FCA FOCUS

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EDITOR'S NOTE:

Welcome to Patton Boggs' inaugural False Claims Act (FCA) newsletter, *FCA Focus*. As the Department of Justice (DOJ) celebrates the 25th anniversary of the statute's 1986 amendments, which catapulted the FCA into prominence as the United States' preferred tool for recovering money from fraud, and as the use of the statute continues to expand, we feel that the time is right to focus a newsletter on this particular statute across all industries.

The last 25 years have witnessed a tremendous growth in the use of this Civil War-era statute from the defense procurement industry (think sawdust for gunpowder in the 1860s, and defective battle gear in recent years) to health care, the financial sector, public housing, and many other industries in between. The application of the statute also has grown more creative, expanding from simple, straight-forward theories (such as billing for goods or services not provided) to more complex theories (such as billing where services were provided but where the entity expressly or implicitly represented compliance with a separate statutory or contractual provision that in actuality was violated). Combined with the amendments passed in 2009 as part of the Fraud Enforcement and Recovery Act (FERA) and then in 2010 as part of the Patient Protection and Affordable Care Act (PPACA), the FCA stands as a formidable weapon against suspected fraud in all industries that receive funds directly or indirectly from the federal government. Add to the sweeping statute the significant addition of personnel and funding at the DOJ, and we expect to see prosecutions extend to a broader range of industries and a broader range of conduct within those industries. We also expect to see whistleblowers who file complaints under the statute's *qui tam* provisions continue to drive the DOJ's agenda, largely due to the sheer number of such complaints.

Our goal is to keep our clients and friends apprised of how FCA developments may affect them and to provide useful practice tips. We hope that you enjoy this inaugural issue and welcome your suggestions as to how we can make this newsletter more useful to you.

- *Total relator share awards from 1987- 2010: $2,877,694,871*
- *Percentage of these awards in cases where U.S. intervened: 96%*

**Source: DOJ and HHS releases; Letter from DOJ/HHS to Senator Grassley, dated January 24, 2011*

RECENT DEVELOPMENTS

DOJ Civil Recoveries in FY2011

DOJ civil fraud recoveries for FY2011 topped $3 billion for the second year in a row. DOJ reported that $2.8 billion of that amount is related to *qui tam* filings, and the U.S. awarded relators in those matters more than $530 billion. In FY2011, there were a record number of new *qui tam* filings (638) and the lowest number of non-*qui tam* new matters (agency initiated proceedings) since 2006. DOJ reported that it recovered $2.4 billion in health care fraud matters, almost $200 million in DoD matters, and almost $400 million in other fraud matters, including financial frauds, non-DoD procurement fraud, and other federal agency enforcement. DOJ reported 800 new *qui tam* filings in FY2010-2011, and 417 in FY2011 alone, far surpassing prior years' annual filings.

In announcing these results, DOJ highlighted its "aggressive pursuit of fraud in government procurement and other forms of financial fraud, including grant, housing and mortgage fraud that emerged in the wake of the financial crisis." In addition, it noted that "the department recovered $422 million in fiscal year 2011 in procurement fraud cases, including $89.3 million in recoveries in connection with the wars in Southwest Asia."

Number of *Qui Tam* Actions Hits Record

In 2010, the number of *qui tam* actions filed hit a record number of 573, of which 382 contained allegations of health care fraud. The prior record for the number of filings was in a surge in 1997-1999, during which an average of 503 cases were filed each year. There is no indication of any abatement of filings against pharmaceutical and device manufactures, hospitals and other health care providers - comprising 382 of these new filings - and against defense contractors - holding firm at about 11 percent of all filings. Nor is there any indication that the historical U.S. rate of intervening in *qui tam* cases, generally hovering around 22-24 percent, will change significantly. Likewise, as has occurred consistently since 1987, the vast majority of recoveries will likely be in cases in which the U.S. intervenes, underscoring the importance of highly effective pre-intervention advocacy by corporations and their counsel to forestall an intervention decision or narrow the scope of one. In 2011, consistent with the administration's announced campaign to reduce federal fraud and waste, the U.S. evidenced its intent to use the FCA against financial institutions, to allege mortgage fraud, and to redress alleged federal procurement fraud, in every area from software to gas leases.

Financial Fraud Cases Hitting Hard

As expected by many, the U.S. is using the FCA to pursue allegations of mortgage fraud during the boom years of the housing bubble. On May 3, 2011, the U.S. Attorney for the Southern District of New York filed a lawsuit against Deutsche Bank AG and its subsidiary MortgageIT alleging damages of at least $386 million, subject to trebling and penalties, on the basis of FHA insurance claims arising from MortgageIT's approval of mortgages for FHA insurance. The theory of the case is alleged false annual certifications provided to maintain the bank's status as a "Direct Endorsement Lender" in a residential mortgage program insured by the U.S. This case is extremely significant as the first public FCA case alleging mortgage fraud against a major financial firm, and the U.S. Attorney stated that "it would not be a fantastical stretch to think we are looking at other lending institutions as well." This statement may relate to press reports in May 2011 that the U.S. is prepared to allege under the FCA that Bank of America, JPMorgan Chase, Wells Fargo, Citigroup and Ally Financial submitted false documents to see federal reimbursement from FHA loans on which they had foreclosed. We also note that for 2011, DOJ requested $178 million solely for the purpose of combating mortgage fraud, and as of March 2010, the Attorney General said the FBI is investigating more than 2,800 mortgage fraud cases.

As reported in November 2011 by *The Wall Street Journal*, the Bank of New York Mellon Corp. is in discussions with the U.S. Attorney's Office for the Southern District of New York to resolve allegations of fraudulently overcharging clients in foreign currency transactions. The New York Attorney General filed suit under the state FCA, modeled after the federal statute, seeking a recovery of nearly $3 billion.

Government Procurement Enforcement Still Vigorous

FCA enforcement is vigorous in nearly every industry that receives federal funding, directly or indirectly. In 2010 and 2011, DOJ resolved substantial cases in procurement, DoD, and other "traditional" areas of FCA enforcement. In October 2011, Oracle agreed to pay $200 million to resolve FCA allegations that it failed to meet its contractual obligations to GSA when it did not offer the GSA the same deep discounts on sales of its software it offered to its commercial customers. In September 2011, the U.S. reached settlements with defense contractors Science Applications International Corp. and Lockheed Martin Corporation which agreed to pay $30 million to resolve allegations of bid-rigging with respect to a government contract to run a supercomputer center at NASA's Stennis Space Center. Also in September, BP Amoco agreed to pay the U.S. $20.5 million to resolve allegations of knowingly underpaying royalties owed on natural gas production from federal and Indian leases. Other examples of recent procurement fraud matters include DOJ FCA settlements with Bell Helicopter Textron, Inc., a helicopter manufacturer that allegedly overcharged DoD for helicopters, parts, and modifications; Lincoln Fabrics Ltd., a manufacturer of Zylon ballistic fabric that allegedly knew that the fabric was unfit for use in body armor but sold bulletproof vests to U.S. agencies regardless; and EMC Corporation, a technology vendor, to resolve allegedly false representations that EMC Corporation would provide the U.S. prices that would match the lower prices offered to its commercial customers.

Pharmaceutical Recoveries Skyrocket to Stratosphere

In cases involving theories under the FCA not advanced by DOJ until around 2004 - primarily theories of "off label" promotion using the Food, Drug and Cosmetic Act as a predicate statute and "AWP" pricing manipulations - DOJ continues to obtain settlements with pharmaceutical companies that involve astounding settlement amounts. In late November 2011, Merck agreed to an FCA settlement and payment of $628 million, plus a $321 million criminal fine, to resolve allegations involving alleged off-label promotion of the painkiller Vioxx and other issues related to Vioxx. This follows GSK's announcement in early November 2011 that it had reached an agreement in principle for it to pay $3 billion to settle its civil and criminal liability arising out of the government's investigation into the company's sales and marketing practices, including the marketing of its diabetes drug Avandia, as well as the investigation of its use of the nominal price exception under the Medicaid Rebate program.

These actions highlight the federal government's unrelenting enforcement sweep against drug companies' sales and marketing practices. In 2009, Pharmacia and Upjohn Inc., then a subsidiary of Pfizer, agreed to pay $2.3 billion - including a civil settlement of $1 billion - to settle civil and criminal liability arising from the alleged illegal "off label" marketing practices for the painkiller Bextra and certain other drugs. Earlier in 2009, Eli Lilly and Company agreed to a $1.4 billion payment - including an $800 million civil settlement - to resolve criminal and civil allegations of improper "off label" practices relating to its antipsychotic Zyprexa. Also, in October 2010, SB Pharmco Puerto Rico Inc., a subsidiary of GSK, agreed to a criminal plea and civil settlement to resolve allegations relating to the manufacture and distribution of certain drugs made at GSK's now-closed Cidra, Puerto Rico, manufacturing facility. That resolution includes a civil settlement under the FCA and related state claims for $600 million.

*For questions on these recent developments, please contact **Larry Freedman**.*

- *U.S. "intervention rate" (intervention decisions divided all elections) in 2010: 24%*

- *Percentage of declined cases that are dismissed, 1987-2010: 86%*

**Source: DOJ and HHS releases; Letter from DOJ/HHS to Senator Grassley, dated January 24, 2011*

PRACTICE ANALYSIS

The Fee-Shifting Provisions of the False Claims Act

The FCA permits both the relator and the defendant to shift attorney fees and costs to the other party. Ample case law exists to define what a defendant must prove to win a fee award. In contrast, because relators' fee shares are often the subject of settlement agreements, the strategies available to defendants to mitigate fee awards are less defined. Here we examine some of those strategies.

The FCA's sections guiding the percentage of proceeds available to a relator provide that the relator "[s]hall *also* receive an amount for reasonable expenses which the court finds to have been necessarily incurred, plus reasonable attorneys' fees and costs. All such expenses, fees and costs shall be awarded against the defendant [emphasis added]." 31 U.S.C. 3730(d)(1) and (2). Information on the allocation of fees in FCA settlements under these sections is largely anecdotal. FCA defendants may face demands in negotiations for fees separate and apart from the damages settlement amount, or arguments for an increase in the damages settlement amount to cover attorneys' fees. For example, a relator may argue for a higher percentage of the total award to compensate its counsel or for an increase in the overall damages pool for this purpose. The statute does not authorize either approach: "[A]ttorneys' fees are not allowable to inflate the recovery of the plaintiff's 'proceeds' under the FCA." *United States ex rel. Sharma v. University of Southern California*, 217 F.3d 1141, 1143 (9th Cir. 2000).

The court in *Sharma* revised an FCA settlement to clarify that the settlement amount was inclusive of attorney fees and that the plaintiff could not reach into the government's share to pay its attorneys. The principle that the attorney fee award should not be taken from the proceeds due the government guided the court. Because the statute authorizes the award of attorney fees and expenses *in addition* to a damages award, defendants have a good counter to the *qui tam* relator who argues that he or she is entitled to a higher damages amount as attorney compensation or for a greater percentage of the total recovery for the same purpose. As far as the defendant is concerned, the *qui tam* plaintiff's attorney fees do not provide the basis for a larger damages award. There is a pitfall here. Because the FCA characterizes the award of fees and expenses as being in addition to the relator's share of the recovery, a settlement agreement that is silent on the issue of fees leaves open the potential for a subsequent suit by the relator for attorney fee compensation. Accordingly, settlement agreements should identify the amount of and payment mechanism for the relator's attorney fees in order to preclude later fee petitions.

Defendants in *qui tam* cases should also be mindful of the statute's limitations on expense and fee recovery to fees which the court finds to have been "necessarily incurred" and "reasonable attorneys' fees and costs." These limitations are particularly relevant in cases in which the government intervenes and leads the litigation effort. In these cases, the government's active presence necessarily fuels the question of whether the relator's expenses were necessarily incurred and its attorney fees reasonable. Even in cases in which the government does not intervene, such qualifiers leave room for fee reduction arguments based on the relator's conduct of the litigation such as delaying tactics, repetitive discovery or rejections of settlement offers. For example, should a defendant make a settlement offer that is rejected and the case either settles or is decided at a similar or lesser value, the defendant should be able to argue that the expenses and fees incurred by relator after the point of the offer were neither necessary nor reasonable.

Similarly, FCA defendants should scrutinize relators' attorney fee calculations for matters that do not advance the FCA case against them. In *United States of America ex rel. Lefan v. General Electric Company*, Nos. 08-5216 (6th Cir. 2010), the court denied that portion of the plaintiffs' attorneys fee request arising from a first-to-file suit related to the FCA case but not directly involving defendant General Electric, as well as a dispute between the relator and the government concerning the relator's share of the recovery. While there is limited precedent guiding the award of attorney fees to *qui tam* plaintiffs, familiarity with the limits on fee recoveries set forth in cases like *GE* and with the manner in which other FCA settlements have been structured will provide a defendant with effective strategies when negotiating FCA settlements.

*For questions on this article, please contact **Mary Beth Bosco**.*

- *As of January 4, 2011, number of sealed qui tam cases under investigation by the U.S.: 1,341*
- *Percentage of these cases alleging health care fraud: 66% (885 cases)*

**Source: DOJ and HHS releases; Letter from DOJ/HHS to Senator Grassley, dated January 24, 2011*

CASE ANALYSIS:

Supreme Court Denies *Certiorari* in FCA Case

The Supreme Court rejected an opportunity to resolve significant controversy among the circuits regarding the appropriate standard applicable under the FCA when an entity (either the claims submitter or an upstream entity) has violated a legal requirement independent of the FCA. *Blackstone Medical, Inc. v. U.S. ex rel. Hutcheson*, 11-269 (December 5, 2011). In December 2011, the Court denied certiorari in a case in which the First Circuit had held that the defendant, a medical device manufacturer, could be liable for false claims submitted by hospitals, where those claims were tainted by the manufacturer's alleged payment of kickbacks to physicians. Although decided in the health care context, the case's most significant ramifications extend well beyond health care.

The relator (a former employee of the defendant) alleged that the defendant medical device manufacturer Blackstone Medical, Inc. (BMI) engaged in a nationwide kickback scheme in violation of the health care Antikickback Statute (AKS) to induce physicians to use its medical devices in spinal surgeries, and that BMI knew this scheme would cause physicians and hospitals to present false claims to Medicare containing material misrepresentations. As alleged, the hospitals actually submitting the Medicare claims for the procedures implanting the devices were unaware of the kickbacks. The United States declined to intervene in the litigation.

The district court dismissed the claims against both BMI and the physicians. First, it found the hospital's claims not to be false under the "express certification" theory of "legal falsity" because the Provider Agreement and the Cost Report Certifications submitted by the hospitals represented compliance by the hospital with respect to its own actions, not for the entire underlying transaction. *United States ex rel. Hutcheson v. Blackstone Medical, Inc*., 694 F. Supp.2d 48, 66 (D. Mass. 2010). The district court also refused to find falsity under an "implied certification" theory, holding that falsity under that theory could be established only if the statute or regulations stated that compliance was a precondition of payment and that, here, the statute and regulations made no such provision. Thus, the hospitals' certifications were not false and BMI could not be liable.

The First Circuit reversed the dismissal, rejecting the district court's positions that (a) for a claim to be false without an express certification of compliance, the predicate statute or regulation must state on its face that compliance is a precondition of payment, and (b) a hospital's representations about its own compliance cannot incorporate an implied representation concerning an upstream device manufacturer's compliance. 647 F.3d 377 (1st Cir. 2011). The appeals court also addressed and rejected various approaches taken by other circuit courts addressing "legal falsity" under both "express" and "implied certification" theories, where the alleged FCA liability was premised on other violations. Instead, the First Circuit simply looked to the Provider Agreement and Cost Report certifications examined by the lower court and concluded that the documents' scope did extend beyond the signatory hospital's own compliance and to the "underlying transactions." To hold otherwise, the court reasoned, would "systematically excuse from FCA liability non-submitting entities that cause the submission of claims that fail to meet that stated precondition." *Id.* at 393.

In its certiorari petition filed with the Supreme Court on August 30, 2011, BMI argued that the disparity between the circuits as to when a claim is legally false must be resolved by the Supreme Court, because the differences are so extreme that the same set of facts could lead to different results depending on the circuit. Brief for Petitioner, BMI v. U.S. ex rel. Hutcheson, 132 S. Ct. 815 (2011) (No. 11-269), 2011 WL 3860767. BMI's petition painstakingly inventoried the different approaches taken by each circuit regarding the question of when "legal falsity" arises under the FCA under "express" and "implied" certification theories. Numerous amici curiae also submitted briefs supporting BMI's petition.

It is impossible to know for certain why the Supreme Court declined to hear the case, but the impact of its denial is easier to judge. The United States and relator's bar, no doubt, will be emboldened by the denial of *certiorari*, viewing it as tacit support for their position. In the AKS context, probably very little will change. As the relator noted in her Opposition, all circuit courts to have considered the question previously, and virtually all district courts as well, have held that FCA liability can be predicated on an AKS violation. Brief in Opposition No. 11-269, filed 10/31/2011, 2011 WL 5145751. Although most such cases focused on situations in which a direct party to the kickback submitted the claims at issue to the government, at least some addressed the issue in contexts similar to this and found potential liability. For example, in a case involving allegations of kickbacks to physicians by a pharmaceutical manufacturer, the district court held a decade ago that the kickbacks could render the claims false even though the kickbacks were paid to physicians who prescribed the drugs, while the actual claims for the drugs were submitted by the unwitting pharmacies that filled the prescriptions. *United States ex rel. Franklin v. Parke-Davis*, 147 F. Supp.2d 39 (D. Mass. 2001). And although this theory may not have been addressed by many courts in written opinions, numerous *qui tams* have been filed based on similar theories, and numerous pharmaceutical and medical device manufacturers have settled such cases for significant sums. Given the recent amendments to the AKS expressly stating that a claim for items or services resulting from a kickback constitutes a false or fraudulent claim under the FCA, this trend should continue.

The greater effects of the First Circuit's decision will be felt outside of the health care industry. Industries governed by countless statutes, regulations, contractual provisions, and other program requirements - for example, higher education, government procurement, and financial services - could experience an increase in *qui tam* litigation as a result of this decision, regardless of whether they directly submit claims or not. While the case law is generally settled that AKS violations can provide the predicate for FCA liability for health care providers, it is much less developed with respect to whether violations of other statutes can form the basis of FCA liability, and the outcome of any particular case could well turn on the particular circuit's interpretation of "legal falsity."

Relators' counsel also may prove more inclined to file such cases in district courts located within the First Circuit now, perceiving that courts there will be quicker to find a premise for liability than in other circuits, and particularly where the allegations push the envelope of the law. Thus, we may see even more cases being filed in the District of Massachusetts than ever before.

*For questions on this article, please contact **Laura Laemmle-Weidenfeld**.*

- *Percentage of declined cases that have resulted in a recovery, 1987-2010: 5%*
- *Number of full-time equivalent work years spent by Assistant U.S. Attorneys devoted to health care fraud enforcement in 2010: Approximately 200*

**Source: DOJ and HHS releases; Letter from DOJ/HHS to Senator Grassley, dated January 24, 2011*

PRACTICE TIP:

Attorneys' Fees in Settlement Negotiation

When negotiating settlement with the United States and relator, the defendant must separately resolve the issue of attorneys' fees with the relator, as discussed above. The defendant and relator also can negotiate mutual releases that are much broader than any releases into which the government would enter, so long as those releases do not affect the government's rights in any way. The attorney fee agreement and mutual releases may be contained either in the body of the settlement agreement or in a separate side letter just between the defendant and the relator. In the latter case, however, cross-reference the side letter in the body of the settlement agreement.