The Government Contractor®

THOMSON REUTERS

Information and Analysis on Legal Aspects of Procurement

Vol. 61, No. 38 **October 16, 2019**

Focus

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FEATURE COMMENT: The False Claims Act: Yesterday, Today And Tomorrow—What A Long Strange Trip It's Been—Part I

I. INTRODUCTION

On the occasion of the 10th anniversary of the Fraud Enforcement and Recovery Act (FERA) and the third anniversary of the Supreme Court's seminal decision in *Universal Health Servs. v. U.S. ex rel. Escobar,* 136 S. Ct. 1989 (2016); 58 GC ¶ 219, 2019 marks a milestone year for the False Claims Act (FCA or Act), which has now been existence since the midst of the Civil War. The fundamental principles that prompted Congress' enactment of the FCA in 1863 have remained constant over the past 156 years, but it took more than a century for the FCA to gain its stride. That occurred in 1986, with the first substantial amendments to the Act, which, among other things, significantly enhanced the Act's qui tam provisions and ushered in a new era of the modern day "whistleblower."

Of course, that was not the end. The resulting explosion in FCA litigation beginning in the late 1980s reached a crescendo in the early 2000s. And it was during the first decade of this century that the Government began achieving sizeable and numerous FCA enforcement results in terms of total monetary recovery (both qui tam and non-qui tam) as evidenced in its annual reporting of statistics. If that was not enough, in tandem, legislative efforts took hold with the passage of the FERA and the Affordable Care Act (ACA), which expanded the scope and reach of the FCA while, at the same time, lowering the bars/hurdles for qui tam relators.

Not surprisingly, since the passage of the FERA and the ACA in 2009 and 2010, respectively, FCA and qui tam enforcement has continued at a record pace. For FCA defendants, there has thankfully been a judicial backstop of decisions establishing some metes and bounds to hold the Government and relators alike, in check. The most notable and powerful decision of recent note is the U.S. Supreme Court's seminal decision in the *Escobar* case—"celebrating" its third anniversary this year. As will be addressed in detail, the *Escobar* decision reinforced the importance of "materiality" of an alleged false claim or statement to be actionable under the FCA. By all accounts, *Escobar* is a "game changer" and gives FCA defendants a significant arrow in their quiver to challenge FCA allegations. *Escobar* has, however, spawned sharp circuit court splits that will almost undoubtedly lead back to the Supreme Court for resolution.

Not only is the post-*Escobar* judicial landscape both uncertain and challenging for FCA defendants/potential defendants, so too is the future of FCA and qui tam enforcement. What are the areas of greatest risk exposure? What are the Government's FCA enforcement imperatives? Which industries or areas of activity will find themselves the new frontier of the FCA? These are questions not easily answered, but necessary to explore.

The first installment of this three-part series focuses on the origins and history of the FCA. The second installment will focus on the emergence of the FCA and its qui tam provisions in the "modern" age. And the third installment will address FCA/qui tam enforcement trends and expectations for the future. These installments (individually or collectively) should not be construed as legal advice.

II. YESTERDAY: HOW WE GOT TO NOW

Any appreciation of the significant role of the FCA in American jurisprudence today—"how we got to now," if you will—requires a fundamental understanding of the FCA's origins and history, its evolving goals over the years, and its successive amendments. As a quick exposition of its history reveals, the FCA is a law that has proceeded in fits and starts. Since its enactment in 1863 as a reaction to rampant fraud by Government contractors supplying the Union Army, the FCA has faced both legislative and judicially imposed hurdles that have threatened its very existence. But time and again, the legislative and/or executive branches have resuscitated it to preserve it as one of the Government's primary weapons for fighting alleged fraud. Although there were notable amendments to the FCA in 1943, the first Congressional effort of significance in this regard came with the 1986 amendments, which dramatically altered and injected a new potency into the Act.

This article addresses the evolution of the FCA from its early years as an antifraud statute in the Civil War, through its various amendments, and to the present day.

The "Original" FCA: A Gun That Couldn't Shoot—As with all wars, the Civil War demanded an exponential increase in the need for military supplies. The emergent nature of this demand for large volumes of supplies and limited sources for them, brought the opportunity for fraud by unscrupulous Government contractors, including those supplying the Union Army. Concerns arose about the enormous funds being expended, the profits being enjoyed by Government contractors, and suspicions of rampant fraud, defective weapons, and price gouging. Congressional hearings in 1862 and 1863 produced over 3,000 pages of testimony alleging fraud, waste and abuse in Government contracting.

It was with this backdrop that Congress enacted the Act of March 2, 1863 (colloquially referred to as the "Informer's Act" or the "Lincoln Law"), which was the original version of what we know today as the False Claims Act. Among other things, it provided criminal penalties for the submission of false claims to the Government and provided for the assessment of double damages and a civil fine of $2,000 per violation. An important aspect of the law was its qui tam provision, which allowed private citizens (qui tam "relators") to bring a lawsuit alleging fraud against the Government, on behalf of the Government, but it also permitted the Government to intervene/take over a qui tam suit at its discretion and at any time. The qui tam provision provided a bounty for the individual bringing the suit on the Government's behalf: one half of any recovery obtained. This was not a novel approach for Congress at the time, as the use of similar qui tam provisions embedded in other federal and state laws was common. It was also much needed because the Department of Justice had not yet been created, and the qui tam provision in the Act and other laws were meant to assist the Attorney General in combatting fraud against the Government.

When the Civil War reached its conclusion and Government military spending diminished greatly, so too did the opportunities for fraud. Consequently, the utilization of the Act by both the Government and qui tam relators hit its nadir and the beginning of what would become over a century of dormancy.

The Original Act (1863): The original FCA was born of wartime fraud. The most common anecdote echoed by Justice Kagan recently in the *Escobar* oral argument—more on that to come—is the "guns that couldn't shoot": defense contractors were supplying faulty rifles to the Union Army. Not surprisingly, therefore, the original FCA had a distinct focus on thwarting fraud against the military—and on military fraudsters. Indeed, the original FCA began with a lengthy list of prohibitions on persons "in the land or naval forces of the United States, or in the militia in actual service." Id. § 1. Only thereafter did the FCA extend those prohibitions to persons *not* in the armed forces.

The original FCA punished a wide array of activities, from false claims to counterfeiting, forgery or submitting/procuring false affidavits or depositions. It also punished agreements, combinations, and conspiracies to "cheat or defraud the Government of the United States." The false claim provision required knowledge that the claim was "false, fictitious, or fraudulent," but left knowledge undefined. It would be a century before mere recklessness would be considered "knowledge" under the FCA.

Violators were liable for a forfeiture of $2,000 "and, in addition, double the amount of damages which the United States may have sustained ... together with the costs of suit." Id. § 3. The original act carried criminal sanctions, as well: imprisonment of 1–5 years or a fine of $1,000–5,000.

The relator provisions have been in the FCA since the beginning, although relators were originally known as "informants." Id. § 4 ("Such suit may be brought and carried on by any person, as well for himself as for the United States; the same shall be at the sole cost and charge of such person, and shall be in the name of the United States, but shall not be withdrawn or discontinued without the consent, in writing, of the judge of the court and the district attorney."). A qui tam "informant" was eligible for one half of the statutory forfeiture and half of the damages. A successful informant could receive "all costs the court may award against the defendant," but could *not* recover the costs incurred by the informant in the case.

Important Pre-1986 Cases and Legislative Developments—Notwithstanding the wars and armed conflicts that followed the Civil War, it wasn't until the 1930s that the FCA regained some traction as an anti-fraud enforcement tool. It was in the 1930s, and amidst the significant increase in Government spending brought about by the New Deal, that awareness of the Act's qui tam provisions re-emerged. Seemingly enticed by the huge amount of Government spending, suspicions of fraud and the prospect of large bounties, qui tam relators began bringing lawsuits on behalf of the Government, but many were "parasitic" in nature as they were not based on firsthand information, but rather, on information obtained from public sources such as Congressional investigations, criminal indictments/records, newspaper articles, etc.

Marcus v. Hess, 317 U.S. 537 (1943): In 1943, the Supreme Court found that the FCA permitted these parasitic suits. *U.S. ex rel. Marcus v. Hess* involved a qui tam relator, Morris Marcus, who allegedly copied a criminal indictment and converted some of the key allegations contained therein into an FCA suit, through which he claimed entitlement to one half of any recovery. Although DOJ strongly opposed the relator's claim to a share of *any* recovery based on nothing more than parasitic allegations, the Supreme Court took the side of the relator, holding that neither the language nor the history of the statute precluded relators from relying solely on public allegations of fraud.

Marcus eliminated any disparity between whistleblower- and Government-brought FCA suits; forecasted the need for a public-disclosure bar; previewed intersection of the FCA and the Double Jeopardy Clause, which is still relevant today; and waded into the question of apportioning forfeitures (today's per-claim penalties).

The case arose out of the New Deal's Public Works Administration (P.W.A.). Certain electrical contractors bid on contracts with local municipalities and school districts in Alleghany County, Pa. that were reimbursed in large part by federal funds. Aware of the federal funding, those contractors conspired to eliminate competition from the bidding, while certifying that their bids were "genuine and not sham or collusive." The contractors were held liable in district court but exonerated by the Third Circuit, which found that their actions fell outside the FCA's reach.

Before reversing the judgment of the court of appeals, the Supreme Court first rejected the Third Circuit's "interpretive approach," namely, that qui tam suits should be viewed with the "utmost strictness." Id. at 542. The Supreme Court was unequivocal: "we cannot say that the same substantive language has one meaning if criminal prosecutions are brought by public officials and quite a different meaning where the same language is invoked by an informer." Id. at 542. In other words, Government suits and relator suits would be equal going forward.

The major bone of contention between the Supreme Court and the Third Circuit was whether this type of fraud—one attenuated by the municipal intermediary between fraudster and Federal Government—was actionable under the FCA. The Supreme Court said that it was: "Government money is as truly expended whether by checks drawn directly against the Treasury to the ultimate recipient or by grants in aid to states." Id. at 544; see also id. & n.7 ("These funds are as much in need of protection from fraudulent claims as any other federal money, and the statute does not make the extent of their safeguard dependent upon the bookkeeping devices used for their distribution."). In other words, if federal dollars are at issue, whether directly or indirectly, the FCA applies. And more importantly—*Marcus*' enduring legacy, really—the Court reasoned that the fraud's "taint entered into every swollen estimate which was the basic cause for payment of every dollar paid by the P.W.A. into the joint fund for the benefit of respondents." Id. at 543. This case is often cited by plaintiffs for the proposition that collusive bidding is actionable under the FCA.

Second, the contractors (and the Government) argued that the whistleblower should be barred from suing because he "received his information not by his own investigation, but from the previous indictment [of the contractors]." Id. at 545. Because the public-disclosure bar would not be added to the statute until decades later, however, the Court dismissed the parties' argument as purely policy driven. In an ominous footnote, the Court perhaps previewed the amendment to come: "There is of course no reason why Congress could not, if it had chosen to do so, have provided specifically for the amount of new information which the informer must produce to be entitled to reward." Id. at 546 n.9.

Third, the Court rejected a double-jeopardy argument by the contractors. Because the Fifth Amendment allows someone to be both charged criminally and sued civilly, the argument failed. The FCA was "remedial" in nature because the Government recovers no more than it lost. Id. at 549. As to the double-damages, that did not make the statute punitive because the other half went to the relator, not the Government. Interestingly, the Court distinguished *treble* damages statutes, like the Sherman Act, which *were* punitive. The FCA has, of course, since been amended to provide for treble damages.

Finally, the Court held that the $2,000 forfeiture was not punitive, but rather "a specific sum ... chosen to make sure that the Government would be made whole." Instead of applying one $2,000 forfeiture per form submitted by the contractors, or merely $2,000 overall, the Court adopted the compromise reached by the district court: $2,000 per *project*. This was based on "the circumstances of this case," id. at 552, and would be revisited by the Court later.

The 1943 Amendments: For all the talk of the 1986 amendments to the FCA, we hear comparatively little about the 1943 amendments. An Act to Limit Private Suits for Penalties and Damages Arising out of Frauds Against the United States, P.L. 78-213, 57 Stat. 608 (1943).

In reaction to the Supreme Court's decision in *Marcus*, Congress amended the FCA on Dec. 21, 1943, by divesting federal courts of subject-matter jurisdiction over any FCA lawsuit brought by a qui tam relator that was "based upon evidence or information in the possession of the United States, or any agency, officer or employee thereof, at the time such suit was brought." Id. Whether the relator was the "original source" of the Government's information was of no moment, as the Government-knowledge defense precluded any FCA case brought by a relator. It applied regardless of whether the information was publicly known. All that was required was that a Government agency knew of the fraud at the time.

The 1943 amendments also limited the Government's period within which to decide whether to intervene in a qui tam lawsuit to 60 days. And, if the Government did timely elect to intervene in a qui tam lawsuit, it became the master of the case, leaving no role for the relator. The Government's election to intervene would also mean that a relator's recovery would be reduced and capped at no more than 10 percent of the Government's recovery but allowing for up to 25 percent if the Government did not intervene. This decrease from 50 percent left far less of an incentive for relators to bring suit.

The effect of the amendments and their "Government knowledge defense" and reduced rewards to relators, diminished whistleblowers' incentives and greatly lowered the number of new qui tam cases. The average number of qui tam cases brought under the FCA from 1943 to 1986 was only six per year. The FCA was largely irrelevant through these years, until Congress again amended the FCA in 1986.

U.S. v. Neifert-White Co., 390 U.S. 228 (1968): U.S. v. Neifert-White Co. further expanded the reach of the FCA. The defendants had prepared "deliberately overstated" invoices to their customers, who used those inflated invoices to support loan applications to the Federal Government. The question was whether the defendants' conduct fell within the ambit of the FCA. The Court had already held that fraudulent applications to the Federal Housing Administration (FHA) were *not* actionable under the FCA, because the FHA "disburses no funds nor does it otherwise suffer immediate financial detriment." *U.S. v. McNinch*, 356 U.S. 595 (1958).

The agency at issue in *Neifert-White* was different. The Commodity Credit Corp. (CCC) was the actual lender, whereas the FHA merely insured loans. The fraudulent applications to CCC, therefore, had "the purpose and effect of inducing the Government immediately to part with money." *Neifert-White*, 390 U.S. at 232. While the opinion's reasoning is brief, it reiterates the sheer breadth of the FCA, which encompasses "all fraudulent attempts to cause the Government to pay out sums of money."

U.S. v. Bornstein, 423 U.S. 303 (1976): U.S. v. Bornstein has enduring relevance to the measure of damages under the FCA and to the ongoing debate over "net" or "gross" trebling of damages.

In *Bornstein*, the Government procured $2.1 million worth of radio kits. The prime contractor subcontracted the supply of certain components (specifically, electron tubes) of the radios. Unfortunately, the subcontractor submitted defective tubes and falsely marked them as compliant. The prime contractor refunded $40.72 per tube ($16,165.84 total). When the Government later sued the subcontractor for the fraud, the district court totaled 35 statutory forfeitures—one for each invoice that the subcontractor had caused the prime to submit—but reduced the amount of the Government's single damages by the amount already paid by the prime. That left only $39.70, doubled to $79.40, plus the forfeitures. The Third Circuit agreed on damages but, harkening back to *Marcus v. Hess*, reduced the number of forfeitures to one, because there had only been one subcontract.

The Supreme Court first addressed the number-of-forfeitures issue. Gleaning "little guidance" from the FCA's legislative history, and clarifying that *Marcus* "in no way stands for the proposition that the number of forfeitures is inevitably measured by the number of contracts involved in a case," the Court was also unconvinced that the forfeitures were inevitably tied to the number of claims submitted. *Bornstein*, 423 U.S. at 311. Instead, each forfeiture must correlate to an act done to cause a false claim, regardless of how many false claims it causes. In *Bornstein*, that meant three forfeitures: one for each shipment of defective tubes from the sub to the prime.

Turning to the damages issue, the Court agreed with the Government that damages should be doubled *before* subtracting any "compensatory payments," in this case, the amount previously recovered from the prime contractor. This has come to be known as the "gross trebling" approach. The Court cited three reasons for adopting the approach: (1) ensuring that the Government recovered not just the amount by which it was damaged, but also the "costs, delays and inconveniences occasioned by the fraudulent claims"; (2) precluding a fraudster (here the subcontractor) from reaping a windfall from "the adventitious actions of other persons" (here the prime contractor); and (3) eliminating the possibility that an FCA defendant could "make the double-damages provision meaningless" by "tendering the amount of the undoubled damages at any time prior to judgment." Id. at 531.

The legacy of *Bornstein* has been undermined slightly by the advent of treble damages, which weakens the first rationale advanced by the Court. The second and third rationales vary greatly depending on the definition of "compensatory damages," which has been the subject of some debate in the courts since *Bornstein* but is still largely an open question. See *U.S. ex rel. Purcell v. MWI Corp.*, 15 F. Supp. 3d 18, 26–27 (D.D.C. 2014), rev'd and remanded on other grounds, 807 F.3d 281 (D.C. Cir. 2015) (holding that the loan repayment was a "compensatory payment" under *Bornstein*).

One of the most significant portions of the opinion is actually buried in footnote 13: "The Government's actual damages are equal to the difference between the market value of the tubes it received and retained and the market value that the tubes would have had if they had been of the specified quality." *Bornstein*, 423 U.S. at 317 (citing C. McCormick, Law of Damages s 42, p. 137 (1935) and six cases in support of the proposition). This may seem a benign point, but FCA plaintiffs routinely ask for more than fair-market damages. For example, they will argue that a defective seat in a $5 million tank renders the tank "worthless" and that they should receive $15 million in treble damages instead of the market value of the defective seat. *Bornstein* provides a strong and historic foundation to rebut these arguments.

The 1986 Amendments—The 1986 amendments gave us the FCA that we know and love today. See False Claims Amendments Act of 1986, P.L. 99-562, 100 Stat. 3153 (1986). No other amendments have so fundamentally altered the FCA, and it is worth recapping the major changes.

First, the stakes were raised, and the bar was lowered. Having imposed double damages for more than a hundred years, the FCA suddenly became a *treble damages* statute. Id. § 2(7). Instead of a $2,000 forfeiture, penalties would be $5,000 to $10,000. The 1986 amendments also redefined "knowingly" false to include "reckless disregard of the truth or falsity of the information." Id. § 2(7). This lowered the "floor" of mens rea required for FCA liability. *U.S. ex rel. Streck v. Allergan, Inc.*, 894 F. Supp. 2d 584, 600 n.11 (E.D. Pa. 2012) (citing *K&R Ltd. P'Ship v. Mass. Hous. Fin. Agency*, 530 F.3d 980, 983 (D.C. Cir. 2008)).

Second, the qui tam provisions were undeniably strengthened. Relators could now net as much as 30 percent of the Government's proceeds in a qui tam case. 1986 Amendments § 3. They could also participate in the case even if the Government intervenes, subject to certain limitations. Id.

Third, a retaliation provision was added. Id. § 4. This allowed anyone who is discriminated against for investigating, initiating, or aiding an FCA case to sue for reinstatement, double back pay with interest, and any special damages suffered because of the discrimination. Id. While not expanding the scope of liability for false claims, per se, the new retaliation provision undoubtedly encouraged relators to bring cases that they otherwise might not have. More on that below. It also changed the dynamic of settling FCA cases, as there could now be counts brought by relators alone—apart from the Government.

The Once and Future King(s)—Relators Cometh—The effect was predictable: qui tam cases exploded in frequency. See generally Kary Klismet, "Quo Vadis, 'Qui Tam' ? The Future of Private False Claims Act Suits Against States After *Vermont Agency of Natural Resources v. U.S. Ex Rel. Stevens*," 87 Iowa L. Rev. 283, 292 & nn.51–54 (2001); U.S. Dep't of Justice, *Fraud Statistics* (Oct. 1, 1986–Sept. 30, 2018), available at *www.justice.gov/civil/page/file/1080696/*

download. In the first year after the amendments, relators filed 30 qui tam cases. DOJ Fraud Statistics, supra. Ten years later, it was 547. After a century of relative neglect, we now see 500–700 qui tam cases per year. And for good reason: from the 1986 amendments through fiscal year 2018, the Government has recovered $42.5 billion though qui tam lawsuits, both intervened and declined.

Defense and Health Industries in the Crosshairs—Although healthcare has been a primary industry target for qui tam suits in the wake of the 1986 amendments, the initial focus was undoubtedly on the defense sector. In the first five years following the amendments, roughly four times as many relators alleged fraud on the Department of Defense than on Health and Human Services. See id. (47 HHS cases in FYs 1987–1991, vs. 164 DOD cases).

This was driven, or at least exacerbated, by procurement scandals out of the Pentagon. The 1980s saw scandals over Pentagon procurements. See generally L.A. Times, "$37 screws, a $7,622 coffee maker, $640 toilet seats; [sic]: suppliers to our military just won't be oversold" (July 30, 1986), available at *www.latimes.com/archives/la-xpm-1986-07-30-vw-18804-story.html*; AP, "Reagan Says Pentagon Didn't Buy $400 Hammer" (May 18, 1985), available at *www.apnews.com/e1f0fe8dc2cd7c275f9fea1966e644c9*. Tales of the $500 hammer and the $1,000 toilet seat drew the public's ire and whistleblowers' attention. Few, if any, major defense contractors escaped significant FCA litigation since the 1986 amendments.

With their appetites whetted with early successes against the defense industry, the Government and relators alike followed the money and set their sights on healthcare entities, including providers, payors and pharmaceutical manufacturers.

The number of FCA cases involving the healthcare industry grew exponentially in the decade following the 1986 amendments, from 12 percent of FCA cases in 1987 to 54 percent of FCA cases in 1997. 12 False Claims Act & Qui Tam Q. Rev. 41 (Jan. 1998) (reporting DOJ statistics). Healthcare fraud cases initially brought under the FCA during this period included allegations of overbilling, "upcoding," improper "unbundling" of goods and services, unnecessary testing, billing for services not rendered, fraudulent cost reporting, quality of care deficiencies, and implied certifications to Governmental entities. As the turn of the century neared, greater focus was placed on pharmaceutical manufacturers with a wave of FCA cases involving "off-label marketing." These cases involve allegations that pharmaceutical companies have improperly marketed their products for non-allowable uses in violation of Medicare and Medicaid regulations, which in turn, renders the claims for reimbursement for such drugs to be false in violation of the FCA. These cases resulted in some of the largest settlements ever achieved under the FCA.

"Yesterday" to "Today"—Informed by the FCA's background of "Yesterday," an understanding of its emergence to become the FCA of "Today" becomes more attainable. The turn of the 21st century has brought with it many developments in the FCA, not the least of which have been on the legislative and judicial fronts and embroidered from time-to-time with policy pronouncements regarding enforcement imperatives. Legislatively, the past two decades have brought the first major revisions to the FCA since the 1986 amendments, including the FERA of 2009 and, in 2010, the ACA and the Dodd-Frank Wall Street Reform and Consumer Protection Act. In addition to far-ranging and sweeping legislative changes, the courts have also stepped in to interpret these emerging changes to the FCA, including the Supreme Court's seminal decision in *Escobar* in 2016, which settled a circuit split, upholding the "implied false certification" theory of FCA liability.

We will address the FCA of "Today," including the legislative, judicial and policy aspects of its evolution, in our next installment of this three-part series. Stay tuned ….

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