SHEPPARD MULLIN
SHEPPARD MULLIN RICHTER & HAMPTON LLP
ATTORNEYS AT LAW

Government Contracts BLOG
For the Latest Updates on Laws Affecting Government Contracts

Government Contracts Blog

Posted at 12:52 PM on January 18, 2011 by Sheppard Mullin

D.C. Circuit Rejects "Collective Knowledge" But Shines Spotlight on Processes

By Robert M. P. Hurwitz

A good internal investigation gives equal scrutiny to people and processes. It may be easier to replace or reprimand the "bad apple" employee than to overhaul a system with which employees are familiar and has become ingrained in the operational culture. Nevertheless, it is increasingly vital that companies take a hard look at systems, structures, and processes. A recent opinion from the D.C. Circuit indicates that these organizational elements will be the next battleground in False Claims Act ("FCA") litigation.

In *United States v. Science Applications International Corporation*, SAIC entered into a contract with the Nuclear Regulatory Commission ("NRC") to provide technical assistance and expert analysis. The contract included strict provisions on conflicts of interest, including a requirement that SAIC seek NRC's prior written approval if it had reason to believe that a proposed arrangement may raise a conflict of interest. SAIC subsequently entered into two contracts that potentially conflicted with its NRC work. SAIC had a computerized compliance system, but it did not capture all of SAIC's business relationships and did not adequately associate keywords with descriptions of work. The descriptions were also incomplete. SAIC did not disclose the new contracts to the NRC. The NRC eventually learned about SAIC's other work from a member of the public and terminated SAIC's contract. The government then sued SAIC under the False Claims Act.

The district court aided the government's case by adopting the "collective knowledge" doctrine. Collective knowledge, the court instructed the jury, means that a corporation is liable for the collective knowledge of all its employees, as long as they obtained their knowledge while acting on behalf of the corporation. SAIC appealed, pointing out that the FCA requires the government to prove "knowledge" in one of three forms: actual knowledge of the false claim, conduct in deliberate ignorance of its truth or falsity, or conduct in reckless disregard of its truth or falsity. The collective knowledge instruction would allow the government to prove liability without demonstrating that any particular employee acted with "knowledge."

The D.C. Circuit agreed with SAIC that the collective knowledge doctrine is inconsistent with the FCA. The court noted that the FCA's triad of actual knowledge, deliberate ignorance, and reckless disregard was designed to capture "ostrich-like" conduct and that, even without the collective knowledge doctrine, companies are already subject to liability if they insulate their officers from the knowledge of subordinates. The D.C. Circuit found that the collective knowledge doctrine exceeded the statute by allowing liability based on nothing more than scraps of innocent information. Collective knowledge would punish companies for behavior that is merely negligent, or possibly even completely blameless.

This is an important victory for contractors, but it may merely shift the argument. The FCA's loose definition of "knowledge" can partially fill the gap left by the rejection of the collective knowledge doctrine. As the court explained, "if a plaintiff can prove that a government contractor's structure prevented it from learning facts that made its claims for payment false, then the plaintiff may establish that the company acted in deliberate ignorance or reckless disregard of the truth of its claims." The court reiterated that a jury can properly find

liability based on "systems and structure."

Plaintiffs may seize on this language to argue that a contractor recklessly impeded the free flow of information. "If only there were better databases or more inclusive meetings," they will argue, "then Employee X would have learned Employee Y's information, and the company would have discovered the impropriety." Thus, instead of arguing about who knew which pieces of information, FCA litigation may focus on why the problematic pieces of information remained segregated.

The FCA does not demand perfection. Unfortunately, litigation is an activity performed in hindsight. Contractors can take some solace in knowing that they need not extract every last bit of information from every employee. However, it is now likely that plaintiffs will structure their allegations in a way that attempts to link an imperfect outcome to alleged defects in contractors' systems, structures, and processes.

Internal investigations provide an opportunity to improve systems, structures, and processes. It is rarely the case that problematic issues point to nothing more than rogue employees. An investigation should address the larger structural implications: is there adequate coordination among supervisors and managers? Do different organizations and business units communicate properly? Are compliance systems designed well? Are they being used to their full potential?

Contractors would be wise to use every internal investigation, in particular the raft of internal investigations prompted by the mandatory disclosure requirements imposed by FAR 52.203-13, as an opportunity not only to reverse the monetary consequences of improper conduct and to punish those responsible, but to implement internal process improvements designed to prevent a recurrence of the problem. Improvements will not only demonstrate a lack of recklessness, but they will also catch issues before they become FCA concerns.

Authored by:

Robbie Hurwitz
(213) 617-5476
rhurwitz@sheppardmullin.com