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Client Alert

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Recent Developments in the False Claims Act / *Qui Tam* Field

Converging Events Signal a Changed Investigation and Litigation Landscape

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A number of events in the last year have converged to create a much more aggressive investigation and litigation landscape for companies receiving government contracts or other funding from federal and state agencies. In addition to recent legislation making it easier to bring lawsuits against those companies, they are also facing increasing scrutiny from government oversight bodies and a growing whistleblowers' bar. This is particularly true in the areas of the provision of healthcare products and services, defense and homeland security contracts, the exploration and development of energy and other natural resources, and the financial services industries. Key to this trend are:

I. Recently enacted amendments to the federal False Claims Act (FCA), 31 U.S.C. 3729 *et seq*., that expand the reach of the FCA and make recovery easier for FCA plaintiffs, which may be supplemented by further proposed legislative changes currently pending before Congress;

II. Dramatic increases in government funds flowing to corporate organizations via both the American Recovery and Reinvestment Act of 2009 (the economic stimulus package) and the Emergency Economic Stabilization Act of 2008 (the financial services industry "bailout");

III. A major increase in the emphasis by both the Executive Branch and Congress on government oversight and enforcement relating to fraud and abuse in government funded contracts and programs; and,

IV. Recently enacted legislative protections for government and private sector whistleblowers.

I. Amendments to the False Claims Act

Recently Enacted Changes

On May 20, 2009, President Obama signed into law S. 386, the Fraud Enforcement and Recovery Act of 2009, Pub. L. No. 111-21, 123 Stat. 1617 (FERA). FERA is designed to strengthen the FCA, a statute that empowers the federal government — as well as individual whistleblower plaintiffs called *qui tam* relators — to bring civil actions in response to "false or fraudulent claims" for payment made to government agencies and programs.[1] The FCA is an important fraud and abuse enforcement tool for the federal government; in FY 2008 alone, the government recovered more than $1.3 billion from FCA actions.[2] However, FERA's sponsors argued that certain recent judicial interpretations of the FCA were inconsistent with the congressional intent underlying previous amendments to the statute, thereby eroding its effectiveness. For instance, Senator Charles Grassley (R-Iowa) argued that these decisions improperly "limited the applicability and the reach of the [FCA], cutting off many worthy cases from ever going forward."[3] The goal of FERA was to undo — in part — this impact by enacting a number of amendments, including the following four important changes:

1. Clarifying that the FCA Covers Claims to Government Contractors and Grantees. As outlined in the Senate Judiciary Committee's Report accompanying S. 386, FERA aims to overturn the Supreme Court's interpretations of the FCA in *Allison Engine Co., Inc. v. United States ex rel. Sanders*, 128 S. Ct. 2123, 2128-31 (2008), that the FCA did not establish liability for certain false or fraudulent claims made to government contractors and grantees, as opposed to claims made directly to the government.[4] FERA seeks to establish clear liability for false or fraudulent claims submitted to government contractors and grantees, "*if the money or property is to be spent or used on the Government's behalf or to advance a Government program or interest.*"[5] In making these changes, Congress also sought to overturn the D.C. Circuit Court's ruling in *United States ex rel. Totten v. Bombardier Corporation*, 380 F.3d 488, 490, 492 (D.C. Cir. 2004), that 31 U.S.C. § 3729(a)(1) requires presentment of a false claim directly to the federal government, as opposed to a government grantee such as Amtrak in that case or, in a different context, state Medicaid programs. In order to effectuate these changes, FERA revises the substantive liability provisions of 31 U.S.C. §§ 3729(a)(1)-(3) as follows:

> (~~1~~**A**) knowingly presents, or causes to be presented, ~~to an officer or employee of the United States Government or a member of the Armed Forces of the United States~~ a false or fraudulent claim for payment or approval;
>
> (~~2~~**B**) knowingly makes, uses, or causes to be made or used, a false record or statement **material** to ~~get~~ a false or fraudulent claim ~~paid or approved by the Government~~;

> (~~3~~**C**) conspires to **commit a violation of subparagraph (A), (B), (D), (E), (F), or (G)** ~~defraud the Government by getting a false or fraudulent claim allowed or paid~~;[6]

While the exact scope of these changes will depend on the outcome of future litigation, it appears clear that they will greatly expand the reach of the FCA into areas once thought outside its purview.

2. Expanding the Definition of "Claim." The statute also expands the definition of a "claim" to reverse *United States ex rel. DRC, Inc. v. Custer Battles*, *LLC*, 376 F. Supp. 2d 617 (E.D. Va. 2005).[7] In that case, the district court held that a defense contractor who had defrauded the government in connection with work in Iraq fell outside of the FCA's ambit because the money lost was Iraqi money under the U.S. government's control.[8] The amendments would allow FCA suits on claims made to the federal government for money or property to which the U.S. does not have title but is under the control of the U.S. government, again, expanding the reach of the FCA into largely new territory.

3. Expanding Reverse False Claim Liability to Include Retention of Overpayments. FERA broadens § 3729(a)(7) to cover not only the use of false records to decrease an obligation to pay the government, but also direct actions to decrease an obligation in which no false record is used.[9] This change is intended to include knowing concealment of an obligation to pay the government even if no false record or statement is made.[10] Additionally, FERA adds a definition of "obligation" that appears to broaden the understanding of that term as interpreted by the courts. FERA's definition includes, among other things, duties arising from contractual, grantor-grantee, or licensor-licensee relationships and *from the retention of overpayments*.[11] The Senate Judiciary Committee explained that the "retention of an overpayment" language "will be useful to prevent Government contractors and others who receive money from the Government incrementally based upon cost estimates from retaining any Government money that is overpaid during the estimate process."[12] Accordingly, to the extent not otherwise already occurring, companies will need to begin actively analyzing what if any "overpayment" retention issues they may have and corresponding self disclosure and repayment obligations.

4. Specifying a Lower Applicable Materiality Requirement. FERA's revised language adds an explicit materiality requirement to §§ 3729(a)(2) and (a)(7), which is defined as "having a natural tendency to influence, or be capable of influencing, the receipt of money or property."[13] This codifies a broader materiality standard that asks whether the claim "could have influenced" the payment decision, as opposed to a more narrow "outcome materiality" test that asks whether the government *actually* relied on the information.

Pending Legislation

Additional bills that would implement more expansive changes to the FCA, such as the False Claims Act Clarification Act (S. 458) and the False Claims Act Correction Act of 2009 (H.R. 1788), remain in various stages of the legislative process. These bills, and earlier versions of S. 386, have proposed a number of

other revisions to the FCA. Significant proposed changes include provisions to: (1) exempt *qui tam* relators from the requirement to plead fraud with specificity under Rule 9(b); (2) abolish defendants' ability to rely on the public disclosure bar to dismiss a *qui tam* action in response to *Rockwell International Corp. v. United States*, 549 U.S. 457 (2007), which limited recovery for a relator from the claims settled because he was not an "original source" of the allegations that led to the settlement; (3) expand the statute of limitations for all claims, including retaliation, to either eight or ten years; and, (4) resolve a current circuit split in favor of allowing government employees to bring *qui tam* cases as relators in certain circumstances after exhausting administrative procedures.

II. Dramatically Increased Federal Spending

Throughout 2008 and 2009, the Executive Branch and Congress have taken a number of steps to address the financial crises threatening the U.S. economy. These efforts have included two major legislative actions that dramatically increased the amount of federal funds flowing to entities transacting business with the government. First, the Emergency Economic Stabilization Act of 2008 (the financial services industry "bailout"),[14] signed into law on October 3, 2008, authorized the Secretary of the Treasury to use up to $700 billion in taxpayer funds to purchase troubled assets from financial institutions. Henry Paulson, Secretary of Treasury under President Bush, made available $350 billion of this capital to U.S. financial institutions and other entities, and on January 16, 2009, the Senate voted to release the remaining $350 billion in authorized "bailout" funds. Second, on February 17, 2009 President Obama signed into law a $787 billion economic stimulus package.[15] This measure, the American Recovery and Reinvestment Act of 2009, included over $460 billion in federal spending for healthcare, education, transportation and infrastructure, and energy. While such massive federal spending presents significant business opportunities for companies involved in these areas, receipt of these funds likely will result in increased governmental oversight and an enhanced potential for scrutiny under the FCA.

III. Increased Government Oversight and Enforcement

Within the last few years, there also has been a major increase in the emphasis placed on government oversight and enforcement of fraud and abuse allegations tied to government funded contracts and programs. This increase has stemmed from concerns — raised by the public, Congress, and the Executive Branch — regarding allegations of serious fraud and abuse in numerous federally funded programs. These include the government "bailout" and "stimulus" programs discussed above, government funding for healthcare programs such as Medicare and Medicaid, and the use of government funds connected with the wars in Iraq and Afghanistan. Accordingly, efforts to significantly increase scrutiny of federally funded contracts and programs and the companies involved with them are now officially underway on several fronts, including the following five areas:

1. Expanded Healthcare Fraud Enforcement Activities. According to White House budget documents, President Obama's proposed fiscal year 2010 budget includes proposals to increase program integrity activities at the Department of Health and Human Services (HHS) to reduce healthcare fraud, waste, and

abuse. Along the same lines, HHS and the Department of Justice (DOJ) recently announced the creation of a new interagency effort - the "Health Care Fraud Prevention and Enforcement Action Team" or "HEAT" - to help prevent and identify fraud and abuse in government healthcare programs.[16] The DOJ and HHS also announced the expansion of Medicare strike forces that have been in operation in south Florida and Los Angeles to include operation in Detroit and Houston. These announcements come as the healthcare industry prepares for a significant increase in audit and investigative activity carried out by an evolving universe of government contractors including Recovery Audit Contractors (RACs), Program Safeguard Contractors (PSCs), Zone Program Integrity Contractors (ZPICs), Medicaid Integrity Contractors (MICs) and Medicare Drug Integrity Contractors (MEDICs). While the responsibilities and jurisdiction of each contractor differ, collectively such activities are designed to identify abusive or problematic activity, recover overpayments, and spark additional scrutiny by appropriate law enforcement agencies as the contractors deem appropriate.

2. Aggressive Oversight of "Bailout" and Stimulus Package Funding. On November 17, 2008, Senator Grassley wrote a letter to the Departments of Treasury and Justice emphasizing the role of whistleblower litigation in prosecuting fraud by recipients of federal "bailout" monies. Arguing that the FCA and its *qui tam* whistleblower provisions "can and will play an important role in preventing, deterring, and prosecuting fraud against the ["bailout" programs]," Senator Grassley urged the Departments of Treasury and Justice to "ensure that whistleblowers are treated seriously, their concerns are reviewed in an expeditious manner, and that any legitimate claims of fraud, waste, or abuse are aggressively investigated and prosecuted to the fullest extent of the law, including seeking recovery of all funds lost via the FCA." While Senator Grassley and others can be expected to maintain congressional oversight of the private sector entities who receive federal funds under the "bailout," corresponding oversight is being provided by the Office of the Special Inspector General for the Troubled Asset Relief Program which was established under the Emergency Economic Stabilization Act.[17] That office, whose responsibility includes conducting, supervising, and coordinating audits and investigations of the use of funds under the "bailout" programs, has made clear its intent to establish "transparency" in the use of "bailout" funds and ensure compliance with all applicable legal and contractual requirements.[18]

As with the Emergency Economic Stabilization Act, congressional leaders have also made clear that they intend to provide rigorous oversight of the use of stimulus funds from the American Recovery and Reinvestment Act. In discussing the need for such oversight, the Chairman of the House Oversight and Government Reform Committee, Representative Edolphus Towns (D-NY), noted that while the stimulus package provides an important "opportunity to heal our ailing economy" it also creates "the monumental challenge of ensuring that American taxpayers' dollars are used wisely and not squandered."[19] Consistent with this, significant oversight structures have been put into place with regard to the funds authorized in the Act. First, the Act establishes and provides $84 million in funding to the Recovery Accountability and Transparency Board to coordinate and oversee the use of covered funds in order to "prevent fraud, waste, and abuse."[20] This Board will carry out its mandate by performing numerous functions, including auditing or reviewing the use of covered funds to determine whether wasteful spending, poor contract or grant management, or other abuses are occurring.[21] The Act also provides more than $416 million in funding for Offices of Inspectors General in various agencies in order to provide oversight of programs, grants and

activities funded by the Act; these agencies include the Department of Defense, the Department of Education, the Department of Energy, the General Services Administration, the Department of Health and Human Services, the Department of Homeland Security, and the National Aeronautics and Space Administration.[22] Finally, FERA also addresses fraud and misuse of government funds related to "Federal assistance and relief" programs,[23] which would include funds appropriated through either the Emergency Economic Stabilization Act and the American Recovery and Reinvestment Act. Among other things, FERA expands federal criminal liability for major fraud against the U.S. by specifically prohibiting fraudulent activities involving "bailout" funds.[24] FERA also provides for significantly increased funding for federal antifraud enforcement. FERA authorizes the appropriation of $165 million for each of the fiscal years 2010 and 2011 to the Attorney General for "investigations and prosecutions and civil and administrative proceedings involving Federal assistance programs and financial institutions" which is to be allocated to the FBI ($75 million for 2010, and $65 million for 2011); the offices of the U.S. Attorneys ($50 million for each year); and the civil, criminal, and tax divisions of the DOJ ($40 million for each year).[25] FERA also authorizes the appropriation of funds to the Postal Inspection Service ($30 million for each year); the Inspector General for HUD ($30 million for each year); the Department of Homeland Security ($20 million for each year); and the SEC ($20 million for each year).[26]

3. Establishment of a Commission on Wartime Contracting. In January 2008 with the passage of the National Defense Authorization Act, Congress created an independent, bipartisan "Commission on Wartime Contracting" to study federal contracting in Iraq and Afghanistan.[27] The Commission held its first public hearings in February and May 2009. Congress has given the Commission very broad authority and duties to study and assess all federal contracts relating to reconstruction, coalition forces logistical support, and security operations in Iraq and Afghanistan. Any number of government contractors in Iraq and Afghanistan may come under close scrutiny as the Commission reviews allegations pertaining to contract performance, waste, fraud, abuse, and mismanagement in wartime contracting.

In order to carry out this review, Congress equipped the Commission with broad powers and authority to secure needed information from both government agencies and private parties. The Commission has the power to seek documents and information, secure testimony under oath, hold hearings akin to congressional investigative hearings, and issue reports on findings of fact and recommendations. The Commission also may refer targeted companies to the Justice Department for potential violations of the laws of war, federal law, or other applicable legal standards. Accordingly, companies contracting with the federal government to perform security and other functions in Iraq and Afghanistan should prepare for the possibility of investigations, high-profile public hearings, extensive press coverage, and potential criminal and/or civil referrals.

4. Establishment of an Ad Hoc Subcommittee on Contracting Oversight. On January 29, 2009, Senator Joseph Lieberman (ID-CT), Chairman of the Senate Committee on Homeland Security and Governmental Affairs, announced that he was creating an Ad Hoc Subcommittee on Contracting Oversight.[28] In contrast to the Commission on Wartime Contracting's focus on Iraq and Afghanistan related contracts, the new Subcommittee will have jurisdiction over all types of federal contracting. Former prosecutor and state

auditor Senator Claire McCaskill (D-MO), a vocal advocate of more aggressive contracting oversight, will chair the Subcommittee. Upon announcing the formation of the Subcommittee, Chairman Lieberman noted that the annual spending on federal contracts has now reached $532 billion, with the Government Accountability Office designating government contracting as being "at high risk of waste, fraud, abuse, mismanagement, or in need of comprehensive reform."[29] He predicted that the new Subcommittee will use its investigative authority to "improve the value of taxpayer dollars devoted to federal contracting." Echoing those expectations, Subcommittee Chair McCaskill added, ". . . [O]utrageous contracting abuses occur in every facet of government. I can't wait to get to work saving huge money for taxpayers. They deserve it."[30]

5. New Federal Contracting Guidelines. On March 4, 2009, President Obama ordered a review of government contracting practices that he declared was "too often" "plagued by massive cost overruns and outright fraud."[31] Citing the dramatic increase in spending on government contracts since 2000, he directed his administration to create new guidelines to combat waste, abuse, poor performance, and inadequate accountability in federal contracting. President Obama stated that he wants the new guidelines to be in place by September 30, 2009, the end of the federal fiscal year.[32] According to the White House website, one of the goals of President Obama's administration is to "[r]eform federal contracting and acquisition" to "make sure that taxpayers get the best deal possible for Government expenditures."[33] This goal follows on Obama's stated agenda as President Elect, when he both promised to "make government spending more accountable and efficient" and to "restore honesty, openness, and commonsense to [military] contracting."[34]

IV. Enhanced Whistleblower Protections

Finally, enhanced whistleblower protections for government and private sector employees has become a key element in the push for greater oversight of federally funded programs. As Representative Towns has stated, "[W]histleblower protection is a critical component of government accountability. At a time when America needs the best value for every dollar spent, we need those protections now more than ever — and particularly now that billions of stimulus dollars, and bills more aimed at stabilizing the financial system, are at stake."[35] Such an understanding led to the inclusion of new whistleblower protection provisions in the 2009 stimulus bill. Specifically, the American Recovery and Reinvestment Act of 2009 contains whistleblower provisions designed to protect certain employees who report waste, fraud, and abuse of stimulus funds. The provisions cover private employers, state and local governments, and federal, state, and local government contractors and subcontractors.[36] (Provisions designed to protect federal employees were removed from the bill by the Senate prior to passage.[37]) The whistleblower protection provisions prohibit nonfederal employers who receive stimulus funds under the Act from firing, demoting, or otherwise discriminating against an employee who discloses information the employee "reasonably believes is evidence of — (1) gross mismanagement of an agency contract or grant relating to covered funds; (2) a gross waste of covered funds; (3) a substantial and specific danger to public health or safety related to the implementation or use of covered funds; (4) an abuse of authority related to the implementation or use of covered funds; or (5) a violation of law, rule, or regulations related to an agency contract (including the competition for or negotiation of a contract) or grant, awarded or issued related to covered funds."[38]

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This alert provides a general summary of recent legal developments. It is not intended to be and should not be relied upon as legal advice.

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[1] 31 U.S.C. § 3729 *et seq*. Whistleblowers who sue under the FCA can share in as much as 30% of the government's recovery of treble damages plus penalties, making *qui tam* actions highly attractive to whistleblowers and an increasingly active plaintiff's bar.
[2] Press Release, Department of Justice, More than $1 Billion Recovered by the Justice Department in Fraud and False Claims in Fiscal Year 2008 (Nov. 10, 2008), *available at* http://www.usdoj.gov/opa/pr/2008/November/08-civ-992.html.
[3] 155 CONG. REC. 32 (daily ed. Feb. 24, 2009) (statement of Sen. Grassley).
[4] *See* S. REP. NO. 111-10, at 10-12 (2009).
[5] *See* Fraud Enforcement and Recovery Act of 2009, Pub. L. No. 111-21, § 4(a)(2), 123 Stat. 1617, 1621 (emphasis added).
[6] *See id.* § 4(a)(1). The reference to "Subparagraph (A), (B), (D), (E), (F), or (G)" is to the recodified substantive liability provisions previously found at 31 U.S.C. §§ 3729(a)(1)-(7).
[7] In fact, on April 10, 2009, the Fourth Circuit reversed and remanded the holdings in the district court's decision in *Custer Battles* regarding the definition of a "claim." *See* 562 F.3d 295, 305 (4th Cir. 2009).
[8] 376 F. Supp. 2d at 646.
[9] Fraud Enforcement and Recovery Act § 4(a)(1).
[10] *See* S. REP. NO. 111-10, at 14.
[11] Fraud Enforcement and Recovery Act § 4(a)(2).
[12] S. REP. NO. 111-10, at 15.
[13] Fraud Enforcement and Recovery Act § 4(a)(2).
[14] Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, 122 Stat. 3765.
[15] American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115.
[16] Carrie Johnson, *Health-Care Fraud to Be Targeted, New Task Force Will Focus on Costly Waste and Abuse,* WASH. POST, May 21, 2009, at A04.
[17] Emergency Economic Stabilization Act § 120.
[18] *See* Letter from Neil Barofsky to the Honorable Charles Grassley, Ranking Member of the Senate Committee on Finance (Jan. 22, 2009), *available at* http://grassley.senate.gov/private/upload/Letter-from-Special-IG-Neil-M-Barofsky-to-Senator-Chuck-Grassley.pdf.
[19] Representative Edolphus Towns, Chairman's Opening Statement and Witness Testimony from Hearing on "Preventing Stimulus Waste and Fraud: Who are the Watchdogs?" (Mar. 19, 2009), *available at* http://oversight.house.gov/story.asp?ID=2348.
[20] American Recovery and Reinvestment Act §1521.
[21] *Id.* § 1523.
[22] *Id.* § 5, div. A, tits. I–XII; Tit. V, § 5007.
[23] Fraud Enforcement and Recovery Act, pmbl.
[24] *Id.* § 2(d) (amending 18 U.S.C. § 1031(a)).
[25] *Id.* § 3(a)-(f).
[26] *Id.*
[27] National Defense Authorization Act for Fiscal Year 2008, Pub. L. No. 110-181 § 841, 122 Stat. 3, 231-32.
[28] Press Release, Homeland Security and Governmental Affairs, Lieberman Announces New HSGAC Subcommittee, McCaskill to Get Contracting Gavel (Jan. 29, 2009), *available at* http://liberman.senate.gov/newsroom/release.cfm?id=307502.
[29] *Id.*
[30] *Id.*
[31] Ross Colvin, *Obama Takes Aim at Costly U.S. Defense Contracts,* REUTERS, Mar. 4, 2009.

[32] Memorandum for the Heads of Executive Departments and Agencies, 74 Fed. Reg. 9755 (Mar. 4, 2009); *see also* John M. Donnelly, *Obama Pursues Crackdown on Procurement Abuses*, CQ Today Online News, Mar. 4, 2009.
[33] The White House, Fiscal Responsibility, http://www.whitehouse.gov/issues/fiscal/.
[34] The Office of the President Elect, Agenda: Fiscal, http://change.gov/agenda/fiscal_agenda/; The Office of the President Elect, Agenda: Defense, http://change.gov/agenda/defense_agenda/.
[35] Press Release, Committee on Oversight and Government Reform, Chairman Towns Statement on The Whistleblower Protection Enhancement Act of 2009 (Mar. 12, 2009), *available at* http://oversight.house.gov/story.asp?ID-2340.
[36] American Recovery and Reinvestment Act § 1553.
[37] *See* H.R. Rep. No. 111-16, at 511 (2009) (Conf. Rep.). On March 12, Congressman Chris Van Hollen (D-MD) announced the introduction of the Whistleblower Protection Enhancement Act of 2009. This legislation, co-sponsored by Congressmen Ed Towns (D-NY), Todd Platts (R-PA), and Bruce Braley (D-IA), seeks to strengthen whistleblower protections for federal employees reporting fraud, waste, and abuse. *See* Press Release, Congressman Van Hollen, Van Hollen Announces Whistleblower Protection Enhancement Act of 2009 (Mar. 12, 2009), *available at* http://vanhollen.house.gov/HoR/MD08/Newsroom/Press+Release+by+Date/2009/3-12-09+Van+Hollen+Announces+Whistleblower+Protection+Enhancement+Act+of+2009.htm.
[38] American Recovery and Reinvestment Act § 1553.