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March 2014 | $12.00

Contract Management

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A DOUBLE-EDGED SWORD CUTS BOTH WAYS

Protecting Your Company from False Claims Litigation

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Originally published in the March 2014 issue of Contract Management Magazine. Copyright 2014, National Contract Management Association.

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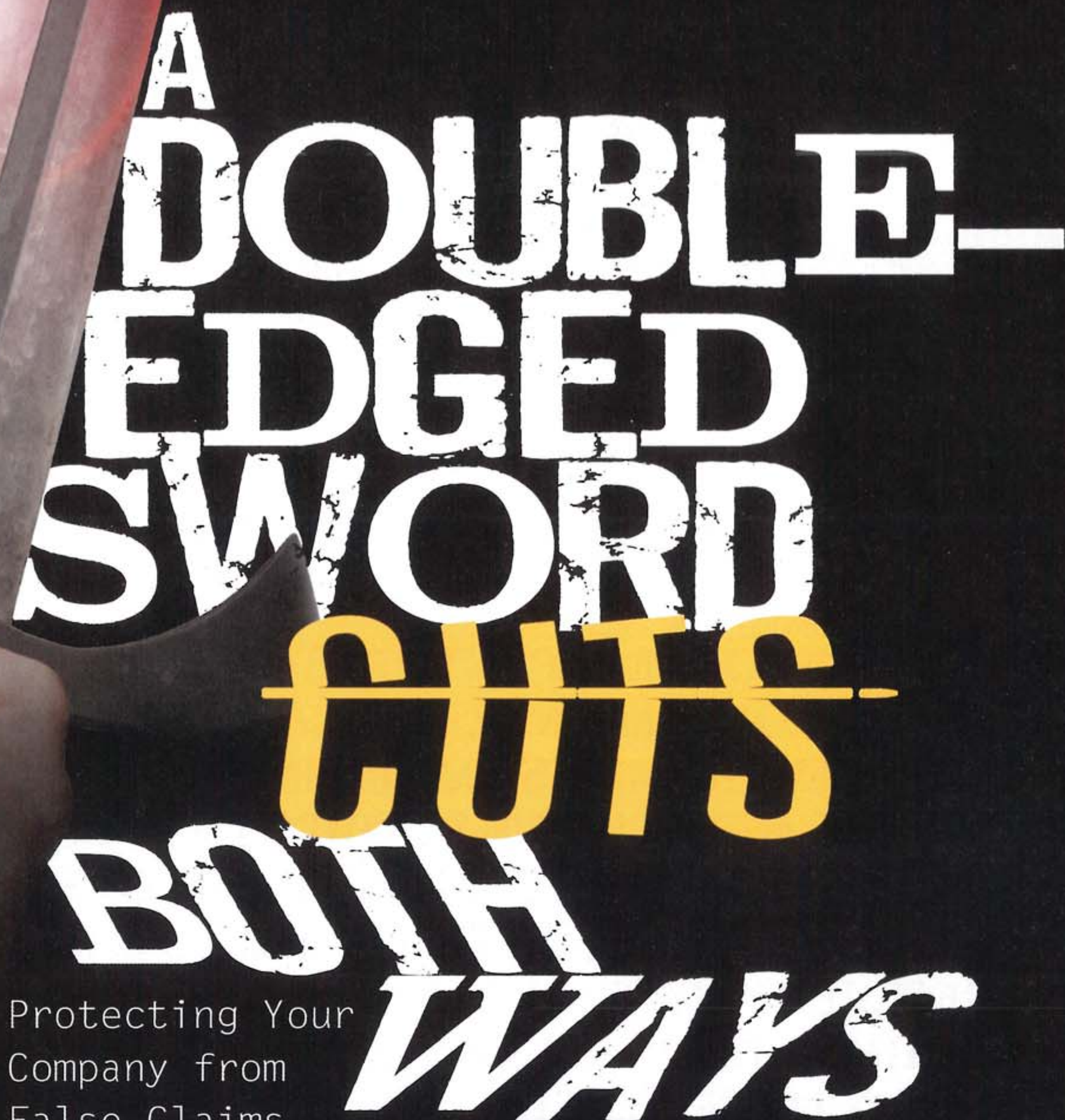

Protecting Your Company from False Claims Act Litigation Instigated by Opportunistic Employees and Competitors

By JOHN L. SINATRA JR. and REETUPARNA DUTTA

ACCORDING TO THE DEPARTMENT OF JUSTICE, THE U.S. FEDERAL GOVERNMENT THIS YEAR RECOVERED $3.8 BILLION IN SETTLEMENTS AND JUDGMENTS UNDER THE FALSE CLAIMS ACT (FCA) THE STATUTE THAT ALLOWS PRIVATE INDIVIDUALS TO BRING AN ACTION ON BEHALF OF THE GOVERNMENT FOR FRAUD AND TO SHARE IN ANY RECOVERY.[1] OF THAT AMOUNT, "RELATORS" (THE FORMAL TERM FOR THE "WHISTLEBLOWERS" WHO BRING THESE CASES) RECEIVED $345 MILLION.[2]

With numbers like that, companies can expect more and more cases to be brought under the FCA by those hoping to get a piece of a potentially lucrative recovery. In this type of environment, opportunistic employees and competitors hoping to get rich may target a company and embroil it in litigation that often spans years. However, two recent decisions illustrate ways in which companies in the right can fight back and protect themselves against the threat of huge damages and penalties under the FCA.

THE EMPLOYEE WHO DOESN'T REPORT POTENTIAL MISCONDUCT

The most common fact-pattern under the FCA involves an employee bringing an action (as a "relator") against his or her employer. In these circumstances, the defendant employer often feels the employee/relator engaged in wrongful conduct surrounding the bringing of the action. For example, the employer may believe that the employee knew about, and participated in, the alleged fraudulent conduct and, therefore, that the employee should bear some of the loss for the violations. Courts,

however, have generally rejected so-called "blame-shifting" causes of action that have the effect of requiring an employee to indemnify the defendant for any loss under the FCA.[3]

But courts *have* allowed defendants in FCA cases to bring counterclaims against an employee/relator if they are based on a theory that is *not* dependent on a finding that the defendant is liable under the FCA. So, for example, claims that are distinct from the conduct underlying the allegedly fraudulent conduct are permissible, as are claims for abuses of the litigation process, which can only succeed where a defendant is found not liable under the FCA, such as claims for defamation and malicious prosecution.[4]

Separately, courts are still struggling to classify claims against an employee/relator for failing to report alleged fraud to the defendant employer, thereby denying the employer the opportunity to address it, and then bringing an FCA action based upon that information. Defendants that have tried to base this claim on an employee's fiduciary duty or duty of loyalty to the company have generally failed.[5] But a recent case demonstrates how this type of claim might be successful.

In *United States ex rel. Wildhirt*,[6] employee relators were employed by defendants and signed a confidentiality, non-compete, and Health Insurance Portability and Accountability Act agreement. The agreement required employees, among other things, to notify defendants of any "suspect practices" and also to certify that they were unaware of any "suspect business practices" being conducted by the defendants other than those disclosed on a "Notification of Suspect Practices" form. The relators filed a whistleblower action under the FCA against the defendants, and the defendants filed various counterclaims, including a claim based on the relators' failure to report suspect practices to the defendants before filing the lawsuit.

Specifically, the defendants claimed that the relators breached the agreement "by representing that they were not aware of any suspect practices by [defendants], failing to report any suspect practices to...management, and then filing the lawsuit claiming facts to the contrary even though neither ever informed [defendants] of these alleged suspect practices."[7] In response to the relators' motion to dismiss, the court noted that, if the defendants were ultimately found liable under the FCA, the claim must be dismissed, but if the defendants prevailed in the underlying action, the claim could proceed if the defendants could show a causal relationship between the relators' failure to report and the filing of the FCA action.

Wildhirt is important for innocent companies. Requiring employees to agree to notify their employer about suspect practices is something companies should consider as it would be a basis for a possible counterclaim in an FCA action.[8]

Moreover, this type of agreement could also be a defense against substantive FCA liability. Arguing to a court that your company didn't have the requisite intent to violate the FCA because your employees failed to notify you about it so they could potentially reap a windfall may be compelling. And, of course, having advance notice of a potential problem gives the company a chance to fix it. The flip side, however, is that if companies do implement such an agreement and do not seriously investigate any "suspect business practices" reported thereunder, the employee/relator could use that as evidence of the requisite intent to violate the FCA (i.e., defendants knew there was a problem and failed to address it).

While this tool may be a double-edged sword, it is worth considering whether it could be successfully applied to your company and workforce.

THE COMPETITOR LOOKING TO TAKE OUT A RIVAL

A less common fact pattern, although an equally problematic one, is the competitor looking to take out a rival company by bringing an FCA action against it. A successful

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competitor will get a portion of the recovery and may also benefit through an increased market share by branding the defendant company as a "fraud" and perhaps even putting it out of business. However, a recent decision illustrates the potential offensive use of the "public disclosure" bar under the FCA against a competitor.

The public disclosure bar in the FCA "bars" actions (unless opposed by the government) if the allegations have already been "publicly disclosed."[9] And in *United States ex rel. Cunningham v. Millennium Laboratories of California, Inc.*,[10] a court opened the door for defendants to use this bar to their advantage.

In that case, the relator was the compliance officer of one of the defendant's competitors, and he brought an FCA action alleging that the defendant company encouraged physicians to bill the government multiple times for single drug tests and to perform medically unnecessary tests on patients.[11] But before this complaint was filed, the defendant company had filed an action against the relator's employer for defamation and interference with contractual relations in California state court, and it attached documents suggesting that the relator's employer was telling others—including one of the defendant's customers—about alleged fraudulent activity in the defendant's billing practices. The district court found that this prior disclosure was sufficient to invoke the "public disclosure bar" and dismissed the complaint, and the relator appealed.[12]

On appeal, the First Circuit found that some of the relator's allegedly unlawful schemes against the defendant were publicly disclosed in the California suit. While the court noted that it shared the "[r]elator's concern that a person or entity committing fraud against the government could theoretically shield itself from a *qui tam* action through preemptively filing its own action, thus creating a sanitized public disclosure while barring a future whistleblower action," it still upheld the public disclosure bar as to these schemes.[13]

This decision opens the door to potential defendants publicly disclosing—on their own terms and in their own manner—any conduct that could potentially form the basis of an FCA case. While no company wants to widely disclose potential misconduct, by controlling the message, a company can dictate the way in which the information is presented and can also claim, if necessary, that it investigated and corrected the issue. Prosecutors will look favorably upon this type of conduct and may not feel the need to waste limited resources on pursuing a company that has already disclosed and fixed any potential problems.

Moreover, as in the case of employee agreements to report problems, defendants who self-disclose and then get sued under the FCA are in a position to argue that the opportunistic relator who brought this case was piggybacking off public allegations that the defendant company affirmatively released in an effort to be open and honest. This could be a powerful weapon in persuading the court that the public disclosure bar should apply and that the relator's case should be dismissed. **CM**

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ENDNOTES

1. Press Release, Department of Justice, "Justice Department Recovers $3.8 Billion from False Claims Act Cases in Fiscal Year 2013" (December 20, 2013) *available at* **www.justice.gov/opa/pr/2013/December/13-civ-1352.html**.
2. *Ibid.*
3. *See United States ex rel. Miller v. Bill Harbert Int'l Const., Inc.*, 505 F. Supp. 2d 20, 26 (D.D.C., 2007) ("Emerging from these cases is the rule that...[an FCA] defendant found liable of [FCA] violations may not pursue a counterclaim that will have the equivalent effect of contribution or indemnification.").

4. *Ibid.*, at 27–28.

5. *See Siebert v. Gene Security Network, Inc.*, 2013 U.S. Dist. LEXIS 149145 (N.D. Cal., October 15, 2013) (dismissing counterclaim based on relator's breach of duty of loyalty in failing to prevent, remedy, or report conduct that the relator believed to be a violation of the FCA; "a breach of fiduciary duty claim arising out of a plaintiff-relator's failure to disclose a False Claims Act violation that subsequently becomes the basis of a *qui tam* claim is barred by the FCA."); *see also Miller*, note 3, at 25–29 (dismissing breach of fiduciary duty counterclaim against relator based on allegations that relator was aware of bid rigging conspiracy at issue in the FCA case and failed to report it to the defendant).

6. 2013 U.S. Dist. LEXIS 133982 (N.D. Ill., September 9, 2013).

7. *Ibid.*, at *19.

8. Significantly, under the New York False Claims Act, the New York State equivalent of the federal statute, employees/whistleblowers are protected from retaliation in their employment for transmitting documents and other information to the government or their counsel—even though there may be a contract with the employer prohibiting such dissemination—as long as the possession and transmission of that information is for the sole purpose of stopping violations of the act. (N.Y. State Fin. Law §191.) New York employers should be aware of this extra layer of protection for employees. It is not necessarily the case that all breaches of these types of agreements will result in actionable counterclaims, and the *Wildhirt* result could be an anomaly. In *United States ex rel. Vainer v. DaVita, Inc.*, 2013 U.S. Dist. LEXIS 51359 (N.D. Ga., February 13, 2013), the court rejected a breach of contract counterclaim in an FCA action based on the failure to report unlawful practices to the defendants, although it is worth noting that the agreement in that case was less explicit with respect to the relator's obligations than in *Wildhirt*. It is important to keep track of this issue to see how the courts are treating these types of counterclaims.

9. 31 U.S.C. 3730(e)(4). The only way for a relator to get around the bar is to show that he or she is an "original source" of the information. An "original source" is one who either 1) prior to a public disclosure, voluntarily disclosed to the government the information on which the claim is based, or 2) has knowledge independent or, and materially adds to, the publicly disclosed allegations and who also voluntarily provided the information to the government before filing an action. (*Ibid.*)

10. 713 F.3d 662 (1st Cir., 2013).

11. *Ibid.*, at 664.

12. *Ibid.*

13. The court did find that the relator's allegations relating to the defendant's encouraging physicians to test excessively in a manner that was not medically necessary was not barred by the public disclosure bar because it was not mentioned in the California case. *(Ibid.*, at 675–676.) And, significantly, the court engaged in the public disclosure analysis under the pre-amended version of the FCA. Under the current version, it is no longer possible for the jurisdictional bar to apply to disclosures made in *state* cases, although the bar applies to disclosures in *federal* cases. *