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Whistleblower Defense Client Alert: What Government Contractors Should Know About Fraud-In-The-Inducement Cases

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A recent holding from the Eastern District of Pennsylvania contains some helpful analysis for defendants facing a fraud-in-the inducement False Claims Act (FCA) case. A fraud-in-the-inducement case is a rare sub-species of FCA cases, with different rules. Unlike a traditional FCA case, there is nothing “false,” factually or legally, on the face of the claims for payment at issue in a fraud-in-the inducement case. Instead, the otherwise unobjectionable claims are false by virtue of the fact that they were submitted under a contract that was procured through the use of false statements.

The case, *U.S. ex rel. Thomas v. Siemens Medical Solutions USA Inc.*, gives defendants facing a fraud-in-the-inducement case a weapon to fight back. The court explained, in a clear and detailed analysis, that a plaintiff cannot succeed on a fraud-in-the-inducement claim without proving an additional element of inducement. The court distinguished the inducement element as separate from and in addition to the normal element of materiality. It held that the inducement element could not be satisfied by showing that the government could have been induced by the alleged false statements at issue. Instead, it required proof of actual reliance (*i.e.*, that the government relied upon the false statements to its detriment in awarding the contract).

In *Siemens*, *qui tam* relator William Thomas sued Siemens Medical Solutions USA, Inc., alleging that his former employer submitted false statements to the government in conjunction with its bids to sell ultrasound and magnetic resonance imaging (MRI) devices to Veteran’s Administration hospitals. The government declined to intervene in the case. In his summary judgment briefs, the relator argued that he needn’t prove that the government actually relied upon a false statement made by Siemens in awarding the contracts. He asserted that “he need not prove that the government relied on the statement because the inducement or reliance element is duplicative of the materiality element,” and it “would serve no purpose to require a relator to show that a statement has a natural tendency to influence or was capable of influencing the government if the relator also had to prove the government was in fact induced to act.” The court rejected

this argument unequivocally, holding that relator's failure to submit any evidence of actual reliance by the government was fatal to his claim.

The court's analysis helpfully compares and contrasts the elements of a "typical" FCA case with those of a fraud-in-the-inducement case. The court explained that in fraud-in-the-inducement cases, the fraud turns on the statement(s) made in the course of procuring the contract. "If a false statement did not actually cause the government to award the contract, then the claims paid under the contract did not derive from an original false misrepresentation" and by extension, cannot be false or fraudulent. Consequently, the court held that "the FCA requires the plaintiff in a fraudulent inducement case to establish that the *decision to award a contract was actually*, not just potentially, based on a false statement." As a result, "a defendant who attempts to induce a contract award by making a materially false statement will not be held liable for making a false claim *unless* the government relied on and was induced by the false statement . . . [a]n *attempted* fraud is not enough—it must be an accomplished fraud."

This decision is good news for companies facing a fraud-in-the-inducement FCA case. Both relators and the Department of Justice have used the unique nature of fraud-in-the-inducement claims to sidestep normal pleading and proof requirements applicable to FCA cases. For example, they have argued (and courts have accepted) that the complaint need not contain particular allegations regarding the details of claims for payment because all the claims submitted under a fraudulently awarded contract are false for the same reason. Similarly, they have argued that damages in fraud-in-the-inducement cases are the full value of the contract regardless of the value the defendant provided based on the theory that, but for the fraudulent bid, the defendant would not have received the contract.

But under *Siemens*, inducement is another element that plaintiffs must plead and prove. And, while the court went to great lengths to segregate materiality from inducement, the end result was effectively the application of the far more defendant-friendly outcome materiality standard to fraud-in-the-inducement cases. That means that at the pleading stage, a plaintiff must plead more than the legal conclusion that inducement occurred and must allege specific facts demonstrating that actual inducement plausibly occurred under the Rule 8 pleading standards in *Twombly* and *Iqbal*. At the summary judgment stage, a plaintiff must come forward with evidence of actual inducement (*i.e.* that the government actually relied on the alleged false statements to award the contract) to survive.