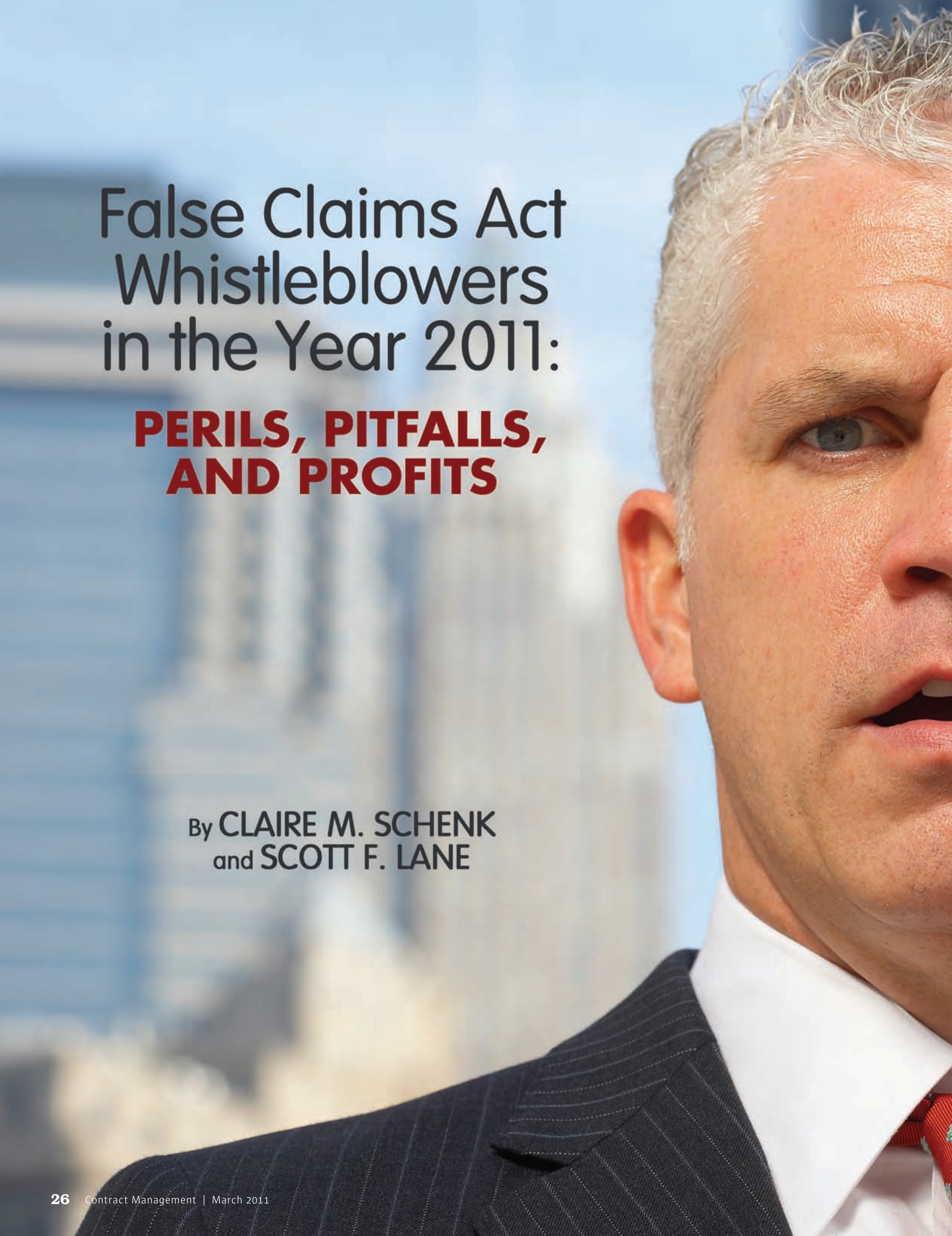

False Claims Act Whistleblowers in the Year 2011:

PERILS, PITFALLS, AND PROFITS

By CLAIRE M. SCHENK and SCOTT F. LANE

In order to identify risks early, contracting professionals must understand what false claims are, what the *qui tam* provisions mean, how liability has been recently expanded, and signals to initiate an internal investigation.

The Department of Justice secured $3 billion in civil settlements and judgments under the False Claims Act[1] in the last fiscal year alone. This lifted the Department of Justice's total recoveries under this law to over $27 billion in nearly 25 years.[2] With such staggering amounts at stake, there is no question why even mentioning the phrase "false claim" to a government contractor draws a cold and nervous chill.

Yet, the stakes have never been higher because the risk of being challenged by a "whistleblower" under the False Claims Act has grown considerably over the past year. Seemingly every recent federal reform law has inconspicuously expanded some provision of the False Claims Act. Many government contractors would have simply not expected the Health Care and Financial Reform bills of 2010 to impact their own liability, but each has taken another step toward expanding whistleblower incentives that reach all government contractors. In order to identify risks early, it is imperative that frontline contracting professionals understand what false claims are, what the *qui tam* ("whistleblower") provisions mean, how liability has been recently expanded, and signals to initiate an internal investigation.

What is a False Claims Act Violation?

Since its inception under President Abraham Lincoln, the purpose of the False Claims Act has always been to combat fraud against the government through civil lawsuits.[3] A violation under the False Claims Act has three core elements.[4] First, there must have been a "claim" against the United States. A "claim" broadly covers any request for money or property presented to the federal government. It can even cover requests submitted to contractors by subcontractors if the money is to be used to advance a government interest and the government is intended to ultimately reimburse the money.[5]

Second, the claim, or a statement in support of a claim, must have been false or fraudulent. This element assesses not only the truth of the claim itself, but also whether the underlying support that *should be* "material" to the government's decision to pay the claim was false. Such underlying support could include, *inter alia*:

- Delivery documentation,[6]
- Oral assertions,[7]
- Proposal documents,[8] and
- Implied certifications.[9]

In one recent case, the D.C. Circuit Court of Appeals held that a contractor's violation of an organizational conflicts of interest clause, which required the contractor to have written contracting officer approval before entering arrangements that might involve a conflict of interest, could form the basis of False Claims Act liability.[10]

Third, the claim must have been made with the requisite level of knowledge. Generally, for there to have been a violation, the contractor must have "knowingly" presented the false claim or "knowingly" made a false statement materially supporting the false claim. "Knowingly" does *not* require any malicious or specific intent to actually defraud the government. Rather, "knowingly" means that a person either:

- 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.[11]

The prosecution of a False Claims Act violation may result in the imposition of staggering damages and penalties. Each

false claim submitted carries a fine of up to $11,000 plus three-times the amount of actual damages.[12] The largest individual False Claims Act recoveries to date have been in the healthcare industry where defendants are both providers and contractors and claims overlap between several agencies.[13] In September 2009, Pfizer Inc. agreed to pay $1 billion to resolve allegations under the False Claims Act that the company's illegal promotion of four drugs caused claims to be submitted to various government healthcare programs for uses that should not have been covered by those programs.[14] The largest settlement resulting from violations by a defense contractor was in April 2009. As discussed further below, Northrop Grumman agreed to a fine of $325 million to settle allegations that a subsidiary it purchased made defective parts for spy satellites and covered up the problems.[15]

What do the *Qui Tam* Provisions Mean?

The False Claims Act was enacted in 1863 in response to rampant fraud by Civil War contractors. The Union Army was being constantly defrauded by contractors who were, among other things, selling the army gunpowder that had been salted down with sand, deceiving the army into purchasing the same cavalry horses several times over, and shipping crates full of sawdust to the frontlines labeled as "muskets."[16] President Lincoln knew the federal government did not have the resources to uncover or prosecute these widespread schemes on its own, so the False Claims Act was created with what are effectively bounty hunter provisions. These provisions simply encourage private citizens with inside information on government fraud to bring lawsuits themselves. These are referred to as "whistleblower" or *qui tam* lawsuits, a Latin phrase meaning "he who brings a case on behalf of our lord the King, as well as for himself." As originally enacted, the False Claims Act compensated private citizens (known as "relators" or "whistleblowers") with 50 percent of the money their lawsuits recovered for the government, and thus, the first federal whistleblower statute was born. Historically, *qui tam* whistleblowers have often included current and former employees, competitors, and suppliers.

The *qui tam* provisions have changed significantly over the years—mostly in the following areas:

- Modifying the *qui tam* share of the recovery;
- Preventing "parasitic" *qui tam* litigation where the facts have already been disclosed to the public, i.e., the "public disclosure bar"; and
- Providing protections for whistleblowers against retaliation.

The first major amendment to the False Claims Act was in 1943. That amendment strictly prohibited any qui tam lawsuit that was based on information already in the possession of the government and modified the 50 percent automatic recovery to be a reward purely in the discretion of the courts. Those aggressive amendments were largely the product of a congressional response to a specific *qui tam* lawsuit where the whistleblower's allegations were opportunistically lifted directly from a federal criminal indictment.[17] Since the whistleblower had no personal knowledge of the allegations and had simply been the first individual to latch onto the government charges, the case is often referred to as an example of a "parasitic" lawsuit.

The next major amendment was in 1986, and it rejuvenated *qui tam* litigation by removing the automatic prohibition in favor of the "public disclosure bar." Under this new public disclosure bar, *qui tam* lawsuits were only prohibited if they were based on information that had already been publicly disclosed—unless the whistleblower was an "original source" of the allegations. The 1986 amendments also created the first whistleblower protections against retaliation and reinstated a minimum whistleblower share of the recoveries (15–30 percent). These amendments represented a significant shift toward encouraging whistleblower lawsuits. As set out below, recent reform initiatives have reduced the scope of the public disclosure bar and expanded these whistleblower protections.

While government contracting has always required an impeccable standard of conduct, *qui tam* recoveries have proven to be an effective tool for the government to expose large violations. Two-thirds of the Department of Justice's recoveries under the False Claims Act since 1986 have derived from *qui tam* litigation.[18] The Pfizer and Northrop Grumman actions were both exposed through *qui tam* litigation. The whistleblower in the Northrop Grumman action was a scientific researcher who discovered that the components being sold for use in satellites were likely to fail when operated under high electrical currents, but he was told not to disclose his findings. When the whistleblower heard about satellite problems being encountered years later, he filed a *qui tam* lawsuit and ultimately received $48.75 million of the $325 million settlement. That lawsuit demonstrates that "ostrich-like behavior" which ignores or suppresses genuine concerns can increase the risk of liability.[19] In order to avoid False Claims Act liability, contracting professionals must be aware that these whistleblower provisions make their communications and representations to government officials and prime contractors subject to an ever-increasing level of scrutiny.

Recent Expansions of the False Claims Act

The False Claims Act has historically encountered very few substantive amendments, but the *qui tam* provisions have recently been stimulated by the Obama administration's fight against fraud. The most significant amendment of late was tucked away in the 2010 Healthcare Reform law, i.e., the Patient Protection and Affordable Care Act (PPACA).[20] Recall that the public disclosure bar prohibits a *qui tam* lawsuit if that lawsuit would be based on information that had previously been publicly disclosed—unless the whistleblower is an "original source" of the allegations. The PPACA narrows the scope of what is considered a "public disclosure." As a result, *qui tam* lawsuits where the information forming the basis of the lawsuit has been disclosed in *state* civil or criminal litigation, *state* administrative hearings, or federal civil litigation where the federal government is not a party is no longer categorically prohibited.[21]

At the same time, the PPACA creates two new ways to qualify as an "original source," enabling many whistleblowers to entirely circumvent the public disclosure bar. First, a whistleblower may now qualify as an "original source" just by having voluntarily disclosed the information to the government before public disclosure occurred. This abandons the former stern rule that an original source was required to have "direct and independent knowledge of the information," in addition to having voluntarily provided it to the government before public disclosure. It is likely that the courts will require that the information first reported by the whistleblower to have been sufficient on its own

to establish a violation in order to qualify as an original source under this exception.[22]

The PPACA amendments went much further than this, however, by creating a second way for a whistleblower to qualify as an "original source," even with an incomplete story of the violations. If the whistleblower simply has "knowledge that is independent of and materially adds to the publicly disclosed" information, and voluntarily provided that information to the government, the whistleblower may now qualify as an original source. The phrase "materially adds" will undoubtedly be the subject of litigation at the U.S. Supreme Court in the future. In the meantime, if the courts give literal meaning to this provision, whistleblowers will be incentivized to voluntarily come forward with information—even after hearing on the evening news that the federal government has already begun prosecutions—to potentially receive a *qui tam* stake. This requires organizations to reconsider the processes used in internal investigations and the scope of personnel that those investigations reach.

A side-effect of expanding who qualifies as an "original source" is that it counteracts the increasing ambiguity of which disclosures trigger the public disclosure bar. This is because the public disclosure bar is not only triggered by disclosures in federal proceedings, but also by disclosures from the "news media." Courts have recently been interpreting "news media" broadly to include disclosures on websites, public databases, and even Wikipedia articles.[23] The general rule coming out of these cases has been that if the public can easily access the website and the information contained on it, it constitutes a public disclosure. The growth in anonymous public communication forums, such as Twitter, Facebook, and blogs attached to various news articles, could have significantly strengthened the impact of the public disclosure bar. The alternative methods to qualify as an original source, however, almost completely offset that expansion.

There is a lingering question regarding whether the PPACA amendments will apply retroactively. Although relaxing the public disclosure bar and expanding who qualifies as an original source did not extend the substance of a contractor's liability under the False Claims Act (since the government could bring an action under the False Claims Act regardless of public disclosure), the PPACA amendments have significantly impaired a defense against *qui tam* litigation. The U.S. Supreme Court previously faced a similar situation regarding the 1986 False Claims Act amendments and denied retroactive effect.[24] If the rule in that case is applied to this amendment, then because the PPACA impairs a defense and there is no specific indication by Congress that the PPACA was intended to apply retroactively, the courts will only apply the new public disclosure bar and original source rules to fraudulent actions occurring after March 2010.

Since the False Claims Act whistleblower incentives have proven to be effective, similar rewards were discreetly incorporated into the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank)[25] in July 2010 for reporting violations of securities laws, including provisions of the Foreign Corrupt Practices Act (FCPA).[26] Section 922 of Dodd-Frank incorporates whistleblower rewards that are similar to those under the False Claims Act; however, Dodd-Frank does not utilize *qui tam* litigation. Rather, the whistleblower works directly with the Securities and Exchange Commission. Over the past year, the Department of Justice has taken aggressive positions on the FCPA, and these new monetary incentives are likely to increase the number of investigations internally and by the government.[27]

Dodd-Frank also contained amendments to the False Claims Act, this time expanding its whistleblower protections. The *qui tam* provisions previously entitled employees to all relief necessary to make them whole if they were discriminated against as a result of their actions to report violations of the False Claims Act. The Dodd-Frank revisions extend those protections beyond retaliation against the reporting employee to any employee "associated" with someone reporting a violation.[28] Accordingly, colleagues, friends, and family members of a whistleblower are now likely legally protected from retaliation.

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The government has created an array of incentives for whistleblowers to continue coming forward at any stage of a contract, investigation, or even after a formal dispute has begun. For contracting professionals, this means that the risk of your organization being affected by a *qui tam* lawsuit is higher than ever, and you should understand the warning signs of a False Claims Act violation.

Signals to Initiate an Internal Investigation

Identifying potential false claims before they have been reported to the government provides valuable opportunities to reduce damages and penalties. If an organization self-discloses issues promptly and prior to reporting by a whistleblower, such good corporate citizenship may facilitate resolution as an overpayment rather than as civil fraud. Even where the reported matter is still prosecuted as fraud, self-disclosure could reduce the damages from triple to double and have a significant impact on settlement discussions.[29]

Obviously, there are a variety of legal issues to consider if you are faced with facts indicating there has been a false claim or statement in support of a claim submitted to the government by your organization, a supplier, or a competitor, and you should coordinate with experienced legal counsel.

> "Contracting professionals cannot afford to ignore the False Claims Act."

A major risk of conducting an investigation without counsel being involved is that an unprivileged investigation will create discoverable information—information that could be used against the organization if a lawsuit develops. Once involved, counsel should consider initiating internal investigations to facilitate early identification upon certain events. For example, Department of Justice investigations and copycat whistleblowers often follow the prosecution of industrywide concerns. If you discover that a competitor has received a subpoena or is the subject of prosecution for activities which are epidemic in your industry, an internal investigation may be warranted. Similarly, if you learn that a former employee or a competitor is investigating your business, it could signal a potential whistleblower proceeding.

These are the types of situations that an organization's compliance plan should be structured to identify and address. Taking a proactive approach helps to control damages, whether it is in the form of financial penalties, bad publicity, or obstruction of justice charges.

Conclusion

Contracting professionals cannot afford to ignore the False Claims Act. In today's contracting environment, there are strong incentives for whistleblowers to utilize *qui tam* litigation and that makes False Claims Act exposure a great risk for government contractors. To manage False Claims Act risks, organizations cannot be too vigilant in adopting and enforcing appropriate compliance procedures (including periodic audits) and in instilling procedures to trigger timely and appropriate internal investigations. Frontline contracting professionals must be alert to the warning signs of actual or potential whistleblower claims. **CM**

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ENDNOTES

1. 31 U.S.C. §§3729–3733.
2. Department of Justice Press Release: "Department of Justice Recovers $3 Billion in False Claims Cases in Fiscal Year 2010"; November 22, 2010; *available at* **www.justice.gov/opa/pr/2010/November/10-civ-1335.html**.
3. *See* S. Rep. No. 99-345 (July 28, 1986), 1986 WL 31937.
4. *United States v. Basin Elec. Power Co-op*, 248 F.3d 781, 803 (8th Cir. 2001).
5. 31 U.S.C. §3729(b)(2).
6. *BMY Combat Systems Div. of Harsco Corp. v. United States*, 38 Fed.Cl. 109 (1997).
7. *United States ex rel. Bryant v. Williams Building Corp.*, 158 F.Supp.2d 1001, 1009 (D.S.D. 2001).
8. *United States ex rel. Campbell v. Lockheed Martin Corp.*, 282 F.Supp.2d 1324 (M.D. Fla. 2003).
9. *United States ex rel. Lemmon v. Envirocare of Utah, Inc.*, 614 F.3d 1163, 1169 (10th Cir. 2010).
10. *United States v. Science Applications Int'l Corp*, 626 F.3d 125, 2010 WL 4909467, No. 09-5385 (D.C. Cir. 2010).
11. 31 U.S.C. §3729(b).
12. 31 U.S.C. §3729(a)(1).
13. Pharmaceutical entities in particular benefit from the sale of their drugs (with the same formulas and advertisements) under numerous federal and state healthcare programs. Therefore, violations by such entities typically implicate interest from at least the Department of Health and Human Services, the Food and Drug Administration, the Veterans Administration, the Office of Personnel Management, Department of Defense TRICARE, and various state Medicaid programs.
14. A portion of the $1 billion settlement was from state False Claims Act liability, and Pfizer paid an additional $1.3 billion to settle criminal charges. *See* Department of Justice, District of Massachusetts Press Release: "Justice Department Announces Largest Health Care Fraud Settlement in its History"; September 2, 2009; *available at* **www.justice.gov/usao/ma/Press%20Office%20-%20Press%20Release%20Files/Sept2009/Pfizer.html**.
15. Department of Justice Press Release: "Northrop Grumman Corp. Settles False Claims Act Case for Defective Satellite Parts"; April 2, 2009; *available at* **www.justice.gov/opa/pr/2009/April/09-ag-305.html**.
16. *See Wilkins v. St. Louis Housing Authority*, 314 F.3d 927, 933 (8th Cir. 2002) (citing congressional testimony).
17. *See United States ex rel. Marcus v. Hess*, 317 U.S. 537 (1943).
18. *See* note 2.
19. *See also*, *United States ex rel. Sikkenga v. Regence Bluecross Blueshield of Uta*h, 472 F.3d 702, 713-714 (10th Cir. 2006).
20. *Public Law* 111-148, H.R. 3590, Section 10104.
21. *Qui tam* lawsuits based on information revealed in such proceedings are still prohibited if the information was also disclosed from the "news media."
22. *Rockwell Intern. Corp. v. United States*, 549 U.S. 457 (2007).
23. *E.g., United States ex rel. Rosner v. WB/Stellar IP Owner, L.L.C.*, --- F.Supp.2d ----, 2010 WL 2670829, *6-7 (S.D.N.Y. 2010); *United States ex. rel. Brown v. Walt Disney World Co.*, 2008 WL 2561975, *4 (M.D. Fla. 2008), *aff'd*, 361 F.App'x 66, 2010 WL 114964 (11th Cir. 2010).
24. *Hughes Aircraft Co. v. United States ex rel. Schumer*, 520 U.S. 939, 948 (1997).
25. *Pub. L.* 111-203, H.R. 4173.
26. 15 U.S.C. §§78dd-1, *et seq.*
27. *See* "Statement of Acting Deputy Assistant Attorney General Greg Andres Before Senate Judiciary Subcommittee on Crime and Drugs"; November 30, 2010; *available at* **www.justice.gov/criminal/pr/testimony/2010/crm-testimony-101130.html** (citing over $1 billion of criminal penalties under the FCPA in the prior 12-month period).
28. *See* Section 1079A of Dodd-Frank.
29. 31 U.S.C. §3729(a)(2).