THE GOVERNMENT CONTRACTOR®

THOMSON REUTERS

Information and Analysis on Legal Aspects of Procurement

Vol. 59, No. 23 **June 21, 2017**

Focus

¶ 183

FEATURE COMMENT: Government Knowledge As A Weapon To Combat FCA Actions

For the better part of 30 years, the Federal Government has used the False Claims Act, 31 USCA §§ 3729–3733, to combat fraud, waste and abuse by those doing business with the Government. Without question, the FCA has been the Department of Justice's weapon of choice in this fight.

Companies and persons who find themselves in the Government's cross-hairs must arm themselves with the very best defenses. This Feature Comment explores one of the most effective defenses in combating FCA actions—Government knowledge itself.

There are various statutory grounds on which a person may violate the FCA. The two most prominent grounds are set forth in 31 USCA §§ 3729(a)(1)(A)–(B). Under these sections, it is unlawful for a person knowingly to (1) present or cause to be presented to the Government a false or fraudulent claim for payment, or (2) make or use a false record or statement that is material to a claim for payment.

Before 1986, Government contractors could often escape liability in FCA qui tam suits by demonstrating Government knowledge of the facts underlying such suits. In 1986, however, Congress eliminated this jurisdictional bar. P.L. 99-562, § 3 (codified at 31 USCA § 3730(e)(4) (1986)); see *U.S. ex rel. Burlbaw v. Orenduff*, 548 F.3d 931, 953 n.20 (10th Cir. 1998).

Since the 1986 amendments to the FCA, courts consistently have held that Government knowledge is no longer a complete defense to the FCA. See *Shaw v. AAA Eng'g & Drafting, Inc.*, 213 F.3d 519, 534 (10th Cir. 2000); 42 GC ¶ 238. Notwithstanding the technical merits of that argument, contractors facing FCA allegations should not be deterred in their efforts to marshal evidence of Government knowledge to combat FCA liability. Targeted contractors can use Government knowledge to attack two requisite elements: materiality and scienter.

Credible evidence of Government knowledge may negate materiality. In 2016, the U.S. Supreme Court in *Universal Health Servs., Inc. v. U.S. ex rel. Escobar*, 136 S. Ct. 1989, 2002–2003 (2016), described the FCA's materiality standard as rigorous, demanding and requiring more than a showing that "the Government would have the option to decline to pay if it knew of the defendant's noncompliance." The Court recognized that if the Government pays a claim, despite knowledge of the defendant's noncompliance with certain contract requirements, this constitutes "strong evidence" that compliance with the requirements is not material. Id. at 2003.

Several circuit courts have applied *Escobar*'s guidance regarding materiality to reject FCA claims in which the Government knew of defendants' noncompliance with requirements. For example, in *U.S. ex rel. McBride v. Halliburton Co.*, 848 F.3d 1027, 1033 (D.C. Cir. 2017), the U.S. Court of Appeals for the D.C. Circuit found that the information allegedly falsified by the defendant was not material because a Government auditor had investigated the allegations previously and never issued any formal findings.

The D.C. Circuit further reasoned that the Government paid and never challenged amounts billed by the defendant. See also *Gerasimos Petratos, et al. v. Genentech Inc., et al.*, 855 F.3d 481, 490 (3d Cir. 2017) ("[W]here a relator does not plead that knowledge of the violation could influence the Government's decision to pay, the misrepresentation likely does not have a natural tendency to influence ... payment."). Government knowledge of the alleged noncompliance and continued payment of claims can be a lethal combination when attacking FCA allegations.

Contractors may also use evidence of Government knowledge to negate the essential element of scienter. The case of *U.S. ex rel. Butler v. Hughes Helicopters, Inc.*, 71 F.3d 321 (9th Cir. 1995); 37 GC ¶ 628, provides a good example. In *Butler*, a qui tam plaintiff brought suit against his former employer, McDonnell Douglas Helicopter Co. (MDHC), under the FCA. The plaintiff alleged that MDHC submitted to the Army false test reports regarding the performance of navigation systems on a helicopter it contracted to produce for the Army.

At the conclusion of a jury trial, the district court granted MDHC's motion for judgment as a matter of law, finding that the plaintiff did not present sufficient evidence that MDHC "knowingly" submitted any allegedly false statements or claims. The court explained that "overwhelming evidence established a pattern of cooperation between the Army and MDHC," and MDHC did not present false test reports with the requisite intent because the Army was aware of all deviations and irregularities in the reports.

On appeal, the *Butler* plaintiff argued that the Army's knowledge of irregularities in the test reports did not defeat MDHC's scienter because only technical representatives, and not contracting officers, were aware of the changes and cooperated with the revisions to the reports. The Ninth Circuit affirmed the district court's directed verdict in favor of MDHC, finding that the Army's knowledge, even through its technical representatives, defeated any inference that MDHC presented false claims to the Government with fraudulent intent. See also *U.S. ex rel. Hagood v. Sonoma Cnty. Water Agency*, 929 F.2d 1416 (9th Cir. 1991) ("That a defendant has disclosed all the underlying facts to the government may ... show that the defendant had no intent to deceive."); 38 GC ¶ 357 (Note 1); *U.S. ex rel. Lamers v. City of Green Bay*, 998 F. Supp. 971, 987 (E.D. Wis. 1998), aff'd, 168 F.3d 1013 (7th Cir. 1999) ("[T]he presence of an open dialogue with government officials about relevant factual circumstances does mitigate ... the degree to which false statements and claims were knowingly submitted."). Credible evidence of open communication with Government personnel, at all levels, concerning the subject matter of the allegation can be devastating to an FCA case.

Although Government knowledge is not a per se defense to the FCA, evidence that the Government knew of, participated in or condoned the alleged noncompliance can be used to strategically attack the essential elements of materiality and scienter. Government contractors would be wise to memorialize all communications with Government personnel regarding compliance issues and payments for goods or services provided. A well-documented course of conduct with the Government will be invaluable if an FCA action arises.

Whether convincing Government prosecutors not to intervene in a qui tam suit or challenging pleadings at the motion to dismiss or summary judgment stage of litigation, contractors can use such powerful evidence to illustrate that any noncompliance with requirements was either immaterial to the Government's decision to pay the contractor or not committed with the requisite intent. Even if it is later proven that the contractor and its Government counterpart were mutually mistaken about a certain requirement, the contractor would not get hit with FCA damage multipliers, fines or penalties. At most, the contractor might be required to work out a contractual resolution with the Government.

✦

This Feature Comment was written for THE GOVERNMENT CONTRACTOR by Scott Roybal and Laura Alexander. Mr. Roybal is a partner and Ms. Alexander is an associate in Sheppard, Mullin, Richter & Hampton LLP's Government Contracts and White Collar Defense Practice Groups in Los Angeles, Calif.