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Focus

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FEATURE COMMENT: The Top FCA Developments Of 2016 For Government Contractors

In 1986, Congress amended the civil False Claims Act to breathe new life into the statute as a fraud enforcement tool. Thirty years later, activity under the FCA is as busy as ever. In fiscal year 2016, the Government and qui tam relators initiated more than 800 new FCA matters, the second-highest number on record. Of these, more than 80 percent were initiated by whistleblowers (referred to as relators under the statute). The $4.7 billion recovered through settlements and judgments makes it the seventh year in a row that total FCA recoveries have exceeded $3 billion. Not only was FY 2016 the third-largest annual haul in FCA history, but the calendar year also saw two U.S. Supreme Court decisions, a significant regulatory change on statutory penalties and many other key opinions in the appellate courts, all of which will shape strategies for litigating or settling FCA cases for years to come. This Feature Comment highlights these top FCA developments of 2016 for Government contractors.

A Closer Look at the FY 2016 Recoveries, Including Settlements and Individual Enforcement Actions—Of the $4.7 billion that was recovered, $2.5 billion related to the health care industry, particularly drug and device manufacturers. $1.7 billion comes from the financial industry where the underlying facts of many cases arose from the 2008 financial crisis (making this year's recovery a likely one-off). The remaining $500 million related to higher education, procurement and other federal programs. In a notable downward trend, recoveries stemming from the defense industry accounted for only $120 million.

Of the recoveries, the largest settlements included Wyeth/Pfizer ($784.6 million), Olympus Corp. ($646 million), Tenet Healthcare ($513 million), Novartis ($390 million) and Freedom Mortgage ($113 million). Additionally, Wells Fargo settled causes of action under the FCA and the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 for $1.2 billion.

The Government also reached a $145 million settlement agreement with Life Care Centers of America Inc. to resolve FCA allegations relating to the provision of medically unnecessary services. The Life Care Centers settlement is notable in that the defendant settled after the District Court for the Eastern District of Tennessee ruled that the Government would be permitted to use statistical sampling—i.e., that the Government could determine the falsity of a statistically significant sample of claims and extrapolate the results across all similar claims for payment. The court's decision on sampling has led to an increase in the number of cases where plaintiffs are pushing for the use of statistical sampling and extrapolation to prove both liability and damages. This past year was also the first full year since the issuance of the Sept. 9, 2015, "Yates Memo," in which Deputy Attorney General Sally Yates emphasized the Department of Justice's commitment to holding individuals accountable for corporate wrongdoing. Accordingly, DOJ held several individuals personally liable for false claims in 2016, notably the founder of Dynasplint Systems Inc. ($10.3 million), the former owner of a Nashville drug testing laboratory ($9.35 million), and the founders of Pharmasan Labs Inc. ($8.5 million).

Looking ahead to 2017, there may be an uptick in the number of settlements as defendants evaluate their exposure in light of the recent increase in FCA monetary penalties discussed below.

Substantial Increase in Penalties—On June 30, 2016, DOJ published an interim final rule nearly doubling the penalty range for violations under the civil FCA. Previously, the range was $5,500–$11,000 for each false claim, but under the new rule, the penalty for each false claim is no less than $10,781 and not more than $21,563, with the potential for annual upward adjustments thereafter. The interim final rule provides that the new penalty amounts are applicable to violations that occurred after Nov. 2, 2015. Relators can collect up to 30 percent of any amount recovered under the FCA (including penalties). Accordingly, the increase in the penalty range will likely incentivize the Government and relators to bring more actions. Conversely, defendants will have more reason to seek an early exit strategy, particularly where the number of potential claims for payment is great. Relators and DOJ stand to gain significant leverage in settlement negotiations, however, given the statutory requirement for the court to assess penalties when a defendant is found liable. Going forward, we will invariably start to see more defendants challenge penalties assessed against them as unconstitutionally excessive under the Eighth Amendment and the Due Process Clause. While such challenges in the past have seldom been successful, the dramatic increase in penalties will likely bring more instances of penalties that greatly outsize damages and, as a result, may give defendants better odds in making such an argument. See McLaughlin, Lombardo and Haylock, Feature Comment, "Substantial Increase In False Claims Act Penalties Impacts The Landscape Of Litigation," 58 GC ¶ 256.

Top FCA Decisions of 2016—This year was no slouch in terms of significant case law development, with the Supreme Court alone issuing two opinions in FCA cases. Here is our list of the top FCA decisions of 2016.

1. Universal Health Servs., Inc. v. U.S. ex rel. Escobar*: Supreme Court Issues Highly Anticipated Opinion on the Implied Certification Theory of Liability*: In a widely anticipated decision, the Supreme Court in *Escobar* recognized that the implied false certification theory of liability is valid in certain circumstances. 136 S. Ct. 1989 (2016). The implied certification theory has been applied in circumstances where a defendant submits a claim that is not on its face inaccurate but is legally false—e.g., when a contractor fails to satisfy a legal requirement underlying a claim for payment. At the time of the Court's ruling in *Escobar*, eight of the 13 U.S. courts of appeals had accepted the implied certification theory in some form and had articulated varying tests for its application.

In *Escobar*, the Court held that contractors can face FCA liability in connection with a claim for payment by the Government if the contractor makes "specific representations about the goods or services provided" and fails to disclose the contractor's noncompliance with material requirements, making the representations "misleading half-truths." The Court explained that a requirement is material if the contractor knows or has reason to know that the violations would be material to the Government's decision to pay a claim. The Court declined to articulate a bright-line rule for materiality and instead laid out several specific factors that might contribute to determining materiality, including evidence that the defendant knows that the Government consistently refuses to pay claims based on noncompliance with the particular statutory, regulatory or contractual requirement. Conversely, evidence that the Government regularly pays a particular type of claim in full, despite actual knowledge that certain requirements were violated, is strong evidence that the requirements are not material.

The materiality standard articulated by the Court is amorphous enough that both the defense and relators bars hailed the decision as a win for their respective camps when the decision was announced. Indeed, the early application of the materiality standard in the lower courts has only underscored the fact that the Court's test leaves significant room for interpretation. When deciding *Escobar*, the Supreme Court vacated decisions from the First, Fourth, Seventh and Eighth circuits and remanded them for further consideration in light of the Court's ruling. Since then, three of the four circuits have revisited their decisions and concluded that their original holdings were still correct even under the new materiality standard. *U.S. ex rel. Escobar v. Universal Health Servs., Inc.*, 842 F.3d 103 (1st Cir. 2016); *U.S. ex rel. Miller v. Weston Educ., Inc.*, 840 F.3d 494 (8th Cir. 2016); 58 GC ¶ 389; *U.S. ex rel. Nelson v. Sanford-Brown*, 840 F.3d 445 (7th Cir. 2016); 58 GC ¶ 388. In the coming year, what is clear is this: the theory of implied certification lives on, and the Court's discussion of materiality will be the cause of significant litigation across all types of FCA cases, not just ones positing implied certification as a basis for liability. Ultimately, that may take things all the way back up to the Supreme Court.

2. State Farm and Cas. Co. v. U.S. ex rel. Rigsby*: Seal Violation Not Grounds for Automatic Dismissal*: In its second FCA opinion this past year, the Supreme Court in *State Farm Cas. Co. v. U.S. ex rel. Rigsby*, 137 S. Ct. 436 (2016); 58 GC ¶ 439, tackled the question of the proper sanction, if any, for a violation of the FCA's seal requirement. The relators, two sisters who previously worked as claims adjustors for the defendant insurance company, alleged that State Farm had fraudulently classified losses as flood damage rather than wind damage so that the claims would be covered by the federal flood insurance program. Section 3739(b)(2) of title 31, U.S. Code requires that a copy of the relators' complaint and written disclosure of material facts be served on the Government and remain under seal for at least 60 days. Relators' counsel violated the seal requirement by disclosing the sealed filing to a member of Congress and several national news organizations in an effort to generate negative media coverage and pressure State Farm into a settlement.

In the *Rigsby* decision, the Supreme Court rejected the defendant's argument that a violation of the seal requirement mandated dismissal, holding instead that the appropriate sanction should be left to the discretion of the district court. The Court reasoned that the statute does not specify the remedy for a seal violation, although it does explicitly mandate dismissal in other situations. Additionally, a rule mandating dismissal could harm the Government's interests, which the seal requirement was designed to protect. The Court noted that while dismissal was not mandatory for every seal violation, it did not rule it out altogether, and so defendants will likely continue to call for dismissal in cases of egregious seal violations. But the overall takeaway is that violations of the seal are not an "easy out" for defendants in FCA cases.

3. U.S. ex rel. Donegan v. Anesthesia Assocs.*: Eighth Circuit Holds that a Reasonable Interpretation of an Ambiguous Regulation Negates a Finding of Scienter*: Defendants have often argued that the FCA's scienter requirement cannot be met where a false claim is based on a reasonable interpretation of an ambiguous regulatory or contractual requirement. Such arguments have proven successful under the right circumstances, such as in last year's decision by the D.C. Circuit in *U.S. ex rel. Purcell v. MWI Corp.*, 807 F.3d 281, 290 (D.C. Cir. 2015), *reh'g denied, cert. denied*, 2017 WL 69203 (Jan. 9, 2017); 57 GC ¶ 393, a case concerning the payment of "regular" commissions which relied heavily on the Supreme Court's opinion in *Safeco Ins. Co. of Am. v. Burr*, 551 U.S. 47 (2007), concerning proof of recklessness in the context of an ambiguous regulation where the agency failed to issue any authoritative guidance concerning its chosen interpretation of the relevant provision. This past year, the Eighth Circuit ruled similarly in a different context. In *U.S. ex rel. Donegan v. Anesthesia Assocs. of Kansas City, P.C.*, 833 F.3d 874 (8th Cir. 2016), the court affirmed summary judgment where the relator alleged that physicians from Anesthesia Associates of Kansas City (AAKC) submitted claims for anesthesia services that were inadequately supervised. Under Centers for Medicare and Medicaid Services regulations, to qualify for a certain level of reimbursement known as "medical direction," an anesthesiologist must be present for certain stages of each procedure, including a period of "emergence" during which a patient wakes up after being anesthetized. According to AAKC's interpretation, "emergence" included time in both the operating room and the recovery room.

The Eighth Circuit considered whether the relator had submitted sufficient evidence that AAKC's alleged practice of billing at the medical direction rate—when the anesthesiologist did not participate in emergence in the operating room—constituted the knowing submission of a false or fraudulent claim or statement. The Eighth Circuit held that the material term, "emergence," was ambiguous and noted that CMS had not issued any formal guidance on its meaning. The court next concluded that AAKC's interpretation of "emergence" was objectively reasonable because medical experts for both parties agreed that "emergence" is a medical term that refers to the post-surgery recovery process that can extend into the recovery room. Citing *Purcell* and *Safeco*, the court held that AAKC's reasonable interpretation of the ambiguous regulation belied a finding of scienter.

In so doing, the Eighth Circuit adds an important decision to a growing body of case law standing for the proposition that defendants should not be held liable for fraud when they reasonably interpret an ambiguous regulation and the agency has failed to take sufficient action to warn the defendant away from their otherwise reasonable interpretation. Along with *Purcell*, the *Donegan* decision creates a more level playing field in the FCA world, one in which defendants face treble damages and statutory penalties, among other ramifications, for failure to comply with regulations that the agency has failed or in some instances chosen not to clarify.

4. U.S. ex rel. Simoneaux v. E.I. DuPont *and* U.S. ex rel. Customs Fraud Investigations, LLC v. Victaulic Co.*: Courts Construe Definition of "Obligation" in Re-*

verse FCA Actions: Two 2016 appellate court decisions interpreted the term “obligation” in cases brought under the “reverse FCA” provision of the statute. See *U.S. ex rel. Simoneaux v. E.I. DuPont de Nemours & Co.*, 2016 WL 7228813 (5th Cir. Dec.13, 2016); *U.S. ex rel. Customs Fraud Investigations, LLC v. Victaulic Co.*, 839 F.3d 242 (3d Cir. 2016). The reverse FCA imposes liability on a defendant who knowingly makes, uses, or causes to be made or used, a false record or statement material to an obligation to pay or transmit money or property to the Government, which may include the knowing retention of an overpayment. The 2009 Fraud Enforcement and Recovery Act (FERA) amendments to the FCA defined “obligation,” in pertinent part, as “an established duty, whether or not fixed.” 31 USCA § 3729(b)(3). Previously, few courts had grappled with this statutory definition.

In *Customs Fraud Investigations*, the Third Circuit held that a failure to mark country of origin could be actionable under a reverse FCA theory of liability if a company knowingly imported unmarked products in an effort to evade custom duties that are due the Government. The court found that defendant Victaulic had an established obligation to pay “marking duties” because under the relevant tariff law, the marking duty was not “voidable for any cause” and was “deemed to have accrued at the time of importation.” 19 USCA § 1304(i). In contrast, in *Simoneaux*, the Fifth Circuit found that the relator had failed to state a reverse FCA claim that DuPont knowingly failed to report chemical leaks to the Environmental Protection Agency in order to avoid paying penalties under the Toxic Substances Control Act (TSCA). The court found that the EPA had discretion to determine whether a penalty should be assessed under the TSCA, and therefore the duty to pay regulatory penalties was contingent and could not be an “established” obligation until the penalties were assessed by the agency.

Although the Third and Fifth circuits reached different outcomes, their decisions offer insight into the potential reach of the reverse FCA as amended by FERA. Under the reasoning in these cases, defendants could face exposure under the reverse FCA theory of liability in cases where there is an “obligation” in light of an established and unavoidable duty. In contrast, defendants may be able to avoid FCA liability in circumstances where there is a potential penalty or fee that is contingent on further Government action.

5. U.S. ex rel. Wall v. Circle C Constr.*: “Tainted Claim” Theory of Damages Rejected*: In *U.S. ex rel. Wall v. Circle C Constr., LLC*, 813 F.3d 616 (6th Cir. 2016), the Sixth Circuit rejected the Government’s damages calculation in an FCA case based on violations of the Davis-Bacon Act (DBA). The case arose from a contract for the construction of Army warehouses. The contract required Circle C and its subcontractors to pay their employees above-market wages in accordance with the DBA and to submit compliance statements that they were paying the required wages. One of the subcontractors underpaid its electricians by $9,916, making several of Circle C’s compliance statements false.

In the ensuing FCA suit, the Government argued that Circle C fraudulently induced it into paying for the full value of the services because the Government would not have paid anything had it known about the fraud. The trial court agreed and found that the underpayment had tainted all of the work under the contract, and the Government was entitled to treble damages on the full value of *all* services rendered, or $777,894, as opposed to just those services that went underpaid. *U.S. ex rel. Wall v. Circle C Constr.*, 43 F. Supp. 3d 853, 873 (M.D. Tenn. 2014).

On appeal, the Sixth Circuit rejected the Government’s “fairyland” damages calculation and vacated the damages award. The court reasoned that the appropriate measure of damages was the market value of the harm—i.e., the difference between what the Government bargained for and what it actually received. Here, the Government received the electrical work but not all of the DBA-compliant wages for which it had bargained. The Sixth Circuit remanded with instructions that the lower court award actual damages in line with the market value ($9,916) of the Government’s injury.

The *Wall* decision is a welcome antidote to the trend in recent years of plaintiffs taking the position that damages should be based on the entire contract value because the claim was somehow tainted by an underlying legal violation. But, as the concurrence to the majority opinion notes, the market value of the harm is not always easily quantifiable. It becomes far more difficult to apply the market value theory of damages in cases where the Government has been denied an intangible societal goal such as buying U.S. goods or increasing small business participation. Thus, defendants seeking to take advantage of this decision in other contexts may be challenged to demonstrate that the alleged harm is quantifiable.

6. U.S. ex rel. Beauchamp v. Academi, Cause of Action v. Chi. Transit Auth.*, and* U.S. ex rel. May v. Purdue Pharma: *Further Definition of the Contours of the Public Disclosure Bar*: The public disclosure bar was amended in 2010 by the Affordable Care Act (ACA), which sought to make it easier for relators to avoid the operation of the bar. Post-amendment, the provision provides that courts shall dismiss an action under the bar if substantially the same allegations were publicly disclosed in (i) a Federal proceeding in which the Government or its agent is a party; (ii) a congressional, Government Accountability Office, or other Federal report, hearing, audit, or investigation; or (iii) the news media, unless the person bringing the action is an "original source" of information. 31 USCA § 3730(e)(4). In 2016, almost half of the circuits issued decisions involving the public disclosure bar. Below we discuss a few of these prominent decisions.

In *U.S. ex rel. Beauchamp v. Academi Training Ctr.*, 816 F.3d 37 (4th Cir. 2016); 58 GC ¶ 81, the Fourth Circuit held that the determination as to whether the public disclosure bar applies should be made on the basis of the qualifying public disclosures that exist at the time when the relator first sufficiently pleads the theory that is potentially barred, not at the time of a subsequent amended complaint. Here, in the original complaint, relators alleged that Academi submitted false reports to the State Department for contractors employed in positions in which they did not actually work and defrauded the State Department by requesting payment for unissued equipment. In its first amended complaint, the relators further alleged that Academi fraudulently billed the State Department for security services performed by contractors who did not achieve requisite marksmanship scores to use certain weapons during contract performance.

While the relators' first amended complaint was pending, two former Academi firearm instructors filed a separate—and public—lawsuit against Academi, alleging they were wrongfully terminated from Academi for reporting the weapons qualification scheme up the chain of command. An online news publication ran a story about the case brought by the Academi firearm instructors, and the relators then filed a second amended complaint that incorporated additional information about the weapons qualification scheme from the firearm instructors' complaint. The district court concluded that the second amended complaint was the proper pleading to use to evaluate the applicability of the public disclosure bar and granted Academi's motion to dismiss, finding that the online news story qualified as a prior public disclosure. The Fourth Circuit reversed, holding that the public disclosure bar was inapplicable because the allegations about the weapons qualification scheme had been alleged with sufficient particularity in the relators' first amended complaint, which predated the article.

In *Cause of Action v. Chi. Transit Auth.*, 815 F.3d 267 (7th Cir. 2016), the Seventh Circuit considered whether a publicly disclosed letter and audit report triggered the public disclosure bar in a suit brought by a Government watchdog organization against the Chicago Transit Authority (CTA). The watchdog organization alleged that the CTA had been reporting fraudulent transit data to the Federal Transit Administration (FTA) in order to secure inflated federal grant allocations. The district court dismissed the action, holding that it lacked subject matter jurisdiction over the FCA claims because the allegations of wrongdoing had been disclosed in a final performance audit report released by the Illinois Attorney General and a letter sent from the FTA to CTA. On appeal, the Seventh Circuit affirmed, finding that allegations in the complaint were substantially similar to those contained in the public materials. In contrast, in *U.S. ex rel. Mateski v. Raytheon Co*., 816 F.3d 565, 567 (9th Cir. 2016), the Ninth Circuit reversed the district court's dismissal based on the FCA's public disclosure bar and found that the relator's claims were not substantially similar to previous, publicly disclosed reports when "viewed at the appropriate level of generality" where the fraud alleged was different in kind and degree from the previously disclosed information.

In *U.S. ex rel. May v. Purdue Pharma L.P.*, 811 F.3d 636 (4th Cir. 2016); 58 GC ¶ 56, the Fourth Circuit held that relators could not proceed with a case based on information obtained by their attorney in a prior litigation. The original relator filed a qui tam action in 2006 against Purdue, but the Fourth Circuit dismissed the claim based on a release he had executed upon accepting a severance package. The relator's wife then retained the same counsel and filed a qui tam action against Purdue with "nearly identical" allegations. Applying the pre-2010 public disclosure bar, the district court dismissed the complaint, holding that the bar stripped the court of subject matter jurisdiction because the allegations were based on the claims from the original relator's suit. On appeal, the Fourth Circuit held that the claims were precluded by the public disclosure bar because the relators' claims were based on facts their counsel learned in the course of making the prior public disclosure of Purdue's allegedly fraudulent scheme.

In sum, 2016 saw much activity involving the public disclosure bar that will impact the ability of contractors to derail qui tam actions on procedural grounds. Such issues may be even more front-and-center in 2017 if Congress were to repeal the entire ACA, which includes amendments to the FCA's public disclosure bar and other sections. Moreover, a case from the Sixth Circuit, *U.S. ex rel. Advocates for Basic Legal Equality, Inc. v. U.S. Bank, N.A.*, could be heard by the Supreme Court, where a petition for certiorari is currently pending (No. 16-130). The petition asks whether a public disclosure of a general—rather than specific—category of alleged misconduct bars a qui tam action about a narrower subtype of that misconduct.

7. U.S. ex rel. Prather v. Brookdale Senior Living Cmty., Inc.*: Sixth Circuit Applies Relaxed Pleading Standard to Qui Tam Suit*: In 2016, the Sixth Circuit recognized, for the first time, an exception to Fed. R. Civ. P. 9(b)'s heightened pleading standard and held that a relator, under the exception's "relaxed standard," adequately pled "presentment" despite the relator's failure to identify the submission of a specific request for payment.

In *U.S. ex rel. Prather v. Brookdale Senior Living Cmty., Inc.*, 838 F.3d 750 (6th Cir. 2016); 58 GC ¶ 372, the relator, a utilization review nurse, alleged that her former employer, Brookdale Senior Living Inc., and other providers of home health services affiliated with her employer (collectively, "Brookdale"), submitted false Medicare claims to the Government. Brookdale hired the relator to help it deal with a "looming financial crisis" presented by a backlog of thousands of Medicare claims and assigned her to work on a "Held Claims Project." The relator subsequently filed a qui tam action against Brookdale, alleging Brookdale failed to comply with the physician-certification and face-to-face documentation requirements necessary for reimbursement for home health services.

Analyzing the relator's complaint, the Sixth Circuit conceded that the relator failed to identify the "actual *submission* of a *specific* request for anticipated payment to the government." As such, the Court acknowledged that the relator failed to meet the heightened pleading standard required by Fed. R. Civ. P. 9(b). The Court did not end its inquiry there, however, as in a split decision it recognized an exception to 9(b)'s stringent requirements because the facts the relator pled supported a "strong inference that a claim was submitted." The relator's "detailed overview of the alleged fraudulent scheme[,]" when combined with the context surrounding the relator's allegations (notably, that Brookdale hired the relator to work through a backlog of Medicare claims, that the relator's responsibilities "focused on reviewing the documentation for [the backlog of] Medicare claims, *in anticipation of them being submitted to Medicare*[,]" and that the relator "received confirmation that the final claims that she reviewed were submitted for payment"), precluded the Sixth Circuit from "deny[ing] the strong inference that the specific documentation that [the relator] reviewed related to patients for whom requests for anticipated payment had been submitted to the Government for payment."

This decision is a warning to contractors facing FCA litigation in the Sixth Circuit, and perhaps in other jurisdictions, for the possibility of exceptions to Rule 9(b)'s heightened pleading standard where the relator pleads specific facts based on personal, billing-related knowledge to support a strong inference that specific false claims were submitted for payment.

The Road Ahead—Starting January 20th, new leadership will take over the front office at DOJ, but FCA enforcement is likely to remain robust going forward. The new administration may choose to focus on certain industries when deciding whether to intervene in cases under seal. For example, the administration's focus on trade could lead to an increase in customs duty cases like the *Customs Fraud Investigations* case described above. Regardless of the incoming administration's enforcement priorities, qui tam activity shows no sign of slowing down. Since 2011, relators have filed more than 600 qui tam suits per year, and that number is expected to remain relatively stable if not increase.

In 2017, contractors will also want to keep an eye on the docket of the Supreme Court, where the justices have heard an FCA-related case for three consecutive terms. While the Court on January 9 denied certiorari in several FCA actions, more petitions are set to be filed, and there is a pending petition for certiorari in which the Court has issued a Call for the

Views of the Solicitor General (CVSG). See *U.S. ex rel. ABLE v. U.S. Bank, N.A*, 16-130. Although far from a guarantee that the Supreme Court will grant review, a CVSG is at the very least an indication that the Supreme Court is taking the petition seriously, suggesting that there could very well be at least one FCA case before the Court for a fourth consecutive term.

Between the increase in penalties, massive recoveries and landmark decisions like *Escobar*, the 30th anniversary of the 1986 amendments was a major year for the FCA. By all accounts, 2017 is poised to be a significant one as well.

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