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False Claims Act and *Qui Tam* Quarterly Review

INSIDE...

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

TAF is a nonprofit public interest 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). TAF's mission is both activist and educational. Established in 1986, TAF serves to: (1) collect and evaluate evidence of fraud against the Federal Government and facilitate the filing of meritorious FCA *qui tam* suits; (2) work in partnership with *qui tam* plaintiffs, private attorneys, and the Government to effectively prosecute *qui tam* suits; (3) inform and educate the general public, the legal community, and other interested groups about the FCA and its *qui tam* provisions; and (4) advance public, legislative, and government support for *qui tam*.

TAF 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*.

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Public Disclosure Bar and Original Source Exception

U.S. ex rel. Biddle v. Board of Trustees of the Leland Stanford, Jr. University, 1998 WL 261412 (9th Cir. May 26, 1998)

The 9th Circuit affirmed the lower court's dismissal of a *qui tam* suit for lack of subject matter jurisdiction on public disclosure grounds. The court held that an Administrative Contracting Officer whose job duties included the disclosure of fraud could not have reported the fraud allegations to the Government "voluntarily" as required to be an original source under the FCA. The 9th Circuit also squarely held for the first time that "based upon" under § 3730(e)(4)(A) means "supported by," not "derived from."

Relator Paul Biddle worked as an Administrative Contracting Officer and Resident Representative for the Office of Naval Research (ONR) at Stanford University. In the course of his employment at ONR, Biddle began to believe that Stanford was overcharging the Government for indirect costs associated with its research contracts. After his internal complaint was ignored, in the summer of 1990 Biddle relayed his concerns to a congressional subcommittee. His report to Congress led to an investigation by the General Accounting Office and the Defense Contract Audit Agency. The following fall, the media began reporting on Biddle's allegations, including interviews with Biddle himself. In 1991, Stanford's indirect cost rate was reduced from 76 percent to 55.5 percent.

Biddle filed his *qui tam* action in September 1991. Following a two year investigation, the Department of Justice declined to intervene. In August 1996, the district court granted Stanford's motion to dismiss Biddle's complaint for lack of subject matter jurisdiction on public disclosure grounds.

Relator's Allegations Were "Publicly Disclosed"

The 9th Circuit concluded that Biddle's allegations had been publicly disclosed through the media prior to the his filing suit. The court disagreed with Biddle's assertion that, if a person provides information to the Government which results in an investigation, and evidence of fraud is made public during the investigation, then the allegations regarding the fraud are not treated as "publicly" disclosed under the Act.

In reaching its conclusion, the court relied upon U.S. ex rel. Devlin v. California, 84 F.3d 358 (9th Cir. 1996), 6 TAF QR 2 (July 1996), which involved a relator who had, like Biddle, been the source of information disclosed by the media. Because the allegations in that case were disclosed by the media prior to the filing of the complaint, even though the plaintiff had been the source of the media's information, the Devlin court held that the plaintiff would need to be an "original source" to get past the § 3730(e)(4)(A) public disclosure bar.

"Based Upon" Means "Supported By"

The appellate court ruled that Biddle's complaint was "based upon" the media disclosures. It noted that the 9th Circuit had never explicitly interpreted the "based upon" language in the current version of the statute. Biddle argued that the court should follow the 4th Circuit's decision in U.S. ex rel. Siller v. Becton Dickinson & Co., 21 F.3d 1339 (4th Cir. 1994), which held that "based upon" means "derived from." However, the court found that its prior decisions "implicitly support" the line of cases which have held that "based upon" means "supported by."

The court asserted its opinion that to follow the 4th Circuit's interpretation that "based upon" means "derived from" would render the original source requirement "superfluous." According to the court, "to say that a relator's complaint is not derived from public disclosures is to say that the relator had direct and independent knowledge of the fraud. Thus, under the Siller view, the 'based upon' language in § 3730(e)(4)(A) duplicates the 'direct and independent knowledge' language in § 3730(e)(4)(B), allowing the relator to avoid the voluntariness requirement in § 3730(e)(4)(B)."

The court also stated that Siller's "derived from" definition would not further the policies underlying the FCA. According to the court, if a relator could bring a *qui tam* action after the allegations were publicly disclosed, the relator would not have the proper incentive to bring the information to the Government at the earliest possible time. Furthermore, the court stated that "where the allegations of the fraud are already public knowledge, the relator confers no additional benefit upon the government by subsequently repeating the fraud allegations in his complaint."

Relator Did Not Act "Voluntarily"

Although the court acknowledged that Biddle had direct and independent knowledge of the fraud and that he was the source of the Government's information, it affirmed the district court's ruling that Biddle had a duty as an Administrative Contracting Officer to disclose fraud and therefore could not have provided such information to the Government "voluntarily" as required by § 3730(e)(4)(B). After examining the applicable federal regulations, official documentation of Biddle's responsibilities, and the statements of his supervisors, the 9th Circuit affirmed the district court's finding that Biddle's job description included the exposure and reporting of fraud. The ruling also encompassed Biddle's disclosure of fraud on contracts which existed prior to his arrival at ONR.

U.S. ex rel. Durcholz et al. v. FKW Incorporated et al., 1998 WL 214605 (S.D. Ind. Apr. 27, 1998)

An FCA case brought by an unsuccessful bidder for a government contract awarded to the defendant company was not jurisdictionally barred under FCA § 3730(e)(4) because the relator qualified as an "original source," ruled an Indiana district court. The court then proceeded to dismiss all but one of the relator's FCA claims on the merits.

The *qui tam* suit filed by Robert Durcholz (along with his company, Durcholz Excavating and Construction, Inc.) arose out of a contract awarded to FKW Incorporated to clear sedimentation ponds at the Crane Naval Surface Warfare Center in Crane, Indiana. Durcholz alleged a number of FCA violations by both FKW and Jeffrey Strange, the Government's contracting officer on the ponds project. After unsuccessful bidding for the contract, Durcholz investigated the contracting process and came up with the basis for the lawsuit.

Despite Multiple Contentions by Defendants, § 3730(e)(4)(A) Bar Only Arguably Triggered

Contending that the § 3730(e)(4) jurisdictional bar was applicable, the defendants pointed to the following alleged public disclosures: (1) a discussion at a February 7 meeting by Brian Frederick, FKW's supervisor of operations at Crane, of the allegations later raised in Durcholz's lawsuit; (2) a private conversation regarding the allegations between Durcholz and Frederick; and (3) Durcholz's receipt of multiple documents pursuant to Freedom of Information Act (FOIA) requests.

The district court first summarily dismissed the contention that the Durcholz-Frederick conversation qualified as a public disclosure, stating that the 7th Circuit has "made it clear that

private communications among private parties are not 'public disclosures' under the Act."

While following precedent considering documents released pursuant to FOIA requests to be public disclosures, the court found that, "[a]lthough documents that Durcholz received through his FOIA requests are relevant to this action and provide supporting evidence for his allegations, the principle allegations of fraud were not disclosed in those documents." As such, those FOIA disclosures did not trigger § 3730(e)(4)(A).

The court considered the defendants' argument that the February 7th meeting constituted an "administrative investigation" under § 3730(e)(4)(A) to be questionable. The court noted that the meeting — which was conducted by Strange's supervisor, Commander Laws, and at which Frederick was the only non-government employee — was not pursuant to a formal inquiry and was apparently not a public proceeding. However, it "seemed to be a preliminary examination into the alleged improprieties in the bidding process, suggesting that the term 'investigation' may apply." (In a footnote, the court explained that, while the contents of the February 7th meeting may not have been publicly disclosed by the meeting itself, they "clearly were publicly disclosed" once Durcholz received the meeting's minutes via a FOIA request.)

Relator Qualifies as an "Original Source"

In any event, the court found that, even assuming the February 7th disclosures triggered § 3730(e)(4)(A), Durcholz qualified as an original source under § 3730(e)(4)(B). According to the court, Durcholz had the requisite independent knowledge "since he knew of the information on which his allegations were based absent any public disclosures." Durcholz had "first hand knowledge of the nature of his own bid and obtained additional information from private conversations with Frederick . . . prior to any public disclosures." Moreover, "Durcholz more than satisfies the 'direct knowledge' requirement because he gained his knowledge through his involvement as an unsuccessful bidder and his independent investigation into the process." Added the court:

> This result is consistent with the purposes of Section 3730(e)(4). In enacting the jurisdictional bar to the FCA, Congress sought to discourage "opportunistic" or "parasitic" suits by strangers to the alleged wrongdoing . . . . Durcholz clearly is not a stranger to the events underlying this action and does not represent the type of opportunistic litigant that Congress sought to bar when it enacted Section 3730(e)(4).

All But One of Relator's Claims Dismissed on Merits

Turning to the defendants' motion for summary judgment on the merits, the court set forth a number of guiding legal principles. First, noting that the 7th Circuit has yet to address the issue, the district court sided with a number of other circuits that have imposed a materiality requirement in FCA cases. According to the district court, "[t]o satisfy the materiality requirement, the falsity must have 'a natural tendency to influence, or [be] capable of influencing, the decision of the decisionmaking body to which it was addressed.'"

Next, the court noted that in some cases government knowledge can be a defense to an FCA claim, although most courts have not held it to be an automatic bar to an FCA claim. According to the court, "the relevance of the government's knowledge is to be determined on a case-by-case basis." The extent and nature of such knowledge may evidence that the defendant did not "knowingly" submit a false claim. "Conversely, the government's knowl-

edge may be too incomplete or come too late in the process to defeat the 'knowingly' element."

Applying these as well as other legal principles to the facts at hand, the district court granted summary judgment for the defendants on all but one of the Durcholz's claims.

U.S. ex rel. Hochman and Deschenes v. Nackman et al., 1998 WL 264841 (9th Cir. May 27, 1998)

See "Knowledge/Falsity of Claim" below at page 17.

U.S. ex rel. Long v. SCS Business & Technical Institute et al., Memorandum Opinion and Order, No. 92-2092 (D.D.C. Mar. 25, 1998)

See "State Entities as FCA Defendants" below at page 14.

Relator's Share

U.S. ex rel. Merena v. SmithKline Beecham Clinical Laboratories, Inc.; U.S. ex rel. Grossenbacher et al. v. SmithKline Beecham Clinical Laboratories, Inc.; U.S. ex rel. Spear et al. v. SmithKline Beecham Clinical Laboratories, Inc., 1998 WL 166256 (E.D. Pa. Apr. 8, 1998)

In hotly contested relator's share litigation, a Pennsylvania district court awarded the relators 17 percent, or approximately $52 million, of the federal recovery obtained from SmithKline Beecham Clinical Laboratories in the largest *qui tam* settlement to date. The ruling came after a seven day evidentiary hearing in which the Government sought to devalue the contribution of the relators and minimize the relators' share. The court found that factors such as personal sacrifices, the existence of a prior government investigation, and the size of the overall recovery are irrelevant in determining the relator's share. Rather, in keeping with the statutory language, the court determined an award based on the relators' substantial assistance to the Government.

In response to the Government's argument that the relators should not share in certain allegedly publicly disclosed claims, the court ruled that the issue was moot since, once the Government intervened, there was no longer a basis for a challenge to subject matter jurisdiction. Finally, in awarding the relators a share of the total federal recovery, the court stated that the statute never contemplated "that a court should, after the fact of settlement, consider each separate claim to determine whether the claim was subject to dismissal because of pre-filing public disclosures and/or whether the relators were an 'original source.'"

In November 1993, Robert Merena filed a *qui tam* suit against SmithKline Beecham Clinical Laboratories (SBCL). While Merena's *qui tam* action remained under seal, two other *qui tam* suits were filed, by Glenn Grossenbacher and Charles W. Robinson, Jr. in December 1993 (Robinson relators) and by Kevin J. Spear and Jack Dowden in February 1995 (Spear relators). In addition, more than six months after the Government and SBCL had reached a settlement in principle, and while the first three actions remained under seal, three more *qui tam* actions were filed. On July 23, 1997, the court dismissed two of the three later-filing relators, and all but one claim of the third later-filing relator. *See* 11 TAF QR 5 (Oct. 1997). All three later-filing relators have appealed their dismissals.

That six separate suits were filed in this manner was partly the result of a lengthy seal period, in which the court granted multiple requests by

the Government to extend the time for its intervention decision. The Government formally intervened in the original three *qui tam* actions on September 27, 1996, two days after the $325 million settlement agreement was signed.

The parties stipulated to the fairness, adequacy, and reasonableness of the settlement. The relators agreed among themselves as to how they would divide any relator's share. In addition, the Government agreed with the Spear relators to pay those relators 15 percent of an allocated share of $13,297,829 as a result of the separate allegations contained in the Spear complaint. The Merena and Robinson relators agreed that this allocated share could be deducted from the total settlement proceeds before determining their respective shares.

The Government contended that in addition to subtracting the amount allocated to the Spear complaint, that there must also be subtracted any amounts paid to various states for their losses under state Medicaid programs. The Government also asserted that the relators were entitled to no share of the proceeds recovered for certain "automated chemistry" false claim allegations. The relators disputed each of these contentions, asserting that they were entitled to a minimum 15 percent share of the total settlement plus earned interest less the agreed amount allocated to the Spear complaint allegations.

The court was therefore asked to determine the total amount upon which a *qui tam* award to Merena and/or the Robinson relators would be based, and the percentage of the total to be awarded to those *qui tam* relators.

Certain Considerations "Irrelevant" in Determining Relator's Share

The court began its analysis by immediately disregarding certain considerations which it considered to be "irrelevant" in determining the relator's share under the statute. These included the relator's personal sacrifices, the fact that the Government was already investigating certain allegations, and the size of the overall recovery.

Section 3730(d)(1) of the Act provides that if the Government proceeds with an action brought by an individual under the *qui tam* statute, the *qui tam* relator shall "receive at least 15 percent but not more than 25 percent of the proceeds of the action or settlement of the claim, depending upon the extent to which the person substantially contributed to the prosecution of the action or settlement of the claim." Section 3730(d)(1) further states that "[w]here the action is one which the court finds to be based primarily on disclosures of specific information (other than information provided by the person bringing the action) . . . the court may award such sum as it considers appropriate, but in no case more than 10 percent of the proceeds, taking into account the significance of the information and the role of the person bringing the action in advancing the case to litigation."

In response to the relators' detailed accounts of the sacrifices made with regard to their occupational reputations, future employment prospects, and family life in becoming whistleblowers and pursuing these actions, the court stated that "[n]othing in the statute remotely suggests that these are appropriate considerations in determining the amount or proportionate share to be awarded *qui tam* relators." The court further stated, "Apparently, Congress concluded that the proportionate share of the proceeds established by the statute was an adequate incentive and compensation for the economic and personal risks in filing a *qui tam* action, and that the primary guideline for the percentage to be awarded should be the aid and assistance the information provides toward the ultimate conclusion of the case."

The court disregarded the Government's assertion that, because of its ongoing LABSCAM investigation, the investigation of SBCL would have been just as successful without the relators: "I find nothing in the statute that states or suggests that merely because the Government is carrying out an investigation, a *qui tam* action is barred. The necessary element under the statute is not an investigation but rather public disclosure."

The Government further argued that, because the recovery against SBCL was so large, the relator's share should be on the lower end of the statutory range. In response, the court stated: "There is nothing in the statute to suggest that the amount of the total recovery is, or should be, an appropriate consideration in determining the percentage range or in calculating the total *qui tam* award."

Finally, the court found that matters occurring after the settlement were "wholly outside" the scope of inquiry in determining the relator's share.

Government Intervention Moots Subject Matter Jurisdiction Issue

Despite the fact that all three *qui tam* actions had already been dismissed with prejudice pursuant to the settlement, the Government, in order to prevent the relators from sharing in any recovery attributable to certain "automated chemistry" claims, moved to dismiss those portions of the *qui tam* complaints. The Government allocated $234,798,505 of the settlement to those claims. The court, finding that both the Merena and Robinson complaints encompassed the automated chemistry claims (which were therefore covered by the settlement), denied the Government's motion.

The Government's main contention as to why Merena and the Robinson relators were not entitled to any share of the automated chemistry recovery was that the court lacked subject matter jurisdiction pursuant to the § 3730(e)(4)(A) public disclosure bar. The Government argued that, at the time of the filing of the *qui tam* actions, these automated chemistry allegations were under active investigation by the Government through its LABSCAM initiative, had been publicly disclosed in the news media, and the relators were not original sources. The court denied the Government's motion to dismiss, stating: "The *qui tam* actions, including all claims asserted therein have already been dismissed with prejudice. They do not have to be re-dismissed." Moreover, the court agreed with the relators' assertions that "irrespective of whether their respective actions, as to some of the claims might have been subject to dismissal under 31 U.S.C. § 3730(e)(4)(A) and (B), no motion to do so was ever made, and upon the Government formally intervening in the action, the question of the court having subject matter jurisdiction was mooted."

The court went on to find that, regardless of whether the automated chemistry claims were ever subject to dismissal, the relators should not be precluded from receiving a share within the 15 to 25 percent range. The court stated: "Where a *qui tam* action is filed, and the Government intervenes and expands the allegations of the complaint, or settles the action, this should not preclude the *qui tam* relator from receiving the minimum statutory *qui tam* share of 15 percent of the entire settlement, as well as a percentage above the 15 percent minimum up to the maximum of 25 percent 'depending upon the extent to which the person substantially contributed to the prosecution of the action.'"

The court denied the Government's motion to dismiss Merena's automated chemistry claims for failure to comply with Rule 9(b), stating:

> How or why this should be done at this time, long after the case was settled and dismissed with prejudice in its entirety is not explained. . . . I consider this argument by the Government to be frivolous. This assertion by the Government is perhaps one of the reasons why the *qui tam* relators feel forced to argue that the Government is trying in every conceivable way possible to defeat their respective claims for the *qui tam* share that they believe they are entitled to receive under the law.

Relator's Share Should Not Be Determined on a Claim by Claim Basis

The district court further denied the Government's request to consider the actions of the relators on a claim by claim basis in order to determine the relator's share. The court listed four main reasons why dollar amounts could not be allocated to the various claims. First, neither the settlement agreement, the release, nor any statement or document on record at the time of the approval of the settlement ever mentioned any sum other than the $325 million. Second, the statute does not state that a relator's share should be determined on a claim by claim basis. Third, the relators did not waive their right to contest any government allocations. Finally, there was no evidentiary basis upon which a monetary allocation among claims could rationally be made.

The court stated: "The *qui tam* statute involved makes no mention of treating a *qui tam* complaint as having distinct and divisible claims for the purpose of determining the *qui tam* relator's share of the proceeds. The statute provides that where the Government intervenes and proceeds with the action, as it did in these cases, the *qui tam* relator shall 'receive at least 15 percent but not more than 25 percent of the proceeds of the action or settlement of the claim.' The statute speaks of the action and claim as a single unit or whole entity." The court added:

> The *qui tam* actions involved here were settled as to all claims, whether or not validly pled or substantively valid, for a single overall sum of money. In determining the portion to be paid to *qui tam* relators, I do not think the statute ever contemplated that a court should, after the fact of settlement, consider each separate claim to determine whether the claim was subject to dismissal because of pre-filing public disclosures and/or whether the relators were an "original source."

Medicaid Fraud Recoveries Belong to States

In keeping with the statutory requirement that the relator's share may be awarded only out of the proceeds received by the Federal Government, the court ruled that the settlement proceeds allocated to the states for their losses under the Medicaid program should be deducted from the overall amount before determining the relator's share. Recognizing that this ruling could be seen as inconsistent with the idea that there should be no dollar allocations for specific claims within the global settlement, the court pointed out that Medicaid programs, although authorized by federal law and supported by federal contributions to the states, are not strictly federal government programs. In this case, the amounts that were paid to the states for Medicaid losses were definite, distinguishable amounts, incorporated by an order of court, and were funds that the Federal Government would never receive.

Relators' Complaints Were Not Based Upon Public Disclosures

Despite acknowledging that it was unclear as to how to reconcile the second sentence of § 3730(d)(1), the "no more than 10%" section, with the § 3730(e)(4)(A) public disclosure bar,

the court essentially rendered the issue moot by finding that the complaints were not based upon any disclosures, public or otherwise, other than those the relators learned as employees of SBCL. As this was the final issue for consideration in determining the net proceeds on which the relator's share would be based, the court ruled that the relators were entitled to an award in the 15 to 25 percent range on the net proceeds of the settlement, with the net proceeds calculated as: the total recovery of the settlement and accrued interest, $333,976,266.40, less the total amount paid to the state Medicaid Fraud Control Units, $14,507,107, less the agreed allocation to the Spear relators of $13,297,829, leaving a balance of $306,171,330 upon which to base the relator's share.

Relators Awarded 17 Percent Share on the Basis of Their "Valuable and Substantial Assistance" to the Government

After describing the relators' contributions at length, particularly the contributions of former SBCL billings systems analyst Robert Merena, the court awarded a relator's share of 17 percent. The court based this award on the relators' "very valuable and substantial assistance to the Government in bringing these actions to a successful settlement and termination."

The Government further attempted to reduce the overall relator's share by contending that the court must decide which relator was entitled to a share and preclude the others from receiving anything on the basis of the § 3730(b)(5) "first to file bar." However, as the relators had previously agreed among themselves as to how to divide any proceeds, the court found that it was not necessary to consider the issue. Reiterating its refusal to quantify or separate the recoveries among the relators, the court stated that "[i]t is clear that the *qui tam* statute contemplated no more than one recovery," and that each relator could plausibly argue that he was entitled to the relator's share. The court concluded that it would decide on one relator's share in the 15 to 25 percent range.

The court acknowledged that it found it difficult to quantify the percentage of contribution of any relator. The court stated, however, that "[t]he evidence is strong . . . that it was the relators who constantly urged the government to enter into serious negotiations with SBCL." The court recognized that the Government would probably have continued to pursue at least the automated chemistry claims against SBCL without the relators, and might have even obtained a substantial settlement, but noted: "How much such a settlement would have been without the assistance of relators would be pure speculation. Relators have deep and extensive knowledge of the inner workings of SBCL and they were able to obtain, provide and more importantly interpret corporate billing records, without which the cases would have had serious problems."

As to awarding more than the minimum statutory share, the court observed: "Whether we consider only the individual contributions of Merena or the individual contributions of the Robinson Relators, certainly some percentage above the minimum 15 percent should be awarded. Both Relators substantially contributed, and were willing to contribute as much as the government was willing to receive."

At the evidentiary hearing, government attorneys from San Diego and Washington, D.C. minimized the efforts of the U.S. Attorney's Office for the Eastern District of Pennsylvania, and thereby the contribution of the relators. The court responded: "In reading the depositions and evidence received into evidence, and listening to the arguments of counsel, I am left with the impression that the attorneys in charge of the LABSCAM investigation, conducted largely from San Diego and

Washington, D.C. by the DOJ, seek to take far more credit for the overall success of the proceedings than is rightly due." The court also stated that, even if the relators had in some way exaggerated the importance of their individual contributions, "the Government through the DOJ has greatly underestimated and minimized the help provided by the Relators."

With regard to the considerable size of the award, the court observed:

> No matter how the *qui tam* award in this case is calculated, it will be quite large. I recognize that some of the arguments presented by the Government attorneys may have been caused by a sincere desire to save as much of the proceeds as possible for the Government. However, an Act of Congress provides for substantial awards in order that persons who acquire first-hand knowledge of false claims being presented to the Government will come forth and file meritorious *qui tam* complaints. The success of this legislation in continuing to achieve its goals can only be assured by unstintingly providing the *qui tam* awards dictated by Congress, irrespective of the size of the awards.

The Government has filed a notice of appeal with the 3rd Circuit.

Government Dismissal of *Qui Tam* Suit

U.S. ex rel. Sequoia Orange Company et al. v. Strathmore Packing House Company et al., 1998 WL 326866 (9th Cir. June 19, 1998)

The 9th Circuit affirmed a lower court's ruling that the Government may dismiss a meritorious *qui tam* suit for a legitimate government purpose so long as there exists a rational relation between the dismissal and that purpose. After examining what it viewed to be increased executive control over *qui tam* suits granted by the 1986 FCA Amendments, the court held that the Government had not overstepped the bounds of its broad dismissal powers in dismissing this action.

This *qui tam* action was brought against the backdrop of conflict in the citrus industry. Relators Sequoia Orange Company (Sequoia), a citrus company, and Lisle Babcock filed 34 *qui tam* actions against various citrus industry growers and packinghouses alleging violations of citrus marketing orders promulgated by the Secretary of Agriculture pursuant to the Agricultural Marketing Agreement Act of 1937 (AMAA), 7 U.S.C. §§ 601-626.

The AMAA authorizes the Secretary of Agriculture to issue marketing orders limiting the quantity of commodities shipped into certain markets, thereby protecting prices and maintaining orderly marketing conditions ("prorate regulation"). The relators began filing actions in 1988 which alleged that the defendants had, over the course of approximately ten years, violated the Secretary's orders by overshipping citrus and failing accurately to report, account, and pay assessments for those overshipments. The Government elected to intervene in 10 of the *qui tam* cases.

In June 1993 the Secretary formally suspended citrus prorate regulation due to widespread divisiveness in the industry. Simultaneously with the suspension of the orders, the Government proposed a settlement of all AMAA and FCA cases alleging prorate violations in order to end industry turmoil. The district court, over the relators' objections, granted the Government's motion to intervene for "good cause" in the remaining 24 *qui tam* cases. The Government represented that it

would litigate the *qui tam* and AMAA actions if a settlement could not be reached.

At the time of the settlement negotiations, the district court ruled in a separate proceeding that the Secretary's orange marketing orders were invalid (the Sunny Cove decision). This made settlement of the FCA and AMAA actions less likely, causing the Secretary to terminate the citrus orders, dismiss all pending AMAA actions, and withdraw from the FCA cases in May 1994 in order to end the conflict in the industry.

In August 1994, the Government, over the relators' objections, moved to dismiss the *qui tam* actions, citing six reasons: (1) to end the divisiveness in the citrus industry; (2) to facilitate a new marketing order; (3) to terminate protracted and burdensome litigation; (4) to protect the U.S. taxpayers from continuing and escalating litigation expenses; (5) to curtail the drain on private resources resulting from the litigation; and (6) to allow the growers, agricultural cooperatives, handlers, and others to work together in shaping new marketing tools.

After a four day evidentiary hearing, the district court granted the Government's motion. The relators appealed, contending that the court could not grant the motion to dismiss unless the *qui tam* cases lacked merit.

FCA Permits Dismissal for Legitimate Government Purpose

After examining the level of executive control granted to the Government by the 1986 FCA Amendments, the 9th Circuit ruled that the statute allows the Government to dismiss a meritorious *qui tam* action for a legitimate governmental purpose. The Government had conceded, for purposes of its motion to dismiss, that the relators' suit was meritorious.

The relators argued that interpreting § 3730(c)(2)(A) to give the Government authority to dismiss a meritorious *qui tam* action was inconsistent with the purpose behind the 1986 amendments, which the relators asserted were intended to increase relator involvement in suits in which the Government intervened. In support of this argument, the relators examined the amendments' legislative history, as well as pointing to the fact that the 1986 amendments, unlike the pre-1986 law, allow the relator to continue as a party to the action after the Government's intervention.

In response, the court stated its view that the 1986 Act increased, rather than decreased, executive control over *qui tam* lawsuits. The court noted a list of provisions in the statute which give the Government supervisory power over the relator once the Government has intervened. These include limiting the number of relator's witnesses, staying the relator's discovery requests in certain circumstances, and allowing the Government to settle over the objections of a relator as long as the court determines such settlement is fair. The 1986 amendments also expanded the Government's intervention powers. The court cited U.S. ex rel. Stillwell v. Hughes Helicopters, 714 F. Supp. 1084 (C.D. Cal. 1989), as concluding that "[t]he 1986 version of the False Claims Act continues the evolution of greater executive control over *qui tam* lawsuits."

Furthermore, according to the court, the Government's power to dismiss or settle an action is broad. The court pointed out that while the statute grants relators an opportunity for a hearing on the Government's motion to dismiss, it does not specify any conditions under which the relator may block the motion.

The court also found that the legislative history of the 1986 amendments supports the proposition that even a meritorious *qui tam* suit may be dismissed "upon a proper showing." According to the court, the legislative history "reflects Congressional intent that the *qui tam*

statute create only a limited check on prosecutorial discretion to ensure suits are not dropped without legitimate governmental purpose."

The court rejected relators' contention that the Government could not move for dismissal after intervening late in the action "for good cause," pursuant to § 3730(c)(3), as it could have if it had intervened originally. The court pointed to its own decision in U.S. ex rel. Kelly v. Boeing Co., 9 F.3d 743 (9th Cir. 1993), which held that "when the Government intervenes late in the action, a fair interpretation of the statute is that the Government has a similar degree of control over the litigation as if it had intervened at the start."

District Court Reasonably Applied a Rational Relation Standard

The relators next challenged the district court's choice of standard governing dismissal. However, the court held that, as the statute itself does not create a particular standard for dismissal, the district court had acted reasonably in adopting a rational relation standard.

The district court's rational relation standard included a two step analysis to justify dismissal: (1) identification of a valid Government purpose; and (2) a rational relation between dismissal and accomplishment of that purpose. If the Government satisfies the two step test, the burden switches to the relator to demonstrate that dismissal is fraudulent, arbitrary, capricious, or illegal. This is the same analysis applied to determine whether executive action violates substantive due process.

The court found that application of the rational relation test pursuant to § 3730(c)(2)(A) does not implicate Constitutional separation of powers concerns, in that it does not impermissibly grant the judiciary approval authority over government decisions to dismiss *qui tam* suits in the exercise of its prosecutorial authority. First, the court found no indication that the notice and hearing requirements pose significant barriers to the executive's exercise of prosecutorial authority. Second, the court found "ample precedent" allowing judicial oversight of the Government's decision to dismiss a *qui tam* action.

Ending Conflict in Citrus Industry is Legitimate Government Interest

The court dismissed relators' contention that the district court misapplied the rational relation standard and that the reasons offered by the Government for dismissal were not rationally related to a legitimate Government interest. The court concluded that the Government met its burden.

The relators gave five reasons why they believed the district court misapplied the standard. The 9th Circuit rejected each one of these contentions in turn.

First, the relators argued that the elimination of legal battles in the citrus industry is not a legitimate Government interest under the AMAA. However, the court disagreed because the statute directs the Secretary to oversee orderly marketing processes.

The relators asserted that the Government's dismissal motion was based on improper factors, such as political pressure from the defendants and members of Congress. However, the court found no evidence that the defendants engaged in bribery, fraud, coercion, or otherwise tried to illegally utilize the political advocacy process.

Next, the relators contended that the Government wrongfully sought dismissal because Sequoia itself was a prorate regulation cheater. The court found that dismissal actually better allowed the Government to end further FCA litigation which could have been harmful to the industry as a whole.

The relators argued that the Government's concern with litigation costs was irrelevant in light of the fact that the FCA contemplates reliance on private funding by relators. However, the court affirmed that the Government legitimately considered the burden that would be imposed upon the taxpayers if it were to continue litigating the FCA claims.

Finally, the relators argued that the district court erred in granting the Government's motion to dismiss the *qui tam* actions relating to the lemon marketing orders because, unlike the orange marketing orders, those had never been invalidated. However, as the Government had presented evidence that the lemon handlers were also under investigation for prorate violations, and since such violations were comparable to prorate cheating in the orange industry, the court found the dismissal of the lemon cases to be rationally related to the legitimate government interest of preserving the financial stability of the lemon industry.

Judicial Estoppel Not a Bar to Government's Dismissal

The 9th Circuit further affirmed that the district court had not abused its discretion in holding that the doctrine of judicial estoppel, which bars the same party from taking inconsistent positions in the same litigation, did not bar the Government from dismissing the *qui tam* actions. In support of its motion to intervene, the Government had represented to the district court that it would litigate the FCA claims if no settlement was reached. The court found, however, that the Government's motion to dismiss was "motivated by events that transpired after its intervention, most notably the decision in Sunny Cove, which declared the orange marketing orders invalid." Therefore, the court found no evidence that the Government acted in bad faith by representing that it would litigate the FCA claims if the negotiations fell through. Rather, the Government had made a rational policy decision, permissible under the *qui tam* provisions, when it thought that settlement was no longer possible after Sunny Cove.

State Entities as FCA Defendants

U.S. ex rel. Graber v. The City of New York et al., Opinion, No. 93 Civ. 8984 (S.D.N.Y. June 12, 1998)

In an opinion sharply differing from a recent D.C. district court opinion (*see* U.S. ex rel. Long v. SCS Business & Technical Institute et al. directly below), a New York district court held that states and cities are not "persons" subject to liability under the False Claims Act. In this case, the district court found that the statute's imposition of treble damages and civil fines is punitive and that Congress never demonstrated an intent to hold states or cities liable under the Act.

In this *qui tam* action, Bracha Graber alleged that both the City of New York (the city) and the State of New York (the state) submitted false claims, statements, and records to obtain federal funding and reimbursements for foster care expenditures under Title IV of the Social Security Act. Graber served as Acting Director of New York's Child Welfare Administration Office of Case Management. The complaint alleged that the city falsified compliance information ultimately relied upon by the federal government to determine the state's eligibility for funding, and that the state accepted federal foster care funding to which it knew or should have known it was not entitled. The Government intervened in Graber's suit after a two year investigation.

Municipalities Are Immune From Exemplary Damages

The City and State of New York moved to dismiss Graber's complaint principally on the

ground that they are not "persons" subject to liability under § 3729 of the Act. The court ultimately held that neither the city nor the state was subject to liability under the statute. The court began by acknowledging that municipalities, unlike states, are typically presumed to be "persons" at common law. However, according to the court, municipalities are not presumed to be persons when punitive or exemplary damages are at stake. The court defined "exemplary damages" as "damages that exceed, or are over and above, actual damages designed to punish especially egregious conduct, to deter the general population by setting an example, or to vindicate public wrongs." As such, according to the court's definition, punitive damages and statutory multiple damages are subsets of exemplary damages awarded not to compensate for injuries but often specifically to punish wrongdoers.

The court listed a line of cases which demonstrate that the doctrine of municipal immunity from exemplary or punitive damages was well recognized as early as the time of the FCA's enactment in 1863. According to the court, in order to subject municipalities to exemplary damages, Congress must clearly abrogate such immunity in the statute.

Statute's Imposition of Treble Damages is Punitive in Nature

The court held that the damages mandated by the FCA are exemplary because "they are not limited to, but rather substantially exceed, the actual damages suffered by the United States. Treble damages and substantial fines are automatically imposed under the False Claims Act irrespective of whether the United States has actually suffered any injury."

The court then stated that, although the FCA is a remedial statute to the extent it seeks to recover monetary losses suffered by the Federal Government through fraud, it is also punitive in nature because of its imposition of treble damages. Moreover, according to the court, that the wrong sought to be addressed is a public, as opposed to an individual, wrong suggests a quasi-punitive purpose.

The court rejected the Government's argument that immunity from exemplary damages may not be invoked by states in suits brought by the Federal Government. The court rejected this argument because "the 11th Amendment played no role whatsoever" in the creation of this immunity. Instead, the immunity is based on general "judicial disinclination to award punitive damages" against municipalities. Moreover, the court stated that the public policy reasons justifying municipal immunity from exemplary damages still apply when the Government is plaintiff. Therefore, the court moved on to consider whether Congress clearly abrogated this policy-based immunity within the FCA.

Congress Did Not Intend to Hold States or Municipalities Liable Under FCA

Examining the text and legislative history of the statute, the court found that Congress never intended to hold states or municipalities liable as "persons" within the meaning of the Act. The court rejected the Government's contention that because the Civil Investigative Demand provision, § 3733(1)(4), defines "person" to include "any state or political subdivision of a state," such definition applies throughout the statute. The court stated that "[m]ilitating against such a broad reading . . . is the very language of the provision, which plainly states that the definitions contained in § 3733 apply 'for purposes of this section.'"

Finding that the plain meaning of the statute does not subject states and municipalities to FCA liability, the court turned to the legislative history of the 1986 FCA Amendments. The court found no support for the contention that in 1986 Congress amended § 3729 to reach states or municipal entities.

The court acknowledged that the Senate Report accompanying the 1986 amendments contains the statement that "[t]he False Claims Act reaches all parties who may submit false claims. The term 'person' is used in its broad sense to include...States and political subdivisions thereof." However, the court accorded little weight to this statement because this passage is found in the "descriptive section" of the Report, and the court asserted that the sentences immediately preceding it demonstrate that the passage refers to the pre-1986 version of the Act. Moreover, the court believed that the cases cited in the passage purporting to hold that states and municipalities are liable as "persons" did not so hold.

Statutory Consistency and Equitable Considerations Also Preclude State and City Liability

The court held that, like the text of the statute and the legislative history, statutory consistency and equitable considerations "militate in favor of a construction of § 3729 that excludes municipalities and states." The court stated that "a more narrow understanding of the term 'person' in § 3729 will not do violence to the statute, and indeed, is consistent with the language and purposes of its other sections." The court dismissed the "natural presumption" that identical words in different parts of the same act are intended to have the same meaning as being easily overcome depending on the words' usage in the statute.

In addition, the court held that the equities of the statute "weigh in favor of" excluding cities and states from liability. The court found that the defendants would suffer obvious hardship from an incorrect interpretation of an ambiguous statute, while the Government still had common law remedies and, in certain circumstances, state and local officials could be sued under the Act in their individual capacities. The court therefore dismissed all of the FCA counts against the city and state, leaving only the Government's other statutory and common law claims open for consideration.

U.S. ex rel. Long v. SCS Business & Technical Institute et al., Memorandum Opinion and Order, No. 92-2092 (D.D.C. Mar. 25, 1998)

A D.C. district court ruled that the 11th Amendment does not bar *qui tam* actions brought against state defendants, and that states are "persons" subject to liability under the FCA. However, the court also held that the 11th Amendment protects state employers from suit under the § 3730(h) retaliation provision, since these suits are brought on behalf of private parties and not on behalf of the Government.

Relator Ronald E. Long served as Coordinator of Investigations and Audit for the Bureau of Proprietary School Supervision (BPSS) of the New York State Department of Education. BPSS is the state agency that regulates proprietary schools in New York. SCS Business & Technical Institute (SCS) operated five New York proprietary schools.

As Coordinator of Investigations for BPSS, Long directed an investigation of SCS which allegedly uncovered a variety of fraudulent practices by SCS pertaining to receipt of federal student loan funds. As a result of Long's investigation, BPSS instituted administrative proceedings against SCS. BPSS and SCS reached an administrative settlement in March 1992.

Long, however, believed the settlement to be a "sweetheart" deal between BPSS and SCS. According to Long, BPSS received a large part of its funding through tuition assessments and fines that SCS paid for violations of state law, thereby giving BPSS an incentive to allow SCS to continue receiving federal funds on a fraudulent basis. Long believed that BPSS had wrongly

limited his investigation of SCS and ignored evidence that SCS continued to present false claims to the Federal Government.

Long brought a *qui tam* action against the State of New York (BPSS), his supervisor at BPSS, Joseph Frey, SCS, the president of SCS, and the chairman of the board of SCS alleging that New York officials, including Frey, falsely represented to the Federal Government that SCS was no longer engaged in fraud. He further alleged that New York and SCS colluded with regard to SCS's continued fraud. The Government intervened as to SCS, its president, and its chairman. The Government declined to intervene against New York and Frey.

New York moved to dismiss Long's second amended complaint for lack of subject matter jurisdiction, failure to state a claim, and failure to plead fraud with particularity pursuant to Fed. R. Civ. P. 9(b). Frey moved to dismiss the second amended complaint for failure to state a claim or, in the alternative, for summary judgment based on 11th Amendment immunity and qualified immunity.

11th Amendment Does Not Bar *Qui Tam* Actions Against States

According to the court, because the United States is always the plaintiff in a *qui tam* action and the 11th Amendment does not prohibit suits by the United States against states in federal court, the 11th Amendment does not bar Long's action against the State of New York.

States Are "Persons" Subject to Liability Under FCA

The court next held that a state may be considered a "person" subject to liability under § 3729 of the Act. The court noted that although Congress did not define the word "person" in § 3729 of the statute, it did define the word in § 3733, which defines "person" for that section as including a state. In addition, courts have allowed states to act as relators where the *qui tam* provisions allow a "person" to bring a civil suit.

New York argued that the court should follow precedent holding that construing the word "person" to include states is generally disfavored. However, the court distinguished those causes of action established for individual plaintiffs from *qui tam* actions, which are brought on behalf of the Federal Government. According to the court, because states are not immune from suits by the Federal Government, Congress was not required to state in the FCA that it intended to abrogate the states' sovereign immunity.

Furthermore, in the absence of express judicial authority on this point, the court examined the Act's legislative history. The court cited to the Senate Report accompanying the 1986 amendments, which stated, "In its present form...[t]he False Claims Act reaches all parties who may submit false claims. The term 'person' is used in its broad sense to include partnerships, associations, and corporations...as well as states and political subdivisions thereof."

1986 FCA Amendments Did Not Change Statute from a Remedial to a Punitive One

The court further rejected New York's argument that the damages provision of the FCA suggests that the statute has a punitive purpose, and therefore that the FCA cannot apply to the states because states enjoy common law immunity to punitive damages which can only be overcome by a clear congressional statement of abrogation. For its holding, the court examined United States v. Halper, 490 U.S. 435 (1988), in which the Supreme Court held that the pre-1986 FCA was remedial, not punitive. Furthermore, the court noted that the 8th Circuit, in U.S. v. Brekke, 97 F.3d 1043 (8th Cir. 1996), 8 TAF QR 7 (Jan. 1997), held that the 1986 amendments imposing treble damages did not turn the statute from compensatory to punitive.

The court found no indication that Congress intended the 1986 amendments to change the statute from a remedial one to a punitive one. The damages provision was amended to modernize the Act, make it consistent with the 1986 Department of Defense Appropriations Act, and to encourage *qui tam* actions. The court therefore concluded that the FCA's penalties are remedial, and not punitive, as long as a rational relation exists between the Government's loss and the damages assessed.

Relator Working for State Agency Did Not Have Duty to Report Fraud to Federal Government

In response to New York's motion to dismiss Long's complaint for lack of subject matter jurisdiction, the court performed a § 3730(e)(4)(A) public disclosure bar analysis. Both Long and the State of New York agreed that the allegations of fraud against SCS were publicly disclosed under the Act as a result of New York's 1992 administrative proceedings against SCS. In addition, the court ruled that because Long had alerted the federal authorities, the allegations against New York and Frey were also publicly disclosed.

The court then immediately moved on to an analysis of the § 3730(e)(4)(B) original source exception. The court found that Long clearly satisfied the "direct" knowledge aspect of the Act's original source provision because he gained first hand knowledge of the defendant's fraudulent conduct "through his own labor." Moreover, Long's knowledge of the allegations was "independent" because it was not dependent on the public disclosures to the federal authorities.

The court rejected New York's assertion that Long could not be an original source because it was his job to report such information to his employer and the Federal Government and therefore that he could not have "voluntarily provided" such information to the Government as required by the statute. Rather, "Long was employed by a state agency and therefore, Long had no duty to report the results of his investigation to federal authorities."

Rule 9(b) Satisfied

The court then proceeded to deny New York's motion to dismiss two counts of Long's complaint for failure to satisfy Fed. R. Civ. P. 9(b). Responding to New York's argument that Long had not pled the fraud against it and Frey with particularity because Long did not "demonstrate" the material elements of a § 3729 (a)(3) conspiracy, the court stated that under Rule 9(b) Long was only required to allege such information, not "demonstrate" it. Furthermore, after finding that the information in Long's complaint included the dates of the conspiracy, where it occurred, the actions of the parties involved, and specific names of the New York officials involved, the court held that Long satisfied Rule 9(b).

The court also ruled that Long satisfied Rule 9(b) as to the second count of his complaint, which alleged violations of §§ 3729(a)(1) and (2) of the statute. At issue was whether New York knowingly "caused" false claims to be presented when it allegedly did not prevent the claims from being presented. The court held that Long had alleged with requisite specificity that New York officials allowed false claims to be presented to the Federal Government over a number of years, even after it knew that false claims were being made.

Relator Lacked Standing to Bring Common Law Claims

The court ruled that Long did not have standing to pursue a common law unjust enrichment claim, because that claim was personal to the United States and therefore Long, as *qui tam* relator, did not suffer an injury in fact. Because it was the United States, and not the relator, who conferred the federal funding benefit at issue,

and at whose expense it would be inequitable for the defendant to retain the benefit, Long did not have standing to bring the claim.

11th Amendment Provides § 3730(h) Immunity to States

Long's complaint further alleged that he had been harassed and discharged from his job in violation of § 3730(h), the whistleblower protection provision of the Act, as well as 42 U.S.C. § 1983. Because the court found that a § 3730(h) action is brought on behalf of the individual plaintiff, and not on behalf of the Federal Government, the court ruled that the 11th Amendment barred Long's § 3730(h) claim against the State of New York.

The court rejected Long's argument that § 3730(h) is an integral component of the *qui tam* provisions and therefore that a suit against a state is not barred by the 11th Amendment because it is brought on behalf of the United States. The court found that the whistleblower provision is "properly understood as authorizing a private right of action distinct from the *qui tam* action authorized by § 3730(b)." Therefore, under the 11th Amendment, such suit could only proceed if Congress had "unequivocally" expressed its intent to abrogate States' immunity under the statute. According to the court, Congress had not done that here.

However, the court also held that, pursuant to Ex Parte Young, 209 U.S. 123 (1908), Long's § 3730(h) suit against Frey for non-monetary relief was not barred by the 11th Amendment. In Ex Parte Young, the Supreme Court held that an individual may bring suit for prospective injunctive relief against a state official, in his official capacity, to end a continuing violation of federal law.

The court rejected Frey's argument that the State of New York, and not he, was Long's "employer." The court stated that in his official capacity Frey represented New York and, as such, was Long's employer. Long could therefore maintain his claim under § 3730(h) for prospective injunctive relief against Frey.

Section 3730(h) Claim Properly Alleged

Finally, the court denied Frey's motion to dismiss Long's § 3730(h) claim for failure to state a claim upon which relief could be granted. The court stated that in order to state a claim under § 3730(h), the relator must show that: (1) he took actions that are protected by the statute; (2) the defendants knew that he took those actions; and (3) he was fired in retaliation for those actions.

First, the court found that Long, by not limiting his investigation as SCS had requested, and by reporting the results of the investigation and New York's interest in federal funds disbursed to SCS, had acted in furtherance of his *qui tam* action. Second, since Long's supervisors knew that he was cooperating with federal officials, to the point of directing Long to return documents seized during the investigation of SCS, the court found that New York and Frey "had reason to believe" that Long would pursue a False Claims Act action against them. Third, Long was demoted and fired after his employer learned of his involvement with the federal authorities. Therefore, the court ruled that Long successfully stated a claim for relief under § 3730(h).

Knowledge/Falsity of Claim

U.S. ex rel. Hochman and Deschenes v. Nackman et al., 1998 WL 264841 (9th Cir. May 27, 1998)

The 9th Circuit affirmed a dismissal of a *qui tam* suit brought by two doctors against their colleagues at a Veterans Administration clinic. The appellate court held that the action was

not jurisdictionally barred under § 3730(e)(4) because there had been no "public" disclosure; however, summary judgment was appropriate because the plaintiffs failed to present sufficient evidence that the defendants had the requisite knowledge for FCA liability.

Doctors Robert Hochman and Susan Deschenes, employees of the Los Angeles Veterans Administration Outpatient Medical Clinic (Clinic), brought a *qui tam* action against Clinic administrators and physicians associated with both the Clinic and the University of Southern California School of Medicine (USCSM), which had an affiliation agreement with the Clinic. The relators alleged four types of misconduct: the erroneous authorization of bonus specialty pay for a defendant anesthesiologist; the unnecessary creation of jobs and hiring of physicians; an improper method of compensation that effectively paid residents who no longer worked at the Clinic; and overpayment of physicians and residents whose attendance records stated that they were at work when in fact they were not present at the Clinic.

In 1992, the Department of Veterans Affairs Inspector General (IG) investigated a confidential informant's allegations of misconduct at the Clinic, including the allegation that certain doctors were paid for time not actually spent at the Clinic. In March 1994, the IG issued a final report which concluded that the allegations could not be substantiated and no further action against Clinic administrators or physicians was justified. In July 1994, Hochman and Deschenes filed their *qui tam* suit. After ruling that the § 3730(e)(4) jurisdictional bar did not apply, the district court granted the defendants' summary judgment motion on the merits.

IG Report Not Publicly Disclosed

The 9th Circuit rejected the defendants' argument that the allegations in the IG's March 1994 final report "had ostensibly been made public" by the IG's semiannual statement to Congress. The defendants relied on U.S. ex rel. Fine v. Chevron, U.S.A., Inc., 72 F.3d 740 (9th Cir. 1995), 4 TAF QR 7 (Jan. 1996), in which the court held that the IG's semiannual statement to Congress constitutes a public disclosure. The 9th Circuit, however, distinguished Fine — where the contents of the report at issue were detailed in the IG's publicly disclosed semiannual statement — from the case at hand, where the district court found that the semiannual statement did not contain the information gathered in the March 1994 report.

Requisite Knowledge Not Sufficiently Shown

Turning to the merits of the case, the appellate court reviewed each of the plaintiffs' four allegations of misconduct and found each lacking. With respect to the allegation that the defendant anesthesiologist improperly received specialty pay, the court noted that a relevant government policy handbook "sets forth potentially conflicting requirements for specialty pay." According to the court, whether or not the anesthesiologist was actually entitled to specialty pay, the record did not support a reasonable inference that the defendants had the requisite knowledge of the alleged falsity: "Absent evidence that the defendants knew that the VHA Guidelines on which they relied did not apply, or that the defendants were deliberately indifferent to or recklessly disregardful of the alleged inapplicability of those provisions, no False Claims Act liability can be found."

Likewise, with respect to the allegation of unnecessary hiring of physicians, the court found no evidence that the defendants made their hiring decisions with actual knowledge that they were unnecessary, or with reckless disregard of or deliberate indifference to that knowledge. Rather, "the record overwhelmingly supports the opposite inference, that the defendants believed such expenditures would benefit the Clinic in the long run. The plaintiffs at best have shown only innocent mistakes

or mere negligence, neither of which can form the basis for False Claims Act liability."

The appellate court ruled that the plaintiff's third allegation — which concerned the Clinic's method of compensating residents — failed for lack of falsity. According to the court, VA policy actually authorized the compensation method at issue.

Addressing the alleged overpayment of physicians and residents, the court noted that there was no evidence that, during the times the defendants were paid while absent from the Clinic, they were not teaching or performing research at USCSM. Rather, the plaintiffs' allegation hinged on their contention that the Affiliation Agreement between USCSM and the Clinic did not authorize off-Clinic research and teaching. However, the court found that the defendants' contrary interpretation of the Agreement "was not in reckless disregard of or deliberate indifference to the language, intent, and function of the agreement." Moreover, "[e]ven if the defendants erred in their interpretation of the Affiliation Agreement, the undisputed evidence demonstrates that the defendants believed that the Affiliation Agreement authorized their conduct."

Refusal to Recuse Upheld

Lastly, the appellate found no abuse of discretion in the district court judge's refusal to recuse himself from the case. The plaintiffs argued for recusal because the judge was a graduate of USC's law school and a member of the law school alumni association, to which he contributed $250 annually.

U.S. ex rel. Roby v. The Boeing Company, Order, No. C-1-95-375 (S.D. Ohio May 8, 1998)

See "Rule 9(b)" below at page 23.

Res Judicata

U.S. ex rel. Barajas v. Northrop Corporation, 1998 WL 309107 (9th Cir. June 12, 1998)

The 9th Circuit affirmed a dismissal of a *qui tam* action based on the res judicata effect of a prior settlement between the Government and the defendant. The court held that the relator's claims arose out of the same "transactional nucleus of fact" as the claims covered by the settlement, thereby precluding the relator from going forward.

Leocadio Barajas brought a *qui tam* suit alleging that his former employer, Northrop Corporation, falsified test results and falsely claimed that required tests had been performed on a navigational device manufactured for cruise missiles purchased by the Government. His complaint further alleged that fluid used to damp movement of parts in the navigational device did not perform to contract specifications. The Government intervened in the action as to all but the damping fluid claims. Six months after it intervened, the Government also indicted Northrop for criminal violations of the FCA. Northrop paid the Government $8 million to settle the civil case, and $17 million in fines and penalties in the criminal case. Barajas was awarded a relator's share of $864,000 out of the $8 million civil settlement.

The navigational device at issue, a "flight data transmitter," contained electronic components enclosed in a box, around which fluid was used to damp movement inside the box. According to the contract specifications, the fluid was supposed to stay sufficiently liquid to perform its damping function down to 65 degrees below zero Fahrenheit. Barajas' *qui tam* complaint, along with alleging that Northrop falsified tests, alleged that the fluid would freeze and therefore stop working at 50 degrees below

zero, a very material difference from the contract specification should the missiles be used in subarctic winter conditions.

The Government's amended complaint in the civil action alleged that Northrop falsified test results and falsely claimed that required tests had been performed on the flight data transmitter, but not that the fluid would freeze at a warmer temperature than specified. However, the criminal indictment did include the allegation that the fluid would freeze. Northrop pled guilty to faking the tests, but did not admit that the fluid would freeze above the specified temperature. The Government accepted the plea without such admission by Northrop. In addition, the Government's civil settlement released Northrop from "any and all...claims under the False Claims Act," including allegations that the damping fluid would freeze at the wrong temperature. The Government expressly released those claims and its case was dismissed with prejudice. Barajas' release, however, reserved his right to pursue his *qui tam* action based on the inadequacy of the fluid.

Barajas filed an amended complaint in which he severed and pursued separately his damping fluid claims, which the Government elected not to join. The district court dismissed Barajas' action on the ground that he was not the "original source" of the damping fluid allegations, because they were publicly disclosed in the indictment and that he supposedly read about them in the newspaper prior to filing his complaint. The 9th Circuit reversed, holding that a factual inquiry was necessary to determine whether Barajas' information had triggered the criminal indictment, thereby still permitting him to be considered the original source.

On remand, the district court dismissed Barajas' claims based on the res judicata effect of the settlement. Barajas again appealed to the 9th Circuit.

Relator's Claims Barred by Res Judicata Effect of Prior Settlement

Because the court viewed the fluid allegations as being encompassed within the settlement agreement with Northrop, the 9th Circuit held that Barajas' separate claims were barred by res judicata. The court disagreed with Barajas' view that the fluid claims were not barred because they had not yet been adjudicated.

Barajas and the Government argued that because the "false testing allegations" were distinct from the "cold fluid allegations," the judgment on the former could not bar the latter. The Government argued that the substitution of inferior fluid took place in Massachusetts, while the false testing took place in California, and that the California Northrop employees did not know that the fluid was faulty.

To determine whether Barajas' claims were barred, the court examined whether the two suits "[arose] out of the same transactional nucleus of fact." The court acknowledged that the two allegations — fluid that fails to meet contract specifications and falsely certifying tests of the fluid for freezing — are distinct, but found that "both wrongful acts arise out of the same attempt to get paid for flight data transmitters not up to specifications." According to the court, because the Government recovered the money it had paid as a result of Northrop's false invoices, "[i]t did not matter to the settlement and judgment whether Northrop's invoices were false for two reasons or one reason...[t]he false invoices for the flight data transmitters were the 'transactional nucleus.'" In other words, while it may have been false for two reasons, there was only one false claim for payment made by Northrop — Northrop's claim for payment on its invoices for the flight data transmitters.

Relator's Standing Lost Once Government Settled and Released Claims

The court additionally ruled that Barajas could not pursue his separate claims because, in the court's opinion, without the Government Barajas did not have standing. Since the Government had settled and released Northrop as to what the court viewed as the same "transaction" at issue, Barajas could not pursue a recovery on the same false claim for a different reason.

The court stated that a *qui tam* relator has Article III standing to sue as an assignee of the Government's claim. Therefore, once the Government recovered money paid on a false invoice, plus penalties, or released its claim, there was no more claim to be recovered by anyone. In this case, "[t]he Government plainly could not recover $3 million on a $1 million invoice based on faked tests, and then recover another $3 million on the same invoice because the goods supplied had not been up to specifications."

Relator's Reservation of Claims a "Nullity"

The court agreed that a settlement can limit the scope of the preclusive effect of a dismissal with prejudice by its terms. Barajas had legitimately reserved the right to litigate the cold fluid claims despite the Government's settlement and release. However, the court called Barajas' reservation a "nullity" which would not actually permit him to recover. In addition, the court reiterated that at the time the Government released "any and all" claims, the parties knew about and could have litigated the fluid claims if they had so chosen.

One circuit judge dissented from the majority opinion, finding that the civil settlement and release did not cover the cold fluid claim. The dissenting judge noted that the Government did not adopt the cold fluid claim in its civil complaint, that throughout the litigation both Northrop and the Government maintained that the cold fluid claim was distinct from the falsification claim, and that in the negotiations leading to the settlement, both parties had acknowledged that the cold fluid claim was not covered by the settlement.

Counterclaims

U.S. v. Royal Geropsychiatric Services, Inc. et al., 1998 WL 292265 (N.D. Ohio June 2, 1998)

In an FCA case alleging health care fraud, an Ohio district court dismissed the defendants' counterclaim against the Government, finding that the defendants could not bring such a claim in federal district court without first exhausting their administrative remedies under the Medicare Act.

The Government's underlying FCA action alleged false billing for psychiatric services to nursing home patients. The defendants' counterclaim asked the court, inter alia, (1) to declare under the Declaratory Judgment Act that the Government had not implemented any regulations prohibiting the defendants' billing and coding practices, and that the Government's use of the FCA in this case was contrary to the purpose and intent of the FCA, (2) to rule that the FCA as applied in this case was void for vagueness in violation of the Fifth Amendment right to due process, and (3) to rule that the defendant Royal Geropsychiatric Services, Inc. was entitled to recoupment for any underbilling arising out of the same transactions that were allegedly improperly billed.

Counterclaim Precluded by Medicare Act's Administrative Exhaustion Requirement

An opposing party may assert a counterclaim against the Government only when the Government has waived its sovereign immunity on that

claim, and the district court concluded that nothing cited by the defendants supported waiver of sovereign immunity for their counterclaim. According to the court, "[j]udicial review of claims arising under the Medicare Act is available only after [HHS] renders a final decision, similar to the exhaustion of administrative remedies scheme provided for old age and disability claims arising under another title of the Social Security Act." The court found that the counterclaim at hand clearly arose under the Medicare Act: "While some of defendants' claims may implicate the False Claims Act, they all rely on the Medicare Act, its attendant regulations, and the bureaucratic scheme." Examining each of the relevant factors regarding whether to waive the Medicare Act's administrative exhaustion requirement, the court found nothing in the record to justify waiver to permit the counterclaim.

Recoupment Claim Would Circumvent Administrative Process

The court noted that generally, despite the sovereign immunity doctrine, a defendant may assert a recoupment claim arising out of the same transaction or occurrence as the Government's claim so as to reduce the Government's recovery. However, the court concluded that, "[i]n this case, Medicare's detailed administrative process is the exclusive mechanism for defendants to recover for any underbillings to the carriers." According to the court, the defendants' recoupment claim "would completely circumvent the detailed administrative process in place to address these matters."

U.S. ex rel. Thistlethwaite v. Dowty Woodville Polymer Ltd. et al., Memorandum Endorsement, No. 94 Civ. 3521 (S.D.N.Y. Apr. 22, 1998)

In a brief Memorandum Endorsement, a New York district court granted the relator's motion to dismiss the defendants' counterclaim for indemnification and contribution. The court cited the "chilling effect" that such counterclaims could have on potential relators.

The district court summarily granted the relator's motion to dismiss the defendants' counterclaim for indemnification and contribution, stating that "[w]ell-established case law holds that there can be no counterclaims for indemnification or contribution in an FCA *qui tam* action." The court cited Mortgages, Inc. v. U.S. District Court for the District of Nevada, 934 F.2d 209 (9th Cir. 1991), which held that the FCA is not intended to ameliorate the liability of wrongdoers by providing defendants with an "unclean hands" defense.

The court noted that permitting such counterclaims would have a chilling effect on *qui tam* actions. The court rejected the defendants' dependence on the one case which they asserted was contrary to the established rule: "[T]hat case . . . did not involve counterclaims against a *qui tam* relator. Because the claims were third-party complaints against other tortfeasors for contribution and indemnification, the chilling effect on genuine informer's actions was not present, as it would be here."

The court added that, although counterclaims for contribution or indemnification are not allowed, the current rule allows for counterclaims for independent damages. The court contrasted the two types of counterclaims: "Counterclaims for indemnification or contribution by definition only have the effect of offsetting liability. Counterclaims for independent damages are distinguishable, however, because they are not dependent on a *qui tam* defendant's liability."

Rule 9(b)

U.S. ex rel. Roby v. The Boeing Company, Order, No. C-1-95-375 (S.D. Ohio May 8, 1998)

A motion to dismiss for failure to comply with Rule 9(b), failure to plead the requisite knowledge for FCA liability, and failure to state a claim upon which relief could be granted was denied in its entirety by an Ohio district court. Of special note, relying on recent Supreme Court precedent, the district court found that materiality is not a required element under the FCA.

Brett Roby filed a *qui tam* action alleging that The Boeing Corporation and its supplier Speco Corporation violated the FCA by selling the Government defective transmission gears installed in Boeing's CH-479(D) Chinook Army helicopters. The Government intervened in Roby's suit. Speco filed for bankruptcy, settled with the Government and Roby, and was dismissed from the case. Boeing filed a motion to dismiss the Government's five count amended complaint on a number of grounds.

Rule 9(b) Satisfied

Boeing first argued that the amended complaint did not satisfy the heightened pleading requirement of Fed. R. Civ. P. 9(b). Specifically, Boeing asserted that the complaint did not inform it of the specific false content associated with any of the 130 alleged false claims; rather, it merely contained a broad accusation that the Speco-manufactured gears installed by Boeing in the Army helicopters did not conform to specifications. As such, Boeing claimed that it could only speculate as to which of the 300 Speco gears were allegedly nonconforming. In addition, Boeing asserted that the complaint failed to identify the persons at Boeing who participated in the alleged misconduct.

The district court rejected Boeing's arguments and found the complaint sufficient to place Boeing on notice of its alleged misconduct. According to the court, the complaint was "replete with statements detailing that Boeing either knowingly or recklessly failed to reinspect and detect problems in the Speco-manufactured gears." Furthermore, Boeing did not have to speculate as to which Speco gears were allegedly nonconforming because the complaint "provides at Paragraph 141 that Boeing acted with the knowledge of falsity or reckless disregard for the truth with respect to every CH-47(D) helicopter it delivered to the United States under Forms DD-250."

Specific Persons Involved in Misconduct Need Not Be Identified

The district court characterized Boeing's contention that the complaint must specifically identify the persons involved in the alleged misconduct as "overreaching." According to the court, Rule 9(b) requires only identification of the parties, and Boeing was adequately identified as the party involved in the alleged misconduct. Recognizing an exception to the Rule 9(b) pleading requirement "when the information is in the exclusive hands of the opposing party," the court stated that "[t]o require that the claimant identify with specificity the identities of those at Boeing who may have actually engaged in the alleged fraudulent activities at different stages in the process would require the Government to know evidentiary matters that may be exclusively within the knowledge of Boeing."

Requisite Knowledge Sufficiently Pleaded

Boeing also maintained that the amended complaint did not establish that it had acted with the requisite knowledge for FCA liability. Specifically, Boeing argued that the complaint, along with the documents cited therein, evidenced that Boeing "acted in vigorous pursuit of resolving and correcting any manufacturing

problems" and therefore its conduct could not have constituted a reckless disregard for the truth or falsity of information about the gears; rather, the worst that could be said was that Boeing had acted negligently.

The district court, however, found that the Government had adequately pleaded that Boeing acted with the requisite knowledge — that is, knowingly or with reckless disregard for the truth or falsity of information pertaining to the allegedly defective gears. Moreover, the court dismissed Boeing's argument regarding its acting vigorously to correct problems with the gears because it would require the court to look beyond the pleadings, which "would [not] be appropriate at this juncture in the proceedings."

Materiality Not a Required FCA Element

Boeing also asserted that the Government's allegations regarding nonconforming continuous intergranular carbide network (CICN) in the gears stemmed from disputes over scientific opinions and theories and thus could not serve as the basis for FCA liability. While the district court agreed that "Congress did not enact the FCA in the interest of addressing disputes of scientific theories," it concluded: "We disagree . . . that [the CICN allegations] are nothing more than disputes over scientific theory and rhetoric. Moreover, we find that the references in the Amended Complaint to the alleged CICN in the gears involve issues of alleged concealment and misrepresentation by Boeing."

Then, rejecting Boeing's contention to the contrary, the court found that "materiality is [not] a required element of proof in actions under the FCA." According to the court, in U.S. v. Wells, 117 S. Ct. 921 (1997), the Supreme Court "rejected reading materiality as an element of the offense charged to defendant where the term was not already provided by Congress." In Wells, the Court concluded that where Congress has not "explicitly included materiality in provisions involving false representations . . . [t]he most likely inference . . . is that Congress deliberately dropped the term 'materiality' without intending it to be an element . . . ." According to the district court, the conclusions of other courts finding that materiality is an FCA element "are weakened significantly in light of Wells."

U.S. ex rel. Long v. SCS Business & Technical Institute et al., Memorandum Opinion and Order, No. 92-2092 (D.D.C. Mar. 25, 1998)

See "State Entities as FCA Defendants" above at page 14.

FCA Liability/Improper RTC Commissions

U.S. ex rel. Martin and Moore v. Bald Eagle Realty et al., 1998 WL 162290 (D. Utah Apr. 6, 1998)

A Utah district court ruled that a real estate broker's collection of a commission from a fraudulent property sale constituted a false claim under the FCA. The court further held that, because the Government met the requirements for Article III standing, standing was thereby also conferred upon the relators.

The plaintiffs alleged, among other causes of action, that defendant Bald Eagle Realty violated the False Claims Act by collecting a listing commission paid by the Resolution Trust Corporation (RTC) to which it was not entitled. The complaint alleged that Jim and Janet Olch, owner and employee of Bald Eagle Realty respectively, failed to disclose a significant conflict of interest in Bald Eagle's work as listing agent for the RTC, thereby obtaining the sale in a fraudulent manner.

The RTC was created by federal statute to oversee the sale or other disposition of assets of failed thrift institutions. Plaintiff Michael Martin was an unsuccessful bidder for the piece of property held by the RTC and sold by sealed bid. The RTC contracted with Coopers & Lybrand to dispose of the property, which in turn contracted with defendant Bald Eagle Realty to serve as the seller's listing broker for the property. The listing agreement between the RTC and Bald Eagle contained several provisions which obligated Bald Eagle to disclose any conflicts of interest that developed in its representation of the RTC for the sale of the property.

Olch made his own offer to buy the property, but his offer was rejected. The written rejection received by Olch included an additional reminder about the importance of avoiding any appearance of favoritism.

Two potential purchasers, Martin and defendant Lapage, submitted "best and final" bids for the property. Bald Eagle played no role in the review of the bids. Lapage's bid was selected. Lapage's earnest money payment on the bid was provided by Olch. In addition, at the closing, the entire purchase price was paid from funds provided by the Olchs, with Bald Eagle receiving a 6 percent commission. Less than two weeks after closing, Lapage deeded the property to the Olchs at the Olchs request. The Olchs never disclosed their role as the financiers of Lapage's bid to either Coopers & Lybrand or the RTC.

Fraudulent Collection of Commission Constitutes False Claim

Although the court excluded two of the false representations at issue as contract disputes not actionable under the FCA, the court ruled that the failure to disclose the Olchs' involvement was actionable under the statute. The court held that a real estate broker's collection of a commission on a sale that the broker knows to be transacted under false pretenses is fraudulent conduct constituting a false claim.

The court found that whether or not Bald Eagle failed to advertise the property in newspapers of general circulation or whether it failed to list the property on the Multiple Listing Service within three days of executing the listing agreement, both of which were required by the agreement, were matters of contract interpretation. However, with regard to the Olchs' failure to disclose their involvement in Lapage's bid, the court stated, "Defendants' failure to disclose the Olchs' involvement in Lapage's bid presents a very different situation and is actionable under the FCA." The court found Olchs' behavior to be "directly analogous" to that of a broker who failed to disclose a conflict in an earlier 5th Circuit case. In that case, the real estate broker collected a commission for the sale of a veteran's home even though the broker had previously learned that the veteran was ineligible for the loan. The 5th Circuit held that this constituted a "fraudulent course of conduct" which constituted a false claim.

Government Suffered Loss Because of Broker's Failure to Disclose Conflict

The court ruled that the defendants' undisclosed conflict caused a loss to the Government since the RTC had paid Bald Eagle an "unearned" commission. The court rejected the defendants' argument that the Government was obligated to pay the commission as long as Bald Eagle advertised the property and there was a sale. The court found that the RTC suffered a loss when Bald Eagle "deprived it of the selling process for which it contracted." The court noted that the RTC could have drafted a contract that simply required the broker to obtain a buyer willing to pay the listed price. Instead, the RTC chose to draft a listing agreement which also focused on the process by which the property was sold.

The court also stated that "[t]he RTC was....entitled to the honest and undivided loyalty of its

fiduciary and a process that was free from both the appearance of impropriety and actual conflicts of interest. Defendants' undisclosed conflict deprived the government of an important contractual benefit. The fact that quantifying the value of that process will be difficult does not make the government's loss less palpable." Furthermore, Bald Eagle would still be liable for a penalty as a result of the false claim even if the Government had suffered no loss.

Relators Had Standing Because Government Suffered Injury

The court further ruled that plaintiffs had standing to maintain their *qui tam* action. Since the RTC was capable of establishing the constitutional requirements for standing, and since prudential standing considerations are not applicable in FCA actions, the plaintiffs satisfied the standing requirements as well.

The court reviewed the three elements which are necessary to satisfy Article III standing requirements — injury in fact, traceablity to the defendant's actions, redressablity by the court. According to the court, if the Government has suffered the injury, then the relator may bring the cause of action. The court held that in this case the RTC — and thereby the plaintiffs — satisfied all of the required elements for Article III standing. The RTC was injured through its payment of an unearned commission. The injury was caused by the defendants' undisclosed conflict. The injury was redressable through the loss of the commission under the terms of the listing agreement and other money damages.

Discovery from the Government

U.S. ex rel. Farrell v. SKF USA, Inc., 1998 WL 265242 (W.D.N.Y. May 18, 1998)

The Government is not a party plaintiff in a non-intervention *qui tam* suit and thus not bound by the Federal Rules of Civil Procedure as they relate to party discovery, ruled a New York district court. Accordingly, the court granted the Government's motion for a protective order against the defendant's deposition notices and document requests.

In March 1994, Charles Farrell filed a *qui tam* action alleging that SKF USA (his former employer) fraudulently concealed the fact that bearings it was selling to the Government were substandard, and SKF submitted invoices to the Government for these bearings knowing they did not meet mandated specifications. In May 1996, the Government declined to intervene in the Farrell's suit. Subsequently, the defendant's motions to dismiss for failure to state a claim and for lack of subject matter jurisdiction were denied, and discovery proceeded.

In October 1997, the defendant served the Government with deposition notices for five Navy employees pursuant to Fed. R. Civ. P. 30, along with a request for the production of documents pursuant to Rules 26 and 34. The Government moved for a protective order, arguing that it was not a party to the litigation and thus not responsible for document production under Rules 26 and 34, which govern discovery from parties. Moreover, the Government argued that the failure of the defendant to comply with the Navy's administrative regulations establishing the procedures and circumstances under which Navy employees may give testimony and release documents precluded the defendant from compelling either deposition testimony or document production.

The defendant countered that it need not follow the Navy regulations because the Government, as the real party in interest in a *qui tam* action, must engage in party discovery under the Federal Rules. However, the court ruled that, while the Government may be the real party in interest, it is not "an actual party to the action in the case where it has declined to intervene" and thus not bound by party discovery rules.

CID Testimony

In re: Oral Testimony of A Witness Subpoenaed, 1998 WL 204684 (E.D. Va. Apr. 23, 1998)

A Virginia district court granted the Government's petition to proceed pursuant to a civil investigative demand (CID) to examine a former employee of the contractor targeted in the Government's FCA investigation outside the presence of counsel retained to represent the interests of the contractor. In support of its ruling, the court stressed not hindering the Government's ability to investigate contractor fraud.

Pursuant to the FCA, the Justice Department issued a CID to a former employee of Newport News Shipbuilding & Dry Dock Company (NNS) for the purpose of investigating allegations that NNS knowingly withheld complete and accurate cost and pricing data from the Navy during its proposal and negotiation of a contract for the construction of the nuclear carrier Ronald W. Reagan. Pursuant to the CID, the employee and his counsel appeared for a deposition. They were accompanied by outside counsel for NNS. The Government objected to the presence of NNS counsel, but the employee's counsel would not let him answer questions until the issue of the right of NNS counsel to be present was resolved.

According to the district court, the issue appeared to be one of first impression. The Government claimed an entitlement to depose witnesses without the presence of counsel for the government contractor being investigated. Arguing in favor of NNS counsel's presence, the employee cited FCA § 3733(a)(2)(D) — which states, "If such demand is for the giving of oral testimony, the demand shall . . . (iv) notify the person receiving the demand of the right to be accompanied by an attorney and any other representative . . . ." — focusing on the phrase "any other representative."

However, based on other language in § 3733 and congressional intent, the court agreed with the Government's position. The court concluded: "To permit the interpretation advanced by the employee subpoenaed pursuant to a lawfully issued CID would require the Court to ignore congressional concerns, disregard legislative history, and eviscerate the statute. The end result would be profound disruption to the government's ability to investigate contractor fraud."

U.S. ex rel. Robinson and Holzrichter v. Northrop Corporation (ND IL No. 89 C 6111)

In April 1998, an Illinois district court granted several motions by Rex Robinson and James Holzrichter in their ongoing *qui tam* action against Northrop Corporation, allowing the relators to amend their complaint and granting discovery of certain information which was or might be claimed to be grand jury material. This complex defense contract fraud case — concerning primarily the B-1, F-15, SP-3, and AN/ALQ 162 programs — was originally filed in 1989. In 1992, the Government elected not to intervene. Discovery is now scheduled to close in October 1998. A trial is likely next year.

U.S. ex rel. Stone v. Rockwell International Corporation (D CO No. 92-CR-107-M)

In April 1998, the Supreme Court, without comment, let stand the 10th Circuit's affirmance of a district court ruling that Rockwell International's 1992 plea agreement with the Government did not preclude the Government from subsequently intervening in James Stone's *qui tam* suit. *See* 11 TAF QR 29 (Oct. 1997). The same day Rockwell executed the plea agreement — under which the company pleaded guilty to various environmental crimes in connection with its operation of the Department of Energy's Rocky Flats Nuclear Weapons Plant — the Justice Department declined to intervene in Stone's *qui tam* suit, which had been filed in 1989. However, in 1995 the Government moved to intervene for good cause under FCA § 3730(c)(3).

U.S. ex rel. American Textile Manufacturers Institute, Inc. v. The Limited, Inc. et al. (SD OH No. C2-97-776)

In May 1998, a second district court judge reaffirmed an initial decision to dismiss a *qui tam* suit brought by the American Textile Manufacturers Institute (ATMI) — the domestic textile industry's national trade association — alleging that The Limited, Inc. and others falsely represented to U.S. Customs officials that they did not violate various customs laws restricting importation of garments from China. ATMI's § 3729(a)(7) "reverse false claim" case was originally dismissed this past November by a different district court judge. *See* 12 TAF QR 6 (Jan. 1998). That judge, however, recused himself from the case after ATMI argued that his relationship with The Limited's lead law firm, which represented him in a traffic case, might have impaired his impartiality. ATMI is reportedly appealing the dismissal to the 6th Circuit.

LEGISLATION THAT WOULD GUT THE FALSE CLAIMS ACT LOSES SUPPORT AFTER DOJ AND HHS ISSUE GUIDELINES

At the urging of the American Hospital Association, legislation was introduced in March in the U.S. House of Representatives and later in the Senate to amend the False Claims Act. The bills, H.R. 3523/S. 2007, would create a separate liability standard for health care providers submitting false claims. Specifically, the legislation would limit FCA actions to only those where damages are a "material amount." Under the ambiguous language of the bills, "material" could mean up to 10% of the provider's total Medicare billings. The legislation would also exempt claims made "in reliance on official guidance" and by providers who are "in substantial compliance with a model compliance plan." Additionally, the bills would elevate the standard of proof from "preponderance of the evidence" to "clear and convincing evidence." Finally, the provisions would be applied retroactively to preclude liability for false claims already submitted. *For the text of the legislation and related materials, see TAF's Internet site at http://www.taf.org.*

The House legislation, introduced by Representatives Bill McCollum (R-Fla.) and William Delahunt (D-Mass.), gained 196 co-sponsors over three months. The identical Senate bill, introduced by Senators Thad Cochran (R-Miss.) and Ernest Hollings (D-S.Ca.), attracted 7 co-sponsors. In general, support for the legislation stemmed from complaints from hospitals that prosecutors were using the False Claims Act in a heavy-handed manner through aggressive "demand letters." The demand letters at issue originated primarily from two national enforcement initiatives — one involving alleged violations of the "DRG 72 hour window" rule, the other involving allegations of improper unbundling of laboratory claims.

BROAD-BASED COALITION OF GROUPS OPPOSE LEGISLATION

Soon after the legislation was introduced, groups representing taxpayers, consumers, seniors, health care workers, and others announced their strong opposition. On April 27, in a press conference led by Sen. Charles Grassley (R-Ia.) and Rep. Fortney Pete Stark (D-Ca.), a number of citizen groups joined together to condemn the proposed FCA amendments. Among other problems, the groups noted that the legislation would create "free fraud zones" and severely weaken the Government's most effective tool against fraud. Moreover, because of the retroactivity provision, the groups warned that the legislation could impede ongoing fraud investigations, including the pending investigation of Columbia/HCA. Calling for a strong False Claims Act, the groups further cited the recent HCFA audit which showed over $20 billion in "improper payments" to Medicare providers last year.

HOUSE JUDICIARY SUBCOMMITTEE HOLDS HEARINGS ON HOSPITAL INDUSTRY COMPLAINTS REGARDING DOJ ENFORCEMENT TACTICS

On April 28, the House Judiciary Subcommittee on Immigration and Claims held an oversight hearing to examine the issues raised by the hospital industry. Testimony was provided by the Department of Justice, HHS Office of Inspector General, HCFA, the American Hospital Association, hospital officials, a billing compliance expert, and the American Association of Retired Persons (AARP). Excerpts from the hearing testimony follow.

ADMINISTRATION SAYS LEGISLATION WOULD FUNDAMENTALLY UNDERMINE EFFORTS TO PROTECT MEDICARE TRUST FUNDS FROM FRAUD AND WARNS OF PRESIDENTIAL VETO

On June 4, the Department of Justice released a letter communicating the official Administration position on H.R. 3523/S. 2007. The Department said that it "strongly opposes" H.R. 3523/S. 2007 because it would "fundamentally undermine our law enforcement efforts to protect the integrity of the Medicare Trust Funds." Describing the legislation as providing "preferential treatment to the health care industry," the Attorney General recommended that the President veto H.R. 3523/S. 2007 should the legislation be passed by Congress. The full text of the Department of Justice letter follows.

DOJ AND HHS IG ESTABLISH DETAILED GUIDELINES FOR FCA MATTERS

Also in early June, in response to industry concerns, DOJ and the HHS OIG both announced that they had established detailed guidelines regarding implementation of the False Claims Act in health care matters, particularly for national enforcement projects. Among other things, DOJ's guidelines provide for the use of "contact letters" and require prosecutors to ensure that there is a sufficient factual and legal predicate prior to alleging an FCA violation. HHS's guidelines indicate that it will establish minimum monetary thresholds for national enforcement projects. Only those matters that exceed the thresholds will be developed for potential referral to DOJ for civil or criminal enforcement. The full text of both the DOJ and HHS guidelines follows.

KEY LEGISLATORS SAY FCA LEGISLATION UNNECESSARY — INSTEAD GAO TO MONITOR DOJ'S ADHERENCE TO GUIDELINES AND REPORT BACK TO CONGRESS NEXT YEAR

Calling the recently released guidelines a "victory" for health care providers and a "solution" to the enforcement problems the hospitals had complained about, Rep. Lamar Smith (R-Tx.), Chairman of the House Judiciary Subcommittee with jurisdiction over H.R. 3523, announced that any need for legislation was eliminated. Similarly, the primary co-

sponsor of the bill, Rep. William Delahunt, said that the legislation was no longer necessary or advisable. Others, however, continued to push for additional assurances that DOJ would adhere to its guidelines. Senator Cochran threatened to attach his FCA bill to an appropriations bill, but eventually worked out a requirement that the General Accounting Office would monitor DOJ's adherence to its guidelines and report back to Congress next year. The GAO reports will likely come out in February and August of 1999.

CONGRESSIONAL BUDGET OFFICE RELEASES COST ESTIMATE FOR LEGISLATION

On July 2, the Congressional Budget Office released its cost estimate for H.R. 3523/S. 2007. CBO estimates that enacting the legislation would increase federal spending by $300 million in fiscal year 1999 and $2.2 billion over the 1999-2003 period. State and local governments could face increased Medicaid costs totaling $60 million in fiscal year 1999.

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EXCERPTS FROM TESTIMONY FROM THE HEARING ON HEALTH CARE INITIATIVES PURSUED UNDER THE FALSE CLAIMS ACT BEFORE THE HOUSE JUDICIARY COMMITTEE SUBCOMMITTEE ON IMMIGRATION AND CLAIMS APRIL 28, 1998

The False Claims Act is Vitally Important to Deterring and Remedying Health Care Fraud

"The False Claims Act is an invaluable tool in the Government's continuing effort to control health care fraud and abuse. In an era when the long-term solvency of Medicare is in doubt, and when our audits reveal huge losses due to improper payments, and when taxpayers, the Congress, and the Administration are rightfully demanding a more concerted law enforcement effort, it would not be wise to weaken the protections afforded by the False Claims Act." *Lewis Morris, HHS Assistant Inspector General for Legal Affairs.*

"AARP applauds the action Congress has taken in recent years to strengthen enforcement tools and provide additional resources to fight fraud through provisions in the Health Insurance Portability Act of 1996 (HIPAA) and the Balanced Budget Act of 1997 (BBA). . . . However, none of these are likely to play a more important role in recovering improper payments or in acting as a deterrent than the False Claims Act." *Ruth Blacker, Member, AARP National Legislative Council.*

"Since the False Claims Act was first enacted in 1863, it has become the Department's primary civil enforcement tool to combat fraud and other false billing in a variety of areas, including defense procurement, food stamps, HUD programs, and health care.... Without the False Claims Act, enforcement and remedial efforts of the Department in health care fraud would be seriously undermined." *Donald K. Stern, United States Attorney for the District of Massachusetts, and Chair, Attorney General's Advisory Committee.*

"In our experience, the penalty provisions of the False Claims Act are also a crucial deterrent to repeat offenders. If a provider or supplier gets caught actually bilking the system, i.e., submitting claims recklessly, and only has to pay the money back, there is precious little incentive for the wrongdoer to stop." *Lewis Morris, HHS Assistant Inspector General for Legal Affairs.*

"Letting providers who intentionally submit improper bills merely pay back the money turns the Medicare Trust Funds into a no-interest loan program. That is something we simply cannot afford to tolerate. In too many instances, when providers found to be billing improperly were merely made to pay back the money, they went on to continue the very same billing practices and waited until being caught again to pay back the money. We need penalties under the False Claims Act if we are to put an end to these deliberate improper billing practices." *Robert A. Berenson, M.D., Director, HCFA Center for Health Plans & Providers.*

"The current False Claims Act was a powerful catalyst when I had to discuss the consequences of non-compliance with senior management. When fully informed of the possible fines and penalties, organizations typically take the high road and allocate the necessary resources. Any weakening of the False Claims Act will dramatically alter the chances that upper management will undertake crucial compliance programs." *Terry L. Cameron, health care industry billing expert, currently Senior Vice President, Medicode Inc.*

"Since being strengthened in 1986, the FCA has proven to be the Government's most effective weapon against fraud — with over $4 billion in recoveries for the U.S. Treasury. About half of those recoveries have stemmed from health care fraud cases. At a time when Medicare and Medicaid fraud remains widespread, Congress should be looking to strengthen the Government's anti-fraud efforts, not cripple them." *Statement entered into Record by Lisa R. Hovelson, Executive Director and General Counsel, Taxpayers Against Fraud, The False Claims Act Legal Center.*

H.R. 3523 Would Seriously Hinder the Government's Anti-Fraud Efforts and Should be Rejected by Congress

"The bottom line is that the problem of health care fraud is real and it is massive in scope. The AHA proposal would hamstring the Government's use of the most important tool we have in stemming the tide." *Lewis Morris, HHS Assistant Inspector General for Legal Affairs.*

"AARP is deeply concerned about the effect that proposed legislation would have on the False Claims Act. We believe such legislation would seriously undermine the FCA, making it much easier for unscrupulous providers to successfully submit fraudulent Medicare claims, and remove an important incentive for providers to take great care to see that their billings are correct." *Ruth Blacker, Member, AARP National Legislative Council.*

"The False Claims Act must remain intact and be used appropriately to continue to preserve and protect the Medicare program for the American people. . . . This is not the time for tying the hands of enforcement authorities by weakening the False Claims Act. There is too much at stake." *Ruth Blacker, Member, AARP National Legislative Council.*

"While the health care industry would like to be exempt from this standard and held accountable only for what amounts to criminal fraud, the Department believes that the False Claims Act — both as it reads today as well as how it is used today — is a critical tool in fighting and deterring fraud and other false billing in the health care industry." *Donald K. Stern, United States Attorney for the District of Massachusetts, and Chair, Attorney General's Advisory Committee.*

"The AHA proposal would erect serious obstacles to pursing Federal health care fraud. Curiously, these obstacles would not be imposed on any other defrauders of federal programs. But under the AHA's proposal, regardless of what some advocates state, members of the health care industry would enjoy immunity from the False Claims Act in many situations." *Lewis Morris, HHS Assistant Inspector General for Legal Affairs.*

"There is simply no principled reason to give the health care industry — or any industry — this type of preferential treatment." *Donald K. Stern, United States Attorney for the District of Massachusetts, and Chair, Attorney General's Advisory Committee.*

"The legislation would establish a series of major exemptions from civil liability under the False Claims Act for fraud perpetrated by providers supplying health care services under the Medicare program. Through its retroactive application it would also protect those companies with enforcement actions already well underway." *Ruth Blacker, Member, AARP National Legislative Council.*

"Because the AHA seeks to have its proposal made retroactive in effect, current enforcement efforts would grind to a halt. . . ." *Lewis Morris, HHS Assistant Inspector General for Legal Affairs.*

"It would not be appropriate or necessary for Congress to change the False Claims Act in order to deal with problems in its implementation." *Ruth Blacker, Member, AARP National Legislative Council.*

"Self-policing and weakening the enforcement capabilities of the False Claims Act is not the answer." *Terry L. Cameron, health care industry billing expert, currently Senior Vice President, Medicode Inc.*

"Legislation to weaken the FCA is primarily the result of an aggressive lobbying campaign by AHA. Not surprisingly, hospitals account for over $100 billion in Medicare billings annually. According to HHS audits, Medicare providers have received over $40 billion dollars in "improper payments" over the past two years. As much as half of that is likely to be due to out-and-out fraud. And recent government investigations have revealed that the AHA's largest member, Columbia/HCA Healthcare, is perhaps the single largest Medicare abuser. . . . In sum, health care fraud is a multi-billion dollar problem. The AHA-backed legislation represents a multi-million dollar lobbying effort to make it worse." *Statement entered into Record by Lisa R. Hovelson, Executive Director and General Counsel, Taxpayers Against Fraud, The False Claims Act Legal Center.*

The Government's National Investigations of Hospitals Were Reasonable

"Unfortunately, our experience with the 72 Hour/DRG project indicated to us that repeated notifications to hospitals of false billings — without the potential for liability and further penalties under the False Claims Act as an economic incentive — had no effect on the providers' conduct. Facing nothing more than the prospect of having to pay back money they should not have received in the first place, providers continued to bill Medicare incorrectly." *Donald K. Stern, United States Attorney for the District of Massachusetts, and Chair, Attorney General's Advisory Committee.*

"Innocent mistakes? Perhaps initially. But at some point, repeated failure to abide by explicit notice becomes, at a minimum, reckless behavior. We had every reason to believe that without this remedy [the FCA], false claims would continue." *Lewis Morris, HHS Assistant Inspector General for Legal Affairs.*

"Whether the regulations are related to lab unbundling, 72 hour window, teaching hospital guidelines or any other federal billing requirement, if technology and a willingness to change current processes are deployed, every claim can be billed correctly." *Terry L. Cameron, health care industry billing expert, currently Senior Vice President, Medicode Inc.*

"There is a need within the healthcare industry to standardize rules associated with claims payment. To insist, however, that current rules, some of which have been on the books for decades, are too complicated and impossible to comply with is hard to imagine. I have worked for organizations that were willing to commit the necessary resources, and successfully implemented processes to comply with federal payment regulations, so I know it can be done." *Terry L. Cameron, health care industry billing expert, currently Senior Vice President, Medicode Inc.*

"Some [DRG 72 hour window] statistics: It is my understanding that approximately 3,000 hospitals to date have received letters from DOJ. Some 1,700 of these have had to pay no penalty whatsoever." *Lewis Morris, HHS Assistant Inspector General for Legal Affairs.*

"[I]t is important to keep these [Health Care Fraud and Abuse Control Program] results in perspective. Hospitals paid approximately $73.2 million last year to settle potential False Claims Act liabilities with the government, while they received over $100 billion in Medicare payments." *Lewis Morris, HHS Assistant Inspector General for Legal Affairs.*

The Government Has Acknowledged and Responded to the AHA's Concerns

"We recognize that there have been legitimate concerns expressed about our civil enforcement strategies in these two national projects [DRG 72 hour window and lab unbundling] and we have taken steps to address them." *Donald K. Stern, United States Attorney for the District of Massachusetts, and Chair, Attorney General's Advisory Committee.*

"Although we believe the AHA proposal is not the answer to the concerns that have brought us here today, we wish to address the objections by the industry to the concept of national enforcement projects." *Lewis Morris, HHS Assistant Inspector General for Legal Affairs.*

"We believe that more outreach activities will be important in educating the provider community regarding our use of the False Claims Act and the fact that the statute does not apply to inadvertent billing mistakes or simple negligence in billing." *Donald K. Stern, United States Attorney for the District of Massachusetts, and Chair, Attorney General's Advisory Committee.*

"We are not in the business of putting rural and community hospitals out of business and we invite rural and community hospitals to meet with us to discuss any inability to pay issues which may arise." *Donald K. Stern, United States Attorney for the District of Massachusetts, and Chair, Attorney General's Advisory Committee.*

"In summary, the Department will meet with any health care provider to discuss potential defenses or mitigating circumstances. While we will continue in appropriate circumstances to use other legitimate means to pursue an investigation, we hope that the use of contact letters will lead to productive discussions with hospitals identified as having potential exposure under the False Claims Act. This approach, combined with the coordination offered by working groups in national projects, will help to ensure that we are using the enforcement tools that Congress has provided us in a fair and reasonable manner." *Donald K. Stern, United States Attorney for the District of Massachusetts, and Chair, Attorney General's Advisory Committee.*

U.S. Department of Justice
Office of Legislative Affairs
Washington, D.C. 20630

June 4, 1998

The Honorable Charles E. Grassley
Chairman
Subcommittee on Administrative Oversight and the Courts
Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

This responds to your request for the Department's views on S. 2007 and H.R. 3523, the Health Care Claims Guidance Act, which would amend the False Claims Act to provide preferential treatment to the health care industry. The Department of Justice strongly opposes this legislation, because its enactment would fundamentally undermine our law enforcement efforts to protect the integrity of the Medicare Trust Funds. The Attorney General would recommend a veto if this legislation were presented to the President.

The bills are founded on two erroneous premises concerning current law: that the False Claims Act penalizes innocent billing errors, and that health care providers can be found liable under the Act if they reasonably rely on advice from the federal government. The express language of the False Claims Act and decisions interpreting the Act demonstrate that the False Claims Act does not penalize innocent mistakes, nor does it permit a recovery from a defendant who reasonably relies on agency advice.

Under this legislation, "bad apple" health care providers would be able to misuse our federal health programs with impunity. They could do so because the legislation would preclude the government from pursuing any false billing under the False Claims Act absent proof that its dollar value was relatively large compared to the provider's total government billings. The legislation would also prevent the government from pursuing a False Claims Act case against any provider that instituted a training and reporting program, even if the provider's senior management ignored the billing rules that were the subject of the training program. The legislation would thus severely restrict the government from pursuing health care providers for fraud or other false billings, at a time when containing health care costs continues to be a top priority of the Administration and Congress.

We also oppose these bills because they provide preferential treatment for the health care industry over all others who submit claims for government funds, including those who provide goods and services for our national defense, those seeking Temporary Assistance for Needy Families, food stamps and other welfare benefits, applicants for government-funded student loans and small business loans, and the companies that build our highways and support our space program. We see no principled basis for establishing a lesser standard for physicians, hospitals and other health

care providers that would immunize them from False Claims Act liability in circumstances in which all others would be liable.

Our most important objections to the specific provisions in the bills are explained below.

1. Change in the Government's Burden of Proof

The Supreme Court has made clear that the normal civil burden of proof, including under statutes providing a civil remedy for fraud, is proof by a "preponderance of the evidence." Herman & MacLean v. Huddleston, 459 U.S. 375 (1983) (securities fraud); Grogan v. Garner, 498 U.S. 279 (1991) (bankruptcy fraud). This is true whether the statutory remedy available is single damages or treble damages. Liquid Air Corp. v. Rogers, 834 F. 2d 1297, 1302-03 (7th Cir. 1987) ("preponderance of the evidence" standard applies in civil actions seeking treble damages under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1964 (c)); Clark Marine Corp. v. Cargill, Inc., 226 F. Supp. 103, 111 (E.D. La. 1964) ("preponderance of the evidence" standard applies in civil actions seeking treble damages under the Sherman Antitrust Act, 15 U.S.C. § 15.)

The Supreme Court has explained in a unanimous decision that the "preponderance of the evidence standard allows both parties to 'share the risk of error in roughly equal fashion.' Any other standard expresses a preference for one side's interests." Herman & MacLean v. Huddleston, 459 U.S. at 390.

This legislation would elevate the normal civil burden of proof in False Claims Act cases involving health care providers to "clear and convincing evidence," a burden of proof that is not generally used in civil cases seeking monetary damages, but is reserved instead for cases involving a loss of personal liberty, such as civil commitment and deportation.

There is no principled basis for giving the health care industry a special preference not accorded other civil litigants, or for according greater weight to the health care industry's interests in False Claims Act cases than to the interests of the taxpayers and the Medicare and Medicaid beneficiaries on whose behalf the United States acts. There is also no reason to make it harder for the federal government to pursue a health care provider for knowing false claims than to pursue bankrupt debtors, food stamp recipients, or those in the defense industry who commit procurement fraud. The False Claims Act, which was amended in 1986 with strong bipartisan support, was specifically intended to protect taxpayers from those who would misappropriate health care dollars to line their own pockets. This change in the burden of proof would prevent the government from effectuating these goals.

2. Requirement that Damages Exceed a Certain Amount

This legislation would preclude a False Claims Act action against a health care provider "unless the amount of damages" that the Treasury sustained was established to be "a material amount." Damages would be considered "material" only if they exceeded a certain proportion of the provider's annual claims upon the same federally-funded health care program. "Materiality" would be defined by the standards promulgated by the American Institute of Certified Public Accountants (AICPA).

The only quantitative standard used by the AICPA to define materiality is a "rule of thumb" of ten percent (10%). (AICPA Audit and Accounting Manual, June 1997 edition, § 3140.19.) Assuming this to be the applicable standard, enactment of this bill would allow unscrupulous providers to submit fraudulent claims equal to 10% of their total Medicare billings, or $21 billion each year. (In 1997, providers were paid approximately $210 billion by Medicare.) Chances are they would not get caught, since, due to funding limitations, fiscal intermediaries are only able to review supporting medical records for approximately 3% of claims.

Even in the unlikely event that these providers happened to be caught, the bills would make them immune from any False Claims Act liability, and they could keep the interest they had earned on their improper receipts.[1] At the end of the day, even a provider who committed outright fraud would have received an interest-free loan at the taxpayers' expense. Indeed, a ten percent materiality standard would have precluded the government from obtaining the majority of its most significant False Claims Act recoveries in recent years, including the $325 million recovery from SmithKline Beecham Clinical Laboratories (for unnecessary and duplicative blood tests) and the $4.2 million settlement with Vendell Healthcare (for billing for unneeded psychiatric services and services not rendered).

Moreover, to the extent the AICPA's 10% standard is not intended to apply, the bill creates an ambiguous standard that will generate considerable confusion and litigation. As one accounting journal put it, "accounting pronouncements offer few specific guidelines for materiality, leaving its determination primarily to a matter of judgment" (i.e., the judgment of each individual accountant). (CPA Journal, July 1990). In practice, even potential liability of hundreds of millions of dollars could be considered immaterial by accountants and lawyers.

In sum, whether the standard is deemed to be the 10% rule of the thumb cited by the AICPA, or a more ambiguous, subjective standard used by accountants, under the bills' materiality provision, large health care conglomerates and enterprises like SmithKline Beecham Clinical Laboratories could be immune from suit under the False Claims Act even when their false claims totaled hundreds of millions of dollars.

3. Immunity For Those With A Corporate Compliance Plan

H.R. 3523 and S. 2007 would give a broad grant of False Claims Act immunity to providers who are "in substantial compliance with a model compliance plan issued by the Secretary of Health and Human Services (in consultation with the Secretary of Defense)." Under these bills, once a provider had set up such a plan, "trained" its employees, set up a hotline, and issued an internal memorandum regarding the importance of "corporate integrity," the provider would have a complete "pass" under the False Claims Act for any fraud or other false billing committed thereafter by its employees. The bills would override normal legal principles (of "respondeat superior") that a corporation is responsible for the acts of its employees. Compliance plans are simply education and reporting plans; they do not contain substantive legal requirements. Providers could follow

[1] Under the Medicare statute, the provider pays interest only for the period starting with HCFA's final determination of the overpayment; no interest is charged if the debt is paid within 30 days (42 USC §§ 1395g(d), 13951(j).) They have no obligation to pay interest for whatever time period they unlawfully held the government's funds prior to that date.

all of the procedures in a compliance program while still being in violation of substantial Medicare rules. In addition, litigating in a False Claims Act case the efficacy and utilization of a purported compliance plan would greatly exacerbate enforcement efforts. If this legislation were enacted, we could see a large upswing in the volume of fraud perpetrated on the government, since law enforcement would have lost its most potent civil tool to pursue it — the False Claims Act — once certain cosmetic steps were taken by unscrupulous providers.

4. Immunity Based on Erroneous "Federal Agency Information"

H.R. 3523 and S. 2007 would give another broad grant of immunity to providers who are able to show that they submitted their false or fraudulent claim "in reliance on (and correctly using) erroneous information supplied by a Federal agency (or an agent thereof) about matters of fact at issue" or "in reliance on (and correctly applying) written statements of Federal policy which affects such claim provided by a Federal agency (or an agent thereof)".

While we agree that we should not pursue under the False Claims Act health care providers who reasonably rely on agency advice, such providers are already protected under the existing False Claims Act. The federal government cannot pursue anyone under the False Claims Act for an innocent mistake or for simple negligence.[2] The False Claims Act mandates that the government show, before obtaining any recovery, that the false claim was submitted "knowingly." If a provider shows that it reasonably relied upon inaccurate information or guidance authoritatively provided by the government, the government could not prove that the claim was submitted "knowingly" and thus the case would fail.

Under these bills, however, there would be no requirement that the provider's reliance on the inaccurate advice be "reasonable" before the provider would be insulated from liability. Even a provider that knew the information was inaccurate would be protected. Since the False Claims Act already protects those who reasonably rely on agency advice, this bill consequently would add protection only for those who "unreasonably" rely.

The Department of Justice is committed to the fair and proper use of the existing False Claims Act and is constantly evaluating and refining its procedures under the Act. As part of this process, and also to respond to the specific concerns raised by Members of Congress and the American Hospital Association, we have taken several actions to ensure that our policies are being implemented rigorously and consistently, including the following:

- On June 3, 1998, the Deputy Attorney General (DAG) issued guidance to Department attorneys on the use of the False Claims Act in civil health care fraud cases. Among other things, the guidance provides that, as a general rule, Department attorneys will now make initial contact with health care providers in national initiatives through the use of "contact letters." The letters will inform health care providers that questionable conduct has been identified and that the Department would like a dialogue with them to ensure that a fair examination of the

[2] See, e.g., S.Rep. No. 345, 99th Cong., 2d Sess. 7 (1986), reprinted in 1986 U.S.C.C.A.N. 5266 ("[t]he Committee is firm in its intention that the act not punish honest mistakes or incorrect claims submitted through mere negligence"); United States ex rel. Wang v. FMC Corp., 975 F. 2d 1412, 142021 (9th Cir. 1992) (allegations of engineer's faulty calculations, without more, insufficient to prove culpability under the False Claims Act.)

relevant facts (including any defenses or mitigating factors) is completed prior to making a decision whether or not any further action is warranted.

- The DAG's guidance memorandum also calls for establishing working groups to oversee the laboratory unbundling initiative and all future national initiatives. These working groups, which are comprised of Assistant United States Attorneys and Trial Attorneys from the Civil Division with particular experience and expertise in the subject matters of the national projects, will help to ensure that the Department's policies are applied consistently.

- We have increased the extent of the training we conduct on the use of the False Claims Act in health care fraud matters. Recent training sessions have addressed the concern about demand letters, and have emphasized the importance of thoroughly investigating cases before allegations of False Claims Act liability or monetary demands are made to confirm that the evidence indicates that all elements of the False Claims Act — including the "knowledge" element — are satisfied.

We urge the Subcommittee to take no further action on this legislation, and we look forward to answering any questions that may arise regarding our concerns about it. The Office of Management and Budget has advised that there is no objection to the submission of this report from the standpoint of the Administration's program, and that enactment of the H.R. 3523 or S. 2007 would not be in accord with the program of the President.

Sincerely,

L. Anthony Sutin
Acting Assistant Attorney General

cc: Honorable Richard J. Durbin
Ranking Minority Member

Office of the Deputy Attorney General
Washington, DC 20530

June 3, 1998

MEMORANDUM FOR:
All United States Attorneys
All First Assistant United States Attorneys
All Civil Health Care Fraud Coordinators in the Offices of United States Attorneys
All Trial Attorneys in the Civil Division, Commercial Litigation Section

FROM : Eric H. Holder, Jr.
Deputy Attorney General

SUBJECT: Guidance on the Use of the False Claims Act in Civil Health Care Matters

One of the Department's most important tools in protecting the integrity of Medicare and other taxpayer-funded health care programs is the civil False Claims Act. While the broad reach and substantial damages and civil penalties under the Act make it one of the Department's most powerful tools, Departmental attorneys are obligated to use their authority under the Act in a fair and responsible manner. This is particularly important in the context of national initiatives, which can have a broad impact on health care providers across the country.

This guidance is being issued to emphasize the importance of pursuing civil False Claims Act cases against health care providers in a fair and even-handed manner, and to implement new procedures with respect to the development and implementation of national initiatives.

1. NATIONAL INITIATIVES.

Generally, national initiatives deal with a common wrongful action accomplished in a like manner by multiple, similarly situated health care providers. National initiatives must be handled in a manner (i) that promotes consistent adherence to the Department's policies on enforcement of the False Claims Act, as well as a consistent approach to overarching legal and factual issues, (ii) while avoiding any rigid approach that fails to recognize the particular facts and circumstances of an individual case.

To achieve these objectives, the Department has instituted the following procedures:

(A) Legal and Factual Predicates.

Before alleging violations of the False Claims Act, whether in connection with a national initiative or otherwise, Department attorneys must evaluate whether the provider: (i) submitted false claims to the government; and (ii) submitted false claims (or any false statements

made to get the false claims paid) with "knowledge" of their falsity, as defined in the Act. These are separate inquiries. Department attorneys shall not allege a violation of the False Claims Act unless both of these inquiries lead to the conclusion that there is a sufficient legal and factual predicate for proceeding. The following issues, among other issues, shall be considered in these determinations:

(i) Do False Claims Exist?

a. Examine Relevant Statutory and Regulatory Provisions and Interpretive Guidance. Department attorneys shall examine relevant statutory and regulatory provisions, as well as any applicable guidance from the program agency or its agents, to determine whether the claims are false. In certain circumstances, such as when a rule is technical or complex, Department attorneys should communicate with knowledgeable personnel within the program agency (e.g., the Health Care Financing Administration, TRICARE, or Office of Personnel Management) concerning the meaning of the provision.

b. Verify the Data and Other Evidence. Department attorneys shall take appropriate steps to verify the accuracy of data upon which they are relying, either independently, or with the assistance of the fiscal intermediaries and carriers, the Department of Health and Human Services Office of Inspector General, the Federal Bureau of Investigation, or another investigative agency.

c. Conduct the Necessary Investigative Steps. Department attorneys should conduct such investigative steps as are necessary under the circumstances, including where appropriate, the subpoenaing of documents and the interviewing of witnesses.

(ii) Did the Provider Knowingly Submit the False Claims?

In the event the claims are false, Department attorneys must also evaluate whether the health care provider "knowingly" submitted the false claims or "knowingly" made false statements to get the false claims paid. As set forth above, and before making this determination, Department attorneys should conduct such investigative steps as necessary under the circumstances, including where appropriate the subpoenaing of documents and the interviewing of witnesses. Under the False Claims Act, false claims and false statements are submitted "knowingly" if the provider had actual knowledge of their falsity, or acted with deliberate ignorance or reckless disregard as to their truth or falsity. While relevant factors will vary from case to case and the list below is not intended to be exhaustive, factors that must be considered are:

a. Notice to the Provider. Was the provider on actual or constructive notice, as appropriate, of the rule or policy upon which a potential case would be based?

b. The Clarity of the Rule or Policy. Under the circumstances, is it reasonable to conclude that the provider understood the rule or policy?

c. The Pervasiveness and Magnitude of the False Claims. Is the pervasiveness or magnitude of the false claims sufficient to support an inference that they resulted from deliberate

ignorance or intentional or reckless conduct rather than mere mistakes?

d. Compliance Plans and Other Steps to Comply with Billing Rules. Does the health care provider have a compliance plan in place? Is the provider adhering to the compliance plan? What relationship exists between the compliance plan and the conduct at issue? What other steps, if any, has the provider taken to comply with billing rules in general, or the billing rule at issue in particular?

e. Past Remedial Efforts. Has the provider previously on its own identified the wrongful conduct currently under examination and taken steps to remedy the problem? Did the provider report the wrongful conduct to a government agency?

f. Guidance by the Program Agency or its Agents. Did the provider directly contact either the program agency (e.g., the Health Care Financing Administration) or its agents regarding the billing rule at issue? If so, was the provider forthcoming and accurate and did the provider disclose all material facts regarding the billing issue for which the provider sought guidance? Did the program agency or its agents, with disclosure of all relevant, material facts, provide clear guidance? Did the provider reasonably rely on such guidance in submitting the false claims?

g. Have There Been Prior Audits or other Notice to the Provider of the Same or Similar Billing Practices?

h. Any Other Information That Bears on the Provider's State of Mind in Submitting the False Claims.

(B) Oversight by National Initiative Working Groups.

For all current and future national initiatives, the Attorney General's Advisory Committee (AGAC) and the Civil Division shall establish a working group to coordinate the development and implementation of each initiative.
Working groups will be comprised of Assistant United States Attorneys and Civil Division attorneys with particular expertise in health care fraud. In accordance with the health care guidelines promulgated in January 1997, in appropriate instances each working group may also need to coordinate and plan the initiative with the Department's Criminal Division.

Each working group will (i) examine the initiative to ensure that a factual and legal predicate is present for the initiative prior to its implementation, (ii) prepare initiative-specific guidance and sample documents (such as legal analyses, summaries of audit data, contact letters, tolling agreements, compliance and settlement agreement language) for use in the initiative, and (iii) prepare a general investigative plan, setting forth suggested investigative steps that each office should undertake prior to proceeding. Working groups shall be responsible for coordination with law enforcement agencies, the Health Care Financing Administration, and other appropriate entities.

While the working groups shall be responsible for coordinating the overall development and implementation of national initiatives, each matter against a specific provider must be evaluated on a case-by-case basis.

(C) Use of Contact Letters in National Initiatives.

As outlined above, Department attorneys participating in national initiatives shall, in general, make initial contacts with health care providers, to resolve a case, through the use of "contact" letters. The purpose of a contact letter is to notify a provider of their potential exposure under the False Claims Act and to offer the provider an opportunity to discuss the matter before a specific demand for payment is made. In limited circumstances, where the specific facts of a situation warrant a different approach, Department attorneys may make an initial contact through other legitimate means.

The use of contact letters to make initial contact with health care providers is in furtherance of Executive Order 12988, which obligates Department attorneys to make a reasonable effort to notify the opposing party about the nature of the allegations, and attempt to resolve the dispute without litigation if at all possible. The type of contact employed will depend on the nature of the allegations and the stage of the investigation. Regardless of the form of initial contact, Department attorneys must ensure that health care providers are afforded: (i) an adequate opportunity to discuss the matter before a demand for settlement is made, and (ii) an adequate time to respond. In addition, Department attorneys shall grant all reasonable requests for extensions of time to the extent that they do not jeopardize the government's claims. The use of statutory tolling agreements are strongly encouraged to allow providers time to respond without jeopardizing the government's claims.

2. ALTERNATIVE REMEDIES.

After reviewing the legal and factual circumstances of a particular matter, Department attorneys shall consider other available remedies — including administrative remedies such as recoupment of overpayments, program exclusions, and civil monetary penalties — to determine what remedy, or combination of remedies, would be the most suitable under the circumstances. Should the recoupment of an overpayment be the most appropriate remedy, Department attorneys shall consider referring the matter to the appropriate carrier/fiscal intermediary for appropriate action.

3. ABILITY TO PAY ISSUES.

Attorneys shall consider any financial constraints identified by a provider in determining a fair, reasonable and feasible settlement between the parties. Hospitals and other health care providers citing an inability to pay a specific settlement amount should be asked to present documentation in support of their stated financial condition.

4. RURAL AND COMMUNITY HEALTH CARE PROVIDER CONCERNS — IMPACT ON AVAILABILITY OF MEDICAL SERVICES.

When dealing with rural and community hospitals and other health care providers, Department attorneys shall consider the impact an action may have on the community being

served. In determining an appropriate resolution, or deciding whether to bring an action, care must be taken to consider the community's interest in access to adequate health care along with any other relevant concerns.

5. HOSPITALS AND OTHER HEALTH CARE PROVIDERS NOT REPRESENTED BY COUNSEL.

Department attorneys shall pay special attention to contacts with hospitals and other providers that choose (due to financial constraints or otherwise) to resolve claims without legal representation. Department attorneys faced with this circumstance must carefully assess every action taken to avoid even an appearance of coercion or overreaching because of the absence of opposing counsel.

6. MINIMIZING BURDENS IMPOSED ON PROVIDERS DURING INVESTIGATIONS.

Department attorneys also should be mindful of the ways in which our investigations and audits can disrupt and burden the day-to-day operations of providers in both a financial and practical sense. In developing and implementing an investigative plan, we should do what we can do to minimize these adverse effects, while still meeting our obligation to diligently investigate allegations of potential fraud. For example, while recognizing that certain circumstances might warrant different approaches, Department attorneys should consider a provider's request to accept the results of an audit of a sample of claims in lieu of a complete audit.

7. PROVIDER ASSISTANCE WITH THE INVESTIGATION.

In determining an appropriate settlement amount, Department attorneys should consider the extent to which a health care provider has cooperated with the audit or investigation of the relevant matter.

8. INDIVIDUALIZED REVIEW.

The proper determination as to the use and application of the False Claims Act or other appropriate remedy requires an individualized review of each case, ensuring that each of the above factors are given full consideration.

9. REVIEW OF GUIDANCE.

In order to assure the fair and appropriate application of the False Claims Act, this guidance will be subject to review in six months.

10. ADDITIONAL INFORMATION.

Questions regarding use of the False Claims Act should be referred to the Health Care Fraud Coordinator in your district, or to Robert Liles, Health Care Fraud Coordinator for the Executive Office for United States Attorneys (tel. no. 202-616-5136), or Shelley R. Slade, Health Care Fraud Coordinator for the Civil Division (tel. no. 202-307-0264).

Department of Health and Human Services
Office of Inspector General

Memorandum

Date : June 3, 1998

From : June Gibbs Brown
Inspector General

Subject : National Project Protocols - Best Practice Guidelines

To : Deputy Inspector General for Investigations
Deputy Inspector General for Audit Services
Assistant Inspector General for Legal Affairs

BACKGROUND

With increasing frequency, the Office of Inspector General (OIG) has coordinated with other agencies on so-called "national projects" aimed at targeting widespread patterns of misconduct among Medicare and Medicaid providers. At this time, I have decided to memorialize recommendations for "best practice" guidelines to be used by the OIG when developing and participating in national enforcement projects. These guidelines are generally applicable to national projects, but not every guideline listed below will necessarily be appropriate for all future enforcement initiatives. However, in the future, any deviation from these guidelines must be approved in advance by the Deputy Inspector General for Investigations in consultation with other components of the OIG, such as the Office of Counsel or Office of Audit Services, as appropriate.[1]

GUIDELINES

1. Minimum Thresholds

After considering and reviewing the statutes, regulations and Medicare and/or Medicaid program guidelines, as well as the applicable provider data, the OIG will set an appropriate minimum monetary threshold and/or percentage error rate for its participation in each national project. This minimum threshold will be used as a guideline for determining which health care providers the OIG will initially refer to the appropriate contractor (carrier or fiscal intermediary) for an overpayment recoupment (if any). Cases involving providers which exceed the project's threshold may be developed for potential referral to the Department of Justice (DOJ) or other appropriate enforcement agency (e.g., the Federal Bureau of Investigation) for consideration under a civil or criminal authority. Obviously, this minimum threshold will vary from project to project and will be based on a number of factors such as Medicare and/or

[1] Note: These Guidelines are for internal OIG use only. They are not intended to impinge on the exercise of legal authorities which are the responsibility of other agencies, nor do they confer rights in favor of any party.

Medicaid revenues, total health care revenues, prior audits and notice to the provider community, provider size, number of erroneous claims, and overpayment liability.

2. Equitable Treatment of Providers

The OIG supports the equitable treatment of providers in national projects, consistent with the prerogatives vested in the various United States Attorneys. Investigative protocols and settlement agreement terms should be consistently applied to minimize variations among judicial districts. Further, compliance or corporate integrity provisions should be uniform and consistently applied to providers targeted in a national project. It may be appropriate to establish a gradation of compliance measures based on objective criteria, such as the size of the provider and scope of the misconduct. If a matter is handled through means involving a criminal conviction or civil penalty, the OIG will develop and require appropriate and measured compliance obligations. Generally, when a matter is referred by the OIG to the contractors for an overpayment recoupment, no compliance obligations will be imposed by the OIG.

3. Resource Allocation Considerations

Prior to the referral of a national enforcement initiative to the DOJ or any other law enforcement agency, the OIG will undertake an assessment of the available investigative resources that it can commit to the national project. The OIG will communicate the results of this assessment to other involved law enforcement agencies with the referral of the national project information and data. The purpose of this assessment is to provide notice to our law enforcement partners of the resources the OIG is able to commit to an initiative.

4. Provider Guidance and Communication

Prior to the formal initiation of a national project, and as appropriate, the OIG will provide information to representatives of the affected health care industry or provider community regarding the project. This prior contact with the provider community will only occur with the concurrence of all appropriate law enforcement agencies. Similarly, the OIG will seek input from the Health Care Financing Administration regarding its views on the proposed national project in the appropriate circumstances and with the concurrence of all affected law enforcement agencies.

5. Assess Legal Sufficiency of Theory Prior to Referral to Department of Justice

Prior to the referral of any data or information concerning the development of a national project, the OIG will assess (including as appropriate, consultation with the Office of the General Counsel) the legal basis and sufficiency supporting the enforcement initiative. In its legal review, the OIG will consider, as necessary, applicable statutes, regulations, program guidance and communications, *de minimus* thresholds, sufficiency and availability of data, case law, statute of limitation issues, appropriate documentation, and burden of proof issues.

6. Central Point of Contact

The OIG will designate a central point of contact from each OIG component involved in a national project in order to coordinate responses on important questions or issues related to that project as they may arise. The OIG will inform the DOJ and any other law enforcement agency involved in the national project of these points of contact.

ALLEGATION: FALSE CERTIFICATIONS UNDER FOREIGN MILITARY SALES PROGRAM

U.S. ex rel. Tribble, Trimmer, and Buffington v. Aerospatiale General Aviation (ED VA No. 98-471-A)

In March 1998, DOJ intervened in a *qui tam* suit alleging that Aerospatiale General Aviation made false certifications in connection with the sale of trainer airplanes to Israel. (Aerospatiale General, a New York corporation with its principal place of business in Florida, is now known as Socata Aircraft.) The certifications arose under the Foreign Military Sales Program, supervised by the Defense Security Assistance Agency. Among the requirements for program funding is that the material or components furnished by the contractor be of U.S. manufacture, unless separately identified in the certification. According to the complaint, funding would not have been provided in this case had the Government known that the U.S. content did not equal the represented amount — over $6 million. Originally filed by the relators in 1994, the lawsuit alleges that the company retained the services of a commission agent in furtherance of the aircraft sale in violation of DSAA Guidelines, and that the 10 percent commission was included as part of the "U.S. content." The relator is represented by William Hardy of Kleinfeld, Kaplan and Becker (Washington, D.C.). The Government is represented by Assistant U.S. Attorney Gerard Mene.

ALLEGATION: UNNECESSARY SERVICES FOR NURSING HOME PATIENTS/DOUBLE BILLING BY TRANSPORTATION COMPANY

U.S. v. Medco Physicians Unlimited et al. (ND IL No. 98C1622)

In March 1998, DOJ filed a False Claims Act suit against Medco Physicians Unlimited and United Transportation Company alleging that they defrauded Medicare and Medicaid. Medco, which operates a community mental health center in Chicago, allegedly billed Medicare for medically unnecessary services and submitted claims for non-reimbursable expenses including a holiday dinner for the owner and 100 members of his family. According to DOJ, United Transportation double billed for services provided to Medco's patients, the majority of whom live in nursing homes. Pursuant to the scheme, United transported patients to Medco and then returned them to the nursing home later in the day. Although fully compensated by Medco for the transportation, United billed Medicaid for full reimbursement as well. Moreover, the defendants allegedly uprooted patients from their nursing homes to provide the same type of custodial care they received at the homes. Medicare does not pay for custodial care offered in a community mental health center or partial hospitalization program. The HHS OIG conducted the investigation. Assistant U.S. Attorney Christopher Tracy is handling the case.

ALLEGATION: PROVIDING FALSE INFORMATION TO NAVY IN CONNECTION WITH COMPUTER SALES

U.S. ex rel. Gundacker v. Unisys Corporation and Lockheed Martin Corporation (D MN 4-96-113)

In April 1998, a *qui tam* suit was reportedly unsealed alleging that Unisys Corporation and Lockheed Martin Corporation defrauded the Government by selling million dollar computers after deceiving the Navy that it would not be possible or practical to shift programs to standard commercial devices available at a much lower cost. The suit was brought by Erik Gundacker, a former company software engi-

neer. Unisys allegedly instructed employees to provide false information to persuade the Navy to buy unnecessary costly computer systems. The suit further alleges mischarging of labor and marketing costs, and the use of falsified rates in proposals. DOJ declined to intervene in the action. The relator's counsel is Dale Nathan of Nathan & Associates (Eagan, MN).

ALLEGATION: SOCIAL SECURITY FRAUD

U.S. v. Rubino (D MA CV 98-10561-RCL)

In May 1998, DOJ announced that it filed a False Claims Act suit against the Estate of Mary Rubino and its executors. From 1976 to 1996, Rubino allegedly fraudulently endorsed her husband's signature on the back of Social Security disability checks intended for him. According to DOJ, she never informed the Social Security Administration of her husband's death in 1976, even in response to an inquiry on that subject 20 years later. Ms. Rubino, who died in 1997, allegedly defrauded Social Security of approximately $149,000 in total. Handling the case is Assistant U.S. Attorney Julie Schrager.

ALLEGATION: UNDERPAYMENT OF OIL ROYALTIES

U.S. ex rel. Johnson, Jr., Martineck, Wright, Brock, Brian, and Project on Government Oversight v. Shell Oil Company, Texaco, Inc. et al. (ED TX No. 9:96CV66)

In May 1998, DOJ announced that it intervened in a *qui tam* suit alleging that Texaco, Inc. and six of its subsidiaries or affiliates knowingly undervalued oil extracted from federal and Indian lands to reduce royalties they would have had to pay the Government and Indian nations under mineral contracts. Texaco allegedly systematically ignored the rules for valuing oil, instead paying royalties on the basis of an improper lower value. According to DOJ, when a producer sells its oil to a corporate affiliate, as Texaco does, it is required to value the oil in accordance with regulatory "benchmarks" designed to replicate the competitive market price.

Oil production on federal and Indian lands is governed by mineral lease agreements between the Department of the Interior and private oil companies under the Federal Oil and Gas Royalty Management Act of 1982. By law, the companies must pay the United States and Indian tribes a percentage of the value of the oil as a royalty. The collection of royalties from companies leasing mineral rights is overseen by the Minerals Management Service of the Interior Department.

In February 1998, DOJ intervened as to four of the 14 companies named in the original lawsuit. The suit was brought by the not-for-profit Project on Government Oversight and several individuals in the industry including petroleum engineers, a petroleum business manager, and an independent oil and gas operator. Michael Havard of Provost & Umphrey Law Firm (Beaumont, TX) is representing the relators. The Government is represented by U.S. Attorney Michael Bradford, Assistant U.S. Attorney O. Kenneth Dodd, and Dodge Wells of the DOJ Civil Division.

ALLEGATION: FRAUDULENT MEDICAID BILLINGS BY PEDIATRICIAN

U.S. v. Mack, M.D. (SD TX No. H 98-1488)

In May 1998, DOJ filed a False Claims Act suit against Houston pediatrician William Mack alleging that he defrauded Medicaid and CHAMPUS by billing for unperformed ser-

vices. Dr. Mack was a provider under the Early Periodic Screening, Diagnosis, and Treatment (EPSDT) program for children "at risk" for health problems. The doctor allegedly failed to complete the mandated lab screening of blood samples and further noted "abnormal findings" to justify another billing for an office visit when the patient's medical file did not support such a notation. (Medicaid does not allow same day billing for office visits and EPSDT screens, with the exception of serious illness detected during the screening.) The complaint alleges a variety of other improper billings for unperformed services including strep tests and complete blood counts. Representing the Government is Assistant U.S. Attorney Joe Mirsky.

ALLEGATION: UNIVERSITY RESEARCH CONTRACT FRAUD

U.S. ex rel. Relator v. University of California (ED CA No. __)

In May 1998, it was reported that a *qui tam* suit has been filed alleging that the University of California defrauded the Government on research contracts at several of its campuses. According to the lawsuit, filed in 1996, the university billed graduate student tuition to research contracts in a variety of fields. The university allegedly provided free tuition to attract top graduate students, particularly foreign nationals, and then used the federal contracts to cover the costs. Congressional investigators have reportedly undertaken a related inquiry into the university's billing practices. The relator is represented by Phillip Benson (Yorba Linda, CA).

U.S. ex rel. Pratt v. Alliant Techsystems Inc. and Hercules Inc. (CD CA No. __)

In March 1998, DOJ announced that two defense contractors agreed to pay the Government $4.5 million to settle a *qui tam* suit alleging they overcharged the Navy for labor costs on contracts implementing the Intermediate-Range Nuclear Forces (INF) Treaty. The suit against Alliant Techsystems Inc. of Hopkins, Minnesota and Hercules Inc. of Wilmington, Delaware was filed in 1995 by a former employee of the defendants, P. Robert Pratt. The 1987 INF Treaty permitted Soviet officials to inspect facilities at a defense plant in Utah that Hercules, and later Alliant, operated. Under contracts with the Navy, Hercules and Alliant could charge the Government for costs associated with monitoring the activities of the inspectors. DOJ intervened in allegations that the firms mischarged costs to Navy INF contracts but did not join as to allegations that they also mischarged time to other federal contracts. The case was investigated by DCIS and DCAA. The relator's share was $900,000.

Unisys Corporation and Lockheed Martin Corporation

In March 1998, DOJ announced that Unisys Corporation and Lockheed Martin Corporation agreed to pay the Government $3.15 million to settle allegations that Unisys sold spare parts at inflated prices to the Department of Commerce for the NEXRAD Doppler Radar System. Lockheed Martin succeeded Unisys on the contract for the NEXRAD System, which is used by the National Oceanic and Atmospheric Administration to probe weather fronts and provide information on storm circulation. According to DOJ, Unisys knew that it paid Concurrent Computer Corporation inflated prices for the spare parts when it passed on those prices to the Government. Unisys had obtained discounts from Concurrent on other items Unisys purchased at its own expense in exchange for agreeing to pay Concurrent the inflated prices at issue.

Separately, in 1997 DOJ filed a False Claims Act suit against Concurrent in Alexandria, Virginia. The suit alleged that Concurrent told the Government that it did not discount spare parts when, in fact, Concurrent had previously granted such discounts to Unisys. The case is scheduled for trial this summer. According to DOJ, Concurrent's FCA liability will be reduced by what the Government received from Unisys and Lockheed in this settlement.

U.S. ex rel. Richmond v. St. Anthony's Memorial Hospital (SD IL No. 95-4160)

In April 1998, DOJ announced that St. Anthony's Memorial Hospital in Illinois agreed to pay the Government $228,500 to settle a *qui tam* suit alleging that it failed to refund Medicare overpayments it received for patients treated at the hospital. According to the suit, filed in 1995 by patient-accounts manager Dirk Richmond, St. Anthony's did not report the overpayments to Medicare as required by program rules. In addition to the settlement payment, the hospital and the HHS OIG entered into a corporate integrity agreement. The case was investigated by the HHS OIG and FBI. The relator's share was 20 percent or $45,700. The relator was represented by Ronald Osman and Timothy Keller of Ronald E. Osman & Associates, LTD (Marion, IL).

U.S. ex rel. Heard v. M/A-COM, Inc. (D MA CV 92-11563)

In April 1998, DOJ announced that M/A-COM, Inc., a division of AMP Incorporated,

agreed to pay the Government $3 million to settle a *qui tam* suit alleging that it failed to perform required quality tests on electronic components known as integrated microwave assemblies (IMAs) that were sold to other defense contractors. The suit was brought by James Heard, a former M/A-COM employee. According to DOJ, M/A-COM sold the IMAs to Westinghouse Electric Corp. and ITT Avionics for use in the Advanced Self-Protection Jammer system, which enables Navy and Air Force aircraft to identify and jam radar signals. M/A-COM was an independent company at the time but was later purchased by AMP Incorporated. The investigation was conducted by the Air Force Office of Special Investigations, NCIS, DCIS, and FBI. The relator's share was $600,000. The relator's counsel was Robert Vogel (Washington, D.C.). Representing the Government were Assistant U.S. Attorney Roberta Brown and David Cohen of the DOJ Civil Division.

U.S. ex rel. Frisco and Jones v. Home Americair of California, Inc. et al. (CD CA CV 93-7186-KMW)

U.S. ex rel. Penizotto v. Bates East Corporation and Cynthia Bates (CD CA CV 96-5824-KMW)

In April 1998, DOJ announced that a national franchisor of home oxygen equipment, three affiliates, and two individuals agreed to pay the Government $5 million to settle two *qui tam* suits alleging false Medicare claims. According to DOJ, Home Americair of California, Inc., its billing company, and two franchises, Florida Homecair and Bates East Corporation of Pennsylvania, engaged in a complex scheme to provide home oxygen equipment to Medicare beneficiaries who did not qualify for the service. In order to collect Medicare payments, the defendants submitted false medical information such as that relating to a patient's blood oxygen level. One suit was filed by a former franchisee of Home Americair, Terry Frisco, and a respiratory therapist, Darrell Jones. The case was consolidated with another *qui tam* case filed by Bates East sales representative Todd Penizotto. Of the total settlement amount, $4.15 million resolves the Frisco and Jones matter.

In addition to the settlement payment, Home Americair agreed to institute a corporate integrity program. The relators' share for Frisco and Jones was 23 percent or $960,250. Penizotto's share was $148,500. Frisco was represented by Michael Leslie of Caldwell, Leslie, Newcombe & Pettit (Los Angeles, CA), and Jones was represented by Robert Vogel (Washington, D.C.). Penizotto's counsel was Lisa Foster of Phillips & Cohen (San Diego, CA). Representing the Government were Assistant U.S. Attorney David Ringnell and Polly Dammann, Daniel Anderson, and Mina Rhee of the DOJ Civil Division.

U.S. v. Ruggiero (D NJ No. 98 1526)

In April 1998, DOJ announced that New Jersey businessman Frank Ruggiero agreed to pay the Government $1.2 million to settle a False Claims Act suit alleging improper claims to the U.S. Postal Service. Ruggiero, doing business as Septic Maintenance, allegedly submitted significantly more mail than he disclosed in his bulk mailing statements and received services for which he did not pay. In a related criminal case, Ruggiero agreed to the entry of a $1.2 million restitution order and to pay $400,000 immediately in satisfaction of the order. The Postal Inspection Service investigated the mat-

ter. Assistant U.S. Attorney Daniel Gibbons handled the civil case. Handling the criminal case was Assistant U.S. Attorney Carolyn Murray.

U.S. ex rel. Boisvert v. FMC Corporation (ND CA No. C-86-20613)

In April 1998, a jury returned a $125 million verdict in a *qui tam* case against FMC Corporation alleging safety problems in connection with the Bradley Fighting Vehicle. The final judgment reportedly will exceed $350 million, which would represent the highest *qui tam* recovery to date. The suit, filed in 1986 by former company engineer Henry Boisvert, alleged that FMC falsely represented that the amphibious vehicle had been extensively tested for swim operations when, in fact, it leaked in water. DOJ declined to intervene in the action. FMC, based in Chicago, sold its defense division last fall. The relator was represented by Phillip Svalya (Cupertino, CA), Allen Ruby of Ruby & Schofield (San Jose, CA), and J. David Black and Roy Bartlett of Jackson Tufts Cole & Black, LLP (San Jose, CA).

U.S. ex rel. Dorer v. Corning Life Sciences, Inc. (D MD No. PJM-95-1589)

In April 1998, Quest Diagnostics Incorporated, a national laboratory headquartered in New Jersey, agreed to pay the Government $6.89 million to settle a *qui tam* suit alleging false Medicare, Medicaid, and CHAMPUS billings. Quest Diagnostics is the successor of Corning Clinical Laboratories, formerly known as Metpath, Inc. The lawsuit, filed in 1995 by former company employee Donna Dorer, alleged that Corning performed and billed for lab tests not ordered by physicians. The Government's investigation identified billing violations by six Quest laboratories in Maryland, New Jersey, New York, Michigan, and Pennsylvania. In the settlement, Quest acknowledged that the practice of performing and billing for tests without appropriate prior or subsequent physician authorization is in violation of federal regulations. Quest further agreed to an amendment to a corporate integrity agreement previously entered into by Corning Clinical Laboratories. The relator's share was $1.156 million. The relator was represented by Robin Page West (Baltimore, MD) and Steve Simms of Greber & Simms (Baltimore, MD). Assistant U.S. Attorney Kathleen McDermott represented the Government.

U.S. ex rel. Relator v. Divers Institute of Technology (WD WA No. __)

In April 1998, DOJ announced that Divers Institute of Technology, which provides vocational and professional training for commercial divers, agreed to pay the Government $2.41 million to settle a *qui tam* suit alleging fraud in connection with federal financial assistance. According to DOJ, the suit also spurred a related criminal action in which the Institute pleaded guilty to making a false claim against the Department of Education, was ordered to pay a $250,000 fine, and was placed on probation for five years. In entering its plea, Divers Institute acknowledged that a former financial aid director had submitted fraudulent financial aid applications for an eight year period. The settlement agreement calls for the Institute to be sold in order to generate the proceeds necessary to pay the Government. The case was investigated by the Department of Education OIG and the FBI. Assistant U.S. Attorney Bob Westinghouse handled the criminal matter, and Assistant U.S. Attorney Dave Jennings the civil case.

U.S. ex rel. Crannage, Chinn, and Green and State of Illinois ex rel. Crannage, Chinn, and Green v. Omnicare, Inc., Home Pharmacy Services, Inc. et al. (SD IL No. 97-973-PER)

In April 1998, Home Pharmacy Services, Inc. agreed to pay the Federal Government and various state entities a total of $5.3 million to settle a *qui tam* suit alleging that it failed to properly credit the Illinois Department of Public Aid for returned medicines. The suit was brought by three former company employees, including two sisters. According to the lawsuit, Home Pharmacy supplied drugs and other pharmaceuticals to nursing home patients, and when the drugs were returned by nursing homes, it did not credit the account of the Department of Public Aid, which had originally paid for them. In a related criminal action, the president of the company pleaded guilty in June.

As part of the settlement, the corporate parent of Home Pharmacy, Omnicare, Inc. of Cincinnati, entered into a corporate integrity agreement with the HHS OIG. The matter was investigated by the Southern Illinois Health Care Fraud Task Force, which consists of DCIS, the Department of Labor, DEA, FBI, FDA, HHS, Illinois Department of Professional Regulation, Illinois State Police Medicaid Fraud Control Unit, Illinois Department of Public Aid, IRS, and Postal Inspection Service. The relators' share was $871,000. The relators were represented by Stephen Meagher of Phillips & Cohen (San Francisco, CA). The Government was represented by Assistant U.S. Attorneys Ranley Killian and Gerald Burke.

U.S. ex rel. Lissack v. Meridian Securities et al. (SD NY No. 95-Civ-1363)

In April 1998, it was reported that CoreStates Financial Corp. of Philadelphia agreed to pay the Government $3.4 million to settle a *qui tam* suit alleging that Meridian Securities, now owned by CoreStates, engaged in "yield burning" in the municipal bond market. Yield burning refers to the practice in which investment banks divert proceeds from bond transactions made on behalf of municipalities that should have gone to the Federal Government. The settlement is the first False Claims Act settlement in a yield burning case to date. The suit was brought by Michael Lissack, a former managing director of Smith Barney. Lissack was represented by John Phillips and Erika Kelton of Phillips & Cohen (Washington, D.C.). The Government was represented by Assistant U.S. Attorney Manvin Mayell.

U.S. ex rel. Colunga v. Hercules Inc. et al. (D UT No. 89-C-954)

In May 1998, it was reported that Hercules Inc. agreed to pay a total of $55 million to settle a *qui tam* suit alleging that its nuclear rocket inspection system was defective. The suit alleged poor quality control inspections for rocket motors during the production of several missile systems including the Trident, Pershing, and Titan. A former company inspector, Katherine Colunga, filed the suit in 1989. Hercules sold its aerospace division to Alliant Techsystems in 1995. DOJ declined to intervene in the action. The relator's share was 30 percent. The relator was represented by Lon Packard and Ron Packard of Packard, Packard & Johnson (Salt Lake City, UT; Palo Alto, CA) and Michael Thorsnes of Thorsnes, Bartolotta, McGuire & Padilla (San Diego, CA).

U.S. ex rel. Faw and Faw v. Brewton-Parker College, Georgia Baptist Convention et al. (SD GA No. CV 697-016)

In May 1998, it was reported that Brewton-

Parker College agreed to pay the Government $4 million to settle a *qui tam* suit alleging fraud in connection with various financial aid programs. According to the complaint, violations included crediting Pell Grant funds to student accounts with no eligibility, not following work-study program requirements, disbursing funds to citizens of foreign countries, failing to pay student loan, scholarship, and work-study monies owed, and falsifying documentation. The students for whom certain improper awards were made were predominantly athletes for Brewton-Parker. The complaint further alleged that the defendants consistently destroyed or altered evidence of the fraud. The suit was brought by Martha Faw, formerly the assistant director of financial aid at the college. The settlement is the largest *qui tam* recovery to date in Georgia, and Ms. Faw reportedly will donate most of her share back to the school for students who were wrongfully denied aid under the scheme. The relator's share was 20 percent or $800,000. The relator's counsel was Mike Bothwell (Roswell, GA). The Government was represented by Assistant U.S. Attorney James Coursey, Jr.

U.S. ex rel. Spear v. Mendez (ND CA No. C95-3369)

In May 1998, it was reported that Fausto Mendez, Jr., president of Medical Science Institute Inc., agreed to pay the Federal Government and State of California $25,000 to settle a *qui tam* suit alleging improper billing by the clinical laboratory. The State, which filed a claim under California's False Claims Act, will receive $1,842 under the settlement. Mendez allegedly routinely billed Medicare for unnecessary complete blood counts and unnecessary manual white blood cell differential tests when automated tests had already been performed and billed. Under the agreement, Mendez reportedly will have no authority over billing or coding decisions involving any federal health care program for five years. The suit was brought by Kevin Spear, a former lab industry salesman. The relator's share was 17 percent. Phillips & Cohen (Washington, D.C.) represented the relator.

CSX Corp. and Cybernetics and Systems Inc.

In May 1998, it was reported that Cybernetics and Systems Inc., a CSX Corp. subsidiary, agreed to pay the Government $28 million to settle False Claims Act allegations involving student loan fraud. Cybernetics formerly operated a student loan servicing business in Jacksonville, Florida. While the Department of Education reimburses lenders if students default on loans, Cybernetics allegedly sought repayment from the Government on fraudulent claims and did not follow proper procedures. Resolution of the matter also included $2 million in criminal fines. Assistant U.S. Attorney Bonnie Glober of the Middle District of Florida handled the case.

U.S. v. Mount Zion Medical and Rehabilitation Center Inc. et al. (SD FL No. 95-2117-CIV)

In May 1998, it was reported that two physicians and a Florida medical center agreed to pay the Government $2.6 million to settle a False Claims Act suit alleging that they caused improper claims to be filed for clinical medical services and non-invasive diagnostic tests under Medicare. The claims involved non-rendered or medically unnecessary services. Mount Zion Medical and Rehabilitation Center reportedly has also agreed to be permanently excluded from federal health care programs, and the physicians have agreed to implement integrity provisions to ensure program compliance.

U.S. ex rel. Kready v. The University of Texas Health Science Center at San Antonio and The University of Texas Medical School at San Antonio (WD TX No. SA96CA0123)

In June 1998, the University of Texas Health Science Center at San Antonio (UTHSCSA) agreed to pay the Government $17.2 million to settle a *qui tam* suit alleging that UTHSCSA improperly submitted claims to Medicare, Medicaid, CHAMPUS, and the State Legalization Impact Assistance Grant program without possessing sufficient documentation to support those claims. UTHSCSA is a component of the University of Texas System, which is an agency of the State of Texas. According to the lawsuit, the University of Texas Medical School at San Antonio, a component of UTHSCSA, submitted claims for services that were purportedly personally provided by faculty physicians when the defendants' records did not support such claims. The suit was filed in 1996 by Benjamin Kready, former executive director of UTHSCSA's Medical Service Research and Development Plan, the practice plan of faculty physicians. The case moved to settlement notwithstanding that the HHS OIG discontinued its PATH (Physicians at Teaching Hospitals) audit of UTHSCSA last year.

In addition to the settlement payment, UTHSCSA has entered into an institutional compliance agreement with the HHS OIG. The case was investigated by the HHS OIG and DCIS. The relator's share was 15 percent or $2.58 million. The relator was represented by Marlene Martin and Curtis Cukjati of Cacheaux, Cavazos, Newton, Martin & Cukjati, L.L.P. (San Antonio, TX). The Government was represented by Assistant U.S. Attorney Winstanley Luke and Alan Kleinburd and Daniel Spiro of the DOJ Civil Division.

Levindale Hebrew Geriatric Center and Hospital, Inc.

In June 1998, DOJ announced that Levindale Hebrew Geriatric Center and Hospital, Inc., a hospital providing long-term nursing care in Baltimore, agreed to pay the Government $827,000 to settle False Claims Act allegations arising from a Medicare fraud scheme. The Government's investigation revealed that Levindale resubmitted denied reimbursement claims for room and board charges after recoding them as new claims for ancillary charges such as supplies. According to DOJ, Medicare paid Levindale for 75 improperly recoded and resubmitted claims. The hospital, which has since merged with Sinai Health Systems, Inc., acknowledged that its submission of claims for reimbursement was not consistent with Medicare regulations. As part of the settlement, Levindale entered into a corporate integrity agreement with the HHS OIG. The matter was investigated by the HHS OIG, FBI, and Blue Cross Blue Shield of Maryland through the Medicare Part A Fraud and Abuse Unit. Assistant U.S. Attorney Allen Loucks of the District of Maryland handled the matter.

North Louisiana Rehabilitation Hospital, Horizon/CMS Healthcare Corporation, Continental Medical Systems, Inc., and Dr. Joseph Mitchell Smith

In June 1998, North Louisiana Rehabilitation Hospital (NLRH) and its Medical Director agreed to pay the Government $4.46 million to settle False Claims Act allegations that they defrauded Medicare. According to DOJ, NLRH increased its Medicare payments by admitting patients whose medical conditions did not warrant inpatient rehabilitation or who could not benefit from the rehabilitation

on account of their conditions. Medicare patients also were allegedly kept at the hospital longer than needed. The settlement is the largest health care fraud settlement ever reached in Louisiana.

NLRH and Medical Director Dr. Joseph Mitchell Smith further improperly assisted Dr. Rel Gray, who served as Program Director for General Medical Services, in concealing fraudulent Medicare billings. The alleged cover-up involved altering more than 600 closed hospital patient files to list Gray as a second medical attending physician when he was only a consultant. According to DOJ, Dr. Gray billed for services he did not render or that were not medically necessary. Gray was convicted of mail fraud in 1996 and served one year in prison.

Under the settlement, NLRH and its owners, Horizon/CMS Healthcare Corporation and Continental Medical Systems, Inc., agreed to pay $4,212,920. Dr. Smith agreed to pay $250,000. Horizon/CMS, Continental Medical, and NLRH have also entered into a corporate integrity agreement with the HHS OIG. The matter was investigated by the HHS OIG and FBI. U.S. Attorney Michael Skinner of the Western District of Louisiana and Marie O'Connell of the DOJ Civil Division handled the case.

TAF News

FCA Conference Materials

- As part of its information clearinghouse activities, TAF has materials available for distribution at conferences and other programs. Information can be tailored to a legal or general audience. Resource material, including statistical information, is also available for those writing articles on the FCA.

Qui Tam Practitioner Guide

- The *TAF Qui Tam Practitioner Guide: Evaluating and Filing a Case* can be ordered at no charge by phone, fax, or mail. This "how to" manual includes sections on evaluating the merits and viability of a case, pre-filing and practical considerations, and preparing and filing the complaint.

TAF on the Internet

- TAF's Internet presence, designed to educate the public and legal community about the False Claims Act and *qui tam*, has expanded to highlight the growing health care trend and recent legislative developments. TAF's site is located at http://www.taf.org.

Previous Publications

- Back issues of the *Quarterly Review*, including the "1997 Year In Review," are available in hard copy as well as on TAF's Internet site.

Quarterly Review Submissions

- TAF seeks submissions for future issues of the *Quarterly Review* (e.g., opinion pieces, legal analysis, practice tips). To discuss a potential article, please contact Associate Director Alan Shusterman.

Anniversary Reports and Video

- To mark the anniversary of the 1986 FCA Amendments, TAF has available a variety of resources including a Tenth Anniversary Report, an Assessment of Economic Impact, and an educational video highlighting the effectiveness of the Act. These materials are available at no charge.

Call for Experts and Investigators

- In response to inquiries, TAF is working to compile a list of experts and investigators across an array of substantive areas. Please contact Staff Attorney Amy Wilken with any suggestions you may have.

Qui Tam Attorney Network

- TAF is continuing to build and facilitate an information network for *qui tam* attorneys. For an Attorney Network Application or a description of activities, please contact TAF. Be sure to ask about TAFNET, our new electronic mail system for Attorney Network members.

TAF Library

- TAF's FCA library is open to the public, by appointment, during regular business hours. To schedule a visit or to inquire about TAF's resources, please contact Staff Attorney Amy Wilken. Submissions of case materials such as complaints, disclosure statements, briefs, and settlement agreements are appreciated.

Acknowledgments

- TAF thanks the Department of Justice and *qui tam* counsel for providing source materials.