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Tom Hagy
Editor-in-Chief

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The False Claims Act: The Anatomy of an Investigation and What's in Store

Jack Siegal*

Abstract: *Government contracts can be lucrative, but they also create risks for contractors (or anyone who receives government funds) who fail to follow the regulations. Failure to record or properly use funds can spell big trouble in the form of penalties, suspension, or debarment, and fraud can be met with even higher penalties and possible criminal prosecution. The goals of this article are to explain how False Claims Act investigations unfold, what to expect should the government appear at your door, and outline important trends in government investigations.*

Contracting to perform work for the government can be a lucrative endeavor. The attendant risks, however, are great—as every veteran government contractor knows. The rules and regulations applicable to government contracts are numerous and byzantine. The Federal Acquisition Regulation (FAR) record-keeping requirements are onerous, to say the least. It is easy to miss something, get tripped up, and make a mistake. If a mistake is not caught, it can be repeated over and over, creating significant financial problems. The same can be true if you *accept government funds as part of a federal relief program*, like many that exist to address the effects of the global pandemic.

Running afoul of the FAR (or similar rules governing government "bailout" programs) can result in significant penalties and suspension or debarment. It stands to reason, then, that most contractors necessarily make every effort to follow the FAR. Even so, government agencies (think civil units of the Department of Justice) are empowered to investigate possible contract/FAR violations, including but not limited to alleged fraudulent overcharging of the government. Such overcharging can have civil ramifications under the False Claims Act (FCA), one of the government's most

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powerful enforcement tools (and may even result in criminal liability). For 2021, the challenges for compliance may be even greater and more complex.

If you are a large government defense contractor, like Lockheed Martin, this article likely presents nothing new. However, the FCA is used to address alleged fraud and abuse of government funds in multiple industries. The goal is to explain at a high level how FCA investigations unfold, and provide an overview regarding what to expect should the government appear with FCA concerns. Finally, we address certain emerging trends for the 2021 regarding FCA investigations.

The False Claims Act: Overview

The False Claims Act, 31 U.S.C. §§ 3729-3733, is a federal statute originally enacted in 1863 in response to defense contractor fraud during the American Civil War.

The FCA provides that any person who knowingly submitted false claims to the government was liable for double the government's damages plus a penalty of $2,000 for each false claim. The FCA has been amended several times and now provides that violators are liable for treble damages (three times the amount of the overcharge) plus a penalty that is linked to inflation (which is currently up to $11,000 per false claim).

In addition to allowing the United States to pursue perpetrators of fraud on its own, the FCA allows private citizens to file suits on behalf of the government (called "qui tam" suits) against those who have defrauded the government. Private citizens who successfully bring qui tam actions may receive a portion of the government's recovery.

The Department of Justice obtained more than $2.2 billion in settlements and judgments from civil cases involving fraud and false claims against the government in the fiscal year ending September 30, 2020. (Source: United States Department of Justice website.)

The Government Cometh

It is not always clear what leads the government to the company's door. Did an employee blow the whistle? Did the procuring agency suspect fraud? Somehow, the government has reason to believe that

the company may have overcharged the government or abused a federal program. If the company is fortunate, it will get wind that the government is asking questions, because an employee, former employee, or contractor may reach out to give the company a warning. (Consult with experienced counsel to consider whether notification requirements should be included in employment and contracting agreements.) Or the company will receive what is commonly called a Civil Investigative Demand (CID), which is the equivalent of a subpoena for access to information.

The CIDs (or their equivalent) will typically contain information requests that collectively demand production of large swaths of information, much of which the company may deem "unnecessary" or "irrelevant." The government, however, is given wide latitude to conduct its investigation based on reasonable suspicion; challenging CIDs on scope grounds is rarely successful.

The company should involve experienced counsel as soon as it suspects a government investigation is afoot, but certainly after receiving a CID. Sometimes insurance coverage is available to cover the costs of responding to the CID. The company, therefore, should also contact its brokers and put the carriers on notice. Additionally, if the company is publicly traded and/or subject to regulatory reporting requirements, corporate counsel should be involved in addressing disclosure issues and timing. A government investigation is generally a material event.

Preserve, Collect, Produce

First, and most critically, the company must preserve all of the information (hard copy and electronic) that is reasonably related to the demand. It may be prudent to exceed that basic standard and preserve information that may even possibly relate to the request, depending on the circumstances. Information loss or destruction after receiving notice of a government demand for records can be devastating—even absent wrongdoing. Depending on the circumstances, the government could view the data loss as obstruction (which may have criminal and other collateral consequences).

It is generally regarded as most prudent for the company to issue a formal "litigation hold," which basically entails management alerting the company's employees and contractors in writing to maintain records. This written "hold" is direct evidence of a good

faith effort to preserve information. Experienced counsel can assist with crafting an appropriate communication.

Next, the company must collect the requested information. In the digital age, much of this information will likely be electronic. Best practice suggests using an expert who, with counsel's guidance, can capture the information in a manner that preserves its integrity. This process, however, is not optional, and is usually relatively expensive and time-consuming, depending on the circumstances. Some companies have engineering and scientific investigations consultants on standby for this very purpose, particularly if the company is not new to litigation.

An expert can also help counsel in defending against the breadth of the CID by articulating the difficulty involved in preserving or producing the volume of requested data. Sometimes, but not often, cost, proportionality, and relevancy can be raised to narrow the CID's scope. For example, in one case, a company used an outdated email system that required the creation of new technology to extract information. The cost of the solution, however, was disproportionately high. As such, the information was not produced. Generally, however, courts view the compliance expenses as part of the cost of doing business; sometimes the opposite is true. The determination is circumstance-specific.

Investigate Expediently

With the documents under control, an internal investigation should follow with all deliberate speed. Typically, management and counsel determine the investigation's scope, which would include reviewing documents and interviewing employees/contractors. Once the company identifies the individuals with the most relevant information, interviews should be scheduled. Expediency is critical; the company needs to get educated about the issues as fast as reasonably possible.

Care should also be taken to determine whether the jurisdiction (state) in which the interviews will occur follows the attorney-client privilege principles articulated in the Supreme Court's decision in *Upjohn v. United States*, namely that counsel should inform employees that counsel represents the company, not the individual employee. Anything revealed during the course of the interview is privileged as between counsel and the company; the employee

has no control over whether the company decides to waive the privilege. Indeed, a company may choose to waive the privilege at some point as part of negotiations with the government. As a side note, conflicts between the company and certain employees, directors, or officers may arise depending on the circumstances. These conflicts, and the complex privilege issues they raise, are beyond the scope of this article. However, such potential conflicts underscore the need for appropriate *Upjohn* warnings.

Typically, contracts, invoices, accounting data, and other financial materials are at the heart of an FCA matter, which will require collection, review, and careful analysis. Indeed, the company will need to compile these materials and oftentimes obtain an independent expert analysis regarding whether, among other things, the government overpaid or the company received funds it should not have. Any accounting expert engagement should be established according to *United States v. Kovel*, which creates a privilege that protects communications from accountants working with attorney during investigations. This way, the accounting and legal experts can work together without fear of their deliberations becoming discoverable. Further, the experts can provide a written analysis which often forms the backbone of any FCA defense.

Sometimes the issues in the case are straightforward and accounting experts are not necessary; each situation is different. The point is, regardless of the investigation's complexity, the company needs to internalize and understand the facts at the core of the government's investigation as soon as possible. Expedient, decisive action is required.

Transparency = Credibility

Generally, the government will communicate during the investigation process. Communication is not cooperation, and cooperation in this context is usually a one-way street. There is no quid pro quo with the government; they have a job to do. However, the relationship need not be openly adversarial.

Indeed, transparency is highly valued. Experienced counsel will utilize a communication style that assures the government the company is taking the investigation seriously and cooperating to the fullest extent possible. This approach lends itself to a helpful

flow of information from the government to counsel that may assist in the investigation.

Transparency, however, does not imply waiving rights or unconditional surrender. The government will typically respect experienced counsel and recognize that investigations have limits; there is room for compromise, if the situation is approached correctly, because the government may be willing to look at certain evidence more favorably for the company (as opposed to assuming they amount to fraud). An investigation is an investigation, not a prosecution. Although the FCA is a civil statute, the issues involved may implicate potential criminal liability exposure. The company should rely on experienced counsel to navigate these concerns.

The ultimate goal is to limit the cost, distraction, and consequences of the investigation. A quick way to have an investigation go sideways is to be unnecessarily adversarial with the government. Alternatively, any hope of resolving issues in a manner more favorable to the company is aided by transparency with its resulting credibility.

To Litigate or Toll?

At any point the government may file a federal lawsuit asserting FCA claims. The company may or may not receive advance notice. Often, but certainly not always, the government may approach the company to enter into a tolling agreement—an agreement that the running time by which the government must bring its claims or lose the opportunity is halted. The FCA statute of limitations is (1) six years from when the alleged fraud on the government occurred, (2) three years after the United States knows or should have known about the alleged fraud, but (3) not more than ten years after the violation. Indeed, the government in some instances will reach back into the distant past to pursue FCA claims.

Experienced counsel can assist the company in weighing a tolling agreement's pros and cons. If staying the limitations period will help lead to fruitful settlement discussions, that would likely be a "pro." Sometimes the government will articulate that it prefers settlement to a lawsuit, but insists that a tolling agreement is a prerequisite for settlement discussions. Each situation is different; tolling agreements can play an important role in keeping the company on the path toward resolution. In some circumstances,

however, such an agreement may be inappropriate, with litigation as the alternative.

Resolution and Considerations

Almost universally, a company's goal is to end the FCA investigation as soon as possible with the least amount of disruption. On rare occasion, the company may ultimately convince the government that its investigation is unwarranted. In other words, sometimes (rarely) the company can account for every purportedly overcharged penny. Most often, however, there is a financial/payment discrepancy that establishes a "damages" amount for the government to recoup.

In addition, the FCA calls for fines in multiples of damages, so even modest overpayments create larger monetary exposure. For example, a $500,000 overpayment on a $30 million contract would result in statutory damages of $2 million (actuals plus three times) and a fine (approximately $500,000).

Experienced counsel, in most cases, should be able to reduce FCA exposure. Whether it was a mistake, the company's accountants failed to catch a problem, or some other legitimate reason, the risk of litigation usually militates in favor of settling, but at a lower amount. Each circumstance and negotiation is different. Experienced counsel will be able to advise regarding what particular strategies work best during negotiation.

Litigation is *public*; settlement *before litigation* can be kept relatively private. Be aware, however, that the government may choose to announce the settlement if it serves a political or other purpose. Efforts can be made to limit publicity, keeping in mind, however, that the government is usually not inclined to do so.

If the company is concerned about public exposure, it should consider preparing press releases and/or other social media content it can use to counter negative publicity. It is important to note that a release from civil FCA liability does *not* release the company from any potential criminal exposure. Those considerations remain separate.

On the bright side, settlements are often *no fault*; the company need not admit liability. Companies can have reasonable assurance that, except in the case of obvious or glaring fraud, the government is open to a no-fault settlement.

Beyond Settlement

The FCA investigation process is not a pleasant experience for any company. However, companies can use it as an opportunity to identify potential FCA weaknesses. Experienced counsel is able to assist going forward and prepared to address any FCA issues that arise in the company's future (with the goal being that there are none).

FCA 2021: What to Expect

According to government press releases, FCA investigations yield billions in government recoveries (e.g., 2019: $2.6 billion; 2020: $1.8 billion). It is safe to assume that the government's investigations and prosecution of FCA claims (as with most industries) were slowed in 2020 by the pandemic, during which the government also diverted unprecedented funds to the private sector, including through government relief and assistance programs. Commentators (including leading practitioners in the field) seem to agree that 2021 will see a resurgence of FCA activity touching on all activities that involve use of government funds.

Indeed, besides the usual Medicaid, misleading labeling of drugs, opioid-targeted investigations, there may be a returned focus on the defense industry, as well as pandemic-related funding programs such as the Paycheck Protection Program and other COVID-19 relief funds. The FCA can also be used to target individuals who participate in fraud or abuse of government funds. In short, there are no shortage of prognostications about 2021 FCA activity, particularly given the new administration, evolution of the pandemic, and the magnitude of funds flowing from the government to private industry. While the number of investigations may increase and address emerging issues related to the pandemic (and related programs), the advice provided in this article about how to address them remains applicable.

Note

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