the DOJ's civil division, while cases with claims under $5 million are handled by U.S. Attorneys. The district court in which the case is filed is also significant. For example, from 1987 through 2005 the Central District in California accounted for over 10% of all FCA filings, almost double that of the next district court.[7]

If the case is not sufficiently strong at the early stages, or if the Government simply does not have the resources to dedicate to the case, the Government can decide not to intervene, in which case the relator is free to prosecute the case on his or her own. If the Government does not intervene, the relator is entitled to a greater share of any proceeds – 25-30% versus 15-25% – than if the Government does intervene. § 3730(d). The Government can also initiate an FCA action without a relator. In recent years, however, this has been rare; approximately 70% of the Government's recovery under the FCA has stemmed from cases brought by relators. However, relator's counsel should bear in mind that recoveries and the realtor share amount were greater in cases where DOJ intervened than in cases where it did not.[8]

Types of FCA Claims

Health care and military procurement cases predominate FCA complaints. In the 1980's, healthcare fraud began to overtake military procurement as the greatest source of *qui tam* suits. Of the 2,490 closed, unsealed *qui tam* cases from
1987 through 2005, roughly 45% were health care related and roughly 32% were related to military procurement.[9] The next largest category of cases were "Miscellaneous" cases (8.5%), grant programs (4.38%), subsidy programs (3.06%) and housing (1.61%).[10]

Qui tam cases are often viewed as enormous cases by definition, but this is a mistake. The median FCA recovery for completed *qui tam* cases from 1987 was $784,597. Of that amount, the median relator share was $123,885.[11] Where the DOJ intervened, the median length of time from filing the complaint to settlement was 38 months and ranged from four months to 187 months.[12] Taking on a FCA case is a major decision as relator's counsel must be certain that they have the resources to litigate the case in the event that the government declines to intervene.

Common FCA Obstacles

The Public Disclosure Bar

The most litigated affirmative defense to *qui tam* actions is the "public disclosure bar." Codified as 31 U.S. C. section 3730(e)(4), this provision provides that *qui tam* actions cannot be based on publicly disclosed information. "Public disclosure" occurs when the subject information is disclosed in a criminal, civil, or administrative hearing; in a congressional, administrative or GAO report, hearing audit or investigation; or in the news media. The scope of the public disclosure bar has been a source of controversy and created splits among the Circuit Courts.

In a critical case dealing with the public disclosure bar, the Supreme Court in *Rockwell Int'l Corp. V. United States* (2007) 549 U.S. 457, affirmed that the public disclosure bar is *jurisdictional*, thus stripping the court of jurisdiction where the relator's information has been publicly disclosed. As such, the bar cannot be waived. § 3730(e). Second, the question of what constitutes a "public disclosure" has been the source of much controversy and varies widely across the Circuits. For example, some circuits have held that a disclosure is "public" when it is revealed to a "stranger to the fraud." *United States ex rel. Fine v. Advanced Sciences* (10th Cir. N.M. 1996) 99 F.3d 1000, 1008. Other articulations of the rule require the information to be "widespread and notorious." UNITED STATES ex rel. MOSSEY v. PAL-TECH (D.D.C. 2002) 231 F. Supp. 2d 94, 97. Still others, like the Ninth Circuit, have held that "the jurisdictional bar is raised so long as the material elements of the allegedly fraudulent 'transaction' are disclosed in the public domain." *A-1 Ambulance Serv. v. California* (9th Cir. Cal. 2000) 202 F.3d 1238, 1243.[13]

Original Source Exception

If the information that serves as the basis for a relator's FCA action has been publicly disclosed, then the relator must qualify as an "original source." An "original source" is "an individual who has direct and independent knowledge of information on which the allegations are based and has voluntarily provided the information to the Government before filing an action under this section which is based on the information." 3720(e)(4)(B). To be an original source, the person must have (1) direct and independent knowledge of the information on which the allegations are based and (2) have voluntarily provided the information to the government before filing the action. Confusion over the original source requirement is heavily litigated. In *Rockwell*, in a decision authored by Justice Scalia, the Court held that the "direct and independent knowledge" requirement of the relator should be consistent with the provision's purpose of preventing parasitic suits, thus suggesting a more exacting standard. *Rockwell*, *supra*, at 457.

Recent Amendments to the FCA

On May 20, 2009, President Obama signed into law several important, relator-friendly amendments to the False Claims Act, as part of the Fraud Enforcement and Recovery Act of 2009 ("FERA"), S. 386 (introduced by Senators Leahy and Grassley).

The amendments affect both the substantive and procedural provisions of the FCA, as follows:

Loosening or Elimination of the Intent Requirement: Last year, in *Allison Engine Co. v. United States ex rel. Sanders* (2008) 128 S.Ct. 2123, the Supreme Court unanimously ruled that under two of the most-commonly utilized provisions of the FCA (the former §§ 3729(a)(2) & (3)), the plaintiff had to establish that the defendant **intended** its false statement or record to result in a payment by the government. The amendments effectively overturned *Allison Engine*'s intent requirement.

Broadening of "Reverse" False Claims Liability: Under the prior version of the FCA, if a defendant receives an overpayment from the government, or otherwise owes the government money, the defendant was only liable if it "makes, uses, or causes to be made or used, a false record or statement to conceal, avoid, or decrease" that obligation. The amendments greatly broadened this so-called "reverse false claims" provision, by adding a clause that creates liability even where a defendant does not make a false record or statement. In particular, the amended subsection imposes liability where the defendant "knowingly conceals or knowingly and improperly avoids or decreases an obligation to pay or transmit money or property to the Government." § 3729(a)(1)(G). Though this provision will require interpretation by the courts, its plain meaning suggests that where an entity is overpaid by the government, realizes it has been overpaid, and takes no action to return that overpayment, it is liable under the amended FCA, whether it affirmatively conceals the overpayment or not.

Elimination of the Direct Presentment Requirement: Under subsection 3729(a)(1) of the prior FCA, "claims" were limited to requests or demands presented "to an officer or employee of the United States Government or a member of the Armed Forces of the United States." Similarly, for purposes of the former subsection (a)(2), claims were limited to those "paid or approved by the Government." Despite broader language elsewhere in the FCA, at least one circuit had interpreted these subsections strictly, as requiring direct presentment of claims to an agent of the government. See *United States ex. rel. Totten v. Bombardier* (D.C. Cir. 2004) 380 F.3d 488. Thus, where a false claim was made on a contractor, a state, or some other entity through which federal funds pass, the direct presentment requirement was not met, and FCA liability did not attach. The amendments effectively overturned *Totten* and similar cases. Specifically, the amendments extended the definition of "claim" to include any request or demand for money or property, "whether or not the United States has title to the money or property," that "is made to a contractor, grantee, or other recipient, if the money or property is to be spent or used on the Government's behalf or to advance a Government program or interest, and if the United States Government" has provided, or will provide, "any portion of the money or property requested or demanded." § 3729(b)(2)(A).

Broadening of Retaliation Provision: In the only amendment directly affecting the *qui tam* provisions of the FCA, Congress has broadened the anti- retaliation provision to protect "contractors" and "agents"; the prior version only covered "employees." The amendments also eliminated the requirement that the

retaliatory acts be taken by the employer. § 3730(h).

Relation Back of Claims Added by the Government: The amendments confirm that when the government intervenes, and adds claims to the relator's complaint, those new claims relate back to the filing of the relator's complaint. § 3731(c).

Civil Investigative Demands: Under the former FCA, only the Attorney General, him – or herself, was authorized to issue civil investigative demands (CIDs), which can include requests for documents, interrogatories, and depositions. In practice, especially under the Bush administration, this meant that this powerful investigative tool was almost never used. The amendments change this, allowing any "designee" of the Attorney General to issue CIDs. § 3733(a)(1). Though it is unclear how far down the chain this power will go, it is likely to reach all the way to AUSAs, or their supervisors.

Power to Share Information: The amendments explicitly allow the Department of Justice to share information obtained through its investigation with relators, and with other Federal, State, and local government agencies. § 3733(i)(2)(l). Under the former FCA, the extent of permissible sharing was unclear, and had led many government attorneys to err on the side of non-cooperation.

Future Amendments to the FCA

Several pending Congressional amendments could significantly strengthen the FCA. Senator Charles Grassley of Iowa, one of the FCA's most powerful advocates, has introduced a bill that would essentially remove the public disclosure bar by providing that only the government could seek dismissal of a *qui tam* suit for violations of the public disclosure bar.[14] A bill introduced in the House, H.R. 1788, would eliminate Rule 9(b)'s pleading requirements in FCA actions, thus encouraging more *qui tam* actions.[15] Finally, Senate Banking Committee chairman Chris Dodd recently introduced one of the largest financial reform bills in modern history. Among its provisions is an FCA styled whistleblower program to be operated within the SEC that provides whistle-blowers up to 30% of recovered funds.[16] Relator's counsel must remember that the FCA is a moving target. Its application varies across the Circuits and is the source of heated debate on Capitol Hill. Counsel needs to carefully determine the applicable standards being used *before* filing suit.

Conclusion

Given the FCA's long history, recent strengthening through Congressional Amendment, and an emerging consensus on the need to aggressively combat acts of fraud against the government, the reach of the FCA will likely grow in years to come. Continuing division among the Circuits on the FCA's provisions, as well as its adoption in nearly half of the U.S. states, means that the FCA practitioner must remain abreast of current legislative and judicial trends. If used properly, the FCA is an indispensable tool to combat

government waste and fraud.

Footnotes

[1] Larry D. Lahman, *Bad Mules: A Primer on the Federal False Claims Act*, 2010, 76 OBJ 901.

[2] Linda J. Stengle, *Rewarding Integrity: the Struggle to Protect Decentralized Fraud Enforcement Through the Public Disclosure Bar of the False Claims Act*, 2008. 33 Del. J. Corp. L. 471, 479.

[3] *United States ex rel. Roby v. Boeing Co.* (2002) 302 F.3d 637.

[4] *Information on False Claims Act Litigation*, 2006. GAO-06-320R.

[5] William Blackstone, *Commentaries*, 1900. Page 162.

[6] GAO-06-320R, 2006, page 22.

[7] *Id.* at 27.

[8] *Id.* at 35.

[9] *Id.* at 28.

[10] *Ibid.*

[11] *Id.* at 3.

[12] *Id.* at 30.

[13] *See generally* John T. Boese, Civil False Claims and Qui Tam Actions (3rd ed. 2010) Vol. 1 § 4, pages 51-59.

[14] "S. 458: False Claims Act Clarification Act of 2009", § 4(b) available at http://www.govtrack.us/congress/bill.xpd?bill=s111-458

[15] H.R. 1788, § 4 available at http://thomas.loc.gov/cgi-bin/query/z?c111:H.R.1788:

[16] Donny Shaw, "Summary of the Dodd Financial Reform Bill." OpenCongress, March 15, 2010.