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NEWSLETTER

The False Claims Act: Leveling the Playing Field

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Government Contracts Issue Update

In December, the U.S. Department of Justice (DOJ) announced that it recovered over $4.7 billion from False Claims Act (FCA) cases in 2016. This was DOJ's third-highest annual revenue from FCA recoveries, and pushed the seven-year-average recovery to just over $4 billion. More and more often, however, those recoveries reflect settlements from likely blameless companies who make a business decision to choose settlement as a way to avoid the high costs, potential treble damages, and collateral consequences flowing from defending the allegations.

While it is not hard to argue that actual government "waste, fraud and abuse" must be addressed, too often that policy objective is invoked to justify the imbalance in FCA litigation that strongly favors the Government and relators. Yet, the Government effectively acts as a *private* civil litigant in this space—frequently threatening treble damages and expensive discovery to extract settlements from companies who did not knowingly submit false claims for payment. This tilts the settlement calculus for defendants, who must consider not only questions of right or wrong, guilt or innocence, but also the significant cost of trying to win when many cards in the deck are already stacked against the defendant.

This article addresses potential FCA reform from the perspective of FCA defense counsel versed in the imbalance built into the FCA that creates this uneven playing field. It focuses on three overarching areas for improvement: discovery practices, bars to recovery, and damage relief.

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Problems in FCA Discovery

- **Extended CID/Investigative Process:** Using Civil Investigative Demands (CID), which allow the Government to collect information from potential defendants through documents, testimony, and interrogatories, the Government can obtain all of the information it needs to build a case against a contractor before traditional discovery commences. Not only can responding to CIDs be costly, without a reciprocal exchange of information from the Government, it can be difficult for contractors to make their case as to why the matter should not move forward. This is compounded by the disparity between the lengthy period in which a relator has to put together a case and convince the Government to intervene (including the Government's investigation) and the comparatively short period a contractor has to convince the Government not to intervene.
- **Risk of Spoliation:** Given the long statute of limitations and slow pace at which the Government typically investigates FCA allegations while a complaint remains under seal, it becomes less and less likely that key government documents—often located at the agency with which the contractor was dealing—will be available when discovery commences. Indeed, presently, the Government typically does not issue preservation notices to affected agencies until after it decides to intervene, rather than while the investigation is ongoing, which increases the spoliation risk for relevant information.
- **Discovery Against the Government:** Once discovery begins, defendants must frequently jump through unnecessary hoops to obtain the evidence they need to defend themselves. Especially in cases where the Government declines to intervene, *Touhy* requests and Rule 45 subpoenas are burdensome and costly discovery tools for the defense.

Potential Discovery Reforms

- ***"Brady"*-like Disclosure Obligations:** Given the punitive element of FCA damages and penalties, which the U.S. Supreme Court has recognized, the Government should be subject to the same "*Brady*" discovery obligations that it has in criminal cases, including obligations to make early disclosure of evidence that tends to negate intent, bears favorably on other elements of liability, or mitigates or eliminates damages. For example, in the Supreme Court's ruling in *United Health Services v. U.S. ex rel. Escobar*, the Court expressly recognized that materiality may be negated by evidence that the Government would have paid (or did pay) the invoices knowing certain requirements were not met. That evidence often resides solely with the Government, which unilaterally can withhold it before discovery (assuming they even preserve it). There are other examples where the Government should have an affirmative burden to disclose – for example, information supporting a breach of the seal, public disclosure, earlier filed cases still under seal, among others. Especially if there is a *qui tam* complaint under seal, the Government should have an obligation to disclose such material to the defendant before making its intervention decision.
- **Immediate Duty to Preserve:** When DOJ is notified of a *qui tam* action, it should be required to issue a preservation notice to all government departments and agencies that could have materials relevant to the proceeding. That notice would require the preservation of all potentially relevant materials, and trigger the automatic duplication and preservation of all relevant government employee email

accounts. In the event such a preservation notice is not issued to relevant persons and agencies, the defendant should have the opportunity to pursue adverse inferences or jury instructions regarding relevant information the Government fails to preserve.

- **Lower the Threshold for Obtaining Key Evidence (and in a Timely Manner):** The Government should consider streamlining processes to facilitate early exchanges of information and to provide companies facing potential "whistleblower" FCA allegations an opportunity to investigate and self-report:
  - *Allow the defense access to sealed materials:* While there may be policy arguments favoring maintaining the *ex parte* seal period in whistleblower-driven actions, reform is needed to ensure that defendants eventually have access to key information before the case gets too far down the road. Specifically, it makes sense for the *ex parte* seal to expire at the end of the sealing period enumerated in the statute—60 days. This means that, while the Government could request extensions to its intervention deadline, the defendants would have access to the *qui tam* complaint and any other materials the relator chooses to share with the Government, including the required written disclosure of all material evidence and information the relator possesses regarding the allegation, during the extension period. Far from obstructing the Government's investigation, our experience shows that companies are typically able to facilitate the investigation if they have a meaningful opportunity to address the underlying *qui tam* allegations.
  - *Require a relator to notify the company of his or her allegation at least 180 days before filing a qui tam complaint:* Pre-complaint notice of a potential FCA violation would enable a contractor to conduct its own internal investigation and determine whether a voluntary disclosure to the Government is warranted. While such an approach was considered and rejected by the U.S. Securities and Exchange Commission when designing its whistleblower program, the process could streamline the Government's ultimate objective of preventing fraud, waste and abuse and facilitate the resolution of potential problems in a cooperative setting, rather than an adversarial one.
  - *Recognize that the Government is the real party in interest in declined qui tam actions:* Because the Government is ultimately the real party in interest, as well as the entity most likely to have highly-relevant information subject to discovery, the FCA's discovery process for "third party" discovery against the Government should be streamlined in cases where the Government declines to intervene but the relator prosecutes the case on the Government's behalf. This would prevent defendants from pursuing time consuming and often-litigated *Touhy* requests to obtain the materials necessary for a defense. It could also compel the Government to seek dismissal of frivolous *qui tam* complaints.

The Need for Higher Bars to Recovery

- *Disclosures Can Lead to Qui Tam Actions:* As it stands, a relator who files suit after a defendant has disclosed improper conduct to a relevant agency is entitled to proceed. To that end, voluntary disclosures of wrongdoing to agencies and contracting officers could spur *qui tam* actions by flagging improper conduct for opportunist employees, creating incentives for companies not to voluntarily disclose.

- *Low "Preponderance of the Evidence" Standard Counsels in Favor of Settlement:* Because the standard for civil liability is only preponderance of the evidence, defendants are wary of taking their chances in front of a jury, who may have an interest in bringing money into the Government fisc.

Potential Solutions for Improved Standards

- *Make Inspector General (IG) Disclosure a Bar to Future Qui Tam Actions:* Both to prevent unnecessary *qui tam* actions and to incentivize responsible contractor conduct, relator complaints based on allegations substantively similar to prior IG disclosures by the company should be barred, much like the current public disclosure bar.
- *Adopt a "Clear and Convincing Evidence" Standard:* Again, given the possibility of treble damages, a non-strictly disinterested jury, the fact that the Supreme Court has labeled the FCA a punitive statute, and the fuzziness surrounding the "knowledge" standard all mitigate in favor of adopting a higher burden of proof to prevent defendants from feeling that they must settle meritless strike suits.

Challenges with FCA Damages

- *Well-Meaning Contractors Can Be Liable Despite Best Efforts at Compliance:* Despite having well-designed compliance programs, it is almost impossible for a contractor, especially large organizations, to prevent every mistake or detect every bad actor. As such, these truly well-intentioned contractors may find themselves facing expensive litigation (or costly settlements) in an attempt to avoid massive damages.
- *Contractors Can Lose Everything, Despite the Government Receiving the Benefit of the Bargain:* In certain situations, contractors face damages amounting to three times the value of the contract even though the goods or services they provided the Government are valuable. Contractors also face statutory penalties over and above actual damages. Such steep penalties mitigate in favor of settling FCA actions—even when such actions are meritless.
- *Double Damages Provision in Statue is Toothless:* Presently, the FCA has a provision that caps damages upon a court finding that the person committing the violation furnished government officials responsible for investigating false claims violations with all information known to that person about the violation within 30 days of the defendant first obtaining the information, if at the time of the disclosure, a case had not yet been filed and the violator was not aware of an ongoing investigation. *See* 31 U.S.C. § 3729. However, this provision is widely viewed by the defense bar to be too restrictive and incongruent with the complexities of government contracting and sophisticated internal investigations.

Potential Alternative Damages Approaches

- *Compliance Program Safe Harbor:* To protect well-meaning contractors from steep liability associated with bad actors, a safe harbor should be established for those with pre-cleared compliance programs. If a contractor has its compliance program certified by a government or third-party body charged with analyzing and certifying compliance programs, damages should not exceed the Government's actual loss plus statutory penalties. This could easily be accompanied by a program akin to the DOJ's "Pilot

Program" in the Foreign Corrupt Practices Act (FCPA) space. There, companies receive significant credit for voluntary disclosure and cooperating with a subsequent investigation.

- *Only Actual Damages Should be Trebled:* When assessing damages, only the net loss suffered by the Government should be trebled. This limitation on trebling meets the purpose of the law, discouraging fraud, prevents inappropriate government windfall, and counsels against the settlement of bogus strike suits.
- *Redefine Application of Statutory Penalties:* Statutory penalties could apply only when there was no loss to the Government. Similarly, the statutory penalties could be used as a cap that is both equal to the sum sought in the claim plus the costs the Government incurred reviewing the claim.
- *Clarify Double-Damages Limitation:* To be meaningful, Congress should clarify what is required and allow a more meaningful period for potential violators to perform a meaningful internal investigation, much as occurs in the FCPA space.

Fraud against the Government certainly is unwanted. However, that moral imperative should not justify an unbalanced discovery and litigation standard that stacks the deck against defendants and impairs their ability to fully and fairly defend FCA allegations. These suggested reforms highlight some of the basic areas in which reform would help streamline the FCA discovery process and help mitigate some of the undue burden that too often forces contractors to prioritize settlement, even when they have not committed any wrongdoing.