

FALSE CLAIMS ACT
v.
THE ENERGY AND MINERALS INDUSTRY

Brian C. Elmer

Mark Koehn

Crowell & Moring LLP

Washington, DC

Prepared for

21st Annual Energy & Mineral Law Institute

May 10-12, 2000

TABLE OF CONTENTS

	<u>Page</u>
I. Introduction.....	1
II. Key Elements Of The False Claims Act.....	3
A. Overview.....	3
B. Key Provisions.....	5
III. Recent Environmental Cases.....	10
A. Cases Alleging Environmental Noncompliance.	10
B. Cases Brought To Attack Perceived Environmentally Harmful Activity.....	19
C. Cases Involving Alleged Underpayment For Extraction Of Federally-Owned Natural Resources.....	25
IV. Dangers Lurking In Deregulation, Privatization And Energy Management.....	28
A. Utilities	28
1. Deregulation.....	29
2. Privatization.....	29
B. Energy Management Services.....	30
V. Significant Legal Issues and Defenses.	32
A. Defenses On The Merits.....	32
1. No Falsity.....	32
2. No Knowledge.....	34
3. No Materiality.....	36
4. No Obligation (A Reverse False Claim Defense).....	38
B. Defenses To <i>Qui Tam</i> Actions Based Upon Lack Of Jurisdiction.	41

1.	Public Disclosure/Original Source.....	41
2.	Other Jurisdictional Defenses And Bars To Parasitic Or Duplicative FCA Actions.....	44
3.	The Constitutional Defenses.....	45
VI.	Significant Strategic And Tactical Issues.....	46
A.	What If There Is A Parallel Criminal Investigation?.....	46
B.	Will The “Real” United States Please Stand Up?.....	48
C.	Accessing Government Personnel and Evidence.....	49
D.	The Use of Experts.	52
E.	The Implications For Suspension, Debarment and Blacklisting.....	53
F.	Matters of Contract Interpretation.	54
VII.	Preventive Measures – How Can This Type Of Liability Be Avoided?.....	56
A.	Identify All Contractual and Legal Requirements Relating To The Protection of the Environment, Health And Safety.....	56
B.	Develop An Environmental Management System.....	58
VIII.	Is There Hope For Legislative Relief?.....	59

I. Introduction.

During the past few years, a virulent strain of False Claims Act (“FCA”) litigation – arising out of alleged noncompliance with environmental, health and safety requirements – has been brought against perceived environmental “bad actors.” Anyone doing business with the government, including subcontractors and suppliers of goods or services to a government contractor, is potentially exposed to the extraordinary liability which is authorized under the FCA.¹ 31 U.S.C. §§ 3729, *et seq.* This statute is far more potent than the “citizen suit” provisions in the environmental laws under which citizens may file suit against anyone who is out of compliance with those laws and seek injunctive relief, civil penalties can be awarded to the government, and litigation costs, including attorneys’ and expert witness fees, awarded to the prevailing party.

The energy and minerals industry likely will be, and to some extent already has been, targeted for attack under the FCA. There are several reasons for this. First, many citizen activists perceive the energy and mineral industries as more likely to adversely impact the environment than other industries. In some states like Montana, where citizen activists secured a legislative halt to new mining activity, the industry is under siege. Second, much of what the energy and minerals industry does occurs on public lands and under leases requiring that royalties be paid to the federal government. Third, these industries are among the most heavily

¹ False Claims Act, 31 U.S.C. §§ 3729, *et seq.* (2000).

regulated in the nation. Heavy regulation often presents challenging compliance problems that, when not met, may lead to FCA *qui tam* actions based upon noncompliance. Finally, deregulation and privatization on the energy side and a new royalties regulatory framework on the minerals side add new compliance challenges that sophisticated *qui tam* plaintiffs' lawyers likely will monitor.

Although our primary focus here (because it is the focus of many of the recent cases) is on the environmental noncompliance context, FCA actions alleging other kinds of regulatory noncompliance, especially in the mineral royalties context, are on the rise. Of course, FCA litigation against Defense Department contractors has been prevalent for years. It is spreading to all areas of government procurement of goods or services. The discussion below applies beyond the environmental noncompliance context to any FCA suit alleging regulatory noncompliance.

This article begins with a discussion of the key elements of the False Claims Act. We then turn to a discussion of some recent cases arising in the environmental noncompliance context. Each case involves threats of exceptionally high potential liability and litigation costs. We then discuss a series of significant legal issues, some of which involve ambiguities in the statute and inconsistency in the case law. From there we turn to significant strategic and tactical issues involving the defense of such cases. We conclude with a discussion of preventive measures, focusing on how this type of liability can be avoided or minimized.

II. Key Elements Of The False Claims Act.

A. Overview.

The False Claims Act allows the federal government to sue anyone who presents a “false claim” which, in the environmental context, can include any request for payment coupled with a misrepresentation with respect to environmental compliance or failure to disclose material noncompliance within any environmental, health or safety requirement. If successful, the government may recover treble damages, a civil penalty of up to \$10,000 per violation, and litigation costs. In addition, any private citizen may file a complaint under seal in federal district court alleging the submission of a false claim. If the government does not elect to intervene, the individual may maintain the suit under the “*qui tam*”² or “bounty hunter” provisions of the statute under which the individual filing the complaint (known as a “relator” in *qui tam* vernacular) may recover up to 30 percent of the trebled damages plus litigation costs and attorneys’ fees.

Given the complex, technical and sometimes ambiguous nature of federal and state environmental and natural resource laws and regulations, it is difficult if not impossible for firms to be in compliance with all of them all of the time. In addition, government contracts contain their own environmental compliance provisions, and

² The phrase “*qui tam*” is short for the expression “*qui tam pro domino rege quam pro se ipso*” which means literally “he who as much for the King as for himself.” A “*qui tam*” suit is brought by a “relator,” *i.e.*, the person who “relates” the evidence of the alleged submission of a false claim in the complaint and who is allowed to proceed with the litigation on behalf of the government.

certain kinds of contracts, such as those involving construction, have site-specific provisions with respect to protection of the environment, health and safety. Who knows which of these, if breached, will be deemed, with the benefit of hindsight, “material” to the government’s decision to pay a claim? Much of the recent litigation has involved the alleged failure to comply with some such provision, and the failure to disclose that noncompliance to the government in connection with the submission of a claim for payment, thereby rendering the claim “false.” Given the lax evidentiary standards and burden of proof in FCA litigation, the existence of this emerging body of law threatens to strip from the government contractor and his suppliers not only any and all profit which may have been realized on the contract, but additional amounts far in excess of that.

The FCA was passed during the Civil War to address the very real problem of fraud committed by suppliers of goods and equipment to the U.S. government. A supplier would agree to furnish a hundred kegs of gunpowder and then deliver 100 kegs of sawdust and submit a bill which was often paid before the goods could be inspected. The “bounty hunter” provision was incorporated in the statute to provide an incentive to anyone who discovered such fraud to bring this to the attention of the government and take a personal hand in helping the government recover damages and penalties. After a complaint is filed, the United States has 60 days within which to intervene and take over prosecution of the case, or decline to intervene and let the relator proceed with the action. The purpose of this provision, however, was to make the government whole and punish the wrongdoer, not to

provide a mechanism by which relators and their lawyers could make a living by filing complaints with far-reaching and intimidating allegations of falsity.

Because the standard of proof is not “beyond a reasonable doubt” or even “clear and convincing evidence,” but simply the preponderance of the evidence test, the specter of treble damages plus penalties and attorneys’ fees is potentially so devastating that quite often, if there is any doubt at all, companies are forced to settle these cases by payments of very large sums rather than run the risk of economic destruction if the case is litigated and lost. The convergence of potential environmental noncompliance and the FCA gives “relators” and their lawyers an extraordinary opportunity to try to use the FCA as a “super-enforcement” statute, circumventing the notice and standing requirements and other limitations imposed by Congress in the typical citizen suit provisions of the environmental statutes.

B. Key Provisions.

The False Claims Act states in pertinent part that:

Any person who —

(1) knowingly presents, or causes to be presented, to an officer or employee of the United States Government, or a member of the Armed Forces of the United States a false or fraudulent claim for payment or approval;

(2) knowingly makes, uses, or causes to be made or used, a false record or statement to get a false or fraudulent claim paid or approved by the Government; [or]

* * *

(7) knowingly makes, uses, or causes to be made or used, a false record or statement to conceal, avoid, or decrease an obligation to pay or transmit money or property to the Government,

is liable to the United States Government for a civil penalty of not less than \$5,000 and not more than \$10,000, plus 3 times the amount of damages which the Government sustains because of the act of that person. . . .³

A person violating this subsection shall also be liable to the United States Government for the costs of a civil action brought to recover any such penalty or damage.⁴

Section 3729(a)(7) in the text quoted above is called the “reverse” false claim provision because it penalizes a false statement made to reduce an obligation owed to the government, as distinct from causing the government to pay money out (sometimes called a “direct” false claim in contrast). Subsection (a)(7) was added in the 1986 amendments to the FCA.⁵

The standard for “knowing” the falsity is very low. Under the Act, “a person, with respect to information, has knowledge if the person:

- (1) has actual knowledge of the information;
- (2) acts in deliberate ignorance of the truth or falsity of the information; or
- (3) acts in reckless disregard of the truth or falsity of the information,

and no proof of specific intent to defraud is required.”⁶

³ 31 U.S.C. § 3729(a) (2000).

⁴ *Id.*

⁵ Prior to that amendment, courts had divided on whether a “reverse” false claim could be brought. *Compare United States v. Howell*, 318 F.2d 162, 166 (9th Cir. 1963) (“[t]he fraudulent reduction of [the defendant’s] liability to the Government does not spell out a false claim”) *with Smith v. United States*, 287 F.2d 299 (5th Cir. 1961) (holding that alleged false reports to the government used to lower the amount of rent paid under a government lease are actionable).

⁶ 31 U.S.C. § 3729(b) (2000).

“For purposes of [Section 3729], ‘claim’ includes any request or demand, whether under a contract or otherwise, for money or property which is made to a contractor, grantee, or other recipient if the United States Government provides any portion of the money or property which is requested or demanded, or if the Government will reimburse such contractor, grantee, or other recipient for any portion of the money or property which is requested or demanded.”⁷

The *qui tam* provisions of the Act state in pertinent part:

(b)(1) A person may bring a civil action for violation of section 3729 for the person and for the United States Government.⁸

The statute further provides, however, that:

(e)(4)(A) No court shall have jurisdiction over an action under this section based upon the public disclosure of allegations or transactions in a criminal, civil, or administrative hearing, in a congressional, administrative, or Government Accounting Office report, hearing, audit, or investigation, or from the news media, unless the action is brought by the Attorney General or the person bringing the action is an original source of the information.

(e)(4)(B) For purposes of this paragraph, “original source” means an individual who has direct and independent knowledge of the information on which the allegations are based and has voluntarily provided the information to the Government before filing an action under this section which is based on the information.⁹

⁷ 31 U.S.C. § 3729(c) (2000).

⁸ 31 U.S.C. § 3730(b)(1) (2000).

⁹ 31 U.S.C. § 3730(e)(4)(A)(B) (2000).

As discussed in more detail in Section V.B.1 below, whether a relator's suit is based upon public disclosures and whether the relator is an "original source" of the information in the complaint is frequently litigated. Generally, if the defendant shows that the relator's allegations of fraud, or essential elements thereof, were publicly disclosed, the court is without jurisdiction unless the relator qualifies as an "original source" – *i.e.*, has direct and independent knowledge of the information and disclosed it to the government prior to filing suit.

The statute provides that a copy of the complaint and a written "disclosure of substantially all material evidence and information the [relator] possesses shall be served on the government" and filed under seal.¹⁰ The government then reviews the complaint and "disclosure statement" and may intervene and proceed with the action within 60 days after it receives these materials.¹¹ The 60-day review period can be extended by court order. If the government decides not to intervene and take over the action, the relator may proceed with the action on his own. When this decision is made, the complaint is unsealed and served upon the defendant. If the government later decides to intervene in the case, it may do so upon a showing of good cause.¹²

With respect to the "bounty hunter" provisions, if the government proceeds with the action, the relator receives between 15 and 25 percent of the proceeds of

¹⁰ 31 U.S.C. § 3720(b)(2) (2000).

¹¹ *Id.*

¹² 31 U.S.C. § 3730(b)(3) (2000).

any settlement or judgment, “depending upon the extent to which the [relator] substantially contributed to the prosecution of the action.”¹³ That amount may be reduced if the court finds that the action was based primarily on disclosures of information which were already the subject of ongoing proceedings. If the government does not intervene and the relator prosecutes the action, he receives 25 to 30 percent of the proceeds of any settlement or judgment. In either case, the relator also may recover from the defendant an amount for any “reasonable expenses” he incurred, plus attorneys’ fees and costs.¹⁴

In a rarely used provision, the court may award the defendant reasonable attorneys’ fees and expenses if the defendant prevails and the court finds that the relator’s claim “was clearly frivolous, clearly vexatious, or brought primarily for purposes of harassment.”¹⁵ The statute also includes “whistle blower” protection which authorizes reinstatement with back pay and any other appropriate relief to “make whole” any employee who was discharged, demoted, threatened, harassed, or otherwise discriminated against because of the bringing or taking of any action under the FCA.¹⁶

¹³ 31 U.S.C. § 3730(d).

¹⁴ *Id.*

¹⁵ 31 U.S.C. § 3730(d)(4).

¹⁶ *Id.*

III. Recent Environmental Cases.

In the last several years, relators – some motivated by environmental concerns and others by “bounty hunter” profits – have brought FCA *qui tam* actions alleging environmental noncompliance or alleging other statutory, regulatory or contractual noncompliance as a means to attack companies engaged in perceived environmentally harmful activity.

A. Cases Alleging Environmental Noncompliance.

The legal predicate for a False Claims Act *qui tam* action alleging environmental noncompliance is the environmental provisions in a government contract. Some environmental provisions are mandatory.¹⁷ Prior to February 25, 2000, government contracts involving payments of \$100,000 or more were required to include a provision obligating the contractor to use “best efforts” to comply with the Clean Air Act and Clean Water Act at “the facility” where the contract is being performed.¹⁸

In addition to such FAR-required clauses, many government contracts include site-specific or job-specific requirements for protection of the environment, human health and safety. These may include erosion control measures, grading requirements, dust suppression requirements, and other provisions relating to any

¹⁷ See Federal Acquisition Regulation (FAR) 52.223-3 (hazardous material identification and material safety data; FAR 52.223-4 (recovered material certification); FAR 52.223-5 (pollution prevention and right-to-know).

¹⁸ 64 Fed. Reg. 72,414 (Dec. 27, 1999) (removing FAR 52.223-2 re Clean Air and Water).

type of activity or releases which may affect the environment or the health or safety of employees or others who may be exposed. Many contracts require “monitoring” to ensure compliance, giving rise to the question as to what constitutes sufficient monitoring. It is easy to be out of compliance with any of these numerous technical requirements, particularly at complex facilities or operations. Federal courts have recognized that it is not possible to be in compliance with all environmental regulatory requirements 100 percent of the time, despite the use of best available technology.¹⁹

In *United States ex rel. Fallon v. Accudyne Corp.*,²⁰ relators, including Atlantic States Legal Foundation (an environmentalist group), alleged that defendant “knowingly failed to comply with environmental compliance provisions contained in government contracts and made false claims for payment by implicitly and explicitly representing that it had so complied.”²¹ Relators also alleged that defendant supplied nonconforming and untested parts. Defendant sought to bar relator’s action on jurisdictional grounds arguing that notices of noncompliance from a state environmental regulatory agency, which resulted from routine inspections, were “public disclosures.”²² The court determined that the notices

¹⁹ *American Petroleum Institute v. Environmental Protection Agency*, 661 F.2d 340, 350 (5th Cir. 1981).

²⁰ *United States ex rel. Fallon v. Accudyne Corp.*, 921 F. Supp. 611 (W.D. Wis. 1995).

²¹ *Id.* at 615.

²² *Id.* at 624. See Section V.B.1. below.

were not “publicly disclosed,” and that if they had been, they did not disclose the “allegations or transactions upon which [relator’s] action is based,” and, in any event, at least some of the relators are “original sources” of the information.²³

Both relators and defendant moved for summary judgment on the scope of the contract provisions and defendant’s certification or representation that it complied with contract requirements.²⁴ The court held that the relators stated a claim under the FCA because, viewing the facts and inferences most favorably to relators, they alleged that “the environmental compliance provisions in the contracts were a material part of those contracts and [defendant] knowingly failed to perform that aspect of the contract, yet sought full payment from the government without disclosing their failure to perform.”²⁵ Nonetheless, the court declined to grant summary judgment to relators because the defendant disputed whether the environmental compliance provisions “were breached and the extent to which [defendant] submitted claims for full payment *knowing* that it had *substantially breached* these requirements.”²⁶ In addition, the court held that “the certifications executed by the defendant are ambiguous” and that their meaning, which could be demonstrated by extrinsic evidence as to the parties’ intent, “must be submitted to

²³ *Id.* at 625 – 26.

²⁴ *Id.* at 626.

²⁵ *Id.* at 627.

²⁶ *Id.* (emphasis added).

the jury as an issue of fact.”²⁷ The court also held that the issue of whether the alleged environmental violations were material to the government’s decision to pay was an issue for the jury.²⁸

Although the defendant settled with relators for about \$12 million, according to defendant’s counsel, most of the settlement amount was paid based upon a relators’ traditional FCA allegation regarding the supply of nonconforming and untested parts rather than the allegation based upon environmental noncompliance.

*United States ex rel. Pickens v. Kanawha River Towing, Inc., et al.*²⁹ was a *qui tam* action against GLR Constructors, a prime contractor, and GLR’s towboat service suppliers, Kanawha River Towing, Inc. and G&C Towing, Inc. Under a contract with the Army Corps of Engineers, GLR built two new locks on a mile-long construction site along one of the busiest segments of the Ohio River. GLR’s towboat suppliers brought materials to and from the construction site by barge. The relator, Earl Pickens, a disgruntled former deckhand with one of the towboat suppliers, alleged that towboats operated by the towboat suppliers and one towboat operated by GLR pumped oily bilge water into the river in violation of the Clean Water Act. Pickens further alleged that the towboat suppliers knowingly caused

²⁷ *Id.* at 627 – 28.

²⁸ *Id.*

²⁹ *United States ex rel. Pickens v. Kanawha River Towing, Inc., et al.*, 916 F. Supp. 702 (S.D. Ohio 1996).

GLR to submit, and that GLR knowingly submitted, false claims for progress payments. The claims were false, Pickens alleged, because GLR asked for payment without disclosing that GLR was in breach of its contract provisions requiring GLR to use “best efforts” to comply with the Clean Water Act, and other environmental protection provisions in the contract documents. Pickens also alleged “reverse” false claims as a result of the towboat operators’ alleged failure to document the oily discharges in vessel logs, thereby avoiding potential Clean Water Act fines and penalties.³⁰

Pickens’ complaint precipitated a criminal enforcement action against one of the towboat companies, Kanawha River Towing, Inc., resulting in a guilty plea for illegal discharges of oily bilge water in violation of the Clean Water Act. Prior to trial, the towboat companies settled with Pickens for approximately \$2 million. The “reverse” false claim as to GLR was dismissed on summary judgment for lack of evidence that the government ever inspected the vessel logs, or would have expected to find in them records of illegal discharges.³¹

GLR prevailed after a three-week jury trial in which Pickens had asked the jury to award over \$19 million in damages, which would have been tripled and added to possible attorneys’ fees and civil penalties of up to \$10,000 per false claim.

³⁰ *Id.* at 702-04.

³¹ *United States ex rel. Pickens v. Kanawha River Towing, Inc., et al.*, Civ. No. C-1-93-790 (S.D. Ohio), Order Granting in Part Defendants’ Motion for Summary Judgment (Dec. 17, 1996).

Pickens based his damages demand on hypothetical Clean Water Act penalties he claimed were avoided by GLR's alleged nondisclosure of illegal discharges.³² After the verdict, the district court denied Pickens' motion for new trial that was based primarily upon the argument that the verdict was against the weight of the evidence.³³ Pickens appealed and the Sixth Circuit affirmed the district court's decision.³⁴

Prior to *Pickens*, two similar FCA *qui tam* actions had been brought in the United States District Court for the Southern District of Ohio, *United States ex rel. Davis v. M/G Transport Services, Inc.* and *United States ex rel. Stevens v. McGinnis, Inc. and Ashland, Inc.*³⁵ Both cases involved the same basic theory that alleged illegal discharges from towboats on the Ohio River, which were undisclosed, gave rise to FCA liability. The complaint in the *M/G Transport* case was filed in 1992 and alleged that during the course of performance of a government contract oily bilge was illegally discharged to the Ohio River. Based on that complaint, in 1993 the FBI boarded M/G Transport's vessels with search warrants looking for

³² The conventional measure of damages under the FCA is the difference in market value between what the government actually received and what it would have received had the claims about its quality been true. *United States v. Bornstein*, 423 U.S. 303, 316 (1976); *United States v. Ekelman & Assoc.*, 532 F.2d 545, 550 (6th Cir. 1976).

³³ *Id.*, Order of July 24, 1998.

³⁴ *United States ex rel. Pickens v. GLR Constructors, Inc.*, 194 F.3d 1314 (6th Cir. 1999).

³⁵ *United States ex rel. Davis v. M/G Transport Services, Inc.*, C-1-92-1001, and *United States ex rel. Stevens v. McGinnis, Inc. and Ashland, Inc.*, C-1-93-442.

evidence of Clean Water Act violations. Indictments of the company, boat pilots and supervisory personnel followed.³⁶

After a seven-week criminal trial, the jury convicted M/G Transport and seven individuals, including the owner and boat captains, of Clean Water Act violations for discharging oily bilge water into the Ohio River and failing to report it or clean it up.³⁷ The civil *qui tam* suit proceeded on the theory that the illegal discharges were not disclosed at the time payment was sought from the United States government and that this failure to disclose an allegedly material violation of the contract rendered all of the claims for payment false. This *qui tam* litigation was settled for a substantial amount of money after the government declined to intervene.

In *United States ex rel. Stevens v. McGinnis, Inc. and Ashland, Inc.*, both “direct” ((a)(1) and (2)) and “reverse” ((a)(7)) false claims were pleaded, based on allegations of non-disclosure of Clean Water Act violations by both the prime contractor, Ashland, and its subcontractor, McGinnis. The government did not intervene, and the *qui tam* relator preceded. Summary judgment was entered for the subcontractor towboat company, and a jury verdict was returned for the prime

³⁶ See *United States v. M/G Transport Services, Inc.*, 173 F.3d 584 (6th Cir. 1999), which reversed in part and affirmed in part a post-trial order by the trial judge setting aside some of the individual convictions. The case provides a description of some of the relevant background facts.

³⁷ *Id.*

contractor, Ashland. The relator appealed and the case was settled pending the appeal.

The latest FCA suit alleging environmental noncompliance involves the gaseous diffusion plant in Paducah, Kentucky. Since the 1940s, the United States has owned a large facility in Paducah that it has used for the development of uranium “enrichment” technologies to separate or concentrate uranium 235 from natural ore using a variety of techniques, one of which was gaseous diffusion. The government hired a series of contractors to operate this facility. Inevitably, a substantial amount of radioactive and hazardous material was generated, including among other things uranium, plutonium, neptunium and other materials.

On June 1, 1999, the Natural Resources Defense Council, Inc. (“NRDC”) and several employees at the Paducah plant filed an FCA *qui tam* action against the government contractors who had operated the facility.³⁸ The National Resources Defense Council is a national environmental organization. The complaint accuses the defendants of submitting claims for payment to the United States under their operating contracts while at the same time 1) making false statements concerning their compliance with applicable environmental, health and safety protection standards and requirements; and 2) failing to disclose the existence of the alleged noncompliance and resulting hazardous conditions. The complaint alleges both direct and “reverse” false claims.

Briefly summarized, the allegations were as follows. Historically, various of the defendants operated the Paducah plant for the Department of Energy (“DOE”) from 1984 until 1998. Both during this period of operation and for over a decade beforehand while a government contractor not named as a defendant operated the facility,³⁹ there was extensive and unlawful disposal of radioactive and hazardous materials to the ground and the groundwater, which resulted in widespread onsite and offsite contamination. The complaint further alleges that the defendants “caused or acquiesced in the continued disposal by their employees of radioactive and possibly hazardous and/or toxic wastes” at the site, and then “knowingly and falsely stated and represented to the Government that such wastes had not and were not being disposed in these landfills, and took other measures to conceal such improper disposal.”⁴⁰

Relators allege that defendants collected hundreds of millions of dollars under these contracts, which were obtained in whole or in part through misrepresentations and nondisclosures. Plaintiffs request treble damages, civil penalties of \$10,000 for each false claim submitted to the government and for each false statement made or used to induce each such false claim, their statutory share

(...continued)

³⁸ *United States of America ex rel. Natural Resources Defense Council, Inc., et al. v. Lockheed Martin Corporation, et al.*, Civ. No 5:99CV00170-R (W.D. Ky. Paducah Div.).

³⁹ Presumably, the prior contractor was not named as a defendant because any FCA claims against it would be barred by the 10-year statute of limitations. 31 U.S.C. § 3731(b) (2000).

⁴⁰ Complaint ¶ 64.

of any recovery plus attorneys' fees and costs, and any other relief to which they might be entitled.

At the time of this writing, the complaint has been unsealed although it has not been served pending the United States' decision on whether to intervene. Costly litigation will almost certainly follow. At the same time, both Congress and DOE have initiated investigations into conditions at the site and allegations of exposure to workers, residents and others offsite.⁴¹ The case received national attention in a series of highly publicized newspaper articles and general multi-media news coverage.⁴²

B. Cases Brought To Attack Perceived Environmentally Harmful Activity.

The allure of sharing in treble damages coupled with caselaw dispensing with traditional standing requirements has led some environmentalist groups to file FCA actions against companies perceived to be harming the environment, although not

⁴¹ Joby Warrick, *Not Just Paducah's Problem? Other Sites Possibly Handled Contaminated Material, Panel Told*, THE WASHINGTON POST, Sept. 23, 1999 at A11.

⁴² See, e.g., Joby Warrick, *In Harm's Way, and In the Dark: Workers Exposed to Plutonium at U.S. Plant*, THE WASHINGTON POST, Aug. 8, 1999 at A1; Joby Warrick, *Richardson Orders Probe of Uranium Plant in Ky.*, THE WASHINGTON POST, Aug. 9, 1999 at A1; Joby Warrick, *A Deathly Postscript Comes Back to Life: After Being Rejected, Warnings of Paducah Atomic Worker Now Hailed as Heroism*, THE WASHINGTON POST, Aug. 11, 1999 at A1.

in violation of environmental laws. One such case was *United States ex rel. North Santiam Watershed Council v. Kinross Gold USA, Inc.*⁴³ filed in 1996.

In *North Santiam*, the relators were not disgruntled or disillusioned employees. One relator, North Santiam Watershed Council (“NSWC”), is a relatively small nonprofit environmental organization in Salem, Oregon. The other relator, Charles Uhlmann, is an individual living in the Los Angeles area who apparently has never worked for a mining company. It is believed that NSWC was opposed, on environmental grounds, to a mining project that one of the defendants planned to develop in Oregon.

In any event, the relators sued 18 hardrock mining companies, each of which, by one calculus or another, was foreign-owned, under the *qui tam* provisions of the FCA. The suit sought treble damages of \$60 **billion** against the mining companies. The novel theory of the relators’ case was complicated, but essentially it went like this: under the Mining Law of 1872,⁴⁴ the defendants have obtained valuable property of the United States in the form of mineral resources that they have extracted under patented and unpatented mining claims that they hold on federal lands. The Mining Law makes those lands available for exploration and purchase by “citizens of the United States” who are in compliance with the “laws of the

⁴³ *United States ex rel. North Santiam Watershed Council v. Kinross Gold USA, Inc.*, No. C-96-3673 (N.D. Cal.).

⁴⁴ *United States ex rel. North Santiam Watershed Council v. Kinross Gold USA*, No. C-96-3673 slip op. (N.D. Cal. March 9, 1998).

United States.”⁴⁵ A separate statute, the Foreign Agents Registration Act (“FARA”),⁴⁶ requires “agents of a foreign principal” to register as such when they engage in various activities in the United States, including “political activities.”⁴⁷ The defendants were owned or controlled by foreign entities, and were thus “agents of a foreign principal.” Nonetheless, they did not register or otherwise disclose their foreign ownership in connection with testimony they gave before Congress on various occasions. The complaint alleged that because of this the defendants violated FARA, but they did not disclose this noncompliance with “the laws of the United States” in obtaining and maintaining their mining claims. As a result, they fraudulently obtained property of the United States, in violation of the False Claims Act, to the tune of billions of dollars.

The defendants filed a joint motion to dismiss the relators’ lawsuit on a variety of procedural and substantive grounds, and the district court, accepting virtually every one of the defendants’ arguments, dismissed the lawsuit.⁴⁸ As to all but one defendant, the court dismissed the lawsuit for improper joinder of defendants not located in California. Although relators might have been able to resurrect their single case by filing 17 individual suits against the dismissed

45 *Id.*

46 *Id.*

47 *Id.*

48 *Id.*

defendants, the court dashed that prospect by dismissing the remaining defendant, Placer Dome, on two independent grounds.⁴⁹

First, the court dismissed the case against Placer Dome for lack of subject matter jurisdiction.⁵⁰ The FCA does not confer federal court jurisdiction over actions that are “based upon the public disclosure of allegations or transactions . . . unless . . . the person bringing the action is an ‘original source’ of the information.”⁵¹ In this case, the court agreed with the defendants that all of the relators’ allegations were based on “information available in the public domain.”⁵² This meant that there was no jurisdiction unless the relators could prove that they were the “original source” of the information. That was not possible here because, as the court found, the relators did not even claim to have any direct or independent knowledge of their allegations. In short, since they were not presenting a case based on the kind of “inside information” that the FCA bounty provisions were designed to draw out, the statute did not provide subject matter jurisdiction over the claim.⁵³

Finally, and perhaps most importantly from a Mining Law standpoint, the court dismissed the relators’ action against Placer Dome because the complaint

49 *Id.*

50 *Id.*

51 *Id.*

52 *Id.*

53 *Id.*

failed to state a claim upon which relief can be granted.⁵⁴ Here, the linchpin of the relators' case was that a violation of FARA was enough to invalidate mining claims because of the Mining Law's requirement that the locators of such claims be in compliance with the "laws of the United States."⁵⁵ If the relators were correct in their allegation that "the laws of the United States" means *all* laws of the United States, the case would have broad and devastating implications. But, applying common sense and relying on a century's worth of Interior Department interpretation, and in the absence of any contrary authority offered by the relators, the court interpreted the operative phrase narrowly:

The Court concludes that the Mining Act cannot possibly have intended to condition mining claims upon compliance with *all* federal laws. . . .FARA is not a mining law. Therefore, Placer Dome's alleged non-compliance with FARA is irrelevant to its claims for mining rights and relators have failed to state a claim under the FCA.⁵⁶

This story has a happy ending for the mining industry, and particularly for the 18 mining company defendants. Still, the case serves as a wake-up call to the powerful incentives of the FCA.

Environmental remediation contractors paid, in part, with federal funds also have been targeted by environmental activists wielding the FCA sword. The case of

54 *Id.*

55 *Id.*

56 *Id.* at 9.

Costner v. URS Consultants, Inc.,⁵⁷ for example, does not break any new ground from an FCA perspective, but it is notable as an example of how an environmental group may bring a *traditional* FCA action against a government contractor even after the group fails in bringing a citizens' suit and state common law action.

In *Costner*, the defendants were environmental remediation contractors performing hazardous waste treatment and disposal services under a federal contract at a chemical plant in Arkansas.⁵⁸ Prior to bringing their FCA action, the relators unsuccessfully sued the defendants in one lawsuit alleging violations of state and federal regulations and seeking to enjoin incineration at the site and, in another lawsuit, asserting a "state nuisance" claim.⁵⁹ The relators' FCA action alleged eight counts of knowing submission of false claims for payment under a federal contract.⁶⁰ The district court denied the defendants' motions to dismiss and the defendants appealed.⁶¹

The Eighth Circuit rejected the defendants' arguments that relators' FCA action was barred by prior litigation. First, the court held that the relators' claims were not precluded on the grounds of *res judicata*.⁶² Specifically, the court stated:

⁵⁷ *Costner v. URS Consultants, Inc.*, 153 F.3d 667 (8th Cir. 1998).

⁵⁸ *Id.* at 670-72.

⁵⁹ *Id.* at 672-73.

⁶⁰ *Id.* at 670-73.

⁶¹ *Id.* at 673.

⁶² *Id.* at 674.

the [prior] litigation was an effort to prevent perceived harm to the environment and public health by seeking enforcement of state and federal environmental regulations and an injunction against waste incineration activity at the [chemical plant] site. In this case, the wrong for which relators seek redress is the alleged submission of false claims for the payment of funds, a claim based upon economic injury to the federal government. Although both claims have their genesis in the [chemical plant] site cleanup, they are independent of each other and seek to redress different injuries resulting from distinct conduct. Thus, the FCA allegations are not, as defendants assert, simply a repackaging of prior claims, but constitute a new set of charges arising from a separate “nucleus of operative facts” upon which no final judgment has been previously rendered.⁶³

Next, the court distinguished the relators’ claims from a challenge to remedial action that would be barred under Section 113(h) of the federal Superfund law.⁶⁴ Finally, the court held that the relators’ claims were not barred by FCA Section 3730(e)(3) which precludes suits based upon allegations or transactions which are the subject of a civil suit or an administrative civil money penalty proceeding in which the government is already a party.⁶⁵

C. Cases Involving Alleged Underpayment For Extraction Of Federally-Owned Natural Resources.

As of this writing, the FCA action *de jour* involves alleged underpayment of royalties on natural resources extracted from federal lands. Cases are now pending

⁶³ *Id.*

⁶⁴ *Id.* at 675.

⁶⁵ *Id.* at 676.

or have been recently settled regarding gas, oil and coal, and a timber case may be coming.

In *United States ex rel. Johnson v. Shell Oil Co.*,⁶⁶ the relators, self-styled oil industry whistleblowers, brought an FCA lawsuit alleging the underpayment of royalties on oil extracted from federal and Indian lands. The relators allege that over a dozen oil companies and their affiliates knowingly submitted false information on Forms MMS-2014 (Reports of Sales and Royalty Remittance) to avoid royalty payments in the hundreds of millions of dollars. The relators and the United States primarily allege that the oil companies knowingly undervalued oil under Minerals Management Services (“MMS”) regulations to justify underpayment of royalties to the United States under federal and Indian leases.⁶⁷

Similar cases have been brought alleging gas companies knowingly underreported the volume and energy content of gas extracted from federal lands to justify underpaying royalties under federal leases.⁶⁸

⁶⁶ *United States ex rel. Johnson v. Shell Oil Co.*, 33 F. Supp. 2d 528 (E.D. Tex. 1999).

⁶⁷ *Id.*

⁶⁸ *See United States ex rel. Koch v. Koch Indus., Inc.*, 1995 U.S. Dist. LEXIS 20832 (N.D. Okla. 1995) (alleging that oil companies employed a scheme to underreport to the United States the amount of crude oil and natural gas taken from federal and Indian lands) and *United States ex rel. Grynberg v. Alaska Pipeline Co.*, 1997 U.S. Dist. LEXIS 5221 (D.D.C. 1997) (alleging that gas companies underrepresented the volume and energy content of natural gas that they extracted from federal and Indian lands).

At least two FCA actions have been brought alleging that coal companies underreported coal prices used to compute federal coal royalty payments in violation of the FCA, including Section 3729(a)(7). One case settled in October 1999 when a coal company, and certain of its current and past affiliates, agreed to pay \$11 million to resolve claims under the FCA and related administrative claims for underpaying royalties.⁶⁹ In that case, the government contended that: (1) a coal company affiliate mined coal from federal lands and sold the coal to a utility company; (2) the utility company sold the coal to another affiliate of the same coal company; and (3) the second coal company affiliate sold the coal to its customers. The government further contends that coal royalties were paid based solely upon the first affiliate's sale to the utility company. The government's press release reporting the settlement asserts that the coal royalties should have been based on the value of the gross proceeds received by both affiliates and not solely on the proceeds received by the first affiliate.⁷⁰ (Interestingly, the government apparently did not target the utility company for its role in the alleged transactions.) The other coal case, *Donnelly v. Nevada Electric Investment Co.*,⁷¹ settled for less than \$200,000. Unlike the oil and gas royalties cases, *Donnelly* involved "traditional" allegations of company wrongdoing.

⁶⁹ DOJ Press Release, Peabody Holding Company Agrees to Pay \$11 Million for Claims of Underpayment of Coal Royalties, issued October 18, 1999.

⁷⁰ *Id.*

⁷¹ *Donnelly v. Nevada Elect. Investment Co.*, Civ. Action No. 2:94cv0286 (D. Utah).

Although we are not aware of any FCA actions brought by environmental activists against timber companies or alleging environmental noncompliance in connection with federal timber contracts, such actions are easily conceivable. Unlike the business of federal mineral extraction, which generally requires royalty payments to the government based upon the quality or value and the quantity of the minerals extracted, the business of federal timber harvesting involves bidding on the right to harvest timber of a known quality and quantity and, if selected, paying the government the contract amount as the harvest progresses. Federal timber contracts typically contain various provisions requiring compliance with environmental laws, use of particular harvesting methods, the precise quantity of trees to be harvested, and the like. Given the magnetic pull of FCA profits, the litigious anti-timber interests that have brought so many Endangered Species Act citizen suits in recent years may well attempt a FCA action alleging fraud in connection with federal timber contracts.

IV. Dangers Lurking In Deregulation, Privatization, And Energy Management.

A. Utilities

Utilities, for years, have lived in a protected backwater of government contracting. Utilities treated the government just like any other customer, and the government rarely objected. Because, after all, what could the government do? The utility was the only game in town. That is changing and with that change will come FCA allegations.

1. Deregulation

Utilities, because of deregulation, are beginning to compete for contracts and provide certain goods and services outside of the narrowing scope of their monopoly. In this Brave New World, utilities, in many ways, are becoming “normal” government contractors. As many before them have learned, with the obligations imposed by the FAR come the risks of the FCA.

For instance, in this higher-risk environment, the utility may face onerous accounting, disclosure and audit obligations. When prices are not set by tariffs, rates, rules or regulations, the utility will probably need an accounting system that segregates allowable versus unallowable costs as determined by government regulations and that have a look, feel and complexity akin to the federal tax laws. The utility in some cases may have to disclose “cost or pricing data” and certify that it is current, accurate and complete as of the date of agreement on price.⁷² The definition of “cost or pricing data” is extremely broad, and the utility will need rigorous internal procedures to ensure that it satisfies this disclosure requirement.

2. Privatization

By September 30, 2003, most of the over two thousand utility systems owned and operated by the Military Departments are to be privatized.⁷³ These utility

⁷² This may occur if the contract is for \$500,000 or more of goods or services and the prices are not set by tariffs, rates, rules or regulations or the procurement does not qualify for another exception to the requirement for cost or pricing data. See The Truth In Negotiations Act, 10 U.S.C. 2306a; FAR 15.4.

⁷³ See DoD Reform Initiative Directive #49 (Dec. 23, 1998).

privatization procurements are not restricted to utilities,⁷⁴ and many of the traditional government contracts rules and regulations will apply. With those rules and regulations will come the risks of the FCA.

B. Energy Management Services

Congress has enacted a complex statutory scheme under which utilities through “utility incentive contracts” and pre-qualified energy savings companies (ESCOs) through “Energy Savings Performance Contracts” (ESPCs) can provide energy management services to the federal government.⁷⁵ On June 3, 1999, President Clinton issued Executive Order 13123 strongly encouraging agencies to use these contracts to reduce energy consumption by “30 percent by 2005 and 35 percent by 2010 relative to 1985” levels. In essence, a new government contracts industry was created. The FCA will not be far behind.

ESPCs, although exempt from the Truth in Negotiations Act (“TINA”), contain many of the government contract clauses that have traditionally been the source of FCA allegations. Utility incentive contracts, which contain the normal panoply of government contract clauses, also have most favored customer pricing clauses. Under these clauses, utilities that charge the government more than their other similarly situated customers could face FCA allegations.

⁷⁴ 10 U.S.C. § 2688(a) (2000). See *Virginia Elec. and Power Co., Baltimore Gas & Elec.*, B-285209; B285209.2, 2000 CPD ¶ 134 (Aug. 2, 2000).

⁷⁵ 10 U.S.C. § 2865 (2000); 42 U.S.C. § 8256, 8287 (2000).

Under the typical most-favored-customer clause, the utility warrants that neither the service rates made available nor the charges billed to a government agency will exceed those available or charged to any other customer served under the same service classification for the same or comparable services under like conditions of use or under similar circumstances. If the charges for any of these services are not established in tariffs, rates rules or regulations, the ordering agency has the right to audit before payment.

Compliance with these requirements could prove difficult, time consuming and expensive. Procedures would have to be adopted to carefully compare the services, conditions, circumstances, charges, rates and prices applicable to the federal government with those applicable to all other customers. When there is an overlap, the government must be charged no more than the other customer.

These provisions could impose certain risks. First, the government could allege that the warrants represent false statements if, for example, through an audit or through other means (*e.g.*, an action filed under the False Claims Act) the charges, rates or prices for a particular service are challenged. Second, if there are false statement allegations, there may also be allegations that any requests for payment made under the contract are false claims. These allegations could subject the utility and individuals to protracted investigations and civil and criminal penalties.⁷⁶

⁷⁶ See, *e.g.*, 31 U.S.C. §§ 3729-3731; 18 U.S.C. § 1001 (2000).

V. Significant Legal Issues and Defenses.

In this section, we explore among other things the principal legal defenses to consider when faced with an FCA action.

A. Defenses On The Merits.

Because there usually is no dispute regarding the existence of a “claim,” defenses often focus on the lack of one or more of the requisite elements for liability, namely: 1) falsity; 2) knowledge; and 3) materiality. In addition, in cases alleging a so-called “reverse” false claim (alleging a false statement used to decrease an obligation to the government), there may be an argument that there is no “obligation” that the defendant’s alleged knowingly false statement concealed, avoided or decreased.

1. No Falsity.

If the claim submitted or statement used is not false, there can be no FCA liability. Generally, there are three defenses to allegations of falsity. First, if the allegedly false statements reflect assertions of judgment or opinion, rather than fact, they may not be false.⁷⁷ This defense may be particularly applicable where the alleged false statement is highly technical and subject to a range of views – for instance, a statement about whether a certain activity adversely impacts human health and the environment may be a statement of opinion rather than fact.

⁷⁷ *United States ex rel. Boisjoly v. Morton Thiokol, Inc.*, 706 F. Supp. 795, 810 (D. Utah 1988) (The certification “reflects an engineering judgment and recommendation. . . . It is clearly not a statement of fact that can be said to be either true or false, and thus cannot form the basis of an FCA claim.” *Id.*).

Second, statements may lack falsity because they are true on their face.⁷⁸

Finally, in cases in which statements are alleged to *imply* false information, the defendant should attempt to show the absence of any basis to imply the falsity alleged. To demonstrate the lack of an implied false statement, a defendant typically shows that the falsity alleged does not touch the “heart of [the contractor’s] agreement with the government.”⁷⁹ For example, a relator might allege that a contractor’s request for payment, which says nothing on its face about environmental compliance, implicitly represents 100 percent compliance with all environmental regulations incorporated in the contract. In defense, the contractor might try to demonstrate that nothing in the contract conditioned payment upon complete compliance with the environmental regulations.

As a practical matter, the task of proving the lack of an implied false statement is substantially the same as proving that the alleged falsity is

⁷⁸ See *Hindo v. University of Health Sciences*, 65 F.3d 608, 613 (7th Cir. 1995), *cert. denied*, 516 U.S. 1114 (1996) (Because “there is nothing false in the [defendant’s] invoices,” the court “must look then for some purposeful scheme by the [defendant] to defraud” the government. *Id.*); *United States ex rel. Milam v. Regents of the Univ. of Cal.*, 912 F. Supp. 868, 883 (D. Md. 1995) (“as a matter of law . . . [FCA] liability cannot be imposed on the basis of a literally true statement” *id.*).

⁷⁹ *Luckey v. Baxter Healthcare Corp.*, 2 F. Supp. 2d 1034, 1045 (N.D. Ill. 1998), *aff’d*, 183 F.3d 730 (7th Cir.), *cert. denied*, 120 S. Ct. 562 (1999) or could not result from a profit motive. See also *United States ex rel. Lamers v. City of Green Bay*, 168 F.3d 1013 (7th Cir. 1999).

immaterial, as discussed below. Some courts have been reluctant to find implied falsity others have not.⁸⁰

2. No Knowledge.

For purposes of the FCA, as noted above, the terms “knowing” and “knowingly” mean that a person, with respect to information, “has actual knowledge,” “acts in deliberate ignorance of the truth or falsity,” or “acts in reckless disregard of the truth or falsity” of the information.⁸¹ The courts recognize several methods to establish that the FCA defendant lacks the requisite “knowledge.”

First, innocent mistakes or negligence are not actionable under the False Claims Act.⁸²

⁸⁰ Compare *Luckey*, 2 F. Supp. 2d at 1045 (“finding . . . a false implied certification under the FCA for every request for payment accompanied by a failure to comply with all applicable regulations, without more, improperly broadens the intended reach of the FCA.” *Id.*) with *Shaw v. AAA Engineering & Drafting, Inc.*, 2000 U.S. App. LEXIS 11027*35 (10th Cir. May 18, 2000) (FCA liability may be based upon an implied certification of compliance with a contract if the contractor knew, or recklessly disregarded a risk, that its implied certification of compliance was false).

⁸¹ 31 U.S.C. § 3729(b). “[N]o proof of specific intent to defraud is required.” *Id.*

⁸² See, e.g., *United States ex rel. Hagood v. Sonoma County Water Agency*, 81 F.3d 1465, 1478 (9th Cir. 1996), *cert. denied*, 117 S. Ct. 175 (1996); see also *United States v. Krizek*, 111 F.3d 934, 941 (D.C. Cir. 1997) (holding an aggravated form of gross negligence, or “gross-negligence-plus,” is equivalent to reckless disregard for purposes of FCA). Consequently, if the defendant can demonstrate that the false information resulted from an honest mistake, there can be no FCA liability. In asserting this defense, it is important to distinguish between the act of making statements to the government and the performance of a government contract. The FCA reaches the reckless submission of false statements to the government. However, “reckless” performance of a contract may not demonstrate “reckless disregard” of the truth or falsity of a statement. *United States ex rel. Pentagen Technologies*

(continued...)

Second, even if the statement is false, if it is based upon the defendant's reasonable interpretation of a contract, law or regulation, the statement may not be "knowingly" false.⁸³

Third, although courts routinely hold that the government's knowledge of the falsity is not a complete defense to FCA liability, it may be possible to demonstrate that, in light of the government's knowledge, the defendant may reasonably have believed that its statements did not mislead the government.⁸⁴

With respect to evidence, the strongest potential ally of a government contractor defendant is the agency, and specifically the key agency personnel, with

(...continued)

Int'l, Ltd. v. CACI Int'l Inc., 1997 U.S. Dist. LEXIS 12244, at *33 (S.D.N.Y. 1997) (allegations of "extreme incompetence" are not enough).

⁸³ *Commercial Contractors, Inc. v. United States*, 154 F.3d 1357, 1366 (Fed. Cir. 1998) ("If a contractor submits a claim based on a plausible but erroneous *contract interpretation*, the contractor will not be liable, absent some specific evidence of knowledge that the claim is false or of intent to deceive.") (emphasis added) *id.*; *United States ex rel. Oliver v. The Parsons Co.*, 195 F.3d 457, 460 (9th Cir. 1999) ("A contractor relying on a good faith *interpretation of a regulation* is not subject to liability, not because his or her interpretation was correct or 'reasonable' but because the good faith nature of his or her action forecloses the possibility that the scienter requirement is met." *Id.*) (emphasis added). Under a similar theory, if the defendant's statement is false but made in good faith based upon the defendant's judgment, the knowledge element is lacking. *Luckey*, 2 F. Supp. 2d at 1049 ("assuming the claim or certification was false, a defendant in a FCA suit would not have 'knowingly' submitted a claim if it was submitted as the product of the defendant's good faith professional opinion or judgment" *id.*).

⁸⁴ *United States ex rel. Lamers*, 998 F. Supp. 971, 988 (E.D. Wis. 1998), *aff'd*, 168 F.3d 1013 (7th Cir. 1999) ("the presence of an open dialogue with government officials about relevant factual circumstances does mitigate a defendant's specific intent to defraud, or the degree to which false statements and claims were 'knowingly' submitted").

whom it contracted. A high premium should be placed on developing testimony from agency personnel responsible for ensuring proper performance by the contractor that they shared the contractor's interpretation of the provisions at issue, and that they were satisfied with the contractor's performance. Short of that, evidence tending to show that the contractor acted under a good faith interpretation of the contract, or the reporting and disclosure requirements, would tend to negate the proposition that the contractor "knowingly" violated the terms of the contract and concealed that "knowing" violation at the time he submitted his claims for payment.

3. No Materiality.

All federal courts of appeals that have considered the issue,⁸⁵ plus the Federal Claims Court and all district courts but one, agree that the alleged falsity must be material to (*i.e.*, would have influenced) the government's decision to pay.⁸⁶

⁸⁵ The Third and Tenth Circuits have expressly reserved judgment on this question. *United States ex rel. Cantekin v. University of Pittsburgh*, 192 F.3d 402, 415 (3d Cir. 1999); *Shaw v. AAA Engineering & Drafting, Inc.*, 2000 U.S. App. LEXIS 11027 (10th Cir. May 18, 2000).

⁸⁶ *United States ex rel. Lamers v. City of Green Bay*, 168 F.3d 1013 (7th Cir. 1999) ("minor technical violations" of a federal regulatory program are "immaterial" and "do not give rise to an FCA claim" *id.*); *United States v. Q Int'l Courier, Inc.*, 131 F.3d 770, 772 (8th Cir. 1997) (the FCA "gives the United States a means to recover from someone who makes a material misrepresentation to avoid paying some obligation owed to the government" *id.*); *United States ex rel. Berge v. Board of Trustees of University of Alabama*, 104 F.3d 1453, 1459 (4th Cir.), *cert. denied*, 522 U.S. 916 (1997) (the FCA "imposes a materiality requirement"); *United States ex rel. Hopper v. Anton*, 91 F.3d 1261, 1266 (9th Cir. 1996), *cert. denied*, 519 U.S. 1115 (1997) (false certifications do not create a cause of action under the FCA unless the
(continued...))

To demonstrate that the alleged falsity regarding environmental noncompliance was not material, discovery should be focused on developing evidence to support the following:

- contract payment requests were not required to contain certifications or statements about environmental compliance;
- the contract included a provision for curing or correcting environmental noncompliance;
- the contract did not authorize the government to withhold payment because of environmental noncompliance; and
- the government’s contracting officer did not and would not withhold payment because of environmental noncompliance.

In presenting the “no materiality” defense, it is important to emphasize that the focus is on whether the alleged false statements about compliance with a contract’s environmental provisions are material to the government’s decision to pay the contractor and *not* whether the government was required to include the environmental provisions in the contract. Virtually all government contracts contain a mandatory FAR clause on Clean Air Act and Clean Water Act compliance. This does not mean that compliance with its terms was “material” to the

(...continued)

certification is a prerequisite to obtaining a government benefit); *United States v. Data Translation, Inc.*, 984 F.2d 1256, 1267 (1st Cir. 1992) (materiality is an element of an FCA action); *United States ex rel. Weinberger v. Equifax, Inc.*, 557 F.2d 456, 461 (5th Cir. 1977), *cert. denied*, 434 U.S. 1035 (1978) (the FCA “interdicts material misrepresentations made to qualify for government privileges or services” *id.*); *Tyger Constr. Co., Inc. v. United States*, 28 Fed. Cl. 35, 55 (1993) (the FCA “covers only those false statements that are material”). The one dissenting district court opinion is *United States* (continued...)

government's decision to pay a claim. In fact, some government contracts have notice and cure provisions designed to address alleged environmental noncompliance without direct resort to allegations of breach of contract.

4. No Obligation (A Reverse False Claim Defense).

If the relator alleges that the defendant knowingly made false statements about environmental compliance to conceal, avoid or decrease an "obligation" to pay hypothetical penalties to the government, there is growing precedent that the FCA does not extend to such potential liability.

In two of the early *qui tam* actions alleging environmental noncompliance, the courts held that alleged *potential* penalties which theoretically could have been assessed for violations of the Clean Water Act are an "obligation" under 31 U.S.C. § 3729(a)(7).⁸⁷

Recently, in a conscious retreat from the reasoning in *Pickens* and *Stevens*, the Sixth and Eighth Circuit Courts have held that the "obligation" sought to be

(...continued)

ex rel. Roby v. The Boeing Co., 1998 U.S. Dist. LEXIS 8129, at 14 (S.D. Ohio May 11, 1998).

⁸⁷ *United States ex rel. Stevens v. McGinnis, Inc.*, 1994 U.S. Dist. LEXIS 20953, at *19-20 (S.D. Ohio 1994) (allegations that vessel owners failed to record and report to the government illegal discharges of pollutants "thus, avoiding fines, penalties, and cleanup costs imposed by" the Clean Water Act, state reverse false claims, *id.*) and *United States ex rel. Pickens v. Kanawha River Towing, Inc., et al.*, 916 F. Supp. 702, 707-08 (S.D. Ohio 1996) (if government, as part of its regulatory role, relies upon or otherwise reviews vessel logs which exclude information about discharges of pollutants that they should ordinarily contain, the vessel operator would have submitted a false report in order to avoid an obligation to the government).

avoided must be a specific, quantified legal obligation at the time the alleged false statement was made or used and not merely potential liability. In *United States v. Q Int'l Courier, Inc.*,⁸⁸ the United States alleged that the defendant owed an obligation to the United States to pay full domestic postage that defendant attempted to avoid through false statements coupled with a practice known as “ABA remail.”⁸⁹ An ABA remailer ships bulk mail from the United States to Barbados for remail to the United States for as little as a tenth of the amount of postage charged for delivery if individually mailed within the United States.⁹⁰ The Eighth Circuit held that the United States must demonstrate that the defendant had some specific obligation to the government to pay money or property that it sought to evade or reduce by using false statements under Section 3729(a)(7). According to the Eighth Circuit,

a defendant must have had a present duty to pay money or property that was created by statute, regulation, contract, judgment, or acknowledgement of indebtedness. The duty, in other words, must have been an obligation in the nature of those that gave rise to actions of debt at common law for money or things owed.⁹¹

“A debt, and thus an obligation under the meaning of the False Claims Act, must be for a fixed sum that is immediately due.”⁹² The court stated that a

⁸⁸ *United States v. Q Int'l Courier, Inc.*, 131 F.3d 770 (8th Cir. 1997),

⁸⁹ *Id.* at 772.

⁹⁰ *Id.*

⁹¹ *Id.* at 773.

⁹² *Id.* at 774 (emphasis added).

regulation that merely provided a range of potential penalties that might be assessed did not “create an immediate duty to pay a specific sum.”⁹³

In *United States ex rel. American Textile Manufacturers Institute, Inc. v. The Limited, Inc.*⁹⁴ (“ATMI”), the Sixth Circuit expressly agreed with the Eighth Circuit’s reasoning in *Q Int’l*. ATMI addressed the district court’s decision to retreat from *Pickens* and *Stevens* regarding the scope of the term “obligation” under the FCA. The Sixth Circuit reasoned that “a plaintiff may not state a reverse false claim unless the obligation attached *before* the defendant made or used the false record or statement.”⁹⁵ The court also noted that Congress intended the term “obligation” to be “more limited” than the defined term “claim.”⁹⁶ Finally, in expressly adopting *Q Int’l*, the Sixth Circuit stated that:

[W]e hold that a reverse false claim action cannot proceed without proof that the defendant made a false record or statement at a time that the defendant owed to the government an obligation sufficiently certain to give rise to an action of debt at common law. . . . A defendant risks liability when making a false statement to conceal, avoid or decrease obligations such as his prior acknowledgment of indebtedness, a final court or administrative judgment that the defendant owes money or property to the government, or a contractual duty to pay or transmit money or property to the government.⁹⁷

⁹³ *Id. Accord, United States ex rel. S. Praver & Co. v. Verrill & Dana*, 946 F. Supp. 87 (D. Me. 1996).

⁹⁴ *United States ex rel. American Textile Mfr. Inst., Inc. v. The Limited, Inc.*, 190 F.3d 729 (6th Cir. 1999), *cert. denied*, 120 S. Ct. 1556 (2000).

⁹⁵ *Id.* at 734 (emphasis added).

⁹⁶ *Id.* at 736.

⁹⁷ *Id.*

A broader interpretation, the court observed, would permit suits based upon “contingent obligations – those that will arise only after the exercise of discretion by government actors” such as imposition of a civil penalty for a violation of law.⁹⁸

A related question, arguably not directly addressed by the recent appellate decisions regarding the “obligation” issue, is whether a mineral leasee’s contractual duty to make royalty payments to the government qualifies as an FCA “obligation.” As of this writing, it appears that no oil, gas or coal company defendant to an FCA action alleging underpaid royalties has yet to move for summary judgment on this basis. The *ATMI* decision clearly suggests that the leasee’s contractual duty to make a royalty payment, because it is due before the government exercises discretion to determine the precise royalty owed, does not qualify as an FCA “obligation.”

B. Defenses To *Qui Tam* Actions Based Upon Lack Of Jurisdiction.

1. Public Disclosure/Original Source.

The most frequently litigated jurisdictional defense to an FCA *qui tam* action is set forth in Section 3730(e)(4) – the public disclosure/original source defense. If challenged, the relator must allege the facts essential to show jurisdiction and

⁹⁸ *Id.* at 738.

support those facts with competent proof.⁹⁹ Generally, courts have broken down the analysis as follows:

1) Has there been a public disclosure of the allegations or transactions in the FCA case? Sources of “public disclosure” are listed in Section 3730(e)(4)(A): “a criminal, civil or administrative hearing, a congressional, administrative or Government Accounting Office report, hearing, audit, or investigation ... the news media[.]” Despite recent statements of a co-sponsor to the 1986 FCA Amendments to the contrary, most courts interpret the phrase “criminal, civil, or administrative hearing[s]” to include federal **and state** hearings.¹⁰⁰ In analyzing “allegations or transactions,” most recent cases have adopted the framework set forth in *United States ex rel. Springfield Terminal Railway Co. v. Quinn*,¹⁰¹ wherein the court instructed that either the allegation of fraud or its essential elements must be in the public disclosure.

2) If so, is the qui tam action based upon the public disclosure?

Most circuits interpret the “based upon” requirement to mean that the allegations in the complaint are “supported by” or “substantially similar to” the publicly disclosed allegations or transactions, although the Fourth Circuit interprets “based

⁹⁹ See, e.g., *United States ex rel. Hafter v. Spectrum Emergency Care, Inc.*, 1999 U.S. App. LEXIS 21384 *11 (10th Cir. 1999); *Shell Oil Co.*, 33 F. Supp. 2d at 533.

¹⁰⁰ *United States ex rel. Hafter v. Spectrum Emergency Care, Inc.*, 1999 U.S. App. LEXIS 21384 *13 n.6 (10th Cir. 1999).

¹⁰¹ *United States ex rel. Springfield Terminal Ry. Co. v. Quinn*, 14 F.3d 645 (D.C. Cir. 1994).

upon” to mean that the relator’s knowledge of the fraud must be actually “derived from” the prior disclosure.¹⁰²

3) If the answer to (1) and (2) are “yes”, is the relator the original source of the information? If he is, then he may maintain the action.

Section 3720(e)(4)(B) requires that an “original source” (a) have “direct and independent knowledge of the information on which the allegations are based” and (b) voluntarily provide the information to the government before filing his or her *qui tam* action. Generally, the courts have interpreted “direct” to mean first-hand knowledge of the essential elements of the alleged fraud gained by relator’s own efforts and “independent” to mean not dependent on a public disclosure.¹⁰³ As recently summarized in *Johnson*, the Second and Ninth Circuits also require that the relator be the source of the information that was publicly disclosed, although the Fourth, Eleventh and District of Columbia Circuits have rejected that interpretation.¹⁰⁴

The District of Columbia Circuit, however, requires that the relator must have come forward with the information prior to the public disclosure.¹⁰⁵ The requirement that the relator make voluntary disclosure to the government may provide a defense against relators who fail to make disclosure until approached by a

¹⁰² See *Shell Oil Co.*, 33 F. Supp. 2d at 540 (discussing cases).

¹⁰³ *Id.*

¹⁰⁴ *Id.* at 541 – 42.

government investigator or are, themselves, government investigators or auditors.¹⁰⁶

2. Other Jurisdictional Defenses And Bars To Parasitic Or Duplicative FCA Actions.

Although less frequently litigated because of their narrow application, the FCA provides other jurisdictional bars to *qui tam* suits brought by a former or present member of the armed forces, against a member of the armed services, or, if the action is based upon information known to the government when the suit is filed, against Members of Congress, judges or senior executive officials.¹⁰⁷

In addition, Section 3730(e)(3) bars suits that are duplicative of a previously filed civil suit or administrative civil money penalty proceeding, and Section 3730(b)(5) generally bars intervention or a later-filed duplicative *qui tam* action by other would-be relators.

(...continued)

¹⁰⁵ *United States ex rel. Findley v. FPC-Boron Employees' Club*, 105 F.3d 675, 690 (D.C. Cir.), *cert. denied*, 118 S. Ct. 172 (1997).

¹⁰⁶ *See, e.g., United States ex rel. Barth v. Ridgedale Electric, Inc.*, 44 F.3d 699, 704 (8th Cir. 1995) (relator approached by government); *United States ex rel. Biddle v. Board of Trustees of Leland Stanford, Jr. University*, 147 F.3d 821 (9th Cir. 1998) (job obligation to disclose).

¹⁰⁷ 31 U.S.C. §§ 3730(e)(1) and (2).

3. The Constitutional Defenses

(a) Standing (Article III)

On May 22, 2000, the Supreme Court laid to rest the question: “Does a private person have standing under Article III to litigate claims of fraud upon the government?” The Supreme Court made clear that there is no defense to a *qui tam* action based upon the relator’s lack of Article III standing holding that “adequate basis for the relator’s suit for his bounty is to be found in the doctrine that the assignee of a claim has standing to assert the injury in fact suffered by the assignor.”¹⁰⁸

(b) Take Care And Separation Of Powers (Article II)

Although the Supreme Court has now upheld a relator’s right to sue, a federal appeals court recently placed FCA *qui tam* relators in its cross-hairs on other constitutional grounds. In *Riley v. St. Luke’s Episcopal Hospital*,¹⁰⁹ the Fifth Circuit held that the FCA provisions violated the take care clause of Article II and the separation of powers doctrine because the *qui tam* provisions leave the executive even less control over a *qui tam* relator than the executive enjoyed under the now discarded independent counsel provisions of the Ethics in Government Act.¹¹⁰ (In other words, the president had more control over Whitewater

¹⁰⁸ *Vermont Agency of Natural Resources v. United States ex rel. Stevens*, 529 U.S. 765 (2000).

¹⁰⁹ *Riley v. St. Luke’s Episcopal Hospital*, 196 F.3d 514 (5th Cir. 1999).

¹¹⁰ *Id.*

Independent Counsel Ken Starr than he has over *qui tam* relators.) One of the three-judge panel wrote a scholarly concurring opinion explaining why the *qui tam* provisions also should fall under Article III standing principles and another wrote a vigorous dissenting opinion defending the constitutionality of the *qui tam* provisions.¹¹¹ Simultaneously with issuing its decision in *Riley*, the Fifth Circuit ordered rehearing *en banc*, thus vacating the decision by the three-judge panel. (As of this writing, the court has not set the date for rehearing.)

VI. Significant Strategic And Tactical Issues.

In addition to the largely “legal” issues discussed above, a thoughtful defense in environmental FCA litigation raises significant strategic and tactical issues. It is to these issues that we turn next.

A. What If There Is A Parallel Criminal Investigation?

When the complaint is initially filed under seal, the Justice Department normally reviews it to determine whether the allegations warrant a criminal investigation. If so, Justice may enlist the Federal Bureau of Investigation to conduct the investigation in addition to the established auditing arms of the agencies which issued the government contract at issue. During the course of these investigations, typically the government requests extension of the 60-day “under seal” time so as not to alert the defendant that it or its officers or employees are the subject of a criminal investigation. Sometimes the first indication a target company

¹¹¹ *Id.*

receives that it is the subject of an investigation is when an officer or employee reports a contact from the FBI or an Inspector General.

Any such contact should immediately be reported to the company's General Counsel. This in turn should trigger internal investigation and "damage control" measures designed to enable management and the General Counsel to (1) obtain as much information as possible concerning the possible allegations, and (2) advise key and potentially affected officers and employees of the investigation. These persons should be informed of their rights and duties, including the right to talk or not to talk to any interviewing agent and the right to counsel before any such decision is made. In some cases, it may be desirable to cooperate with the government in an undercover investigation, such as where a rogue employee has acted in violation of law and company policy. A detailed discussion of the handling of criminal investigations is beyond the scope of this article. However, the important point is that strategic planning must be commenced immediately and carefully, with the advice of counsel who are experienced in such matters.

Once the complaint is unsealed and served, this triggers the timetable under the Federal Rules of Civil Procedure for the filing of an answer and any affirmative defenses, as well as any motions to dismiss. It also opens the opportunity for discovery by all parties.

The specter of such discovery can put the defendant in the "no-win" situation of responding to discovery which could prove damaging in both the civil and criminal cases, or pleading the Fifth Amendment in response to a number of

questions, which is likely to both whet the appetite of the criminal investigators and cause substantial embarrassment and prejudice in the civil case. To deal with this problem, it is standard practice to move in the civil case for a stay of discovery until completion of the criminal investigation. Most courts are sympathetic to this dilemma and generally grant such motions for a reasonable time.

B. Will The “Real” United States Please Stand Up?

Assuming the United States elects not to intervene in the civil FCA litigation, the *qui tam* relator may then prosecute the case in the name of the United States. Courts have held that the United States government is the “real parties in interest.”¹¹² This is consistent with the fact that both stand to recover very substantial sums if the relator wins his case. Strategically, the relator’s counsel will take every opportunity to remind the court, and eventually the jury, that he is proceeding “on behalf of the United States.” In the courtroom, from *voir dire* through closing arguments, counsel for relator will typically refer to his “client” as “the United States” or “the government and the relator” in an effort to capture the moral high ground.

The relator in fact may be a disgruntled employee motivated by revenge, greed or other factors which make it important that the defendant not allow the relator to gain that moral high ground. This can be done first by emphasizing wherever possible the true identity of the relator, and the fact that he is in the case

¹¹² See, e.g., *United States ex rel. Berge*, 104 F.3d at 1458.

not to protect the taxpayers' interests but to line his and his lawyer's pockets through participation in the hoped for recovery and attorneys' fees.

One element that may be especially effective in this effort, to the extent supported by the facts, is the working relationship between the defendant and the department or agency of the government with which it had the contract. If you have a satisfied customer, he may be your best advocate. If agency personnel will testify favorably with respect to the defendant's performance of the overall contract, or compliance with the specific provisions at issue, or "best efforts," "substantial compliance" or the like, this witness can be proffered as the "real" United States government. It is of great importance that a trier of fact hear directly from the government agency who was responsible for ensuring compliance with the contract. Such testimony can be extraordinarily helpful when it is favorable.

C. Accessing Government Personnel and Evidence.

Government agencies typically have regulations which spell out the terms and conditions on which evidence may be obtained from them for use in litigation and, more broadly, under the Freedom of Information Act.¹¹³ Although the United States government is the "real party in interest" in the litigation, if it has not intervened in the case, defendant may not simply serve interrogatories and requests to produce directed to the government, even though the U.S. Attorney's Office will

¹¹³ Freedom of Information Act, 5 U.S.C. § 552 (2000).

normally insist on its right to be served with all or significant pleadings.¹¹⁴ Frequently, the United States, including the Environmental Protection Agency, Coast Guard and the Department of Defense, will have documents to which defendant needs access and may in addition have witnesses whom the defendant would like to depose.

The regulations of the agency in question concerning obtaining use of such evidence, sometimes referred to as “*Touhy*” regulations after a case which addressed this issue,¹¹⁵ are designed to protect agencies and government personnel from being burdened with discovery in matters not of their own creation. Generally, these regulations impose severe limitations on the ability of a defendant to obtain testimony and documentary evidence from the agency.¹¹⁶ The government can, and often does, decline to allow its people to be deposed or subpoenaed. It routinely objects to the production of documentary evidence, especially if a criminal investigation is still proceeding. This provides an additional reason for seeking to stay civil litigation until any criminal investigation has been completed.

¹¹⁴ 31 U.S.C. § 3730(c)(3).

¹¹⁵ The term “*Touhy* regulations” caught on after the Supreme Court, in *United States ex rel. Touhy v. Ragen*, 340 U.S. 462, 568 (1951), ruled that agency employees may not be held in contempt for refusing to answer a subpoena if prohibited from responding by a superior.

¹¹⁶ See, e.g., the Department of Defense regulations at 32 C.F.R. Part 97 and the Department of Transportation regulations at 49 C.F.R. Part 9.

Relevant documents can be obtained under the Freedom of Information Act although it is often a time consuming and frustrating process. With respect to witnesses, however, typically the *Touhy* regulations require an extensive showing that the testimony of the witness sought is necessary in the interest of justice and cannot be obtained from other witnesses or in a manner less burdensome to the government.

Counsel for the relator will frequently not want such evidence produced. Because the U.S. Attorney's Office may be relying on counsel for relator to ferret out through discovery and investigation evidence which may be useful to the government, the U.S. Attorney may well be inclined to try to accommodate a request by relator's counsel that such evidence not be produced. The United States has a further vested interest in resisting such discovery by virtue of the fact that if the relator wins, the United States receives at least 70 percent of the damages awarded. This incentive naturally encourages the government to hide behind its *Touhy* regulations and refuse to make witnesses and other evidence available on the ground that it is disruptive and burdensome to the performance of their duties. However, their real motive often is that they do not want to help the defendant. When an agency or the Justice Department of the United States seeks to block such discovery, courts all too often defer to that request. This can work to the substantial disadvantage of the defendant, frustrating what would otherwise be a clear right to exculpatory evidence, or at least the right to see the evidence and determine for himself the extent to which it is exculpatory.

In our experience, obtaining documents or testimony under an agency's *Touhy* regulations often reduces to a careful negotiation. For instance, assume a defendant requests deposition and trial testimony from an agency witness. In response, the agency may offer that the witness will respond to interrogatories. Ultimately, the agency may agree to allow a videotaped deposition that, when the agency later refuses to allow the witness to testify at trial, may be used because the witness is "unavailable."

D. The Use of Experts.

As in many environmental and other cases, the early selection and use of well qualified experts can be helpful in determining whether there was environmental noncompliance and whether it was "material." Often companies have on their staff well qualified technical personnel. They can provide valuable education on the scientific and technical issues and also on the facts.

However, in anticipation of trial, as well as in the process of forming an objective evaluation of contract compliance or breach, it is often important to secure the services of an outside expert. This will assure counsel for defendant not only the requisite degree of expertise but also the objectivity which is essential to a realistic and sound evaluation of the strengths and weaknesses of allegations of environmental noncompliance. In addition, experts on matters of government contract interpretation and application can also be helpful though courts differ on the admissibility of such expert testimony. Often it is disallowed if it is simply a

statement of the law that courts usually view as their own province.¹¹⁷ Whether an expert is eventually called to testify at the trial or simply relied on by counsel as an educational consultant, the early involvement of an expert can help shape the strategy of the defense and identify strengths, weaknesses and responsive strategies.

E. The Implications For Suspension, Debarment and Blacklisting.

As noted above, where a person or entity is either convicted of a criminal violation of environmental law or incurs a substantial adverse judgment in a civil case, the company or affected facility could be “suspended” or “debarred” from doing business with the government.¹¹⁸

This is of particular significance in considering any settlement of environmental *qui tam* litigation. EPA has an aggressive program for suspending and debarring contractors in cases of environmental noncompliance.¹¹⁹ In any settlement, every effort should be made to secure the agreement of the government not to suspend or debar the defendant. This is often difficult to do, but important to

¹¹⁷ Compare *United States ex rel. Compton v. Midwest Specialties, Inc.*, 142 F.3d 296, 301 (6th Cir. 1998) (experts may not testify as to the legal effect of a contract) with *United States v. Leo*, 941 F.2d 181, 196 (3d Cir. 1991) (affirming a trial court’s admission of testimony of an expert in the field of government contracting as to the custom and practice in government contracts).

¹¹⁸ See, e.g., 40 C.F.R. Part 32, subparts C and D.

¹¹⁹ *Id.*

try, particularly if the defendant has any significant business relationship with the federal government.

Decisions by EPA or other agencies with suspension and debarment authority generally involve such questions as whether the settlement, judgment or conviction reflects inattentiveness on the part of company management to compliance with environmental, health and safety laws and other requirements. Suspension is a quick sanction and intended to be of short duration.¹²⁰ Debarment is of longer duration, may follow suspension, and usually remains in place until a company has taken measures to effectively demonstrate to the government that it has not only corrected any items of noncompliance but eliminated the “root cause” of the noncompliance. This often requires establishment of a program adequate both to ensure achievement of present and future compliance and to demonstrate that the company is sensitive to the importance of environmental, health and safety protection. Satisfaction of these requirements often takes substantial time and expenditures, hence the desirability of avoiding the sanctions in the first place if at all possible.

F. Matters of Contract Interpretation.

Ordinarily under the parole evidence rule, testimony of the parties to the contract, or other witnesses for that matter, is not admissible to alter or vary the terms of a contract. However, consistent with that rule, testimony is admissible to

¹²⁰ See 40 C.F.R § 32.415.

clarify patent or latent ambiguities.¹²¹ A patent ambiguity is one which appears on the face of the contract due to inconsistent or ambiguous provisions. A latent ambiguity is one which is not apparent on the face of the contract but may emerge as work under the contract progresses. An example of a latent ambiguity is where a standard FAR clause states that environmental compliance is to take place at the “facility” where the contract is to be performed, but in practical application there turns out to be some uncertainty as to the boundaries of the facility. In such a case, testimony of the parties would be admissible concerning their interpretation of the contract.¹²²

The testimony of officers or employees of either party should be admissible to explain how the contract operated and was performed in actual practice, completely apart from the parole evidence rule.¹²³ Only in this way can pages of what otherwise would be an extremely dry, technical and often bewildering and

¹²¹ See, e.g., *Avedon Corp. v. United States*, 15 Cl. Ct. 771, 777-78 (1988) (“The familiar rule that non-patent ambiguities be resolved against the drafter is subject to the condition that the alternative interpretation tendered by the other party be a reasonable one.” *Id.*).

¹²² See, e.g., *Harris v. Lockheed Aircraft Corp.*, 572 F.2d 138, 141 (6th Cir. 1978) (looking to actions of parties in finding that unambiguous union employment contract did not include amendment negotiated by other unions in their employment contracts); *United States v. Arden Engineering Atlantic Contractors, Inc.*, 462 F.2d 1039, 1040-41 (1st Cir. 1972) (upholding use of extrinsic evidence that government contractor had explicitly excluded welding of reinforcing steel from its bid to find that the contract for electrical work did not include such welding).

¹²³ See, e.g., *Rudd-Melikian, Inc. v. Merritt*, 282 F.2d 924, 928 (6th Cir. 1960) (“A contract is to be construed as a whole so as to ascertain and give effect to the true intent of the parties, and the circumstances under which the Contract
(continued...)”)

voluminous contract be made intelligible to the trier of fact. It is important to lay a foundation both factually and legally for the admissibility of testimony in which a witness is asked to guide the trier of fact through the principal provisions of the contract and describe how the work was performed and the roles of the government contracting agency and the performing party. While the testimony of the defense witnesses will be instructive, favorable testimony by the government witnesses is often especially valuable since the responsibility of the government personnel often includes ensuring that environmental provisions and other requirements of the contract were complied with. Thus, as a strategic matter, every effort should be made to secure such testimony.

VII. Preventive Measures – How Can This Type Of Liability Be Avoided?

A. Identify All Contractual and Legal Requirements Relating To The Protection of the Environment, Health And Safety.

For a government contractor, the first step in avoiding, or at least minimizing, potential exposure to FCA liability arising out of environmental, health and safety requirements is to carefully review the proposed contract language and

(...continued)

was executed, and the conduct of the parties thereafter can be considered . . . in determining what their intention was, without it being a violation of the parole evidence rule. [citations omitted] When a contract is silent with respect to a matter vital to the rights of the parties, [the trier of fact] . . . , in construing it, is necessarily compelled to resort to a consideration of the surrounding circumstances and the conduct of the participants indicating their interpretation.” *Id.*) (citations omitted).

identify all contractual requirements relating to these subjects. This includes all applicable laws and regulations which are incorporated by reference, all FAR clauses and any other provisions of the contract which address protection of the environment, health and safety. Often these other provisions are found in the “special clauses” or in the contract specifications which are for the most part site-specific.

A fair reading of the FCA, as well as the overwhelming majority of the case law, suggests that emphasis should be placed on those provisions which could be regarded as a prerequisite for payment. Put differently, if the failure to comply with such a requirement might affect the government’s decision to pay a claim for work which is arguably affected by or subject to the environmental protection requirement, then nondisclosure of any noncompliance could be regarded as “material” and capable of triggering liability. However, until the “materiality” issue is clearly resolved, it would be prudent to identify *all* such requirements and develop a program to ensure compliance with them.

Look for “notice and cure” provisions regarding environmental noncompliance. Such provisions may demonstrate that environmental noncompliance alone would not justify a government decision to withhold payment for contract work performed. However, compliance with such provisions must be a high priority.

B. Develop An Environmental Management System.

Many companies already have in place an “environmental management system” (“EMS”) or “environmental health and safety management system” designed to ensure compliance with all applicable environmental, health and safety (“EHS”) requirements. Typically these programs include regular self-auditing, followed by prompt correction of any noncompliance. It is important to be sure that one or more knowledgeable employees is placed in charge of implementation of this program, that he or she is diligent in ensuring that it is carried out, and that sufficient resources are assigned to facilitate its implementation. This person should be fully accountable to a senior manager and have sufficient authority to require prompt correction of any noncompliance.

A sound environmental management system requires express support at the highest level of the company. For the EMS to be effective, the message from top management must be clear that protection of the environment, health and safety is part of everyone’s job description. In many companies, environmental excellence is rewarded, and environmental noncompliance or substandard performance is penalized financially and otherwise as appropriate. Much has been written on how to design and implement an effective EMS.¹²⁴ A detailed discussion of such

¹²⁴ See, e.g., Frank B. Friedman, *Practical Guide To Environmental Management* (Environmental Law Institute, 7th ed. 1997); John Voorhees and Robert Woellner, *International Environmental Risk Management* (Lewis Publishers 1997); and Ridgway M. Hall, Jr. and David R. Case, *All About Environmental Auditing* (2d ed. Federal Publications 1992).

programs is beyond the scope of this monograph. However, companies looking for guidance in this area may refer to the texts cited in the preceding footnote and other materials which are widely available.

VIII. Is There Hope For Legislative Relief?

Thus far, efforts to redraft the FCA or discourage its abuse by relators and their counsel have fallen short. One prominent advocate for reform, former Secretary of Defense Frank C. Carlucci, argues that the FCA should require proof of the defendant's actual intent to defraud and that the burden of proof be raised to "clear and convincing evidence."¹²⁵ This seems justified given that the FCA is a "fraud" statute, and normally fraud must be proven by clear and convincing evidence. The Justice Department, however, has not supported these reforms. This is perhaps not surprising given that the Justice Department holds in the FCA one of its most important enforcement tools. Furthermore, when the Justice Department decides not to incur the costs of intervening and running the case, it can sit back and let the lawyer for the *qui tam* relator press the case and await its share of the recovery.

In the environmental context, the attraction of huge FCA windfall recoveries may entice some environmental groups to turn away from traditional environmental statutory citizen suits. The presence of the Natural Resources Defense Council as a relator in the Paducah case seems to be a disturbing harbinger of this.

¹²⁵ See, Frank C. Carlucci, *Fixing False Claims*, WASHINGTON TIMES, Dec. 31, 1997 at A17.

Because of widely held perceptions in the industrial community that the statute needs reform along the lines indicated above, and that the Justice Department is implementing it in an unduly rigorous fashion and encouraging *qui tam* relators to do likewise, a Defense Policy Advisory Committee on Trade was formed several years ago. It includes a number of large firms which regularly do business with the federal government, plus representatives of the Department of Defense and the U.S. Trade Representative. Substantial case histories documenting abuses of the Act have been presented to the Defense Department and relevant Congressional committees.

Unfortunately, protecting the legitimate interests of large corporations has not been a high priority with the public and has required more political courage than many legislators have thus far been willing to demonstrate. While that effort continues, the principal source of relief must be, for the foreseeable future, the preventive measures of the contractors themselves and zealous defense of any litigation that is filed notwithstanding those efforts.