The *False Claims Act and Qui Tam Quarterly Review* is published by the Taxpayers Against Fraud Education Fund. This publication provides an overview of major False Claims Act and *qui tam* developments including case decisions, DOJ interventions, and settlements.

The TAF Education Fund is a nonprofit charitable organization dedicated to combating fraud against the Federal Government through the promotion and use of the *qui tam* provisions of the False Claims Act (FCA). The TAF Education Fund serves to inform and educate the general public, the legal community, and other interested groups about the FCA and its *qui tam* provisions.

The TAF Education Fund is based in Washington, D.C., where it maintains a comprehensive FCA library for public use and a staff of lawyers and other professionals who are available to assist anyone interested in the False Claims Act and *qui tam*.

TAF Education Fund

Board of Directors
Neil Getnick, *Chairman*
Fred Anderson
Albert Campbell
Joseph Gerstein
John Phillips
Margaret Richardson
Linda Sundro
Gregory Wetstone

President's Council
Kenneth Nolan, *Chairman*
James Alderson
James Breen
Neil Getnick
James Helmer
John Phillips
Scott Powell

Advisory Committee
Michael Behn
John Clark
Erika Kelton
Mark Kleiman
Candace McCall
Timothy McInnis
Philip Michael
Lesley Skillen
Shelley Slade
David Stone

Professional Staff
James Moorman, *President and CEO*
Joseph E. B. White, *Director of Legal Education & Programs,* Quarterly Review *Editor*
Patrick Burns, *Communications Director*
Anthony Cotto, *Legal Resources Administrator*
Carmen Ruffin, *Office Administrator*
Takeia Garner, *Executive Assistant*

Taxpayers Against Fraud Education Fund
1220 19th Street, NW
Suite 501
Washington, DC 20036
Phone (202) 296-4826
Fax (202) 296-4838
www.taf.org

Copyright © 2006 TAF Education Fund. All Rights Reserved.

TABLE OF CONTENTS

FROM THE EDITOR vii

Recent False Claims Act & *Qui Tam* Decisions 1

I. FALSE CLAIMS ACT LIABILITY 3

A. Fraud-in-the-Inducement
U.S. ex rel. Hendow v. University of Phoenix,
2006 WL 2530394 (9th Cir. Sept. 5, 2006)

II. STATUTORY INTERPRETATIONS 7

A. Section 3729(a)(1) & (A)(2) Presentment Requirement
U.S. ex rel. Farmer v. City of Houston,
2006 WL 2382327 (S.D. Tex. Aug. 16, 2006)

U.S. ex rel. DRC, Inc. v. Custer Battles, LLC,
2006 WL 2388790 (E.D. Va. Aug. 16, 2006)

B. Section 3729(A)(7) Obligation to Pay
U.S. ex rel. Zelenka v. NFI Industries, Inc.,
436 F. Supp. 2d 701 (D.N.J. July 6, 2006)

III. JURISDICTIONAL ISSUES 15

A. Section 3730(e)(4) Public Disclosure Bar and Original Source Exception
U.S. ex rel. Zaretsky v. Johnson Controls, Inc.,
2006 WL 2268938 (9th Cir. Aug. 9, 2006)

U.S. ex rel. Parikh v. Premera Blue Cross,

2006 LEXIS 70933 (W.D. Wa. Sept. 29, 2006)

U.S. ex rel. Rost v. Pfizer Inc.,
2006 WL 2501454 (D. Mass. Aug. 30, 2006)

IV. FALSE CLAIMS ACT RETALIATION CLAIMS 25

A. Section 3730(h) Retaliation Claims
Overton v. The Board of Commissioners of Rio Blanco County,
2006 WL 2844264 (D. Colo. Sept. 29, 2006)

V. COMMON DEFENSES TO FCA ALLEGATIONS 27

A. Lack of a Claim
U.S. ex rel. Crews v. NCS Healthcare of Illinois, Inc.,
2006 WL 2371457 (7th Cir. Aug. 17, 2006)

B. Statutory Immunity
U.S. ex rel. Parikh v. Premera Blue Cross,
Case No. C01-0476P (W.D. Wa. Sept. 22, 2006)

C. *Res Judicata*
U.S. ex rel. Sarafoglou v. Weill Medical College of Cornell University,
2006 WL 2615510 (S.D.N.Y. Sept. 12, 2006)

D. No Request for Government Funds
U.S. ex rel. McCandliss v. Sekendur,
2006 WL 2644954 (N.D. Ill. Sept. 12, 2006)

VI. FEDERAL RULES OF CIVIL PROCEDURE 35

A. Rule 9(b) Failure to Plead Fraud with Particularity
U.S. ex rel. Singh v. Bradford Regional Medical Center,
2006 WL 2642518 (W.D. Pa. Sept. 13, 2006)

VII. LITIGATION DEVELOPMENTS 39

Leon v. IDX Systems Corporation,
2006 WL 2684512 (9th Cir. Sept. 20, 2006)

The Heart Doctors, P.S.C. v. Layne,
2006 WL 2692694 (E.D. Ky. Sept. 13, 2006)

U.S. ex rel. Fullington v. Parkway Hospital, Inc.,
2006 WL 2766075 (E.D.N.Y. Sept. 19, 2006)

U.S. ex rel. Stierli v. Shasta Services Inc.,
2006 WL 2585524 (E.D. Cal. Sept. 8, 2006)

U.S. ex rel. SNAPP, Inc. v. Ford Motor Company,
2006 WL 2583257 (E.D. Mich. Sept. 7, 2006)

U.S. ex rel. Fowler v. Caremark Rx, Inc.,
2006 WL 2425331 (N.D. Ill. Aug. 21, 2006)

Giles v. United States,
2006 WL 2173145 (Fed. Cl. Aug. 3, 2006)

U.S. ex rel. Hill v. Morehouse Medical Associates, Inc.,
236 F.R.D. 590 (N.D. Ga. July 17, 2006)

United States v. Dynamics Research Corp.,
2006 WL 2007649 (D. Mass. July 17, 2006)

Hoyte v. American National Red Cross,
2006 WL 1971710 (D.D.C. July 14, 2006)

Anderson v. McTish, Kunkle & Associates,
2006 WL 1985762 (M.D. Pa. July 13, 2006)

INTERVENTIONS & SUITS FILED/UNSEALED 45

JUDGMENTS & SETTLEMENTS 49

LEGISLATIVE UPDATE 63

Guidelines for Evaluating State False Claims Acts
U.S. Department of Health & Human Services, Office of the Inspector General

LEGAL ANALYSIS 73

"Buying In": Why Externalities Support False Claims Act Liability 75
Ryan D. Derry

False Claims Act Remedies 93
Paul D. Scott

UPCOMING LEGAL BATTLES 111

Revisiting the Public Disclosure Bar & Its Original Source Exception
Jeremy Friedman, William Hurlock, and Claire Sylvia

FROM THE EDITOR

I regularly lecture to groups of health care compliance officers, where I am, inevitably, welcomed with a mix of stares, glares, and jeers. Indeed, just recently I spoke before a graduate program geared toward aspiring hospital administrators. My goal, as naïve as it may sound, was to convince this audience that I was a friend, not a foe, of health care providers. How, you may ask, does a person who teaches attorneys to bring *qui tam* actions befriend a group of potential targets? The answer is actually quite simple: You convince them that you want to go out of business. And, based on the piercing looks from the front row, this group wholeheartedly shared my desire.

Before an army of defense attorneys offers to pack my office files, I should probably elaborate. As the Director of Legal Education for Taxpayers Against Fraud, I am *against fraud*, not *for whistleblowing*. Admittedly, whistleblowers have increasingly become necessary to ferret out deep-seeded corporate fraud; however, if there was no corporate fraud, there would be no whistleblowers. True, this over-simplistic view of corporate America glosses over the intricate inner workings of large hospital chains and disregards the destructive capabilities of rogue employees. Nevertheless, I submit to you that in the vast majority of the cases, the whistleblower begins her journey as the company's most important employee—the employee willing to highlight a potential problem.

So, how does this "most important employee" evolve into a person bringing suit *against* the hospital? Simple. The hospital chooses to ignore the employee's helpful insight into a problem. And, instead of hugging this employee for exposing a potential liability, the hospital will, all too often, alienate, isolate, and terminate the employee, forcing her to look outside of the corporate walls for a solution. In turn, the hospital has turned their most loyal and helpful employee into a potential whistleblower.

The fact remains that the regulations and laws governing hospitals are becoming more and more complex. In turn, hospitals increasingly need to rely on employees to insure compliance with these mandates. If, however, the hospital discourages employees from speaking up about issues, these employees will continue speaking about these issues in the form of *qui tam* lawsuits . . . and I will keep my job.

Regretfully overworked,
Jeb White
jwhite@quitam.org

Recent False Claims Act & *Qui Tam* Decisions

JULY 1–SEPTEMBER 30, 2006

A. Fraud-in-the-Inducement

U.S. ex rel. Hendow v. University of Phoenix, 2006 WL 2530394 (9th Cir. Sept. 5, 2006)

The Ninth Circuit reversed a California district court's dismissal of an FCA *qui tam* action, alleging that the defendant-university knowingly made false promises to comply with the incentive compensation ban to become eligible to receive Title IV funds. The court of appeals, endorsing the fraud-in-the-inducement theory of FCA liability, held that liability attaches to each claim submitted to the government under a contract, when the contract or extension of a government benefit was originally obtained through false statements or fraudulent conduct.

When an educational institution wishes to receive federal subsidies under Title IV and the Higher Education Act, it must enter into a Program Participation Agreement with the Department of Education, in which it agrees to abide by a series of statutory, regulatory, and contractual requirements. One of these requirements is a ban on incentive compensation: a ban on the institution's paying recruiters on a per-student basis. Mary Hendow and Julie Albertson, former University of Phoenix employees, brought an FCA *qui tam* action against the University, alleging that the University knowingly made false promises to comply with the incentive compensation ban in order to become eligible to receive Title IV funds.

After the government declined to intervene in the action, the University filed a motion to dismiss, arguing that the relators' complaint failed to state a claim under the FCA. The district court, buying the University's argument, rejected the relators' claim under the "false certification" theory, for the applicable regulation "only requires that [the University] enter into an agreement, and does not require a certification." Second, the district court rejected relators' claim under the "promissory fraud" theory, because they did not "identif[y] any certification which is a prerequisite for [the University] to receive federal funds." The relators appealed the decision to the Ninth Circuit.

A False "Certification" Is Not Required

The court of appeals began its analysis by observing that many different courts have held that a claim under the FCA can be false where a party merely falsely certifies compliance with a statute or regulation as a condition to government payment. *See, e.g., Mikes v. Straus,* 274 F.3d 687, 697–700 (2d Cir. 2001); *United States ex rel. Quinn v. Omnicare Inc.*, 382 F.3d 432, 441 (3d Cir. 2004). In fact, the Ninth Circuit, in *United States ex rel. Hoper v. Anton*, 91 F.3d 1261 (9th Cir. 1996), embraces this theory of liability.

Dissecting the language espoused in *Hopper*, the court of appeals enunciated four conditions necessary to succeed on the false certification theory of FCA liability. First,

there must be a *false* claim, rather than a mere unintentional violation. Second, the false claims must in fact be "false when made." Third, the false statement or course of conduct must be material to the government's decision to pay out moneys to the claimant. Fourth, for a false statement or course of action to be actionable under the false certification theory of liability, it is necessary that it involve an actual *claim*, which is to say, a call on the government fisc.

After laying out these four pillars, the Ninth Circuit chastised the lower court for adding atextual liability requirements:

> We note that the University and the district court below have taken our holdings to mean that the word "certification" has some paramount and talismanic significance, apparently believing that a palpably false *statement* does not bring with it False Claims liability, while a palpably false *certification* will. So long as the statement in question is knowingly false when made, it matters not whether it is a certification, assertion, statement, or secret handshake; False Claims liability can attach.

FCA Liability Can Attach To A False Promise

The court, then, endorsed another approach to finding FCA liability in the absence of an explicitly false claim—the "promissory fraud" or "fraud-in-the-inducement" theory. This theory, adopted by even the U.S. Supreme Court, holds that FCA liability will attach to each claim submitted to the government under a contract, when the contract or extension of government benefit was originally obtained through false statements or fraudulent conduct. *See United States ex rel. Marcus v. Hess,* 317 U.S. 537, 542 (1943).

The court took particular note of a recent Seventh Circuit decision that adopted the promissory fraud theory in a case almost identical to one at bar, *United States ex rel. Main v. Oakland City Univ.,* 426 F.3d 914 (7th Cir. 2005). In *Main,* Judge Easterbrook examined the plain language of 31 U.S.C. § 3729(a)(2) and determined that FCA liability was clear: "[t]he University 'uses' its phase-one application (and the resulting certification of eligibility) when it makes (or 'causes' a student to make or use) a phase-two application for payment. No more is required under the statute." *Id.* The Ninth Circuit found this reasoning to be quite persuasive, especially as applied to the case at bar.

Here, the applicable statute, regulation, and agreement all explicitly conditioned participation and payment on compliance with, among other things, the precise requirement that the relators alleged that the University knowingly disregarded.

No Distinction Between A Condition Of Participation Versus A Condition Of Payment

The University countered that the ban was merely a condition of *participation,* not a condition of *payment*. But, according to the court, "that is a distinction without a difference." Indeed, "[i]n the context of Title IV and the Higher Education Act, if [the

court] held that conditions of participation were not conditions of payment, there would be no conditions of payment at all-and thus, an educational institution could flout the law at will."

The Ninth Circuit reduced the debate to one pithy statement: "[I]f the University had not agreed to comply with them, it would not have gotten paid." The court required nothing more from the relators.

Accordingly, the court of appeals, in reversing the lower court decision, ruled that the relators had raised an actionable cause of action under the FCA.

A. Section 3729(a)(1) & (A)(2) Presentment Requirement

U.S. ex rel. Farmer v. City of Houston, 2006 WL 2382327 (S.D. Tex. Aug. 16, 2006)

A Texas district, ignoring its earlier ruling, held that Section 3729(a)(2) liability does not attached where a false claim was never actually presented to a federal government employee or official, even though all of the resulting payments came from federal funds. In this case involving hurricane relief efforts, the federal government relied upon federal grantees to quickly distribute funds to construction companies. However, because the companies submitted their false claims for payment to the grantees and not to the government, a federal government "employee or official" never reviewed the claims.

After Tropical Storm Allison heavily damaged her Houston, Texas home in 1999, Marsha Farmer applied for assistance under the Emergency Home Repair Program (EHRP), a program which is funded by the United States Department of Housing and Urban Development (HUD). Under a grant agreement with HUD, the City of Houston authorized and approved a grant allocation for the EHRP and selected Houston Area Urban League (HAUL), a non-profit corporation, to implement a portion of the program.

HAUL inspected Farmer's property and sent her a write-up outlining the repairs to be made and the quantity and type of materials to be used. Farmer noticed several incorrect quantities on the write-up, most notably, that HAUL listed 4,000 square feet of roofing material, when she knew that only 2,000 square feet of roofing material was needed the last time she had the roof replaced. She then utilized the Texas Public Information Act to investigate other repairs made by HAUL under the EHRP. She inspected the City's disbursements to HAUL under the program from November 1999 through February 2003, and compared them with estimates of roof size, based on the square footage of the repaired houses, which she obtained from the Harris County Appraisal District. Farmer determined that the EHRP was paying for excessive roofing materials that were never used. Utilizing this method of comparison, she determined that the program was paying for excessive charges in other areas as well, including gutters, foundations, water lines, utility lines, windows, smoke detectors, base cabinets, and counter tops.

Ultimately, Farmer filed an FCA *qui tam* action against the City of Houston and HAUL, alleging that the defendants made false claims in request for payment forms and other supporting documents, which were submitted by HAUL to the City, and subsequently approved and paid by the City, exclusively using HUD grant funds.

After the government declined to intervene, the defendants encouraged the court to dismiss the case on summary judgment, arguing that the case could not proceed,

for Farmer could not show that either the City or HAUL presented a claim for payment or approval to the federal government. Farmer argued, on the contrary, that the presentment of a claim to the federal government is not a necessary element of a claim under 31 U.S.C. § 3729(a)(2), and that the defendants' filings under the EHRP were subject to government approval by virtue of HUD's auditing power.

Section 3729(a)(2) Requires Presentment To A Federal Government Employee Or Official

The statutory language of 31 U.S.C. § 3729(a)(2) creates liability for any person who "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." 31 U.S.C. § 3729(a)(2). The defendants, spotlighting the D.C. Circuit's opinion in *United States ex rel. Totten v. Bombardier Corp.*, 380 F.3d 488 (D.C.Cir.2004), asserted that the payment of a claim with federal funds does not give rise to section 3729(a)(2) liability, unless there is evidence that the claim was presented to the federal government.

While the court had rejected the defendants' *Totten* argument at the motion to dismiss stage, the court changed its mind at the summary judgment stage (and after the author of the *Totten* decision, John Roberts, had been confirmed as the next Chief Justice of the U.S. Supreme Court.) The court, parroting the arguments announced in *Totten*, now found that reading section 3729(a)(2) to *not* require the presentment of a claim to the government would render the words "by the Government" in (a)(2) meaningless: "If Congress intended for liability to attach under section 3729(a)(2) simply by making or using a false record to get a claim paid by a recipient of federal funding, then the reference to false records or statements made 'to get a false or fraudulent claim paid or approved' would have been sufficient without the additional requirement that the claim be paid or approved 'by the Government.'" *Citing Totten*.

The court, after wholeheartedly adopting the *Totten* Section 3729(a)(2) presentment requirement, ruled that this new mandate was not satisfied by Farmer's complaint.

No "Presentment" When Federal Funds Are Withdrawn From A Line Of Credit

Farmer countered the City's withdrawal of federal funds from the line of credit established by HUD constituted the presentment of a claim to the federal government. Moreover, she argued that the presentment requirement was met by the audit authority that HUD maintained over the City's EHRP. Again citing *Totten*, the court rejected both of these arguments:

> "While Relator's claims are factually correct, in that the City withdrew HUD grant funds from a line of credit, and that HUD retained audit power over the EHRP, this does not constitute presentment of a claim to the government. Although the City withdrew the funds

> from a line of credit, HUD had already approved the grant of the federal funds to the City and, accordingly, had previously established the line of credit for the particular amount of funds granted. The False Claims Act does not reach such claims, where the federal funds at issue have already been provided by the Government."

Citing Totten, 380 F.3d at 493.

Here, because HUD provided the funds to the City *before* the City withdrew from the line of credit, and before HUD conducted any audit, the court ruled that neither of these events could constitute presentment of a claim to the federal government. In turn, because Farmer failed to present evidence that the claims were presented to the federal government for payment or approval, the court granted the defendants' motion for summary judgment.

U.S. ex rel. DRC, Inc. v. Custer Battles, LLC, 2006 WL 2388790 (E.D. Va. Aug. 16, 2006)

A Virginia district set aside a jury verdict in an FCA *qui tam* action, in which the relators alleged that a contractor violated the FCA when it submitted false claims to the Coalition Provisional Authority in Iraq. The court, applying the ruling from the controversial *Totten* decision, held that FCA liability did not apply because a false claim was never presented to an "officer or employee of the United States government." Notably, government employees reviewed these allegedly false claims, but, according to the court, this did not qualify under the Act, for these employees were acting in the role of CPA officials, not federal government officials, when they received the claims.

Soon after the fall of Saddam Hussein regime, Custer Battles, LLC signed a contract with the Coalition Provisional Authority (CPA) in Iraq to provide support services to the CPA while the CPA launched the Iraqi Currency Exchange (ICE) project, which was the CPA's effort to exchange new Iraqi dinars for the old Saddam Hussein-era dinars in circulation.

A former Custer Battles employee and DRC, Inc., a former Custer Battles subcontractor, file an FCA *qui tam* action against Custer Battles alleging, *inter alia*, that the company hatched a scheme to create the appearance of higher direct costs by presenting falsely inflated invoices to the CPA from fictional subcontractors purportedly providing services under the ICE contract. After the government declined to intervene in the action, the relators took the case through a successful jury trial, in which the jury found the defendants jointly and severally liable for $3 million in damages to the United States.

The defendants subsequently filed a Rule 50 motion, seeking judgment as a matter of law on various grounds. Specifically, the defendants challenged, *inter alia*, whether the relators adduced evidence at trial that any false claims (actionable pursuant to 31 U.S.C. § 3729(a)(1)) or false records (actionable pursuant to 31 U.S.C. § 3729(a)(2))

were knowingly presented, or caused to be presented, to *employees or officers of the United States acting in their official capacity*.

Sections 3729(a)(1) and (a)(2) Require Presentment To A Federal Government Employee Or Official

The court first turned its attention to those claims raised under FCA Section 3729(a)(1), which attaches liability to "any person who knowingly presents, or causes to be presented, to an officer or employee of the United States government . . . a false or fraudulent claim for payment of approval." The defendants argued that there was no evidence of presentment to an "officer or employee of the United States government" because the CPA was an international entity, not an American entity, and because CPA personnel, even if U.S. officers or employees, were acting in their CPA capacities, not in their official U.S. capacities.

As an initial matter, the court pointed to its earlier ruling in which the parties did not dispute that "[b]efore FCA liability will attach to a 'claim' for payment under § 3729(a)(1), the false or fraudulent 'claim' must be 'knowingly present[ed], or caus[ed] to be presented, to an officer or employee of the United States Government or a member of the Armed Services of the United States.'" *DRC I,* 376 F.Supp.2d at 647 (citing 31 U.S.C. § 3729(a)(1)).[FN8] Moreover, the court stripped another quote from its earlier decision, which maintained that the presentment requirement could not be satisfied by presentment to a United States government employee or officer where the employee or officer is not working in his or her official U.S. capacity:

> [I]t cannot be that the presentment requirement is satisfied as long as a false claim is presented to a person who happens to be an employee of the United States government, without respect to whether that person is acting in his or her capacity as a U.S. government employee. To be sure, if a contractor submitted a false claim to a U.S. government employee for remodeling her kitchen, the presentment requirement would not be satisfied. Thus, *if the CPA was not a U.S. entity, then those U.S. employees detailed to the CPA were acting in their capacity as officers of the CPA, not as employees of the United States government.*"

Id. at 648 n. 86. Thus, the court required the relators to produce evidence that the defendants presented, or caused to be presented, false claims to U.S. government employees or officers working in their official capacity.

Taking it one step further, the court embraced the controversial *Totten* ruling, which grafts the presentment requirement to Section 3729(a)(2). While the relators steadfastly challenged this reading of the Act, the court stressed that this was the view adhered to at the trial, as the jury was instructed with respect to Section 3729(a)(2) as follows:

> Finally, a defendant is only liable if the relators have proven, by a preponderance of the evidence, that any false record or statement was made or used in order to get paid or approved a false claim which called upon the $3 million advance payment, and was presented to the United States Government.

The court then emphasized that if the CPA was an international entity, rather than a U.S. entity, submission of claims to the CPA, without more, would not satisfy the presentment requirement. The court ran the CPA through a litany of factors, ultimately concluding that the CPA was an international entity: "[A]lthough the CPA was principally controlled and funded by the U.S., this degree of control did not rise to the level of exclusive control required to qualify as an instrumentality of the U.S. government. In fact, the evidence clearly establishes that it was created through and governed by multinational consent."

Thus, because the court ruled that the CPA was not a U.S. government entity, and therefore U.S. employees of the CPA were not working in their official capacity as employees or officers of the United States government, the court ruled that the relators failed to provide sufficient evidence to enable a jury to find presentment. Accordingly, the court granted the defendants' motion for judgment as a matter of law.

B. Section 3729(A)(7) Obligation to Pay

U.S. ex rel. Zelenka v. NFI Industries, Inc., **436 F. Supp. 2d 701 (D.N.J. July 6, 2006)**

A New Jersey district court dismissed an FCA *qui tam* action alleging that a warehousing company violated the reverse FCA provision when it submitted documents to a customs agency to wrongfully enter a program with reduced governmental oversight. The court ruled that there was no existing Section 3729(a)(7) "obligation to pay," for the defendant's obligation to pay fees for future customs inspections was not "sufficiently certain" at the time the claims were submitted.

In November 2002, Deanna Zelenka was hired by NFI Industries, Inc. to run the operations of an NFI subsidiary's manufacturing and warehousing business in New Jersey. At about this same time, NFI entered into an agreement with Honeywell International, Inc. to consolidate Honeywell's warehousing of certain chemical products and hazardous materials in the northeast United States to one facility in Pennsauken, New Jersey, owned or leased by one or more of the NFI Companies.

During the course of her employment, she discovered that the Pennsauken Facility was not ready to store the chemical products and hazardous materials being transferred by Honeywell to the facility. She also discovered that NFI and Honeywell were not only hiding this information from the government, but the companies had actually applied to enter a special government program, in which the companies certified that the Pennsauken Facility met the a number of requirements for procedural, physical and personnel security, education and training, access controls, manifest procedures and conveyance security. Companies that participate in this special program, the Customs and Trade Protection Against Terrorism (C-TPAT) program of the United States Custom and Border Protection Agency, receive certain benefits for complying with the guidelines, including fewer inspections by Customs and reduced border wait times, and reduced selection rates for Compliance Measurement Examinations.

After raising her concerns with several high-ranking NFI officials, NFI vice president of risk management Craig Bollinger "acknowledged to Zelenka the misrepresentations that NFI was engaging in." Unsatisfied with their lack of candor with the government, Zelenka filed an FCA *qui tam* action against NFI Industries and Honeywell, alleging that they violated the FCA, in submitting various certifications and other documents connected to their participation in the C-TPAT program. After the government declined to intervene in the action, the defendants filed a motion to dismiss.

Reverse FCA Liability Provision Requires A "Present Duty To Pay"

The FCA attaches liability under Section 3729(a)(7) for making a "reverse false claim" when a defendant "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. . . ." Zelenka argued that this theory of liability attached to the defendants, in that as a result of its participation in C-TPAT, fewer of

Honeywell's shipments into the United States were inspected by Customs than would have been had it not taken part in C-TPAT, and thus it paid fewer inspection fees than it would have, had it not been a C-TPAT participant.

The court reduced the controlling issue to whether an "obligation" under Section 3729(a)(7) encompasses a potential or contingent obligation, such as a fee that would be assessed upon the occurrence of a possible future event. The court quickly noted that other courts have defined the scope of the term obligation in § 3729(a)(7) to preclude a claim based upon potential or contingent obligations. The court was particularly swayed by the Sixth Circuit decision, *American Textile Manufacturers Institute, Inc., v. The Limited, Inc.*, 190 F.3d 729, 738 (6th Cir.1999), in which the Sixth Circuit emphasized a "present duty to pay" and held that "[c]ontingent obligations-those that will arise only after the exercise of discretion by government actors-are not contemplated by the [False Claims Act]."

Here, because Honeywell was not obliged to pay inspection fees until Customs chooses to inspect its shipments, the court determined that there was no "present duty to pay," as it agreed was required under the Section 3729(a)(7) reverse FCA liability provision. In turn, the court granted the defendants' motion to dismiss.

A. Section 3730(e)(4) Public Disclosure Bar and Original Source Exception

U.S. ex rel. Zaretsky v. Johnson Controls, Inc., 2006 WL 2268938 (9th Cir. Aug. 9, 2006)

The Ninth Circuit reversed and remanded a California district court's ruling that the public disclosure bar precluded a suit in which the relator provided relevant information to the government after a public disclosure. The court of appeals held that the FCA does not require relators to report information prior to the public disclosure to qualify for the public disclosure bar's original source exception. The court pointed to the language of the Act, which merely requires the relator to provide this information to the government prior to filing a *qui tam* action.

In addition to operating as independent companies, Yardley-Zaretsky, Inc. and the George Yardley Co. were authorized sellers of Johnson Controls, Inc. products, including control systems that monitor and coordinate the air environment in large buildings and building complexes. According to Roman Zaretsky, President of Yardley-Zaretsky, Inc., Johnson Controls threatened the Yardley Companies with termination of their authorized seller rights if they bid against Johnson Controls on certain government jobs, including jobs at the Long Beach Veterans Administration Hospital and the University of California, Riverside.

Initially, Zaretsky and the Yardley Companies filed a state court action against Johnson Controls, but the plaintiffs later voluntarily dismissed this suit. The plaintiffs, then, filed a *qui tam* action against Johnson Controls, alleging that the company violated the California and federal FCAs by engaging in bid-rigging on federal and state government jobs. The defendant filed a motion to dismiss, arguing that the *qui tam* complaint was barred under the FCA public disclosure bar. The lower court, in granting the defendant's motion, held that to qualify as an "original source" under the FCA, a prospective relator must provide the government with the pertinent information prior to the "public disclosure" at issue if, but only if, the "public disclosure" occurs through a private lawsuit brought by the prospective relator. Here, because the relators did not provide information to the government prior to the public disclosure (their own state court action), the court ruled that the public disclosure bar applied and they did not qualify for the bar's original source exception.

The relators appealed the decision to the Ninth Circuit, arguing that federal and California FCAs do not require them to inform the government prior to public disclosure to qualify as "original sources."

Original Source Must Inform Government Before Filing Action, Not Before Public Disclosure

The Ninth Circuit observed that there is a circuit split on this very issue, with the Eighth Circuit adopting the relators' interpretation and the D.C. Circuit embracing the defendants' view. *Compare Minn. Ass'n of Nurse Anesthetists v. Allina Health Sys. Corp.*, 276 F.3d 1032, 1050–51 (8th Cir. 2002) *with United States ex rel. Findley v. FPC-Boron Employees' Club*, 105 F.3d 675, 690–91 (D.C. Cir. 1997).

After reading the statutory language, the Ninth Circuit quickly endorsed the relators' interpretation. Subsection (B) of § 3730(e)(4) *explicitly* provides a time frame for when individuals wanting to take advantage of the "original source" exception to the "public disclosure" bar must "voluntarily provide[ ] information to the government," stating in no uncertain terms that they must do so "*before filing an action under this section*." § 3730(e)(4)(B) (emphasis added).

The court of appeals rejected the D.C. Circuit's interpretation as being atextual, against the purpose of the Act, and unmindful of the unambiguous plain language of the Act. Quoting the Eighth Circuit, the Ninth Circuit stressed that it "would change the balance Congress struck if we were to further restrict the class of those whose discoveries had been made public but who were nevertheless permitted to proceed as relators." Therefore, the court of appeals held that the FCA does not require individuals to inform the government prior to the public disclosure at issue to qualify as "original sources." The court, noting the almost identical language of the California FCA public disclosure bar's original source exception, also applied the same holding to the State FCA.

Accordingly, the Ninth Circuit reversed the district court's grant of summary judgment.

U.S. ex rel. Parikh v. Premera Blue Cross, 2006 LEXIS 70933 (W.D. Wa. Sept. 29, 2006)

A Washington district court, examining whether certain exhibits qualified as "public disclosures" under the FCA public disclosure bar, ruled that the bar did not apply, for the selected items did not reveal enough information to allow the government to pursue an investigation into the operations of this specific FCA defendant.

From October 1998 to May 2002, Girish Parikh worked as an appeals coordinator and as a government program auditor for Premera Blue Cross, a Medicare Fiscal Intermediary that processes claims for the states of Washington and Alaska. After bringing concerns of fraud to his employer, Parikh was fired. Parikh subsequently brought an FCA *qui tam* action against his former employer, alleging that the Medicare Fiscal Intermediary submitted false claims to the Center for Medicaid and Medicare Services (CMS) for services that it did not render. Parikh also alleged that the company failed to collect overpayments it made to health care providers. Premera countered by filing a motion to dismiss, arguing that the FCA public disclosure bar precluded the

relator from bringing the suit. In support of its motion, the defendant submitted 59 separate documents that it contended were public disclosures satisfying 31 U.S.C. § 3730(e)(4)(A).

Public Disclosure Bar Only Applies To "Allegations And Transactions," Not Mere Information

In order for the FCA public disclosure bar to apply, there are two requirements. First, the disclosure must come from either a 1) "criminal, civil, or administrative hearing;" 2) a "congressional, administrative, or GAO report, hearing, audit, or investigation;" or 3) from the "news media." If the court is satisfied that the alleged disclosure comes from one of these statutory sources, then the court must also determine if the content of the disclosure is comprised of "allegations or transactions" giving rise to the relators claim, in contrast to "mere information." *United States v. Alcan Elec. and Engineering, Inc.*, 197 F. 3d 1014, 1019 (9th Cir. 1999). The court reduced the issue in the present case to whether or not the purported public disclosure revealed enough information to allow the government to pursue an investigation into the operations of a given defendant.

Then, the court proceeded to review the various documents cited by the defendant, ultimately concluding that none of the documents met the threshold of "allow[ing] the government to pursue an investigation into the operations" of Premera. Notably, the court went through great efforts to explain why a particular GAO report did not qualify as an FCA "public disclosure." This document was a GAO report dated September 2000 and entitled, "Medicare: HCFA Could Do More to Identify and Collect Overpayments."

In *Alcan Electrical*, the Ninth Circuit held that a GAO report constituted a public disclosure. In that matter, the GAO report at issue did not name the defendant explicitly, but contained enough information to instigate a governmental investigation of the *defendant*. 197 F. 3d 1014. The Ninth Circuit has also framed this test in another way, stating that: [i]f X + Y = Z, Z represents the allegation of fraud and X and Y represent its essential elements. In order to disclose the fraudulent transaction publicly, the combination of X and Y must be revealed, from which readers or listeners may infer Z, i.e., the conclusion that fraud has been committed. *United States ex rel. Foundation Aiding the Elderly v. Horizon West, Inc.*, 265 F. 3d 1011, 1015 (9th Cir. 2001)(citations omitted). By adopting this formula, the Ninth Circuit signaled its desire that courts look for substantive allegations in purported public disclosures that would allow the government to commence an investigation of a particular defendant, even if that defendant is not named.

Applying the *Alcan Electrical* rational to the GAO report in question, the court noted that it was phrased in general terms and described new, experimental programs that were being implemented to address the overpayment problem. It did not appear clear to the court from this document that the government or the GAO's office knew who the problem contractors within the system were, or even which regions of the country were most problematic. Instead, this document appeared to provide "mere information." For this reason, the court found that it was not a "public disclosure" under the FCA.

Having made this finding, the court did not reach the issue of whether or not Parikh could be considered an original source of the information contained in the documents under the original source exception. Accordingly, the Court denied defendant's motion to dismiss.

U.S. ex rel. Rost v. Pfizer Inc., 2006 WL 2501454 (D. Mass. Aug. 30, 2006)

A Massachusetts district court granted a defendant's motion to dismiss an FCA *qui tam* action, which alleged that the defendant-pharmaceutical companies caused false claims to be presented to the government when they off-label marketed a human growth hormone. The court ruled that the companies' voluntary disclosure of information to varied federal officials regarding the prohibited off-label marketing did not constitute a "public disclosure" for purposes of the FCA public disclosure bar. However, the court ruled that the complaint did not satisfy the particularity requirements of Rule 9(b), for it did not "identify particular false claims for payment that were submitted to the government."

According to Pharmacia and its former employee Dr. Peter Rost, from 1997 to 2003, Pharmacia promoted and marketed its drug Genotropin for uses which were not approved by the FDA. Specifically, Pharmacia's drug Genotropin was approved by the FCA to treat a limited range of hormonal deficiencies in children and adults, but Pharmacia touted the drug as a treatment for short children without hormonal deficiencies or as an anti-aging treatment for adults.

Rost, as a vice-president of marketing, immediately raised concerns about this illegal marketing with his supervisors at Pharmacia. In July 2002, when Pfizer announced plans to merge with Pharmacia, Rost raised his concerns about the marketing of Genotropin with Pfizer executives. Plaintiff even provided Pfizer representatives with evidence of Pharmacia's extensive off-label marketing campaign. Nearly a year later, on May 16, 2003, Pfizer contacted senior officials at the FDA and the Office of Inspector General of the Department of Health and Human Services to disclose the issues surrounding their off-label marketing of Genotropin. On May 19, 2003, Pfizer sent a detailed letter to the FDA addressing the same issues.

Just a few days later, on June 3, 2003, Rost informed the United States Attorney for the District of Massachusetts that he was preparing to file a *qui tam* action alleging fraud relating to the off-label marketing of Genotropin. On June 4, 2003, Rost delivered a copy of his complaint to the U.S. Attorney's office and, on June 5, 2003, he filed his complaint with the court.

After the government declined to intervene in the case, the defendants filed a motion to dismiss, arguing that the action was barred under the FCA public disclosure bar and that the complaint failed to satisfy the particularity requirements of Rule 9(b).

Voluntary Disclosures To Government Officials Does Not Trigger FCA Public Disclosure Bar

In assessing jurisdiction under the public disclosure bar, courts must examine three different issues. First, the court must determine whether the allegations of fraud in the relator's complaint were "publicly disclosed" before the relator filed his action. Second, the court must examine whether relator's allegations are "based upon" that public disclosure. If the answer to either of these questions is "no," then the inquiry ends and the court has jurisdiction over relator's claims. If the answers to the first two questions are "yes," then the court must consider whether the relator is an "original source" of the information in his complaint. If relator is an "original source," he may prosecute his *qui tam* action.

Thus, the court was first faced with the issue of whether the defendants' voluntary disclosure of information to various government officials constituted a "public disclosure" under the FCA public disclosure bar. Rost argued that the defendants' disclosure did not rise to the level of a "public disclosure" because the information was not sufficiently public and because it was not disclosed in any one of the statutorily required manners enunciated in Section 3730(e)(4)(A).

The defendants, on the other hand, pointed to *United States ex rel. Mathews v. Bank of Farmington*, 166 F.3d 853 (7th Cir. 1999), in which the Seventh Circuit held that "[d]isclosure of information to a competent public official about an allege false claim against the government . . . [is a] public disclosure within the meaning of § 3730(e)(4)(A) when the disclosure is made to one who has managerial responsibility for the very claims being made."

The court, in rejecting the *Mathews* holding, held that disclosure to a competent government official, alone, does not, and in fact cannot, constitute a public disclosure under the FCA's public disclosure bar. For support, the court cited the plain and ordinary definitions of the terms "public" and "disclosure," and the history and public policy underlying the post-1986 FCA.

According to the court, the term "public" is ordinarily defined as something that is "exposed to general view . . . of, relating to, or affecting all the people or the whole area of a nation or state . . . [or] accessible to . . . all members of the community." The term "disclosure" is ordinarily defined as something that is exposed to view or made known. Therefore, a "public disclosure" is information that someone has exposed, made known, or at least made accessible, to all members of the community or, in other words, the general public. Moreover, the court determined that the plain meaning and ordinary usage of the term "public" means the general public. The general public is an entity that is distinct, separate from, and independent of the government.

According to the court, the *Mathews* court's holding, and the defendants' argument, also conflict with the history of the FCA and the public policy underlying the 1986 FCA amendments. In 1986, Congress rejected the FCA's pre-1986 jurisdictional limitation, which barred *qui tam* actions that were based on information that the government already had in its possession. The *Mathews* court's rule, taken to its logical

extreme, represents a reversion to and restatement of the previously rejected jurisdictional limitation.

The *Mathews* court's holding, and the defendants' arguments, also failed as a matter of policy. In the 1986 amendments to the FCA, Congress recognized that the government's possession of knowledge of fraud does not necessarily mean that the government will or is in a position to prosecute the fraud. In particular, the government does not have the resources to investigate and prosecute all allegations of fraud brought to its attention and may have reasons to forego taking any action on the matter. As the court noted, Congress had these precise concerns in mind in 1986 when it strengthened incentives for private individuals to bring *qui tam* actions.

The court further honored the underlying legislative history: "Congress intended the public disclosure bar as a means to prohibit only those truly parasitic lawsuits. Actions in which the disclosed information lies only in the hands of the government and the party who disclosed it to the government are not parasitic. When the private plaintiff does not, and cannot, know the information in the government's possession, there is no public host for the plaintiff to feed off."

Moreover, the court noted that the defendants' disclosures to the government did not satisfy the specific statutory public for a listed in Section 3730(e)(4)(A). The defendants, however, argued that their disclosures to OIG, FDA, and DOJ officials occurred during the course of an administrative investigation and, therefore, did satisfy the statutory requirements. The court, after dissecting the underlying facts, determined that there was no evidence that an investigation took place before Rost filed his complaint. In fact, the defendants stated only that the OIG assigned an agent to the case.

The defendants, furthermore, did not disclose any information during the course of any government investigation. The defendants' disclosures to the government, at best, initiated the government's investigation. According to the court, "[T]he fatal flaw of Defendants' argument, in any case, is that none of the information disclosed by Defendants to the government was ever exposed, by either Defendants or the government, to the general public."

Thus, the court held that the defendants' voluntary disclosure of information to various government officials did not constitute a public disclosure for the purposes of the FCA public disclosure bar.

Only Actions Derived From Public Disclosures Are Barred Under the FCA Public Disclosure Bar

The defendants furthered stretched the statutory language by arguing that Rost's *qui tam* action was "based upon" its disclosures to the government.

The court noted the proverbial circuit split on how to determine whether an FCA action is "based upon" publicly disclosed information. The majority of courts have held that an action is "based upon" a public disclosure "when the supporting allegations are similar to or 'the *same as* those that have been publicly disclosed . . . *regardless of where*

the relator obtained his information.'" The minority approach, on the other hand, interprets "based upon" as meaning "derived from."

Choosing to honor the plaint meaning, the court adopted the minority rule and held that a *qui tam* action is "based upon" a public disclosure only when the allegations supporting the action are "derived from" the public disclosure. This interpretation of "based upon" is amply supported by the plain language of the statute and the ordinary meaning of the phrase "based upon." "To 'base upon' means to 'use as a basis for.'" *Webster's Third New International Dictionary* 180 (1986).

In addition to giving effect to the plain and unambiguous language contained in the public disclosure bar, the court stressed that the minority position better serves the policies behind the FCA:

> *Qui tam* actions that contain allegations similar, or even identical, to publicly disclosed information are not necessarily parasitic. Such actions are parasitic only when the plaintiff's allegations are actually derived from, or leeched off, the public disclosures. The majority view's interpretation strikes too broadly and effectively prohibits actions that have not "fed off" public disclosures and are thus not parasitic. The "derived from" interpretation, on the other hand, serves to filter out only those *qui tam* actions which are truly parasitic.

Turning, then, to the case at bar, the court quickly concluded that Rost's complaint was not derived from the defendants' disclosures to the government. Instead, Rost's complaint was derived from his own independent investigation of the defendants' off-label marketing scheme, and from his personal knowledge of the defendants' activities. Rost, furthermore, had no knowledge of the defendants' disclosures to the various government officials.

In turn, the court ruled that the FCA public disclosure bar did not bar Rost's claims.

Original Source Must Inform Government Prior To Filing Action, Not Prior To Public Disclosure

Even though the court did not need to address the original source question, the court decided to further educate the defendants (and several wayward courts) about the true meaning of the original source exception. Thus, the court, for the sake of analysis, then assumed that the defendants' disclosure to the government was a public disclosure and that Rost's complaint was based on that disclosure.

This statutory definition requires that an original source draft his or her complaint from both "direct" and "independent" knowledge of the fraudulent conduct. Pulling together the relevant case law, the court ruled that a *qui tam* plaintiff's knowledge is considered direct when the plaintiff acquires it "through her own efforts without an intervening agency." *United States ex rel. O'Keeffe v. Sverdup Corp.* 131 F. Supp. 2d 87, 93 (D. Mass. 2001) (*citing United States ex rel. Springfield Terminal Ry. Co. v. Quinn*,

14 F.3d 645, 651 (D.C. Cir. 1994)). A plaintiff's knowledge is "independent" if it is not dependant upon information contained in any public disclosures. *Id.*

The defendants, offering up an atextual reading of the Act, argued that for a *qui tam* plaintiff to qualify as an original source, the plaintiff must also disclose his or her information to the government *before* any public disclosure occurs. The court noted that this additional temporal factor has found its way into some appellate court decisions. The court, seemingly shocked by the blatant disregard for the statutory language, noted that there are, in fact, three different approaches that courts have taken in defining the necessary elements of the original source exception. *See United States ex rel. McKenzie v. Bellsouth Telecomms., Inc.*, 123 F.3d 935, 941–43 (6th Cir. 1997).

The first approach to the original source provision holds that the statute requires only that a *qui tam* plaintiff have direct and independent knowledge of the facts alleged in his or her complaint and that the Plaintiff disclose that information to the government before filing his action. *See, e.g., United States ex rel. Fine v. Advanced Sciences, Inc.*, 99 F.3d 1000, 1006–07 (10th Cir. 1996). This approach relies primarily on the plain language of the FCA. Courts that have adopted a second approach have added the requirement that an original source "must have directly or indirectly been a source to the entity that publicly disclosed the allegations on which a suit is based." *See, e.g., United States ex rel. Dick v. Long Island Lighting Co.*, 912 F.2d 13, 16 (2d Cir. 1990). Finally, the third approach, which the defendants argued in this case, requires that an original source inform the government of his or her allegations before those allegations are otherwise publicly disclosed. *See, e.g., United States ex rel. Findley v. FPC-Boron Employees' Club*, 105 F.3d 675, 691 (D.C. Cir. 1997).

After consideration of the above approaches to the original source provision, the court adopted the first approach, and held that, in order to qualify as an original source, a *qui tam* plaintiff need only have direct and independent knowledge of the alleged fraud and have disclosed that information to the government prior to bringing his or her *qui tam* action: "Although the courts that adopt these approaches may think these additional requirements better serve the purpose of the FCA, the text of the statute simply does not support either additional requirement."

The court, then, concluded that Rost, as vice president of Pharmacia's Endocrine Care Unit, had personally uncovered the evidence of Pharmacia's unlawful conduct. Accordingly, Rost qualified for the original source exception, for his knowledge was both direct and independent, and he voluntarily disclosed his information to the government before he filed his action.

Detailed Complaint Failed To Satisfy Particularity Requirement Of Rule 9(b)

Strangely, after the court touted the level of "direct and independent knowledge" that Rost brought to the table, the court ruled that his complaint did not satisfy the particularity requirements of Rule 9(b). To reach this conclusion, the court chained itself to a quote from the First Circuit, which maintains that a relator must identify with

particularity "actual false claims that the defendants submitted to the government." *United States v. Karvelas*, 360 F.3d 220 (1st Cir. 2004).

Forcing the case at bar through such a narrow Rule 9(b) opening, the court ruled that the complaint did not meet this threshold requirement of providing the court with an individual sheet of paper that was presented for payment. This ruling was levied, even though the court credited the "great detail" of Rost's complaint: "Plaintiff's complaint alleges, in great detail, the framework of Defendants' illegal marketing, promotion, and distribution of Genotropin. Plaintiff's complaint discusses bribes, kickbacks, and other financial incentives given from Defendants to various drug distributors and physicians. Plaintiff's complaint, furthermore, alleges very serious violations of federal regulations regarding the marketing, distribution, and sale of pharmaceuticals."

Nonetheless, the court blocked Rost's complaint, for he did not provide the court with an individual claim at this early stage of the litigation. And, perhaps even more shocking, the court refused to grant Rost a chance to amend his complaint, choosing instead to dismiss the action with prejudice.

FALSE CLAIMS ACT RETALIATION CLAIMS

A. Section 3730(h) Retaliation Claims

Overton v. The Board of Commissioners of Rio Blanco County, 2006 WL 2844264 (D. Colo. Sept. 29, 2006)

In an FCA anti-retaliation suit, a Colorado district court denied a defendant's motion for summary judgment, for fact issues existed over whether the plaintiff-employee's actions were consistent with her official duties. However, as to the plaintiff's action against her supervisor, the court ruled that this suit could not proceed, for the FCA anti-retaliation provision only applies to "employers" and there was no evidence that her supervisor was her "employer," as defined under the common law meaning.

For nearly twenty years, Debra Overton worked as either a laboratory technician or a supervisor at Pioneers Hospital in Rio Blanco County, Colorado. However, on July 5, 2004, she was fired, according to Overton, because she voiced her opinion that the hospital was engaging in illegal Medicare and Medicaid billing practices.

The billing practices dispute arose in 2004, when the hospital began operating a family clinic and billing for lab work done in the clinic's own laboratory. According to Overton, the clinic was not complying with applicable federal certification regulations, and therefore the hospital could not legally bill Medicare and Medicaid for work performed at the clinic's lab. Overton raised her concerns to several hospital officials, including the hospital's CEO, CFO, and medical director. When their responses did not satisfy her, Overton raised her concerns with an employee of Quorum Healthcare, an independent consulting business that frequently worked with the hospital. Finally, on June 17, 2004, while a state inspector was visiting the hospital's lab, Overton told the inspector of her concerns. Subsequently, the hospital fired Overton.

Overton filed an action against the hospital and the CEO, claiming, *inter alia*, that they violated the FCA anti-retaliation provision, for she was retaliated against because of actions she took in furtherance of a FCA action. The defendants argued that her actions were not sufficient to put them on notice because her "investigation" consisted of nothing more than what was required by her job.

The court, rejecting the defendants' argument, ruled that this case involves genuine issues of fact regarding Overton's official job duties. Moreover, the court determined that a reasonable jury could find that persistent and repeated questioning of multiple sources-first her supervisors, then an outside consultant, and finally a state inspector-was sufficient to put the defendants on reasonable notice of a *possible* FCA action. Therefore, the defendants are not entitled to summary judgment on this claim.

No FCA Anti-Retaliation Action Against Individual-Supervisor

As for Overton's suit against the CEO of the hospital, the court ruled that this action could not proceed under the FCA anti-retaliation provision. The FCA only provides a remedy against "employers" under 31 U.S.C. § 3730(h). In response, Overton argued that the CEO was liable, for he was her "de facto" employer. The court, however, agreed with a D.C. Circuit Court decision: "In the absence of explicit statutory language to the contrary, we therefore infer that Congress intended 'employer' in § 3730(h) to have its ordinary, common law meaning." *United States ex rel. Siewick v. Jamieson Sci. & Eng'g, Inc.*, 322 F.3d 738, 740 (D.C. Cir. 2003). Because Overton failed to provide evidence that the CEO was her "employer" in the commonlaw sense of the word, the court ruled that summary judgment was appropriate on her FCA claim against the CEO.

COMMON DEFENSES TO FCA ALLEGATIONS

A. Lack of a Claim

<u>*U.S. ex rel. Crews v. NCS Healthcare of Illinois, Inc.*</u>, 2006 WL 2371457 (7th Cir. Aug. 17, 2006)

The Seventh Circuit affirmed an Illinois district court's summary judgment for defendants, in which a *qui tam* relator alleged that a pharmacy and its parent company violated the FCA by submitting Medicaid claims for recycled and repackaged drugs, which may have been previously paid for by the Medicaid program. The court ruled that this theory of liability requires a showing of at least one instance where two separate Medicaid charges were submitted for the same pill. Because the relator was not able to meet this requirement, the court affirmed the lower court's decision.

In 1998, Denise Crews was working as a pharmacist at an NCS Healthcare-owned pharmacy, when the pharmacy was raided by law enforcement personnel. Eventually, NCS pled guilty to one count of misbranding drugs under the federal Food, Drug and Cosmetic Act, for the repackaging and recycling of drugs without regard to lot numbers or expiration dates. *See* 21 U.S.C. § § 331(b),(k), 333(a)(1). In addition, Crews's supervisor Jeff Connell pled guilty to causing an employee to submit a false certification in connection with federal regulations regarding the storage and handling of controlled substances. *See* 18 U.S.C. § § 1001, 2.

In 1999, Crews filed an FCA *qui tam* complaint, alleging that NCS submitted false claims to Medicaid by submitting claims for medications that had been recycled, repackaged, and previously paid for by Illinois Medicaid for another patient. She further alleged that NCS resold medications that had been returned by nursing homes without crediting Medicaid for the returned medications. She also alleged that NCS submitted false claims by dispensing medication without regard for expiration dates and lot numbers. The district court, however, granted summary judgment for the defendants, explaining that Crews did not point to any particular claim that was false. Crews appealed the decision to the Seventh Circuit.

Must Tie One Particular Recycled Drug To A Particular False Claim

Crews argued that "basic math proves that 6% to 12% of recycled drugs would have been [re]distributed to Medicaid recipients [and thus rebilled to the Medicaid program]." The court of appeals, uncomfortable with this mathematical extrapolation, reduced the legal question to whether Crews had to "tie one particular recycled medication to a particular false claim."

While the Seventh Circuit cited cases from three other circuits, it was most persuaded by the reasoning in a Third Circuit decision, *United States ex rel. Quinn v. Om-*

nicare, Inc., 382 F.3d 432 (3d Cir. 2004), which, when faced with nearly identical facts, required the relator "to establish, in at least one instance, that a given pharmaceutical had been paid for by Medicaid, returned to the pharmacy, and then redispensed and rebilled to Medicaid." *Quinn,* 382 F.3d at 440. In the case at bar, the court of appeals determined that Crews did not meet this burden:

> [S]imply by chance, all recycled drugs could have wound up in the hands of non-Medicaid patients. Statistically unlikely, to be sure, but possible. In fact, Crews introduces no evidence that that is not what happened. The burden is on Crews to show the link between two vouchers that represent two separate charges for the same pill, a burden Crews fails to carry.

Moreover, the Seventh Circuit, borrowing yet again from *Quinn*, found that the claims also could not be false, for "there [are] no regulatory requirement of the reversal of a claim once a medication [has] been returned." Therefore, "if there is no requirement to adjust the claim, there is no liability for a failure to do so."

Accordingly, the Seventh Circuit affirmed the lower court's decision.

B. Statutory Immunity

U.S. ex rel. Parikh v. Premera Blue Cross, Case No. C01-0476P (W.D. Wa. Sept. 22, 2006)

In an FCA *qui tam* action against a Medicare Fiscal Intermediary, a Washington district court, rejecting a reading endorsed by the Eleventh Circuit in *United States ex rel. Body v. Blue Cross and Blue Shield of Alabama, Inc.*, 156 F.3d 1098 (11th Cir. 1998), held that 42 U.S.C. § 1395h(i) does not establish absolute immunity for intermediaries. Instead, the court found that Congress merely intended to provide qualified immunity for certain "certifying and disbursing officers" defined in Sections 1395h(i)(1) and (2).

From October 1998 to May 2002, Girish Parikh worked as an appeals coordinator and as a government program auditor for Premera Blue Cross, a Medicare Fiscal Intermediary that processes claims for the states of Washington and Alaska. After bringing concerns of fraud to his employer, Parikh was fired. Parikh subsequently brought an FCA *qui tam* action against his former employer, alleging that the Medicare Fiscal Intermediary submitted false claims to the Center for Medicaid and Medicare Services (CMS) for services that it did not render. Parikh also alleged that the company failed to collect overpayments it made to health care providers. Premera countered by filing a motion to dismiss, arguing that 42 U.S.C. § 1395h(I) shielded Premera with full immunity from FCA liability.

Plain Language Does Not Grant Full Immunity for Medicare Fiscal Intermediaries

In assessing the defendant's argument, the court first turned to the relevant statutory language of 42 U.S.C. § 1395h(I). The statute addresses liability for contractors and carriers of Medicare benefits. In relevant part, the statute reads:

> (1) No individual designated pursuant to an agreement under this section as a certifying officer shall, in the absence of gross negligence or intent to defraud the United States, be liable with respect to any payments certified by him under this section.
>
> (2) No disbursing officer shall, in the absence of gross negligence or intent to defraud the United States, be liable with respect to any payments by him under this section if it was based upon a voucher signed by a certifying officer designated as provided in paragraph
>
> (1) of this subsection.
>
> (3) No such agency or organization shall be liable to the United States for any payments referred to in paragraph (1) or (2).

42 U.S.C. § 1395h(I) (2002).

The court found that Congress did not intend for this statement to establish absolute statutory immunity for intermediaries, but rather qualified immunity as given to the certifying and disbursing officers in paragraphs (1) and (2).

Premera, however, claimed that the words "any payments" in subsection (3) referred to those payments made by certifying or disbursing officers, and not to the limiting clause "in the absence of gross negligence or intent to defraud the United States." The crux of Premera's argument was that if Congress had intended to apply the words "in the absence of gross negligence or intent to defraud the United States," to agencies or organizations such as Premera, it would have explicitly included the language in the statute.

On the other hand, Parikh stated that the plain language of the statute indicates that Congress intended limited immunity. The clause "payments referred to in paragraph (1) or (2)" directly refers back to the two previous subsections, in which immunity is explicitly qualified. On policy grounds, Parikh asserted that it does not make sense for Congress to want to shield organizations, even non-profit organizations, from liability for intentionally defrauding the government.

Another clue to Congress' drafting intent is the way the term "payments" is referred to in the title of the section. The title reads: Liability of certifying and disbursing officers under agreement for *negligent, etc., payments.* 42 U.S.C. § 1395h(i)[emphasis added]. The court therefore read subsection (3) to mean intermediary agencies and organizations are immune from liability for any payments made by their certifying or disbursing officers, in the absence of gross negligence or intent to defraud the United States.

Legislative History And Subsequent Statute Clarifies Scope Of Immunity

Next turning to the underlying legislative history, the court noted that the accompanying conference report provides explicit insight into the Congressional intent: "The Senate amendments [Nos. 55 and 129] . . . would grant agencies and organizations authorized to make payments under Part A . . . the same immunity from liability for incorrect payments . . . as would be provided their certifying and disbursing officers." H.R. Conf. Rep. No. 89-682, at 2231 (1965).

Perhaps even more convincing, in 2003, Congress enacted the Medicare Prescription Drug, Improvement, and Modernization Act (MMA), which explicitly limited intermediaries' immunity in the language of the statute to those acts performed without reckless disregard of its obligations or with intent to defraud the United States. While this provision does not apply retroactively, the supporting legislative history, nonetheless, stated that the new statute merely "clarified" the interpretation of the earlier statute. In turn, the court construed this clarification to mean that qualified immunity for fiscal intermediaries like Premera was Congress' original intention.

Body Rejected

In support of its claim for unqualified statutory immunity, Premera cited two 11th Circuit cases, *United States ex rel. Body v. Blue Cross and Blue Shield of Alabama, Inc.*, 156 F.3d 1098 (11th Cir. 1998) and *United States ex rel. Sarasola v. Aetna Life Ins.*, 319 F.3d 1292 (11th Cir. 2003). Both of these decisions held that Congress intended for the statute to "give[] fiscal intermediaries full immunity from liability for payments that are certified by its certifying officers and issued by its disbursing officers." *Body*, 156 F.3d at 1111. However, neither the *Body* nor the *Sarasola* court considered the insight provided by the MMA of 2003 because they were decided prior to its enactment.

Accordingly, in light of the ambiguity of the old statute and the clarification provided by the recently enacted MMA and the Congressional language regarding intent, the court interpreted subsection (3) of 42 U.S.C. § 1395h(i), as enacted in 1965, to mean that fiscal intermediaries are granted limited immunity. In turn, the court denied Premera's motion to dismiss.

C. *Res Judicata*

***U.S. ex rel. Sarafoglou v. Weill Medical College of Cornell University*, 2006 WL 2615510 (S.D.N.Y. Sept. 12, 2006)**

A New York district court, granting in part and denying in part an FCA defendant's motion to dismiss, ruled that in the *qui tam* context, the relator is in privity with the government, such that, if *res judicata* is deemed applicable against the government, then a relator's claims under the FCA are foreclosed as well. Thus, *res judicata* barred the relator's FCA allegations against a medical college and specific individuals who were released under an earlier settlement agreement, even though the relator's complaint asserted greater misconduct regarding a specific grant than was asserted in the settlement agreement or the government's complaint.

In September 2003, Dr. Kyriakie Sarafoglou brought an FCA *qui tam* action against several defendants, including his former employers Weill Medical College of Cornell University and New-York Presbyterian Hospital (NYPH), an affiliate of Cornell, alleging, *inter alia,* that the defendants violated the FCA by (1) submitting false claims to obtain federal research funds, and (2) retaliating against her when she expressed concerns to her supervisors about the false claims.

After two years of investigating the allegations, the government partially intervened in the case in June 2005. At the same time that the government decided to intervene, it also reached a settlement with Weill. The settlement released Cornell Medical and the individual defendants from certain claims under the FCA. NYPH was explicitly not covered by the settlement agreement.

In October 2005, Sarafoglou decided to pursue her FCA *qui tam* action against the defendants, pursuing claims that she asserted were not covered by the settlement agreement, including claims under the FCA anti-retaliation provision and claims raising allegations in connection with a federal grant not mentioned in the settlement agreement. The defendants moved to dismiss the complaint, arguing, *inter alia,* that the claims were barred under the principles of *res judicata* and that the claims did not satisfy the particularity requirements of Rule 9(b).

Relator Is in Privity With Government for the Purposes of *Res Judicata*

Under the doctrine of *res judicata,* a subsequent action is barred where: (1) the prior action concluded with a final adjudication on the merits; (2) the prior claims and the current claims involve the same parties or those in privity with them; and (3) the claims asserted in the present action were, or could have been, asserted in the prior action because they arise from a common nucleus of operative fact. *See Monahan v. New York City Dep't of Corr.,* 214 F.3d 275, 285 (2d Cir. 2000).

Pointing to a Ninth Circuit decision, the district court ruled that in the *qui tam* context, the relator is in privity with the government. *See United States ex rel. Barajas v. Northrop Corp.,* 147 F.3d 905, 910 (9th Cir.1998). Thus, if *res judicata* is deemed applicable against the government, then a relator's claims are foreclosed as well.

In turn, after the court determined that the false claims from the amended complaint all arose from the same nucleus of operative fact as the settlement agreement, the court ruled that they were foreclosed under principles of *res judicata*. *See Barajas,* 147 F.3d at 910–11 (barring an FCA claim under *res judicata* because it was part of the same transactional nucleus of fact as a previous FCA claim brought by the government.)

Nevertheless, the relator asserted that the false claims in her amended complaint were not covered by the government's complaint-in-intervention or the settlement agreement. In particular, the relator argued that her complaint provided a level of detail that was not present in the settlement. The court, however, stressed that "the mere fact that the plaintiff alleges greater misconduct in the amended complaint is of no consequence because ultimately all the false claims in the current complaint are based on the same nucleus of operative fact." *See, e.g., Waldman v. Vill. of Kiryas Joel,* 207 F.3d 105, 110–11 (2d Cir. 2000) ("[C]ases consistently hold that the facts essential to the barred second suit need not be the same as the facts that were necessary to the first suit.").

Thankfully for the relator, the court only applied this ruling to allegations involving the specific grant settled in the FCA action. In turn, to the extent that the relator's false claims related to a different grant, the court ruled that these claims were not barred by *res judicata*, for false statements and claims made in connection with a different grant would not be part of the same transactional nucleus of fact. Moreover, the court noted that the settlement agreement explicitly provided that NYPH was not released and that NYPH was not covered by its terms. Thus, none of the claims against NYPH, including the false claims, the conspiracy to submit false claims, and retaliation, were barred by *res judicata*.

D. No Request for Government Funds

<u>*U.S. ex rel. McCandliss v. Sekendur*</u>, 2006 WL 2644954 (N.D. Ill. Sept. 12, 2006)

An Illinois district court, in refusing to grant an FCA *qui tam* relator's motion for summary judgment, ruled that a genuine issue of material fact existed where a defendant lied to one of two government agencies and where only one of the agencies actually paid out money. The court, quoting a Seventh Circuit decision, ruled that "the fraudulent statement's purpose must be to coax a payment of money from the government."

On February 20, 1992, Batur Sekendur filed what appears to be his second application for disability benefits with the SSA, asserting disability since May 7, 1991 based on symptoms of "chronic neck sprain, fibromyositis, depression, migraine, headaches, allergies, chronic fatigue." During the same time period of the alleged onset of Batur's disability and his submissions to the Social Security Administration (SSA) to obtain disability benefits, Batur applied to the FAA for his First Class Medical Certification for his Student Pilot Certificate on October 17, 1991. In the FAA Certificate, Batur stated that he did not "ever" have or "have now" any of the listed impairments or conditions on the form, including frequent or severe headaches, hay fever or allergy, mental disorders of any sort such as anxiety or depression, "admission to hospital," or other illness, disability, or surgery.

In September 1994, while Batur's claim for disability was near to being granted, Batur's brother Oral opened One Visit Dental Center, which offered patients crowns and inexpensive, quickly-made dentures, using Batur's dental license and listing Batur as the owner. When the State of Illinois brought charges against Oral for practicing dentistry without a license and against Batur for aiding and abetting Oral by permitting Oral to use his name and license for One Visit Dental, Batur admitted to working occasionally since being awarded disability benefits.

In August 2002, Glen McCandliss, an attorney whom Batur had originally hired to sue his private disability insurer and whom Batur later sued for malpractice, filed an FCA *qui tam* action against Batur and Oral alleging that Batur filed false claims for disability benefits with the SSA and Oral Sekendur conspired with him. After the government declined to intervene, the two parties filed cross-motions for summary judgment.

Concluding that genuine issues of material fact existed in the case, the court quickly denied both parties' motions for summary judgment. Specifically, the court emphasized that the issue of whether Batur lied to the SSA to receive benefits or lied to the FAA was a crucial distinction under the FCA. Of the two federal agencies, only the SSA paid out money on a claim to Batur, and therefore, according to the court, Batur is liable under the FCA only if he lied to the SSA. *See United States ex re. Gross v. AIDS Research Alliance-Chicago*, 415 F.3d 601 (7th Cir. 2005) (under the FCA "the fraudulent statement's purpose must be to coax a payment of money from the government").

A. Rule 9(b) Failure to Plead Fraud with Particularity

U.S. ex rel. Singh v. Bradford Regional Medical Center, 2006 WL 2642518 (W.D. Pa. Sept. 13, 2006)

A Pennsylvania district court, rejecting a defendant's Rule 9(b) motion to dismiss, ruled that Rule 9(b) does not require an FCA *qui tam* relator to identify an actual false claim that was submitted to the government. Instead, Rule 9(b) merely requires relators to plead with particularity the "circumstances" of the alleged fraud, so as to place the defendants on notice of the precise misconduct with which they are charged.

Physicians Dilbagh Singh, Paul Kirsch, Rao Nadella, and Martin Jacobs filed an FCA *qui tam* action against the medical center and various other entities and individuals, alleging that a fraudulent scheme arose out of Bradford Regional's equipment sublease with V & S Medical Associates, LLC, an entity owned by defendant-doctors Vaccaro and Saleh, who are medical staff physicians at Bradford Regional. Specifically, the relators alleged that false claims were presented by physicians to whom the defendants provided kickbacks; physicians to whom the defendants provided illegal remuneration; and/or physicians with whom the defendants entered into prohibited financial relationships in violation of the Medicare anti-kickback statute, 42 U.S.C. § 1320a-7b(b), and the prohibition on physician "self-referrals" contained in the Stark Law, 42 U.S.C. § 1395nn.

The defendants filed a motion to dismiss, arguing that the complaint failed to satisfy the particularity requirements of Rule 9(b); that the complaint failed to state a claim upon which relief could be granted, for the Complaint failed to allege any violations of the Stark Law; and that the complaint based its FCA allegations on certifications that allegedly were made in a Medicare cost report that could not have been filed prior to the filing of the complaint.

Rule 9(b) Does Not Require Identification Of A Specific Claim

The court, in rejecting the defendants' burdensome Rule 9(b) reading, quoted the controlling Third Circuit case law: "Rule 9(b) requires plaintiffs to plead with particularity the 'circumstances' of the alleged fraud in order to place the defendants on notice of the precise misconduct with which they are charged, and charges of immoral and fraudulent behavior. It is certainly true that allegations of 'date, place or time' fulfill these functions, but nothing in [Rule 9(b)] requires them." *Seville Industrial Machinery Corp. v. Southmost Machinery Corp.*, 742 F.2d 786, 791 (3d Cir. 1984).

The district court also observed that other courts presented with fraud schemes similar to the scheme alleged in the present case have also concluded that Rule 9(b) is satisfied without requiring specific identification of claims. *See, e.g., United States* ex rel. *Thompson v. Columbia/HCA Healthcare Corp.*, 20 F. Supp. 2d 1017, 1049 (S.D. Tex. 1998) ("The basic framework, procedures, the nature of fraudulent scheme, and the financial arrangements and inducements among the parties and physicians that give rise to Relator's belief that fraud has occurred have been alleged with specificity; Plaintiffs are entitled to discovery before being required to list every false claim, its dates, the individuals responsible, and why each patient was not eligible for Medicare.").

And, perhaps most telling, the United States Supreme Court, in a case concerning the limitations period for RICO claims, commented on Rule 9(b) in conjunction with the flexibility under Rule 11(b)(3), noting that Rule 9(b)'s particularity requirements are relaxed where the plaintiff lacks access to all facts necessary to detail his claim. *Rotella v. Wood*, 528 U.S. 549, 560 (2000).

Key Distinction Between Motion To Dismiss Versus Summary Judgment Stage Of Litigation

Highlighting a common mistake, the court also stressed the different pleading requirements at the motion to dismiss stage of litigation versus the summary judgment stage. Indeed, the court pointed to a recent Third Circuit decision to underscore the difference. In *United States* ex rel. *Quinn v. Omnicare, Inc.*, 382 F.3d 432 (3d Cir. 2004), the court of appeals required the relator to identify a specific claim. However, the court distinguished *Quinn* from the case at bar, as it "did not involve a motion to dismiss but, rather, review of a summary judgment decision where the failure to establish an element essential to its case, *i.e.*, the actual submission of a claim to the government for payment, meant there was no issue of material fact to be decided." Significantly, the relator's claims in *Quinn* were not dismissed at the motion to dismiss stage.

Clausen and *Karvelas* Clarified

The defendants attempted to counter this distinction by offering up a laundry list of decisions from the other circuits. However, the court disagreed with the defendants on the significance of their supporting case law, in particular *United States ex rel. Karvelas v. Melrose-Wakefield Hospital*, 360 F.3d 220 (1st Cir. 2004), *United States ex rel. Clausen v. Laboratory Corporation of America*, 290 F.3d 1301 (11th Cir. 2002) and *United States ex rel. Schmidt v. Zimmer*, 2005 WL 1806502 (E.D. Pa. July 29, 2005).

The district court took painstaking efforts to emphasize that the Eleventh Circuit's *Clausen* decision does not require identification of specific claims. Indeed, in an Eleventh Circuit decision issued after *Clausen*, the court of appeals ruled that a complaint that failed to identify specific claims for payment submitted by the defendant satisfied Rule 9(b). *United States ex rel. Hill v. Morehouse Medical Associates, Inc.*, 2003

WL 22019936 (11th Cir. 2003). The Eleventh Circuit explained that *Clausen* merely required that "some indicia of reliability must be given in the complaint to support the allegation of fraud" to satisfy Rule 9(b). *Hill*, 2003 WL 22019936, *3. The *Hill* panel also explicitly stated that "failure to allege patient names and the exact dates that claims were submitted to the government . . . is not fatal to a claim under the FCA." *Hill*, 2003 WL 22019936, n. 8. In a later case, the Eleventh Circuit, once again, ruled that a relators' complaint satisfied Rule 9(b) despite the fact that the relators did not identify specific claims for payment. *United States* ex rel. *Walker v. R & F Properties of Lake County, Inc.*, 433 F.3d 1349, 1353 (11th Cir. 2005). Thus, the court vehemently denied that *Clausen* stands for the proposition that identification of specific claims is required to satisfy Rule 9(b) at the motion to dismiss stage.

As for the defendants' reliance on *Karvelas* and *Schmidt*, the district court pointed out that both of these decisions relied on and agree with *Clausen* without adding any new reasoning.

Complaint Satisfied Rule 9(b) Without Identifying Specific Claims

Turning the court's attention to the facts of the case, the court failed to see how requiring the relators to provide a single claim example would put the defendants in a better position to answer and defend against the claims. Agreeing with the relators, the court determined that the falsity of the claims did not turn on anything unique to any individual claim or that would be revealed from an examination of any claim, but rather that the claims were "false because of the improper financial arrangements between [Bradford Regional] and the physicians." Specifically, the relators alleged that Bradford Regional entered into an improper financial relationship with V & S Medical Associates and the defendant-doctors. The relators further alleged that every claim submitted as a result of a referral from the defendant-doctors was false. In turn, the "addition of specific identifying information of each claim would add little to complete the description of the scheme since the fraudulent conduct at issue does not rely on any specific claim."

Accordingly, the court ruled that the complaint satisfied the particularity requirements of Rule 9(b).

The defendants also argued that the Stark Law does not apply to the lease at issue in this case and thus the complaint failed to state a Stark Law claim upon which relief could be granted. In addition, the defendants argued that the relators' FCA claims should be dismissed since the certifications that allegedly were made in a Medicare cost report could not have been filed prior to the filing of the *qui tam* complaint. Without explaining further, the court concluded that it was premature to determine these issues at this stage as it clearly required the introduction of evidence.

In turn, the district court denied the defendants' motion to dismiss.

__Leon v. IDX Systems Corporation__, 2006 WL 2684512 (9th Cir. Sept. 20, 2006)

The Ninth Circuit affirmed a Washington district court's dismissal of an FCA retaliation suit, where the plaintiff-employee's destruction of data on an employer-owned laptop prejudiced the defendant-employer. The court ruled that dismissal was warranted in this case, for lesser sanctions would not have appropriately addressed the employee's conduct and the employee's deliberate actions "undermined the integrity of the judicial proceeding."

Starting in 2001, Dr. Mauricio Leon worked as the director of medical informatics at IDX Systems Corporation. In mid-2002, Leon began complaining of mismanagement of the Standards-Based Interoperable Guideline System (SAGE) project, claiming that there were irregularities in the financing and reporting of the federally-funded project. On April 25, 2003, after putting Leon on unpaid leave, IDX brought an action for declaratory relief, seeking to establish that it could terminate Leon's employment without violating the anti-retaliation provisions of the FCA, SOX, and the ADA. On May 20, 2003, Leon filed his own action, which included, *inter alia*, claims for retaliation under the FCA anti-retaliation provision.

Leading up to the litigation of these claims, IDX's attorneys sent letters to Leon's attorney, requesting that Leon return an IDX-issued laptop. In response, Leon's attorney asked if Leon could keep his laptop for the duration of an audit of the SAGE project. Subsequently, IDX's counsel stated that Leon could keep the laptop for the specific purpose of responding to the auditors; however, IDX cautioned that Leon should take care to preserve all data.

After the audit was completed, Leon retuned the laptop to IDX. However, prior to returning the computer, Leon admittedly deleted entire directories of personal files. Moreover, before he shipped the computer back to IDX, he wrote a program to "wipe" any deleted files from the unallocated space in the hard drive. IDX's expert concluded that more than 2,200 files had been deleted. After receiving this information, IDX moved for dismissal of Leon's action based on his intentional spoliation of evidence.

After the court found that Leon acted in bad faith, the district court dismissed all of Leon's claims with prejudice after determining that Leon despoiled evidence by deleting the files from his IDX-issued laptop computer. The court also imposed a $65,000 monetary spoliation sanction. Leon appealed the decision to the Ninth Circuit.

The court of appeals first turned its attention to the destruction of evidence. Under the controlling case law, a party's destruction of evidence qualifies as willful spoliation if the party has "some notice that the documents were *potentially* relevant to the litigation before they were destroyed." *United States v. Kitsap Physicians Serv.*, 314 F.3d 995, 1001 (9th Cir. 2002) (emphasis added). In the case at bar, the Ninth Circuit ruled that

the district court's finding that Leon acted in bad faith was not clearly erroneous. The court concluded that Leon's actions constituted willful spoliation because he knew he was under a duty to preserve all data on the laptop, but he intentionally deleted many files and then wrote a program to write over deleted documents.

The court then address whether dismissal was the appropriate action. Dismissal is an available sanction when "a party has engaged deliberately in deceptive practices that undermine the integrity of judicial proceedings" because "courts have inherent power to dismiss an action when a party has willfully deceived the court and engaged in conduct utterly inconsistent with the orderly administration of justice." *Anheuser-Busch, Inc. v. Natural Beverage Distribs.*, 69 F.3d 337, 348 (9th Cir. 1995) (internal quotation marks and citations omitted). Before imposing the "harsh sanction" of dismissal, however, the district court is cautioned to consider the following factors: "(1) the public's interest in expeditious resolution of litigation; (2) the court's need to manage its dockets; (3) the risk of prejudice to the party seeking sanctions; (4) the public policy favoring disposition of cases on their merits; and (5) the availability of less drastic sanctions." *Id.*

In the case at bar, the lower court found that IDX would be prejudiced by Leon's deletion of the files, especially since there was no way of recreating the contents of these files. Likewise, the court of appeals easily walked through the remaining factors, each time siding with IDX. Indeed, the only factor weighing against dismissal was "the public policy favoring disposition of cases on their merits," which, standing alone, was "not sufficient to outweigh the other four factors."

Under its "inherent powers," a district court may also award sanctions in the form of attorneys' fees against a party or counsel who acts "in bad faith, vexatiously, wantonly, or for oppressive reasons." *Primus Auto. Fin. Servs., Inc. v. Batarse,* 115 F.3d 644, 648 (9th Cir. 1997) (discussing a sanction against an attorney)

Leon's only argument on appeal was that the sanction was "excessive" because not all the attorneys' fees requested by IDX were attributable to the spoliation issue. The district court, however, found that IDX's accounting of fees was reasonable. Upon reviewing the record on this issue, the Ninth Circuit, again, found no clear error in the district court's determination.

Accordingly, the court of appeals found that the district court did not abuse its discretion when it dismissed Leon's action and when it imposed a monetary sanction.

The Heart Doctors, P.S.C. v. Layne, 2006 WL 2692694 (E.D. Ky. Sept. 13, 2006)

A Kentucky district court refused to allow an FCA defendant to bring a breach of contract action against a third party based on the allegations raised in a settled FCA action. The court ruled that the defendant could not bring any claim against any party seeking to offset their FCA liability, including any state law claims that, if prevailed on, would end in the same result.

Sandra Ramney, a nurse formally employed at The Heart Doctors, P.S.C. in London, Kentucky, successfully brought an FCA *qui tam* action against her former employer,

in which she alleged that the company had violated billing rules that required a physician's presence and direct supervision when chemotherapy is being administered. Specifically, Ramney alleged that staff physician Dr. Layne was not present when certain chemotherapy services were provided and that she administered such services without any supervision. After Layne admitted that he had committed these billing violations, the company ultimately paid $434,180 to the United States pursuant to a settlement agreement. Layne was not a party to the *qui tam* action or to the settlement agreement.

The Heart Doctors subsequently filed a breach of contract claim against Layne based on the allegations raised in the FCA action. Layne moved for summary judgment, arguing that a defendant in an FCA action cannot seek indemnification from a third party. In response, the company argued it was not asserting an indemnification claim against Layne but was instead asserting a breach of contract claim.

In *Mortgages, Inc. v. United States District Court*, 934 F.2d 209 (9th Cir. 1991), the Ninth Circuit addressed this issue. In that case, the defendants in an FCA action filed third party complaints against the *qui tam* plaintiffs asserting various state law claims pursuant to each of which the FCA defendants sought indemnification and/or contribution against any judgment in favor of the United States. *Id.* at 210–11. The Ninth Circuit concluded that there was no basis for recognizing a right of contribution or indemnification in FCA *qui tam* actions. The *Mortgages* court found that the FCA did not expressly grant a right of indemnification to defendants and that there was nothing in the statute's legislative history that mentioned contribution or indemnification. Furthermore, the FCA did not intend to "ameliorate the liability of wrongdoers by providing defendants with a remedy against a *qui tam* plaintiff with 'unclean hands.'" *Id.* The court of appeals determined that, because there was "no basis in the FCA or federal common law to provide a right to contribution or indemnity in an FCA action, . . . there c[ould] be no right to assert state law counterclaims that, if prevailed on, would end in the same result." *Id.* at 214.

The district court also highlighted a district court decision, *United States ex rel. Madden v. Dynamics Research Corp.*, 4 F.3d 827. In *Dynamics Research Corp.*, the district court rejected the arguments that *Mortgages* applies only to FCA defendants seeking a remedy against *qui tam* plaintiffs with unclean hands and that *Mortgages* does not apply to cases in which the FCA defendant's liability is vicarious and not direct. The *Dynamics Research* court stated that the Ninth Circuit's opinion "relies very little on the fact that the defendant in its case was seeking damages from a *qui tam* plaintiff" and that "nothing in the Ninth Circuit's federal common law analysis suggests that the court would have arrived at a different conclusion if the potential indemnitee had been a third party . . . instead of a *qui tam* plaintiff."

The district court followed suit, holding that the company may not now bring any claim against any party seeking to offset their FCA liability including any state law claims that, if prevailed, on would end in the same result. Accordingly, the court dismissed the company's complaint.

U.S. ex rel. Fullington v. Parkway Hospital, Inc., 2006 WL 2766075 (E.D.N.Y. Sept. 19, 2006)

In a partially intervened FCA *qui tam* action, a New York district court, interpreting the automatic stay exception outlined in Bankruptcy Code, 11 U.S.C. § 362(b)(4), stayed only those claims in which the government had declined to intervene. The court determined that *qui tam* relators do not qualify as a "governmental unit" for the purposes of the stay exception.

U.S. ex rel. Stierli v. Shasta Services Inc., 2006 WL 2585524 (E.D. Cal. Sept. 8, 2006)

A California district court denied an FCA defendant's motion for attorneys' fees under 31 U.S.C. § 3730(d)(4), for the defendant did not qualify as a "prevailing party," where the government had sought and obtained dismissal of the underlying FCA *qui tam* action. Moreover, the court stressed that the *qui tam* claim was not *per se* unreasonable or without foundation simply because the relator did not ultimately prevail.

U.S. ex rel. SNAPP, Inc. v. Ford Motor Company, 2006 WL 2583257 (E.D. Mich. Sept. 7, 2006)

A Michigan district court, in ruling that a *qui tam* action fell outside of the FCA statute of limitations, ruled that the three-year tolling provision, 31 U.S.C. § 3731(b)(2), only applies to cases in which the government intervenes.

U.S. ex rel. Fowler v. Caremark Rx, Inc., 2006 WL 2425331 (N.D. Ill. Aug. 21, 2006)

An Illinois district court, in dismissing an FCA *qui tam* action alleging that a defendant-pharmacy benefit management company defrauded the government, ruled that the complaint did not satisfy Rule 9(b) where the complaint did not tie a specific fraudulent transaction to an invoice submitted to the government. Notably, the court reached its conclusion with very little discussion, case law, or legal analysis.

Giles v. United States, 2006 WL 2173145 (Fed. Cl. Aug. 3, 2006)

The Court of Federal Claims, granting an FCA defendant's motion to dismiss, ruled that it did not have jurisdiction to hear *qui tam* actions, for 31 U.S.C. § 3732(a) confers exclusive jurisdiction to the district courts to hear such claims.

U.S. ex rel. Hill v. Morehouse Medical Associates, Inc., 236 F.R.D. 590 (N.D. Ga. July 17, 2006)

A Georgia district court granted an FCA *qui tam* relator's motion for discovery sanctions against a defendant. The court levied sanctions after the defendant failed to complete production of medical records in the suit alleging submission of false Medicare claims, despite being warned that failure to timely comply with the court's discovery

orders would subject the defendant to severe sanctions. The defendant is prohibited from using any improperly withheld and untimely disclosed evidence, including any of the medical records at issue. Moreover, the defendant was ordered to pay the relator's attorneys' fees incurred in filing her motion for sanctions.

United States v. Dynamics Research Corp., 2006 WL 2007649 (D. Mass. July 17, 2006)

In a government-initiated FCA action against a defense contractor, the contractor filed a third-party complaint against two of its subcontractors, alleging common law indemnification and contribution. The subcontractors filed motion to dismiss in a Massachusetts district court. The court, in granting the motion to dismiss, ruled that counterclaims for indemnification and contribution are unavailable to third-party defendants in FCA actions.

Hoyte v. American National Red Cross, 2006 WL 1971710 (D.D.C. July 14, 2006)

A District of Columbia district court granted a defendant's motion to dismiss an FCA anti-retaliation action, on the grounds that the activity the plaintiff-employee engaged in could not have led to a viable FCA claim against the defendant.

Anderson v. McTish, Kunkle & Associates, 2006 WL 1985762 (M.D. Pa. July 13, 2006)

A Pennsylvania district court refused to dismiss an FCA anti-retaliation action, after ruling that the complaint sufficiently stated a cause of action under 31 U.S.C. § 3730(h). Specifically, the plaintiff alleged that he was laid off after challenging the legality of his employer's activities, those activities included fraudulent conduct which resulted inflated claims for payment to the Federal Highway Administration, and he was ordered to conceal those activities from the government.

Interventions & Suits Filed/Unsealed

JULY 1–SEPTEMBER 30, 2006

U.S. *ex rel.* McBride v. Kellogg, Brown & Root, (D.D,C.)

According to a *qui tam* lawsuit filed in September 2006, Halliburton subsidiary Kellogg, Brown & Root charged millions to the government for recreational services never provided to U.S. troops in Iraq, including giant tubs of chicken wings and tacos, a widescreen TV, and cheese sticks meant for a military Super Bowl party. Instead, the suit alleged, KBR used the military's supplies for its own football party.

Filed last year in U.S. District Court in Washington, D.C., by former KBR employee Julie McBride, the lawsuit claims the giant defense contractor billed the government for thousands of meals it never served, inflated the number of soldiers using its fitness and Internet centers, and regularly siphoned off great quantities of supplies destined for American soldiers.

McBride was hired by KBR in 2004 as a "morale, welfare and recreation" coordinator at Camp Fallujah, a Marine installation about 35 miles west of Baghdad. She was fired the next year after making several complaints about KBR's accounting practices, the suit says, and was kept under guard until she was escorted to an airplane and flown out of the country.

Representing McBride is attorney Alan Grayson of Grayson Kubli P.C. (McLean, VA).

U.S. *ex rel.* Ven-A-Care v. Dey, Inc., (D. MA)

In September 2006, the federal government intervened in an FCA *qui tam* suit filed against Dey, Inc. The suit, filed in the District of Massachusetts, was brought by Ven-A-Care of the Florida Keys Inc., a small provider of home drug-infusion services, which has filed several other drug-pricing cases alleging pharmaceutical firms violated the False Claims Act.

The government's complaint-in-intervention against Dey alleges that the Medicare and Medicaid programs have provided Dey's health care provider and pharmacy customers with more than $500 million in reimbursement for the drugs that are the subject of the complaint. According to the government, starting at least as long ago as 1993, Dey reported prices used to help set government reimbursement rates that were more than five times the actual sales prices. The lawsuit includes claims originally filed in federal court in Florida and were subsequently transferred to District Court of Massachusetts.

Medco, (E.D. Pa.) (D.N.J.)

Medco announced that it has learned of two *qui tam* actions, in addition to one currently being settled in the Eastern District of Pennsylvania. Of the new lawsuits, one filed in the Eastern District of Pennsylvania and the other filed in the District of New Jersey, Medco said the actions were sealed, and that each action appears to allege billing violations.

According to Medco, the Pennsylvania case appears to allege the company billed government payors using invalid or out-of-date national drug codes. The New Jersey case appears to allege that Medco charged government payors a different rate than it reimbursed pharmacies; engaged in duplicate billing; refilled prescriptions too soon; and billed government payors for prescriptions written by unlicensed physicians and physicians with invalid Drug Enforcement Agency authorizations.

Medco said the additional whistleblower actions are not being considered in the current settlement negotiations with the Justice Department. Medco said it didn't know the identity of the filers or any other defendants in the actions.

U.S. *ex rel.* Fulp v. Dr. Marquez, (S.D. Tex.)

In September 2006, the U.S. Attorney's Office of the Southern District of Texas intervened in a $5 million lawsuit against Dr. Raul Marquez and two hospitals that Marquez is affiliated with and owns—Cornerstone Regional Hospital and Cornerstone Rehabilitation Hospital.

The investigation began in late 2002, when Dr. Ray R. Fulp, III, an orthopedic surgeon who was working with Marquez, approached federal authorities and alleged that Marquez was defrauding Medicare and Medicaid by billing for services that were not performed. The surgeon later filed the *qui tam* suit.

The government alleges that Marquez ordered his staff to lie in the billing provided for Medicare and Medicaid reimbursement. Specifically, the staff is accused of using improper coding for treatments patients did not receive. They are also accused of telling Medicare that patients had been discharged and sent home when in fact they were transferred to an in-patient rehab center. Medicare reimbursement pays doctors more if a patient is discharged home instead of an inpatient facility for additional treatment.

The relator's lawyer is Daniel Gurwitz of Atlas & Hall, L.L.P. (McAllen, TX).

The investigation was jointly conducted by the Federal Bureau of Investigation, the Office of Inspector General for the Department of Health and Human Services, and the Texas Medicaid Fraud Control Unit. The case will be litigated by Assistant United States Attorney Andrew A. Bobb.

Judgments & Settlements

JULY 1–SEPTEMBER 30, 2006

U.S. *ex rel.* Lee v. Horizon West, Inc., (N.D. Cal.)

In September 2006, Horizon West Inc. and its wholly owned subsidiary, Horizon West Healthcare Inc., agreed to pay the United States **$14.7 million** to settle allegations that the companies falsely inflated the number of nursing hours spent on Medicare patients when reporting their costs to Medicare from 1991 to 1998. The nursing home chain runs approximately 30 facilities in California and Utah. The relator's share has not yet been announced.

The *qui tam* suit was filed in 2000 by Julia Lee, a former Horizon West employee. The relator's attorneys were Don Warren and Philip Benson of Warren Benson Law Group (Newport Beach, CA).

The case was investigated by the U.S. Department of Health and Human Services, Office of Inspector General; and the Federal Bureau of Investigation. The matter was handled by the Justice Department's Civil Division and the U.S. Attorney's Office for the Northern District of California in San Francisco.

U.S. *ex rel.* Hall v. Pediatrix Medical Group Inc., (D.Md.)

In September 2006, Pediatrix Medical Group Inc., whose network of affiliated physician groups provides medical services in various hospital neonatal intensive care units in 32 states and Puerto Rico, agreed to pay the government over **$25 million** to settle allegations that Pediatrix improperly billed Medicaid, TRICARE and the Federal Employees Health Benefits Program for neonatal care provided by their doctors. The company has agreed to abide by the terms of a Corporate Integrity Agreement (CIA) for five years.

According to the settlement agreement, from January 1996 through December 1999, Pediatrix improperly applied CPT billing codes to neonatal services that did not accurately correspond to the medical condition of the infant or the services provided. Specifically, Pediatrix admitted infants to hospital neonatal intensive care units using a CPT code for admission of critically ill infants, when as many as one-third or more of those infants were not, in fact, critically ill. Pediatrix used critical/unstable and critical/stable CPT codes for subsequent days of treatment, when as many as 50 percent or more of those infants were not in fact critically ill. Pediatrix also used critical/unstable and critical/stable CPT codes on discharge days, when as many as 85 percent or more of those infants were not in fact critically ill.

The *qui tam* suit was filed by relator Daniel M. Hall, M.D., a board certified neonatologist. The attorney for the relator was James Ratner of the Law Office of James T. Ratner (Mt. Tremper, NY). As a result of the settlement, Hall will receive $1,557,588, or 6 percent of the total federal recovery.

The investigative work performed by the Offices of the Inspector General for the Department of Health and Human Services and the Office of Personnel Management and by the Defense Criminal Investigative Service. Assistant U.S. Attorneys Roann Nichols and Tarra DeShields, handled the case in Maryland and Assistant U.S. Attorney Edwin Winstead handled the case in the District of Colorado.

The investigation was conducted jointly by the U.S. Attorney's Offices for the Districts of Maryland and Colorado and a team from the Medicaid Fraud Control Units for the states of North Carolina, South Carolina, New Jersey and Maryland.

U.S. *ex rel.* Educational Career Development Inc. v. Central Florida Regional Workforce Development Board, Inc., (M.D. Fla.)

In August 2006, Workforce Central Florida (WCF) and Workforce Central Florida Foundation Inc. agreed to pay the United States **$3,483,664** to settle claims that they defrauded the U.S. Department of Labor and U.S. Department of Health and Human Services.

WCF receives federal grants to provide such services as job placement and training, temporary cash assistance, and special support services such as subsidized child care and transportation. The settlement resolved allegations that WCF and the Workforce Central Florida Foundation violated the False Claims Act by misusing federal grant funds to make improvements to their privately-owned administrative office and by then charging excessive lease costs to federal grants.

The allegations arose from a lawsuit filed by relator Educational Career Development Inc. The relator will receive $627,059, or 18 percent of the share of the proceeds. The lawyer for the relator was Daniel N. Brodersen of Beusse Wolter Sanks Mora & Maire, P.A. (Orlando, FL).

The civil investigation and settlement was handled by the Civil Division of the Justice Department.

U.S. *ex rel.* Chomyn v. Force Protection Inc., (D.S.C.)

In August 2006, Force Protection Inc., a Ladson, South Carolina defense contractor that makes armored vehicles for the Defense Department agreed to pay the government $1.8 million to resolve allegations brought in a *qui tam* lawsuit

The suit claimed that the company used the advance government payments for purposes other than that to which the United States government had intended. The company said the error essentially amounted to depositing the payment into the wrong bank account. The company's vehicles are used Afghanistan and Iraq to find and remove bombs.

The relators, Perry Chomyn and Robin Swain, were two former employees of Force Protection. The relators' attorney was Justin Lucey of Justin O'Toole Lucey, P.A. (Mount Pleasant, SC). The two former employees will receive $315,000, or 18 percent of the share of the proceeds of the settlement,

U.S. v. Schering-Plough, (D. MA)

In August 2006, Schering-Plough agreed to settle a False Claims Act suit for **$255,025,000**. Specifically, Schering will pay $159,502,000, plus interest, to the United States in civil damages for losses suffered by the Medicare program, the federal portion of the Medicaid program, the Veteran's Administration, the Department of Defense and the Federal Employees Health Benefits program as a result of Schering's

improper drug promotion and marketing misconduct, and Medicaid rebate fraud. Schering will also pay a total of $91,602,000, plus interest, to settle its civil liabilities to the fifty states and the District of Columbia for losses the state Medicaid programs suffered. In addition, Schering will refund $3,921,090 to the Public Health Service (PHS) programs that also were entitled to a lower price on certain drugs.

The government alleged that Schering illegally promoted the drug Temodar for types of brain cancer for which it was not then government-approved and did the same by promoting hepatitis and cancer drug Intron A for superficial bladder cancer. Schering told the FDA that the "off-label" promotions in 2001, 2002 and 2003 were isolated incidents. But the government found that they were part of a national plan in which Schering salespeople were trained on how to win off-label sales and were paid for doing so. Tactics included "illegal remuneration" to doctors for "sham advisory boards" and "lavish entertainment." The government also alleged that Schering defrauded Medicaid of $4.3 million in 1998 and 1999 by failing to give the federal and state program for the poor the best price on antihistamine Claritin RediTabs. Schering also gave free drugs to a health maintenance organization in order to secure future purchases. By law, it should then have given Medicaid bigger rebates to ensure that it got the best price for the drug. Schering also underpaid rebates for stomach ailment drug K-Dur.

The civil investigation and settlement were handled by Assistant U.S. Attorneys Susan Winkler, Jennifer Boal, Chief of Sullivan's Civil Division, Gregg Shapiro, and Department of Justice Trial Attorney Andy Mao of the Fraud Section of the Civil Division.

[Note: Schering Sales, part of Schering, agreed to plead guilty to one count of conspiracy for making false statements to the government and to pay a $180 million criminal fine.]

U.S. *ex rel.* Baker v. Rehabilitation Specialists of Livingston County, (E.D. Mich.)

In August 2006, Mark Miller, the former CFO of Rehabilitation Specialists of Livingston County, agreed to pay $1 million to the United States to settle allegations that Miller received Medicare payments to which he was not entitled.

The allegations stated that Miller participated in double billing Medicare for costs associated with the delivery of physical, occupational and speech therapy services during his tenure at the company.

The relator was Robert Baker, a former employee of the outpatient rehabilitation clinic. His attorneys were Justin Ravitz and Patricia Stamler of Sommers Schwartz PC (Southfield, MI). The relator's share has not yet been disclosed to the public.

The investigation was conducted by the Federal Bureau of Investigation and the Department of Human Services, Office of Inspector General. The United States was represented by Assistant United States Attorney Leslie Matuja Wizner.

[Note: This matter is still pending in federal court against other defendants, including Michigan Alled Health Professionals, Rehabilitation Specialists of Livingston County, Rehabilitation Specialists of Macomb County, Bradley Putvin, and Vickey DeYoung.]

U.S. v. Beverly Enterprises Inc., (N.D. Cal.)

In August 2006, Beverly Enterprises Inc. agreed to pay the United States and the State of California **$20 million** to settle allegations against its former wholly owned subsidiary, MK Medical. Beverly has agreed to settle these allegations by paying $14,487,278 to the United States and $5,512,722 to the state of California.

According to the claims, MK Medical submitted false claims for payment to the Medicare and Medi-Cal programs from 1998 until 2002, while Beverly owned the company. The subsidiary, a now-defunct wholesaler of durable medical equipment (DME), billed Medicare and Medi-Cal for DME provided to the programs' beneficiaries without obtaining the proper claims and medical documentation.

The investigation was conducted by the Justice Department's Civil Division, the U.S. Attorney's Office for the Northern District of California in San Francisco, the Office of Inspector General for the Department of Health and Human Services and the Federal Bureau of Investigation.

U.S. *ex rel.* Kirby v. University Hospitals Health System, (N.D. Ohio)

In August 2006, University Hospitals Health System agreed to pay about **$14 million** to settle a lawsuit that alleged some of its affiliated doctors improperly made referrals of Medicare cases. In addition to the settlement payment, the hospital system has agreed to be monitored by the Department of Health and Human Services' Office of Inspector General.

The lawsuit alleged that the system and its primary medical campus, University Hospitals of Cleveland, entered into improper financial arrangements with physicians to motivate them to make referrals of Medicare patients to other doctors within the system.

University Hospitals of Cleveland is an affiliate of Case Western Reserve University. There are nearly 25,000 physicians and employees at the system's partner hospitals, making it one of northern Ohio's largest employers.

Dr. Thomas J. Kirby, a heart surgeon, filed the *qui tam* lawsuit a few months after he was removed from the hospital system's staff. Dr. Kirby was awarded a $1.5 million, or 11 percent of the settlement. The relator's attorney was Robert J. Rotatori of Rotatori, Bender, Gragel, Stoper & Alexander (Cleveland, OH).

Assistant U.S. Attorney Alex Rokakis negotiated the settlement on behalf of the Justice Department.

U.S. *ex rel.* Mallavarapu v. Acadiana Cardiology, (W.D. LA)

In August 2006, Our Lady of Lourdes Regional Medical Center agreed to pay the United States **$3.8 million** to settle claims that they defrauded Medicare, TRICARE and Medicaid from 1999 to 2003

The claims alleged that the facility violated the False Claims Act by submitting claims for medically unnecessary elective angiogram, medically unnecessary elective

angioplasty, and medically unnecessary elective stenting procedures performed at the hospital by Dr. Mehmood Patel.

The allegations arose from a lawsuit filed by Dr. Christopher Mallavarapu, a cardiologist and former professional colleague of Dr. Patel. Dr. Mallavarapu will receive $760,000, or 20 percent of the settlement. The relator was represented by Timothy Basden and Alan Breaud of Breaud & Lemoine, P.L.C. (Lafayette, LA).

The civil investigation and settlement were jointly handled by the Office of the U.S. Attorney for the Western District of Louisiana and the Civil Division of the Justice Department.

U.S. *ex rel.* Carrington v. Age Refining, Inc., (W.D. Tex.)

In August 2006, Age Refining Inc., the company's former affiliate, Age Transportation, and Albert Gonzalez, the founder and chairman emeritus of Age Refining agreed to pay the United States **$9 million** to resolve allegations of false certification in connection with government contracts. The allegations were that the company falsely certified its compliance with the provisions of the Historically Underutilized Business Zone (HUBZone Act of 1997) program in order to entitle the company to a price evaluation preference in connection with bidding for JP-8 jet fuel and other contracts with the Department of Defense. The HUBZone Empowerment Contracting Program was created to stimulate economic development and create jobs in urban and rural communities by providing federal contracting preferences to small businesses. These preferences go to small businesses that obtain HUBZone certification in part by employing staff who live in a HUBZone. The company must also maintain a "principal office" in one of these specially designated areas.

Notably, Age Refining also agreed to reform its business practices and has been decertified as a HUBZone company by the SBA. However, it will become eligible to reapply for HUBZone status in February 2007.

The United States initiated the investigation in response to a *qui tam* action brought by James Carrington, a former employee of Age Refining. As a result of the settlement, Carrington will receive $1.7 million, or 19 percent of the settlement. The relator's attorney was Marlene M. Martin from the Law Office of Marlene M. Martin (San Antonio, TX).

The settlement is the culmination of a joint investigation involving agents and attorneys from the U.S. Attorneys Office in San Antonio; the U.S. Department of Justice; the Defense Criminal Investigative Service, Office of the Inspector General, Department of Defense, U.S. Air Force Office of Special Investigations; U.S. Small Business Administration; and Defense Energy Support Center, Defense Logistics Agency.

U.S. *ex rel.* Vavra v. EGL, Inc., (C.D. Ill.)

In August 2006, EGL, Inc. paid the United States **$4 million** to settle claims based on the company's alleged inflation of invoices for military cargo shipments to Iraq.

Houston-based EGL, operating as Eagle Global Logistics, was a subcontractor for Kellogg Brown and Root, the prime contractor for the U.S. Army's Logistics Civil Augmentation Program (LOGCAP III) contract for logistical support of military operations overseas. The invoices were for shipments of military goods from Dubai to Iraq from late November 2003 through July 2004.

As a result of the settlement, David Vavra and Jerry Hyatt will receive $800,000, or 20 percent of the proceeds, as their relator's share.

The Defense Criminal Investigative Service; Federal Bureau of Investigation; Internal Revenue Service, Criminal Investigation Division; and the U.S. Army Criminal Investigation Division all have participated in the investigation.

[Note: Christopher Joseph Cahill, EGL's former regional vice- president for the Middle East and India, had previously pleaded guilty to adding $1.14 million in fraudulent "war risk surcharges" to the invoices. Cahill also admitted that when he became aware of a government investigation of EGL's charging of the war risk surcharges, he directed a subordinate to create fraudulent invoices purporting to show war risk surcharges billed to EGL.]

U.S. *ex rel.* Relators v. CGI-AMS, Inc., (S.D. Ohio)

In July 2006, CGI-AMS Inc. agreed to pay **$1.53 million** to settle a *qui tam* lawsuit. The computer vendor was known as American Management Systems when the suit was filed in 2002. CGI Group of Montreal acquired it in 2004.

AMS was hired by the former Ohio Department of Human Services in 1997 to install a computer system that would help Ohio's county caseworkers spend less time on data-entry tasks and more time with people in need of benefits. The agency, now called the Department of Job and Family Services, used federal money to pay for the computer system.

Four Ohio state employees, Randall Smith, Michel Wilcox, Alice DeWeese and Ronald Wilinski, exposed questionable billing practices by the computer consulting firm. They said AMS billed the State for unrelated work and billed top dollar for work performed by unqualified employees.

The relators will be paid $232,000, or 15 percent of the settlement. The firms that represented the relators were Volkema Thomas (Cincinnati), Helmer, Martins, Rice & Popham (Cincinnati), and the Nolan Law Firm (Fort Lauderdale, FL).

[Note: The computer system installed by AMS never lived up to its original billing, as it is used by only 42 of Ohio's 88 counties. Today, CGI-AMS is involved in several computer projects for the department, although on a much smaller scale.]

U.S. *ex rel.* Relators v. General Electric Co., (W.D. Ky.)

In July 2006, General Electric Co. (GE) and two of its subcontractors agreed to pay the United States **$11.5 million** to settle a lawsuit that alleged that GE sold defective blades for engines in U.S. military airplanes and helicopters.

The lawsuit alleged quality-control problems over a period of years involving the manufacture of several types of engine blades at GE's Aircraft Engines division facility in Madisonville, KY. These alleged problems included nonconformance in casting and in non-destructive testing. Two subcontractors, Howmet Corp., a subsidiary of Alcoa, and Precision Castparts Corp. manufactured unfinished castings for the blades, which GE then finished at the Madisonville facility. Both subcontractors were also named as defendants.

Several employees of GE's Madisonville facility filed the *qui tam* lawsuit. The relators will be paid $2,357,500, or 20 percent of the settlement. The firms that represented the relators were Volkema Thomas (Cincinnati), Helmer, Martins, Rice & Popham (Cincinnati), and Priddy, Cutler, Miller & Meade (Louisville).

The Defense Criminal Investigative Service, the U.S. Army Criminal Investigation Command, the U.S. Navy Criminal Investigative Service, the U.S. Air Force Office of Special Investigation and the U.S. Department of Transportation, Office of the Inspector General investigated the case. The Defense Contract Audit Agency provided audit support. The Justice Department's Civil Division and the Office of the U.S. Attorney for the Western District of Kentucky negotiated the settlement.

[Note: GE faces a separate lawsuit filed by a former Madisonville plant supervisor, Richard Gardner. He is seeking $50 million, claiming he was fired after testifying before the federal grand jury that investigated the allegations.]

U.S. *ex rel.* Orbeck v. Marion County Medical Center, (D.S.C.)

In July 2006, Marion County Medical Center reached a settlement for **$3.75 million** with the government over accusations of false claims submitted to the Medicare, Medicaid, and Tricare programs.

The allegations involved the high salaries of two doctors and claims for hospital services provided by Marion that were referred, ordered or arranged for by the same physicians whose salaries were paid by Marion. Also, the Center was accused of submitting claims for services that the documentation did not prove actually happened.

Dr. Kenneth Orbeck, a family practitioner and a former employee of the center, was the relator in the case. Dr. Orbeck will receive $610,083, or 16 percent, as his share of the settlement. He was represented by attorney Ernest Nauful from Ernest J. Nauful, Jr., P.C. (Colombia, SC).

U.S. v. Medtronic, Inc., (W.D. Tenn.)

In July 2006, Medtronic, Inc. agreed to pay **$40 million** to the United States based upon allegations about certain sales and marketing practices in the Spinal business.

Two *qui tam* suits alleged that the Medtronic Sofamor Danek division (MSD) paid kickbacks to doctors to induce them to use MSD's spinal products. The government alleged that, between 1998 and 2003, Medtronic paid kickbacks in a number of forms, including sham consulting agreements, sham royalty agreements and lavish trips to desirable locations.

The first lawsuit remains under seal and the whistleblower involved has not been identified. The second, however, was filed by Jacqueline Kay Poteet, a former senior manager of travel services for the company. The government is seeking to dismiss Poteet's case, in order to deprive her of a share of the settlement. The relators' attorney, Andrew Carr of Bateman Gibson (Memphis), has said he would object to the proposed settlement.

The Justice Department's Civil Division, the United States Attorneys' Office in Memphis, the Federal Bureau of Investigation, the Office of Inspector General of the Department of Health and Human Services, the U.S. Postal Service and the Tennessee Bureau of Investigation handled this case.

[Note: Poteet filed a motion in the Western District of Tennessee alleging that "this case has not been adequately investigated" by the U.S. government, and that the $40 million amount is "woefully inadequate."]

U.S. *ex rel.* McNutt v. Haleyville Medical Supplies, Inc., (N.D. Ala.)

In July 2006, Gerald M. Burleson, his wife Frances R. Burleson, and their businesses (Haleyville Medical Supplies, Inc., City Pharmacy of Haleyville, Inc., Care Medical of Jasper, Inc., Care Pharmacy, Inc., and Winfield Medical Supply, Inc.) agreed to pay the United States **$3.14 million** to settle civil healthcare fraud claims.

The healthcare fraud investigation arose out of a *qui tam* lawsuit. Relator Brent McNutt alleged that the Burlesons paid kickbacks to individuals who improperly referred patients to the Burlesons for durable medical equipment and respiratory medications. Although the Burlesons attempted to camouflage the kickbacks as payments to "employees" for services rendered, the "employees" provided minimal to no services. The relator also alleged that Gerald Burleson defrauded Medicare by dispensing a "compounded" medication rather than the medication in fact prescribed by the patient's physician.

The relator's attorneys were Brad Pigott and Cliff Johnson of Pigott Reeves Johnson & Minor (Jackson, MS). The relator's share has not yet been disclosed to the public.

The U.S. Food and Drug Administration Office of Criminal Investigations, Department of Health and Human Services Office of Inspector General, the Federal Bureau of Investigation and the Defense Criminal Investigative Service investigated this case. Assistant United States Attorney Lloyd C. Peeples was the lead attorney in the civil investigation.

[Note: In a related criminal action, Gerald Burleson pled guilty to criminal healthcare fraud and drug misbranding charges arising out of the allegations in the qui tam *suit and was sentenced to serve 18 months in prison.]*

U.S. *ex rel.* Russell v. Odyssey HealthCare, Inc., (E.D. Wis.)

In July 2006, Odyssey HealthCare, Inc. agreed to pay the United States **$12.9 million** to settle allegations that the company submitted false claims to Medicare. Odys-

sey HealthCare also entered into a Corporate Integrity Agreement with the Office of Inspector General of the Department of Health and Human Services. The national hospice provider allegedly billed Medicare for services provided to patients who were not terminally ill, and therefore ineligible for the Medicare hospice benefit.

The settlement, which covered a period from 2001 to 2005, resolved charges originally brought against Odyssey HealthCare by a former regional vice president, JoAnne Russell. As part of the settlement, Russell will receive $2,326,500, or 18 percent of the settlement. The relator's attorney was Nola Hitchcock Cross from Cross Law Firm, S.C. (Milwaukee, WI).

This settlement was the result of a collaborative investigation involving the Department of Justice's Civil Division, the U.S. Attorney's Office for the Eastern District of Wisconsin, the U.S. Attorney's Office for the Southern District of Texas, and the Department of Health and Human Services' Office of the Inspector General.

STATE FCA CASES

Navigant Consulting Inc., (California)

Management consulting services provider Navigant Consulting Inc. announced in September that an arbitrator ruled the company must pay fees relating to a previous dispute with the City of Vernon, CA. The dispute relates to electric distribution maintenance services that a Navigant subsidiary, RMI-US, provided to the City before Nov. 30, 2005. The company no longer provides electric distribution maintenance services.

The arbitrator ordered Navigant to repay Vernon $13.4 million in service fees that the City paid to the company, plus about $23 million in treble damages under the California False Claims Act and roughly $935,000 in cleanup expenses incurred in connection with an oil spill in 2001 at the city's generation station.

The city may also recover attorneys' fees and arbitration costs. Navigant said it "strongly disagrees" with the arbitrators ruling and damages award and will appeal the ruling to a three-judge panel.

Legislative Update

Guidelines for Evaluating State False Claims Acts

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Office of Inspector General Notice
Publication of OIG's Guidelines for Evaluating
State False Claims Acts
71 Federal Register 48552 (Monday, August 21, 2006)

SUMMARY: Under section 1909 of the Social Security Act (the Act), 42 U.S.C. 1396h, the Inspector General of the Department of Health and Human Services is required to determine, in consultation with the Attorney General, whether a State has in effect a law relating to false or fraudulent claims submitted to a State Medicaid program that meets certain enumerated requirements. If the Inspector General determines that a State law meets these requirements, the State medical assistance percentage, with respect to any amounts recovered under a State action brought under such a law, shall be increased by 10 percentage points. This notice sets forth the Inspector General's guidelines for evaluating whether a State law meets the requirements of section 1909 of the Act.

DATES: Effective Date: These guidelines are effective on August 21, 2006.

FOR FURTHER INFORMATION CONTACT: Roderick T. Chen, Office of Counsel to the Inspector General, (202) 401-4134, or Joel Schaer, Office of External Affairs, (202) 619-0089.

SUPPLEMENTARY INFORMATION:

I. Background

Section 1909 of the Act, added by section 6031 of the Deficit Reduction Act of 2005 (Pub. L. 109-171), creates a financial incentive for States to enact legislation that establishes liability to the State for individuals or entities that submit false or fraudulent claims to the State Medicaid program. This incentive takes the form of an increase in the State's share of any amounts recovered from a State action brought under a qualifying law.[1] In order for a State to qualify for this incentive, the State law must meet certain enumerated requirements, as determined by the Inspector General of the Department of Health and Human Services in consultation with the Attorney General.

Medicaid, authorized under Title XIX of the Act, 42 U.S.C. 1396–1396v, is a joint Federal and State program that pays for medical and other related benefits provided to needy beneficiaries. States that participate in Medicaid administer their own programs within broad Federal guidelines and receive matching funds from the Federal government. The Federal share generally varies between 50 percent and 83 percent, depending on the State per capita income.

False or fraudulent claims presented to State Medicaid programs by participating providers and others may give rise to civil liability under the Federal False Claims Act

1. The increase results from a 10-percentage point decrease in the Federal share of any recovery from a State action brought under a qualifying law.

(FCA), 31 U.S.C. 3729–3733. Under the FCA, any person who knowingly submits a false or fraudulent claim to a State Medicaid program is liable to the Federal Government for three times the amount of the Federal Government's damages plus penalties of $5,000 to $10,000 for each false or fraudulent claim. Any recovery of damages to the State Medicaid program will be shared with the State in the same proportion as the State's share of the costs of the Medicaid program. For example, if a State's Medicaid share is 40 percent, then the State would be entitled to receive 40 percent of the damages and the Federal Government would retain 60 percent of the damages.

Under the *qui tam* provisions of the FCA, private persons (known as relators) may file lawsuits in Federal court against individuals and/or entities that defraud the Federal government by filing false or fraudulent Medicaid claims. The Department of Justice (DOJ) has an opportunity to investigate the relator's allegations, and DOJ may intervene and take over the prosecution of the action. If DOJ chooses not to intervene, the relator has the right to conduct the action. In general, with respect to recoveries of Federal damages and penalties in cases in which DOJ has intervened, the relator is entitled to between 15 and 25 percent of the recovery of Federal damages and penalties depending upon the extent to which the relator substantially contributed to the case. In general, the relator is entitled to between 25 and 30 percent of any recoveries of Federal damages and penalties if DOJ has not intervened in the case. Because the FCA applies only to false claims against the Federal Government, the relator is not entitled to a share of the State portion of a Medicaid recovery under the FCA.

Many States have enacted their own false claims acts that establish civil liability to the State for individuals and entities that submit false or fraudulent claims to the State Medicaid program. Generally, these laws include *qui tam* provisions that reward relators with a share of the State portion of recoveries in cases of Medicaid fraud. Currently, if a State obtains a recovery as the result of a State action relating to false or fraudulent claims submitted to its Medicaid program, it must share the damages recovered with the Federal Government in the same proportion as the Federal Government's share in the cost of the State Medicaid program. For example, if a State's Medicaid share is 40 percent, then the State would retain 40 percent of any damages recovered from an individual or entity that has defrauded Medicaid, and the Federal Government would be entitled to the remaining 60 percent of damages.

II. Section 1909 of the Social Security Act

In order to encourage States to pursue Medicaid fraud, Congress added a new section 1909 to the Act, effective January 1, 2007. Under this section, if a State has in effect a State false claims act that meets certain enumerated requirements, the Federal medical assistance percentage will be decreased by 10 percentage points with respect to any amount recovered under a State action brought under such a law. Therefore, the State's share of any recovery in an action under such a law will be increased by 10 percentage points. For example, if a State has a qualifying State false claims act and the State's Medicaid share is 50 percent, the State would be entitled to 60 percent of the

amount of the recovery, while the Federal Government would receive the remaining 40 percent.

Section 1909(b) of the Act requires the Inspector General to determine, in consultation with the Attorney General, whether a State has in effect a false claims act that meets the following requirements:

1. The law must establish liability to the State for false or fraudulent claims described in 31 U.S.C. 3729 with respect to any expenditure described in section 1903(a) of the Act;

2. The law must contain provisions that are at least as effective in rewarding and facilitating *qui tam* actions for false or fraudulent claims as those described in 31 U.S.C. 3730–3732;

3. The law must contain a requirement for filing an action under seal for 60 days with review by the State Attorney General; and

4. The law must contain a civil penalty that is not less than the amount of the civil penalty authorized under 31 U.S.C. 3729.

A State that, as of January 1, 2007, has a law in effect that meets the enumerated requirements shall be considered in compliance with such requirements so long as the law continues to meet such requirements.

The effective date of section 1909 of the Act is January 1, 2007. Thus, a State with a law in effect that meets the enumerated requirements will qualify for a 10 percentage point increase in its share of any amounts recovered from a State action brought under the law if the recovery is received on or after January 1, 2007. A State may enact a law before, on, or after January 1, 2007. Furthermore, the action that gives rise to the recovery may be commenced before, on, or after January 1, 2007. As long as the State's law meets the enumerated requirements on or after January 1, 2007, and the recovery from the action brought under the qualifying law is received by the State on or after January 1, 2007, the State will qualify for a 10 percent increase in its share of the amount recovered.

It is important to note that section 1909 of the Act does not require a State to have in effect a false claims act or to enact a false claims act that meets these minimum requirements. States may choose not to enact false claims acts, or may choose to enact false claims acts that do not meet the enumerated requirements. However, a State that does not have such a law in effect will not qualify for the 10 percentage point increase in its share of any recoveries from an action brought under such a law.

III. OIG Guidelines for Evaluating State False Claims Acts

Section 1909(b) of the Act sets forth four requirements that a State law must meet if the State is to qualify for the 10 percentage point increase in any State Medicaid share recovered under the law. The Inspector General is required to determine, in con-

sultation with the Attorney General, whether a State law meets these requirements. After reviewing section 1909 of the Act and consulting with DOJ, OIG has developed guidelines to use in evaluating whether a State law meets the enumerated requirements. It is important to note that these guidelines are not model statutory provisions. OIG is not requiring any specific language to be included in State false claims acts. Rather, the guidelines reflect the provisions relevant to OIG's review of whether a State law meets the requirements of section 1909(b) of the Act.

A. Liability for False or Fraudulent Claims

Under section 1909(b)(1) of the Act, the State law must establish liability to the State for false or fraudulent claims described in 31 U.S.C. 3729, with respect to any expenditure described in section 1903(a) of the Act. Section 1903(a) of the Act describes expenditures related to State Medicaid plans, including all expenditures for medical assistance under a State Medicaid plan. When evaluating a State law to determine whether it meets the requirements of section 1909(b)(1) of the Act, OIG will consider whether the law provides for the following:

1. Liability to the State for false or fraudulent claims with respect to Medicaid program expenditures, including:
   - Knowingly presenting, or causing to be presented, a false or fraudulent claim for payment or approval to the Medicaid program;
   - Knowingly making, using, or causing to be made or used, a false record or statement to get a false or fraudulent claim paid or approved by the Medicaid program;
   - Conspiring to defraud the Medicaid program by getting a false or fraudulent claim allowed or paid;
   - Knowingly making, using, or causing 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 Medicaid program.
2. Definitions for the terms "knowing" and "knowingly" meaning that a person, with respect to information: (a) Has actual knowledge of the information; (b) acts in deliberate ignorance of the truth or falsity of the information; or (c) acts in reckless disregard of the truth or falsity of the information. In addition, no proof of specific intent to defraud should be required.

B. *Qui Tam* Provisions

Under section 1909(b)(2) of the Act, a State law must contain provisions that are at least as effective in rewarding and facilitating *qui tam* actions for false or fraudulent

claims as those described in 31 U.S.C. 3730–3732. When evaluating a State law to determine whether it meets the requirements of section 1909(b)(2) of the Act, OIG will consider whether the law provides for the following:

1. A provision that authorizes a person (relator) to bring a civil action for a violation of the State false claims act for the person and for the State, which will be brought in the name of the State.

2. A provision that requires a copy of complaint and written disclosure of material evidence and information to be served on the State Attorney General in accordance with State Rules of Civil Procedure.

3. A provision that provides that when a relator brings a *qui tam* action, no person other than the State may intervene or bring a related action based on the facts underlying the pending action.

4. Provisions that set forth rights of parties to *qui tam* actions, including:

    - If the State proceeds with the action, the State has primary responsibility in the action, but the relator shall have the right to continue as a party to the action; and

    - If the State elects not to proceed with the action, the relator may conduct the action but the State may intervene at a later date upon a showing of good cause.

5. Provisions that reward a relator with a share of the proceeds of the action or settlement of the claim, including:

    - If the State proceeds with an action brought by the *qui tam* relator, the relator receives at least 15 percent of the proceeds of the action or settlement of the claim, and may receive a higher percentage depending on the relator's contribution to the prosecution of the action;

    - If the State does not proceed with an action, the relator receives at least 25 percent of the proceeds of the action or settlement, and may receive a higher percentage depending on the relator's contribution to the prosecution of the action; and

    - The court is authorized to award the relator an amount for reasonable expenses, including attorneys' fees and costs, to be awarded against the defendant.

6. A statute of limitations period not shorter than 6 years after the date of the violation is committed, or 3 years after the date when facts material to the right of action are known or reasonably should have been known by the State official charged with the responsibility to act in the circumstances, whichever occurs last.

7. A provision that establishes the burden of proof, for each of the elements of the cause of action including damages, no greater than a preponderance of the evidence.

8. A provision that provides a cause of action for relators who suffer retribution from employers for whistleblower activities related to the State false claims act.

OIG is required to consider whether the State law is at least as effective in rewarding and facilitating *qui tam* actions when compared to the provisions at 31 U.S.C. 3730–3732. State false claims acts may include procedural rights, reductions in relator awards, jurisdictional bars, and other *qui tam* provisions similar to those found in the FCA that do not conflict with the requirements of section 1909(b)(2) of the Act. However, if such provisions are more restrictive than the provisions in the FCA, OIG may determine that a State law is not as effective in rewarding or facilitating *qui tam* actions. OIG will make such determinations on a case-by-case basis and in consultation with DOJ.

C. Seal Provisions

Under section 1909(b)(3) of the Act, a State law must contain a requirement for filing an action under seal for 60 days with review by the State Attorney General. When evaluating whether a State law meets the requirements of section 1909(b)(3) of the Act, OIG will consider whether the law provides a provision that requires the complaint to be filed in camera and to remain under seal for at least 60 days. In addition, OIG will consider whether the State law's seal provisions operate in a way that conflict with the Federal seal in a pendant FCA case.

D. Civil Penalty Provisions

Under section 1909(b)(4) of the Act, the State law must contain a civil penalty that is not less than the amount of the civil penalty authorized under 31 U.S.C. 3729. OIG will review a State law to determine if these provisions include a provision that sets at least treble damages (or double damages in instances of timely self-disclosure and full cooperation) and civil penalties at amounts of at least $5,000 to $10,000 per false claim.[2]

IV. OIG Procedures for Reviewing State False Claims Acts

As noted above, the effective date of section 1909 of the Act is January 1, 2007. A State that, as of January 1, 2007, has a law in effect that meets the enumerated requirements shall be deemed in compliance with such requirements for so long as the law continues to meet such requirements.

2. DOJ is authorized to adjust the civil penalties under the FCA for inflation and has issued regulations that raise the FCA penalties. See Public Law 101-410, 104 Stat. 890 (Oct. 5, 1990); 28 CFR 85.3. However, the statutory provisions of the FCA identify the range of civil penalties as $5,000 to $10,000, and OIG will review State laws based on those statutory provisions.

With the publication of these guidelines, OIG will accept requests for review of State laws to determine if they meet the requirements of section 1909(b) of the Act. In order to request OIG review of a State law, the State Attorney General's office should submit a complete copy of the State law, or any other relevant information, to the following address: Office of Inspector General, Department of Health and Human Services, Cohen Building, Mail Stop 5527, 330 Independence Avenue, SW., Washington, DC 20201, Attention: Roderick Chen, Office of Counsel to the Inspector General.

Submissions by telecopier, facsimile, or other electronic media will not be accepted. OIG will review the State law under these guidelines and in consultation with DOJ, and inform the State Attorney General's office in writing whether the State law meets the requirements of section 1909(b) of the Act.

Legal Analysis

- **Buying In: Why Externalities Support False Claims Act Liability**
- **False Claims Act Remedies**

“BUYING-IN”:
Why Externalities Support False Claims Act Liability

Ryan D. Derry[1*]

I. INTRODUCTION

Is a contractor on sound legal footing to intentionally undervalue a bid? Is a below cost bid legally actionable? If actionable, is deflated bidding fraud?[2]

These are not new questions. They have long been posed and responded to with different answers and supporting rationales. Ralph Nash and John Cibinic, for example, have seriously questioned whether buying-in, or "submitting an offer below anticipated costs," [3] should even be characterized as an improper business practice.[4] In contrast, the United States as *amicus curiae* in *United States* ex rel. *Bettis v. Odebrecht Contractors of California, Inc.*[5] argued that undervaluation of a bid should not only be prohibited but should be actionable under the False Claims Act (FCA).[6] Even more recently, in the latest edition of this Journal, Professor Chris Yukins discussed UNCITRAL's recent work addressing below cost bidding and whether the United States' policies appropriately address the risks associated with such a practice.[7]

Previous academic work on undervalued bids has focused on the risk that a below cost contractor will be unable to complete the "work adequately or will be motivated to cut corners" in the contract at hand.[8] The risk of undervalued bidding has not been discussed from a systemic view. While no student of government contracts ever wishes to find himself in disagreement with Ralph Nash and John Cibinic, I find myself in exactly such a position. Given the unique traits of government procurement and the externalities associated with these characteristics, undervalued bids should be both prohibited and subject to FCA liability.

This Note begins with background material on both buying-in and the FCA. The discussion then moves to *United States* ex rel. *Bettis v. Odebrecht Contractors of Cali-*

1.* Ryan Derry is a May 2006 graduate of The George Washington University Law School. This article was first published in the summer 2006 edition of the *Public Contract Law Journal*, 35 PUBCONLJ 709 (Summer 2006). Mr. Derry can be reached at rderry@law.gwu.edu. TAFEF received permission to reprint this article.

2. The terms "buying-in," "below cost," "deflated bid," and "undervalued bid" are used interchangeably within this Note. All of the terms suggest intentional actions on the part of the would-be contractor.

3. FAR 3.501-1.

4. Ralph C. Nash & John Cibinic, *Buying-In: An Improper Business Practice?*, 18 Nash & Cibinic Rep. ¶ 14, Apr. 2004, at 53.

5. United States *ex rel.* Bettis v. Odebrecht Contractors of California, Inc., 393 F.3d 1321 (D.C. Cir. 2005).

6. Brief for the United States as Amicus Curiae Supporting the Appellant in Part, *Bettis*, 393 F.3d 1321 (No. 04-5051) [hereinafter United States Amicus Brief], 2004 WL 1860069, at *10.

7. *See* Christopher R. Yukins, *A Case Study in Comparative Procurement Law: Assessing UNCITRAL's Lessons for U.S. Procurement*, 35 Pub. Cont. L.J. 357, 482–83 (2006) (suggesting U.S. procurement policy should take undervalued bidding into consideration with respect to "price realism" so that the Government minimizes the possibility of failed contract performance).

8. Nash & Cibinic, *supra* note 3, at 56. *See also* Yukins, *supra* note 6, at 483–84 ("[T]he United States ha[s] been reluctant to encourage challenges based on unrealistically low bids . . . . [T]he Government in fact retains a real risk that a below-cost bid will result in failed performance.").

fornia, Inc.,[9] where the court faced the question addressed here: whether intentionally undervaluing a bid is unlawful.[10] The court's analysis in *Bettis* and the possible implications of the court's holding are the touchstones for this Note.[11]

It is arguably difficult to understand how an undervalued bid should be illegal if one of the goals of public procurement is cost minimization. However, FCA liability with respect to undervalued bids should not be viewed only within the context of the contract at hand. There are externalities associated with a contractor's actions that make FCA liability analogous to predatory pricing. Therefore, section IV is a short discussion and primer into the current law with respect to predatory pricing. Following the background as to predatory pricing, I explore the unique circumstances surrounding public procurement, including: 1) the changes and modification clause; 2) equitable adjustments; and 3) the goal of clear and open competition in procurement. This Note concludes with a discussion as to the administrability of FCA liability for undervalued bids.

II. BACKGROUND

A. Buying-In

The Federal Acquisition Regulation (FAR) terms a below cost bid as "buying-in" and classifies this as an "improper business practice."[12]

> Buying-in, as used in this section, means submitting an offer below anticipated costs, expecting to—
>
> (1) Increase the contract amount after award (e.g., through unnecessary or excessively priced change orders); or
> (2)Receive follow-on contracts at artificially high prices to recover losses incurred on the buy-in contract.[13]

The practice is viewed as an "improper business practice" due to fear that "buying-in may decrease competition or result in poor contract performance."[14] In order to minimize the concerns surrounding buying-in, the FAR requires the Contracting Officer to take "appropriate action."[15] It does not, however, make buying-in unlawful.[16] The

9. 297 F. Supp. 2d 272 (D.D.C. 2004).

10. *Id.* at 279–80.

11. The facts and holding of *Bettis* are outlined *infra* at Section II.C. *Bettis* is a framework and springboard for later discussion of FCA liability. This Note does not question the district court's judgment with regards to the factual claims. The sole purpose of this Note is to question and examine whether FCA liability should be found for intentionally undervalued bids as a legal matter.

12. FAR 3.501-1.

13. *Id.*

14. FAR 3.501–2(a).

15. *Id.*

16. W. Waste Mgmt., Comp. Gen. B-216392, Sept. 24, 1984, 84-2 CPD ¶ 344, at 2 ("The submission of a below cost offer . . . is known as 'buying-in.' Such a bidding approach is not illegal."). *See also* FAR 3.501–2(a) (noting the Contracting Officer should take steps only to minimize the risk of buying-in and ensure "buying-in losses are not recovered by the con-

suggestions for "appropriate action" merely include: seeking a price commitment encompassing as much of the entire contract performance as possible; amortization of nonrecurring costs; and treatment of unreasonable price quotations.[17]

B. The False Claims Act

In contrast to the buying-in provisions of the FAR, the FCA makes illegal the presentation of any "false or fraudulent claim for payment or approval."[18]

In 1863 during the midst of the Civil War, Congress passed the original version of the FCA.[19] Congress enacted the FCA in response to alleged over billing when the Government was paying to secure goods and services for the Union Army.[20] The original act provided for only Government enforcement. Potential violators faced the threat of both criminal and civil liability.[21] The *qui tam* provisions, which allow a private "relator" to file suit on behalf of the Government, were adopted in 1943.[22] Additionally, in 1986 the FCA was amended to increase the financial reward available to a private plaintiff.[23] Since this time the level of *qui tam* suits brought under the FCA has been substantial.[24]

Given the rationale for adoption of the original statute and the FCA prosecutions that have occurred since that time, FCA application has traditionally been concerned with reducing cases where the Government is over charged.[25]

---

tractor through the pricing of—(1) change orders; or (2) follow-on contracts subject to cost analysis").

17. FAR 3.501–2(b).

18. 31 U.S.C. § 3729(a) (2000). The FCA, in pertinent part, provides:

> Any Person who—
> (1) knowingly presents, or causes to be presented . . . a false or fraudulent claim paid 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]
> (3) conspires to defraud the Government by getting a false or fraudulent claim allowed or paid;
> . . .
> is liable to the United States Government for a civil penalty. . . .

Id.

19. 132 Cong. Rec. H9382–03 (daily ed. Oct. 7, 1986) (statement of Rep. Glickman).

20. *Id*.

21. *Id*.

22. *Id*.

23. *See* False Claims Amendments Act of 1986, Pub. L. No. 99-562, sec. 3, § 3730, 100 Stat. 3153, 3156–57.

24. *See* William E. Kovacic, *Whistleblower Bounty Lawsuits as Monitoring Devices in Government Contracting*, 29 Loy. L.A. L. Rev. 1799, 1801 (1996) (noting that between 1986 and 2005 over 1105 *qui tam* suits were filed).

25. 132 Cong. Rec. H9382-03 (daily ed. Oct. 7, 1986) (statement of Rep. Glickman); *see also* Kovacic, *supra* note 23, at 1805 (highlighting recoveries in recent FCA litigation, which indicates the large over billing damages awarded to the Government and private relator). But see United States v. Farina, 153 F. Supp. 819 (D.N.J. 1957), for a historical application of the FCA to an undervalued bid. The issue in *Farina* was essentially the same as the question analyzed in this Note. The *Farina* court was primarily concerned with whether FCA liability flowed from the submission of a revised lower bid following contact by the Contracting Officer. *Id*. at 820. The court held that the "receipt of a revised and predated bid" was not actionable under the FCA. *Id*. at 822. The court questioned:

> How has the Government been defrauded or how would it be defrauded by the mere receipt of a revised and predated bid which, if accepted, would cause the Government to expend less in payment of the undertaking proposed by the bid? It is not readily conceivable [that] the Government would be damaged to its prejudice under that circumstance. *Id*.

C. The *Bettis* Case

The case *United States* ex rel. *Bettis v. Odebrecht Contractors of California, Inc.*[26] begs the question whether this traditional view of the FCA is appropriate.[27]

In the early 1990s Alva Bettis and Odebrecht Contractors of California, Inc. (OCC) were competitors for a fixed price contract to construct the Seven Oaks Dam in San Bernardino, California.[28] Following bid submission, OCC was awarded the contract in 1993.[29] OCC's bid of $167,777,000 was almost $30 million less than the next lowest bid. Additionally, the bid was $35 million below the Army Corps of Engineers' (COE) cost estimate.[30]

At that time, bidder Tutor-Saliba challenged the award of the contract to OCC on the grounds that OCC's bid was unreasonably low.[31] That bid protest was resolved and OCC was officially awarded the contract in March of 1994.[32]

As the construction of the dam began, COE expected some changes to the construction cost due to the variable nature of the amount of work required.[33] However, the changes and costs of the project quickly ballooned.[34] Changes in construction technique, design, and amount of earth to be excavated resulted in a final project cost of $267,801,501.[35] OCC received over $100 million in equitable adjustments but still lost over $30 million on the project.[36]

Six years after the original contract award, in 1999, Bettis filed suit under the FCA alleging OCC had fraudulently undervalued its services when submitting its original bid.[37] Bettis alleged that OCC commenced this scheme in order to be assured the award of the contract, with an eye towards recouping any losses through adjustments during performance.[38] Bettis tried the case alone, as the Government chose not to intervene.[39]

26. 297 F. Supp. 2d 272 (D.D.C. 2004).

27. See discussion of *Farina supra* note 24 for an earlier case confronting many of the same questions before the court in *Bettis*.

28. *Bettis*, 297 F. Supp. 2d at 273.

29. *Id.*

30. *Id.* at 276.

31. *Id.*

32. *Id.*

33. *See id.* at 275–76.

34. *Id.* at 276.

35. *Id.*

36. *Id.*

37. *Id.* at 274. Although Bettis's complaint included seven counts, his FCA claim is the only one of interest to this discussion.

38. *Id.* at 278.

39. Under the FCA the Government can either (1) dismiss, (2) intervene as plaintiff, or (3) allow the original plaintiff to proceed with the suit with no governmental assistance or intervention. *See* Paula J. Zimmerman, Note, *The* Sequoia *Significance: The Role of the Civil False Claims Act's Dismissal Provision In Procurement Reform*, 29 Pub. Cont. L.J. 329, 333 (2000) (discussing the Government's variable role in FCA suits).

The district court granted summary judgment for OCC on two grounds.[40] First, the court found the evidence of fraud at the initial bidding stage to be lacking any "inference that defendant fraudulently induced COE to sign the contract by submitting a bid that it knew or should have known was false, intending to seek subsequent adjustments."[41] Second, Judge Huvelle relied on the court's previous memorandum opinion, holding that as a matter of law, it was "nonsensical" and "illogical" to find a defendant liable under the FCA for an intentionally deflated bid.[42]

> The FCA should not be used to penalize a party for making claims for payment that seek less money than what the government would have been asked to pay if the allegedly fraudulent statement had never been made. Attaching liability in this context would only punish the contractor for having had illicit thoughts at the time of the bidding, rather than for doing what the text of the statute actually forbids: submitted demands for money to which it is not legitimately entitled.[43]

Bettis appealed to the United States Court of Appeals for the District of Columbia Circuit.[44] On appeal the United States filed an amicus brief in support of Bettis's position.[45] The Government supported Bettis, and argued that as a matter of law a deflated bid should be actionable under the FCA.[46]

> This analysis [based on the fraud-in-the-inducement theory] compels the same conclusion where the fraudulent conduct is a deflated bid. The FCA itself does not distinguish between high fraudulent bids, low fraudulent bids, or bids inconsistent with federal rules. The FCA speaks only of conduct that is 'false' or 'fraudulent'—terms broad enough to encompass deflated, as well as inflated, bids in appropriate circumstances. . . . Accordingly, a deflated bid should be treated just like an inflated one, so that the former, like the latter, can be actionable under the statute even though none of the payment requests is inconsistent with the original bid.[47]

The circuit court ultimately affirmed the district court.[48] However, the circuit court's holding rested on the absence of evidence on which a "reasonable jury [could] conclude

40. *Bettis*, 297 F. Supp. 2d at 279, 281.

41. *Id*. at 283.

42. *Id*. at 280. This holding is in line with that of United States v. Farina, 153 F. Supp. 819, 822 (D.N.J. 1957). *See* discussion *supra* note 24.

43. *Bettis*, 297 F. Supp. 2d at 280 n.14 (quoting United States *ex rel.* Bettis v. Odebrecht Contractors of California, No. 99-2879, mem. op. at 12 (D.D.C. Oct. 24, 2002)).

44. United States *ex rel*. Bettis v. Odebrecht Contractors of California, Inc., 393 F.3d 1321 (D.C. Cir. 2005).

45. United States Amicus Brief, *supra* note 5.

46. *Id*. at *10.

47. *Id*. at *14-*16.

48. *Bettis*, 393 F.3d at 1323.

that Odebrecht fraudulently induced the Government to award it the contract."[49] The court failed to address whether Bettis's claim was barred as a matter of law due to inapplicability of the FCA to undervalued bids.[50]

III. APPLICATION OF THE FALSE CLAIMS ACT TO BUYING-IN

When the FCA was first enacted in 1863 the purpose was to chill the fraudulent over billing charged to the Government during the Civil War.[51] Furthermore, Congress amended the FCA in 1986 due to publicized reports of excessive government fraud.[52] The 1986 Amendments provided for increased civil and criminal liability for violators of the FCA and a broadening of the opportunities under which private *qui tam* actions could be brought.[53]

However, as the United States pointed out in its amicus brief, the language of the FCA is quite broad.[54] The FCA allows for civil and criminal liability for any person who knowingly presents a false or fraudulent claim for payment, knowingly uses a false record to get a false claim paid, conspires to get a false claim paid, or knowingly uses a false record to avoid payment to the Government.[55] The aim of the FCA is to make unlawful "submi[ssion] of demands for money which [the contractor] is not legitimately entitled."[56] Many courts have read this rationale to support a "fraud-in-the-inducement" application of FCA liability.[57]

The question in cases such as *Bettis* and other instances of possible intentional undervaluation is should possible intentional undervaluation trigger FCA liability? Nash and Cibinic conclude that it should not.[58] However, as stated previously, many commentators on the undervalued bid issue have focused solely on the contract at hand, in particular the risk of nonperformance.[59] In order to engender a more robust discussion and analysis, a number of antecedent questions must be posed before moving to the ultimate question of whether harm does arise from undervalued bidding. First, what level of undervaluation should be thought of as a false or fraudulent claim? Second,

49. *Id.*

50. *See id.* (discussing the two theories on which the district court based its grant of summary judgment but ultimately affirming on the factual ground alone). *But see* Ralph C. Nash & John Cibinic, *Postscript: Buying-In as Fraud*, 19 Nash & Cibinic Rep. ¶ 15, Mar. 2005, at 47 (suggesting that the circuit court's opinion indirectly supports the district court's theory).

51. 132 Cong. Rec. H9382-03 (daily ed. Oct. 7, 1986) (statement of Rep. Glickman).

52. Zimmerman, *supra* note 38, at 332.

53. *Id.* at 333.

54. United States Amicus Brief, *supra* note 5, at *14–*16.

55. 31 U.S.C. § 3729(a) (2000). "Knowingly" is defined as having actual knowledge, acting in deliberate ignorance of the truth or falsity, or acting in reckless disregard of the truth or falsity of information. *Id.* § 3729(b).

56. United States *ex rel.* Bettis v. Odebrecht Contractors of California, Inc., 297 F. Supp. 2d 272, 280 n.14 (D.D.C. 2004) (quoting United States *ex rel.* Bettis v. Odebrecht Contractors of California, No. 99-2879, mem. op. at 12 (D.D.C. Oct. 24, 2002)).

57. *See, e.g.*, United States *ex rel.* Harrison v. Westinghouse Savannah River Co., 176 F.3d 776, 787 (4th Cir. 1999).

58. Nash & Cibinic, *supra* note 3, at 53; Nash & Cibinic, *supra* note 49, at 47.

59. *See supra* note 7 and accompanying text.

does such claim result in payment of funds that the contractor is not legitimately entitled? Finally, is there harm affected on anyone from such contractor actions?

A. What Level of Undervaluation is a False Claim?

The *Bettis* case and the types of contract awards this Note is concerned with are contracts awarded on any variation of a fixed price bid.[60] Only fixed price contracts allow a contractor to undervalue a bid because other forms of contracts, such as cost reimbursement or cost plus fixed fee, are not usually awarded exclusively based upon cost.[61] Fixed price contracts are awarded based upon the bid price, enabling equal opportunity for award amongst firms.[62] Because the lowest bid "wins," an applicant has substantial incentive to lower its bid and increase its chances of award.

The problem in such analysis is that the determination of pricing level is too low. However, other legal fields have dealt with similar problems. The issue of predatory pricing in the antitrust field provides significant economic literature and background as to when a product, in this case, a bid, is undervalued.[63] For purposes of this discussion, a bid should be viewed as undervalued when the firm knows the applicable cost structure and submits a bid that is below this cost structure.[64]

B. Is the Contractor Legitimately Entitled?

The purpose of the FCA is to hold parties responsible when they submit a false claim for monies that they are not "legitimately entitled" to.[65] However, in an undervalued bid situation, the bid that the contractor submits is arguably below what it should cost the Government. The individual claims for payment are not above what the contractor is "legitimately entitled" to. On the contrary, the individual claims are actually lower than what the contractor is "legitimately entitled" to. The argument that liability should be found seems entirely counterintuitive.

However, the original award of the contract is based upon a false bid. Therefore, under the fraud-in-the-inducement theory, the contractor is not necessarily "legitimately entitled" to the contract at all.[66] Any claim submitted under the contract is not a claim to which the contractor is "legitimately entitled" because the contractor was not legitimately entitled to the contract in the first place.[67]

60. *Bettis*, 297 F. Supp. 2d at 275.

61. See FAR 16.301, for a discussion of cost-reimbursement contracts and FAR 16.306, for the regulations regarding cost-plus-fixed-fee contracts.

62. 10 U.S.C. § 2305(b)(3) (2000) (assuming a contractor is deemed responsible and responsive by the Contracting Officer).

63. *See* Patrick Bolton et al., *Predatory Pricing: Strategic Theory and Legal Policy*, 88 Geo. L.J. 2239, 2271–74 (2000).

64. Yukins notes that some bids are not intentionally undervalued; instead, a firm simply may be mistaken as to its actual internal costs of production. *See* Yukins, *supra* note 6, at 475.

65. *Bettis*, 297 F. Supp. 2d at 280 n.14 (quoting United States *ex rel.* Bettis v. Odebrecht Contractors of California, No. 99-2879, mem. op. at 12 (D.D.C. Oct. 24, 2002)).

66. *See* United States Amicus Brief, *supra* note 5, at *10-*16, for an extensive discussion of the judicial history surrounding the fraud-in-the-inducement theory.

67. United States *ex rel.* Harrison v. Westinghouse Savannah River Co., 176 F.3d 776, 787–88 (4th Cir. 1999).

C. What Is the Harm Affected Upon the Government?

The fraud-in-the-inducement theory may sound nice, but the argument is pointless if the behavior does not result in harm to the Government. There are, however, many harms to the Government caused by undervalued bids. Although a goal of public procurement is obtaining goods and services at least cost to the Government,[68] the external cost associated with accepting a falsely undervalued bid has ripple effects in the economy and government procurement process. The actual cost, when the externalities are accounted for, is not appropriately reflected in the risk a contractor will fail to perform on its undervalued bid. The externalities should be acknowledged and examined by courts when ruling on these questions.

IV. AN ANALOGOUS EXAMPLE: PREDATORY PRICING

Predatory pricing is a useful analogous case study to examine before tackling the impact of fraudulent undervalued bids and the associated external costs.

A. Background

Much like applying the FCA to undervalued bids, the very concept of predatory pricing seems at first counterintuitive. The goals of procurement include lowest cost acquisition.[69] Similarly, the goals of a free market economy include efficient pricing, which in a perfectly competitive market would result in pricing at lowest cost.[70] The lowest price possible can benefit society because consumers receive goods and services at low, affordable prices, possibly even below costs.

Contrary to this argument, the Robinson-Patman Act terms pricing below cost predatory and declares it unlawful to the extent that it injures competition.[71] The Act states that predatory pricing schemes injure competition only when the price is "below an appropriate measure of . . . [the producer's] costs" and "the competitor ha[s] a reasonable prospect of recouping its investment in below-cost prices."[72]

1. Pricing Below Costs

While there are extremely technical definitions as to what amounts to a "predatory price,"[73] the basic meaning of the term is that the price charged is below whatever cost

68. *See* 10 U.S.C. § 2305(b)(3) (2000). Where the lowest cost bid is to be awarded the contract, it can be inferred that the goal of such bidding is to provide goods and services to the Government at least cost.

69. *Id.*

70. *See* Don E. Waldman & Elizabeth J. Jensen, Industrial Organization: Theory and Practice 30–34 (1998), for the argument that a perfectly competitive structure is efficient because all possible gains from trade have been realized. Firms in perfectly competitive markets are faced with a flat demand curve which means they can only price at the competitive level or demand will be zero. William H. Jordan, *Predatory Pricing After* Brooke Group: *The Problem of State "Sales Below Cost" Statutes*, 44 Emory L.J. 267, 277 (1995).

71. 15 U.S.C. § 13(a) (2000).

72. Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 210 (1993).

73. See Bolton, *supra* note 62, at 2271–74, for a discussion of different measurements for when a price is predatory or

the provider or manufacturer faces.[74] A price below cost can result in a significant competitive advantage for the predatory firm over firms with higher prices. The low price helps the firm by driving rivals from a market or dissuading entry into a certain market in the first place.[75]

By ensuring competitors do not enter a specific market, the predatory firm is then left free to recoup its investment.[76] With no competition, the predatory firm can raise prices to a supra competitive level, similar to a pricing scheme that a monopolist might undertake.[77] Ultimately a predatory scheme is profitable only at a later date "because of its exclusionary or other anticompetitive effects."[78] The consumer and the economy are not injured until recoupment occurs.[79]

2. Legal Presumptions With Regards To Predatory Pricing

In theory, predatory pricing is relatively straightforward. In practice, where there are multiple firms in any given market, it becomes more complex. The complexity has in recent years resulted in commentators questioning whether predatory pricing is plausible under actual market conditions.[80] And while predatory pricing has been prosecuted since the early 1900s,[81] recent courts have all but foreclosed the likelihood of finding illegal predation.[82] The incentives for predatory pricing have not changed but courts have seemingly applied a blanket presumption that successful predatory pricing is all but impossible.[83]

In *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*, the Supreme Court remarked that predatory pricing as an economic practice is always impracticable and rarely successful.[84] Seven years after *Matsushita*, the Court was still doubtful as to the feasibility of predatory pricing. In *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, the Court declared, "predatory pricing schemes in general are implausible."[85]

---

below cost. Possible and often used pricing benchmarks are average variable cost (where the producer only covers the cost associated with making each unit of a good and not the fixed costs associated with such manufacturing) and average total costs (which include these fixed costs). *Id.* at 2271.

74. *Brooke*, 509 U.S. at 210.

75. Waldman & Jensen, *supra* note 69, at 245–48. *See also* Yukins, *supra* note 6, at 475 (noting predatory pricing and maintenance of market share as two motivations for a Contractor to submit a below-cost bid).

76. Waldman & Jensen, *supra* note 69, at 245–48.

77. Bolton, *supra* note 62, at 2242–43.

78. *Id.*

79. This is because prior to recouping, the only impact from a predatory price is a low-price. While a low price can result in inefficient substitution of exchangeable goods, it does not actually result in an injury such as paying prices above the level that they should be. *See Brooke*, 509 U.S. at 224.

80. *See, e.g.*, Kenneth G. Elzinga & David E. Mills, *Predatory Pricing and Strategic Theory*, 89 Geo. L.J. 2475, 2479 (2001).

81. *See* Standard Oil Co. v. United States, 221 U.S. 1, 30 (1911).

82. Bolton, *supra* note 62, at 2241 (finding that between 1993 and 2000 "no predatory pricing plaintiff . . . prevailed on the merits in federal courts").

83. *Id.* at 2243.

84. 475 U.S. 574, 589 (1986).

85. 509 U.S. 209, 210 (1993).

Such a view of predatory pricing is similar to the view of buying-in as nothing more than a contractor's "hope spring[ing] eternal" with no chance of recouping costs.[86]

Despite the Court's strong opinion that predatory pricing is not feasible, recent commentators have urged support of the continued ban on predatory pricing.[87]

> It is now the consensus view in modern economics that predatory pricing can be a successful and fully rational business strategy. In addition, several sophisticated empirical case studies have confirmed the use of predatory pricing strategies. The courts, however, [continue to rely] instead on earlier theory that is no longer generally accepted.[88]

B. Modern Predatory Pricing Models

As highlighted above, the classic predatory pricing model outlines that the incentive for a firm to undertake predatory pricing is to enable itself at one point to charge supra competitive monopoly prices.[89] However, such a specific model forecloses other rationales for the behavior. The classical model of predation is outdated because recent economic understanding is that firms compete on more than just price.[90] There are a number of economic theories as to why a firm may wish to exercise predatory practices which do not involve supra competitive monopoly profits in the long run.[91]

A predatory firm may lower its price so the market share of a rival drops to such a level that the rival can neither stay liquid nor receive proper financing.[92] A firm may also enter into a predatory pricing scheme in one market as a signal to other firms to remain outside of another certain market that it wishes to keep for itself.[93]

This analysis indicates that loss recouping can occur more broadly than courts have previously accepted. Undervalued bid submissions should be viewed as similar to this more modern view of predatory pricing.

V. APPLICATION OF BUYING-IN IN PUBLIC PROCUREMENT

The remainder of this Note will focus on why liability for undervalued bids should not be legal as a matter of law.[94] In both predatory pricing and undervalued bidding, the behavior complained of seems at first glance to be innocuous or even a benefit

86. *See* Nash & Cibinic, *supra* note 3, at 53.

87. Bolton, *supra* note 62, at 2241.

88. *Id*. *But see* Elzinga & Mills, *supra* note 79, at 2277.

89. Bolton, *supra* note 62, at 2241.

90. See *id*. at 2243–50, for a cursory examination of literature that has been published and an argument for smarter and more modern predatory pricing analysis.

91. *See id*. at 2285–321.

92. See *id*. at 2285–93, for a comprehensive discussion of financial market predation and a case study regarding its proper application.

93. See *id*. at 2299–304, for a case study and explanation of cost signaling and reputation effect predation.

94. I.e., *per se* legal. The court in *Bettis* did not hold that falsely undervalued bids should be *per se* legal, but it did hold that FCA liability does not apply to undervalued bids. United States *ex rel*. Bettis v. Odebrecht Contractors of California, Inc., 297 F. Supp. 2d 272, 281 (D.D.C. 2004).

the Government and marketplace. Like the antitrust statutes' treatment of predatory pricing, actual harm only results from an undervalued bid when there is behavior or motivation in addition to the undervaluation.

The unique context of public procurement provides an atmosphere where undervaluation of a bid results in external costs that increase the actual cost to society. Additionally, government contractors have at their disposal techniques for loss recouping unavailable in conventional markets.

A. Incentives for Undervaluation: Opportunities for Recoupment and Modifications

1. The Changes and Modification Clause

Government contractors may seek either bilateral[95] or unilateral[96] modifications to an existing contract without first breaching the prior contract. A Contracting Officer is free to modify a contract as long as he or she believes the modification is in the best interest of the Government.[97] Additionally, a changes and modifications clause allows for the efficient addition or change in the goods or services an agency requires without a new contract competition.[98]

There are limitations to what changes or modifications a Contracting Officer can make to an existing contract. "The Competition in Contracting Act of 1984 (CICA)[99] requires executive agencies to promote full and open competition through the use of competitive procedures when procuring goods or services."[100]

However, full and open competition is sometimes "impractical or inefficient."[101] Therefore, changes "within the scope" of the original contract are allowed.[102] CICA does not require new competition for changes "within the scope" because "the potential for modification—was included with the original competition."[103]

Four factors are considered in determining whether a modification is "within the scope" of the original competition or is a "material departure":

(1) The magnitude of any changes in the type of work;

95. FAR 43.103(a). "Bilateral modifications are used to— (1) Make negotiated equitable adjustments resulting from the issuance of a change order; (2) Definitize letter contracts; and (3) Reflect other agreements of the parties modifying the terms of contracts." *Id.*; *see also* Richard J. Prevost, *Contract Modification vs. New Procurement: An Analysis of General Accounting Office Decisions*, 15 Pub. Cont. L.J. 453, 454 (1985).

96. FAR 43.103(b). "Unilateral modifications are used, for example, to— (1) Make administrative changes; (2) Issue change orders; (3) Make changes authorized by clauses other than a changes clause (e.g., Property clause, Options clause, Suspension of Work clause); and (4) Issue termination notices." *Id.*; *see also* Prevost, *supra* note 94, at 454.

97. LDG Timber Enters., Inc. v. Glickman, 114 F.3d 1140, 1143 (Fed. Cir. 1997).

98. J. Andrew Jackson & Steven A. Alerding, *Expanding Contracting Opportunities Without Competition*, 26 Pub. Cont. L.J. 205, 205 (1997).

99. *See* Pub. L. No. 98-369, div. B, tit. VII, 98 Stat. 494, 1175 (1984) (codified as amended at 41 U.S.C. 253 (2000)).

100. Jackson & Alerding, *supra* note 97, at 205.

101. *Id.*

102. *Id.* at 206.

103. *Id.*

(2) The magnitude of any changes in the performance period;

(3) The magnitude of any changes in cost; and

(4) Whether the modification is of a nature that potential offerors could reasonably have anticipated under the changes clause.[104]

The Government can increase or decrease the cost or size of a contract in three types of scenarios: new procurement modifications; equitable adjustment modifications; and cost overrun modifications.105 In *Bettis*, the relator alleged that OCC used the equitable adjustment modifications clause to recoup losses. While highly implausible, the procurement modifications clause would provide some opportunity to recoup losses.

2. New Procurement Modifications

New procurement modifications allow a Contracting Officer to modify an existing contract in order to procure new goods beyond specifications in the original contract without having to undertake a second competition.[106] Such changes, even "within the scope" of the original contract, are not necessarily minor.[107] For example, in *Caltech Service Corp*., the original contract called for "receiving, documenting, consolidating, packing, and loading cargo" at an Air Force subcontractor's site.[108] When the Air Force required additional cargo services at the same site, the contract was modified to provide these services.[109] The modification resulted in a thirty percent increase in cost, but the Comptroller General held that the additional provision of these services was still within the scope of the original contract.[110] The modification was deemed insignificant because the "functions under the original contract and those represented by the modification [were] the same."[111]

A modification involving a similar function is not the only variable leading to significant modifications. Additionally, the broader the original competition and contract, the broader the range of allowable subsequent modifications.[112] "The Court of Appeals

104. *Id*. at 206–07("A larger magnitude of changes under factors 1, 2, and 3 will be permitted if potential bidders would have reasonably anticipated such changes (factor 4). In fact, the fourth factor is apparently the deciding issue.").

105. John D. Schminky, *Proper Funding of Contract Modifications Under the Antecedent Liability Rule*, 26 Pub. Cont. L.J. 221, 225 (1997). The contract modifications in *Bettis* were equitable adjustment modifications and cost-overrun modifications. United States *ex rel*. Bettis v. Odebrecht Conractors of California, Inc., 297 F. Supp. 2d 272, 276 (D.D.C. 2004).

106. *See* Schminky, *supra* note 104, at 225–26 (discussing antecedent liability with regards to new-procurement modifications).

107. A determination as to whether a change is "within the scope" of the contract is not dependent on the subjective intent of the Contracting Officer at the time of award. See, for example, LDDS WorldCom, Comp. Gen. B-266257, B-266258, Feb. 8, 1996, 96-1 CPD ¶ 50, at 4, in which the Contracting Officer considered a certain contract modification to be outside the scope of the contract at the time of solicitation. Ten years later, however, modifications which included the same subject that the Contracting Officer had previously highlighted, were held to be within the scope of the initial contract. *Id*.

108. Caltech Serv. Corp., Comp. Gen. B-240726.6, Jan. 22, 1992, 92-1 CPD ¶ 94, at 2.

109. *Id*. at 3.

110. *Id*. at 5.

111. *Id*.

112. Jackson, *supra* note 97, at 210.

for the Federal Circuit recently held in *AT&T Communications, Inc. v. WilTel, Inc.* that 'a broad *original competition* may validate a broader range of later modifications without further bid procedures.'"[113] In addition, the Federal Circuit held that because the *original contract* was broad,[114] the *contractor's* proposed modification resulting in an additional $100 million in costs was within the scope.[115]

Under the *AT&T Communications, Inc.* standard, a contractor bidding in a broad competition or for a broadly written contract is aware of an increased opportunity to expand the original contract and is more likely to underbid in the hope of recouping its profit through a new procurement modification.

3. Equitable Adjustments

In *Bettis*, Bettis claimed that the equitable adjustment modifications awarded during the construction of the Seven Oaks Dam should result in FCA liability.[116] Bettis alleged OCC undervalued its bid initially because it planned to substitute more expensive construction methods and receive beneficial equitable adjustments at a later date.[117]

Equitable adjustments are awarded when expectations the parties relied on in the original bidding process change or when the government modifies some part of the contract.[118] If the modification of the contract results in "an increase or decrease in the cost of, or the time required for, performance . . . the Contracting Officer shall make an equitable adjustment in the contract price, the delivery schedule, or both, and shall modify the contract."[119]

An equitable adjustment will include any additional costs and provide for a normal profit on top of that change in cost.[120] Bettis argued that it is this profit on the changed work that OCC hoped to gain and was the motivation behind OCC's bid.[121]

In reality, Bettis's argument that OCC undervalued its bid hoping to regain losses through later equitable adjustments is implausible. Given that equitable adjustments are for unforeseen circumstances, such as delays,[122] OCC would have had to have known in advance that the specifications or design details would need to be changed during performance. This is unlikely. However, the implausibility of Bettis's claims should not limit the opportunities for contractors to effectively take advantage of deflated bidding.

113. *Id.* (emphasis added).

114. The court held that the original contract language which required the contractor to "provide analog, digital, and 'T1' dedicated transmission services" opened the door to further transmission means. *Id.* at 210–11. Therefore, the addition of a new circuitry was "within the scope." *Id.*

115. *Id.* (noting that the modification in *AT&T* was at the contractor's suggestion).

116. United States *ex rel.* Bettis v. Odebrecht Contractors of California, Inc., 297 F. Supp. 2d 272, 279 (D.D.C. 2004).

117. *Id.* at 283–84.

118. Schminky, *supra* note 104, at 226–27.

119. *Id.* at 227.

120. Reginald M. Jones, *Update on Proving and Pricing Inefficiency Claims*, 23 Construction L. 19, 50 (2003).

121. *Bettis*, 297 F. Supp. 2d at 274.

122. Schminky, *supra* note 104, at 226–27.

B. Rationale and Costs Associated with Undervaluation of a Bid

Through new procurement modifications, some possibility of recoupment does exist for a government contractor that undervalues its bid. Granted, the opportunity is dependent on a number of factors, not the least of which is just the opportunity to modify the contract awarded. However, predatory pricing also includes the possibility of recoupment,[123] which also requires a number of factors to be successful. Additionally, even having a pricing scheme dependent on a number of factors "can be a successful and fully rational business strategy."[124] Undervaluation of a bid is economically feasible within a given contract.[125]

We now turn to the rationale for such undervaluation even if costs cannot be recouped in the given contract. This is the external cost to Government and society which other commentators do not recognize as potential rationales for buying-in.

1. Foreclosure of Rivals

A significant motivation behind submission of an undervalued bid could be foreclosure of rivals from the marketplace. By undervaluing its bid, the contractor improves its chances of winning the procurement, particularly when price is a significant selection factor in the procurement. Furthermore, an undervalued bid may signal to other competitors that the contractor has some cost structure that allows it to provide the Government with goods or services at a lower cost. As a result possible competitors decide they might as well not incur the significant costs[126] of bidding for government contracts when the undervaluing contractor is participating.[127]

By reducing the number of competitors in government contracting, the contractor harms the Government by reducing the level of full and open competition.[128] Furthermore, promotion of innovation and integrity in contracting can be retarded without full and open competition.[129]

123. Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 210 (1993).

124. Bolton, *supra* note 62, at 2241.

125. Undervaluation of a bid is also feasible through cross-subsidization. This has not been highlighted individually because the costs and benefits—highlighted below—will be the same as with contract modification. Furthermore, such cross-subsidization is only unique insofar as most contractors are involved in the public and commercial fields. Steven L. Schooner, *Fear of Oversight: The Fundamental Failure of Businesslike Government*, 50 Am. U. L. Rev. 627, 634 (2001). See, for example, Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 577–78 (1986), where a firm allegedly cross-subsidized between two markets (the U.S. and Japanese markets for televisions). Similar cross-subsidization could occur between government contracting and conventional general public sales. Possible rationales for such activity could be increased consumer name recognition, when connected with a government program, or the ability to drive a rival from the marketplace (discussed below).

126. See generally Heyer Products Co. v. United States, 140 F. Supp. 409 (Ct. Cl. 1956), for an example of a plaintiff attempting to litigate to recover its bid preparation costs.

127. See Waldman & Jensen, *supra* note 69, at 312–17, for an extensive discussion of the Kreps and Wilson Predatory Pricing Model, which illustrates the economic opportunity to secure a rival's exit from a market. A firm could apply such a goal in public procurement.

128. Jackson, *supra* note 97, at 205.

129. *Id.*

2. Relationship With Contracting Officers: Diminished Full and Open Competition

In addition to foreclosing rivals from the government contracting arena, a firm can also use a contract to cement its own relationship with Contracting Officers.

Due to recent changes in procurement, Contracting Officers now have increased flexibility in procuring smaller amounts of goods. In 1999 more than ten billion dollars was spent in micro-authority purchased by government employees, which requires no competition, standardization, or visibility.[130] Furthermore, new streamlined processes for the procurement of goods and services valued at less than $100,000 afford Contracting Officers large latitude in procurement.[131]

> The contracting officer:
>
> (1) need only "promote competition to the maximum extent practicable";
>
> (2) can limit the competition to as few as three vendors "within the local trade area";
>
> (3) may "solicit quotations orally to the maximum extent practicable"; and
>
> (4) in certain circumstances, solicit from a single source.
>
> Contrasted with the Government's typical policy of broadly advertising its procurements, fewer firms are aware of, or realize they missed the opportunity to compete for, the large number of Federal purchases under the $100,000 simplified acquisition threshold.[132]

Therefore, the relationships the contractor develops with a Contracting Officer in one procurement can help the contractor secure further awards of micro and simplified acquisitions contracts.[133] Empirical evidence also suggests that relationship building with a Contracting Officer can even be beneficial in future sealed bidding and competitive negotiation situations.[134] While some of these activities may be illicit, a contractor is provided the opportunity to recoup losses.

130. Schooner, *supra* note 124, at 661.

131. *Id.* at 662.

132. *Id.* at 662–63.

133. One needs only to be anecdotally aware of the Darleen Druyun case to recognize the risks associated with Contracting Officer relationship building with bidders and contractors. *See generally Boeing's Tawdry Deal*, N.Y. Times, Nov. 26, 2003, at A24.

134. *See id.*

C. Administratibility

Certainly the subject and concept of this Note is novel. It would extend the FCA and *qui tam* suits into a new area of application. This extension of FCA liability would lead to new administrative challenges.

Currently, the *qui tam* provisions of the FCA result in significant numbers of FCA suits.[135] The incentive for a plaintiff in such cases is often very strong. Between 1985 and 1995 almost $185 million had been paid in "bounties" to *qui tam* relators.[136] With the plaintiff capable of receiving between ten and thirty percent of any recovery, there is an incentive for disgruntled individuals to file baseless claims.[137]

However, the incentive to bring a fraudulent claim is lessened in the case at hand.[138] As discussed above, FCA liability results in criminal and civil liability.[139] The penalty is a fine of between $5,000 and $10,000 and treble damages.[140] Damages are calculated on the amount of the fraudulent claim.[141]

Calculating damages may be the most difficult concept in imposing FCA liability for deflated bids. If there are externalities involved there are damages. The damages must be calculated beyond the context of the original contract. The damages and external costs associated with a deflated bidding scheme depend upon how the defendant intended to recoup their losses, including modifications, foreclosing rivals, or relationship building with Contracting Officers. Any calculation of damages would need to be flexible for an efficient predatory pricing legal regime.[142]

VI. CONCLUSION

FCA liability should be extended to undervalued fraudulent bids. In the alternative, such fraudulent activity should not be declared per se legal. Certainly more extensive analysis and study is required on the topic. The purpose of this Note is to provide an analogous example by way of predatory pricing to enlighten the debate as to the possible harms in buying-in that are not fully reflected in the contract alone.

135. Kovacic, *supra* note 23, at 1802 (showing in 1995, for example, there were 274 *qui tam* actions filed).

136. *Id*. at 1804.

137. *Id*. at 1805.

138. Additionally, there are safety nets from overzealous *qui tam* suits. The FCA enables the Government to dismiss any suit not supported on the facts. Zimmerman, *supra* note 38, at 336. *But see* Kovacic, *supra* note 23, at 1818 ("The DOJ appears, in effect, to have adopted a policy of seeking dismissal of a *qui tam* suit only when there is a jurisdictional flaw in the relator's suit—for example, reliance on publicly available information. There has been only a single reported instance in which the DOJ has sought to dismiss a *qui tam* suit on the ground that the suit lacked substantive merit or otherwise contradicted the interests of the United States."). Whether the dismissal provision is actually relied upon to dimiss claimless suits is a secondary issue from the fact that the provision exists. The theory of the dismissal provision should apply to undervalued bids so that baseless suits can be disposed of early in the judicial process. *See* Zimmerman, *supra* note 38, at 334–39 (arguing for greater use of the dismissal provision in FCA cases).

139. 31 U.S.C. § 3729(a)(7) (2000).

140. *Id*.

141. *Id*.

142. *See* Bolton, *supra* note 62, at 2252 (discussing predatory pricing damages calculation).

First, such fraudulent bidding is not an improbable practice. Firms can and do have an incentive to undervalue their bids to the Government because of possible recoupment through modifications. In addition to recoupment through modifications, firms have the ability to drive other bidders from the marketplace and entrench themselves in the field.

These practices cut against the aim of CICA, which works to promote efficiency, economy, and openness in government contracting.[143] Any movement away from competitive procurement towards procurement based upon a company's long term strategy for success in the government contracts field leads to losses for the public. There are also external costs associated with buying-in such as foreclosure and forcing rivals out of the market, also resulting in costs to the public. Because of these high social costs, buying-in should be actionable under the FCA. The language of the FCA does and should apply to undervalued bids.[144]

143. 41 U.S.C. § 253 (2000).

144. 31 U.S.C. § 3729(a) (2000). The statute provides that presentation of a false claim is illegal—not simply a false claim in excess. *See also* discussion *supra* note 46 and corresponding text.

FALSE CLAIMS ACT REMEDIES

Paul D. Scott, Esq.[1*]

The False Claims Act ("FCA" or "Act") provides that a person who violates the Act "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 . . . ." 31 U.S.C. § 3729(a).[2]

While this language is unambiguous, its application is anything but straightforward, for the sheer variety of government programs and related financial transactions to which the FCA has been applied have required courts to fashion numerous and distinct formulas for calculating damages in individual proceedings. Nonetheless, there are several overarching considerations that are potentially relevant in all manner of cases. These include 1) the remedial purposes of the Act, 2) determining actual damages, 3) calculating the ultimate damage award, 4) determining penalties under the Act, and 5) constitutional limitations on damages and penalties. Each of these topics is examined, in turn, below.

I. REMEDIAL PURPOSES OF THE ACT

In formulating a remedy for fraud against the Government, Courts occasionally look to the equitable doctrines of restitution and unjust enrichment, in addition to legal principles of damages. *See e.g. United States v. American Heart Research Foundation, Inc.*, 996 F.2d 7 (1st Cir. 1993). By its plain language, however, the False Claims Act provides only for the award of damages and penalties. A threshold issue in a False Claims Act case is thus whether the remedy being sought qualifies as damages as defined under the Act. In *U.S. ex rel. Taylor v. Gabelli, et al.*, No. 03 Civ. 8762 (PAC), 2005 WL 2978921 (S.D.N.Y Nov. 4, 2005), a case of first impression, the question of available remedies under the Act was examined in detail.

The principal allegation in *Gabelli* was that defendants had misrepresented themselves as small businesses in order to obtain discounted spectrum licenses in auctions by the Federal Communications Commission. Relator argued that the available remedies under the Act should include the disgorgement of profits earned by the defendants in reselling the licenses. The district court, however, held that "the law of remedies . . . strikes a clear distinction between damages—a compensatory form of relief—and restitution—a form of relief that prevents unjust enrichment." *Id.* at *3 (S.D.N.Y. Nov. 4, 2005). "Damages typically focus on the plaintiff and provide 'make-whole,' compensatory, monetary relief; restitution, by contrast, concentrates on the defendant—preventing unjust enrichment, disgorging wrongfully held gains, and restoring them to the plaintiff." *Id.* at *4. "[U]nder current FCA jurisprudence, courts narrowly construe "damages" to mean some form of "actual damages" and, thus, exclude various other

1.* Mr. Scott is the founder of the Law Offices of Paul D. Scott, P.C. (www.fraudhotline.com) in San Francisco, California. He can be reached at pdscott@sbcglobal.net.

2. Violations of the FCA occurring after September 29, 1999 are subject to increased penalties of between $5,500 and $11,000. *See* 28 U.S.C.A. 2461 (note); 28 C.F.R. 85.3(a)(9) (2005).

types of damages (such as prejudgment interest and consequential damages)—let alone restitutionary remedies such as contribution, indemnification, or disgorgement of unjust gains." *Id.* at *11. Disgorgement of profits, as a form of restitution, was, in the court's view, therefore not an available remedy under the Act. *Id.*

The court also rejected the relator's contention that disgorgement was the equivalent of "rescissory damages" and thus covered by the explicit terms of the Act, holding that "rescissory damages" are normally available as a form of restitution in rescission cases, and rescission is not an available remedy under the False Claims Act. *Id.* at *5.

Lastly, the court did not accept the relator's argument that the Government was actually harmed by the fraud. The Government had argued that, if it had discovered the fraud, it could have re-auctioned the licenses and collected the same proceeds earned by defendants from reselling the licenses, but the court viewed this as simply an attempt to "disguise . . . disgorgement of allegedly unjust riches." *Id.*

Putting aside the soundness of the court's reasoning, the impact of its decision should be extremely limited, for it is a highly unusual circumstance where the illicit profit a defendant gains from defrauding the government does not involve an outlay of federal funds or otherwise cause the Government monetary damage. Had the fraudulent bids not been submitted, the government would presumably have received lower amounts from other legitimate bidders, and those bidders, not the Government, would likely have enjoyed most of the profits unjustly earned by the defendants on any resale of the licenses.[3] In the vast majority of cases, however, a defendant's unjust profit comes at the expense of the Government and is thus typically included within a standard damage calculation. *Compare United States v. Bound Brook Hosp.*, 251 F.2d 12, 13–14 (3d Cir. 1958) (in case brought under Surplus Property Act, resale proceeds treated as a "pecuniary loss" to the Government).

II. DETERMINING ACTUAL DAMAGES

"No single rule can be, or should be, stated for the determination of damages under the Act . . . ."[4] By necessity, courts have employed different rules to determine damages in line with the myriad different cases that have been brought under the Act.[5] Nevertheless, some general rules relevant to broad categories of cases can still be stated, which this article reviews below.

---

3. As the court observed, the resale of the licenses was not forbidden, "[n]or was it contemplated that the Government would share in the resale proceeds." *Id.* at *6.

4. S. Rep. No. 615, 96th Cong., 2d Sess. at 4 (1980). "Fraudulent interference with the government's activities damages the government in numerous ways that vary from case to case. Accordingly, the committee believes that the courts should remain free to fashion measures of damages on a case by case basis. The Committee intends that the courts should be guided only by the principles that the United States' damages should be liberally measured to effectuate the remedial purposes of the Act, and that the United States should be afforded a full and complete recovery of all its damages." *Id.*

5. Notably, proof of financial damages is not required for liability under the Act. U.S. *ex rel.* Romano v. New York Presbyterian Hospital, 2006 WL 897208 (S.D.N.Y. April 6, 2006); Young-Montenay, Inc. v. United States, 15 F.3d 1040 (Fed. Cir. 1994); United States *ex rel.* Harrison v. Westinghouse Savannah River Co., 176 F.3d 776, 785 n.7 (4th Cir. 1999); United States v. Advance Tool Co., 902 F. Supp. 1011, 1018 (W.D. Mo 1995). Penalties can still be awarded in such circumstances. U.S. *ex rel.* Hagood v. Sonoma County Water Agency, 929 F.2d 1416, 1421 (9th Cir. 1991).

A. Common Schemes and Corresponding Damage Theories

1. Overbilling

A common type of False Claims Act case involves overbilling by a contractor for goods or services provided. In such cases, the measure of damages is relatively simple. Courts look at the additional amount paid beyond what should have been paid for the products or services provided to determine the Government's damages. *See e.g. United States v. Halper*, 490 U.S. 435 (1989) (in case where doctor upcoded charges for office visits by patients, measure of damages the additional amount billed beyond the amount properly due for the services provided); *United States v. Grannis*, 172 F.2d 507, 509 (4th Cir. 1949) (combination of improperly charged profits and rebates not passed on to government the measure of damages).

2. Substandard Products

In *United States v. Bornstein*, 423 U.S. 303 (1976), the Court endorsed a benefit-of-the-bargain approach to calculating damages in the context of substandard products sold to the Government. The defendant in the case supplied substandard radio tubes, pursuant to a subcontract, which were then included in radios sold to the Government by the prime contractor. The Supreme Court subsequently held that "[t]he Government's actual damages are equal to the difference between the market value of the tubes it received and retained and the market value that the tubes would have had if they had been of the specified quality." *Id.* at 317 n. 13.

Cases interpreting *Bornstein's* benefit-of-the-bargain rule have held the difference in value can amount to as much as the full contract value or even the replacement cost of the product in question.

In *United States v. Aerodex*, 469 F.2d 1003 (5th Cir. 1973), the measure of damages was the full amount of the contract. The defendant in *Aerodex* had delivered falsely denominated aircraft engine bearings to the Navy. Upon discovering the problem, the Government removed and replaced the bearings with the correct bearings. The Fifth Circuit thus awarded the total contract price of $27,000 as damages, holding that "[t]he Government paid $27,000 for bearings it did not receive." *Id.* at 1011. The market value of the falsely labeled bearings was implicitly assumed to be zero. *See also Faulk v. United States*, 198 F.2d 169 (5th Cir. 1952) (in case where defendant substituted reconstituted milk for fresh milk, jury not instructed to consider market value of reconstituted milk in measuring damages) (cited in *Bornstein*).

In *United States ex rel. Roby v. Boeing Co.*, 302 F.3d 637 (6th Cir. 2002), the benefit-of-the-bargain rule was effectively interpreted to permit recovery of replacement costs. In *Roby*, a subcontractor delivered a defective gear to defendant Boeing, which included the part in a helicopter delivered to the Army. The helicopter subsequently crashed, due to the defective gear. Boeing argued that it should only be liable for the value of the defective gear. Alternatively, it argued that it should only be liable at most

for the $4.1 million it was paid by the Government for the helicopter. *Id.* at 646. The Sixth Circuit disagreed, noting that the part was "flight critical." *Id.* at 647. In this context, the Government's damages equaled "the difference between the market value of [the helicopter] as received (zero) and as promised." *Id.* at 648. While the Government was not entitled to damages based on the value of a new helicopter, it was entitled to the value of a remanufactured helicopter that met contract specifications.[6]

A similar conclusion was reached in *Commercial Contractors, Inc. v. United States*, 154 F.3d 1357 (Fed. Cir. 1998). In *Commercial*, the defendant constructed a flood canal that was substantially defective, but it was not possible to determine the actual loss in value of the product supplied. The Court, relying on principles articulated in the Restatement (Second) of Contracts, therefore held that the Government could recover the replacement cost of the channel, as long as it could establish the defective work undermined the channel's structural integrity or the cost of repair was "not clearly disproportionate to the probable loss in value caused by the defects in question." *Id.* at 1373. *See also Advance Tool Co.*, 902 F. Supp. 1011, 1017 (W.D. Mo. 1995) (no award of damages where government did not present evidence concerning fair market value of goods provided by defendant); *Ab-Tech Constr., Inc. v. United States*, 31 Fed. Cl. 429, 434 (1994) (damages not awarded to government due to its failure to prove a difference in value between what it paid for and what it received), *aff'd*, 57 F.3d 1084 (Fed. Cir. 1995).[7]

3. Failure to Deliver Products or Services

In failure to deliver cases, courts frequently assess damages based on the amount paid for that which was not provided. *See e.g., United States v. Krizek*, 909 F. Supp.. 32 (D.D.C. 1995) (claims submitted to Medicare and Medicaid for psychiatric services not actually provided). But this reasoning makes sense only when the false representation involves a product or service that does not need to be replaced (e.g., a medically unnecessary service for a Medicare patient). When a product or service is not delivered as originally promised, and the Government still needs to obtain the product or service, it is more appropriate to apply the benefit-of-the-bargain rule, as doing so protects the Government against an increase in price of the product or service. *See United States v. Bornstein*, 423 U.S. 303 (1976).

4. Failure to Test

When the fraud at issue involves a failure to test, the reasoning applied by courts generally echoes the "benefit of the bargain" test, but miscellaneous factors (including,

6. The court noted that the crash of the helicopter and its contents caused a loss of "at least $10 million." *Id.* at 640. For additional discussion of *Roby* and consequential damages, see Section II(C) *infra*.

7. The benefit-of-the-bargain rule should not be confused with the out-of-pocket rule of damages. The out-of-pocket rule "is stated as the difference between the price paid by the person defrauded and the value of the property he has received in fact from the fraud doer." United States v. Ben Grunstein & Sons Co., 137 F. Supp. 197, 204–05 (D.N.J. 1956); *see also* United States *ex rel.* Marcus v. Hess, 317 U.S. 537 (1943). While both rules consider the value of what was delivered, the benefit-of-the-bargain rule considers the market value of what the government should have received, as opposed to simply what it paid. The benefit-of-the-bargain approach thus includes as damages any increases in price of the product in question between the date of the initial transaction and the day of trial.

but not limited to, the type of product, the government's use of the product, and the costs of inspection and repair) can lead to awards ranging from nominal damages to replacement cost and more.

In *United States ex rel. Compton v. Midwest Specialties, Inc.*, 142 F.3d 296 (6th Cir. 1998), the defendants failed to perform tests of brake shoe kits delivered to the Army. Subsequent testing by the Government indicated that more than 60 percent of the kits did not meet contract specifications. *Id.* at 302. In light of these facts, combined with the Government's decision not to use the brake shoes after discovering the lack of testing, the court deemed the brake shoe kits valueless and awarded the full contract amount as single damages. *Id.* at 304–305.

The Court of Claims reached a similar result in *BMY-Combat Systems v. United States*, 44 Fed. Cl. 141 (1998). In *BMY-Combat*, the defendant failed to perform adequate tests on mounting brackets for howitzers delivered to the Army. The damages awarded by the court included costs of inspection and repair, costs of having replacement brackets manufactured for precautionary purposes, and interest on progress payments. *Id.* at 148–150.

In *United States v. Collyer Insulated Wire Co.*, 94 F. Supp. 493, 496 (D.R.I. 1950), the defendant delivered wire to the United States that had not been tested to the proper specifications, and 51 percent did not, in fact, meet specifications. *Id.* at *498*. The government used the wire, however, and "there were no complaints relative to the cable." *Id.* at 498. In this context, the court awarded only nominal damages.[8]

5. False Certification of Entitlement to Payment

When false statements are made to qualify for program payments (e.g., loan guarantees), "[o]rdinarily, the measure of the government's damages would be the amount that it paid out by reason of the false statements over and above what it would have paid if the claims had been truthful." *United States v. Woodbury*, 359 F.2d 370, 379 (9th Cir. 1966). Cases applying this "but-for" standard have varied in result, depending primarily on whether the government suffered an actual loss.

In *United States v. Ekelman & Associates, Inc.*, 532 F.2d 545, 550 (6th Cir. 1976), the defendants made false statements regarding creditworthiness on a loan application to obtain loan guarantees. The measure of damages applied by the Court included the guarantee amount along with the costs of maintaining and repairing the defaulted property until resold. *Id.* at 551. The court reasoned that, as a result of the fraud, "the property securing the guaranteed and insured loans and the necessary burden of preserving the property were thrust on the government." *Id.* Accordingly, the court concluded "that the government is entitled to the *reasonable* expenses incurred in preserving the property." *Id.* All of the funds included as damages would not have been expended by the Government "but for" the defendants false representations.

Similarly, in *United States v. TDC Mgmt. Corp., Inc.*, 288 F.3d 421, 428 (D.C. Cir. 2002), the government paid for certain ombudsman services by the defendant that ultimately did not have value due to the defendant's failure to avoid conflicts of inter-

8. Notably, $210,000 in penalties were also awarded. *Id.*

est and its attempts to profit from its ombudsman role. In this context, the Court of Appeal upheld the district court's use of a "but for" measure of damages, by including all tainted progress payments to the defendant in damages. *Id.*

The Fourth Circuit, in *United States ex rel. Harrison v. Westinghouse Savannah River Co.*, 352 F.3d 908, 922–923 (4th Cir. 2003), cited *Ekelman's* "but-for" reasoning with approval, but did not award damages in the case, because the government had suffered no actual loss. While the defendant engaged in misconduct in connection with the retention of a subcontractor, there was no evidence the government paid more for the subcontractor than it would have paid for any other firm, and no evidence indicated the subcontractor failed to perform the work for which it was paid. *Id. But see United States v. Brothers Const. Co. of Ohio*, 219 F.3d 300, 317–18 (4th Cir.) (in criminal case where disadvantaged Section 8(a) contractor improperly diverted work to other contractor, full amount paid to contractor deemed government's loss under criminal sentencing guidelines, despite fact that work was completed to contract terms), *cert denied*, 531 U.S. 1037 (2000). *See also Toepleman v. United States, 263* F.2d 697, 700–01 (4th Cir. 1959) (holding that the United States is entitled to recover double the loss it suffered "but for the fraud").

In *United States v. Cooperative Grain and Supply Co.*, 476 F.2d 47 (8th Cir. 1973), the defendant falsely represented that it had produced certain grain, when it had, in fact, only produced 86 percent of the grain. The government, which had paid certain warehousing charges for the grain pursuant to a price support program, argued that all of the warehousing charges should be included in damages. The court, however, concluded that the damage amount should be limited to 14 percent of the warehousing charges, as 86 percent of the grain qualified for the price support. *Id.* at 53. Accordingly, while the Court did not award the Government everything it sought, the court effectively awarded as damages that amount the government would not have paid "but for" defendant's misconduct.

The only decision notably out of line with the foregoing authority is the divided opinion in *United States v. Hibbs*, 568 F.2d 347, 351 (3d Cir. 1977). But the decision, which rejected the "but for" standard employed by the lower court, appears to be wrongly decided. In *Hibbs*, a real estate broker falsely represented to the Government that real property serving as collateral for a guaranteed loan met certain Federal Housing Administration standards. The loan later went into default due to the financial condition of the mortgagor. The Court of Appeal calculated the damages caused by the broker as the difference between the true value of the collateral and the value of the collateral as represented on the loan application. The court did not award the full guarantee payment as damages. The explanation given by the court was that "the same loss would have been suffered by the government had the certifications been accurate and truthful." *Id.*

In *United States v. First National Bank of Cicero*, 957 F.2d 1362 (7th cir. 1992), however, the Seventh Circuit Court of Appeals specifically rejected the Third Circuit's reasoning in *Hibbs*. The Seventh Circuit pointed out that the Third Circuit was mistaken in its assumption that "the same loss would have been suffered" if the representations had been truthful. *Id.* at 1374 n. 12 (quoting *United States v. Hill*, 676 F. Supp.

1158, 1162 (N.D. Fla. 1987)). The Seventh Circuit noted that the district court in *Hibbs* had, in fact, held the Government would *not* have insured the mortgage had it not been for the false certifications. *Id.* Accordingly, if the representations had been accurate, the Government, in reality, "would not have lost any money." *Id.*[9]

6. Premature Progress Payment Requests

Defendants frequently contend that the only damage to the United States in premature progress payment cases is the time value of money. At least one circuit, however, disagrees. In *Young-Montenay, Inc. v. United States*, 15 F.3d 1040 (Fed. Cir. 1994), the defendant made false statements in order to accelerate payments before they would otherwise have been due under the contract. The Federal Circuit held that the measure of single damages was the amount paid prematurely, since "the government was denied the use of the overpaid money" and since, because of the overpayment, "the contractor had less incentive to complete the project in a timely or satisfactory manner." *Id.* at 1043 n.3. *But see United States v. American Precision Products Corp.*, 115 F. Supp. 823, 828 (D.N.J. 1953) (holding government does not suffer damage if it ultimately receives the item for which it has paid; time value of money not considered).

7. Bid-rigging

The "measure of damages under the False Claims Act in cases involving collusive bidding is the difference between what the Government actually paid out to the contractor and what it would have paid for the same work in the competitive market." *United States v. Cripps*, 460 F. Supp. 969, 976 (E.D. Mich. 1978) (competitive price based on actual cost and not including defendant's profit margin); *Brown v. United States*, 524 F.2d 693, 706 (Ct. Cl. 1975) (competitive price determined by taking contractor's actual cost and adding a profit margin). *See also United States ex rel. Marcus v. Hess*, 41 F. Supp. 197, 216 (W.D. Pa. 1941), rev's 127 F.2d 233 (3d Cir. 1942), *reinstated and* aff'd, 317 U.S. 537 (1943) (in bid-rigging case, evidence admitted regarding the difference in price between fraudulent bids and fair competitive bids; contractor's actual costs deemed irrelevant).

8. Defective Pricing

Many government contracts are sole-source contracts that require the government to determine the price of the contract based on the contractor's own cost and pricing information. The Truth in Negotiations Act ("TINA"), 10 U.S.C. 2306a, governs such contracts. Some of TINA's features have been applied to False Claims Act cases, including, most notably, TINA's "rebuttable presumption that the Government is damaged dollar for dollar by the non-disclosed amount once non-disclosure is shown." *See*

9. The dissent in *Hibbs* pointed out that the mistaken result reached by the court was likely driven by the fact that applying the correct rule would have resulted in a harsh remedy against the defendant broker. The damages in the case would have been greater than a typical loan guarantee fraud case, since the real estate serving as collateral turned out to be valueless due to a lead paint condition. *Hibbs*, 568 F.2d at 352.

United States ex rel. Taxpayers Against Fraud v. Singer Co., 889 F.2d 1327, 1333 (4th Cir. 1989) (undisclosed volume discount assumed to have full impact, i.e., had dollar-for-dollar impact on price). The burden is then on the contractor to show "nonreliance on behalf of the Government in order to rebut the natural and probable consequences of the existence of the nondisclosed or inaccurate data." *Sylvania Elec. Products, Inc. v. United States*, 479 F.2d 1342, 1349 (Ct. Cl. 1973).

Multiple Award Schedule contracts awarded by the General Services Administration (for purchases by government agencies of commercially available products) similarly require the submission of pricing information by contractors, for the purpose of insuring that the Government is being given the best available price by the contractor. The measure of damages in such cases is generally the difference between the amount paid by the Government and the amount it would have paid had it been charged the supplier's lowest commercial price. *See generally, United States v. Data Translation, Inc.*, 984 F.2d 1256, 1266 (1st Cir. 1992).

9. Kickbacks

In *United States v. Killough*, 848 F.2d 1523 (11th Cir. 1988), the defendant paid kickbacks to state officials in charge of administering federal funds. The kickbacks paid totaled $577,000, and the jury awarded $633,000 in the case. "The government introduced the inflated invoices into evidence, as well as testimony from other contractors who were willing to do the work for less money and expert testimony on the fair market value . . ." *Id.* at 1531. The court determined that "[a]lthough [the amount of the kickback] was neither a floor nor a conclusive presumption of the measure of damages, it was relevant as circumstantial evidence." *Id.* at 1532. "Taken together, this was more than sufficient evidence from which the jury could have determined damages attributable to the defendants." *Id.* at 1531. The court rejected the argument that the Government had suffered no damages simply because honest contractors had submitted higher bids than the collusive contractors. *Id.* at 1532. See *also United States ex rel. Thompson v. Columbia/HCA Healthcare Corp.*, 20 F. Supp. 1017, 1047–1049 (S.D. Tex. 1998) (in case involving payment of kickbacks by one medical provider to another, where financial impact on government unclear, conduct may still be actionable; "pecuniary damage to the public fisc is no longer required for an actionable claim under the FCA").

B. Statistical Extrapolation

In some FCA cases (often involving the Medicare program), the amount of damages is difficult or impossible to ascertain simply as a consequence of the number of false claims submitted by the defendants in connection with a particular scheme. Courts have permitted proof of damages in such cases through the use of statistical sampling. *See e.g., United States v. Cabrera Diaz*, 106 F. Supp.2d 234 (D.P.R. 2000); *United States v. Krizek*, 192 F.3d 1024 (D.C. Cir. 1999) (psychiatric services). *See also Brooks v. De-*

partment of Agriculture, 841 F. Supp. 833 (N.D. Ill. 1994) (damages over 10 months extrapolated from several month sample of reliable data); *U.S. ex rel. Trim v. McKean*, CIV0-94-617-C (W.D. Okl. 11/20/98) (medical upcoding).

In the related area of Medicare overpayment cases, courts have similarly permitted proof of damages through statistical extrapolation. *See Ratanasen v. State of California*, 11 F.3d 1467 (9th Cir. 1993) (rejecting due process challenges to the use of statistical extrapolation); *Yorktown Medical Laboratory, Inc. v. Perales*, 948 F.2d 84, 89–90 (2d Cir. 1991) (same); *Illinois Physicians Union v. Miller*, 675 F.2d 151, 155 (7th Cir. 1982) ("the use of statistical samples has been recognized as a valid basis for findings of fact in the context of Medicaid reimbursement"); *Chaves County Home Health Service v. Sullivan*, 931 F.2d 914 (D.C.Cir. 1991), *cert. denied*, 502 U.S. 1091, 112 S.Ct. 1160, 117 L.Ed.2d 408 (1992) (holding that HHS could disallow claims by extrapolating from audits of sample Medicare claims, but disallowance subject to appeal by provider).

In employing statistical proof to establish damages, courts have recognized a few basic rules, which should apply equally in FCA cases.

First, there is no rule of law stating how large a sample size must be. *Ratansan v. Cal Dept of Health Services*, 11 F.3d 1467, 1469 (9th Cir. 1993) ("whether the use of sampling and extrapolation is proper is a question of law, while whether the sample size, etc., were appropriate is a question of fact").

Second, there is no rule of law stating that samples must be stratified. *Id*. at 1471–72.

Third, there is no legal requirement that a 90 percent confidence interval be used. The Center for Medicare and Medicaid Services ("CMS") uses the lower bound of a 90 percent confidence interval in Medicare overpayment cases. HCFA Program Manual Memo, Transmittal B-01-01 (January 8, 2001). But this approach, which "works to the financial advantage of the physician," *id*. at 6, while perhaps necessary in a criminal case, should not be required in a FCA case. *See Brown v. Bowen*, 847 F.2d 342, 345 (*7th* Cir. 1988) ("All burdens of persuasion deal with probabilities. The preponderance standard is a more likely than not rule, under which the trier of fact rules for the plaintiff if it thinks the chance greater than .5 that the plaintiff is right. The reasonable doubt standard is much higher, perhaps .9 or better. The clear and convincing standard is somewhere in between"); see also *U.S. v. Shonubi*, 895 F. Supp. 460, 521 (E.D.N.Y. 1995) (describing approximate confidence level required under different burdens of proof as "95% plus" to prove allegations beyond a reasonable doubt, "70% plus" to meet the standard of clear and convincing evidence, and "50% plus" to meet a preponderance of the evidence standard).

FCA cases are not scientific experiments. Simply because statisticians normally use 90 percent or 95 percent confidence intervals when conducting scientific research should not determine the standard appropriate in a civil case. *See e.g. Bazemore v. Friday*, 478 US 385, 400 (1986) ("a plaintiff in a title VII suit need not prove discrimination with scientific certainty; rather his or her burden is to prove discrimination by a preponderance of the evidence."); *Pitre v. Western Electric Co.*, 843 F.2d 1262, 1269 (10th Cir. 1988) ("statistics that are irrelevant to the social scientist may well be rel-

evant to a court . . . [W]hile social scientists search for certainty, the trier of fact in a Title VII case need only find that discrimination is more likely than not").[10]

C. Consequential Damages

Courts have generally held that consequential damages are not recoverable under the False Claims Act. *United States v. Aerodex*, 469 F.2d 1003 (5th Cir. 1972); *BMY-Combat Systems v. United States*, 44 Fed. Cl. 141, 147 (1998). When it amended the Act in 1986, Congress considered the possibility of explicitly including consequential damages but ultimately elected not to do so. *Cook County v. United States ex rel. Chandler*, 538 U.S. 119, 131 n. 9 (2003). There is still, however, some debate over the definition of consequential damages, and there are exceptions to the general rule in cases where it is not possible for the Government to prove the exact amount of its damages.

As the district court aptly stated in *United States ex rel. Roby v. Boeing Co.*, 79 F. Supp. 2d 877, 894 (S.D. Ohio 1999), the issue "boils down to one of causation, specifically, proximate causation."[11] The court noted that Black's Law Dictionary defines consequential damages as: "such damage, loss or injury as does not flow directly and immediately from the act of the party . . . damages which arise from the intervention of special circumstances not ordinarily predictable." *Id.* at 891, n. 41 (internal quotes omitted). In contrast, direct damages are those "which arise naturally or ordinarily from a breach of contract; they are damages which in the ordinary course of human experience can be expected to result from a breach." *Id.* at 890, n. 39 (internal quotes omitted). Thus, while acknowledging that consequential damages are not recoverable under the Act, the court held that "if the Government and relator present sufficient evidence that the damages sought are of a direct, proximate, and foreseeable nature, then those damages may be available to the Government and Relator under a FCA theory of recovery." *Id.* at 895. The court also noted the availability of damages for "incidental or maintenance" costs resulting from a fraud, as distinguished from "consequential damages." *Id.* All these issues were held to be questions of fact. *Id.*

On appeal, the Sixth Circuit upheld the district court decision, initially noting that the amount "wrongfully paid" was the amount paid in response to Boeing's entire claim for payment, not just the amount paid for the defective gear. *United States ex rel Roby v. Boeing,* 302 F.3d 637, 646–647 (6th Cir. 2002). But the contract amount was not the measure of damages.[12] Consistent with the benefit-of-the bargain rule, the court held the Government's damages equaled "the difference between the market value of [the helicopter] as received (zero) and as promised." *Id.* at 648. While the Government was not entitled to damages based on the value of a new helicopter, it was

10. *See also* Bigelow v. RKO Radio, 327 U.S. 251, 264 ("The jury may make a just and reasonable estimate of the damage based on relevant data . . . In such circumstances, juries are allowed to act on probable and inferential as well as upon direct and positive proof"); United States v. Halper, 490 U.S. 435, 446 (1989) ("the Government is entitled to rough remedial justice, that is, it may demand compensation according to somewhat imprecise formulas such as reasonable liquidated damages or a fixed sum plus double damages").

11. For additional discussion of *Roby*, see Section II(A)(2) *supra*.

12. The court distinguished *United States ex rel. Compton v. Midwest Specialties, Inc.*, 142 F.3d 296, 305 (6th Cir. 1998), which awarded the contract amount as damages, based on the fact that the Government "apparently did not claim that its full or actual damages were more than the contract price in *Compton* . . . ."

entitled to the value of a remanufactured helicopter that met contract specifications. *Id. See also United States v. Woodbury, 359 F.2d 370,* 379 9th Cir. 1966) (government's damages included "money spent by its employees in straightening out the mess [caused by the false claims] and in protecting its interest thereafter"); *United States v. Ekelman & Assocs., Inc.,* 532 F.2d 545, 550–51 (6th Cir. 1976) (in loan fraud case, Government permitted to recover not only the guarantee amount but also the reasonable expenses incurred in preserving the properties that served as collateral for the loans); *Daff v. United States,* 31 Fed. Cl. 682, 695 (1994) (damages included government's inspection and repair costs resulting from failure of contractor to reveal fact that product had failed to pass required tests).

In those cases where it is not possible for the Government to quantify its damages, damages akin to consequentials may be permissible. In such cases, the "replacement costs" or the "cost of remedying defects" may be used as measures of damages if those costs are "not clearly disproportionate to the probable loss in value caused by the defects in question." *Commercial Contractors, Inc. v. United States,* 154 F.3d 1357, 1372–1373 (Fed. Cir. 1998). "The cost of remedying defects is not regarded as disproportionate if the defects significantly affect the integrity of a structure being built. In that setting, the injured party is entitled to recover the cost of remedying the defects despite the fact that the cost may be very high." *Id.* at 1372. *See also Daff v. United States,* 78 F.3d 1566 (Fed. Cir. 1996) (costs incurred in testing and repairing included in single damage calculation); *BMY-Combat Systems v. United States,* 44 Fed. Cl. 141 (1998) (damages included costs of replacement parts, costs of inspection and replacement of parts, and interest).

D. Reverse False Claims

The False Claims Act provides for the award of damages against defendants who use a "false record or statement to conceal, avoid, or decrease an obligation to pay or transmit money or property to the Government." 31 U.S.C. 3729(a)(7). Determining what has been underpaid to the government often raises issues similar to those in cases involving affirmative claims for payment. If a defendant understates their obligation to pay a specific amount, calculating damages involves simply determining the difference between the amount paid and the amount due—effectively the converse of the approach used in overbilling cases. The primary tasks are to determine whether an obligation exists and the amount of that obligation. Once the existence and dollar value of the obligation is determined, the damage calculus generally proceeds the same way. *See e.g. United States ex rel. Dunleavy v. County of Delaware,* 1998 WL 151030 (E.D. Pa. 1998).

E. Mitigation

In *Toepleman v. United States,* 263 F.2d 697, (4th Cir.), *cert. denied sub nom. Cato Bros., Inc. v. United States,* 359 U.S. 989 (1959), the defendant made false representations concerning cotton held by the government as collateral on a loan. The defendant of-

fered to redeem the cotton shortly after the fraud was discovered, when it could have been sold at a profit, but the government declined the offer and sold the cotton several years later at a loss. Under these circumstances, the defendant argued it should not be liable for the loss suffered by the government on the transaction. The Court of Appeals, however, held as follows: "Having by his fraud thrust this burden on the United States, the appellant cannot be exonerated by the failure of the Government to cast it off at the most propitious time. The fraud was the effecting cause of the loss, the drop in the market a foreseeable incident." *See also United States v. Ekelman & Associates, Inc.*, 532 F.2d 545 (6th Cir. 1976) (citing *Toepleman*).

F. Government Discovery of Fraud and the Damage Amount

The argument is sometimes made by defendants that the government's damages under the False Claims Act should stop accruing once the government discovers the defendant's fraud, but this argument is without merit. In *United States v. Ehrlich*, 643 F.2d 634, 639 (9th Cir.), *cert.* denied, 454 U.S. 940 (1981), the Ninth Circuit held that defendants were liable for payments made after the government's discovery of fraud, noting that, if the government had ceased making payments, it would have been potentially liable to a third party. Practical concerns like this frequently motivate the government to continue making payments when it becomes aware of fraud, making it appropriate to leave the burden on defendants, rather than the government, to discontinue the conduct. *Compare U.S. ex rel. Hagood v. Sonoma County Water Agency*, 929 F.2d 1416 (9th Cir. 1991) (government knowledge not a defense as to falsity of claim).

G. Interest

It is generally accepted that prejudgment interest is not available under the FCA, as relief for this harm is contemplated by the Act's treble damage provisions. *Cook County v. United States ex rel. Chandler*, 538 U.S. 119, 131 n. 9 (2003) (in explaining compensatory component of treble damages, Court noted that "[t]he FCA has no separate provision for prejudgment interest, which is usually thought essential to compensation."); *but see United States v. Cooperative Grain and Supply Co.*, 476 F.2d 47 (8th Cir. 1973) (awarding prejudgment interest).

III. CALCULATING THE ULTIMATE DAMAGE AWARD

The Act provides for the award of treble the single damage amount. The trebling calculation is based on the amount of the United States damages at the time it pays the false claim. *See United States v. Ekelman Associates, Inc.*, 532 F.2d 545, 550 (6th Cir. 1976). After a payment has been made on a false claim, defendants will sometimes reimburse the falsely claimed amount or the government will otherwise mitigate its damages. In such cases, treble damages are still calculated in the same fashion (i.e., based on the damage resulting from the initial false claim) and the amount recovered by the Government is simply credited against the trebled amount. *Id. See also United*

States v. Bornstein, 432 U.S. 303, 306–07 (1976) ("make-whole purpose of the Act is best served by doubling the Government's damages before any compensatory payments are deducted"); *Young-Montenay, Inc. v. United States*, 15 F.3d 1040 (Fed. Cir. 1994) (in case where defendant fraudulently collected $49,000 in progress payments before they were due, court awarded treble that amount—$147,000, despite the government's request for only the net amount of $98,000).[13]

IV. DETERMINING PENALTIES UNDER THE ACT

The statutory language on penalties under the FCA is mandatory. It states that any person who violates the False Claims Act "is liable to the United States Government for a civil penalty . . . ." 31 U.S.C. 3729(a). Courts have historically read this language as making the imposition of penalties automatic under the terms of the Act. *United States v. Killough*, 848 F.2d 1523, 1533 (11th Cir. 1988) (penalties "mandatory for each claim found to be false"); but see *Peterson v. Weinberger*, 508 F.2d 45, 55 (5th Cir. 1975) (holding district court had discretion to award penalties in proportion to the damages sustained by the Government); *United States ex rel. Garibaldi v. Orleans Parish School Board*, 46 F. Supp. 2d 546 (E.D. La. 1999) (follows *Peterson*).

A. Determining the Amount of Each Penalty

The False Claims Act originally specified a $2,000 penalty per violation. 31 U.S.C. § 231. The 1986 Amendments to the FCA raised the penalty amount to "not less than $5,000 and not more than $10,000 . . . ." 31 U.S.C. 3729(a). As noted supra, to account for inflation, violations of the FCA occurring after September 29, 1999 are subject to increased penalties of between $5,500 and $11,000. *See* 28 U.S.C.A. § 2461 (note); 28 C.F.R. § 85.3(a)(9) (2005).

The Act gives Courts broad discretion in determining the amount of each penalty within the statutory range. In exercising this discretion, Courts have cited one or more of a wide variety of factors, including the culpability of the defendant, criminal prosecution of the defendant, the defendant's financial condition, and the government's costs of investigation and prosecution. The number of penalties has also appeared to play a role. *See Hays v. Hoffman*, 325 F.3d 982, 993–94 (8th Cir. 2003) (defendant's conduct a factor in awarding maximum penalty but number of penalties also reduced

13. A defendant's exposure for damages under the Act may be limited to double damages plus costs if they disclose the fraud in accordance the Act's voluntary disclosure provision:

(A) the person committing the violation of this subsection furnished officials of the United States responsible for investigating false claims violations with all information known to such person about the violation within 30 days after the date on which the defendant first obtained the information;

(B) such person fully cooperated with any Government investigation of such violation; and

(C) at the time such person furnished the United States with the information about the violation, no criminal prosecution, civil action, or administrative action had commenced under this title with respect to such violation, and the person did not have actual knowledge of the existence of an investigation into such violation;

31 U.S.C. 3729(a). *See United* States *ex rel.* Falsetti v. Southern Bell Tel. and Tel. Co., 915 F. Supp. 308, 312 (N.D. Fla. 1996) (noting the omission of penalties in the Act's voluntary disclosure provision).

by decision); *UMC Electronics Co. v. United States*, 43 Fed. Cl. 776 (1999), *aff'd*, 249 F.3d 1337 (Fed. Cir. 2001) (defendant's conduct a factor in awarding maximum penalty but only one penalty awarded); *U.S. ex rel. Virgin Islands Housing Authority v. Coastal General Construction Services Corporation*, 299 F. Supp. 2d 483 (D.V. I. 2004) (defendant's conduct, government's costs, public policy concerns, criminal prosecution of defendant, and defendant's ability to pay considered in awarding 10 penalties of $5,000); *U.S. v. Bottini*, 19 F. Supp. 2d 632 (W.D. La. 1997), *aff'd*, 159 F.3d 1357 (5th Cir. 1998) (defendant's conduct and ability to pay both factors); *United States v. Stocker*, 798 F. Supp. 531 (E.D. Wis. 1992) (government's costs considered in awarding 28 penalties of $5,000).

B. Determining the Number of Penalties

The number of penalties under the Act is typically based on the number of demands for payment by the Government. *See U.S. v. Krizek*, 111 F.3d 938–40 (D.C. Cir. 1997); *United State v. Woodbury*, 359 F.2d 370 (9th Cir. 1966); *United States v. Aerodex*, Inc. 469 F.2d 1003, 1011 (5th Cir. 1973); *U.S. v. Rohleder*, 157 F.2d 126, 130–131 (3d Cir. 1946); *U.S. v. Grannis*, 172 F.2d 507, 515–516 (4th Cir. 1949); *Miller v. United States*, 550 F.2d 17, 23–24 (Ct. Cl. 1977).

But some courts, consistent with the Supreme Court's holding in *United States v. Bornstein*, 423 U.S. 303, 313 (1976), have focused on the defendant's wrongful acts and thus properly considered false statement and conspiracy violations in assessing penalties as well. *See U.S. ex. rel. Koch v. Koch Industries*, 57 F. Supp.2d 1122 (N.D. Okla. 1999) (penalties based on number of leases where royalties underreported; not based on single payment demand into which false information was consolidated); *United States v. Zan Machine*, 803 F. Supp. 620, 624 (E.D.N.Y. 1992) (penalties assessed based on the number of false records, rather than payment demand); *United States v. Greenberg*, 237 F. Supp..439, 443 (S.D.N.Y. 1965) (false payroll reports used rather than payment demand); *United States v. Board of Education of the City of Union City*, 697 F. Supp. 167, 175–177 (D.N.J. 1988) (penalties assessed based on number of false claims, false records or statements, and conspiracy); *see also United States v. Peters*, 927 F. Supp. 363 (D. Neb. 1996), *aff'd*, 110 F.3d 616 (8th Cir. 1997) (penalties assessed based on false claims and conspiracy).

In cases where defendants are conducting business indirectly with the Government, the number of penalties may be determined by the number of fraudulent acts by the defendant, which may or may not necessarily coincide with the number of resultant payment demands on the Government by the company conducting business directly with the Government. *See Bornstein*, 423 U.S. at 313 (penalties assessed against subcontractor based on number of deliveries by subcontractor; not based on number of claims made against the Government by the prime contractor). *See also United States v. Ehrlich*, 643 F.2d 634 (9th Cir. 1981) (where defendant submitted false information to mortgagee and aware the false information would lead to false claims, defendant assessed penalty for each false claim submitted to govoucher).

V. CONSTITUTIONAL LIMITATIONS ON PENALTIES AND DAMAGES

A. Penalties

In cases involving large numbers of claims, constitutional limits have sometimes been placed on the number of available penalties.

1. Double Jeopardy Clause

Historically, the only constitutional limit on penalties was derived from the Double Jeopardy Clause. In *United States v. Halper*, 490 U.S. 435 (1989), the Supreme Court reasoned that, in cases where the defendant had a prior criminal conviction, a large penalty award under the FCA could effectively amount to punishment and thus violate the Double Jeopardy Clause.

In *Hudson v. United States*, 522 U.S. 93 (1997), however, the Supreme Court reconsidered *Halper* and rejected its "punitive versus non-punitive" framework for evaluating penalties. The issue, in the Court's view, was whether the penalties were criminal or civil. The Court concluded that civil penalties could only be considered criminal in effect if Congress intended them to be so, or the "clearest proof" demonstrated they were "so punitive in form and effect as to render them criminal despite Congress' intent to the contrary." *Id. (internal citation omitted).* Civil False Claims Act penalties would plainly never meet the foregoing standard and thus could not present a basis for a Double Jeopardy violation. Notably, however, the Court also observed that "the Due Process and Equal Protection Clauses already protect individuals from sanctions which are downright irrational . . . [and] [t]he Eighth Amendment protects against excessive civil fines, including forfeitures." *Id.* at 103. This observation presaged the Court's subsequent analysis of these same issues.

2. Excessive Fines Clause

The Eighth Amendment provides: "Excessive bail shall not be required, nor excessive fines imposed, nor cruel and unusual punishments inflicted." *U.S. Const., Amdt. 8.*

In *United States v. Bajakajian*, 524 U.S. 321 (1998), the Supreme Court applied the Excessive Fines clause for the first time, in a case involving a forfeiture for failure to report currency. The Court examined two issues in determining whether the sanction violated the Excessive Fines Clause: First, the Court examined whether the forfeiture was punitive; then, upon concluding that it was, the court evaluated whether the forfeiture was excessive. On the latter issue, the Court held "a punitive forfeiture violates the Excessive Fines Clause if it is grossly disproportional to the gravity of the defense it is designed to punish." *Id.* at 322.

Four main factors were relevant to the Court in evaluating the gravity of the defendant's offense: (1) the severity of the violation; (2) whether the crime was related to any other illegal activities, (3) the maximum criminal penalty the defendant might have faced, and (4) the harm caused by the violation. *Bajakajian*, 524 U.S. at 337–40.

Subsequent to *Bajakajian*, the Ninth Circuit held in *United States v. Mackby*, 339 F.3d 1013 (9th Cir. 2003) that an award of $174,454.92 in treble damages and $550,000 in penalties was not excessive under the Eighth Amendment. While the court did not consider the *Bajakajian* factors a "rigid set of factors," it did reference them in its decision. *Id.* at 1017.

The Court of Appeal first pointed to the fact that, unlike the defendant in *Bajakajian*, Mackby was "among the class of people targeted by the Act." Also, while Mackby was assessed $550,000 in penalties, he had committed a total of 8499 violations of the Act. *Id.* at 1018.

In comparing the penalties and damages awarded against Mackby to the potential criminal sanction for the conduct, the court observed that the criminal sanction could conceivably have been worse—several years of jail time and restitution for the full amount of the fraud. *Id.* Also relevant was the fact that the defendant's conduct—falsely representing himself as a licensed medical provider—harmed the Government, both in the form of monetary damages and harm to the administration and integrity of Medicare. *Id.* at 1018–1019.

Lastly, the Court noted that "some part of the judgment against Mackby [was] remedial." *Id.* Relying on *United States v. Bornstein*, 423 U.S. 303, 314 (1976), the Ninth Circuit observed that the pre-amendment version of the Act—which called for double damages and $2,000 in penalties per false claim—had been deemed "largely remedial" by the Supreme Court. *Id.* at 1019. Accordingly, it held that "at least some portion of the award that was over and above the amount of money actually paid out by the government was similarly remedial." *Id.*

In the end, the Court of Appeals upheld the award of penalties equal to 9.5 times the amount of single damages. *See also TXO Production Corp v. Alliance*, 509 US 443 (1993) (in upholding case with $19,000 in actual damages and $10,000,000 in punitive damages, Court observed it has "consistently rejected the notion that the Constitutional line is marked by a simple mathematical formula"); *United States v. Byrd*, 100 F. Supp. 2d 342 (E.D. N.C. 2000) (in case with $85,012 in damages, court awarded $1.3 million in penalties—more than 15 times single damages); *U.S. v. Advance Tool Co.*, 902 F. Supp. 1011, 1018 (W.D. Mo 1995) (court awarded $365,000 in penalties in case with zero damages and $3,430,000 in possible penalties available); *Hays v. Hoffman*, 325 F.3d 982, 993–994 (8th Cir. 2003) ($1.68 million in penalties reduced to $80,000 in case involving $6,000 overcharge; while Excessive Fines Clause not the basis relied upon for the reduction, court noted district court's decision was "laced with Excessive Fines Clause implications").[14]

B. Treble Damages

No case has ever held that treble damages under the FCA violate the U.S. Constitution. In *Vermont Agency of Natural Resources v. United States ex. rel. Stevens*, 529 U.S.

14. As of this date, no court has applied the Due Process clause to limit the award of penalties under the False Claims Act. *But see* State Farm Mutual Automobile Insurance Co. v. Campbell, 538 U.S. 408, 410 (2003) ("in practice, few awards exceeding a single digit ratio between punitive and compensatory damages will satisfy due process").

765, 784 (2000), the Supreme Court described treble damages under the False Claims Act as "essentially punitive in nature." In *Cook County v. United States ex rel. Chandler*, 538 U.S. 119, 130 (2003), however, the Court clarified its statement in *Stevens*, observing that "treble damages have a compensatory side, serving remedial purposes in addition to punitive objectives." *Id.* The Court thus held that the FCA's treble damages provision "certainly does not equate with classic punitive damages," and the Court did not otherwise challenge the provision. *Id.* at 132. It is thus highly unlikely the Act's treble damage provision, by itself, will ever be subject to serious Constitutional challenge. Future cases in this area will undoubtedly be limited to an analysis of the combined impact of damages and penalties in assessing the potential constitutional infirmities of judgments rendered under the Act. *See United States v. Mackby*, 261 F.3d 821 (9th Cir. 2001) ("treble damages provision, at least in combination with the Act's statutory penalty provision, is not solely remedial and therefore is subject to an Excessive Fines Clause analysis under the Eighth Amendment").

Upcoming Legal Battles

Revisiting the Public Disclosure Bar and its Original Source Exception

REVISITING THE PUBLIC DISCLOSURE BAR & ITS ORIGINAL SOURCE EXCEPTION

Jeremy Friedman,[1] *William Hurlock,*[2] *and Claire Sylvia*[3]

I. INTRODUCTION

In the twenty years since Congress revitalized the False Claims Act, one provision has proved more troublesome than any other. Initially intended to address an impediment to *qui tam* actions that the 1943 amendments to the Act had created, the public disclosure bar contained in section 3730(e)(4) has generated unanticipated problems of its own. In some cases, courts have interpreted that provision to operate in the same way as the 1943 provision that section 3730(e)(4) was intended to fix. Reliance on catchy phrases, such as "a whistleblower sounds the alarm, he does not echo it," or the Act seeks to reward "true inside informers," can sometimes substitute for careful analysis of the statutory language, substantial legislative history, and the policy choices reflected in the Act.

Although the history of the public disclosure bar and its original source exception has been recounted in a number of reported cases, that history bears revisiting to highlight how some courts have interpreted the provision in ways not only inconsistent with the text of section 3730(e)(4), but also that undermine the Act and the purposes of that section. In this paper, we revisit the development of this provision, the issues to be addressed in applying the bar and its exception, and recent developments in the case law interpreting both.

II. THE BAR TO CASES BASED UPON THE PUBLIC DISCLOSURE OF ALLEGATIONS OR TRANSACTIONS IN PARTICULAR FORA

A. The Act of March 2, 1863

When the False Claims Act was first enacted in 1863, the Act authorized a person to bring a suit on behalf of the Government to recover double damages suffered by the government from the submission of false claims as well as a civil forfeiture of $2,000 for each false claim. The Act did not authorize the Government to intervene and take control of the case, and the successful plaintiff was awarded one half the amount collected.[4] Although the Act was based on the theory that providing to "a confederate a strong temptation to betray his coconspirator," would produce valuable information, the Act was "not confined to that class."[5]

Eventually, one type of *qui tam* case gave rise to policy concerns. In *United States ex rel. Marcus v. Hess*,[6] the Attorney General sought to persuade the Supreme Court that

1. Jeremy Friedman, Law Offices of Jeremy Friedman, Oakland, California.

2. William Hurlock, Boies, Schiller & Flexner, LLP, Short Hills, New Jersey.

3. Claire Sylvia, Phillips and Cohen LLP, San Francisco, California.

4. Act of March 2, 1863, ch. 67, 12 Stat. 696.

5. Cong. Globe, 37th Cong., 3d Sess. 955–56 (1863).

6. 317 U.S. 537 (1943).

the Act did not authorize purely parasitic *qui tam* suits in which an individual who did not himself have information about fraud simply copied a public criminal indictments filed by the government and then filed an identical civil *qui tam* suit and collected the bounty. Viewing the issue as a straightforward question of statutory construction, the Court disagreed. The Court held that the statute contained "no words of exception or qualification such as we are asked to find."[7] The Court also rejected the Government's argument that allowing such suits was contrary to the purposes of the Act. The Court observed that even if the relator "contributed nothing to the discovery of this crime, he has contributed much to accomplishing one of the purposes for which the Act was passed. The suit results in a net recovery for the government of … three times as much as fines imposed in the criminal proceedings."[8]

B. The 1943 Amendments to the False Claims Act

The Attorney General then turned to Congress, which amended the Act in 1943. Among the significant changes, the 1943 amendments provided that courts lacked jurisdiction over any *qui tam* action that was "based upon *evidence or information in the possession of the United States, or any agency, officer or employee thereof*, at the time such suit was filed."[9]

Courts interpreted this provision expansively to mean that if the "the evidence and information in the possession of the United States at the time the False Claims Act suit was brought was sufficient to enable it adequately to investigate the case and make a decision whether to prosecute," the *qui tam* suit was barred.[10] This provision thus came to be known as the "government knowledge bar" because it precluded any *qui tam* suit if the government already had information about the fraud in its possession, regardless of who in the government bureaucracy had the information and whether anything was happening with the information. Moreover, government knowledge precluded a *qui tam* action even if it was not parasitic at all. For example, in *United States ex rel. Wisconsin v. Dean*,[11] the Seventh Circuit held that the relator, the State of Wisconsin, was precluded from bringing a *qui tam* action because the Government was already aware of the fraud allegations. But the only reason the Government was already aware of the allegations was that Wisconsin had previously reported them, as it was required to do by law.[12]

7. Id. at 547.

8. Id. at 545.

9. Act of December 23, 1943, ch. 377, 57 Stat. 608. The amendments also required relators to provide all their information to the Department of Justice at the time they filed the complaint and gave the Department the opportunity to intervene and take exclusive control over the suit. The amount of the relator's reward was also reduced from 50 percent to a discretionary amount not to exceed 10 percent if the Government intervened, and not to exceed 25 percent if the Government did not intervene.

10. Pettis ex rel. United States v. Morrison-Knudsen Co., Inc., 577 F.2d 668, 674 (9th Cir. 1978).

11. 729 F.2d 1100 (7th Cir. 1984).

12. The 1986 government knowledge bar was recently applied retroactively to bar a *qui tam* case involving allegations that predated the 1986 amendments. See United States ex rel. Makro Capital of America, Inc. v. UBS, 436 F. Supp. 2d 1342 (S.D. Fla. 2006)(noting that "Congress has implicitly agreed with [relator's] criticism" that the 1943 amendments were inconsistent with the general purpose of the False Claims Act and its *qui tam* provisions, but that the policy considerations underlying the repeal of the section were not relevant to the relator's case).

C. The 1986 Amendments

When Congress revisited the False Claims Act in 1986, it identified the 1943 "government knowledge bar" as one of the reasons the *qui tam* provisions of the Act had been rendered largely ineffective as a fraud fighting tool.[13] Congress sought to remove the barrier that had been created to *qui tam* suits, while at the same time not opening the door to purely parasitic suits that were based on copying indictments and government investigations. The new amendment sought to bar parasitic actions that were based upon information that had already been disclosed in certain types of government proceedings, while still allowing a person who had voluntarily brought the information to the government before filing suit (as, for example, the relator in *United States ex rel. Wisconsin v. Dean*, *supra*) to proceed with his case.[14] The result was section 3730(e)(4), which provides:

> (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 [General] 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.
>
> (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.

This section, which was intended to eliminate the government knowledge bar, has, like its predecessor, been interpreted expansively by the courts. As a result, the provision has precluded a broad range of *qui tam* suits, and in some cases has been interpreted in a way that reverts to the 1943 version of the law.[15]

At the most general level, the section requires a two-step inquiry. First, a court must determine whether the complaint is based upon a public disclosure of allegations or transactions in one of the statutorily enumerated fora. If there has been a such a disclosure, the case may still proceed if the relator is an "original source" of the information within the meaning of subsection 3730(e)(4)(B). The following sections discuss the main issues that arise in applying the public disclosure bar and its original source exception, with emphasis on recently decided cases.

13. S. Rep. No. 345, 99th Cong., 2d Sess. (1986).

14. See United States ex rel. Lamers v. City of Green Bay, 168 F.3d 1013, 1017 (7th Cir. 1999).

15. See 145 Cong. Rec. E1546 (July 14, 1999)(remarks of Rep. Berman and letter to Attorney General Reno) (critiquing cases).

III. PUBLIC DISCLOSURE

A. Public Disclosure in an Enumerated Fora

Although called the "public disclosure bar," section 3730(e)(4) is not triggered by *any* public disclosure. The public disclosure of the fraud must have taken place "in" one of the following fora enumerated in the statute:

- a criminal, civil, or administrative hearing;
- a congressional, administrative, or [General] Accounting Office report, hearing, audit, or investigation;
- or from the news media.[16]

Most courts have recognized that this list is an exclusive list of the possible sources of public disclosure that could trigger the bar.[17] It is important to address at the outset whether a particular alleged disclosure in fact even occurred in one of the enumerated fora, as not every public disclosure triggers the bar, and failure to raise this argument can waive it.

Despite Congress's adoption of an exclusive list of public disclosures that it determined struck the appropriate balance between encouraging *qui tam* relators and precluding parasitic suits, defendants have sought to read this section broadly to block *qui tam* suits.[18] Courts have also sometimes read this section expansively to include a range of situations where the government could have *potentially* learned of the fraud.[19] As one example of this, a number of courts initially concluded that a government agency's response to a Freedom of Information Act ("FOIA") request constituted a "public disclosure" within the meaning of section 3730(e)(4).[20] While any member of the public *could* seek the information, and the information is in the possession of the Government, that is not the criteria for triggering the public disclosure bar under section 3730(e)(4). A FOIA response does not fall into any of section 3730(e)(4)'s enumerated categories, as it is not itself an investigation, report, or hearing. While some courts have viewed a FOIA response as a "report," as Judge Becker of the Third Circuit pointed out in his dissenting opinion in *United States ex rel. Mistick PBT v.*

16. See United States ex rel. Haight v. Catholic Health Care West, 445 F.3d 1147, 1151–52 (9th Cir. 2006).

17. See, e.g., United States ex rel. Dunleavy v. County of Delaware, 123 F.3d 734, 744 (3rd Cir. 1997); United States ex rel. Smith v. Yale University, 415 F. Supp. 2d 58, 70 (D. Conn. 2006); United States ex rel. DRC, Inc. v. Custer Battles, 2006 U.S. Dist. LEXIS 58217, *40, n.19 (E.D. Va. Aug. 16, 2006).

18. See, e.g., United States ex rel. Fry v. Guidant Corp., 2006 WL 1102397 (M.D. Tenn. Apr. 25, 2006) (rejecting argument that documents the defendant provided to a government entity investigating the *qui tam* relator's allegations constituted a public disclosure).

19. See, e.g., United States ex rel. Smith v. Yale University, 415 F. Supp. 2d 58, 70, n.7 (D. Conn. 2006)(noting split in circuits on whether discovery material that could potentially be made public, but has not been filed with a court, constitutes a public disclosure).

20. See, e.g., United States ex rel. Mistick PBT v. Housing Authority of City of Pittsburgh, 186 F.3d 376, 383 (3d Cir. 1999); United States v. A.D. Roe Co., Inc., 186 F.3d 717 (6th Cir. 1999); United States ex rel. Reagan v. East Texas Medical Center Regional Healthcare System, 384 F.3d 168, 176 (5th Cir. 2004).

Housing Authority of City of Pittsburgh,[21] a FOIA response simply provides documents sought by the request and does not create government work product, like the reports and investigations enumerated in the Act.[22] While documents produced in response to a FOIA request could themselves be reports or investigations that would trigger the bar, the response itself is not necessarily such a document.

In an important recent decision, the Ninth Circuit rejected the argument that a FOIA response is a public disclosure under section 3730(e)(4). In *United States ex rel. Haight v. Catholic Healthcare West*[23] the relator investigated a government-funded research project conducted by one of the defendants and discovered the fraud alleged in her complaint. As part of her investigation, she made a FOIA request for documents related to the study. She obtained a copy of a grant application and continuation forms, as well as a paper written by one of the defendants. She was directed elsewhere to obtain other documents. The defendants moved to dismiss the complaint on the grounds that the FOIA response was a public disclosure under section 3730(e)(4) and therefore the complaint was barred. The district court granted the motion, but the Ninth Circuit reversed.

The Ninth Circuit observed that a FOIA response did not fall into any of the categories enumerated in section 3730(e)(4). The Court agreed with Judge Becker's view that a FOIA request requires only that federal agencies search for records responsive to a FOIA request and is, "in essence, a mechanism for duplicating records in the possession of the federal government."[24] Moreover, the court explained, interpreting the Act to preclude cases based on information derived from materials gained through FOIA was inconsistent with the 1986 amendments. The court observed that the public disclosure bar was designed to bar suits where "the government could already be expected to be on notice of the fraud. . . . By limiting the enumerated sources to that narrow list, however, Congress also sought to capitalize on the independent efforts of prospective *qui tam* relators who call information to the attention of the government."[25] Quoting the D.C. Circuit, the Ninth Circuit observed that "'[t]he entire *qui tam* regime is premised on the idea that the government's knowledge of misrepresented claims against the federal fisc (without knowledge that they are misrepresented) does not in itself translate into effective enforcement of the laws against fraud.'"[26] Finally, the court noted that a contrary holding would deter persons who suspect fraud from investigating, because FOIA requests are one of the simplest ways that an interested citizen can uncover possible fraud against the Government. Nor would the court's approach harm the Government, which would benefit from encouraging private citizens with suspicions of fraud to take the most expeditious route toward uncovering the information.[27]

21. 186 F.3d 376 (3d Cir. 1999).

22. Id. at 393 (Becker, C.J., dissenting).

23. 445 F.3d 1147 (9th Cir. 2006).

24. Id. at 1153.

25. Id. at 1154–55.

26. Id. at 1151 (quoting United States ex rel. Springfield Terminal Ry. Co. v. Quinn, 14 F.3d 645, 656 (D.C. Cir. 1994).).

27. Id. at 1155, n.5; see also id. at 1156 (observing that Haight did not act opportunistically, but "performed precisely the sort of investigative work that the *qui tam* provisions of the FCA encourage in order to promote detection of fraud against

Subsequently, the district court in *United States ex rel. Villafane v. Solinger*[28] followed the *Haight* decision, and held that a response under Kentucky's Open Records Act, which it viewed as analogous to FOIA, did not constitute a public disclosure within the meaning of 31 U.S.C. § 3730(e)(4). The court also noted that although it did not need to decide the question, even if a FOIA response did constitute disclosure in one of the fora enumerated in the statute, some courts had questioned whether a *state* report or investigation would be covered.[29]

In *United States ex rel. Rost v. Pfizer, Inc.*,[30] the district court addressed whether a defendant's voluntary disclosure of information to a government official constituted a "public disclosure" that would bar a *qui tam* action. The court rejected this argument, and the reasoning of the Seventh Circuit case on which it was based.[31] The district court reasoned that the term "public" meant the "general public," as distinct from the government that represents the public. In addition, the court reasoned that interpreting public to mean government official would revert to the "government knowledge" bar that Congress rejected when it adopted the 1986 amendments. The court concluded that Congress recognized that when it adopted those amendments that the government's possession of knowledge about fraud does not mean it is in a position to prosecute it and that Congress intended only to bar those suits that are truly parasitic.[32]

B. Based Upon

If there has been a public disclosure of fraud in one of the enumerated fora, the complaint is barred only if it is "based upon" the publicly disclosed allegations or transactions. The "based upon" element of the public disclosure bar has proven quite problematic. The majority of courts have concluded that "based upon" means that the complaint's allegations are "substantially similar to" the disclosed allegations and transactions, *regardless* of where the particular *qui tam* relator obtained his or her information.[33] Courts that have adopted this approach have concluded that where the relator's allegations of fraud have already been disclosed, the relator confers no additional benefit upon the government by repeating the allegations, and should be rewarded only if he or she was an original source of the information.[34] But this is not a natural reading of "based upon." In addition, this reading of the section expands the public disclosure

the government").

28. 2006 U.S. Dist. Lexis 75063 (W.D. Ky. Oct. 12, 2006).

29. *Id.* at *16, n.7.

30. 2006 WL 2501454 at *12 (D. Mass. Aug. 30, 2006).

31. See United States ex rel. Mathews v. Bank of Farmington, 166 F.3d 853 (7th Cir. 1999) (holding that disclosure of information to a competent public official can be a public disclosure).

32. United States ex rel. Rost v. Pfizer, Inc., 2006 WL 2501454 at *12 (D. Mass. Aug. 30, 2006).

33. See, e.g., Minnesota Ass'n of Nurse Anesthetists v. Allina, 276 F.3d 1032, 1044–1047 (8th Cir. 2002); see also United States ex rel. Biddle v. Board of Trustees of Leland Stanford Jr. University, 161 F.3d 533, 538–39 (9th Cir. 1998); United States ex rel. Aflatooni v. Kitsap Physicians Services, 163 F.3d 516, 522 (9th Cir. 1998); United States ex rel. Laird v. Lockheed Martin Eng'g and Sci. Serv. Co., 336 F.3d 346, 352 (5th Cir. 2003); United States ex rel. Smith v. Yale University, 415 F. Supp. 2d 58 (D. Conn. 2006)(citing cases).

34. *Biddle*, *supra*, 161 F.3d 533.

bar to a point that it begins to operate as the 1943 government knowledge bar did—precluding *qui tam* suits that are not in any sense parasitic.

The minority view, adopted by the Fourth and Seventh Circuits, is that the public disclosure bar is triggered only if the complaint is "derived from" the publicly disclosed allegations.[35] These courts interpret "based upon" to mean "use as a basis for" or "derived from," which is also consistent with Congress's goal of barring parasitic actions.[36]

Following the majority approach, in a recent decision the court in *United States ex rel. Smith v. Yale University*,[37] dismissed a *qui tam* complaint that contained allegations "substantially similar" to those disclosed in a previously filed state court action, where the relator had not established that he was an original source of the allegations.[38] The court noted that the law in the Second Circuit, which controlled in that case, as well as the law in a majority of circuits, is that "based upon" means "substantially similar to."[39]

Three recent district court decisions have followed the minority approach and found that a relator's allegations were not "based upon" publicly disclosed information because not derived from it. In *United States ex rel. Olson v. ITT Educational Services, Inc.*,[40] the court found that section 3730(e)(4) did not bar the relator's complaint. Although issues similar to the complaint's allegations had been raised in a federal criminal investigation, the court concluded that the relator's allegations were not "based upon" those disclosures. Following controlling Seventh Circuit law, the court held that an action is "based upon" a public disclosure when it "both depends essentially upon publicly disclosed information and is actually derived from that information." The relator's information was not derived from the public disclosure, rather, it was obtained from his own personal experience as an instructor for the defendant.[41]

In *United States ex rel. Fowler v. Caremark*,[42] the district court found that the relator's allegations, although similar to publicly disclosed allegations, were not "based upon them." Following the Seventh Circuit's test, the court observed that a complaint was not based upon public information if the relator obtained the information from a non-public source, even if the relator's information is identical to the publicly disclosed information.[43] The court found that the relators had personal knowledge of the alleged fraud, conducted their own investigation, and obtained their exhibits through discovery independent of the public disclosure.[44]

35. United States ex rel. Siller v. Becton Dickinson & Co., 21 F.3d 1339 (4th Cir. 1994); United States ex rel. Mathews v. Bank of Farmington, 166 F.3d 853, 864 (7th Cir. 1999); *see also* United States ex rel. Jones v. Horizon Healthcare Corp., 160 F.3d 326, 335–36 (6th Cir. 1998))(Gilman, J. concurring); *Mistick, supra,* 186 F.3d at 394–402 (Becker, C.J., dissenting); United States ex rel. DRC, Inc., v. Custer Battles, 2006 U.S. Dist. LEXIS 58217 * 40, n.20 (E.D. Va. Aug. 16, 2006).

36. *Siller*, supra, 21 F.3d 1339.

37. 415 F. Supp. 2d 58 (D. Conn. 2006).

38. Id. The relator did not argue that his complaint was not based upon the publicly disclosed allegations, but instead argued that he was an original source of the allegations.

39. Id. at 71.

40. 2006 U.S. Dist. LEXIS 1668 (S.D. Ind. Jan. 9, 2006).

41. Id. at *21.

42. 2006 U.S. Dist. LEXIS 5892 (N.D. Ill. Aug. 21, 2006).

43. Id. at *12.

44. Id. at *14–15 (noting that relators were the type of whistle-blowers 31 U.S.C. § 3730 seeks to encourage).

Although the First Circuit has not yet addressed whether it follows the majority or minority interpretation of "based upon," a Massachusetts district court recently adopted the minority view. In *United States ex rel. Rost v. Pfizer, Inc.*,[45] the court held that interpreting "based upon" to mean "derived from" the public disclosure is more consistent with the plain language of the statute. In addition, the court viewed the majority approach as striking "too broadly and effectively prohibit[ing] actions that have not 'fed off' public disclosures and are not parasitic."[46] Noting that the primary objection to this interpretation has been that it potentially renders superfluous the "original source" exception (discussed below), the court observed that this could have been a drafting error in a complex statute, but that that was not a basis for discarding the plain language of the statute.[47]

C. Allegations or Transactions

If there is a public disclosure in one of the designated fora, the case is barred only if the complaint is based upon the publicly disclosed "allegations or transactions." Most courts have concluded that the disclosure need not be identical to the allegations in the complaint, but must include the material elements of the alleged fraud.[48] In an often repeated approach, the D.C. Circuit explained the significance of the terms "allegation" and 'transaction" as follows: using the formula X (misrepresented state of facts) + Y (true state of facts) = Z (fraud), if both X and Y have been disclosed, then the material elements of the fraud are disclosed, even if the plaintiff comes forward with additional evidence. But where only one element of the fraudulent transaction is disclosed, the *qui tam* plaintiff may come forward with the other additional elements.[49]

In a recent decision, the court in *United States ex rel. Cooper & Associates v. Bernard Hodes Group., Inc.*[50] found that the material elements of fraud had been disclosed where the allegedly misrepresented facts that the defendants were small businesses were disclosed in an OIG report, but the true state of facts—that the businesses were not small businesses—had been disclosed in various media reports documenting the size of the businesses.[51]

In another recent case, the Seventh Circuit concluded that disclosure of an industry-wide practice constituted a public disclosure with respect to any potentially identifiable defendant who engaged in the practice. In *United States ex rel. Gear v. Emergency*

45. 2006 WL 2501454 at *12 (D. Mass. Aug. 30, 2006).

46. *Id.*

47. *Id.*

48. See United States ex rel. Springfield Terminal Ry. Co. v. Quinn, 14 F.3d 645, 654 (D.C. Cir. 1994) (both the true state of facts and the allegedly false representations must have been disclosed). See also, e.g., United States ex rel. Cooper & Associates v. Bernard Hodes Group., Inc., 422 F. Supp. 2d 225 (D.D.C. 2006).

49. See *Springfield Terminal*, *supra*, 14 F.3d at 654.

50. 422 F. Supp. 2d 225 (D.D.C. 2006).

51. In this case, the court assumed that the various material elements of fraud may have been disclosed in separate places, without regard to whether the Government would be in a position to put those elements together. See also United States ex rel. Haight v. Catholic Health Care West, 445 F.3d 1147, 1152, n.1 (9th Cir. 2006) (assuming that disclosure need not have been made in a single document).

Medical Associates of Illinois, Inc.,[52] the relator brought a *qui tam* action against a health care provider alleging that the defendant had charged the Government for services performed by medical residents in a University residency program (which are not reimbursable) as if those services had been performed by attending physicians. This type of allegation had been the subject of a nationwide government investigation, known as "PATH" (Physicians at Teaching Hospitals) to determine whether hospitals were engaging in this practice. The investigation and the resulting settlements were widely reported. Although this specific defendant had not been identified in the Government investigation, the court concluded that disclosure of an industry-wide practice would bar a *qui tam* action against *any* defendant who was "directly identifiable" from the public disclosures.[53] Although the defendant in *Gear* was not identified in any of the disclosures, the court concluded that the defendants were "implicated."[54]

In contrast, some courts have concluded that the disclosure must include all the essential elements of fraud against a specifically identified defendant.[55] As one court observed, "Requiring that allegations specific to a particular defendant be publicly disclosed before finding the action potentially barred encourages private citizen involvement and increases the chances that every instance of specific fraud will be revealed. To hold otherwise would preclude any *qui tam* suit once widespread—but not universal—fraud in an industry was revealed."[56]

The importance of working through these issues at an early stage cannot be understated, as is highlighted by the recent decision in *United States ex rel. Cooper & Assoc. v. Bernard Hodes Group, Inc.*[57] There, the court awarded attorney's fees and costs to defendants on the grounds that the relator's action was frivolous and vexatious because the lawsuit "fl[ies] in the face of the available evidence" where the relator knew of the Government's decisions to award the subject contracts to the defendants despite its knowledge that they were not small or disadvantaged businesses.[58]

IV. THE ORIGINAL SOURCE EXCEPTION

The original source exception is a limited exception to the public disclosure jurisdictional bar. Under this exception, even if there has been a public disclosure that would bar a *qui tam* complaint, the relator is not barred from pursuing the case if the relator was an original source of the publicly disclosed information. Conversely, if there has

52. 436 F.3d 726 (7th Cir. 2006).

53. Id. at 729.

54. Id.

55. See United States ex rel. Cooper v. Blue Cross and Blue Shield, 19 F. 3d 562, 566 (11th Cir. 1994); see also United States ex rel. Lidenthal v. General Dynamics Corp., 61 F. 3d 1402 (9th Cir. 1995), cert. denied, 517 U.S. 1104 (1996) (disclosures that make no mention of specific defendant insufficient to invoke bar).

56. United States ex rel. Cooper v. Blue Cross and Blue Shield, 19 F. 3d 562, 566 (11th Cir. 1994); see also 145 Cong. Rec. E1546 (July 14, 1999)(remarks of Rep. Berman and letter to Attorney General Reno) (critiquing notion that report of industry-wide practice sufficiently informs Government of fraud against a particular defendant).

57. 422 F. Supp. 2d 225 (D.D.C. 2006).

58. Id. at 239.

been no public disclosure, "there is no need for a *qui tam* plaintiff to show that he is the 'original source.'"[59]

The Act defines "original source" as an individual who has (1) direct and independent knowledge of the information on which the allegations are based; and (2) has voluntarily provided the information to the Government before filing an action under this section which is based on the information."[60] This section reviews the elements of the original source exception.

A. Direct and Independent Knowledge of the Information

Courts have interpreted "direct and independent" in a myriad of ways. In general, courts view the "direct" requirement as requiring a close connection between the relator and the discovery of the fraud, as for example, when the relator's information derives from his own investigation or observation of events.[61] Independent knowledge is generally viewed as substantive information that is not dependent on the public disclosure.[62] The following recently decided cases are illustrative of how courts have defined this issue.

In *United States ex rel. Nelson v. Biolink Partners*,[63] the relator filed a *qui tam* complaint alleging that defendants received federal grant funds from Government agencies based on false information that they were the true holders of certain patents. The defendants moved to dismiss the action based on the fact that the allegations had been publicly disclosed and the relator was not the original source of the allegations of fraud. The court reviewed the three-part test adopted by the United States Court of Appeals for the Eighth Circuit to determine if a relator is barred by section 3730(3)(4): "(1) Have allegations made by the relator been 'publicly disclosed' before the *qui tam* suit was brought? (2) If so, is the *qui tam* suit 'based upon' the public disclosure? and (3) If so, was the relator an 'original source' of the information on which the allegation was based?"[64] The court observed that independent knowledge has been long recognized as

59. United States ex rel. Haight v. Catholic Health Care West, 445 F.3d 1147, 1151 (9th Cir. 2006)(quoting United States ex rel. Wang v. FMC Corp., 975 F.2d 1412, 1416 (9th Cir. 1992)); United States ex rel. Fry v. Guidant Corp., 2006 WL 1102397 (M.D. Tenn. Apr. 25, 2006); United States ex rel. Nelson v. Biolink Partners, 2006 WL 861338 (D. Neb. Apr. 4, 2006). Thus, in the recent decision in *United States Gibbons v. Kvaerner Philadelphia Shipyard, Inc.*, 2006 WL 328362 (E.D. Pa. Feb. 10, 2006), the court denied the defendants' motion to dismiss for lack of subject matter jurisdiction on the grounds that the relator was not an original source under section 3730(e)(4) because the defendants failed to first establish that the relator's allegations had been publicly disclosed. "Defendants' failure to even allege such a public disclosure dooms the application of the False Claims Act's jurisdictional bar provision." Id. at *8 (noting that the relator also claimed to be an original source, having direct and independent knowledge of the allegations and that she voluntarily provided the information to the government before bringing her *qui tam* suit).

60. See 31 U.S.C. § 3730(e)(4)(B).

61. See, e.g., United States ex rel. Springfield Terminal Railway Co. v. Quinn, 14 F.3d 645 (D.C. Cir. 1994); United States ex rel. Aflatooni v. Kitsap Physician Services, 163 F.3d 516, 525–26 (9th Cir. 1999).

62. See, e.g., United States ex rel. Stinson, Lyons, Gerlin & Bustamante v. Prudential Ins. Co., 944 F.2d 1149, 1160 (3rd Cir. 1991); United States ex rel. Alcan Elec. and Engineering, Inc., 197 F.3d 1014, 1020 (9th Cir. 1999).

63. 2006 WL 861338 (D. Neb. Apr. 4, 2006).

64. Id. at *3. The court characterized this as a test of whether the relator was an "original source," but the test incorporates both the requirement of a public disclosure, and the original source exception. The court did not analyze the public disclosure prong in detail, concluding that the allegations in the complaint were "disclosed to the NIH in the fall of 2001, and to other third parties by e-mails beginning as early as October of 2001." It is unclear from the opinion that these were public disclosures in one of the fora designated in the Act. See supra, section III(A).

"knowledge that is not dependent on public disclosure."[65] Direct knowledge has been defined as "knowledge 'marked by absence of an intervening agency.'"[66] The court found that the relator was an original source because the relator had direct knowledge of the true state of facts (that he was the owner, inventor, and patent holder) even though he did not have personal knowledge of all of the elements of the cause of action (his review of NIH documents confirmed his suspicions that the Defendants had misrepresented their status as the inventors and patent holders).[67]

In *United States ex rel. Smith v. Yale University*,[68] the district court concluded that the relator had not adequately established that he had direct and independent knowledge of the core allegations in the complaint and therefore was not an original source.[69] The court found that the core allegations were not based on the relator's first-hand knowledge, but rather were derivative of other sources.[70]

In *United States ex rel. Rost v. Pfizer, Inc.*,[71] the court found that the relator's knowledge of alleged off-label marketing of a drug was based upon his own direct discovery of information through his personal efforts and investigations.

B. Voluntarily Provide Information to the Government Before Filing the *Qui Tam* Action

Section 3730(e)(4)(B) requires that to qualify as an original source, the relator must have provided the information to the Government before filing an action "under this section." Several courts have addressed this component of the original source exception this past year. The United States District Court for the Northern District of California addressed the mandatory pre-filing disclosure requirement in *United States ex rel. Westerfield v. Univ. of San Francisco*.[72] In *Westerfield*, the relator filed a False Claims Act case alleging that the defendant failed to provide accommodations for disabled students pursuant to the requirements set forth in the Americans with Disabilities Act ("ADA"), falsely certified as a condition to receiving Government funds that it complied with certain statutes relating to discrimination, and manipulated data on the total number of disabled students. The relator filed a state court action prior to filing the *qui tam* action. The Defendant moved to dismiss on the ground that the relator's

65. Id. at *4.

66. Id.

67. Id.

68. 415 F. Supp. 2d 58 (D. Conn. 2006).

69. Id.

70. Id. The court rejected the Defendant's arguments that the relator could not have direct knowledge of allegations relating to events that occurred after he left the defendant's employ. The court concluded that as long as the allegations "flow from matters over which he had direct knowledge while employed" he is not prevented from establishing direct and independent knowledge of allegations solely because some of the conduct continued after his departure. Id. at 73–74. The court also rejected the defendant's argument that some of the allegations were untrue, and therefore the relator could not have direct knowledge of them. The court observed that whether the allegations had merit, was an analytically distinct inquiry and immaterial to the original source issue. Id. at 74–75.

71. 2006 WL 2501454 at *12 (D. Mass. Aug. 30, 2006).

72. 2006 WL 335316 (N.D. Cal. Feb. 14, 2006).

allegations had been publicly disclosed.[73] The relator did not initially contest that "the allegations which form the basis of her False Claims Act claim had been previously disclosed by her complaint and related filings in her state law action," but did argue that she was an original source of the allegations.[74]

The court concluded that the allegations and transactions disclosed in her state court action were "substantially similar" to the allegations contained in her False Claims Act claim and that the relator needed to show that she was an original source of the information.[75] The court observed that to qualify as an original source, the relator must demonstrate that "she voluntarily disclosed the information to the government before filing the [False Claims Act] claim and that she has direct and independent knowledge of the information on which the allegation of her [False Claims Act] claim are based."[76] While the relator represented at the hearing on the motion that she had voluntarily notified the Government before filing the *qui tam* action, she did not so allege in her complaint or provide evidence of this fact. The court dismissed her False Claims Act claims with leave to amend to allege the facts necessary to demonstrate that she voluntarily provided the information to the Government prior to filing suit.[77]

In *United States ex rel. Gear v. Emergency Med. Assoc. of Ill. Inc.*,[78] discussed above, the Seventh Circuit affirmed the district court's ruling that the relator's allegations regarding charging for the services of medical residents as if they were attending physicians were based on public disclosures. The appellate court also affirmed the district court's ruling that the relator was not an original source of the information contained in the allegations because the statute requires the relator to have "voluntarily provided the information to the Government before filing [the] action"[79] and the relator admitted never having spoken to the Government about his claims before filing his lawsuit.[80]

In *United States ex rel. Maxwell v. Kerr-McGee Chem. Worldwide, LLC*,[81] the relator, a Government employee and auditor, filed a *qui tam* complaint alleging that defendants failed to obtain the fair market value for oil produced from certain Government lands. Defendants moved to dismiss because, among other reasons, the allegations were publicly disclosed and the relator was not an original source. The defendants argued that the relator was not an original source because, among other reasons, he could not have voluntarily provided the information to the Government because he was a Government employee and it was his duty to provide the information. The court

73. Id. at *3.

74. Id.

75. Id. at *5.

76. Id.

77. Id. The court rejected the Defendant's argument that the relator was required to inform the Government of the case prior to any public disclosure, rather than prior to the filing of the *qui tam* action. See id. at n.4; see also infra section IV(C) (discussing additional requirement superimposed by some courts, but recently rejected by the Ninth Circuit).

78. 436 F.3d 726 (7th Cir. 2006).

79. Id. at 729.

80. Id. at 730.

81. 2006 WL 1660538 (D. Col. June 9, 2006). The court rejected the argument that his knowledge was not direct because other people did some of the audit work that revealed the fraud, as the relator introduced sufficient evidence to establish his involvement in uncovering the fraud. Id.

found that the relator voluntarily disclosed the information to the Government in his role as a "citizen" prior to filing the *qui tam* complaint.[82]

C. Judicially Created Requirement that Information Be Provided to the Government Before the Actual Public Disclosure Occurs

While section 3730(e)(4)(B) expressly provides that the information must be provided to the Government "before filing an action under this section which is based on the information," some courts have imposed an additional requirement—that the relator voluntarily provide information to the Government *prior to the public disclosure*.[83] This additional requirement has become a significant impediment for relators. The United States Court of Appeals for the Ninth Circuit very recently addressed this issue in *United States ex rel. Zaretsky v. Johnson Controls, Inc.*,[84] and rejected this requirement as inconsistent with the statutory language and purposes.

In *Zaretsky*, the relators, president and vice president of a company, filed a *qui tam* complaint alleging that the defendants engaged in bid-rigging violations involving federal and state Government jobs.[85] Prior to filing the *qui tam* complaint, the relators also filed a civil complaint against the defendants alleging a bid-rigging scheme in violation of the Sherman Anti-trust Act.[86] After filing the civil complaint, but before filing the *qui tam* complaint, relators sent a letter to state and federal officials alleging that the defendants violated the False Claims Act and the California False Claims Act.[87]

Before the discovery cut-off, defendants moved for summary judgment arguing, among the other things, that the district court lacked subject matter jurisdiction because the relators' complaint was based upon a public disclosure and they were not original sources.[88] Defendants argued that because the public disclosure came as a result of the relators' civil lawsuit, they had to provide the Government with the pertinent information *prior* to the public disclosure (*i.e.*, prior to filing the Sherman Act suit).[89] Defendants contended that because the relators did not notify the Governmental entities of the existence of the information until after they filed their civil suit, their claims were barred.[90]

The relators did not contest that the civil complaint formed the basis of a public disclosure, but they argued that the statute did not require that a relator provide the

82. Id. at *7.

83. See, e.g., United States ex rel. Walburn v. Lockheed Martin Corp., 431 F.3d 966 (6th Cir. 2005) (holding that relator's allegations that defendants falsified dosage readings concerning certain gases were publicly disclosed in relator's earlier civil action concerning similar conduct and relator did not qualify as an original source of the information because he failed to report evidence of fraud to the Government prior to filing his *initial* suit).

84. __ F.3d __, 2006 WL 2268938 (9th Cir. Aug. 9, 2006).

85. Id. at *1.

86. Id.

87. Id.

88. Id.

89. Id. at *2.

90. Id.

pertinent information to the Government before the public disclosure. The United States District Court for the Central District of California granted summary judgment in favor of defendants and the relators appealed.

In reviewing the lower court's ruling, the Ninth Circuit reiterated that under the law of that circuit, an "original source . . . must show that he or she has direct and independent knowledge of the information on which the allegations are based, voluntarily provided the information to the government before filing his or her *qui tam* action, and had a hand in the public disclosure of allegations that are a part of the suit."[91] The issue was whether "prospective relators needed to provide the requisite information directly to the Government *prior to the public disclosure* at issue.[92]

In undertaking its analysis, the court recognized the current split in the circuits on this issue. Of the circuit courts that have addressed this specific issue, the Eighth Circuit has held that the False Claims Act does not require a prospective relator to provide the requisite information to the Government prior to a public disclosure.[93] However, the United States Court of Appeals for the Sixth Circuit and the District of Columbia Circuit do require that the relator provide the pertinent information to the Government prior to the public disclosure.[94] The court further concluded that "no other circuit court has directly addressed the issue, although the Tenth Circuit had observed without deciding that the voluntary disclosure element was something to accomplish before filing suit.[95]

In analyzing this issue, the Ninth Circuit found no basis in the text or structure of the False Claims Act for the proposition that information be given to the government before the public disclosure.[96] The district court had concluded that requiring the relator to notify the Government prior to the public disclosure would protect the Government from those relators that would settle a suit prior to the Government discovering it, which would actually limit the Government's ability to learn about fraud perpetrated against it. However, the court of appeals recognized that the statute treats all forms of public disclosure the same. The court realized that pre-filing agreements by a potential relator to refrain from filing suit entered into without the Government's knowledge or consent are unenforceable. The court recognized that the district court's approach did "little to further the goal or ensuring that pre-filing releases do not squelch the flow of information about fraud to the Government."[97] While potential relators could still issue demand letters and settle prospective suits before filing the case that constituted the public disclosure, once suit is filed, the Government has a better chance of discovering it.[98]

91. Id. at *3.

92. Id.

93. Id. (citing Minn. Ass'n of Nurse Anesthetists v. Allina Health Sys. Corp., 276 F.3d 1032, 1050–51 (8th Cir. 2002)).

94. United States ex rel. McKenzie v. BellSouth Telecomms., Inc., 123 F.3d 935, 941–43 (6th Cir. 1997); United States ex rel. Findley v. FPC-Boron Employees' Club, 105 F.3d 675, 690–91 (D.C. Cir. 1997).

95. Id. at *3 (citing United States ex rel. King v. Hillcrest Health Center, Inc., 264 F.3d 1271, 1281, n.3 (10th Cir. 2001).

96. Id. at *8.

97. Id.

98. Id.

In concluding, the Ninth Circuit recognized that "it would change the balance Congress struck if we were to further restrict the class of those whose discoveries had been made public but who were nevertheless permitted to proceed as relators."[99] The court concluded that "the FCA does not require individuals to inform the government prior to the public disclosures at issue to qualify as 'original sources.'"[100]

The United States Court of Appeals for the Sixth Circuit requires that the relator provide the pertinent information to the Government *prior* to the disclosure. A district court in the Sixth Circuit recently followed this approach in *United States ex rel. Fry v. Guidant Corp.*[101] In that case, the relator, a former salesman, filed a False Claims Act case against manufacturers of implant medical devices, defibrillators and pacemakers, alleging companies defrauded Government of certain credits and rebates for replacements. Defendants moved to dismiss on the grounds that, among other reasons, the relator's allegations had been publicly disclosed in a previously filed action and the relator was not an original source. In granting the defendants' motion to dismiss, the Court, adhering to the precedent established in the Sixth Circuit, found the relator was not an original source because he failed to inform the Government of the "alleged fraud before the information was publicly disclosed."[102]

D. Judicially Created Requirement in Certain Circuits That the Relator Must Have Been the Source of the Public Disclosure

In addition to the requirements outlined above, other circuits have superimposed yet another element onto the original source exception. In some circuits, a relator must "play a role in the public disclosure at issue if they are to partake of the original source exception."[103] The Ninth Circuit, one of the circuits that imposes this requirement, did not revisit this requirement in the recent *Zaretsky* case discussed above. The United States Court of Appeals for the Second Circuit also subscribes to this approach.[104]

As courts rejecting this requirement have noted, it has "no basis in text or legislative history."[105] Courts imposing this requirement have concluded that once there has been a public disclosure, a *qui tam* action is unnecessary, and for this reason the section

99. Id. (internal citations omitted).

100. Id. Accord United States ex rel.Westerfield v. Univ. of San Francisco, 2006 WL 335316, at * n.4 (N.D. Cal. Feb. 14, 2006)(discussed *supra*).

101. 2006 WL 1102397 (M.D. Tenn. Apr. 25, 2006).

102. Id. at *9.

103. Zaretsky, __ F.3d __, 2006 WL 2268938 at *6 (citing Wang v. FMC Corp., 975 F.2d 1412, 1417 (9th Cir. 1992) ("section 3730(e)(4)(A) requires a *qui tam* plaintiff to have played some part in his allegation's original public disclosure").

104. See United States ex rel. Dick v. Long Island Lighting Co., 912 F.2d 13, 16 (2d Cir. 1990) ("[T]here is an additional requirement that a *qui tam* plaintiff must meet in order to be considered an "original source," namely, a plaintiff also must have directly or indirectly been a source to the entity that publicly disclosed the allegations on which a suit is based."); see also United States ex rel. Smith v. Yale University, 415 F. Supp. 2d 58, 71, n.9 (D. Conn. 2006) (discussing Circuit split and noting that law in the Second Circuit is to impose this additional requirement).

105. United States ex rel. Mathews v. Bank of Farmington, 166 F.3d 853, 865 (7th Cir. 1999); United States ex rel. Fine v. Advanced Sciences, 99 F.3d 1000, 1006–07 (10th Cir. 1996); United States ex rel Siller v. Becton, Dickinson & Co., 21 F.3d 1339, 1355 (4th Cir. 1994); United States ex rel. Cooper v. Blue Cross & Blue Shield, 19 F.3d 562, 568 n.13 (11th Cir.1994); United States ex rel Stinson, Lyons, Gerlin & Bustamante v. Prudential Ins. Co., 944 F.2d 1149, 1160 (3d Cir. 1991).

should be read to require disclosure to the Government before the public disclosure.[106] While this policy argument may have merit, given that the statute very explicitly provides that the information must be provided before filing suit (and not some other event), there is no reason to reach it.

The court in *United States ex rel. Rost v. Pfizer, Inc.*[107] held that the "unambiguous language of the FCA dictates" the conclusion that the plaintiff need only have disclosed the information to the government before filing the complaint, and that there is no support in the statute for the additional requirements imposed by some courts. The court observed that "[a]lthough the courts that adopt these approaches may think these additional requirements better serve the purpose of the FCA, the text of the statute simply does not support either additional requirement."[108]

This judicially created requirement adds yet another wrinkle to the fabric of the original source exception.

V. CONCLUSION

The public disclosure bar continues to be a significant hurdle for *qui tam* plaintiffs. Although many cases have analyzed the public disclosure bar and its original source exception, returning to the text of the statute, the legislative history, and Congress's purpose in enacting the 1986 changes will be essential to maintaining the balance that Congress struck in adopting section 3730(e)(4).

106. United States ex rel. Findley v. FPC-Boron Employee's Club, 105 F.3d 675, 690–91 (D.C. Cir. 1997).

107. 2006 WL 2501454 at *12 (D. Mass. Aug. 30, 2006).

108. *Id.*