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Focus

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FEATURE COMMENT: The Top FCA Developments Of 2019

2019 saw a host of False Claims Act developments including several significant settlements, a U.S. Supreme Court decision on the statute of limitations and the implementation of several important policy changes that the Department of Justice had announced a year earlier. This Feature Comment highlights these and other top FCA developments and looks ahead to what is in store for Government contractors in 2020.

Recovery Statistics and Notable Settlements—On Jan. 9, 2020, DOJ announced that the Government had recovered more than $3 billion in settlements and judgments in fiscal year (FY) 2019. This amount was a slight uptick from the prior year in which $2.88 billion was recovered. Of the 2019 total, $2.1 billion came from qui tam cases, with relators receiving over $265 million for their efforts. Not only was the Government's total haul higher than in the prior year, but the number of new case filings also increased from 767 actions in FY 2018 to 782 new suits filed in FY 2019, which included 636 new qui tam matters and 146 affirmative civil enforcement actions filed directly by DOJ.

Consistent with prior years, healthcare-related settlements and judgments ($2.6 billion) made up the majority of the recoveries. Atop the list was a settlement paid by Reckitt Benckiser Group to resolve civil liability related to its marketing of an opioid addiction treatment drug. As part of the agreement, the company agreed to pay $500 million to the Federal Government and up to $200 million to participating states. 2019 was also a banner year for grant-related recoveries including a $112.5 million payment by Duke University to resolve allegations that it submitted falsified research in applications and progress reports on National Institutes of Health and Environmental Protection Agency grants.

After a down year, there was an increase in 2019 in Department of Defense related recoveries, with more than $250 million paid out by contractors to resolve FCA allegations. Headlining the defense-related recoveries was a $34.6 million payment by aluminum manufacturer Hydro Extrusion Portland Inc. to settle allegations that the company delivered aluminum extrusions that did not comply with contract specifications. In another notable settlement, software company Informatica LLC paid $21.57 million to resolve allegations that it provided misleading information about its commercial sales practices when negotiating prices with the General Services Administration in connection with Multiple Award Schedule contracts. Apropos of the Government's focus on bid-rigging in federal procurements—as demonstrated by the creation of the Procurement Collusion Strike Force—two South Korea-based companies agreed in March to pay over $50 million to resolve civil antitrust and FCA claims related to an alleged bid-rigging conspiracy in connection with Government contracts for the delivery of fuel to U.S. bases in South Korea.

What can contractors take away from these recovery statistics? For starters, it is notable that the number of new FCA filings has not waned in recent years. The Supreme Court's 2016 decision in *Escobar* has been widely interpreted as raising the bar as to what must be pled or proven to satisfy the FCA's materiality standard. But if *Escobar* created an additional obstacle, this hurdle does not appear to have dissuaded the Government and relators who have continued to bring new cases at a steady clip. Second, while the Government's haul in any given year may ebb and flow, the overall numbers have consistently been staggering—literally, billions of dollars—for years now, and that's not likely to change anytime soon.

Sustained Use of DOJ's Dismissal Authority—2019 saw increased activity in the courts related to the Government's decision the year before to revive its dormant authority at 31 USCA § 3730(C)(2)(A) to dismiss qui tam suits notwithstanding the objections of a relator, so long as the relator has been notified by the Government and the court has provided the relator with an opportunity for a hearing. The increase in § 3730(C)(2)(A) filings that began in 2018 continued in earnest last year. In late June 2019, the then-director of the Civil Fraud Section, Michael Granston, announced that more than 30 cases had been dismissed since DOJ adopted guidance in January 2018 encouraging its lawyers to seek dismissal of qui tam cases that lack substantial merit. In fact, that number is now approaching 50, roughly the same number that DOJ moved to dismiss over the previous 30 years combined.

The wave of § 3730(C)(2)(A) motions filed since the release of the so-called "Granston memo" in January 2018 has resulted in several decisions with courts applying two competing standards of judicial review—i.e., the *Sequoia Orange* and *Swift* standards. The Ninth Circuit's "rational relation" standard, established in *Sequoia Orange v. Baird-Neece Packing Corp*., requires that the Government establish a valid Government purpose and a rational relation between dismissal and accomplishment of the purpose. 151 F.3d 1139 (9th Cir. 1998). If the Government meets this standard, the burden shifts to the relator to show that the dismissal is fraudulent, arbitrary or an abuse of power. In contrast, the District of Columbia Circuit's standard in *Swift v. U.S*. recognizes that the U.S. is the real party of interest in every FCA case—even when DOJ declines intervention—such that the Government has an unfettered right to dismiss. 318 F.3d 250 (D.C. Cir. 2003); 45 GC ¶ 93. While some courts have adopted one of the two standards, even those siding with the more deferential *Swift* standard tend to make findings based on the rational relation test as well, if only to stave off potential appeals.

To date, the vast majority of DOJ's motions to dismiss have been granted, with the high-water mark coming in November 2019 when, on a single day, three district courts granted § 3730(C)(2)(A) motions. But the Government's use of § 3730(C)(2)(A) in 2019 has not been without setbacks. For instance, in *U.S. ex rel. CIMZNHCA, LLC v. UCB, Inc.*, the U.S. District Court for the Southern District of Illinois denied DOJ's motion to dismiss after holding an evidentiary hearing, in which the judge asked questions about the scope of the Government's investigation and the details of its cost-benefit analysis. 2019 WL 1598109 (S.D. Ill. Apr. 15, 2019). Finding that the application of the *Swift* standard would render the hearing provided for in the statute superfluous, the court applied the standard from *Sequoia Orange*. After considering the Government's stated reasons for seeking dismissal against the facts and evidence presented, the court concluded that the record did not support a rational relationship between the Government's identified cost and policy considerations and dismissal of the action.

The *CIMZNHCA* decision has since been appealed to the Seventh Circuit and may yet be overturned, although the court could also determine that the Government's interlocutory appeal does not merit a ruling on the question of the dismissal standard to be applied. Another denial of a § 3730(C)(2)(A) motion is currently on appeal at the Ninth Circuit in *U.S. ex rel. Thrower v. Acad. Mort. Corp.*, 2018 WL 3208157 (N.D. Cal. 2018), appeal docketed, No. 18-16408 (9th Cir. July 27, 2018), and there is a pending petition for certiorari in *U.S. ex rel. Schneider v. JPMorgan Chase Bank, Nat'l Assoc.*, No. 19-7025, 2019 WL 4566462 (D.C. Cir. Aug. 22, 2019), *petition for cert. filed*, 60 U.S.L.W. 3422 (U.S. Nov. 26, 2019) (No. 19-678). Accordingly, it may be only a matter of time before the high court weighs in on the contours of the Government's dismissal authority. Until then, the rise in § 3730(C)(2)(A) dismissals has been a welcome development for contractors that might otherwise be forced to bear the expense of defending against a meritless qui tam.

Formalization of Cooperation Credit Policy—In May 2019, DOJ announced the release of the long-awaited guidelines for cooperation credit in FCA cases. DOJ formalized the guidelines in § 4-4.112 of the Justice Manual, which sets forth internal guidance for DOJ attorneys. The guidelines set forth actions companies can take to earn cooperation credit in ongoing FCA investigations, starting with voluntary disclosure as the most significant form of cooperation. Beyond that, the guidelines include a list of examples of steps that parties can take to earn credit, even in the context of responding to a formal subpoena or civil investigative demand, such as identifying individuals responsible for the misconduct, providing facts relevant to potential wrongdoing by third parties, and assisting in the determination or recovery of losses to the Government.

The guidelines also underscore the importance of the remedial measures taken in response to violations such as conducting a thorough investigation of the underlying behavior, implementing or enhancing an effective compliance program designed to ensure similar problems do not occur again, and appropriately disciplining or replacing employees responsible for the misconduct.

Notably, the guidelines do not quantify the specific credit that companies can receive. Rather, they make cooperation credit available on a sliding scale, and provide DOJ attorneys with discretion to reduce the damages multiplier and the penalties to be assessed. Notably, a company's maximum credit may not exceed an amount that would result in the Government receiving less than full compensation for its losses, lost interest, costs of investigation and the relator's share of any recovery.

Perhaps the most important takeaway from the guidelines is the focus on the importance of compliance programs. The guidelines make clear that the strength of a company's compliance program will be considered when evaluating potential cooperation credit but also when evaluating whether a violation occurred in the first instance. Specifically, footnote one to the guidelines states that DOJ will consider the nature and effectiveness of a compliance program in evaluating whether any violation of law was committed knowingly. To put a finer point on this statement, investments in compliance will be money well spent both in an effort to prevent regulatory violations from occurring in the first place but also as a basis for receiving cooperation credit or for evidence to defeat allegations that a contractor acted with reckless disregard.

Supreme Court Addresses Statute of Limitations Split—In a unanimous decision issued in May, the Supreme Court held in *Cochise Consultancy Inc. et al. v. U.S. ex rel. Hunt*, 139 S. Ct. 1507 (2019); 61 GC ¶ 149, that qui tam relators can invoke the three-year tolling provision at § 3731(b)(2) in cases where the Government declines intervention.

Under the statute, cases must be brought either within six years of the alleged FCA violation or three years after material facts "are known or reasonably should have been known by the official of the United States charged with responsibility to act in the circumstances," up to a maximum of 10 years after the violation occurred. Prior to the Court's decision in *Hunt* there was a split among the circuits on the proper interpretation of § 3731(b), with some circuits holding that the provision at § 3731(b)(2) was for the benefit of the Government and therefore not available to relators in cases where the Government declined to intervene. In contrast, the Ninth Circuit held that a relator could utilize § 3731(b)(2)'s three-year tolling period in a non-intervened case and equated the relator with "the official of the United States charged with the responsibility to act" when analyzing the triggering date of when facts material to the action were known.

In *Hunt*, the justices resolved this split by interpreting the plain text of the statute and finding that the three-year limitations period was just as applicable in cases in which the Government elects not to intervene as those in which it does. This decision will allow relators to take advantage of § 3731(b)(2) in declined cases so long as their action is brought within the statute's overall 10-year limitations period. The Court also held that a relator is not the official of the U.S. whose knowledge triggers the three-year period in § 3731(b)(2), reasoning that a private whistleblower is neither appointed as an officer of the U.S. nor employed by the U.S. At the same time, it declined to clarify who from the Government qualifies as the "official" whose knowledge counts for purposes of the three-year tolling provision, leaving unaddressed a question that could become important in the wake of the *Hunt* ruling.

While the changes brought by the *Hunt* decision will not affect all FCA cases, they do offer the prospect of a significantly broader scope of liability and damages for allegations that reach far into the past. Defendants facing such extensive periods of liability and damages will have to consider whether and how to demonstrate that the three-year limitation to the 10-year default period (based on the Government's actual or constructive knowledge) should be applied, likely a considerable challenge in almost any case. In short, the practical impact of the *Hunt* decision will likely have a lasting impact.

Increased Risk Associated with Cybersecurity Noncompliance—A settlement announced in 2019 underscores the growing FCA risks for contractors associated with cybersecurity noncompliance. In August, Cisco Systems Inc. agreed to pay more than $8.6 million to settle the allegations in *U.S. ex rel. Glenn v. Cisco Sys. Inc.*, No. 1:11-cv-0400 (W.D.N.Y.), that it violated the FCA by selling video surveillance systems to state and federal agencies that contained software flaws that exposed those agencies to potential cyber intruders and by failing to inform Government agencies that the software did not comply with the standards imposed by the Federal Information Security Management Act. The relator, a cybersecurity specialist for one of Cisco's resellers, discovered the alleged security weakness. In addition to *Glenn*, in May 2019, a court denied a motion to dismiss a qui tam brought by a company's former director of cybersecurity compliance, alleging noncompliance with the DOD's cybersecurity requirements in Defense Federal Acquisition Regulation Supplement 252.204-7012.

In light of the myriad cybersecurity and privacy-related requirements that are routinely included in federal solicitations, such as FAR 52.204-21 and other agency-specific clauses like DFARS 252.204-7012, the *Glenn* case is a wake-up call for Government contractors to be vigilant in understanding and complying with their cybersecurity obligations or risk the possibility that a disgruntled employee in the information technology department or a cybersecurity auditor could call attention to the company's shortcomings by filing a qui tam suit or triggering a Government investigation. From a technical perspective, compliance can be challenging, as the pertinent requirements are dense, complex, and constantly evolving. Moreover, there can be divergent views as to what is in fact required under FAR or DFARS safeguarding clauses and applicable National Institute of Standards and Technology security controls. While such a fact may ultimately prove a defense, it also increases the likelihood of perceived noncompliance and, ultimately, litigation. While the floodgates may not yet have opened, it is apparent that relators and the Government are adding cybersecurity noncompliance to the ever-expanding list of areas for bringing FCA actions.

Small Business Fraud in the Crosshairs—2019 saw a continued emphasis on enforcement in cases involving allegations of small business fraud. For example, Luke Hillier, the former CEO of Virginia-based defense contractor ADS, agreed to pay $20 million to settle allegations that his company misrepresented that it qualified as a small business concern to induce the award of a contract. The Government alleged that this representation was false due to ADS' affiliations with other entities.

Cases involving small business contractors—where individual owners often hold significant influence in closely held corporations—have been fertile ground for the application of DOJ's policy of holding individuals accountable. The $20 million settlement with Hillier followed a settlement that had been entered into with the company for $12 million and a $225,000 settlement with the former general counsel, making the combined settlement the largest-ever recovery in a case alleging small business contracting fraud.

In addition, the criminal and civil resolution in *U.S. v. Otero* is a cautionary tale as to how allegations of small business fraud can metastasize into a criminal action. In *Otero*, the owner of a San Diego construction company entered into a business agreement with a service-disabled veteran-owned small business (SDVOSB) with the stated purpose of using the SDVOSB's status to win set-aside awards. Over time, the companies obtained approximately $11 million in Government construction contracts. According to the business agreement, the two companies agreed that Otero's company would provide all the management, labor, and material and keep 98 percent of every payment, leaving the SDVOSB with only two percent of the proceeds. In June 2019, Otero was sentenced to 18 months in prison and paid $3.2 million to settle the civil FCA allegations.

Cases like those brought against Hillier and Otero are attractive for prosecutors and qui tam relators in light of the Small Business Act's presumption-of-loss rule, which provides for a rebuttable presumption that the single damages to the Government are the full value of the contract or grant when the defendant received the award by willfully misrepresenting its small business size or status. Application of the presumption of loss can result in large recoveries in civil cases as well as stiff sentences when applied in the context of the federal sentencing guidelines. The potential criminal exposure in cases involving small business fraud was driven home in April 2019, when a former executive of a construction company was sentenced to over four years for his alleged use of straw owners to fraudulently obtain set-aside contracts worth more than $160 million.

Notably, while allegations of small business fraud lie at the heart of these schemes, these cases are increasingly pulling in defendants that are far from small. For example, in September the U.S. District Court for the District of Maryland denied a motion to dismiss in *U.S. ex rel. Fadlalla v. Dyncorp Int'l LLC*, allowing the relator to proceed with a complaint alleging that a joint venture of two multinational corporations falsely represented the status of workers to make it appear that they were employed by small businesses in order to fulfill small business subcontracting requirements on a $4.6 billion interpretation and translation contract. The outcome of *Fadlalla* remains to be seen, but it is representative of a growing trend of cases in which large primes are being named as defendants in FCA suits for allegedly claiming credit for awarding small business subcontracts to companies that fail to meet the necessary size and status requirements.

Estoppel and Parallel Proceedings—Fraud on the Government can lead to civil liability, criminal penalties, or both. While criminal and civil fraud matters are distinct in many ways, the interplay between such charges and allegations can be important in investigations and litigation alike. 2019 saw several decisions concerning the impact that criminal and civil proceedings can have on each other. For example, in *U.S. v. Whyte*, the defendant argued that the Government was collaterally estopped from pursuing a criminal case against him by the outcome of a prior qui tam action in which the Government did not intervene and the relator was ultimately unsuccessful in proving that Whyte had presented any false claims. 918 F.3d 339 (4th Cir 2019); 61 GC ¶ 88. The Fourth Circuit disagreed, holding that the Government's criminal prosecution of Whyte was not collaterally estopped by the prior FCA action since the Government had not intervened in it and therefore could not be considered to have been a party with a full and fair opportunity to litigate.

In a more defendant-friendly decision, the Third Circuit in *U.S. ex rel. Doe v. Heart Sol., PC*, held that a corporate FCA defendant was not collaterally estopped from contesting FCA liability (including the elements of falsity and scienter) or damages because of its owner's criminal conviction and plea of healthcare fraud concerning the same transactions. 923 F.3d 308 (3d Cir. 2019). The court did not address, however, the impact of the owner's conviction and plea to bind the company as to, for example, knowledge.

These cases are at minimum a reminder that DOJ is always on the lookout for the case it believes it can win, criminal or civil. At the same time, the *Doe* decision provides some level of support to corporate defendants that, depending on the circumstances, an individual criminal plea or judgment will not automatically estop the company from otherwise putting on a full defense in a civil FCA suit.

Materiality—Some three and one-half years after the Supreme Court's landmark decision in *Universal Health Servs., Inc. v. U.S. ex rel. Escobar*, 136 S. Ct. 1989 (2016); 58 GC ¶ 219, materiality remains front and center in litigation from the pleading stage through discovery and trial. While many of the more significant decisions concerning the application of *Escobar* to a materiality analysis have favored defendants, this past year saw the playing field evening out, with some circuits even appearing to be willing to shift the burden of proof to the defendant to prove a lack of materiality in order to grant dismissal.

In *U.S. ex rel. Lemon v. Nurses to Go, Inc.*, the Fifth Circuit found that relators satisfied the requirement to plead materiality in alleging that the defendant made fraudulent implied certifications that hospice patients qualified for continuous home care services. 924 F.3d 155 (5th Cir. 2019). Referring to the various types of evidence that the high court in *Escobar* discussed as relevant to materiality, the Fifth Circuit stated that "[n]o one factor is dispositive" and characterized its approach as "holistic." In so doing, the court found that the regulations at issue were expressly designated as conditions of payment, accepted the relator's general allegations that the Government's criminal and civil enforcement actions against other hospice providers that had committed similar violations raised a reasonable inference that the Government would deny payment if it knew about defendants' alleged violations, and found that the Government would "attach importance" to those alleged violations. In crediting the allegations of prior Government enforcement, the Fifth Circuit excused the relator's inability to plead any specific examples of such enforcement in advance of discovery, a significant holding as to what it considered adequate to meet the pleading standard.

In *Godecke v. Kinetic Concepts, Inc.*, the Ninth Circuit also reversed the dismissal of a qui tam complaint, finding that relators' claim that the requirement to obtain a written order for medical equipment was an express condition of payment and had been extensively negotiated sufficiently alleged materiality to survive a motion to dismiss and accepted the conclusory assertion that the Government would not have paid the claims if it had known of the absence of the prior written order. 937 F.3d 1201 (9th Cir. 2019). In turn, the court rejected defendant's argument that the Government retained the option to reimburse the claim in full despite the prior written order requirement not being met, finding that the defendant had failed to show that the Government had in fact paid a particular claim in full in such a situation. In short, where *Escobar* cautioned against conclusory assertions of materiality and expressly called out the plaintiff's burden to plead materiality, *Godecke* appears to do the opposite, permitting conclusory pleading and arguably shifting the burden to the defendant to disprove immateriality. In somewhat similar fashion, the Third Circuit in *U.S. ex rel. Doe v. Heart Sol., PC*, held that materiality was properly shown by evidence where Medicare regulations precluded payment of diagnostic neurological testing claims without certification of a supervising neurologist and the defendant offered no evidence in rebuttal. The Court added that its conclusion as to materiality "also means that there was causation ... [i]n other words, but for the misrepresentations, Medicare would have never paid the claims."

While emanating from health care matters, the above decisions are emblematic of the continued significance of materiality in FCA matters and demonstrate that the *Escobar* framework has afforded the courts a certain level of discretion to fashion a materiality analysis that comports with what the particular court sees as the proper result in a given case.

2020 Vision: The Year Ahead for the FCA— As we look ahead, two contrasting but interrelated trends appear concerning DOJ's enforcement of the FCA. On the one hand, DOJ is projecting a more defendant-friendly "image." While § 3730(c)(2)(A) dismissals aren't anywhere near an everyday occurrence, DOJ has certainly proven that it will make use of its authority to end qui tam suits. And the recent issuance of cooperation credit in FCA matters provides defendants with some reason to believe that good faith cooperation efforts will be more directly credited by DOJ in its investigations. On the other hand, it is also clear that the Government will continue to seek out new classes of defendants to pursue under the FCA, and with increasingly aggressive theories of liability. And whether DOJ will truly provide valuable credit for cooperation remains to be seen. On balance, it is likely that the latter points will prove more impactful as the year progresses, but time will tell.

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