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Litigation Alert
May 2012

What You Don't Know *Can* Hurt You: A Primer on the False Claims Act

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Right now, without your knowledge, your company could be a defendant in a lawsuit seeking tens of millions of dollars in penalties. The case could have been filed years ago, over conduct that could have happened years before that, by someone who could have continued to work for - and gather evidence against - your company ever since. Or perhaps the lawsuit has not yet been filed, but one of your current or former employees is preparing to do so. The government could be marshaling evidence through enhanced audits, administrative subpoenas, or other seemingly innocuous means that would not suggest that an investigation is even occurring. And you could conceivably remain in the dark until the government decides to unseal the complaint and issue a press release that lands your company in the spotlight that is page 1 of The New York Times.

It may sound far-fetched, but it happened thousands of times last year alone. And if your company does business with the government or participates in a federally-funded program, it could be next. All thanks to the False Claims Act (FCA).[1] The FCA, which began as a response to a handful of unscrupulous Civil War defense contractors, has in recent years become a powerful weapon for fighting fraud on virtually any federally-funded program. FCA actions can present unparalleled and often unfamiliar risks to your company, not only to its coffers but also its credibility and, in extreme cases, its continued existence. Retaining counsel that has successfully navigated and stays abreast of those risks is thus of critical importance.

Below is a short history of and primer on the FCA, followed by a discussion of emerging trends in FCA litigation and best practices for avoiding and responding to FCA complaints.

Of Horses, Hammers and Healthcare

The FCA was enacted in 1863 after it was revealed that defense contractors had (among other things) taken to selling sickly horses and mules to the Union Army.[2] It was expanded in 1986 after it was reported that defense contractors had (among other things) taken to charging the Pentagon $435 for ordinary hammers,[3] and was expanded yet again in 2009 after courts had limited its scope and Congress anticipated

1 31 U.S.C. §§ 3729-33
2 *See* False Claims Act, Ch. 67, 12 Stat. 696 (Mar. 2, 1863).
3 *See* False Claims Act Amendments, Pub. L. 99-562, 100 Stat. 3153 (Oct. 27, 1986).

widespread fraud on the then-recent Troubled Assets Relief Program.[4] In its current form, it provides for the recovery of treble damages;[5] civil penalties ranging from $5,500.00 to $11,000.00 per false claim,[6] with each and every individual invoice potentially qualifying as a separate "claim";[7] the government's costs of bringing suit;[8] and, in egregious cases, criminal penalties.[9] Whether treble damages or civil penalties predominate often depends on the industry involved.

For example, healthcare enterprises that generate large numbers of small claims are more affected by the civil penalty provision, whereas defense contractors that generate small numbers of large claims are more affected by the treble damages provision. In any event, with the size of the federal deficit and federal programs increasing every year, it has become the government's favorite weapon for fighting—or at least being perceived as fighting—fraud affecting the federal treasury. According to the Department of Justice:

> Thousands of FCA cases are filed every year,[10] meaning the government can cherry pick those that promise to be the most lucrative, newsworthy, or both.

> Since 1986, more than ***$34 Billion*** has been recovered in FCA cases.[11]

> In 2011 alone, the federal government recovered more than ***$3 Billion*** in FCA cases. [12]

> In 2011 alone, nearly ***$2.4 Billion*** was recovered from healthcare enterprises.[13]

> More than ***$5.9 Billion*** of the ***$7.5 Billion*** recovered since January 2009 involved federal healthcare programs.[14]

> Recoveries in FCA cases ***doubled in 2011***,[15] and are ***projected to double again in 2012***.[16]

> Approximately 30 states have enacted and are enforcing their own false claims acts, particularly California, Texas, Florida and Illinois.[17]

"Setting a Rogue to Catch a Rogue"

When the FCA was first enacted, federal officials and resources were focused almost exclusively on the war effort. Rather than burdening the government with the obligation to investigate and prosecute violations of the new statute, Congress conferred standing on private citizens (known formally as "relators" and colloquially as "whistleblowers") to file civil actions on behalf of the federal government (known as "qui tam" actions). Whistleblowers may file such suits so long as they are an "original source" of the facts

4 *See* Fraud Enforcement & Recovery Act of 2009 (FERA), Pub. L. No. 111-21, 123 Stat. 1617 (May 20, 2009).
5 *See* 31 U.S.C. § 3729(a)(1).
6 *See id.*
7 *See* 31 U.S.C. § 3729(b)(2).
8 *See* 31 U.S.C. § 3729(a)(3).
9 *See* 18 U.S.C. § 287 (2006).
10 *See e.g.,* United States Department of Justice (Civil Division) ("USDOJ") *Fraud Statistics – Overview,* October 1987-September 2011, at 1-2.
11 *Id.*
12 *Id. ; see also* http://www.justice.gov/opa/pr/2011/December/11-civ-1665.html
13 *Id.* ¶ 4.
14 *See* http://www.justice.gov/opa/pr/2011/September/11-civ-1162.html; *see also* http://www.taf.org/top20.htm (listing the 25 largest FCA settlements, 23 were against pharmaceutical companies and other healthcare enterprises).
15 *See,* USDOJ *Fraud Statistics – Overview* at 1-2.
16 *Id.*
17 *See* Cal. Gov't Code §§ 12650-12656; Fla. Stat. §§ 68.081-.09; Tex. Hum. Res. Code Ann. §§ 36.001-.132; 740 Ill. Comp. Stat. §§ 175/1-/8.

alleged, as opposed to simply learning about them from a prior "public disclosure."[18] The paradigm of "setting a rogue to catch a rogue"[19] remains largely in place today:

> ***More than 80%*** of FCA cases are initiated by whistleblowers.[20]

> Whistleblowers can receive anywhere from ***15-30% of the government's recovery***, depending on whether the government intervenes in the action.[21]

> The FCA prohibits employers from discharging or discriminating against whistleblowers and creates a private right of action for employee whistleblowers.[22]

> The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010[23] expanded whistleblower protections and ***required the SEC to establish a "whistleblower officer"*** in order to handle an anticipated increase in whistleblower activity.[24]

> In 2011 alone, whistleblowers recovered more than ***$500 Million*** in FCA cases.[25]

> In one recent settlement, ***six whistleblowers shared a $168 Million award***.[26]

Emerging Theories of Liability – Implied Certification

A result of the government's relentless pursuit of FCA damages is the judiciary's consideration – and in some cases, adoption – of expansive theories of liability. Courts traditionally limited FCA liability to "factually false claims," e.g., where a contractor knowingly bills the government for 100 widgets even though it only built 50 widgets.[27] Over time, however, the government explored and the courts embraced the "false certification theory," i.e., where a contractor falsely represents that it complied with applicable regulations in connection with the receipt of federal funds. This expansion of FCA liability has (not surprisingly) led to more investigations and, in turn, more recoveries.

Today, federal courts are being confronted with the next wave of FCA expansion – the so-called "***implied*** false certification theory." Under this theory, courts are no longer limited to actual statements of compliance with federal regulations. Rather, the mere submission of a bill (which makes no mention of a regulation, let alone compliance with it) arguably constitute a false statement for purposes of triggering FCA liability, so long as the underlying contracts, statutes, or regulations themselves expressly ***or implicitly*** make compliance a prerequisite to the government's payment. The government has gradually convinced a number of courts to recognize this theory, most recently the United

18 *See* 31 U.S.C. § 3730(e)(4).
19 *See* Sen. Jacob M. Howard (1863), When Bad Things Happen to Good Rogues, (Pac. Standard Magazine Mar. 28, 2010 ("I have based the [False Claims Act] upon the old-fashioned idea of holding out a temptation, and 'setting a rogue to catch a rogue,' which is the safest and most expeditious way I have ever discovered of bringing rogues to justice.").
20 *See, e.g.,* USDOJ *Fraud Statistics – Overview* at 1-2.
21 *See* 31 U.S.C. § 3730(d)(1), (d)(2).
22 *See* 31 U.S.C. § 3730(h).
23 Dodd-Frank Wall Street Reform & Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010); *See id.* at 1841 (§ 922), 1739 (§ 748) (creating whistleblower program relating to commodities and futures trading); § 1057 (creating whistleblower program relating to financial services industry).
24 *See* http://www.sec.gov/spotlight/dodd-frank/whistleblower.shtml.
25 *See, e.g.,* USDOJ *Fraud Statistics – Overview* at 1-2.
26 *See* http://www.reuters.com/article/2010/10/29/us-whistleblowers-awards-analysis-idUSTRE69S4LZ20101029; *see* http://www.justice.gov/opa/pr/2012/January/12-ag-142.html.
27 *See, e.g., United States ex rel. Wilkins v. United Health Group, Inc.*, 659 F.3d 295, 305 (3d Cir. 2011) (citing *United States ex rel. Conner v. Salina Reg'l Health Ctr., Inc.*, 543 F.3d 1211, 1217 (10th Cir. 2008).

States Court of Appeals for the Third Circuit.[28] This further expansion of liability, coupled with the recent uptick in filings, casts an even larger net over (and risk to) government contractors.

An Ounce of Prevention...

Although some whistleblowers are animated by the possibility of sharing in the government's recovery (which, after all, is the purpose of the qui tam provisions) or exacting their revenge on their employer for some supposed slight by exposing it to potentially ruinous liability (which is not), others are truly troubled by what they deem to be misconduct and indifference by their employer. For this latter group, having and using an effective compliance program can go a long way toward avoiding an FCA action altogether.

Although much more could be said on this subject, a few best practices bear mentioning here:

> **Have a Compliance Program and Compliance Officer.** Although it should go without saying, companies that regularly do business with the government or participate in federally-funded programs should have a formal compliance program and a person or department responsible for implementing it. Employees should be given copies of the compliance program in employee handbooks or otherwise, and should be notified and regularly reminded about where to find the compliance program and how to reach the compliance officer, both of which should be made as easy as is reasonably possible.

> **Require All Employees to Report Non-Compliance.** Rather than just simply being encouraged to report non-compliance, employees should be required to report any potential non-compliance, first to their supervisor but also to the compliance officer if the supervisor's response is inadequate, and advised that failure to do so may result in disciplinary action, including termination. Having a meaningful process in place for making and responding to reports of non-compliance can go a long way to deterring not only the filing of an FCA complaint, but also the government's intervention in one.

> **Require All Managers to Certify Compliance.** Similarly, having management-level employees execute regular certifications of compliance can be an effective way to remind them of their and their employer's obligations and potential liabilities under the FCA. Form certifications should be written in a way that allows and indeed encourages employees to report any suspected non-compliance.

> **Document the Company's Response to Reports.** An employer should thoroughly investigate an employee's report of potential non-compliance and should document its investigation (and any remedial measures taken). At a minimum, the reporting employee should be interviewed by at least two people (so that they can corroborate what was said during the interview) and

[28] *Id. at 306.*

notified as appropriate about the progress and results of the investigation (so that the employee understands that the report was taken seriously and the investigation was conducted responsibly).

> **Condition the Retention of Severance on Reporting.** An exit interview of a departing employee is another opportunity to learn about potential non-compliance, and ideally would be conducted as a matter of course. So too is a severance agreement, which should require the employee to: (1) fully disclose any non-compliance; and (2) return any severance payments if any provision in the agreement, including the disclosure requirement, is breached. Such provisions can be effective at smoking out and/or discouraging would-be whistleblowers.

> **Obtain Broad Releases from Departing Employees.** Although some courts enforce releases of FCA claims, others have refused to do so on public policy or other grounds. Including a general release that is broad enough to extend to FCA claims, but does not invite a public policy defense by calling out the FCA by name, is generally preferable.

> **Monitor Trends in FCA Litigation.** Is there a trend in the types of cases being brought? Is the government focusing on a particular industry? For how much are cases against similarly situated companies being settled? How have courts in the districts in which your company does business responded to attempts to expand the scope of the FCA? Paying close attention to trends in FCA litigation will help avoid surprises, assess risk, and allow for a more efficient and effective response to an investigation.

...And a Pound of Cure

Of course, even a comprehensive compliance program will not deter the most mercenary whistleblowers from filing suit. The early stages of most FCA suits are similar: the whistleblower files a complaint under seal, meaning the defendant may not know for years that it has been sued or that it is employing someone who is actively gathering evidence against it; the government receives the complaint and a disclosure statement that describes the evidence in support of the complaint, neither of which is given to the defendant; the government assumes responsibility for investigating and prosecuting the case,[29] having 60 days in which to conduct an initial investigation of the whistleblower's claims; the government files the first of what could be many motions to keep the complaint under seal while the investigation continues;[30] and the government eventually notifies the defendant about the investigation, usually by issuing a Civil Investigative Demand, which unlike an administrative subpoena can request not only documents, but also interrogatory responses and deposition testimony.[31]

29 *See* 31 U.S.C. § 3730(c)(1) (giving the government "primary responsibility for prosecuting the action"); *id.* § 3730(c)(2)(C) (allowing government to limit relator's participation). Whereas the government may dismiss an action without the consent of the relator, *see id.* § 3730(c)(2)(A), the relator cannot dismiss an action without the consent of the government, *see id.* § 3730(b)(1). Only if the government declines intervention does the relator assume responsibility for prosecuting the case. *Id.* § 3730(b)(4)(B).

30 *See* 31 U.S.C. § 3730(b)(3).

31 *See* 31 U.S.C. § 3733.

It is at this point that FCA cases can take dramatically different paths depending in large part on how the defendant responds. Should the defendant resist or cooperate with the investigation? Should it conduct its own internal investigation? Should it rely on in-house counsel or retain outside counsel to prepare witnesses and collect, review and produce documents? And how should its approach change if its executives (or its general counsel) are implicated in the alleged fraud? Or if the government indicates that it intends to pursue criminal penalties, debarment from future government contracts, or referral to congressional agencies or potentially 50 state Attorneys General?

The answer to these questions will vary depending on the unique facts of each case, and will have profound implications as the case goes forward. On the one hand, having a meaningful dialogue with the government about whether intervening is a worthwhile use of its resources means exposing the flaws in its case, which in turn allows it to address those flaws (to the extent it can) in its complaint if it intervenes. On the other hand, having such a dialogue is often the best and, in some cases, the only chance to convince the government not to intervene – a decision that can be the turning point in the case. Indeed, of the approximately $3 Billion recovered in 2011, ***only 4.9% was obtained in actions in which the government declined to intervene***.[32] Moreover, making a voluntary disclosure to and cooperating with the government during the course of its investigation has the effect of reducing the amount of recoverable damages,[33] which can be useful in negotiating an amicable resolution.

32 *See* USDOJ *Fraud Statistics – Overview* at 1-2.
32 *See* 31 U.S.C. § 3729(a)(2).

False Claims Act Team

Should you have any questions or require any assistance with regard to any of the information in this alert, please contact the authors, your regular Drinker Biddle contact, or any member of Drinker Biddle's False Claims Act Team.

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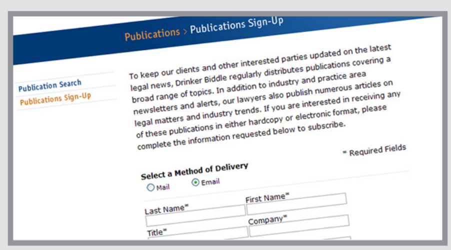

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