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Focus

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FEATURE COMMENT: The Top FCA Decisions of 2015 For Government Contractors

2015 saw much activity concerning the civil False Claims Act, 31 USCA § 3729 et seq. Together, the Government and qui tam relators initiated more than 700 new FCA matters. And for the sixth year in a row, total FCA recoveries exceeded $3 billion. This year, though, nearly one-third of those recoveries came from qui tam cases in which the Government declined to intervene. On top of that, the Government issued the "Yates memorandum," promising more aggressive action against individuals involved in fraud, and Congress passed legislation requiring agencies to increase civil penalties that will likely lead to significant upward adjustments to FCA penalties in mid-to-late 2016, from the current range of $5,500 to $11,000 per false claim to as high as $9,300 to $18,600.

With all that in mind, the question for contractors becomes how the case law is developing, and what recent decisions will prove important for contractors in the coming year and beyond. Here is our list of *the top FCA decisions of 2015 for Government contractors.*

10. *Kellogg Brown & Root v. U.S. ex rel. Carter*: A Limit on Tolling the FCA Statute of Limitations, and a Narrowing of the First-to-File Bar—The Supreme Court's highly anticipated decision in this long-running case proved to be a mixed bag for contractors. At issue was whether the Wartime Suspension of Limitations Act (WSLA) applied to civil fraud actions such as those under the FCA and whether the FCA's first-to-file bar served as a permanent or only a temporary barrier to related but later-filed qui tam suits.

In *Kellogg Brown & Root v. U.S. ex rel. Carter*, 135 S. Ct. 1970 (2015); 57 GC ¶ 169, the Court reversed the Fourth Circuit's extension of the WSLA's tolling provision to civil actions involving fraud when the U.S. is at war, which provision the court of appeals held suspended the civil FCA's six-year statute of limitations. The WSLA applies to any "offense …involving fraud or attempted fraud against the United States or any agency thereof." 18 USCA § 3287. The Court focused its interpretation of the statute on the word "offense" in finding that the "text, structure, and history of the WSLA show that the Act applies only to criminal offenses." In so doing, the Court avoided any need to analyze whether the WSLA applies only when the U.S. has formally declared war.

The Court also decided an important issue concerning the scope of the FCA's first-to-file bar, which provides that "no person other than the government may intervene or bring a related action based on the facts underlying the pending action." 31 USCA § 3730(b)(5). Circuit courts had split on whether the bar's application lasts only while the earlier-filed suit remains pending or in perpetuity. The Court affirmed the Fourth Circuit's holding that the bar is only temporary and no longer bars a related action once the first-filed suit has been dismissed or resolved. In other words, the Court agreed that the use of the word "pending" limited the bar's applicability to actions currently pending in court and rejected petitioners' argument that "pending" was merely "used as a short-hand for the first filed action."

The *Carter* decision provides a breath of relief for contractors on the FCA's statute of limitations, as the implications of tolling the statute of limitations when the U.S. is involved in a "war," in this day and age, represented a slippery slope of disastrous proportions. On the other hand, contractors will now find little shelter in the first-to-file bar, as follow-on, related suits are no longer barred once

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the first action has been resolved. This decision will do little to disincentivize parasitic, related suits by qui tam relators, while leaving contractors to rely on more traditional defenses to such actions.

9. *U.S. ex rel. Osheroff v. Humana, Inc.*: 11th Circuit Strengthens Original Source Requirement—The public disclosure bar is a hurdle that a relator must face when bringing an action based on publicly disclosed allegations or transactions. The original source exception provides a relator with a way to overcome that hurdle, however, making its interpretation and application by the courts paramount for relators and defendants alike.

In *U.S. ex rel. Osheroff v. Humana, Inc.*, 776 F.3d 805 (11th Cir. 2015), the Eleventh Circuit for the first time interpreted the amended "original source" provision of the FCA, which defines an original source as someone who has "knowledge that is independent of and materially adds to the publicly disclosed allegations or transactions." 31 USCA § 3730(e)(4)(B). The prior version required "direct and independent knowledge," and thus, the amendment was largely viewed as lowering the bar for a relator to qualify as an original source. In *Osheroff*, however, the court applied the amended language similarly to its prior precedent, holding that the relator's only independent knowledge did not materially add to the publicly disclosed allegations because it was merely background information or provided additional details, despite the fact that the relator conducted his own investigation. The court expressly noted that the public disclosures themselves in the instant case were already sufficient to give rise to an inference of the fraud alleged in the suit.

Osheroff is an important development in the case law interpreting the amended original source exception and provides some teeth to the requirement that the relator's independent knowledge "materially add" to that which has been publicly disclosed.

8. *U.S. ex rel. Hartpence v. Kinetic Concepts, Inc.*: No Requirement for Original Source to Be Involved in Public Disclosure Itself—In *U.S. ex rel. Hartpence v. Kinetic Concepts, Inc.*, 792 F.3d 1121 (9th Cir. 2015); 57 GC ¶ 223, the Ninth Circuit held that a relator is not required to have played a role in the public disclosure of the allegations that are a part of his suit to be deemed an "original source." In so doing, the court abrogated its 23-year-old ruling in *Wang ex rel. U.S. v. FMC Corp.*, 975 F.2d 1412 (9th Cir. 1992); 34 GC ¶ 732, which announced that requirement as part of a three-part original-source test. The first two prongs parallel the statutory language and require the relator to show that (1) he has direct and independent knowledge of the information on which the allegations … are based and (2) he has voluntarily provided the information to the Government before filing his civil action. The Ninth Circuit relied on the Supreme Court's decision in *Rockwell Int'l v. U.S.*, 549 U.S. 457 (2007); 49 GC ¶ 141, as well as the plain meaning of § 3730(e)(4)(B), in finding that *Wang* improperly "read a non-existent, extra-textual third requirement" into the statute from the FCA's legislative history in requiring that the relator also have had a hand in the public disclosure of the allegations that are a part of his suit.

7. *U.S. ex rel. Miller v. Weston Educ. Inc.*: Knowingly False Promise in a Program Participation Agreement Could Be Material Under Fraud-in-the-Inducement Theory—Under the FCA's materiality requirement, the false claim or statement must have a "natural tendency to influence, or be capable of influencing, the payment or receipt of money or property." 31 USCA § 3729(b)(4). The reach of that broad definition in determining whether statements made outside of the actual claims are material to payment, therefore, often proves critical.

In *U.S. ex rel. Miller v. Weston Educ. Inc.*, 784 F.3d 1198 (8th Cir. 2015), the Eighth Circuit broadened that reach, overturning a district court's grant of summary judgment in favor of the defendant, a for-profit college which signed a Program Participation Agreement (PPA) with the Government to participate in programs that provide federal financial assistance to students. Relying on a theory of fraudulent inducement, relators alleged that defendant induced the Department of Education to provide funds by falsely promising to keep accurate student records of performance and eligibility for financial assistance. Instead, relators alleged, defendant intended to manipulate the grades of students to keep them eligible for federal loans and grants and permit the college to continue collecting the students' federal funding. The district court found that the falsified records did not cause the improper distribution of funds and therefore were not material to the Government's funding decision. The Eighth Circuit, however, found a "causal link" between the for-profit college's promise to maintain adequate records and the Government's disbursement of funds. Specifically, it found that the

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for-profit college could not have executed the PPA without promising that it would maintain adequate records because the relevant statute, regulation, and contractual agreement all explicitly condition participation and payment on compliance with the requirements that relators allege the college knowingly disregarded. Without the PPA, the for-profit college could not have received any federal funds.

Miller demonstrates the impact of the broad materiality requirement in permitting actions not specifically tied to false claims themselves to proceed under theories of promissory fraud and fraud in the inducement.

6. *U.S. v. United Techs., Inc.*: Benefit-of-the-Bargain Theory Requires Court to Assess Value Received by the Government in Calculating Damages—An issue that has surfaced recently as more FCA cases proceed into damages phases is how to calculate the damages to the Government and whether to account for any benefit the Government has received despite the false claims. The Government has argued successfully in some contexts that the fair value of the services or products it received are irrelevant to its damages, while defendants have maintained that no damages result if the Government got what it paid for despite any fraudulent misrepresentations.

In *U.S. v. United Techs., Inc.*, 782 F.3d 718 (6th Cir. 2015); 57 GC ¶ 115, the Sixth Circuit vacated a $657 million damages award against United Technologies Corp. because the district court did not account for the fair market value of the goods and services received by the Government and the role of competition in setting a fair market value. The court concluded that the district court erroneously held that competition between Pratt & Whitney and GE Aircraft was irrelevant to the Government's claim for damages. Rather, a comparable sales analysis is the "preferred method" for establishing fair market value, and the method "applies even though the market for fighter jet engines is heavily regulated …, has two sellers, and [] results in few sales per year." The court concluded that GE's "engine prices are … a natural place to look for evidence of the value the government received" and the "only question is whether those engines are adequately comparable to Pratt's." The "proper approach" for the district court "was to start with GE's prices and make adjustments for any material differences between the engines." The Sixth Circuit instructed the district court to recalculate its damages under the benefit-of-the-bargain method to determine whether the Government got what it paid for in spite of the misstatements.

In upholding the benefit-of-the-bargain theory and requiring consideration of the fair market value of what the Government received, *United Technologies* represents an important "win" for contractors in the area of FCA damages.

5. *Schroeder v. U.S.*: Criminal Conviction Results in Mandatory Dismissal of *Qui Tam* Relator and Recovery Bar—The FCA balances its financial incentives for relators to uncover and disclose fraudulent conduct with various requirements aimed to prevent parasitic lawsuits. One of those provisions states, "If the person bringing the action is convicted of criminal conduct arising from his or her role in the violation of § 3729, that person shall be dismissed from the civil action and shall not receive any share of the proceeds of the action." 31 USCA § 3730(d)(3).

Schroeder v. U.S., 793 F.3d 1080 (9th Cir. 2015), provided the Ninth Circuit with an opportunity to address whether an exception could apply to the criminal conviction bar. Schroeder, the relator, had previously pled guilty to one felony count of conspiracy to commit fraud, a conviction that stemmed from the claims underlying his qui tam suit. Schroeder argued that he should not be dismissed because his role in the fraudulent scheme was only "minor," as his role consisted merely of submitting false timecards like many of his colleagues. The court rejected this argument, finding that the purpose of the 1988 amendment that codified § 3730(d)(3) was to restrict eligibility of relators in just such cases and that the statute by its plain language provided no exception to dismissal where a conviction was involved.

4. *U.S. ex rel. Rigsby v. State Farm Fire Cas. Co.* and *Smith v. Clark/Smoot/Russell*: Violation of Seal Provision Does Not Require Dismissal—A relator filing an FCA qui tam case must file it under seal and serve it only on the Government to provide the Government time to investigate the allegations and determine whether to intervene. 31 USCA § 3730(b)(2). An issue that has divided courts is whether a relator's violation of that seal requirement should result in dismissal.

In *U.S. ex rel. Rigsby v. State Farm Fire Cas. Co.*, 794 F.3d 457 (5th Cir. 2015), the Fifth Circuit held that the relators' violations of the FCA's seal requirements did not mandate dismissal.

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The court acknowledged the divergent opinions of the Second, Sixth and Ninth Circuits on the issue, but rejected the Sixth Circuit's per se rule of mandatory dismissal, opting instead to apply the Ninth Circuit's three-factor balancing test: (a) the harm to the Government caused by the disclosure, (b) the nature of the violation and (c) the existence or non-existence of bad faith or willfulness. The court determined that these factors weighed in relators' favor and that dismissal was inappropriate.

In *Smith v. Clark/Smoot/Russell*, 796 F.3d 424 (4th Cir. 2015), the Fourth Circuit similarly rejected the notion that the relators' violations of the seal requirements mandated dismissal of their complaint. Following the Second Circuit, the Fourth Circuit assessed whether the violation frustrated the purposes of the seal requirement: (1) to permit the U.S. to determine whether it already was investigating the fraud allegations (either criminally or civilly); (2) to permit the U.S. to investigate the allegations to decide whether to intervene; (3) to prevent an alleged fraudster from being tipped off about an investigation; and (4) to protect the reputation of a defendant in that the defendant is named in a fraud action brought in the name of the U.S., but the U.S. had not yet decided whether to intervene. The Fourth Circuit determined that the violations did not incurably frustrate those stated purposes.

These decisions demonstrate that many courts view the FCA's seal requirements as important but not so critical as to mandate dismissal when a relator violates them. Contractors should consider the governing case law and balancing test to be applied in determining whether to use resources in challenging a violation of the seal provision.

3. *U.S. ex rel. Michaels v. Agape Senior Cmty., Inc.*: Fourth Circuit to Address District Court's Rejection of the Use of Statistical Sampling to Prove Liability and Damages—An increasingly common tactic in FCA cases is the attempt to prove liability, damages or both by the use of statistical sampling. District courts have provided different answers to this question depending on the circumstances of the claims at issue, and the validity of the sample offered for extrapolation is often critical.

In *U.S. ex rel. Michaels v. Agape Senior Cmty., Inc.,* 2015 WL 3903675 (D.S.C. June 25, 2015); 58 GC ¶ 9, the district court rejected the use of statistical sampling to prove liability and damages. Relators argued that defendants submitted false claims to federal healthcare programs for nursing home-related services that were not medically necessary. During discovery, relators argued that because of the large number of claims at issue, their experts should review a small percentage of the claims, determine what percentage of those claims were not medically necessary, and extrapolate across the population of submitted claims. The court concluded that it would not allow plaintiffs to use statistical sampling because sampling was a permissible method only if the individual review of claims was impossible, rather than simply time-consuming and expensive.

Because of the effect of the statistical sampling ruling on the outcome of the case, the court certified its ruling for interlocutory appeal to the Fourth Circuit to address the question of whether sampling is an appropriate means of establishing liability and damages. In September, the Fourth Circuit agreed to hear the appeal. The court's decision, if it reverses the district court, could greatly expand the ability of relators to pursue cases without having to prove all of the allegedly false claims at issue or the specific damages resulting from each claim.

2. *U.S. ex rel. Purcell v. MWI Corp.*: Reasonable Interpretation of an Ambiguous Regulation Precludes Finding of Scienter Absent Authoritative Guidance Warning Defendant Away From Its Interpretation—Contractors face treble damages and statutory penalties under the FCA's provisions. Thus, the prospect of FCA liability for violating undefined or ambiguous regulations where the agency's interpretation of those provisions differs from the contractor's interpretation is an ominous one to say the least. Prior case law supported the notion that a contractor who reasonably interprets an ambiguous regulation should not usually be held liable. But grey area remains concerning whether a contractor may still be held liable under the FCA, notwithstanding the reasonableness of its interpretation, if it does not take steps to ensure that its interpretation is the same one held by the Government, particularly where the contractor's interpretation is advantageous to it.

In *U.S. ex rel. Purcell v. MWI Corp.*, 807 F.3d 281 (D.C. Cir. 2015); 57 GC ¶ 393, the D.C. Circuit overturned a jury verdict and ruled in favor of MWI in a long-running civil FCA lawsuit in which the Government asserted claims for approximately $225 million in trebled damages (plus additional

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civil penalties). The Government alleged that false claims and statements were submitted to the Export-Import Bank of the U.S. in connection with eight loans to the government of Nigeria for the purchase of MWI's water pumps. The key issue was whether MWI's certification that the commissions it paid its sales agent in connection with the sales were "regular" was knowingly false. MWI argued that its certification could not have been knowingly false because the term "regular commissions" was ambiguous, MWI made the certification based on a reasonable interpretation of the term, and the agency never defined "regular commissions" or authoritatively clarified its meaning. The unanimous panel agreed and held that MWI could not have acted "knowingly" where there was no evidence that the Government "had officially warned MWI away from its otherwise facially reasonable interpretation of [an] undefined and ambiguous term," citing the Supreme Court's decision in *Safeco Ins. Co. of Am. v. Burr*, 551 U.S. 47, 69–70 & n.20 (2007).

In addition, the court rejected the Government's subjective intent and "duty to inquire" arguments, explaining both that (a) subjective intent was irrelevant because the defendant's interpretation of the term was reasonable and that (b) a failure to seek a legal opinion from the Bank did not support a finding that MWI acted recklessly under the FCA. This case establishes important precedent that, if a defendant adopts an objectively reasonable or plausible interpretation of an ambiguous regulatory term and the agency has not officially warned the defendant from its interpretation via authoritative guidance, the FCA scienter element cannot be established.

1. *Universal Health Servs. v. U.S. ex rel. Escobar*: Supreme Court to Decide Viability and Limits of Implied Certification Theory of Liability—The implied certification theory of legal falsity under the FCA has gained ground among the circuits and become an increasingly popular hook for attaching liability in new cases brought under the FCA. Under this theory, a defendant may be held liable for submitting claims to the Government knowing that it is in violation of a statutory, regulatory or contractual term material to payment of the claim or participation in the program. At present, eight of the 13 circuits have accepted the implied certification theory in some form, but the eight circuits have reached varying conclusions about the appropriate scope of the theory. With a split among the circuits ranging from full-blown acceptance of the theory to its rejection, the forum for FCA suits involving implied certification claims has become a critical factor in the viability of the action.

This year alone has seen three significant circuit decisions that widened the split concerning the implied certification theory, with varying tests applied and opposite results reached. In *U.S. ex rel. Badr v. Triple Canopy*, 775 F.3d 628 (4th Cir. 2015); 57 GC ¶ 24, the Fourth Circuit held that liability under the implied certification theory could arise if a contractor—with the requisite scienter—withheld information about noncompliance with material contractual requirements. In applying a materiality test, the Fourth Circuit joined the First Circuit in departing from the "express condition of payment" test applied by the majority of circuits in implied certification cases. Contrast that with *U.S. v. Sanford-Brown, Ltd.*, 788 F.3d 696 (7th Cir. 2015); 57 GC ¶ 224, in which the Seventh Circuit rejected the implied certification theory in a case which involved a condition of participation rather than a condition of payment. The Seventh Circuit did not address whether it would adopt the implied certification theory if presented with a clear condition of payment case. Finally, in *Universal Health Servs. v. U.S. ex rel. Escobar*, 780 F.3d 504 (1st Cir. 2015), a case concerning a medical provider's alleged violations of medical licensing and supervising regulations, the First Circuit, much like the Fourth Circuit in *Triple Canopy*, held that noncompliance with a material precondition of payment, even if that precondition is not expressly designated as such, is sufficient to state a viable FCA claim.

By agreeing to hear the *Escobar* case, the Court appears set to resolve the circuit split over the implied certification theory of legal falsity. Specifically, the Court has indicated that it will consider (a) whether the implied certification theory of legal falsity under the FCA is viable; and (b) if so, whether a Government contractor's reimbursement claim can be legally false when the claimant failed to comply with a statute, regulation or contractual provision that is deemed "material" to the Government's decision to pay the claim, even when the statute, regulation or contractual provision does not expressly state that compliance with that provision is a condition of payment. That the Supreme Court's forthcoming decision is highly anticipated is an understatement at best. That decision will shape the landscape of FCA liabil-

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ity and is certain to have an enormous impact not only on the many pending cases involving the implied certification theory but also on the type of FCA cases that may be brought going forward.

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