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FEATURE COMMENT: 2017 Civil False Claims Act Update

The Civil False Claims Act, 31 USCA § 3729 et seq., was enacted in 1863 in response to allegations of fraud in Civil War procurements. The FCA has since become the Government's weapon of choice to combat fraud.

The Trump administration has not issued any formal policy statements about the FCA. However, statements made by administration officials during their Senate confirmation hearings show that the administration favors vigorous enforcement of the FCA. Attorney General Jeff Sessions stated during his confirmation hearing,

[t]his government must improve its ability to protect the United States Treasury from waste, fraud, and abuse. This is a federal responsibility. We cannot afford to lose a single dollar to corruption, and you can be sure that if I am confirmed, I will make it a high priority of the department to root out and prosecute fraud in federal programs and to recover any monies lost due to fraud or false claims.

Deputy Attorney General Rod Rosenstein stated during his confirmation hearing, "We have enforced [the FCA] in my office in the District of Maryland ... and we certainly will continue to enforce that."

This Feature Comment briefly reviews the basic elements of the FCA and its qui tam provisions and enforcement statistics. It then discusses a number of recent FCA developments: (1) lower courts' application of *Escobar*, (2) the applicability of arbitration agreements to FCA claims, and (3) the Department of Defense's new counterfeit parts requirements for contractors that provide electronic parts.

Basic Elements of the FCA and Qui Tam Provisions—The FCA makes it unlawful for a person to knowingly (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. 31 USCA §§ 3729(a)(1)(A)–(B) (2009); *Hooper v. Lockheed Martin Corp.*, 688 F.3d 1037 (9th Cir. 2012); *Harrison v. Westinghouse Savannah River Co.*, 176 F.3d 776 (4th Cir. 1999); 41 GC ¶ 317. There are various statutory grounds on which a person may violate the FCA. This Feature Comment focuses on the two most prominent grounds set forth in 31 USCA §§ 3729(a)(1)(A)–(B). A person acts "knowingly" under the FCA if he or she acts with "actual knowledge, deliberate ignorance or reckless disregard of the truth or falsity of information." 31 USCA § 3729(b). Mistakes and ordinary negligence, however, are not actionable. *U.S. v. Sci. Applications Int'l Corp.*, 626 F.3d 1257, (D.C. Cir. 2010).

The FCA provides for up to treble damages and penalties of between \$10,781.40 and \$21,562.80 per violation. Violators are also subject to administrative sanctions, including suspension or debarment from participating in Government contracts. The FCA has a lengthy statute of limitations of no less than six years and, in some cases, up to 10 years after a violation has been committed.

The FCA permits private citizens, known as qui tam relators, to bring cases on behalf of the Government. In qui tam cases, the complaint and a written disclosure of all relevant evidence known to the relator must be served on the U.S. attorney for the judicial district of the court where the case was filed as well as on the U.S. attorney general. The qui tam complaint is then ordered sealed for a period of at least 60 days, and the Government is required to investigate the allegations contained therein and decide whether to intervene. Should the Government decline to intervene, the relator may proceed with the complaint on behalf of the Government. The complaint must be kept confidential and is not served on the defendant

until the seal is lifted. Relators receive a “whistleblower bounty” of 15–25 percent of the recovery if the Government intervenes in their cases, and 25–30 percent if the Government declines.

Hundreds of FCA Cases and Billions of Dollars in Recoveries—Chart 1 shows recent FCA

trends including a steady increase in qui tam-driven cases. Over 700 FCA cases have been filed each year for the last five years, and 85 percent of those cases have been qui tam cases. A near-record total of 845 FCA cases were filed in 2016, and 702 of those cases were qui tam cases.

— CHART 1 —

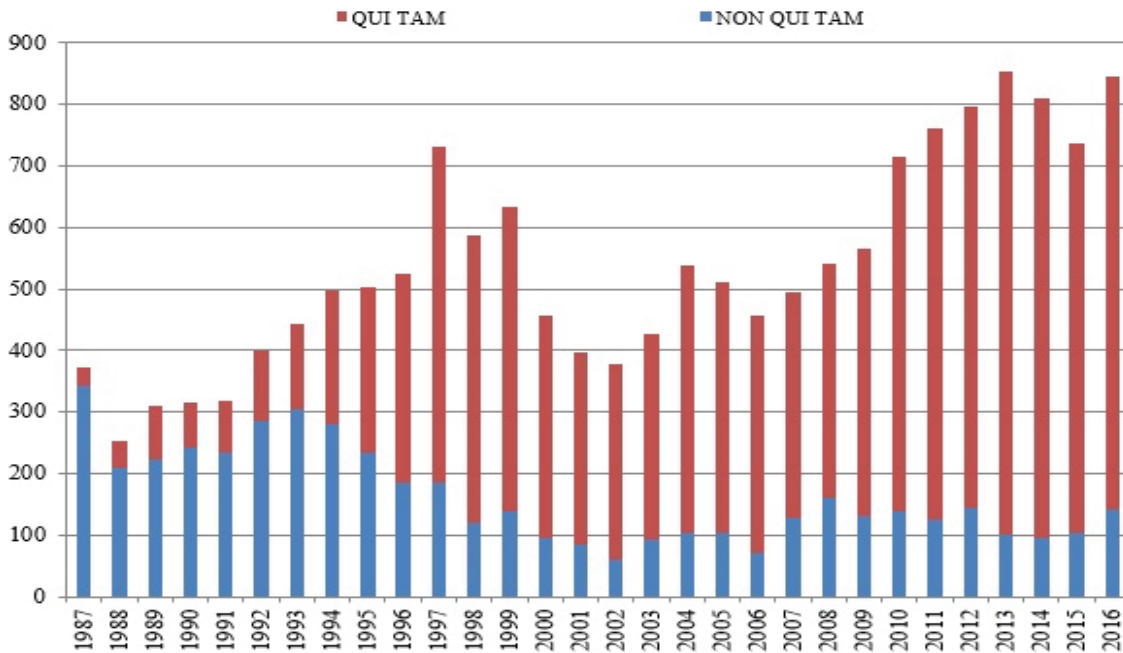


Chart 2 shows annual recoveries by the Government in FCA cases, and it compares recoveries coming from qui tam cases in which the Government declined to intervene versus non-qui tam cases or qui tam cases in which the Government intervened. Over the last five years, the Government has recovered \$25 billion. Predictably, nearly all of the recoveries came from non-qui tam cases and qui tam cases where the Government intervened.

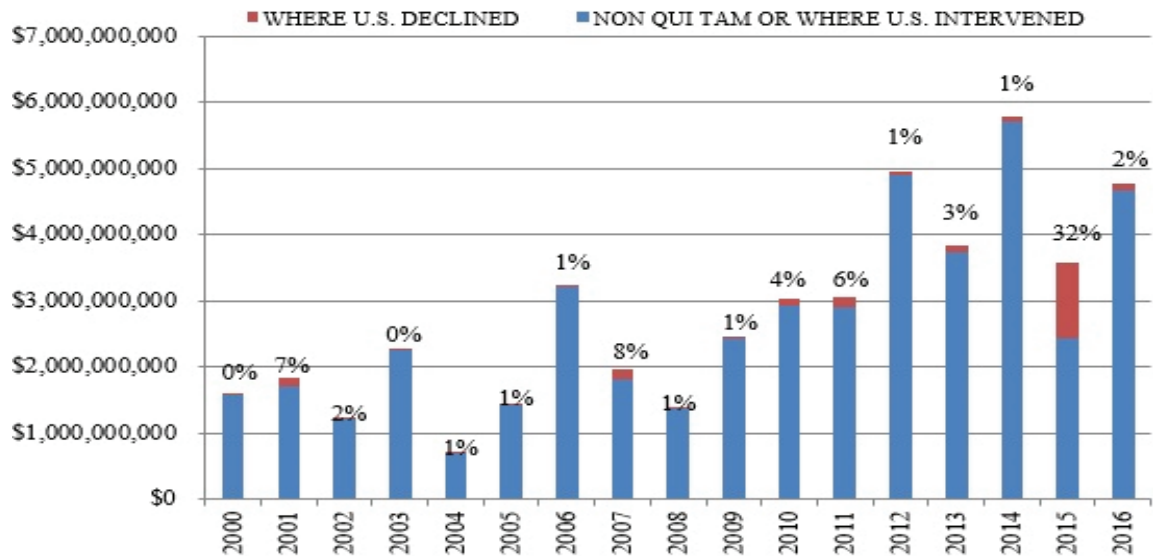
Lower Courts’ Application of *Escobar*—*Summary of the Escobar Decision*: The U.S. Supreme Court’s unanimous decision last year in *Universal Health Servs., Inc. v. U.S. ex rel. Escobar*, 136 S. Ct. 1989 (2016), affirmed the FCA’s implied certification theory in certain circumstances. The implied certification theory posits that the submission of a claim for payment or approval is treated as an implied certification that the company submitting the claim has complied with all statutory, regulatory and contractual requirements, even if the claim does not contain an express certification of compliance with those requirements, so long as those requirements are material to

the claim. Failure to comply with such a requirement makes the claim false.

The Supreme Court in *Escobar* explained that the claim for payment submitted by the company made “specific representations” about the services rendered by referencing payment codes that correspond to counseling services performed by designated professionals, but failed to disclose that the persons performing those services were untrained and unlicensed. The Supreme Court explained that such “half-truths—representations that state the truth only so far as it goes, while omitting critical qualifying information—can be actionable misrepresentations [under the FCA].”

The Supreme Court’s decision is not an endorsement of the implied certification theory in all circumstances. For example, the decision does not answer the question of whether a straight claim for payment, without half-truths about the contracted-for goods or services, is actionable if there was noncompliance with a statutory, regulatory or contractual requirement. The outer limits of the implied certification theory are

— CHART 2 —



therefore still unclear, and the lower courts will continue to assess the theory's viability on a case-by-case basis.

Apart from the implied certification theory, the Supreme Court in *Escobar* offered guidance on the FCA's "materiality" standard. The Court stated that expansive arguments of liability are disfavored and that a "rigorous" and "demanding" fact-based analysis must be used. The Court added that the FCA is not "a vehicle for punishing garden-variety breaches of contract or regulatory violations," and that "[m]ateriality ... cannot be found where noncompliance is minor or insubstantial." The Court explained that Government knowledge and course of dealing are highly relevant in assessing materiality, and materiality cannot be legislated:

[I]f the Government pays a particular claim in full despite its actual knowledge that certain requirements were violated, that is very strong evidence that those requirements are not material. Or, if the Government regularly pays a particular type of claim in full despite actual knowledge that certain requirements were violated, and has signaled no change in position, that is strong evidence that the requirements are not material.

The Supreme Court rejected the position that any requirement is material if the company knows that the Government could refuse payment if it were aware of noncompliance.

Ninth Circuit Requires Specific Misrepresentations under Implied Certification Theory: The U.S.

Court of Appeals for the Ninth Circuit applied *Escobar* for the first time in *U.S. ex rel. Kelly v. Serco, Inc.*, 846 F.3d 325 (9th Cir. 2017). In *Kelly*, the relator alleged that the defendant failed to use a particular cost tracking system called an "earned value management system" that was required by its Government contract. The only representations contained in the defendant's claims for payment were the period of performance and the total costs and fees incurred. Accordingly, the relator's FCA claim was based on the implied certification theory.

The Ninth Circuit affirmed the trial court's dismissal on summary judgment. The Ninth Circuit stated that there was not any evidence that the defendant's claims for payment "contained any false or inaccurate statements." The Ninth Circuit further stated that the relator's "FCA claim fail[ed] because the FCA attaches liability, not to the underlying fraudulent activity or to the Government's wrongful payment, but to the claim for payment."

Campie Created Potential Circuit Split on Materiality: The Ninth Circuit applied *Escobar* most recently in *U.S. ex rel. Campie v. Gilead Scis., Inc.*, 862 F.3d 890 (9th Cir. 2017); 59 GC ¶ 236. In *Campie*, the relator alleged that the defendant misrepresented the source of the active ingredients for its HIV drugs to get the Food and Drug Administration to approve the drugs. The relator further alleged that the defendant concealed information about quality issues when it later obtained FDA approval to use that source. FDA

approval is required to get Government reimbursement claims paid.

The Ninth Circuit rejected the argument that continued FDA approval and Government reimbursement for the drugs meant that any false statements were immaterial, and it reversed and remanded the trial court’s dismissal of the case for failure to state a claim. The Ninth Circuit distinguished the case from *Escobar*, which held that continued reimbursement was strong evidence of immateriality. The court stated, “there are many reasons the FDA may choose not to withdraw a drug approval, unrelated to the concern that the government paid out billions of dollars for nonconforming and adulterated drugs.” The Court added that there was a dispute between the parties about “exactly what the government knew and when,” which made it premature to decide if reimbursement was paid despite knowledge of noncompliance.

It remains to be seen whether *Campie* can be limited to its facts or whether it represents a departure by the Ninth Circuit from what seemed to be an emerging consensus that *Escobar*’s materiality standard required evidence that the Government’s decision to pay a claim would likely have been different had it known about the defendant’s alleged FCA noncompliance. See, e.g., *U.S. v. Sanford-Brown, Ltd.*, 840 F.3d 445 (7th Cir. 2016) (affirming dismissal because the Government had “already examined” the alleged noncompliance “multiple times over and concluded that neither administrative penalties nor termination was warranted”); 58 GC ¶ 388; *U.S. ex rel. D’Agostino v. ev3, Inc.*, 845 F.3d 1 (1st Cir. 2016) (affirming dismissal because “the fact that [the agency] has not denied reimbursement ... in the wake of D’Agostino’s allegations casts serious doubt on the materiality of the fraudulent representations ... [and] in the six years since D’Agostino surfaced the alleged fraud, the FDA has apparently demanded neither recall nor relabeling of Onyx—this notwithstanding the agency’s option [to do so]”); *Abbott v. BP Exploration & Production, Inc.*, 851 F.3d 384 (5th Cir. 2017) (affirming dismissal because the fact that there had been both a congressional and a Department of the Interior investigation into the alleged noncompliance and no action was taken against the defendant was “strong evidence” of immateriality); *U.S. ex rel. Swoben v. Scan Health Plan*, 2017 WL 4564722 (C.D. Cal. Oct. 5, 2017) (holding that the relator did not adequately allege materiality because the complaint failed to allege that the Government

would not have made payments to the defendant had it known about the alleged noncompliance). The defendant in *Campie* has filed a petition for a writ of certiorari with the Supreme Court.

FCA Claims outside Scope of Arbitration Agreement—The Ninth Circuit in *U.S. & State of Nevada ex rel. Welch v. My Left Foot Children’s Therapy, LLC*, 871 F.3d 791 (9th Cir. 2017), held that an arbitration agreement between an employer and an employee was not broad enough to cover the employee’s FCA claims. The Ninth Circuit stated that the FCA claims did not fall within the scope of the agreement because the agreement, by its own terms, only applied to claims between the parties—the employer and the employee—and the FCA claims belonged to the Government. The Ninth Circuit noted in dicta, however,

[H]ad the parties wished to agree to arbitrate FCA claims, they were free to draft a broader agreement that covers “any lawsuits brought or filed by the employee whatsoever” or “all cases Welch brings against [My Left Foot], including those brought on behalf of another party.” But having instead drafted a more limited clause that covers only those claims that Welch, rather than the government, has, Defendants cannot now argue that we should ignore this textual limitation.

It remains to be seen if such an arbitration agreement would be upheld. Regardless, there is still another question of whether an employee could waive all rights to personal gain under the FCA, i.e., the whistleblower bounty.

DOD’s New Counterfeit Parts Requirements—In August 2016, DOD rolled out two new Defense Federal Acquisition Regulation Supplement provisions for contractors that provide electronic parts or assemblies containing electronic parts to the Government. These new regulations were effective immediately and impose significant risks on contractors.

DFARS 252.246-7008, Sources of Electronic Parts, requires contractors to purchase parts from the original manufacturers or authorized suppliers (original source) whenever available. If an original source is unavailable, contractors are required to vouch for their suppliers, and they assume all of the risk if a vendor delivers a counterfeit part. DFARS 252.246-7007, Contractor Counterfeit Electronic Part Detection and Avoidance System, requires contractors to establish and maintain elaborate electronic part detection and avoidance systems. The systems must include risk-

based policies and procedures that address several different areas, including

- training;
- inspection and testing;
- processes to abolish counterfeit parts proliferation;
- tracking from original source to product acceptance;
- use of suppliers in accordance with 252.246-7008, Sources of Electronic Parts (described above);
- detection, reporting and quarantining of suspected counterfeit parts;
- methodologies to determine if suspected counterfeit parts are counterfeit; and
- flowdown to subcontractors.

These two new regulations arguably impose near

strict liability on contractors, essentially requiring them to guarantee their supply chains. Failure to follow these rules can result in costs being disallowed and FCA liability.

Conclusion—There is little doubt that FCA enforcement will continue in 2018 and beyond. Government contractors must therefore remain vigilant and ensure that they operate on the up-and-up.



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