Risky Business of the False Claims Act, Part II - What Your Business Needs to Know About the FCA & How You Might Encounter It

02.09.2018

In Part I of our False Claims Act (FCA) blog series, we examined the evolution of the FCA and why some understanding of its parameters is important to businesses engaged in, among others, the government contracts, medical, financial services and senior housing sectors. In this segment, we delve into the basic components of the FCA and situations that might lead to a business becoming involved in an FCA matter. In Part III, we will address potential prophylactic measures that may reduce the likelihood of encountering an FCA matter or that may reduce the consequences should one become enmeshed in such a situation.

The U.S. Government can draw upon a variety of statutory remedies against those who seek to defraud it. Central to the regime are the civil FCA (31 U.S.C. § 3729 *et seq.*) and its criminal law counterparts (18 U.S.C. §§ 371 & 1001). On the criminal side, the government also can draw upon a variety of other provisions to address related matters such as mail fraud (18 U.S.C. § 1341); wire fraud (18 U.S.C. § 1343); bribery (18 U.S.C. § 201); and the like. On the civil side, the government also can draw upon the Program Fraud Civil Remedies Act of 1986 (31 U.S.C. §§ 3802 *et seq.*); the Forfeiture of Fraudulent Claims statute (28 U.S.C. § 2514); the Contract Disputes Act fraud provision (41 U.S.C. § 7103(c); and principles of common law fraud, each of which target analogous deceptive conduct under standards similar to those under the FCA. In addition, individuals motivated by the bounty hunter incentive aspect of the FCA (31 USC § 3730) (potential recovery of 15%-30% of proceeds), and acting as private attorneys general, may initiate *qui tam* actions for themselves and for the United States under the FCA. Many states also have adopted fraud statutes analogous to the federal model, which they can assert independently or in conjunction with a federal FCA action.

The primary distinction between criminal and civil fraud involves the existence of intent. A criminal violation under Section 287 involves one making or presenting a claim to an agency of the United States, when the actor knew the claim to be false, fictitious or fraudulent and with consciousness that he/she was violating the law or doing something wrong. A section 1001 criminal violation requires the "knowing and willful" use of a false, fictitious or fraudulent statement, representation, writing or document, or falsifying, concealing or covering up by any trick, scheme or device a material fact. Although section 287 is currently used sparingly, often yielding to other criminal statutes (*e.g.*, wire fraud, bribery, kickbacks, etc.), section 1001 is familiar because it is referenced on many official forms that one submits to the government (*e.g.*

, Labor Department payroll forms, SBA certification forms, passport applications) and is implicit in most submissions to the government. As a practical matter, the criminal fraud laws are used sparingly against individuals who engage in egregious misconduct, with businesses and individuals being more likely to encounter the civil FCA.

The civil FCA does not purport to penalize all frauds perpetrated on the government or all transgressions that might otherwise be actionable, but it does cast a broad net regarding perceived misconduct. It penalizes anyone who knowingly presents or causes to be presented a false claim for payment or approval (*i.e.*, the improper act). It likewise penalizes anyone who uses or causes to be made or used, a false record or statement (*e.g.*, false proposal, false invoice, false record) to support a claim. Conversely, under the "reverse" FCA provision, the FCA penalizes anyone who knowingly and improperly makes or uses a false statement or record regarding an obligation to pay or transmit money or property to the government or to conceal, avoid or decrease an obligation to pay or transmit money or property to the government. It also penalizes those who conspire to commit any of the foregoing offenses.

FCA violations are industry-agnostic, although most FCA cases have been concentrated over the past few years in health care, financial services and government contracts. They can arise at any stage of the procurement cycle, billing cycle, application process or other transaction process and can be asserted against entities and persons several steps removed from a prime contractor, medical provider or grantee. Thus, loan applicants, loan officers, a range of medical services providers, various prime contractors, subcontractors and suppliers, and even the bicyclist Lance Armstrong, have faced FCA claims, investigations and actions. And, although government counsel must make strategic decisions about where to allocate resources, and *qui tam* relators must evaluate potential recovery, businesses should be wary about ever thinking that any fraudulent conduct is too small to attract attention.

Typical FCA claims involve direct misrepresentations in offers, grant applications and loan applications; defective products or services; false invoices; misrepresented qualifications and capabilities; false testing or inspection reports; miscoding or other falsifications of medical records; and falsified time records, cost records or books. In addition, or as part of the matters above, many cases involve false "certifications." There can be false "express" certifications, such as small business status; Buy-American certification; certified performance standards for equipment; time sheet certifications; certified licensure and training; or cybersecurity compliance certifications.

There also can be false "implied" certifications, arising from the submission of a claim in which there are representations made about a furnished product or service, but the submitter knowingly fails to disclose its failure to comply with some statutory, regulatory, or contractual standard that would or likely would have caused the government not to pay the claim or entered the contract had it known the true facts. For example, in the United States Supreme Court's 2016 decision in *Escobar*, in which the court confirmed that an implied certification could violate the FCA, a mental health facility sought reimbursement from a state Medicaid program for the treatment and prescription medicine it furnished to a patient who later died.

In its submissions, which appeared accurate on their face, the facility failed to disclose that the persons who furnished the services and issued the prescriptions for which reimbursement was sought were unlicensed and unqualified to do so under state Medicaid regulations. The Supreme Court ruled that an implied certification of this nature might violate the FCA where:

1. a company makes specific representations about the goods or services provided; but
2. where undisclosed noncompliance makes those representations misleading in a situation where the submitter knows that the noncompliance would be material to the

government's payment decision.

In other words, a health care provider should expect that the government would likely refuse to reimburse for services rendered by unqualified or unlicensed persons. Or, a contractor should know that the government would be unwilling to pay for weapons that do not shoot or guards who cannot shoot straight. The situation, however, might be different if the guns do function, or the guards do shoot straight, but companies have breached requirements to present certifications attesting to same, or have lost training records, or a medical facility has mislaid required health care plans or failed to submit certifications of otherwise qualified medical staff. In this regard, significant litigation has arisen since *Escobar* regarding the parameters of implied certifications under the FCA.

In each FCA case, the plaintiff must establish four elements. First, there must be a "false or fraudulent course of conduct," which is generally the most straightforward of the elements. For example, a violation can occur where one knowingly misstates the amount of time worked on a project or during a week, or overstates the quantity of goods delivered, or the amount of an invoice. Similarly, a violation can occur if one knowingly submits an "express" certification that one is a small disadvantaged business, or one's products conform with the "Buy American Act," or that the company has completed the eVerify immigration evaluation for all employees, or that one has paid his or her personnel in accordance with the Service Contract Act, or that one's materials or products meet specified testing or performance standards. Or a violation may occur in situations involving an "implied" certification, where it is alleged that, in submitting a claim for payment or reimbursement, one has failed to disclose noncompliance with some statutory, regulatory or contractual standard.

Second, the claim must be made with requisite "scienter," which is what distinguishes a civil FCA violation from a criminal fraud violation: a civil FCA violation does not require intent. It merely requires "scienter," *i.e.*, knowledge that one's actions or statements are wrong and material to the government. Scienter under the FCA includes not only acts undertaken with "actual knowledge" (which can brush up against the criminal fraud statute), but also includes acts or omissions reflecting a "deliberate ignorance of the truth" (like an ostrich burying its head in the sand) or with "reckless disregard for the truth" (something akin to gross negligence).

In *Escobar*, the Supreme Court emphasized that scienter is a rigorous standard to be applied strictly. In this context, although mere careless or negligent conduct might not violate the FCA, one might run afoul of this aspect of the FCA through continued sloppiness or a failure to attend to apparent issues that should have commanded greater attention. Deliberate ignorance may arise when one confronts significant questionable conduct but turns his or her back on, or otherwise fails to address, the matter in a reasonable manner (*e.g.*, a senior company official failing to investigate apparent timekeeping irregularities that have come to her attention and caused her concern, or allowing delivery and invoicing for an IT solution while ignoring internal reports about defects in the system).

Because of the relatively low bar, "reckless disregard" is the most common theory a company may confront and is the area where disputes about whether conduct was merely negligent or something more are likely to occur. Where issues arise whether negligence, or something more, is involved, the resolution may turn on the significance or the duration of the misconduct (*e.g.*, a single erroneous report during a long contract versus an extended course of failing to catch erroneous reports). For example, as the Supreme Court observed in *Escobar*, because a reasonable person would realize the imperative of a functioning firearm on a contract to furnish weapons, one's failure to appreciate the materiality of that condition would amount to deliberate ignorance or reckless disregard of the truth or falsity of the information even if the government failed to spell it out in a document.

Third, the alleged false claim must be "material." The FCA defines materiality to be an act that has "a natural tendency to influence, or be capable of influencing, the payment or receipt of money or property." In *Escobar*, the Supreme Court emphasized, in the context of implied certifications but with application to all cases, that materiality is a rigorous and demanding standard. The court explained that the FCA is not a vehicle to punish garden-variety contract breaches or minor regulatory violations. Nor is it intended to address situations where the government has the right to opt-out of paying. Rather, it addresses those situations where a reasonable person would decline to pay for a product or service, or enter the agreement in the first place, if he or she were aware of the misrepresentation. Fleshing out the lesson of *Escobar*, and whether it might be extended to other situations, continues to be the subject of significant litigation.

Fourth, the fraudulent conduct must result in a "claim to the government." Traditionally, the FCA was interpreted to require that the demand for money or property be submitted to the government. More recently, the FCA's reach has been extended and now includes a demand made to a prime contractor, subcontractor, grantee, subgrantee, or other recipient, where the money is to be spent on the government's behalf, or the government is to provide the money demanded, or the government is to reimburse the contractor or grantee. Thus, a claim subject to the FCA may involve alleged misconduct well removed from the government. Depending on their conduct, those lodged between the transgressor and the government may themselves become caught up in an investigation or proceedings, directly or through an alleged FCA conspiracy.

A final aspect of the FCA needs to be noted: whistleblower protection. The FCA seeks to encourage the disclosure of potential FCA violations within an entity and/or to the government. To that end, the FCA bars retaliation against ". . . lawful acts by the employee, contractor, agent or associated others in furtherance of an action under [FCA] or other efforts to stop [FCA] violations. . ." (31 U.S.C. § 3730(h)). The penalties and equitable relief associated with violations of this provision are significant.

To prevail, an employee must establish that:

1. he or she engaged in a protected activity under the FCA,
2. the employer took some adverse employment action against the employee and
3. the adverse action was causally related to the protected activity.

What triggers potential exposure varies among the courts across the country. However, liability can arise for retaliation regardless of whether the whistleblower launches an FCA *qui tam* case, reports alleged misconduct to the government, or merely undertakes protected conduct within the company. Under current standards, retaliation is broadly construed to include more than termination and, depending on the circumstances, might include aspects of reassignment,

adverse pay decisions, or a significant change in duties, responsibilities or working conditions.

Conclusion

As currently constructed and construed, the civil FCA ought to be viewed by business as a significant vehicle for the government or a *qui tam* relator to challenge perceived wrongdoing, or for a discontented employee or business partner or competitor perhaps to create mischief. In the current environment, where the government and *qui tam* relators remain aggressive in what they are willing to allege constitutes an FCA violation, the challenge for companies and individuals is that defending against alleged misconduct is expensive and disruptive to corporate and personal lives and reputations, even when one successfully turns aside one of these matters.

Companies are therefore interested in whether there are actions they might undertake to improve the odds against facing such matters and whether it is possible to otherwise reduce one's potential exposure. Understanding the parameters of the FCA is an early but important step in the process of protecting one's company and investment from unnecessary transgressions, reducing the likelihood of facing an FCA investigation or matter and reducing the potential scope of company exposure in the event that one becomes involved in a matter.

In our next blog on the FCA we will turn to how one can build on knowledge of the FCA to develop practical prophylactic measures.

Related People

- Anthony H. Anikeeff – 703.760.5206 – aanikeeff@williamsmullen.com
- Arrion N. Dennis – 804.420.6477 – adennis@williamsmullen.com