

How to Prevent and Defend Against False Claims Allegations: Legal Issues and Strategic Considerations

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I. INTRODUCTION

If you have California clients that do work on projects with public funding, whether federal, state or local, then you need to be aware of, and advise your clients on, their potential liability for false claims. You also need to be aware of the peculiarities of both the federal and state False Claims Acts (“FCA”), both substantive and procedural, which raise many legal and strategic issues unique to FCA lawsuits.

II. COUNSELING YOUR CLIENTS BEFORE THEY GET INTO TROUBLE

As with many liability issues, the best time for you to advise your clients (and for your clients to call you) is early on. False claims considerations arise when a contractor is deciding whether to bid on a job and when it prepares its bid. Once performance begins, false claims considerations arise with the submission of invoices, change order requests, and contract claims, as well as documents supporting them.

A. False Claims Issues In Bid Preparation

Contractors need to realize that, when they bid on jobs with public funding, they need to scrutinize their bids with more care than they necessarily do on private jobs. False statements in a successful bid may render every request for payment under the resulting contract a false claim. Even unsuccessful bids may be false claims if they contain false statements, though the law on this is unclear. Common pitfalls requiring special attention include certifications, subcontractor listings, disadvantaged business participation, and representations regarding payment of prevailing wages. Contractors should make doubly sure these bid items are correct.

When deciding whether to bid on a publicly funded project, a contractor should evaluate the public owner. Does it have a history of bringing false claims lawsuits or counterclaims? Some public owners (*e.g.*, the City and County of San Francisco and the Los Angeles Metropolitan Transit Authority) have repeatedly asserted false claims in response to contractor claims. When deciding whether and how much to bid on jobs with such owners, contractors should take into account the risks of defending against false claims allegations and recovering less on legitimate contract claims. If the contractor decides to bid on such jobs, it also needs to scrutinize its bid with extra care.

B. False Claims Issues In Contract Negotiations

When negotiating the prime contract between the contractor and public owner, the contractor should make sure that the agreement clearly defines the scope of any representations and certifications the contractor will be expected to make during contract performance. A subcontractor should do the same when negotiating its contract with the prime contractor on a publicly funded job.

When a prime contractor is negotiating subcontracts on a publicly funded job it needs to pay careful attention to provisions regarding pass-through claims. The prime does not want to be put in a position where it may be obligated to submit a subcontractor's potentially false claim and thereby subject itself to liability. Similarly, the prime contractor should insist on including a provision in the subcontract requiring the subcontractor to defend and indemnify the prime contractor for false pass-through claims.

III. CONTRACT CLAIMS AND FALSE CLAIMS COUNTERCLAIMS

A. False Claims Considerations Before Submitting A Contract Claim

Contractors need to scrutinize their contract claims with extra care on publicly funded jobs. If they have not already done so, they need to examine their bid before submitting a contract claim, because at least some public owners are likely, in response to a contract claim, to scrutinize not only the claim but also the contractor's bid. False statements in the bid may subject the contractor to false claims liability, even if they have nothing to do with the contractor's claim.

B. Where A Contractor Should Sue If Its Contract Claim Is Denied

On federal projects, a contractor has two forums in which it may appeal a contracting officer's denial of its contract claim: an agency Board of Contract Appeals (BCA) or the Court of Federal Claims (COFC). If there is any significant risk that the Government might assert a false claims counterclaim in response to the contractor's claim, the contractor should sue in the applicable BCA. The boards, unlike the COFC, have no jurisdiction to hear fraud claims. As a result, the Government cannot assert false claims counterclaims in BCA actions. And, while the Government can still file a separate FCA lawsuit in district court, the agency lawyers who represent the Government at the Boards are much less likely to consider the possibility of false claims in a contract dispute than their counterparts from the Department of Justice, who represent the Government in COFC actions.

On state or local funded projects in California, the general venue rules apply. A difficulty contractors face is the added uncertainty of how a court will rule on false claims

issues due to the Superior Courts' inexperience with public contract issues in general and false claims laws in particular.

IV. FALSE CLAIMS LAWSUITS

A. Pre-Litigation

1. Internal Investigations and Disclosures

Oftentimes, a contractor will become aware of potential false claims issues before any litigation is started or even threatened. In many of those instances, the contractor can avoid, or at least substantially limit, its liability by conducting a prompt and thorough internal investigation and, where appropriate, taking corrective action. As a result, you should advise your clients about how to recognize potential false claims issues. Ideally, this investigation will be conducted under the attorney-client privilege and attorney work product protection, such that the results of the investigation will not be discoverable.

Some less obvious questions a contractor should investigate are as follows:

- Were any of the contractor's claims false because they impliedly certified that the contractor had complied with a statutory or regulatory requirement (*e.g.*, ADA workplace, OSHA and Cal OSHA, environmental)?
- Were any claims false because there was a false representation in the contractor's bid documents (*e.g.*, re subcontractor participation)?
- Where a false claim has likely been submitted, was the level of intent or "scienter" sufficient to potentially expose the contractor and/or individual employees to criminal liability?
- Where the contractor has likely submitted a false claim or claims, what is its potential exposure for not only Government damages but also penalties (number of claims, culpability of conduct)?

Where the contractor discovers that it may have submitted a false claim, it should consider making a disclosure to the Government. Both the federal and state statutes

provide that, if a contractor discloses all relevant information it has about a false claim before the Government has initiated an investigation or lawsuit regarding the same conduct, the court may reduce the Government's damages recovery from treble to double damages.

In addition, the contractor should consider whether or not it should make a public disclosure of a potential false claim or claims. If there is a significant concern that a whistleblower will initiate a lawsuit based on the false claim or claims, making such a disclosure may bar that lawsuit. To be effective, the disclosure must contain adequate information to disclose the entire fraud and must be made in an appropriate forum (*e.g.*, a civil discovery response, the news media), and the whistleblower cannot be an original source of that information. Before making such a disclosure, the contractor should also consider the risk that it may prompt the Government to file suit, because public disclosure does not bar non-*qui tam* (*i.e.*, government-initiated) FCA lawsuits.

Finally, the contractor needs to consider whether there is a significant chance that the contracting Government agency will terminate the contractor for default or that the Government debarment authority will consider suspending, and ultimately debarring, the contractor based on the potential false claims. Where there is significant risk, the contractor should take steps to cure any breaches of contract and to show its "present responsibility," *i.e.*, its ability to perform public contracts in compliance with the law. Depending of the facts of the case, this may entail significant corrective action, including terminating responsible employees (though the contractor needs to be careful where there is or may be a relator employee) and substantially changing billing, accounting, quality control, manufacturing, purchasing, or subcontracting procedures.

2. Government Investigations

The contractor may be investigated by the Government in connection with potential false claims. Generally speaking, the contractor should cooperate fully with such an investigation while, at the same time, acting to protect its rights and the rights of its employees.

The first issue with a Government investigation is the form it takes. The contractor can tell a lot about an investigation based on who is conducting it and what tools the investigation uses. For example, the contractor may be able to determine whether the Government views the contractor's conduct as potentially criminal (in which case, the contractor should get criminal defense counsel involved as soon as possible). The contractor may also see indications of whether a whistleblower is involved and whether the contracting Government agency is taking an active role (which may bear on the contractor's risk of being terminated for default and/or debarred).

Where the investigation indicates the Government is focusing on potential civil false claims, the next issue is whether or not there is a whistleblower. Sometimes the government will tell the contractor; sometimes it will not. If there is no whistleblower, that tells the contractor that the Government initiated this investigation on its own, out of internal Government concerns. In such instances, if the contractor can convince the investigators that no false claims were submitted or, if they were, reach a mutual resolution, then the contractor can avoid litigation. If, however, there is a whistleblower, then the contractor's task is to try to convince the Government not to intervene in the whistleblower's lawsuit. The contractor may be able to do so not only by demonstrating that it did not submit false claims but also by convincing the Government that it should not expend its resources on the case (*e.g.*, because

the likely recovery is small, the litigation is likely to be protracted and expensive, the proof will be difficult for a fact finder to understand, etc.). The benefits of convincing the Government not to intervene are immense – contractors are much more likely to prevail, or at least limit their exposure, in non-intervened cases.

3. Employment Issues

Once a contractor is aware that a whistleblower is out there, it must be especially careful in its dealings with potential whistleblowers among its employees. The contractor should review recent employee complaints for any items relevant to potential false claims. Human Resources personnel should be instructed to notify the contractor's counsel before any adverse employment actions are taken against potential whistleblower employees. To the maximum practicable extent, persons making employment decisions regarding such employees should be insulated from information regarding those employees' whistleblowing activities and false claims allegations.

B. Litigation

1. Pre-Trial

a. Contractor Motions to Dismiss and Demurrers

Contractors may bring several defense motions or demurrers at the outset of litigation to try to get all or parts of false claims lawsuits against them dismissed. The most commonly brought of these motions is a motion to dismiss or special demurrer for failure to plead fraud with particularity. Both federal and state courts agree that the pleading with particularity requirements for fraud claims apply to false claims actions. These motions are particularly effective in *qui tam* actions, where the complaints are often less detailed.

Contractors also frequently bring motions to dismiss or general demurrers attacking false claims complaints for failure to state a claim. Such a motion may attack a complaint's failure to allege one of the statute's *prima facie* elements of liability. Common grounds for such a motion include failure to plead falsity (*e.g.*, where the complaint alleges a claim was false based on contract interpretation, scientific or engineering judgment or violation of a legal or regulatory requirement that was not a condition of payment) or materiality (*e.g.*, where the alleged falsity or claims were *de minimus*). Another ground for such a motion is failure to meet the false claims statute of limitations, which is complicated and so often violated. Finally, in *qui tam* actions, the public disclosure bar may be a valid ground for such a motion but only if the disclosure either is alleged in the complaint or documents incorporated into the complaint (both of which are unlikely) or is subject to judicial notice. If not, that issue may have to wait until summary judgment.

Another pleading motion available to contractors in appropriate cases is a motion to dismiss for lack of subject matter jurisdiction. Under both the federal and state acts, a *qui tam* action is jurisdictionally barred if another false claims action (by the Government or another relator) has been filed previously. However, the "first to file rule" is very limited and will only bar an action based on the same allegations. Some courts also consider the public disclosure bar to be jurisdictional.

Contractors have tried some other methods of attacking false claims complaints without success. For example, contractors have tried, without success, to attack *qui tam* complaints by asking courts to dismiss based on the relator's failure to follow the various procedures the acts require for *qui tam* actions, such as making an adequate disclosure to the Government before filing the complaint, filing under seal without serving

defendant, etc. These motions have by and large been denied on the ground that contractors lack standing to raise non-compliance with these rules, which are primarily, if not exclusively, intended for the Government's benefit.

Contractors have also sought dismissals for failure to state a claim based on sovereign immunity and the government contractor defenses, asserting that the contractors were acting as government agents or at the government's direction and so are immune from liability for their actions. These efforts have all failed.

Many contractors have also attacked the federal FCA on the ground that it is unconstitutional (primarily based on the separation of powers doctrine). All of these attempts have failed.

In California, a contractor brought an anti-SLAPP ("Strategic Lawsuits Against Public Participation") motion to dismiss a false claim complaint on the theory that public contracting is "public participation," such that FCA lawsuits filed to discourage that participation are subject to the state's anti-SLAPP statute. The motion was denied on the ground that public contracting was not the type of public participation the statute was designed or intended to protect. The court in that case did leave the door open for such motions in the limited case in which the complaint alleges that a court or administrative complaint was a false claim.

Another theory for dismissal under California law that will not work is to assert that claims to state and local public entities are subject to the litigation privilege under Gov't Code § 12654(e). This theory fails due to express language in the state False Claims Act that states that the litigation privilege does not prevent allegedly false statements from giving rise to FCA liability.

b. Government Motions

The contractor is not the only party that can seek dismissal of a *qui tam* lawsuit. Both the federal and state statutes grant the Government the right to seek dismissal of these lawsuits. The Government may exercise this right, for example, where the lawsuit is likely to disrupt a vital government program or where the relator has blatantly disregarded the FCA's procedural requirements. While the contractor should consider ways it may be able to persuade the Government to exercise this right, as a practical matter the federal government will almost never do so. While such motions are more common at the state level, they are still rare.

In intervened *qui tam* cases, a contractor may also try to persuade the Government to seek a court order restricting the relator's participation in the lawsuit. While extreme circumstances may merit such relief early in the case, this approach is more likely to succeed where the relator has subjected the contractor to harassment, undue burden or unnecessary expense during the litigation (for example, through oppressive, duplicative discovery).

c. Cross-complaints

Once a contractor has been served with a false claims complaint, it should consider whether it has any viable counter- or cross-claims. In *qui tam* cases in which the relator (*e.g.*, an employee or subcontractor) was a participant or even the principal actor in the submission of false claims, the contractor may have the desire to file a counterclaim for indemnity from the relator. Unfortunately, federal case law is clear that such a counterclaim will not be allowed and even indicates that a separate action raising claims related to the same conduct would be barred. Whether a contractor can seek contractual or equitable

indemnity from non-parties, such as non-relator employees, subcontractors or suppliers, is unclear.

Whether a contractor can countersue the Government for claims under the contract depends on whether the original action is brought under the federal or state act. Federal False Claims Act complaints may only be brought in federal District Courts. Those courts do have jurisdiction to hear tort and certain statutory claims against the federal Government but do not have jurisdiction to hear contract claims. Under the federal Contract Disputes Act, only agency Boards of Contract Appeals and the Court of Federal Claims have jurisdiction to hear contract claims against the federal Government. In contrast, California Superior Courts are empowered to hear contract claims against state and local public entities. As a result, a contractor could raise those claims by cross-complaint in a state false claims action.

d. Discovery Issues

False claims actions raise many discovery issues common to multiparty litigation (such as the applicability of the joint interest privilege to communications between the government and relator) and to Government actions (such as the discoverability of government investigation documents, *e.g.*, pre-intervention decision documents). Another feature of false claims actions present in other Government actions is the availability of “sunshine” laws (the federal Freedom of Information Act (FOIA) and the state Public Records Act) to obtain documents earlier than discovery would otherwise allow.

False claims actions also raise discovery issues specific to those lawsuits. One such issue is the discoverability of relators’ pre-litigation disclosures to the Government. Both the federal and state acts require that relators disclose to the Government all

information in their possession material to their false claims allegations before they may file a *qui tam* complaint. Whether this disclosure is discoverable depends on its content. To the extent that portions of the disclosure contain absolute work product (*e.g.*, attorney impressions), those portions are likely protected. On the other hand, a mere collection of documents – though arguably qualified work product – is probably not protected.

A similar issue is the discoverability of documents filed under seal before the Government makes its intervention decision. Both the federal and state acts permit the Government to submit materials to the court *in camera* while the action is under seal (*e.g.*, documents supporting a request to extend the deadline for intervention). Whether a contractor defendant can later discover such materials will depend upon a balancing of its need for the materials against the Government's interest in non-disclosure (*e.g.*, the extent to which the materials reveal confidential investigation techniques or their disclosure could jeopardize an ongoing investigation).

An issue that may arise in federal false claims actions is whether the government or relator has met specificity requirements for the statement of damages in its FRCP Rule 26 initial disclosures. Where the alleged false claims involve multiple contracts and/or defendants, courts will require the Government or relator to make reasonable efforts to allocate the alleged damages. Failure to do so may result in discovery sanctions.

Finally, in federal, non-intervened false claims actions, there are unique limitations on the contractor's ability to interview government witnesses informally. Such informal discovery efforts are governed by the federal Touhy regulations. These regulations contain specific procedural requirements. For example, they require the party seeking an interview to define specifically the topics of discussion in advance of the interview.

e. Summary Judgment Issues

(1) Why Summary Judgment Is Especially Important in False Claims Cases

The reasons to seek summary judgment in a false claims case are similar to many other types of cases, but they are often more pronounced. False claims cases are particularly difficult to defend in front of a jury, and, due to the potential severity of the consequences of a false claims judgment (including not only treble damages and penalties but also debarment), summary judgment is often the last chance a contractor has to get out of a false claims lawsuit without having to pay an exorbitant settlement. At the very least, summary adjudication can substantially limit the Government and relator's claims, which are frequently pled expansively, by limiting the number of claims at issue and by defining the measure of damages or even eliminating damages from the case.

Another reason why summary judgment is an especially important tool in false claims cases is courts' general inexperience with false claims issues. Construction cases are complicated enough for generalist judges, but the many unique procedural and substantive aspects of false claims cases make those cases even more difficult for judges to understand and adjudicate correctly. Where the same judge will both hear the summary judgment motion and preside over the trial, summary judgment motions can be extremely useful in educating that judge before trial.

(2) False Claims Issues Often Amenable to Summary Judgment

There are a number of legal issues that often arise in false claims actions and that may be amenable to summary judgment. With regard to the falsity of a claim, issues of whether the alleged falsity is a matter of contract interpretation or scientific or engineering

judgment (rather than truth) may be resolved by summary judgment. Likewise, where the theory of falsity is that the claims impliedly certified compliance with legal or regulatory requirements, the issue of whether the requirements that were allegedly violated were a condition of payment may be amenable to summary judgment.

As with most issues of intent, most issues with regard to scienter are not amenable to summary judgment. One exception may be where the contractor has undisputed evidence that, before it submitted its alleged false claims, it disclosed to the Government all facts which allegedly made its claims false. Another exception is where the contractor has an affirmative defense that it relied on the advice of counsel or an expert in interpreting the requirement at issue, and so lacked the requisite reckless intent. (Note: A contractor should carefully consider the implications of raising this defense before doing so because it will waive privileges that may apply to materials that the contractor may not wish to disclose.)

Another issue that may be amenable to summary judgment is whether the alleged falsity of a claim is material. Falsity is “material” for false claims purposes if it was likely to have affected the Government’s decision to pay the claim. A contractor may be able to obtain summary judgment on this issue where either an alleged false claim is based on an insignificant or *de minimus* violation or the undisputed evidence shows that the Government knew of the alleged falsity when it chose to pay the claim.

Another false claims issue in *qui tam* cases that is often amenable to summary judgment is whether a public disclosure bars the action. Both the federal and state acts bar *qui tam* actions where (1) the alleged false claims were the subject of a prior public disclosure and (2) the relator was not an “original source.” Where the undisputed evidence shows that there was a public disclosure, the court can determine whether the disclosure

contained sufficient facts to bar the action, *i.e.*, whether it disclosed the entire alleged fraud or all of the facts material to that fraud. And, where the undisputed evidence shows that the relator did not have direct and independent knowledge of the false claims, the court can decide as a matter of law that the relator does not qualify as an original source.

An issue that sometimes arises in *qui tam* cases brought by current or former employee relators is the effect of a prior settlement and release of claims by the relator on his or her false claims allegations. The typical situation is one in which an employee settles a wrongful termination or demotion lawsuit and signs a general release of claims and then sues in a separate *qui tam* action for alleged false claims. While a contractor can successfully use such a release to obtain summary judgment on a false claims retaliation claim, federal courts have uniformly declined to apply such releases to bar actions for the false claims themselves.

2. ADR and Settlement

Due to the severe consequences a contractor may face if found liable for false claims, the parties usually settle false claims actions before trial. The unique, tri-party aspect of *qui tam* suits (Government, relator and defendant) can have a major impact on settlement and ADR efforts.

In non-intervened *qui tam* cases, contractors should consider inviting the Government to participate in any settlement discussions or ADR. In many of these cases, however, the relator and the contractor end up conducting settlement discussions and engaging in ADR without the Government's participation. Regardless of whether the Government participates, the federal and state acts give the Government the right to object to any proposed settlement between the relator and the contractor, and, in some federal jurisdictions, the courts have interpreted the federal act as giving the Government an absolute

veto. Regardless of jurisdiction, contractors should keep the Government's ability to blow up a settlement in mind when discussing allocation of settlement payments between claims entirely payable to the relator (*e.g.*, false claims retaliation and other employment-related claims, as well as relator's attorneys' fees and costs) and claims payable to both the Government and the relator (*i.e.*, damages and penalties for false claims).

In *qui tam* cases in which the Government does intervene, the relator has a right to continued participation in the case. Nevertheless, where the contractor views the relator to be an impediment to settlement, and the Government is willing, they may discuss settlement or engage in ADR directly without the relator. While both the federal and state acts give relators the right to object to settlements, the court will rarely second-guess the Government's judgment on what is a fair and reasonable settlement.

Finally, there are some important aspects of false claims liability that a contractor typically will be unable to include in a settlement. In federal false claims actions, the Government has consistently refused to include in a settlement agreement any position regarding: (a) contract issues (*e.g.*, termination for default, effect on past performance rating, debarment and suspension from public contracting); (b) criminal liability (*i.e.*, whether prosecutors will pursue criminal claims against the contractor or its employees); (c) allowability under cost-based public contracts of the contractor's litigation costs; and (d) tax treatment of any relator recovery. While a contractor typically will be unable to include provisions on these issues in the settlement agreement, it should keep them in mind when considering other representations in the agreement that may affect those issues. And, with regard to criminal issues, it is usually in the contractor's best interests to get those issues resolved, if possible, before settling a civil false claims action.

3. Trial

For that rare false claims case that actually goes to trial, there are several areas of dispute that commonly arise. The parties will often have differing views regarding jury instructions and motions *in limine* regarding the significance of government knowledge of the alleged false claims (*e.g.*, whether it negates scienter or materiality), the definition of falsity (*e.g.*, whether it includes issues that are arguably matters of contract interpretation or scientific or engineering judgment), and the requirements for application of the public disclosure bar and the original source exception to that bar (*e.g.*, whether a disclosure meets the statutory requirements for a “public disclosure” or whether the relator must be a catalyst of the public disclosure to qualify as an “original source”).

The parties are also likely to disagree concerning the damages and penalties that may be awarded if liability is established. The proper measure of damages in a false claims case is very case specific, and different methods can result in wildly varying awards. In cases in which the civil penalties far exceed the government’s damages, the contractor may be able to successfully challenge and limit the penalties award under the Excessive Fines Clause of the Eighth Amendment of the U.S. Constitution. Also, the contractor may be able to challenge a damages award to the extent that the damages may be characterized as consequential damages or as including prejudgment interest, both of which are not recoverable under the federal and state acts.

4. Post-Trial

After trial, the prevailing party is entitled to recover its litigation costs, but, in most instances, only a prevailing *qui tam* relator is entitled to recover its attorneys’ fees. Both the federal and state acts allow prevailing relators to recover their attorneys’ fees.

There is no provision for the Government's recovery of fees, and a prevailing defendant may recover its fees only if it can prove that the false claims allegations were frivolous – a nearly impossible standard to meet.

C. Post Litigation

After a case is either settled or adjudicated, the contractor still needs to resolve the issue of debarment and suspension. At the federal level, each Government agency has a designated debarment authority. The contractor needs to consider whether there is a significant chance that the debarment authority will consider debarring the contractor based on the results of the false claims litigation. To the extent that there is significant risk and the contractor has not taken corrective action to show its “present responsibility,” it should do so as quickly as possible. The contractor should fully cooperate with any inquiries by the debarment authority.

V. CONCLUSION

In many ways, the state and federal false claims acts raise unique or unusual issues for contractors and their counsel. From the decision to bid on a publicly-funded project to the submission of the last request for payment, contractors and their counsel need to be familiar with these issues and be prepared to deal with them. The consequences of failing to do so can be severe.