The Civil False Claims Act: What it is and Why it is Important under the CARES Act

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THE CARES ACT AND RELATED LEGISLATION

- Coronavirus Preparedness and Response Supplemental Appropriations Act
  - "Phase I," signed into law March 6, 2020
  - $8 billion for medical treatments and testing
- Families First Coronavirus Response Act (FFCRA)
  - "Phase II," signed into law March 18, 2020
  - $104 billion expanding benefits for workers and nutritional assistance to families
- Coronavirus Aid, Relief, and Economic Security (CARES) Act
  - "Phase III," signed into law March 27, 2020
  - $2 trillion relief package, followed by the PPP Enhancement Act on April 23, 2020, providing an additional $484 billion to shore up the PPP, EIDL program, and hospitals

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POTENTIAL AREAS FOR RISK OF FRAUD UNDER THE CARES ACT AND RELATED GOVERNMENT GUIDANCE

- The Paycheck Protection Program (PPP)
- The Families First Coronavirus Response Act (FFCRA)
- Section 3610—DoD and GSA class deviations
- Title IV Lending Facilities

POTENTIAL AREAS FOR RISK OF FRAUD: THE PAYCHECK PROTECTION PROGRAM

- Forgivable loans up to a maximum of $10 million for payroll and certain other operating costs
- Much confusion about the "good faith" certification applicants are required to make
- Many other areas of confusion: how to count employees for eligibility, what is/is not forgivable, application of affiliation rules, etc.
- Treasury has announced it will review any loan over $2 million
- DoJ has already charged two men with fraud under this program

POTENTIAL AREAS FOR RISK OF FRAUD: THE FAMILIES FIRST CORONAVIRUS RESPONSE ACT

- Entitles most employees of businesses with fewer than 500 employees to Emergency Paid Sick Leave (EPSL) and Emergency Family Medical Leave (EFML)
- Employers are eligible for tax credits that reimburse for the costs of the leave
- Has fairly complex requirements for employee eligibility, which can impact employer eligibility for the tax credits

POTENTIAL AREAS FOR RISK OF FRAUD: CARES ACT TITLE IV PROGRAMS

- These are still being worked out
- $17 billion set aside for "businesses critical to maintaining national security"
- Programs will vary, depending on the size of the business
- There is still much debate about what kinds of strings will be attached

POTENTIAL AREAS FOR RISK OF FRAUD: CARES ACT SECTION 3610

- Authorizes federal agencies to reimburse contractors for paid leave that the contractor provides to keep its employees in a "ready state"
- DoD and GSA have issued class deviations with further guidance on what qualifies
- Will be reimbursed at the minimum applicable billing rate
- Contractors must keep careful records—there is a fine line between what is allowable and what is not

POTENTIAL AREAS FOR RISK OF FRAUD: INTERACTIONS BETWEEN THESE PROGRAMS

- It is possible that a contractor could qualify for or receive funds under more than one of these programs
- Section 3610 specifically states that costs reimbursed must be reduced if relief is obtained under one of the other provisions
- Contractors must be very careful about record-keeping, allocation of costs, and disclosure to the government
- Many questions remain

POTENTIAL AREAS FOR RISK OF FRAUD: CARES ACT OVERSIGHT

- The CARES Act creates three separate oversight mechanisms:
  - $25 million for the Office of the Special Inspector General for Pandemic Recovery (SIGPR)—oversees Treasury and the $500 billion in aid under Title IV
  - $80 million for the Pandemic Response Accountability Committee (PRAC)—oversees all appropriated COVID-related spending
  - Congressional Oversight Commission—pays particular attention to the Fed and Treasury
- These are in addition to already-existing oversight by DoJ, inspectors general, auditors, whistleblowers, GAO, etc.

Real World Examples – Disaster Relief

- While the CARES Act response to COVID-19 is unprecedented in breadth and scope, FCA cases arising out of smaller-scale disaster relief are instructive
- Two illustrative FCA cases arising out of the Hurricane Katrina response:
  - *United States v. Lighthouse Disaster Relief et al.* (Case No. 06-161, M.D. La.)
  - *United States ex rel. Jacquet Constr. Servs., LLC* (Case No. 07-3584, E.D. La.)

Real World Examples – Takeaways

- The *Lighthouse* and *Jacquet* cases reflect:
  - The willingness of the government (and *qui tam* plaintiffs) to pursue civil FCA claims for many years if necessary
  - The seriousness with which the government will pursue perceived false claims in connection with disaster relief efforts
- After the urgency of disaster relief efforts passes, the government may second-guess response efforts by contractors
- The FCA also encourages whistleblowing – even false whistleblowing – that can lead to expensive litigation with pressure to settle for large sums
- Present situational urgency may not provide a safe harbor when claims are investigated months or years later

False Claims Act Defined

- The Civil False Claims Act ("FCA" or "Act") imposes civil penalties and damages on parties that submit false or fraudulent claims to the federal government
- See 31 U.S.C. § 3729
- A person can be found liable under the Act based on seven situations, including:

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How Is Liability Established Under the FCA?

Situation Number 1:

- Any person who knowingly presents, or causes to be presented, a false or fraudulent claim for payment or approval

How Is Liability Established Under the FCA?

Situation Number 2:

– Any person who knowingly makes, uses, or causes to be made or used, a false record or statement material to a false or fraudulent claim

How Is Liability Established Under the FCA?

Situation Number 3:

- Any person who conspires to commit a violation of [this Act]

How Is Liability Established Under the FCA?

Situation Number 4:

- Any person who has possession, custody, or control of property used, or to be used, by the Government and knowingly delivers, or causes to be delivered, less than all of that money or property

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How Is Liability Established Under the FCA?

Situation Number 5:

- Any person who is authorized to make or deliver a document certifying receipt of property used, or to be used, by the Government, and, intending to defraud the Government, makes or delivers the receipt without completely knowing that the information on the receipt is true

How Is Liability Established Under the FCA?

Situation Number 6:

- Any person who knowingly buys, or receives as a pledge of an obligation or debt, public property from an officer or employee of the Government, or a member of the Armed Forces, who lawfully may not sell or pledge the property

How Is Liability Established Under the FCA?

Situation Number 7:

- Any person who knowingly makes, uses, or causes to be made or used, a false record or statement material to an obligation to pay or transmit money or property to the Government, or knowingly conceals or knowingly and improperly avoids or decreases an obligation to pay or transmit money or property to the Government
- Commonly called a "reverse false claim"

Most Commonly Invoked Portion of the Act

Situation Number 1:

  - Any person who knowingly presents, or causes to be presented a false or fraudulent claim for payment or approval

- What does this mean?

Elements of Situation Number 1

- Courts have found three essential elements:
  1. The presentation of a “claim” for payment to the U.S. Government; and
  2. The claim must be false or fraudulent; and
  3. The person “knowingly” presents a claim that is false or fraudulent.

Claims

- The Act defines a "claim" as:
  - Any request or demand, whether under a contract or otherwise, for money or property and whether or not the United States has title to the money or property, that
    - Is presented to an officer, employee or agent of the United States; or
    - Is made to a contractor, grantee, or other recipient if the money or property is to be spent or used on the Government's behalf or to advance a government program or interest, and if the United States Government
      - Provides or has provided any portion of the money or property requested or demanded; or
      - Will reimburse such contractor, grantee, or other recipient for any portion of the money or property which is requested or demanded; and
  - Does not include requests or demands for money or property that the Government has paid to an individual as compensation for Federal employment or as an income subsidy with no restrictions on that individual's use of the money or property

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The Impact of Removing the Presentment Requirement

- In a multi-tiered contract, the false statement of a second-tier subcontractor could subject the first-tier subcontractor and the prime to FCA liability.

- An individual (including subawardees and contractors) who makes a false statement on an application for grant funds funneled through a State could give rise to FCA liability.

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The Claim Must Be False or Fraudulent

- No statutory definition for false or fraudulent.
- Largely defined by judicial interpretation.

“Knowingly” Present a Claim That Is False or Fraudulent

- The Act defines “knowing” and “knowingly” as:
  - [A] person with respect to information-
    - has actual knowledge of the information;
    - acts in deliberate ignorance of the truth or falsity of the information; or
    - acts in reckless disregard of the truth or falsity of the information,
    - and no proof of specific intent to defraud is required
- To establish “reckless disregard” the government must show:
  - “Aggravated gross negligence,” “gross negligence-plus,” or an “extreme version of ordinary negligence”

Other Elements

- **Intent**
  - The “knowing” aspect of the FCA has led to wide debate over a scienter (or intent) requirement. Courts vary on their interpretation, but generally FCA liability requires a demonstration of more than mistake or negligence.
- **Materiality**
  - In 2008, the Supreme Court stated that the government “must prove that the defendant intended that the false record or statement be material to the Government’s decision to pay or approve the false claim”
  - FERA defined material to mean “having a natural tendency to influence, or be capable of influencing, the payment or receipt of money or property.”
- **Damages**
  - Some courts require damages for damages to be assessed.

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Implied Certification

- *Universal Health Services v. Escobar*, 136 S. Ct. 1989 (2016). The U.S. Supreme Court upheld the theory that "implied certification" would remain a viable theory of liability under the False Claims Act.
- The Court explained when "a defendant makes representations in submitting a claim but omits its violations of statutory, regulatory, or contractual requirements, those omissions can be a basis for liability if they render the defendant's representations misleading with respect to the goods or services provided."

Implied Certification

- Specifically, the Supreme Court held that implied certification could be a basis for FCA liability when:
  - "the claim does not merely request payment, but also makes specific representations about the goods or services provided"; and
  - "the defendant's failure to disclose noncompliance with material statutory, regulatory, or contractual requirements makes those representations misleading half-truths."

Implied Certification

- Of particular note:
  - The Court repeatedly emphasized that “[n]ot every undisclosed violation of an express condition of payment automatically triggers liability;” and it is insufficient “for a finding of materiality that the Government would have the option to decline to pay if it knew of the defendant’s noncompliance.”
  - Materiality cannot be found where noncompliance is minor and insubstantial.
  - The parties’ course of conduct can be one way to determine which noncompliances are material. For example, “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.”

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Penalties and Damages for an FCA Violation

- In any action brought under the FCE, the Government has the burden of proof on all essential elements of the cause of action – including damages.
- Recover penalties up to three times the amount wrongfully charged to the government (treble damages), **and**
- Fines between $11,665 and $23,331 **per claim**.
  - Actual fines may vary between agencies, and *when* the actual violation occurs can further impact the possible fines.
- The government may also be able to recover interest.
- Penalties limited to two times amount wrongfully charged if full disclosure made to government within 30 days of knowledge of violation, full cooperation with investigation, and no government investigation pending at time of disclosure

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Penalties and Damages for an FCA Violation

- Trebling damages can be complicated, as the courts must determine what value was received and when to apply the trebling factor.
- Net vs. Gross Trebling:
  - Gross trebling: Damages are calculated based on the total amount paid by the government. The benefits the government may have received are not subtracted until after the damage amount is tripled.
  - Net trebling: Damages are limited to the total amount expended less any benefit conferred by the violating party.
  - Assume that as a result of false claims, the government paid $500,000 for services that had a value of $400,000.

    Gross Trebling: (500,000 × 3) – 400,000 = 1,100,000

    Net Trebling: (500,000 – 400,000) × 3 = 300,000

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Examples of Damage Calculations

Fraudulent Conduct	Typical Measure of Damages
Delivery of defective/non-conforming goods or services	Difference between value of what was received and the value of what should have been delivered (value of goods had there been no fraud).
Failure to provide goods or services bargained for	Amount paid for the goods or services not delivered.
Misrepresentations of cost resulting in overcharges	Amount charged to government as a result of misrepresentations.
Bid-rigging/Collusion	Difference between what the government paid and what it would have paid in a competitive environment.
False Certification	Measured by the amount of money paid out by reason of the false claim over and above what it would have paid if claims had been truthful.
Defective Pricing	Typically arise in "Multiple Award Schedule" and TINA cases. Damages are usually calculated as the difference between what the government was paid and what it should have paid.
Government loans obtained by fraud	Measured by the damages that the government would not have incurred “but for” the fraudulent loan.
Government grants obtained by fraud	Measured by the full amount of grants awarded to defendants based on false statements.
Reverse false claim	Usually measured as the difference between the amount paid and what should have been paid to the government.
Retention of overpayment	Typically the amount of the overpayment that was not returned.

Statistical Sampling and the FCA

- A recent trend is the use of statistical sampling methods to determine damages in FCA cases.
- The FCA does not statutorily authorize statistical sampling, nor does it prohibit it.
- With the absence of such guidance, courts have needed to make case-by-case determinations based on the specific facts presented and claims asserted.
  - Damages or liabilities?
  - Some courts have been more willing to allow plaintiffs to use statistical sampling techniques to establish damages when liability has already been proved.
  - In cases where a potential large volume of false claims were submitted, a claim-by-claim approach may be expensive and impractical.
    - Statistical sampling was found to be a valid methodology for establishing liability. *E.g., United States v. Life Care Centers of America, Inc.*, 114 F. Supp. 3d 549, 565-570 (E.D. Tenn. 2014) (rejecting defendant's argument that statistical sampling cannot be used to establish liability)

Defenses to an FCA Claim

- Although the Government's burden is fairly low to establish an FCA violation, there are several potential defenses, including:
  - Government knowledge
  - Reasonable interpretation
  - Reliance on expert counsel
- Successful performance of a contract or achieving grant goals is NOT a defense.

Defenses: Government Knowledge

- Government knowledge can act as a defense that negates a contractor's intent to defraud.
- Courts have considered a host of factual issues in their analysis of the government knowledge defense, including a showing that the claimant did not possess the requisite intent, including:
  - The claimant's openness with the government about its operational problems;
  - The on-site presence of government officials;
  - The availability of data demonstrating the operational problems;
  - The government's actual knowledge of the operational problems; and
  - The government's actual knowledge of regulatory violations.

Defenses: Government Knowledge

- The government knowledge defense is not an absolute defense.
- There are a number of factors that may negate this defense, such as:
  - The government's knowledge was insufficient to understand the falsity;
  - The government's knowledge was incomplete;
  - The government was not informed of the falsity in a timely manner;
  - The appropriate person within the government did not have the knowledge of the falsity; or
  - The government official with knowledge could not have justly acquiesced to or even condoned the falsity.

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Defenses: Reasonable Interpretation

- A party's reasonable interpretation of an unclear or ambiguous statutory or regulatory provision may negate the reckless disregard/intent standard of the FCA.
- Similarly, a plausible contract interpretation negates FCA liability, even if ultimately proved incorrect.

Defenses: Reliance on Expert or Counsel

- The “expert advice” defense is available as long as the defendant has made full disclosure of the facts to the expert and is relying on the advice in good faith.
- The “advice of counsel” defense is similarly available but often requires the waiver of the attorney-client privilege.

Defenses: Statistical Sampling

- Statistical sampling may be necessary in certain circumstances if:
  - The full population of data needed to accurately assess damages does not exist
  - The resources and/or time available to respond is limited
  - The volume of data necessary is unmanageable or significantly slows down the process
  - The data formats and/or quality of data varies
- If statistical sampling is permitted:
  - As the defendant, do you have the time, resources, and data available to combat the statistical sampling or extrapolation by reviewing the entire population?
  - Was the data used appropriate for the specific case?
  - Was the sample size and/or technique employed appropriate and representative?
  - Where outliers considered?

Qui Tam Actions

- A private individual (i.e., a former disgruntled/whistleblower employee) can also bring an FCA action; this is referred to as a *qui tam* action.
- Under this authority, the government can either take over (or “intervene in”) the action, or leave it to the private individual (or the “relator”) to litigate.
  - If the government intervenes, it has the primary responsibility for prosecuting the action without regard to the relator’s interest.
  - If the government elects not to intervene, the relator has responsibility for prosecuting the action.
- The government can also dismiss or settle an action.

Qui Tam Actions

- Award to relator:
  - If the government intervenes:
    - The relator can receive between 15% and 25% of the proceeds of the action/settlement, depending on the contribution, plus expenses.
    - Under some circumstances the court must limit the relator's proceeds to no more than 10%, plus expenses.
    - A relator's individual culpability can reduce the award, although it does not prevent the relator from bringing the action.
  - If the government does not intervene:
    - The court will determine an amount reasonable that shall not be less than 25% or more than 30%, plus expenses

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Qui Tam Actions – FERA Changes

- Government can intervene and either amend the "relator's" complaint or file its own complaint to clarify or add detail at any time and is not bound by any statute of limitations.
- Attorney General may delegate the authority to issue Civil Investigative Demands (subpoenas).
- Investigative information may be shared with relators or state or local law enforcement.

The Mandatory Disclosure Rule

- Mandatory disclosure of an FCA violation:
  - Federal Acquisition Regulation rule requires government contractors to timely disclose in writing when its "principals" have "credible evidence" of a violation of federal criminal law involving fraud, conflict of interest, bribery, gratuities, or the FCA.
- This rule went into effect on December 12, 2008 and is implemented through the inclusion of FAR clause 52.203-13.

The Mandatory Disclosure Rule

- The disclosure must be made to both the contracting officer and the cognizant Inspector General's Office.
- "Principal" includes "an officer, director, owner, partner, or a person having primary management or supervisory responsibilities within a business entity (e.g., general manager; plant manager; head of a division or business segment; and similar positions)."
- There are no definitions for "timely" or "credible evidence" in the rule.
  - The preamble to the rule explains with regard to "timely" that "[u]ntil the contractor has determined the evidence to be credible, there can be no 'knowing failure to timely disclose.'"

False Claims Act

- Particular problem areas:
  - Sloppy time charging
    - Mischarging, cross charging, ghost charging
  - Billing fraud
  - Inflated equitable adjustment claims
  - Failure to distinguish funds from different projects at all times
  - TINA and defective pricing

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Potential Indicators of Fraud

- Cost mischarging examples:
  - Unallowable costs (political contributions, certain entertainment costs, advertising)
  - Labor mischarging (transfer of labor costs, time sheet fraud, ceiling limitations)
  - Incorrect cross walks of internal resources to contractual positions
  - Commercial vs. Government contracts
  - Material mischarging and product substitution
  - Unsupported progress payment

Indicators of Fraud

- Product substitution examples:
  - Delivery of look-alike goods made from non-specification materials
  - Providing foreign-made products where domestic product required
  - Failure to update catalogue information to accurately portray available product specifications
  - Failure to properly test materials
  - Falsification of test documents

Indicators of Fraud

- Other red flags:
  - Thin/no peer review processes
  - Lapses in the enforcement of the Code of Conduct or similar policy
  - Transferring charges from one delivery order to another
  - Unexpected resignation or replacement of key management personnel
  - Managers retroactively assigning charge numbers
  - Weakening in the company's financial condition (e.g., recurring operating losses)
  - Actual results not meeting forecasts
  - Discrepancies between reported facts, observed data, and supporting documentation
  - Inadequate or apparently altered supporting documentation

Indicators of Fraud

- Other red flags (cont'd):
  - Unexpected year-end transactions that result in significant revenues
  - Unusual accounting practices for revenue recognition and cost deferral
  - Changes in accounting methods that are designed to enhance profit numbers
  - Changes in independent accountants that resulted from disagreements

Practical Tips

- Know your company's compliance policies and ensure that your employees are familiar with them.
  - Proposal and grant application preparation.
  - Cost accounting and billing.
  - Government ethics and whistleblower policies (ideally, with some provision for anonymous reporting of complaints and potential violations).
- Review federal contract, subcontract, and grant opportunities carefully to identify all requirements and certifications, including
  - Required express and implied certifications in proposal.
  - Cost accounting and cost principle requirements.
  - Invoicing instructions.

Practical Tips

- Educate employees about the FCA.
- Talk to employees about potential problems and encourage them to err on the side of caution.
- Ensure employees understand the terms of contracts they work under.
- Document and justify costs.
- Channel communications to the Agency through a single (or a few) representative(s).
- Consider exit interviews for former employees.

CARES Act: It Ain't Money for Nothing - A Government Contractor's Guide to Mandatory Disclosures

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