False Claims Act Suits Should Concern Defense Contractors

by Daniel W. Park

During the past 15 years, the U.S. Department of Justice has collected more than $5.2 billion from False Claims Act cases, and the pace of recoveries is increasing.

Last year alone, the DOJ collected at least $1 billion in settlements. The hardest hit industries have been defense and healthcare.

In the jargon of the False Claims Act, private individuals who bring False Claims Act cases are known as qui tam plaintiffs or relators. For the public at large, these people are simply known as "whistleblowers."

A whistleblower can bring a lawsuit in the name of the government.

This means that almost any current employee, former employee or even business competitor can initiate a False Claims Act suit. If the whistleblower prevails, he or she receives a percentage of the government's total recovery. Because the False Claims Act's penalties can be severe, the incentive to bring a case is correspondingly great.

Of the False Claims Act cases that the DOJ has prosecuted to resolution (either settlement, judgment or dismissal), it has recovered money in about 97 percent of the cases.

Defense contractors need to be aware that a violation of the False Claims Act is easy to allege and difficult to defend. The False Claims Act prohibits "knowingly" presenting a false or fraudulent claim to the U.S. government and "knowingly" making a false record or statement to get a false claim paid.

Under the False Claims Act, "knowing" is defined as either actual knowledge, deliberate ignorance or reckless disregard for the truth of falsity of the claim. Thus, those who do business with the government can be held liable under the False Claims Act for claims that they did not even actually know were false.

The punishment can be severe. Those found liable under the False Claims Act must pay three times the actual damages sustained by the government as a result of the false claim. In addition, violators must pay a penalty between $5,500 and $11,000 for each false claim.

It is not always clear what constitutes a violation. For example, in some cases, courts take a strict view that any regulatory violation can make a claim false. In one case, a defendant was accused of not complying with the regulations in the federal Cost Accounting Standards. The defendant argued that its claims were not "false" because it had a reasonable, good-faith belief that it had complied with the Cost Accounting Standards. Although acknowledging that the Cost Accounting Standards were "unquestionably technical and complex," the court said that unless there was literal compliance with the regulations, the claim was "false."

Other courts have taken a less black-and-white view of what makes a claim "false." Such was the case when a contractor was accused of failing to comply with Federal Transportation Authority regulations dealing with the administration of bus routes. The FTA was aware of many of the regulatory problems stated in the claim, but had chosen not to pursue them. The court decided that technical violations of a federal regulation do not make a claim "false." In that court's view, the False Claims Act "is not an appropriate vehicle for policing technical compliance with administrative regulations."

Even if a claim is false, the False Claims Act only imposes liability for false claims that were "knowingly" submitted. Congress specifically included the "knowing" requirement to make it clear that the False Claims Act should not punish honest mistakes or innocent claims submitted through mere negligence.

Defendants have successfully defeated False Claims Act actions when they could show that the facts and circumstances that allegedly made the claim false were known to the relevant government officials or the defendant had a reasonable, honest, good-faith belief that the claim was not false.

In one case, the defendant was accused of submitting claims for payment despite poor engineering work and faulty designs. The government, however, knew about the deficiencies. The court concluded that the defendant was not cheating the government and had not violated the False Claims Act.

Some courts have acknowledged the difficulty that people and companies who do business with the federal government face in keeping up with the maze of rules and regulations. Government contractors are routinely asked to certify compliance with countless arcane regulations that only a handful of specialists understand.

For that reason, courts have begun to distinguish minor technical violations from true acts of fraud.

This area of the law is still evolving. One test that appears to be emerging asks whether compliance with the rule or regulation is an essential condition for the government to pay the claim. This test has broad implications for limiting False Claims Act lawsuits. Without this limitation, any technical non-compliance with federal regulations could potentially result in false claims liability or, at the very least, an expensive lawsuit. With the limitation, nit-picking claims can be weeded out early in the litigation.

How can government contractors limit their exposure to False Claims Act lawsuits?

Regularly Perform Compliance Checkups. An assessment team should be comprised of people from both outside and inside the department being investigated. If a compliance check-up reveals a potential problem, the company must get experienced legal advice. The penalties for violating the False Claims Act are severe.

Respect Employees' Concerns. Most False Claims Act cases start with whistleblowers who believe that their employer did not take seriously their concerns about potential problems. If an employee raises a question about a possibly fraudulent practice, the allegation should be investigated. The employee who believes that the employer is trying to act responsibly is much less likely to file a lawsuit alleging fraud.

Conduct Proper Investigations. Every employee should be encouraged to report problems. Employees, however, should be urged to keep their reports as factual as possible and to avoid making statements that sound like legal judgments.

Protect Confidentiality. Investigations conducted under an attorney's supervision can be privileged from disclosure in the event a lawsuit is later filed.

Ask Questions. While it may be practically impossible to examine every possible rule or regulation that could apply, internal discussions and inquiries into applicable regulations can defeat a false claims accusation. Conversely, failing to ask appropriate questions or failing to follow up on reported problems can create a negative inference of recklessness or deliberate ignorance.

Keep Government Contract Administrators in the Loop. Frequent reports can disprove an allegation that the company was hiding things from the government.

Disclosure. Voluntarily reporting of confirmed contract or regulatory violations quickly can protect against a False Claims Act lawsuit. In some cases, delay in reporting known problems can be interpreted as a "cover up," which is often perceived as worse than the "crime."

Follow Through. If a problem is discovered, a plan should be put into place to address it. Prompt corrective action may defeat a later accusation of knowingly submitting false claims. **ND**

Daniel Park is an attorney in the Los Angeles office of Sheppard, Mullin, Richter & Hampton LLP. He can be reached at dpark@sheppardmullin.com.