WALK
THE
TALK

DEFENDING FCA CLAIMS: MAKING THE FCA PLAINTIFF WALK THE TALK

DAVID L. DOUGLASS

Dear Relator's Counsel:

I am writing in response to your gracious offer to provide my client the opportunity to settle your allegations that my client violated the False Claims Act, thereby saving millions in defense costs by paying millions more in tribute. While I appreciate the summary you provided of your client's one-sided investigation, which I note relies heavily on documents and information obtained in violation of the terms of your client's employment, it appears your client is the victim of his limited knowledge of my client's practices and his ignorance of the applicable laws and regulations.

In my experience as defense counsel, I have found it is all too often true that it is one thing to accuse but a different thing to prove. I have generally been well served to be guided by the sentiment captured by Willard Duncan Vandiver, who in 1899 proclaimed:

> *I come from a state that raises corn and cotton and cockleburs and Democrats, and frothy eloquence neither convinces nor satisfies me. I am from Missouri. You have got to show me.*

Notwithstanding that I am from New York, I find wisdom in the words of the gentleman from Missouri. More important, however, so does the Supreme Court. As you know, the Court has held that an FCA Plaintiff asserting an implied false certification theory of liability, as you do here, must establish facts in support of the materiality and scienter elements of FCA liability. Here, where you neither allege any facts concerning whether or how the agency evaluated the impliedly false certifications you allege nor do you offer any evidence that my client knew or should have known these statements were material to the agency's decision to pay, you have not established an FCA violation.

Based on the agency's knowledge of the facts related to the claims submitted by my client and our knowledge of the agency's policies and practices, I am confident we can persuade you that your client's allegations are unfounded. We look forward to seeking judicial assistance in resolving this matter, should that become necessary.

Sincerely,

Counsel for the Target

The False Claims Act (FCA) was originally enacted during the Civil War to help the government identify and prosecute war profiteers who had sold defective weapons, munitions, and supplies to the Union Army. Indeed, it was originally also known as the "Lincoln Law." The law's unique contribution to combatting fraud was the idea of "using a rogue to catch a rogue." The statute provided that those who reported fraud against the government would be rewarded with a share of the government's recovery. Between then and now, use of the statute has ebbed and flowed and it has been repeatedly amended as Congress and the courts continue to seek the appropriate balance between encouraging private citizens to report willfully fraudulent conduct while discouraging purely parasitic suits and, importantly, sparing companies from both meritless claims and exposure to treble damages, severe financial penalties, and attorney's fees awards based on innocent mistakes or simple misunderstanding of the applicable regulatory requirement.

The question the law raises today is whether a Civil War-era statute enacted when the government relied only lightly on private industry remains appropriate in an age of comprehensive regulation and oversight of government contractors, on whom the government depends to meet vital societal needs from health care to military defense, to technology goods and services, to roads, education, clear

air, etc. While indisputably some unscrupulous individuals and businesses defraud the government, it must equally be conceded that this conduct is the exception rather than the rule. Common sense and experience teach us that the overwhelming majority of businesses are run by individuals who strive to abide by the law in the conduct of their business affairs just as they do in the conduct of their personal affairs. If it were otherwise, the False Claims Act would be a woefully inadequate tool to combat pervasive fraudulent conduct.

Even assuming there is still value in encouraging individuals to report truly willful schemes to defraud by evading the many safeguards that now exist, one still must ask whether society is served by a system that incentivizes private individuals to bypass corporate compliance systems and government reporting channels in the hope of reaping a financial windfall, for their attorneys as well as themselves. From a policy perspective, a statute that incentivizes employees to circumvent internal compliance systems undercuts the public policy to encourage and reward corporate self-policing. Corporations are understandably frustrated when, despite incurring the expense of establishing and operating compliance programs, they face crippling financial penalties for conduct they would have remedied if only their employee had reported it internally, as they are encouraged to do, rather than file a *qui tam* action.

Setting aside the public policy considerations, the unique provisions of the FCA, which require filing an action under seal and then allowing the government time to conduct a lengthy investigation before disclosing the allegations or the facts to the target, create the unintended consequence of asymmetric information; a situation that occurs "where one party has different information to another."[1] Information asymmetry is problematic for relators and the government because not only does it impede settlement, but it also causes target companies to undervalue good cases more than they overvalue bad cases.

In the 1960s, George Akerlof wrote a paper entitled "The Market for Lemons," which although initially rejected by three leading economics journals won him the Nobel Memorial Prize in Economic Sciences. That paper studied a hypothetical used-car market in which bad cars are, of course, "lemons" and good cars are "peaches." Due to market asymmetry, sellers receive an appropriate price for a lemon, but the peaches are not sold because buyers lack the information necessary to accurately assess whether a peach is appropriately priced. These cars remain on the lot.[2]

The FCA's seal provisions similarly cause defendants to undervalue a "peach" claim. At the point at which the government (or relator) discloses the allegations to the target company, they have more information concerning the conduct than does the target. Or at least they believe they do. Compounding the challenge is the phenomenon of confirmation bias. Upon identifying a possible false claim, the whistleblower seeks out a lawyer who holds him or herself out as an expert in representing whistleblowers, touting the hundreds of millions of dollars in FCA recoveries they have achieved. The lawyer then counsels the whistleblower to seek additional facts and information to establish or strengthen an FCA claim. Based on counsel's guidance, the whistleblower is likely to select inculpatory documents and overlook or ignore exculpatory ones. Similarly, he or she is unlikely to speak with company personnel who can provide relevant context or counterpoint. The whistleblower and his or her lawyer then file their *qui tam* action and disclose to the government all the facts that support their allegations. If the allegations are sufficiently alluring to attract the government's interest, it then sets out to test the whistleblower's allegations. While undoubtedly all participants in this process believe they are seeking the truth, the process nevertheless presents a high risk of confirmation bias, as the government investigators are subject to the very human tendency to retain facts that corroborate their belief and dismiss those that refute them. Hence, when the government and/or relator (FCA plaintiffs) decide to make their demand on the target company it has insufficient information to assess whether the relator's case is a lemon or a peach and is understandably skeptical that a full and objective review of the facts will validate the allegations, as in the hypothetical letter that prefaced this paper.

Relator counsel and defense counsel both observe government attorneys wrestle with this tension but from very different perspectives. Whereas relator counsel may see government attorneys as too cautious or too unwilling to take on corporate defendants, defense counsel see government attorneys as too often willing to invest disproportionate time and resources prosecuting creative and even fanciful allegations that attempt to paint routine regulatory issues as nefarious schemes to defraud. Thus, it is after spending time, perhaps years, investigating a relator's allegations that a relator sees a corporation's unwillingness to credit the allegations as recalcitrance. To the corporation, however, the allegations are contrary to not only its policies and practices but often the relevant agency's practices. Complicating the situation, except in those cases of clear, blatant fraud (which typically settle quickly and quietly), the allegations are premised on complex facts governed by imprecise regulations and case law.

As Sen. Daniel Patrick Moynihan famously said, "Everyone is entitled to his own opinion, but not his own facts." An unintended consequence of the seal and investigation provisions of the FCA is that they create the precise situation of which Sen. Moynihan warned. The government and relator are operating on one set of facts, while the target company is operating on a different set of facts. Thus, the problem relators face is neither timid government attorneys nor illogical judges but the simple reality that it is one thing to accuse but a whole different thing to prove.

The seal and investigative provisions of the FCA distort the litigation process and complicate dispute resolution because they shift the discovery process from the reciprocal one that typically characterizes civil litigation to a sequential process in which the government and relator conduct discovery first, through the documents the relator has (ahem) "liberated" from the company, followed by civil investigation demands or subpoenas the government subsequently issues. Only once litigation commences does the defendant enjoy an opportunity to compel discovery to test the allegations. The resulting picture is often very different from the outline presented in an FCA complaint.

Whereas the Lincoln Law was necessary because of the lack of government oversight, today, those who provide goods and services to the government are subject to an extensive network of testing requirements, audit and oversight mechanisms, reporting obligations, and numerous programs that enable honest individuals who become aware of fraud to report it directly to the government, without the promise of financial gain.[3]

Additionally, government regulation has grown in scope and complexity, as reflected in judicial commentary. For example, courts have characterized the Medicare statute as follows:

- "among the most intricate ever drafted by Congress," with a "byzantine construction" that is "almost unintelligible to the uninitiated,"[4]

- a "virtually impenetrable thicket of legalese and gobbledygook,"[5] and
- "an aggravated assault on the English language, resistant to attempts to understand it."[6]

Given the complexity of government regulation today, it is completely understandable that determining whether a claim or statement in support of a claim is knowingly and materially false or merely an innocent mistake or a matter of differing interpretations can be a prolonged process involving inconsistent facts, irretrievable information, and disputed interpretations.

Earlier this year, in *Universal Health Services Inc. v. United States et. al., ex rel. Escobar et al.,*[7] a unanimous Supreme Court reemphasized that the False Claims Act is not a means of imposing treble damages and other penalties for insignificant regulatory or contractual violations.[8] *Escobar* arose from a tragic fact pattern in which it was alleged that a minor was diagnosed as suffering from bipolar disorder by a practitioner who "identified herself as a psychologist with a Ph.D., but failed to mention that her degree came from an unaccredited internet college and that Massachusetts had rejected her application to be licensed as a psychologist. Likewise, the practitioner who prescribed medicine to [the patient], and who was held out as a psychiatrist, was in fact a nurse who lacked authority to prescribe medications absent supervision."[9] The minor suffered a seizure triggered by an adverse reaction to the medication the practitioner prescribed and died.[10] It was further alleged that not only were the practitioner and nurse unqualified, but the clinic's director also facilitated the misrepresentation of staff qualification and, in contravention of applicable regulatory requirements, counseled patients and prescribed drugs without supervision.[11]

The FCA claims arose from the facility's billing practices. "When submitting reimbursement claims, [the facility] used payment codes corresponding to different services that its staff provided to [the patient], such as 'Individual Therapy' and 'Family Therapy'" and "misrepresented their qualifications and licensing status to the federal government to obtain individual national provider identification numbers, which are submitted in connection with Medicaid reimbursement claims and correspond to specific job titles."[12] The patient's parents filed an FCA action against the facility alleging that its reimbursement claims made impliedly false claims about the services provided by failing "to disclose serious violations of regulations pertaining to staff qualifications and licensing requirements for these services."[13]

The case called upon the Court to resolve a split among the Courts of Appeals concerning the validity and scope of the implied false certification theory of FCA liability. Under this theory, a claim or statement in support of a claim can violate the FCA even though it is not facially or explicitly false but nevertheless impliedly certified compliance or conformance with an applicable program requirement. The Court observed that the Seventh Circuit rejected the implied false certification doctrine, "reasoning that only express (or affirmative) falsehoods can render a claim "false or fraudulent" under [the FCA]."[14] Other courts, however, "have accepted the theory, but limit its application to cases where defendants fail to disclose violations of expressly designated conditions of payment."[15] While, "others hold that conditions of payment need not be expressly designated as such to be a basis for False Claims Act liability."[16]

The Court makes two important rulings but limits their reach by emphasizing the high evidentiary bar FCA plaintiffs must clear. The Court endorsed the implied certification theory of liability and, further, overruled those circuits that held that the implied certification theory applies only to certifications of compliance with conditions of payment (as distinguished from conditions of participation), ruling that the FCA "does not limit such claims to misrepresentations about express conditions of payment."[17] While the conditions of payment versus conditions of participation distinction has been a long-established judicial construction, it is frankly difficult to disagree with the Court's statutory interpretation. As the Court observed, neither the FCA's text nor the common-law meaning of fraud, "tether liability to violating an express condition of payment. A statement that misleadingly omits critical facts is a misrepresentation irrespective of whether the other party has expressly signaled the importance of the qualifying information."[18]

While this aspect of the ruling no doubt disappoints FCA defense counsel and their clients, the more significant aspect of the holding is, at least potentially, the Court's statement that concerns about fair notice and open-ended liability "can be effectively addressed through strict enforcement of the Act's materiality and scienter requirements. These requirements are rigorous."[19]

Looking back, the FCA's materiality element was judicially engrafted into the statute to exclude from potential FCA liability statements that while false statements simply didn't matter to the government payment decision.[20] To relieve the government of the burden of proving how a specific false statement was material to the government's payment decision, courts eased the materiality test to "whether the false statement has a natural tendency to influence agency action or is capable of influencing agency action."[21] However understandable the judicial concern over the evidentiary burden of proof may have been, over time the "capable of influencing" test has relegated the materiality element to the realm of the theoretical. The materiality element became a mere shibboleth: FCA plaintiffs were merely required to allege that a statement was capable of influencing agency decision-making to survive a motion to dismiss or, to survive a motion for summary judgment, have a government official state that the alleged false statement "could have" influenced agency decision-making rather than proving how it might have done so.

It is the evisceration of the materiality element that the *Escobar* decision firmly rejects, instructing that the FCA's materiality and scienter requirements must be strictly enforced:

> The materiality standard is demanding. The False Claims Act is not "an all-purpose antifraud statute,[22] or a vehicle for punishing garden variety breaches of contract or regulatory violations. A misrepresentation cannot be deemed material merely because the government designates compliance with a particular statutory, regulatory, or contractual requirement as a condition of payment. Nor is it sufficient for a finding of materiality that the government would have the *option* to decline to pay if it knew of the defendant's materiality, in addition cannot be found where noncompliance is minor or insubstantial.[23]

Providing further guidance, the Court provides examples of evidence relevant to establishing whether an implied certification of compliance satisfies the materiality standard:[24]

> [1] A misrepresentation cannot be deemed material merely

because the government designates compliance with a particular statutory, regulatory, or contractual requirement as a condition of payment.

[2] Nor is it sufficient for a finding of materiality the government would have the option to decline to pay if it knew of the defendant's noncompliance.…

[3] [E]vidence the defendant knows the government consistent refuses to pay claim in the mine run of cases based on noncompliance with the particular statutory, regulator, or contractual requirement.

[4] Conversely, if the government pays a particular claim in full despite its actual knowledge that certain requirements were violated that is very strong evidence that those requirements are not material.

[5] "Or, 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.

Prior to *Escobar*, the Court had already held that a statement or action is not reckless unless it not only violates "a reasonable reading of the statute's terms, but shows that the company ran a risk of violating the law substantially greater than the risk associated with a reading that was merely careless."[25] Last year, the influential D.C. Circuit Court of Appeals, relying in part on the Court's instruction in *Safeco*, affirmed the reversal of a jury verdict in favor of the government in an FCA case, holding that the government had failed to establish the defendant's interpretation of a regulation was objectively unreasonable, either facially or because the agency had issued "authoritative guidance" concerning the government's interpretation.[26]

Thus, the Supreme Court has made clear the FCA imposes on FCA plaintiffs a high burden to plead and then prove the defendant knew or clearly should have known its certifications were false *and* material to the government's decision to pay the claim. *Escobar* will profoundly reshape and refocus FCA investigations and litigation predicated on implied false certification theories. FCA plaintiffs must establish factually that (1) the agency would have denied payment but for the allegedly false certifications (materiality) and (2) the defendant knew or reasonably should have known the agency would deny payment based on the allegedly false statements (knowledge). Because it is unlikely a relator will have access to either agency or company decision-makers, the evidentiary obstacles to establishing a *prima facie* case of an FCA violation have increased substantially, provided, of course, the lower courts follow the Supreme Court's teachings. Where the government conducts the investigation, it will have to consult with agency decision-makers to confirm that in fact the agency has, or at least would have, in fact denied payment based on the alleged false statements at issue. This requirement alone should address one of the greatest sources of frustration for FCA defendants: the government's routine failure to consult with agency officials concerning how the agency evaluates the kind of information submitted by the defendant. All too often, the FCA defendant or its counsel are aware that an agency routinely pays claims based on statements the government or relator allege are false. This phenomenon reflects the difference between punitive laws and administrative law. Punitive laws are intended to deter and punish clearly defined conduct. Administrative law, however, is intended to regulate complex and dynamic systems, such as building fighter jets or providing health care. Administrative law is often intentionally capacious and flexible.[27] Punitive laws, such as the FCA, are poorly tailored to fit the intentionally flexible qualities of administrative laws.

Thus, it is essential that FCA liability be imposed only for objectively false statements. Yet it is an all too familiar experience in FCA litigation that the FCA plaintiff, whether the government or the relator, has never simply consulted the relevant agency's personnel. At minimum this failure feeds the asymmetry of information that impedes fair resolution of FCA cases because defendants and defense counsel, who are often thoroughly versed in agency practice, have superior information to FCA plaintiffs concerning how agencies administer their programs, pay claims and resolve errors.

Importantly, FCA plaintiffs can no longer assume that in ruling on a motion to dismiss a court will accept bare-bones allegations that an alleged false statement was capable of influencing the agency's payment decision. The Supreme Court was incandescently clear on an FCA plaintiff's pleading burden. "The standard for materiality that we have outlined is a familiar and rigorous one. And False Claims Act plaintiffs must also plead their claims with plausibility and particularity under Federal Rules of Civil Procedure 8 and 9(b) by, for instance, *pleading facts* to support allegations of materiality."[28] In short, no longer can FCA plaintiffs survive a motion to dismiss simply by alleging the alleged false statement could have influenced the agency's payment decision, they must offer *facts* concerning the agency's payment decision on the specific impliedly false certification at issue, its decision-making history on comparable allegedly false certifications, or the defendant's actual knowledge that the agency would reject claims supported by the allegedly false certifications at issue. FCA plaintiffs would be well-advised to recognize that even if a trial court ignores the Court's holding and applies a less-rigorous pleading standard, they face protracted and expensive litigation only to revisit the issue on summary judgment and, if necessary, on appeal, where the circuit courts of appeal are far more likely to apply the Court's test.

Thus, whatever rights a relator may have to spirt away corporate documents, they must obtain facts to satisfy the materiality and scienter elements, which will often prove an insurmountable obstacle. The interests of relators, the government, and businesses—not to mention the public interest—is best served when suspected noncompliance is reported to the company so that all the relevant facts can be revealed and remedial action taken, if necessary. Only where the parties are unable to reach agreement despite good-faith efforts to do so, should they incur the expense and disruption of FCA litigation. ⊙

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Endnotes

[1]Tejvan Pettinger, *Asymmetric Information Problem*, Economics Help (Nov. 28, 2012), http://www.economicshelp.org/blog/glossary/

asymmetric-information (last visited Sept. 21, 2016).

[2]*See Secrets and Agents*, The Economist (July 23, 2016), http://www.economist.com/news/economics-brief/21702428-george-akerlofs-1970-paper-market-lemons-foundation-stone-information (last visited Sept. 21, 2016).

[3]*See e.g.,* Report Fraud, Office of Inspector General, https://oig.hhs.gov/fraud/report-fraud (last visited Sept. 21, 2016); The Department of Defense Hotline, Office of Inspector General, http://www.dodig.mil/hotline (last visited Sept. 21, 2016).

[4]*Schweiker v. Gray Panthers*, 453 U.S. 34, 43 (1981).

[5]*Lamore v. Ives*, 977 F.2d 713, 716 (5th Cir. 1992).

[6]*Friedman v. Berger*, 409 F. Supp. 1225, 1226 (S.D.N.Y. 1976).

[7]*Universal Health Serv. Inc. v. United States et. al., ex rel. Escobar et al.*, 136 S.Ct. 1989 (2016).

[8]*Id.* at 2004. *See also e.g., United States v. Science Apps. Int'l Corp.*, 663 F.3d 1257, 1261 (D.C. Cir. 2010) ("FCA liability attaches only for false or fraudulent claims and not for accidental or even negligent breaches of contract."); *United States ex rel. Joseph T. Siewick v. Jamieson Sci. & Eng'g Inc.*, 214 F.3d 1372, 1378 (D.C. Cir. 2000) (Where disputed legal issues arise from vague provisions or regulations, a contractor's decision to act on its interpretation cannot result in his filing a "knowingly" false claims).

[9]*Id.* at 1997.

[10]*Id.*

[11]*Id.* at 1997.

[12]*Id.*

[13]*Id.*

[14]*Id.* at 1999, citing *United States v. Sanford-Brown Ltd.*, 788 F.3d 696, 711-712 (2015).

[15]*Id.*, citing *e.g., Mikes v. Straus*, 274 F.3d 687, 700 (2d Cir 2011).

[16]*Id.* citing *e.g., United States v. Science Apps. Int'l Corp.*, 626 F.3d 1257, 1269 (D.C. Cir. 2010).

[17]*Id.* at 1999, citing *SAIC*, 626 F.3d at 1268.

[18]*Id.*

[19]Internal citation omitted. *Id.* at 2002.

[20]*See e.g., United States v. Snider*, 502 F.2d 645, 652 n.12 (4th Cir. 1974); *Tyger Constr. Co. v. United States*, 28 Fed. Cl. 35, 55 (1993) ("[T]he FCA covers only those false statements that are material.").

[21]*United States ex. rel Berge v. Board of Trs. of the Univ. of Ala*, 104 F.3d 1453, 1459 (4th Cir. 1997).

[22]*Allison Engine Co. v. United States ex re. Sanders*, 553 U.S. 662, 672 (2008).

[23]Citation omitted. *Id.* at 2003 (emphasis added).

[24]*Id.* at 2004.

[25]*Safeco Ins. Co. of Am. v. Burr*, 551 U.S. 47, 69 (2007) (interpreting the Fair Credit Reporting Act).

[26]*United States ex. rel Purcell v. MWI Corp.*, 807 F.3d 281-289 (D.C. Cir. 2015).

[27]*See e.g., Purcell,* 807 F.3d at 289 ("Bank officials acknowledged at trial that the bank had preferred to keep the standard flexible in order to make the loan approval process more efficient.").

[28]*Id.* at 2004 (emphasis added).

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