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False Claims Act: an Inspector General's Best Friend

By John F. Carroll¹

Federal and State False Claims Acts facilitate recovery against contractors who bill the government fraudulently. FCAs have many components which make them potent anti-corruption weapons.

Introduction

The False Claims Act is a civil anti-fraud statute designed to ease monetary recovery for the government in cases where contractors have not delivered as promised due to fraud. There is a federal FCA, also known as the Lincoln Law because of the statute's history, and numerous state and local FCAs that largely parallel the federal version.² These statutes serve not only to compensate fraud victims, but also to punish and deter fraud against the government, which Congress and state legislatures recognize as a severe, pervasive, and expanding national problem. As described further below, FCAs are a particularly compelling tool because while they are not criminal laws, they are more than simply compensatory in nature.

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² The federal statute can be found at 31 U.S.C. §§ 3729–3733. Jurisdictionally, the federal statute can be utilized when at least some portion of the governmental funds at issue consist of federal funds.

Historically, the FCA developed in the 1860s out of the American Civil War, which was marked by fraud on all levels, especially with regard to Union War Department contracts. Indeed, some say the False Claims Act came about because of bad mules. Specifically, during the war, unscrupulous contractors sold the Union Army, among other problematic goods, decrepit horses and mules in ill health, faulty rifles and ammunition, and rancid rations and provisions. The federal False Claims Act, passed by Congress on March 2, 1863, was an effort by the government to respond to this entrenched fraud, particularly given the Justice Department's reluctance at that time to prosecute fraud cases. Importantly, the legislation included a reward provision permitting citizens to sue on behalf of the government and be paid a percentage of the recovery.

The essence of a False Claims Act suit alleges the presentation of a false or fraudulent claim by a contractor to the government to obtain payment from the government. Following the Civil War-era enactment of the federal FCA, thirty states (and some municipalities) have passed their own versions to cover false claims to their own governments; most of these statutes address all areas of government purchasing.³

³ States with FCAs are listed here. Some states restrict application of their FCAs to Medicaid fraud, as indicated by asterisk: California, Colorado*, Connecticut*, Delaware, District of Columbia, Florida, Georgia, Hawaii, Illinois, Indiana, Iowa, Louisiana*, Maryland*, Massachusetts, Michigan, Minnesota, Montana, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Carolina, Oklahoma, Rhode Island, Tennessee, Texas, Virginia, Washington, and Wisconsin.

Obviously, Inspectors General will often choose to focus on criminal charges in government fraud cases. However, in cases where the evidence of fraud is not overwhelming, or, at the other end of the spectrum, where there is reason to seek additional sanctions against a particularly egregious fraudster, the use of the FCA should be considered. And, indeed, nothing precludes bringing both a criminal case and an FCA action. Several aspects of FCAs make them terrifically powerful tools for government investigators fighting corruption, namely: (1) less onerous requirements to show fraud than apply in criminal cases, including no requirement of actual knowledge or intent to defraud; (2) an applicable burden of proof of preponderance of the evidence; (3) mandatory treble damages along with other substantial financial penalties for wrongdoers; and (4) the reward provision, which encourages whistleblowers to come forward with allegations and evidence of wrongdoing.

What Makes a False Claim

The essence of the FCA is the *false claim* -- essentially a bill or invoice or some other documentation that requests payment from the government for purchase of goods or services, in which there is some meaningful falsity. There is no set formula for how a false claim must be made in order to fall within the FCA; the objective of the law is to protect funds and property of government regardless of the particular form the claim takes. Examples of frauds in FCA cases have included:

- Billing for goods and services that were never delivered or rendered
- Presenting broken or untested equipment as operational and tested
- Shifting expenses from one fixed-price contract to another
- Illegal marketing of prescription drugs and devices through kickbacks
- Billing for non-FDA approved drugs or devices
- Performing inappropriate or unnecessary medical procedures in order to increase Medicare reimbursement
- Billing for work or tests not performed
- Certifying improperly or untested materials or goods
- Billing for premium goods but providing inferior goods
- Phantom employees and doctored time slips, like charging for employees that were not actually on the job, or billing for made-up hours in order to maximize reimbursements
- Upcoding employee work, such as billing at an iron worker's rate when work was performed by a laborer
- Being over-paid by the government for sale of a good or service, and then not reporting that overpayment
- False certification that a contract falls within certain guidelines (*i.e.* the contractor is a minority or veteran)
- Winning a contract through kickbacks or bribes
- Inflating the alleged costs on a cost-plus contract

The main elements of a false claim under the FCA are three-fold: the claim must be: (1) false, (2) made knowing that the claim was false and (3) material to payment.⁴

A false claim can be any invoice or bill for payment from the government in any format that might take. It may also be a false document that supports payment, such as a claim of eligibility for a government benefit, check or service. For example, a government contractor's false certification that it has paid the applicable prevailing wage as required by federal or state law comes within the purview of the False Claims Act. Similarly, a certification that a contractor has engaged an appropriate percentage of women or minorities to comply with minority-owned business subcontractor requirements falls within the statute.

The Claim

The claim is simply a demand for payment of government funds, like a bill or invoice. It need not be made directly to the government. A claim can also be any request or demand, whether under a contract or otherwise, for money or property which is made to a contractor, grantee, or other recipient if the government provides any portion of the money or property which is requested or demanded, or if the government will reimburse such

⁴ These elements refer to the most common type of claim under the FCA, called an affirmative false claim, in which a defendant submits a fraudulent claim requesting payment by the government to the defendant. Liability under the FCA can also be present in a scenario referred to as a reverse false claim, wherein a defendant, instead of actively seeking to obtain money from the government, fraudulently retains government funds to which it is not entitled.

contractor, grantee, or other recipient for any portion of the money or property requested or demanded. As an example, a sub-contractor's invoice to a general contractor may constitute a false claim where the general contractor receives some portion of the funds from the government.

Similarly, a recipient of government program funds, for example a school participating in the National School Lunch Program, which in turn pays a contractor for services in connection with that government program, may be the intermediary for a false claim from the contractor since the school is reimbursed by the government for providing school lunches.

Knowledge Requirement

Because the FCA is a civil anti-fraud statute, the burden of proving the fraud is friendlier to the plaintiff than the burden in traditional criminal fraud cases. The knowledge standard under FCAs is that the perpetrator: (1) have actual knowledge of the information; or (2) act with deliberate ignorance to the truth or falsity of the information; or (3) act in reckless disregard of the truth or falsity of the information. No proof of specific intent to defraud is required, but neither an innocent mistake nor simple negligence is sufficient to meet the standard of proof.

Damages and Penalties

The FCA carries a potent sting. As an initial matter, should the government prevail in an FCA suit, there is a mandatory trebling of the government's actual damages from the fraud, which typically consist of the

amount of money fraudulently obtained and/or withheld by the defendant.

In addition to the above, for each individual claim for payment that the defendant made, the FCA calls for the defendant to pay an additional amount, which is also mandatory; this per-claim amount varies between approximately \$5,000 and \$10,000 depending on the applicable FCA.⁵

As a result, these two components of the remedies portion of the law work together to ensure complete recovery by the government, and then some. In cases where damages may be difficult to calculate or are small, as in a situation of hundreds of small claims for inappropriate medical services, the combined liability for each false claim could be significantly greater than even trebled damages. Likewise, in a big-budget contract where a single invoice is the operative claim, the trebling of the damages will result in nearly all of the financial liability. The operability of both of these provisions at the same time means that regardless of the kind of false claim at issue, the resulting award in a successful FCA suit will be financially meaningful. In turn, what this signifies in practice is that, even aside from the common desire to avoid expensive litigation, defendants facing viable FCA actions are almost universally eager to resolve these claims outside of court, since where the amount of money is significant the risk of losing an FCA action can seriously threaten a corporate defendant's existence.

⁵ Some FCAs provide a range amount for each violation, in which case the judge would determine the amount within the range that the defendant would pay per false claim made.

Suing on Behalf of the Government—the Qui Tam Action

The most typical FCA plaintiff is the government through an Attorney General’s office, U.S. Attorney’s Office, or a local government’s litigation shop such as New York City’s Corporation Counsel. However, the FCA has the additional and unusual characteristic that cases under its purview may also be filed by private citizens with knowledge of false claims even though the plaintiff is not an aggrieved or injured party. A case brought in this manner, called a *qui tam*⁶ (pronounced “Key Tom”) action, allows a private person, known as a “relator,” to bring a lawsuit on behalf of the government, where the relator possesses information that the named defendant has knowingly submitted or caused the submission of false or fraudulent claims to the government. The relator need not have been personally harmed by the defendant’s conduct; instead, the relator receives legal standing to sue by way of a “partial assignment” to the relator of the injury to the government caused by the alleged fraud. Relators filing under the FCA stand to receive a portion (usually about 15-25 percent) of any recovered damages *and* their attorney fees.⁷ Additionally, if a relator/whistleblower has also sued for retaliation – for example, for

⁶ In common law, a writ of *qui tam* was a writ whereby a private individual who assisted a prosecution received all or part of any penalty imposed. Its name is an abbreviation of the Latin phrase “*qui tam pro domino rege quam pro se ipso in hac parte sequitur*,” meaning “[he] who sues in this matter for the king as well as for himself.”

⁷ The relator’s information must not be public knowledge, unless the relator qualifies as an “original source.” So for example, if the fraud is in the public domain because of publication in a periodical, unless the putative whistleblower can show she was the source of the information in the article, she would be barred from recovery.

wrongful termination following whistleblowing activity -- the settlement of that claim is an entirely separate matter from the FCA suit.

Once a relator brings suit on behalf of the government, the government has the option to intervene in the suit. If the government does intervene, it will notify the company or person being sued that a claim has been filed. *Qui tam* actions are filed under seal, which seal must be partially lifted by the court to allow this type of disclosure. The seal prohibits the defendant from disclosing even the existence of the case to anyone, including a defendant's shareholders, a fact which potentially conflicts with a publicly-held defendant's obligations under Securities and Exchange Commission or stock exchange regulations that require it to disclose lawsuits that could materially affect stock prices. The government may subsequently, without disclosing the identity of the plaintiff or any of the facts, begin taking discovery from the defendant.

If the government does not participate in a *qui tam* action, the relator may proceed alone without the government, though such cases historically have a much lower success rate. Relators who do prevail in such cases will receive a higher relator's share, though the government still receives the bulk of the recovery. It is conventionally thought that the government chooses to intervene in only those cases in which the government believes it will prevail. The calculus, however, is not that simple. For example, a case might be quite viable but may not lead to intervention by the government because the

government has otherwise allocated necessary resources. A decision not to intervene on this basis would be somewhat short-sighted, however, given the likelihood of early settlement, particularly of clearly meritorious matters.

Conclusion

Several aspects of FCAs make them potent weapons against fraud and worthy of greater use by Inspectors General. Most notably, in comparison to criminal fraud prosecutions, FCA cases have less onerous requirements, including the lack of an actual knowledge or intent to defraud requirement, a lower burden of proof of preponderance of the evidence, and mandatory treble damages and other financial penalties for wrongdoers. These penalties are potentially devastating to a defendant company, making early settlement – prior to the bulk of significant litigation resource outlays by the plaintiff – the norm.

FCA cases have the added benefit of attracting whistleblowers by enabling them to obtain their own recoveries. Thus, some of the work of bringing an FCA case (at least in the initial stages) may be borne by a relator, and the government can choose whether or not to involve itself in the suit after its filing when it can better evaluate the suit's strength. This not only leads to a greater number of cases against government fraudsters, but allows the conservation of scarce government resources.

For these reasons, whenever a significant government purchasing inquiry arises, Inspectors General and other oversight authorities should

consider the filing of an FCA suit as a potential weapon in their anti-fraud arsenals.