"The Federal False Claims Act - What Does It Mean for Nonprofit Organizations?"

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- **THE CIVIL FALSE CLAIMS ACT:**
    - The Civil False Claims Act[2] ("FCA" or "Act") imposes civil penalties and damages upon parties that submit false or fraudulent claims to the federal government. Specifically, the most commonly invoked portion of the Act provides that:

      Any person who –
      1) knowingly presents, or causes to be presented, to an officer or employee of the United States Government or a member of the Armed Forces of the United States a false or fraudulent claim for payment or approval … is liable to the United States Government …[3]

- **ELEMENTS:**
    - Most courts read this language to require at least three essential elements:
        - <u>The presentation of a "claim" for payment to the U.S. Government</u>;
            - Claim – The Act defines a "claim" as:

              [A]ny request or demand, whether under a contract or otherwise, for money or property which is made to a contractor, grantee, or other recipient if the United States Government provides any portion of the money or property which is requested or demanded, or if the Government will reimburse such contractor, grantee, or other recipient for any portion of the money or property which is requested or demanded.[4]

            - Presentment – "presents, or causes to be presented":

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[2] 31 U.S.C. §§ 3729 *et seq.*
[3] *Id.* at § 3729(a)(1).
[4] *Id.* at § 3729(c).

- The "causes to be presented" clause doe not require the person actually presenting the claim to know it is false.[5]
- A claim must be presented to an employee of the U.S. Government, acting in his or her capacity as an employee of the U.S. Government.[6]
- Claims passed through prime contractors, grantees, etc. fall within the "caused to be presented" clause to the U.S. Government.[7] In such instances the sub-contractor, grantee, etc. will be liable.[8]

- <u>The claim must be false or fraudulent</u>; and
  - No statutory definition for false or fraudulent.
  - Largely defined by judicial interpretation.
- <u>The person "knowingly" presents a claim that is false or fraudulent</u>.
  - Knowingly - 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.[9]

[5] *See, e.g., U.S. v. Mackby*, 261 F.3d 821, 827-28 (9th Cir. 2001).
[6] *See U.S.* ex rel. *DRC, Inc. v. Custer Battles, LLC*, No. 1:104CV199, 2005 U.S. Dist. LEXIS 13743, at *100-101 (E.D. Va. July 8, 2005).
[7] *See, e.g., U.S.* ex rel. *Totten v. Bombardier Corp.*, 286 F.3d 542, 547 (D.C. Cir. 2002).
[8] *See, e.g., U.S. v. Rachel*, 289 F.Supp. 2d 688, 695-96 (D. Md. 2003).
[9] 31 U.S.C. § 3729(b).

- To meet the standard for reckless disregard, the government must only establish "aggravated gross negligence," "gross negligence-plus," or an "extreme version of ordinary negligence."[10]

- Additional elements:
  - Intent – the "knowing" aspect of the FCA has lead 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.[11]
  - 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."[12]
  - Damage – Some courts require damages for damages to be assessed.[13]

- **PENALTIES/DAMAGES:**
  - If an FCA violation occurs, the government can:
    - Recover penalties up to three times the amount wrongfully charged to the government (treble damages), and
    - Fines between $5,500 and $11,000 per fraudulent claim.[14]
    - The government may also be able to recover interest.[15]

[10] *U.S. v. Krizek*, 111 F.3d 934, 941-42 (D.C. Cir. 1997).
[11] *See, e.g., U.S.* ex rel. *Oliver v. Parsons Co.*, 195 F.3d 457, 464-65 (9th Cir. 1999).
[12] *Allison Engine Co. v. U.S.* ex rel. *Sanders*, No. 07-214, 2008 WL 2329722 (U.S. June 9, 2008).
[13] *See, e.g., United States v. Killough*, 848 F.2d 1523, 1533 (11th Cir. 1988) (allowing penalties but not damages to be assessed).
[14] 31 U.S.C. § 3729(a).
[15] Although the FCA allows the government to recover interest, most courts have found that treble damages are sufficient to make the government whole and, therefore, pre-judgment interest has not generally been awarded. *See, e.g., Foster Wheeler Corp.*, 447 F.2d 100 (2d Cir. 1971).

        - 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.[16]

- **DEFENSES:**
    - Although the government's burden under the FCA is relatively low, the FCA is subject to several defenses. These defenses include:
        - Government Knowledge
            - The government knowledge defense negates the falsity requirement, and the intent requirement that courts have generally read into the FCA.[17]
                - 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 (scienter):
                    - 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;

[16] 31 U.S.C. § 3729(a)(2)

[17] *United States ex rel. Durcholz v. FKW Inc.*, 189 F.3d 542, 545 (7th Cir. 1999) ("If the government knows and approves of the particulars of a claim for payment before the claim is presented, the presenter cannot be said to have knowingly presented a fraudulent or false claim. In such a case, the government's knowledge effectively negates the fraud or falsity required by the FCA."); *see also, Becker v. Westinghouse Savannah River Co.*, 305 F.3d 284, 289 (4th Cir. 2002) ("the government's knowledge of the facts underlying an allegedly false record or statement can negate the scienter required for an FCA violation"); *see also United States ex rel. Kreindler v. United Techs. Corp.*, 985 F.2d 1148, 1157 (2d. Cir. 1993); *Shaw v. AAA Eng'g & Drafting, Inc.*, 213 F.3d 519, 534 (10th Cir. 2000); *United States ex rel. Costner v. United States*, 317 F.3d 883, 888 (8th Cir. 2003) (en banc).

- The government's actual knowledge of the operational problems; and
- The government's actual knowledge of regulatory violations.[18]

- 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;[19]
  - The government's knowledge was incomplete;[20]
  - The government was not informed of the falsity in a timely manner;

[18] *United States ex rel. Costner v. United States*, 317 F.3d 883, 886-88 (8th Cir. 2003) (en banc). Similarly, courts have also found that government knowledge, coupled with an expressed desire by the government for the contractor to continue performance, negates a FCA action against that contractor. *See, e.g., Paradyne Corp. v. U.S. Dept. of Justice*, 647 F.Supp. 1228, 1237 (D.D.C. 1986) (granting summary judgment in favor of the contractor when a government agency "has five times renewed a contract which it knew, or should have known, would be performed by a corporation which allegedly used fraud to procure the contract in the first instance."). In addition, some courts view the government's knowledge and acquiesce to the alleged false conduct as "not actually false but rather conform[ing] to a modified agreement with the Government." *United States ex rel. A+ Homecare, Inc. v. Medshares Management Group, Inc.*, 400 F.3d 428, 454 fn, 21 (6th Cir. 2005); *see also United States ex rel. Windsor v. Dyncorp, Inc.*, 895 F.Supp. 844, 850 (E.D.Va. 1995) (granting summary judgment in favor of the defendant, in part, because the government had full knowledge that "over time, the … contract … became outdated and did not accurately correspond to existing conditions," and as a result "it was impossible for [the contractor] to provide some of the services required under the contract."). Finally, government knowledge has been found by some courts to establish a course of conduct that negated the allegations of false claims. *See, e.g., United States v. Southland Management Corp.*, 326 F.3d 669, 675 (5th Cir. 2003) (en banc) ("When we apply [the FCA] to the Contract [at issue] and the course of conduct between [the cognizant government agency] and the [claimant], we conclude upon this record that the [claimants] were entitled to the . . . payments sought, and thus, they made no false claims.").

[19] *See, e.g., United States ex rel. Durcholz v. FKW Inc.*, 189 F.3d 542, 545 (7th Cir. 1999) (stating that "government's knowledge [is] not a bar to a FCA claim if the knowledge is incomplete or acquired too late in the process."); *see also United States ex rel. A+ Homecare, Inc. v. Medshares Management Group, Inc.*, 400 F.3d 428, 454 fn, 21 (6th Cir. 2005) (finding the government knowledge defense unpersuasive because the claimant "neglected to disclose all the pertinent information" to the government).

[20] *See id.*

- The appropriate person within the government did not have the knowledge of the falsity;[21] or
- The government official with knowledge could not have justly acquiesced to or even condoned the falsity.[22]

- 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.[23]
  - Similarly, a plausible contract interpretation negates FCA liability.[24]
- Reliance on Expert or Counsel
  - The "expert advice" defense is available so long as the defendant has made full disclosure of the facts to the expert and is relying on the advice in good faith.[25]

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[21] In *United States ex rel. Butler v. Hughes Helicopter, Inc.*, a relator argued that the government knowledge defense did not apply because "the *wrong* Army personnel knew," in this case an Army technical representative. 71 F.3d 321, 326 (9th Cir. 1995) (emphasis in original). The relator argued that for the government knowledge defense to apply, "contracting officers capable of modifying the contract requirements" were the only appropriate officials to possess such knowledge. *Id.* The Ninth Circuit disagreed and held that the "only reasonable conclusion a jury could draw from the evidence was that [the claimant] and the Army had so completely cooperated and shared all information during the testing that [the claimant] did not 'knowingly' submit false claims." *Id.* at 327; *see, e.g., United States ex rel. Costner v. United States*, 317 F.3d 883, (8th Cir. 2003) (en banc) (finding that a project manager, engineers, a risk assessment specialist and other scientists assigned to the work-site were sufficient government officials to invoke the government knowledge defense).

[22] *See United States v. Cripps*, 460 F.Supp. 969, 974 (D.C. Mich. 1978) (stating that "[i]f anyone [] authorized [the claimant] to violate the contract [or contract materials], that person exceeded his or her authority and the government is not bound by the unauthorized acts of its agents."); *see also United States v. Mack*, 2000 WL 33993336, *6 (S.D. Tex. 2000) (finding that agents for a contractor or state government overseeing a federal program "cannot be imputed to the federal government to preclude suit under the FCA. Any such agent purporting to authorize Defendant to submit false claims … was acting outside his or her authority.") (internal citations omitted). Another argument is that the government official acted outside the scope of his authority or in a *ultra vires* manner. *United States v. Cripps*, 460 F.Supp. 969, 974 (D.C. Mich. 1978).

[23] *See, e.g., Safeco Insurance Co. of America v. Burr*, 127 S. Ct. 2201 (U.S. 2007); *see also Hagood v. Sonoma County Water Agency*, 81 F.3d 1465, 1478-79 (9th Cir. 1996).

[24] *See, e.g., U.S.* ex rel. *Hochman v. Nackman*, 145 F.3d 109 (9th Cir. 1998).

- The "advice of counsel" defense is similarly available but often requires the waiver of the attorney-client privilege.[26]

- NOT A DEFENSE THAT AN ORGANIZATION SUCCESSFULLY PERFORMED THE UNDERLYING CONTRACT OR ACHIEVED THE GOALS OF A GRANT PROGRAM.[27]

- ***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.[28]
  - Under this authority, the government can take over (or intervene) the action, or leave it to the private individual (or relator).[29]
    - If the government intervenes, it has the primary responsibility for prosecuting the action without regard to the relator's interest.[30]
    - If the government elects not to intervene, the relator has responsibility for prosecuting the action.[31]
  - The government can also dismiss or settle an action.[32]
  - Award to relator:
    - If the government intervenes:

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[25] *See, e.g., U.S. v. Butler*, 211 F.3d 826, 833 (4th Cir. 2000).
[26] *See, e.g., U.S. v. McLennan*, 563 F.2d 943, 945 n.2 (9th Cir. 1977).
[27] *See U.S. ex rel Longi v. Lithium Power Technologies, Inc.* (Nos. 08-20194, 08-20306) (5th Cir., July 9, 2009) (Company liable for $4.9M (three times amount of original grant awards) based on false representations contained in grant proposals notwithstanding that it successfully designed and developed lithium batteries that were found satisfactory by Dept. of Defense).
[28] *See* 31 U.S.C. § 3730(b)(1).
[29] *Id.* at § 3730(b)(4).
[30] *Id.* at § 3730(c)(1).
[31] *Id.* at § 3730(b)(4)(B).
[32] *Id.* at § 3730(c)(2).

- The relator can receive between 15 and 25% of the proceeds of the action/settlement depending on the contribution, plus expenses.[33]
- Under some circumstances the court must limit the relator's proceeds to no more than 10%, plus expenses.[34]

▪ 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.[35]

- **OTHER ISSUES:**

o Implied False Certification Theory:

▪ Some courts recognize a theory that claims submitted to the government contain implicit certifications of regulatory or statutory compliance.[36]

▪ Of those courts, many limit this theory to situations where the government's payment is specifically conditioned on certification of statutory or regulatory compliance.[37]

o Reverse False Claims:

▪ Section 3729(a)(7) imposes FCA liability for the use of a false statement or record to conceal, avoid or reduce a payment obligation to the government.

[33] *Id.* at § 3730(d)(1).
[34] *Id.*
[35] *Id.* at § 3730(d)(2).
[36] *See, e.g., U.S.* ex rel. *Pogue v. Diabetes Treatment Ctrs. of Am., Inc.* 238 F. Supp. 2d 258 (D.D.C. 2002).
[37] *See, e.g., U.S.* ex rel. *Bowan v. Education Am., Inc.*, No. 04-20384, 116 Fed. Appx. 531, 2004 WL 2712494 (5th Cir. Nov. 30, 2004).

- **RECENT DEVELOPMENTS:**
    - Mandatory disclosure of an FCA violation.
        - New Federal Acquisition Regulation rule requires government contractors to timely disclose in writing when its "principles" have "credible evidence" of a violation of federal criminal law involving fraud, conflict of interest, bribery, gratuities or the FCA.[38]
            - The disclosure must be made to both the contracting officer and the cognizant Inspector General's Office.[39]
            - "Principles" include "an officer, director, owner, partner, or a person with primary management or supervisory responsibilities within a business entity (*e.g.*, general manager, plant manager, head of a subsidiary, division, or business segment, and similar positions)."[40]
            - 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.'"[41]
        - This rule went into effect on December 15, 2008 and is implemented through the inclusion of FAR clause 52.203-13.[42]

[38] 73 Fed. Reg. 67,064, 67,091-92 (Nov. 12, 2008); *codified at* 48 C.F.R. § 52.203-13.
[39] 73 Fed. Reg. at 67,091; *see also* 48 C.F.R. § 52.203-13(b)(3)(i).
[40] 73 Fed. Reg. at 67,090; *see also* 48 C.F.R. § 2.101(b)(2).
[41] 73 Fed. Reg at 67,074.
[42] *Id.* at 67,090-91.

        - However, even if contracts do not include this clause, the rule is still effective because it provides that a non-disclosure can serve as a basis for debarment.[43]
    - Heightened scrutiny with American Recovery and Reinvestment Act ("ARRA").
        - ARRA has fostered wide interest in government contracting and grants.
        - ARRA emphasizes that relevant Inspectors General be vigilant in ensuring such dollars are not subject to fraud and abuse.
    - Recent legislation "clarifiying" FCA requirements with respect to "presentment" and other requirements. (P.L. 111-21, Sec. 4 (May 20, 2009)).
        - Substantially amends 31 U.S.C. § 3729 by deleting current language specifying that false claim be presented "to an officer or employee of the United States Government" from former § 3729(a)(1) and making similar deletions to other subsections of § 3729(a).
        - Intended to close perceived "loophole" resulting from decision in *Allison Engine Co. v. U.S.* ex rel. *Sanders*, No. 07-214, 2008 WL 2329722 (U.S. June 9, 2008). Supra at p. 3, n. 12.

- **COMMON PITFALLS FOR NONPROFIT ORGANIZATIONS:**
    - Not confirming in advance federal contract and grant program-unique requirements.
        - Requirements, especially for grants, can vary significantly from program-to-program.

[43] *Id.* at 67,091; *see also* 48 C.F.R. § 9.406-2.

- Not ensuring your organization's policies and procedures are consistent with federal requirements.
    - Cost accounting and invoicing not compliant with applicable federal cost principles.
    - Purchasing and subcontracting/subgranting processes not consistent with federal requirements favoring competition and adequate justification for noncompetitive awards.
    - Ethics, conflict of interest, and whistle-blower policies do not mirror federal requirements.
- Not "flowing down" mandatory federal requirements to subcontractors and subgrant recipients.
- Internal controls that are either inadequate to ensure early detection of problems, or are simply not followed.

- **ELEMENTS OF A SUCCESSFUL COMPLIANCE PROGRAM:**
    - Review and update policies and forms on a regular basis – consider an external "audit" or assessment if it's "been a while."
        - 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.
    - Regular and meaningful training on federal compliance requirements that is tailored to the specific audience (e.g., senior management, cost accounting and billing, business development, contracts and grants management).
    - Consider exit interviews for former employees.