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Eight Steps Companies Can Take To Prevent Whistleblower Liability


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There is no easier way for a company to turn a small gain into a multi-dimensional catastrophic loss than by violating the False Claims Act.

A simple example is the government contractor who overbills the government $1,000, spread over 100 false claims (charging, for example, $100 instead of $90 on 100 separate orders). That contractor faces potential liability exceeding $1 million. Here's how: First, damages are typically trebled before any possible offsets are applied. See *United States v. Bornstein*, 423 U.S. 303 (1976) (addressing application of offsets).

Thus, 100 claims at $100 each are trebled. Then there is an offset of the $90 of value received for each of the 100 claims. This calculation yields $21,000. Civil penalties are then added. Using the higher end of the penalties range, say $10,000 per claim, yields another $1 million.

Although this simple illustration may seem extreme, the government can be counted on to make an argument like this when it crafts its initial settlement demand, usually without regard to mitigating factors. And most frauds against the government are much larger than the one illustrated above.

Moreover, if the particular facts of a case render a meaningful damages analysis overly burdensome, the government can be counted on to make use of sometimes-crude extrapolation techniques to arrive at a range of settlement numbers.

Not all of the consequences of alleged False Claims Act violations, however, are as obvious as defense costs, judgments, and settlements. For instance, an investigation and accompanying litigation, once public, can stigmatize the accused company in the marketplace. An accused company can expect trouble recruiting new employees, maintaining employee morale, retaining sales to non-governmental and not-at-issue governmental customers, as well as maintaining the vitality of existing and potential business partnerships. Competitors will take full advantage of the situation.

In addition, a publicly traded company will likely be required to disclose the matter in its securities filings, thereby jeopardizing its share price. The company may also face debarment proceedings, risking its ability to conduct future business with affected government agencies. And then there is the specter of parallel criminal proceedings. In short, the opportunity for substantial damage to an accused company is significant.

The federal False Claims Act, originally enacted to combat Civil War-era abuses of the federal fisc, is triggered primarily by "false or fraudulent claim[s]" for payment that are knowingly made to the federal government. The FCA reaches a diverse array of frauds, ranging from overbilling and product substitution to underpayment. And the cases span the economy.

No government contractor, government program participant, or government supply chain member is immune. Every company and individual culprit is fair game, and everyone, from those in the defense industry and the health care and pharmaceutical industries to those in the transportation and shipping industries, is at risk.

The False Claims Act generally provides whistleblowers a 15 to 25 percent share in the government's recovery when they uncover, report, and sue upon the fraud. There are about 1,000 whistleblower, or qui tam, cases currently under seal and pending investigation by the Justice Department. In addition, almost half of the states now have their own similarly worded false claims acts. Some, like New York's, even cover frauds upon local governments. A handful of the largest states have recently taken aggressive enforcement action of their own.

The dynamic and the pressures laid out above are well known to the Justice Department. In fact, the deck is often so stacked against the corporate defendant in these cases that settlements, not dismissals or judgments, can be the norm. Even companies that have quite good cases on the merits are compelled by costs and business considerations to settle to avoid the risk of losing at trial. And because the determination of whether there is scienter is at the discretion of the government at the time of its decision to intervene in or commence a lawsuit, the defendant has no ultimate control.

Against this stark backdrop, the prospect of learning about a pending whistleblower case from the Justice Department can be among a company's worst fears. So what is a company to do? Short of forgoing government business altogether, here are some simple suggestions to help avoid false claims problems.

• Institute a compliance program.

Prevention is the best defense. Companies must take potential false claims issues seriously before they arise, identifying areas of potential risk and resolving any issues that are found.

Thus, a robust compliance and corporate integrity program with recurring training for employees will raise awareness and prevent lapses. The compliance culture has to start at the top. The compliance program ought to be evenly and consistently enforced at all employee levels and under all circumstances. Uneven or preferential enforcement will likely create even more potential liability for the company.

In addition, the compliance program should be reviewed and updated periodically, both to account for changes in the company's business and market and to address any meaningful legal developments. Keep records of compliance audits, employee training, and any disciplinary measures taken.

A good plan with proof that it was followed, while not foolproof, can help convince the government (and a fact-finder) that the allegations may indeed have been unfounded. At a minimum, a workable plan and a compliant culture can positively affect the discretion of the government lawyers. Their absence, under some circumstances, actually can help establish liability. See, for example, *United States v. Merck-Medco Managed Care, LLC*, 336 F. Supp. 2d 430, 441 (E.D. Pa. 2004) (non-existent or insufficient compliance programs can satisfy the scienter requirement).

When things are going well, extra layers of corporate governance and bureaucracy can seem like an unnecessary hindrance. But the alternative will be a greater drag on profits and morale.

• Address problems.

Sweeping a suspected violation under the company's rug is a recipe for disaster. If a violation is suspected, the company should immediately engage competent counsel to assess the situation.

In addition, create a culture where all employees, even those in less responsible positions who are often in the best place to detect wrongdoing, are comfortable raising suspicions with management and are confident that they will be taken seriously.

A company that ignores this corporate "angel," put there to keep the company out of danger, risks transforming him or her into an employee who feels compelled to look outside the company for someone to listen. The relators' bar and the government will be all ears. And the "angel" can turn into the whistleblower.

• Evaluate business partners.

It is important to evaluate business partners because an innocent company that gets caught up in its business partner's False Claims Act investigation and litigation is nevertheless in the position of having to defend a possibly meritless investigation, with the costs and risks to its own reputation.

• Maintain good employee relations.

Disgruntled employees are a frequent source of False Claims Act accusations. Valid claims notwithstanding, employees without loyalty and good feelings about their employer, for whatever reason, are more likely to bring claims that are marginal or even without merit. For example, see *Mikes v. Straus*, 274 F.3d 687 (2d Cir. 2001) (employee-relator brought frivolous claim against her former employer). Make employee cooperation a positive part of the company's culture.

• Look out for government overpayments.

If the government accidentally overpays a contractor, the money must be returned. It is imperative for companies not to retain any funds owed to the government. In addition, the company should ask itself whether its billings and accounts receivable systems and personnel are capable of catching and rectifying overpayments of legitimate invoices.

• Reduce payments to the government carefully.

Companies must exercise prudence, openness, and care when attempting to reduce payments that they may owe the government, for example, for fees or royalties, or to pay for government property. See, for example, *United States v. Pemco Aeroplex Inc.*, 195 F.3d 1234 (11th Cir. 1999) (a "reverse false claim" action was stated where the government contractor misidentified surplus airplane wings to reduce its payment to the Air Force).

• Bill and contract carefully.

Companies must make sure that add-ons, surcharges, and extras actually apply. And they must not be hidden on the bill. These charges must be clearly understood and agreed to by the government. Misapplication of these extra charges can lead directly to a violation.

Companies should also take care that contract negotiations on these issues are above board, well documented, and result in straightforward contractual language. Anything less can lead to a charge that the government was misled. And it could lead to the government's use of the contract language against the company.

When contracting with the government, it is imperative not to try to extract a concession or term that is unduly one sided, unfair, or out of line with industry norms. If a company does try to do this, the government's contracting or procurement officer may later feel compelled to deny or color the facts as a

self-preservation measure when confronted with the company's defense that the officer knowingly agreed to it.

Finally, depending on the complexity of the industry and the procurement regime, the company may want to hire a competent and experienced government contracting expert. False Claims Act cases are bred in this interface. Thus, real competence is invaluable.

• Disclose product shortcomings.

Be sure that the company's communications with the government carefully document a product's characteristics and qualities. Thorough and precise descriptions can prevent later allegations that a product's potential or perceived defects or shortfalls were concealed. For example, see United States v. United Techs. Corp., 777 F. Supp 195 (N.D.N.Y. 1991) (relator alleged concealment of a defective design), aff'd 985 F.2d 1148 (2d Cir. 1993). The same is true for component parts that are incorporated into an end product that is then sold to the government.

As businesses face greater and greater economic threats and challenges, it may be tempting to cut corners or to turn a blind eye to potentially questionable practices. But the multi-faceted doom that False Claims Act violations can invite is a stark deterrent. In fact, the current economic and fiscal climates will likely prompt an even greater emphasis on this already growing source of governmental revenue. A company with an engrained compliance culture will be best able to ensure that this problem passes it by.

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