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ALERT

Not So Fast Congress: There's a Better Way to Reform the False Claims Act

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We can all agree that true fraud, waste, and abuse should be eliminated from government contracting. We can also agree that meritless and protracted False Claims Act (FCA) cases needlessly divert government resources and waste everyone's time and money. Congress therefore needs to find a way to strike a balance in FCA enforcement: efficiently moving forward with cases involving real fraud while quickly rooting out the meritless ones. Congress' latest attempts at reforming the FCA, however, fail to accomplish either goal.

With staunch FCA advocate Sen. Chuck Grassley (R-IA) at the helm, Senators recently introduced bipartisan legislation to amend the FCA and "beef up the government's most potent tool to fight fraud." These proposed amendments primarily respond to two of the biggest FCA developments in the past five years. *First*, the U.S. Supreme Court's 2016 unanimous *Escobar* decision clarified materiality is a "rigorous" standard and gave it more bite, particularly by holding that continued payment, despite the government's actual knowledge of a violation, "is strong evidence that the requirements [violated] are not material." *Second*, Deputy Assistant Attorney General Michael D. Granston's 2018 "Granston Memo" identified factors to guide U.S. Department of Justice's (DOJ) decision to move to dismiss *qui tam* whistleblower actions under its 31 U.S.C. § 3730(c)(2)(A) authority. DOJ has since incorporated that guidance into the Justice Manual. Although DOJ has only moderately increased its (c)(2)(A) dismissals, Sen. Grassley nevertheless expressed concerns that the Granston Memo undercut the FCA's purpose as early as September 2019 and pledged in July 2020 to introduce legislation to "clarif[y] ambiguities created by the courts and rein[] in" DOJ's (c)(2)(A) authority.

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The proposed new legislation makes several key changes to the FCA, including:

Materiality Burden-Shifting: The bills would create a double standard for the element of materiality. Although the exact language has varied slightly among the proposals, both versions allow the government or relator to prove that a false claim or statement was material by a "preponderance of evidence," while the defendant must rebut this by "clear and convincing evidence" of immateriality. The bills counteract the purported effect of *Escobar*, which, as Sen. Grassley's office characterized it, "made it all too easy for fraudsters to argue that their obvious fraud was not material simply because the government continued payment."

This change is overbroad. As the Supreme Court emphasized in *Escobar*, evidence of whether a false statement or claim was actually material to the government's decision to award a contract or pay a claim is a critical element of every FCA action. Continued payment, however, is but one potential materiality argument. The legislation would alter the burden of proof for the element in every case. It is also unfair. The FCA is a fraud statute. It carries damages and penalties in part because fraud necessarily involves deception. But when the government has eyes wide open to the alleged fraud and consciously chooses to continue paying, the appropriate remedy is, at most, contractual or administrative—not a fraud suit under the FCA. If the government chooses to accept performance, at a minimum, it has essentially elected its remedy going forward and should not demand treble damages and penalties for continued performance. Indeed, contractors often cannot unilaterally stop performing because they have their own contractual obligations to continue. Moreover, evidence of materiality is almost always within the government's possession and control. Yet, the proposed legislation inappropriately shifts more of the burden of proof onto defendants. Finally, the change is confusing. The two parties now have different evidentiary standards for the same element in the same case.

If Congress is contemplating any change in FCA materiality standards, it should apply the "clear and convincing evidence" *uniformly* to all parties in FCA actions, given the statutory sledgehammer of treble damages and penalties, which the Supreme Court has recognized are punitive in nature.

Government Reimbursement: One concern the Granston Memo raised is that litigation discovery into an agency's decision-making, especially in a *qui tam* case DOJ deemed unworthy of intervention, could burden the government. Rather than find ways to streamline such discovery, the proposed amendments aim to discourage it by allowing the government to seek reimbursement—from both defendants and relators—for expenses in responding to discovery requests (including attorneys' fees and costs) unless the requesting party can demonstrate the information sought is relevant and proportional to the needs of the case. One version of the amendments would further require the requester to demonstrate that the request was not unduly burdensome on the government.

This is unnecessary. Rule 26 of the Federal Rules of Civil Procedure already limits discovery to relevant, proportional, and not unduly burdensome requests. And Rule 45 allows recipients of litigation subpoenas to recover attorneys' fees from parties who do not take reasonable steps to avoid imposing undue burden. This proposed change is also unfair. Although the government stands to benefit the most from a successful *qui tam* action, the costs of the action are shifted even more to the relator, who likely has limited resources, and the

defendant, who has no choice but to defend itself in a litigation it did not file. Nor does the legislation actually improve the process. *Touhy* requests are already costly and laborious, taking several months if not years. Disputes over expenses will likely lead to side litigation further delaying defendants' access to key evidence. And with FCA cases often involving tens or hundreds of millions of dollars in damages, it is unlikely that relators or defendants will refrain from pursuing key discovery even at the risk of paying the government's expenses.

If Congress wants to improve FCA discovery, it should make the government subject to party discovery requests, recognizing that the government is the real party in interest in an FCA action—and therefore has the most to gain—and relieving relators and contractors from the bureaucratic *Touhy* process.

A New (c)(2)(A) Dismissal Standard: The Granston Memo prompted an uptick in (c)(2)(A) dismissal motions causing courts to grapple with the appropriate review standard. Despite a three-way circuit split emerging, DOJ has remained largely successful with these dismissals. However, as DOJ explained to Sen. Grassley, since issuing the Granston Memo DOJ had only filed 45 motions to dismiss as of December 2019. Since then, DOJ's use has remained limited. As Mr. Granston explained recently at the American Conference Institute's False Claims and *Qui Tam* Enforcement conference, DOJ had only filed (c)(2)(A) motions in about 2% of *qui tams* since issuing the 2018 Granston Memo and a mere six dismissals occurred in 2020. Despite this limited use, the proposed amendments attempt to rein in DOJ's dismissal authority by creating a new standard: "the qui tam plaintiff shall have the opportunity to show that the reasons are fraudulent, arbitrary and capricious, or contrary to law."

If anything, Congress should be encouraging (c)(2)(A) dismissals under the Granston Memo's factors to allow the government to redirect its limited resources to combat true fraud and waste. The overwhelming majority of annual *qui tam* recoveries come from *intervened* cases. While a small number of non-intervened cases prevail, many are frivolous or are shown to otherwise lack merit after laborious and expensive litigation. By rooting out the meritless cases quickly and easily, DOJ can reduce costs for everyone. Bogus suits have significant costs and needlessly burden contractors (who must defend them), their agency customers (who must provide discovery), and taxpayers (because the fees to defend meritless claims are often allowable costs). Even DOJ must spend time monitoring these cases and filing statements of interest whenever novel issues arise that could affect the government in future cases. By creating a more robust standard with multiple avenues for defeat, Congress is discouraging DOJ's attempts to root out meritless cases.

Instead of muddying the FCA waters, Congress could use this opportunity to address some real problems with the False Claims Act and combat fraud and waste more fairly and efficiently. The fastest way to eliminate fraud is for contractors to identify and disclose it. The current system, however, provides little time for contractors to do so. Furthermore, FCA actions are notoriously long and expensive, drawn out by long government investigations and slow litigation. Memories can fade and evidence can get lost before a defendant even has a chance to take discovery. Even more, the FCA's treble damages and penalties often force contractors to settle regardless of a suit's merit. Here are a few steps Congress can take to address these problems and reform the FCA:

- **Provide Specific and Clear Incentives to Motivate Compliance and Disclosure**
  - Problem: Unattainable and inconsistently applied cooperation credit discourages disclosures. The statute provides an unrealistic short period of time for disclosure. Under § 3729(a)(2), a voluntary disclosure within 30 days of discovery may reduce damages to two times the government's loss. This unreasonable amount of time, however, does not allow potential violators sufficient time to perform meaningful investigations. And when DOJ routinely settles cases for similar amounts, it provides little incentive to make a voluntary disclosure. Unsurprisingly, this provision is rarely used. Recently, DOJ provided additional guidance in May 2019 that offered settlement credit to anyone who makes a timely voluntary disclosure, cooperates with the government's investigation, and takes its own remedial measures. In those situations, a defendant may be able to settle for as little as the government's loss plus the relator's share and cost of investigation. However, in our experience, DOJ does not consistently apply these factors and is reluctant to award substantial credit when companies make disclosures. Nor does DOJ's guidance even acknowledge the double damages figure provided in the statute, which should be the ceiling for damages in any case involving a disclosure and cooperation.
  - Solution: To further reduce fraud and encourage cooperation, Congress should provide specific and clear incentives for compliance and disclosure, such as limiting damages and ensuring finality. If Congress is truly interested in reducing fraud, it should give credit to companies that implement rigorous compliance programs and designate an independent accrediting body to certify that such programs meet appropriate standards. After all, stronger compliance programs will further prevent and faster detect any potential violations. But they are not infallible, so this credit would fairly recognize well-meaning contractors' intentions. Congress can also codify credit for timely disclosure of a potential FCA violation by capping damages at double and encouraging DOJ to consistently and transparently settle for as low as single damages based on disclosures, cooperation, or remedial measures taken. Additionally, Congress should clearly define "timely" as a reasonable time period such as 90 days (or longer if good cause shown) to allow a realistic opportunity for investigation before making a disclosure. Lastly, the statute should also more clearly bar subsequently filed *qui tams* to prevent unnecessary costs of revisiting the same issues and to further incentivize disclosures.
- **Accelerate the FCA Process**
  - Problem: A lengthy statute of limitations, combined with slow investigations, results in FCA actions routinely dealing with extremely old conduct. This leads to significant evidentiary challenges. The FCA's statute of limitations period ranges from six to ten years after the purported violation, depending on when the matter came to the government's attention. On top of that, courts usually start the clock on the date of the last claim submitted, even if the only falsehood occurred in the proposal and the subsequent contract performance was smooth-sailing. And once a relator files a *qui tam* suit under seal, the statute of limitation can toll for years while the government decides whether to intervene—sometimes delaying a case for many months or years without any notice to a defendant. Together, these add up to litigation 10–20 years after the events in question. This delays

the government's recoveries and defeats the purpose of a statute of limitations: to ensure that an unjust outcome does not arise from the loss of evidence (fading memories, loss or death of witnesses, technological challenges, etc.).

- Solution: Congress should clarify that the statute of limitations for fraud in the inducement claims starts ticking on the date of the alleged misrepresentation that induced the government's decision. And while the government needs time to conduct an investigation, the statute should require DOJ to make an intervention decision within 18 months, unless the defendant consents to a longer period under seal. Relatedly, Congress should clarify once a court has unsealed an FCA action, an amended complaint and related filings cannot be filed *ex parte*, and the court cannot reseal the case except to the extent it relates to newly added defendants. At bottom, existing defendants should have access to amended complaints in real time to prevent additional evidentiary delays. Resealing otherwise belies the statute's plain terms, which refer to a singular complaint, and the purpose of the sealing requirement. Indeed, the Supreme Court recently recognized that the "seal provision was meant to allay the Government's concern that a relator filing a civil complaint would alert defendants to a pending federal criminal investigation" in *State Farm Fire & Cas. Co. v. United States ex rel. Rigsby.* Yet DOJ's sealing practices have strayed far afield of the purpose and language of the statute. Implementing these measures better protects against stale or missing evidence and further incentivizes whistleblowers to promptly bring claims.

- **Impose the Same Preservation Duty on the Government as Other Litigants**
  - Problem: Although the government knows that litigation is underway as soon as relators file their *qui tam* suits (or earlier), it routinely takes the position that its document preservation obligations do not begin until it decides to intervene in or file a suit. However, given the possible length of time under which the government can investigate a sealed complaint, this approach makes it unlikely that the most important documents—especially the ones that will show whether the defendants' claims were material to the government's payment decision—will be available when discovery finally starts.
  - Solution: Fundamental fairness demands the real party in interest be subject to the same preservation duties as the other parties. Upon receiving notice of a *qui tam* action, DOJ should be required to issue a preservation notice to all government departments and agencies that could have materials relevant to the proceeding. The notice should require the preservation of all potentially relevant materials and trigger the automatic duplication and preservation of all relevant government employee email accounts.
- **Jump Start Litigation with Broader Disclosure Obligations**
  - Problem: Using Civil Investigative Demands (CIDs), the government can develop a robust investigation file that includes most, if not all, of the relevant evidence before traditional discovery commences. Getting access to these materials, however, is slow and difficult for defendants and even relators, who have to rely on *Touhy* requests to contracting or regulatory agencies. Even when the government responds, the litigants often only see a small subset of the evidence the government gathered.

  - Solution: Given the punitive element of FCA damages and penalties, the government should be subject to similar "*Brady*"-type discovery obligations that it has in criminal cases, including obligations during the investigative or litigation stage to make early disclosure of evidence that tends to negate intent, bears favorably on other elements of liability (such as first-to-file, original source, or breach of seal issues), or mitigates or eliminates damages. This is not only fair but promotes judicial economy. The early disclosure obligations are more efficient than *Touhy* requests and can swiftly resolve litigation by enabling both sides to evaluate possible dismissal, settlement, or summary judgment sooner.

- **Impose Damages and Penalties Fairly**
  - Problem: Even if a contractor provided valuable goods or services to the government, contractors can still lose everything when threatened with damages of three times the value of the contract and statutory penalties above actual damages. These outsized threats, coupled with significant litigation costs, can force settlement of FCA actions even if the allegations are meritless.
  - Solution: Congress should clarify how damages and penalties are applied. When assessing damages, only the government's net loss should be trebled. This meets the FCA's purpose, discourages fraud, deters settling meritless cases, and prevents unnecessary windfall. Additionally, statutory penalties should apply only when the government suffers no loss and should not exceed the government's costs incurred in reviewing and pursuing the claim.

These changes are just some of the possibilities for meaningful FCA reform and highlight Congress' missed opportunity with the proposed 2021 amendments. If Congress truly intends to bolster its best tool to fight fraud, it should consider these measures the next time its picks up the pen.