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The Government Contractor®

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Information and Analysis on Legal Aspects of Procurement

Vol. 55, No. 1 **January 9, 2013**

Focus

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FEATURE COMMENT: The Top 10 FCA Decisions Of 2012 For Government Contractors

2012 was another banner year for the civil False Claims Act, 31 USCA § 3729 et seq. The Government and qui tam relators, together, initiated a record 782 new FCA matters. And Tony West, the Department Of Justice's acting associate attorney general, lauded the nearly $5 billion recovered in FCA settlements and judgments.

But, alas, not all matters are created equal. While some FCA cases may have resulted in larger recoveries or received more attention throughout the year, the following decisions will end up being the most significant from a legal and practical perspective. Therefore, without further ado, here is our list of *the top 10 FCA decisions of 2012 for Government contractors ...*

10. *U.S. ex rel. Schweizer v. Océ N.V.*: A Limit on the Government's Authority to Settle—With relators filing record numbers of FCA suits year after year, the Government is faced with more and more decisions of whether to dismiss (highly unlikely), whether to intervene or whether to settle qui tam actions. A recent decision from the U.S. Court of Appeals for the D.C. Circuit highlights that the Government's options may be more constrained than it once thought.

In *U.S. ex rel. Schweizer v. Océ N.V.*, 677 F.3d 1228 (D.C. Cir. 2012); 54 GC ¶ 162, the D.C. Circuit held that, in order for the Government to settle a qui tam action over a relator's objection, the court must first find that the proposed settlement is "fair, adequate, and reasonable under all the circumstances." The relator, a former Océ employee, brought a qui tam suit against the company alleging that Océ knowingly breached the price reduction and country of origin clauses in its General Services Administration supply schedule contract. The Government declined to intervene, but nevertheless engaged in settlement discussions with the defendant and attempted to settle the case without the relator's participation. The district court declined to review the settlement, but, in light of the settlement, dismissed the relator's primary FCA claims (everything but the relator's FCA retaliation claim).

The D.C. Circuit reversed. The court held that although the Government has unfettered discretion to dismiss qui tam actions, it does not enjoy the same luxury when it comes to settling. Compare 31 USCA § 3730(c)(2)(A) (Government's authority to dismiss) with § 3730(c)(2)(B) (Government's authority to settle). The court held that if a relator objects to a settlement, "an agreement between the government and the *qui tam* defendant needs judicial approval to become effective." See § 3730(c)(2)(B) ("The government may settle the action with the defendant notwithstanding the objections of the person initiating the action *if* the court determines, after a hearing, that the proposed settlement is fair, adequate, and reasonable under all the circumstances." (emphasis added)).

Océ represents a procedural hurdle that must be overcome before the Government can settle an FCA action over a relator's objection. Relators seeking large FCA recoveries may be dismayed by Government settlement efforts, or believe, whether rationally or not, that their claims are worth significantly more than what the Government and defendant have valued them at and are willing to settle them for. Ultimately, requiring the judicial endorsement of qui tam settlements may prove a mere perfunctory exercise, but for now it remains a potentially complicating factor in a defendant's efforts to settle qui tam cases with the Government.

9. *U.S. ex rel. Baker v. Community Health*: The Government's Duty to Preserve Evidence in FCA Cases—Qui tam complaints are filed under seal for 60 days, 31 USCA § 3739(b)(2), allowing the Government to investigate the relator's allegations

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without the defendant's knowledge. The Government typically receives extensions of this 60-day period, however, which means that qui tam allegations stay under seal for months, if not years. During this time the Government can interview witnesses and collect key documents and evidence to build a case against the contractor, who may be unaware of the investigation or allegations. For contractors, this raises a question: When does the Government have a duty to preserve evidence in FCA cases?

This question was answered in *U.S. ex rel. Baker v. Cmty. Health Sys., Inc.*, 2012 WL 5387069, (D. N.M. Oct. 3, 2012). In *Baker*, the court held that the Government's duty to preserve evidence is triggered (at the latest) when a defendant notifies the Government that it will not settle a case or when the Government decides it will intervene.

In *Baker*, a relator filed a qui tam complaint in 2005. Although the Government soon instructed defendants and a New Mexico state agency to preserve documents, the Government did not issue a similar preservation notice to the relevant *federal* agency until 2009, more than three years later. By this time, key documents had been lost. The Government defended its approach by arguing that it was "DOJ policy to issue litigation holds when intervention was 'reasonably foreseeable,' " which the Government claimed occurred when it received permission to intervene.

The court disagreed, concluding that litigation was reasonably foreseeable as soon as the Government received a letter from defendants "unequivocally" rejecting settlement. At the very least, litigation was foreseeable as soon as the Government requested authority to intervene. Because the court found that the Government's document preservation efforts were both untimely and inadequate, causing the destruction of relevant evidence that was material to the defendant's Government-knowledge defense and the loss of which prejudiced the defendant, it ordered the Government to, among other things, produce documents withheld under a claim of work product, attorney-client privilege and the deliberative process privilege, and to show cause why it should not be required to conduct an additional forensic search for the missing documents.

In ordering the Government to produce privileged documents, the court reasoned that the Government's destruction of documents had deprived the defendants of non-privileged documents needed to test the Government's allegations. The court also noted that the Government—by trying to withhold documents related to the very same individuals whose e-mail messages had been destroyed—was "attempting to use the work product doctrine, the deliberative process privilege and the attorney client privilege as both a sword and a shield."

Although *Baker* does not create a bright-line rule pinpointing when the Government must preserve evidence, it is clear that the Government may not wait until it intervenes. In FCA cases, the Government's duty to preserve evidence may be triggered, at the latest, when the defendant notifies the Government that it will not settle the case. From that moment, the Government should be on notice that litigation is reasonably foreseeable. In qui tam actions, the duty to preserve might even be triggered upon the filing of the relator's initial complaint in certain circumstances. *Baker* also suggests that spoliation of documents, by any party, may result in privilege waiver—including the attorney-client privilege—if privileged documents bear on the same important issue as the documents that were lost or destroyed.

8. *Chapman Law Firm v. U.S.*: Defending FCA Actions with the Contra Proferentem Doctrine—The number of FCA cases based on an implied certification theory has skyrocketed, especially those in which the Government or qui tam relators have argued that a company submits false claims if, in performance of a contract or grant, it violates a contractual provision or a federal statute or regulation incorporated by reference. The defense in such cases is typically that the conduct at issue was consistent with the company's contractual responsibilities. In *Chapman Law Firm, LPA v. U.S.*, 103 Fed. Cl. 28 (2012), the U.S. Court of Federal Claims applied the doctrine of contra proferentem in interpreting an ambiguous contract term underlying an FCA counterclaim.

The contract at issue between Chapman Law Firm and the Department of Housing and Urban Development required Chapman to perform property inspections using licensed inspectors if there was "a contemplated real estate transaction." Both parties stipulated that Chapman performed inspections using unlicensed inspectors for certain transactions, but Chapman contended that it did so only when there were no contemplated real estate transactions which would have, under Ohio law, triggered the requirement for it to use licensed inspectors. The Government countered that HUD was always a "party in-

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volved with a contemplated real estate transaction," and so all inspections needed to be performed subject to state law using Ohio-licensed home inspectors.

After looking at the contract, and Ohio law incorporated by reference into the contract, the court held that the phrase "contemplated real estate transaction" was ambiguous because both parties' interpretations were within a zone of reasonableness, and that the ambiguity was latent, not patent. The court noted that HUD had drafted and selected the contractual language at issue. It held that in such circumstances, it must apply the doctrine of contra proferentem—which requires that ambiguous or unclear terms that are subject to more than one reasonable interpretation be construed against the party who drafted the document. The court construed the disputed provision "less favorably" to the Government, and found that Chapman had not violated its contractual obligations or submitted any false claims.

Chapman illustrates that the contra proferentem doctrine can be used to defend against overreaching FCA cases that are premised on ambiguous contractual provisions, as long as the provisions were drafted by the Government and the ambiguity is latent and not patently obvious, such that the contractor had a duty to inquire about it at the start.

7. *U.S. v. Kernan Hospital*: Limiting the Government's Use of Civil Investigative Demands—An important tool in the Government's arsenal for uncovering fraud is the civil investigative demand (CID). Under 31 USCA § 3733(a), the Government may, "before commencing a civil proceeding under [the FCA] or other false claims law," issue a CID requesting documents, responses to written interrogatories, or deposition testimony. CIDs allow the Government to investigate the facts and develop its claims against a defendant, and they have become a much more commonly used tool since the passage of the Fraud Enforcement and Recovery Act of 2009, which made the issuance of CIDs significantly less onerous. Because they were sparsely used until recently, there has been very little case law challenging their use.

In *U.S. v. Kernan Hosp.*, 2012 WL 5879133 (D. Md. Nov. 20, 2012), the U.S. District Court for the District of Maryland shed some light on the limits of the Government's use of CIDs. The court properly held that the purpose of the FCA's CID provision is to allow the Government a quick and efficient means of determining whether to bring an FCA suit. Therefore, the Government cannot issue a CID *after* having initiated an investigation into possible FCA violations and having filed suit on the basis of that investigation.

In *Kernan*, the Government filed an FCA suit alleging that Kernan devised a scheme to fraudulently increase its reimbursement under Medicare, Medicaid and Tricare. Prior to filing its complaint, the Government had investigated the alleged scheme for three years, issuing various subpoenas and CIDs along the way. Despite the Government's lengthy investigation and opportunity for fact development, the district court concluded that the Government's complaint failed to plead its fraud allegations adequately, and it dismissed the complaint without prejudice. Following this dismissal, the Government attempted to obtain the information necessary to cure the defects in its complaint by issuing another CID to Kernan regarding its reimbursement scheme.

Kernan petitioned to set aside the CID, and the district court granted the petition. The court examined the language of 31 USCA § 3733(a)(1), and held that "the plain meaning of the statute makes clear that the tool is to be used 'before commencing a civil proceeding.' " Further, the court noted, "the legislative history confirms that the civil investigative demand is a prefiling investigative tool that Congress created to aid the government in deciding whether to file suit in the first place." Given that the Government had already decided to file, and indeed had filed suit against Kernan, the court held that the Government's new CID could not serve its intended purpose.

Kernan demonstrates an important limit on the Government's ability to investigate potential FCA violations. At some point in every investigation, the Government must make a determination whether to proceed to litigation. After making that determination, the Government cannot be allowed to go back and have another chance to investigate the same or similar conduct.

6. *U.S. ex rel. Davis v. District of Columbia*: Limited Damages for Immaterial Breaches—In *U.S. ex rel. Davis v. Dist. of Columbia*, 679 F.3d 832 (D.C. Cir. 2012); 54 GC ¶ 177, the D.C. Circuit reinforced its 2010 holding in *U.S. v. Sci. Applications Int'l Corp.*, 626 F.3d 1257 (D.C. Cir. 2010) (*SAIC*); 53 GC ¶ 25, limiting the damages available for immaterial breaches of Government contracts.

In *SAIC*, the D.C. Circuit held that if a contractor agrees to provide goods or services to the Government, the proper measure of damages is "the dif-

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ference between the value of the goods or services actually provided by the contractor and the value the goods or services would have had to the government had they been delivered as promised." The court in *SAIC* thus overturned a district court jury instruction requiring the jury to equate the Government's damages directly to the full amount of payments the Government made to the contractor.

In *Davis*, a relator alleged that the District of Columbia and its schools violated the FCA by submitting Medicaid reimbursement claims without maintaining adequate supporting documentation. He argued that the entire amount the Federal Government paid to the defendants constituted damages because the Government would not have paid anything had it known there was no documentation for the reimbursement claim. He did not, however, allege that any services paid for were not provided.

Given the absence of any alleged damages, the district court found that the Government suffered no damages, and the D.C. Circuit affirmed that finding. Quoting *SAIC*, the D.C. Circuit held that to establish damages, a plaintiff must prove that " 'the performance the government received was worth less than what it believed it had purchased.' " In *Davis*, because there was no question whether the services paid for were provided, the court held that the maintenance of supporting documents had "no independent monetary value." The court analogized to a dinner scene: "A server's failure to bring a receipt after dinner causes no harm when you know you've been properly charged. The same is true here: The government got what it paid for and there are no damages." The court, however, found that the relator's allegations were not precluded by the public disclosure bar and that statutory penalties were available if the relator could establish liability.

Davis represents a continuing effort by the D.C. Circuit to rein in exaggerated FCA damages theories for immaterial contractual breaches. As relators continue to use new and expanded theories of FCA liability—e.g., implied false certifications—it will be important to see whether other courts follow the D.C. Circuit's lead and refuse to recognize damages theories that are divorced from any actual harm to the Government, but that result "because of" a false claim or statement.

5. *U.S. ex rel. Wall v. Circle C Construction*: DBA Violations Can Lead to FCA Liability—The Davis-Bacon Act (DBA), 40 USCA § 3141 et seq., imposes certain federal labor policies on contractors doing business with the Government. It requires Government contractors to pay their employees prevailing wages established by the secretary of labor. And it mandates that Government contracts contain stipulations that the contractor or subcontractor shall pay its employees specified wage determinations. See 40 USCA § 3142(c). But can violations of the DBA lead to FCA liability?

In *U.S. ex rel. Wall v. Circle C Constr., LLC*, 697 F.3d 345 (6th Cir. 2012); 54 GC ¶ 355, the U.S. Court of Appeals for the Sixth Circuit held that if a contractor misrepresents the wages its pays to its DBA-covered employees, the contractor can violate the FCA. Circle C had a contract with the Army to construct buildings at the Fort Campbell military base. The contract included wage determinations for electrical workers beginning at a base hourly rate of $19.19. However, the district court found that, with few exceptions, Circle C and its subcontractors only paid their electrical workers between $12 and $16 per hour. Therefore, the court found Circle C liable for knowingly submitting false payroll certifications under the DBA.

The Sixth Circuit affirmed the district court's decision holding Circle C liable under the FCA. In doing so, it reviewed and upheld the district court's dismissal of Circle C's argument that the Department of Labor's Wage and Hour Division had primary jurisdiction over the Government's complaint. The Sixth Circuit noted that there is a "dichotomy between a contractor's misrepresentation of wages and its misclassification of workers." Because the only issue here was whether Circle C's electrical workers were paid their proper wage, the court held that the issue was one of misrepresentation, and there was no need to defer to the agency's expertise. Therefore, the district court properly exercised jurisdiction over the FCA complaint.

Circle C demonstrates how allegations of DBA violations can easily be transformed into FCA violations. So long as a plaintiff does not allege that a contractor misclassified its workers, a court may consider an alleged DBA violation to be a misrepresentation, and thus an FCA violation. (The same logic may also be applied to alleged violations of other statutes, including the Service Contract Act, 41 USCA §§ 6701–07.) And the broad remedies available to plaintiffs under the FCA—e.g., treble damages and mandatory penalties—make this an attractive proposition. At the least, Government contractor and subcontractor

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employees dissatisfied with their pay—and seeking additional compensation—may begin to question whether their employers are complying with the DBA. Government contractors, especially prime contractors, must closely monitor their own payroll certifications and the activities of subcontractors and employees under their control.

4. *U.S. v. BNP Paribas SA*: The WSLA Suspends the FCA's Statute of Limitations—Has the FCA's six-year statute of limitations been overridden? According to a district court, the Wartime Suspension of Limitations Act, 18 USCA § 3287 (WSLA), suspends the FCA's general six-year statute of limitations.

Under the WSLA, "When the United States is at war or Congress has enacted a specific authorization for the use of the Armed Forces, ... the running of any statute of limitations applicable to any offense [] involving fraud or attempted fraud against the United States or any agency thereof ... shall be suspended until 5 years after the termination of hostilities." In *U.S. v. BNP Paribas SA*, 2012 WL 3234233 (S.D. Tex. Aug. 6, 2012), the U.S. District Court for the Southern District of Texas held that the WSLA applies to the FCA and has been triggered by the U.S. operations in Iraq and Afghanistan.

In *BNP Paribas*, the Government asserted FCA and common law claims based on allegations that, from 1998 through 2006, BNP engaged in a scheme to defraud the U.S. in connection with commodity payment guarantees provided by the Department of Agriculture. BNP moved to dismiss the allegations, arguing that the Government's claims were time-barred by the FCA's six-year statute of limitations, 31 USCA § 3731(b). The Government responded that the WSLA served to suspend the FCA's statute of limitations.

The court agreed with the Government. The court held that despite the WSLA's location in the criminal code and its explicit reference to any "offense"—a term synonymous with criminal conduct—the WSLA applies to civil claims under the FCA. Further, the court concluded that the U.S. was "at war" in Iraq and Afghanistan in 2005 when BNP's alleged fraud occurred, or that alternatively, Congress had "enacted a specific authorization for the use of the armed forces" sufficient to trigger the WSLA. Though Congress only added the congressional authorization provision to the WSLA in 2008, see P.L. 110-417 § 855 (2008), the court held that it applied to BNP's conduct because the statute of limitations for BNP's alleged fraud had not yet run when Congress enacted the WSLA's 2008 amendments. Therefore, the court held that the WSLA suspended the FCA's statute of limitations and that the Government's claims were not time-barred.

BNP Paribas, if followed by other courts, allows the Government to prosecute civil FCA claims well beyond the customary six years from the date the alleged fraud occurred—even when those claims have nothing to do with the Government's war efforts.

3. *U.S. ex rel. Feldman v. Cornell University Medical College*: When Damages Equal the Full Value of the Contract or Grant—The FCA provides for damage recoveries equal to "3 times the amount of damages which the government sustains" because of a false claim or statement. 31 USCA § 3729(a)(1). For most FCA cases, if a contractor or grantee provides a *tangible* benefit to the Government, such as an airplane part or battery, calculating damages is no different than a breach of contract claim: the fact-finder uses a benefit-of-the-bargain analysis to calculate the difference in market value between what the Government paid for and what it received.

But how are damages calculated if the Government's benefit is *intangible* and does not have an ascertainable market value—if, for example, it provides grant money to university hospitals and research facilities? The U.S. Court of Appeals for the Second Circuit addressed this question in *U.S. ex rel. Feldman v. Cornell Univ. Med. Coll.*, 697 F.3d 78 (2d Cir. 2012), finding that damages equal the full value of the contract or grant.

In *Feldman*, a qui tam relator brought an FCA suit against Cornell University Medical College and a professor of psychology, recipients of federal funding from a National Institutes of Health grant program. The relator alleged that the defendants submitted an initial grant application to NIH promising to create a program that "would train as many as six post-doctoral fellows at a time in child and adult clinical and research neuropsychology with a strong emphasis upon research training with HIV/AIDS."

The relator alleged and presented evidence at trial that defendants, in both their initial grant application and their renewal applications, had misstated the program's curriculum, resources, faculty and training. For example, although the initial grant application explained that "the majority of [the] clinical work will be with persons with HIV infection," the relator presented evidence that only three of the 165 clinical cases

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handled by the program involved HIV-positive patients. He also presented evidence that the proposed curriculum was never implemented, that key faculty members identified in the application did not contribute in any substantive way to the program, and that the research and clinical training that was proposed "differed significantly from the actual training received."

The case was tried to a jury for eight days, resulting in a partial verdict for the relator. The jury found the defendants not liable for false statements in their initial grant application, but did find the defendants liable for false statements in several of their grant renewal applications. Although the jury did not calculate damages, the district court determined that the Government's actual damages were the entire amount of grant money for each of the renewal years that had been procured through misstatements.

On appeal, the Second Circuit agreed, reasoning that the Government's damages equaled the full amount of the renewal year grants because it had received "no tangible benefit" from the defendants' rogram. Because the grant represented a failed "attempt to ... promote 'child and adult clinical and research neuropsychology with a strong emphasis upon research training with HIV/AIDS,'" the Government had "entirely lost its opportunity to award the grant money to a recipient who would have used the money as the government intended."

Feldman illustrates that a contractor or grantee may be held liable for the full amount of the contract or grant if it provides a "non-conforming good or service" when the money was intended to benefit a third party, rather than the Government itself, and any intangible benefit is impossible to calculate. *Feldman* and similar cases may provide for large damage awards in cases challenging, for example, a defendant's status as a small or disadvantaged business.

2. *U.S. ex rel. Hooper v. Lockheed Martin*: Cost Estimates and Fraudulent Underbids—Can a cost *estimate* be too low? Yes, according to the U.S Court of Appeals for the Ninth Circuit, which held that a contractor can be held liable under the FCA if it makes false estimates and engages in underbidding to win a contract.

In *U.S. ex rel. Hooper v. Lockheed Martin Corp.*, 688 F.3d 1037 (9th Cir. 2012); 54 GC ¶ 257, the Ninth Circuit found that a relator presented a genuine issue of material fact as to whether Lockheed's proposals on a cost-reimbursement contract included cost estimates which it knew were lower than the costs it expected to incur. The relator alleged that Lockheed employees were instructed to lower their cost estimates without regard to actual cost. The court found that the relator presented evidence that one Lockheed employee "was simply asked [by management] to change the cost" even though the change was not based on engineering judgment. He called the inputs used to create the bid "bad, bad guesses." When the same employee allegedly objected to a similar cost reduction on another contract, his supervisors dismissed him from the contract bid meeting altogether, and then cut the company's proposed cost by nearly half.

Relying on cases from the First and Fourth circuits, the court concluded that a contractor that makes a false estimate, in which the bid is not what the contractor intends to charge, can be found liable under the FCA. The court held that underbids can be a source of liability under the FCA, "assuming that the other elements of an FCA claim are met."

Apart from finding disputed facts on the element of "knowledge" of underbidding, the court did not consider two other key elements of FCA liability—whether there was an actual false claim for payment and whether the alleged false estimates were "material." First, the relator admitted that all of the costs incurred under the cost-reimbursement contract were properly incurred on the contract and not mischarged, thereby undermining his allegation that there was any false claim for payment. Second, the court ignored the question of materiality, although it noted that the Air Force had hired independent consultants to review the bids, and the consultants found that Lockheed had "overstated potential cost savings," but still concluded that Lockheed's bid was "realistic." Indeed, the Air Force itself was aware that Lockheed's bid might lead to cost growth beyond targeted cost, but it nonetheless found that such risk was "acceptable" and that Lockheed's price was "fair and reasonable."

Hooper illustrates that cost estimates provided to the Government during the procurement process may, if intentionally understated, be a basis of FCA liability. Although the Ninth Circuit did not provide a standard by which estimates will be evaluated, the court's decision suggests that a cost estimate may be deemed false or fraudulent if it is lower than what a contractor intends to charge.

1. *U.S. ex rel. Williams v. Renal Care Group*: Interpreting Federal Regulations to Maximize Profit Is Not Fraudulent—To incur FCA liability, a contractor must have acted with the requisite

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knowledge that its claims were false. Such knowledge can be actual, 31 USCA § 3729(b)(1)(A)(i), or constructive, either because the contractor acted in deliberate ignorance of the truth, § 3729(b)(1)(A)(ii), or in reckless disregard of it, § 3729(b)(1)(A)(iii). When it comes to adhering to complex and often ambiguous federal regulations, however, what can a contractor do to help ensure that it will not be found to have acted recklessly when it submits claims for payment?

The Sixth Circuit addressed this question in *U.S. ex rel. Williams v. Renal Care Group, Inc.*, 696 F.3d 518 (6th Cir. 2012); 54 GC ¶ 354. In *Williams*, two relators filed a qui tam complaint against a dialysis provider, and the U.S. intervened because the company had "created a wholly-owned subsidiary to take advantage of loopholes in the Medicare regulatory scheme that would permit it to increase profits." The U.S. argued that the subsidiary was simply a sham corporation established to maximize profits to which the parent corporation was not entitled. The district court agreed, granting summary judgment for the Government and concluding that the defendants "acted with 'reckless disregard' of relevant Medicare statutes and regulations."

The Sixth Circuit, however, disagreed and reversed. It concluded that the defendants did not "knowingly" submit false claims to Medicare because they, among other things, followed industry practices and publications, and sought guidance—both from outside legal counsel and agency officials—on how to follow ambiguous Medicare regulations. The court dismissed the idea that contractors "ought to be punished solely for seeking to maximize profits," and rejected the Government's argument that companies "recklessly" misinterpret federal regulations if they do so. "To deem such behavior 'reckless disregard' of controlling statutes and regulations," the Sixth Circuit wrote, "imposes a burden on government contractors far higher than what Congress intended."

Williams presents an important lesson—that a contractor's effort to maximize profit is not, as the Government and relators sometimes believe, per se the tell-tale badge of fraud. For companies and contractors that must interpret ambiguous provisions, *Williams* also demonstrates that seeking the advice of outside counsel and federal agency officials, and acting openly and consistently with industry standards, will help to establish good faith efforts at compliance and ultimately help to prevent FCA exposure.

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