



FALSE CLAIMS

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Increased government spending and growing demands for financial accountability have led to a flurry of activity under the False Claims Act (FCA). Last year alone, the United States obtained \$2.4 billion in civil settlement judgments resulting from FCA cases—the second-largest annual recovery ever. The statute also underwent significant changes through the Fraud Enforcement and Recovery Act of 2009 (FERA), and additional amendments resulted from the passage of health care reform. Coupled with the flow of billions of dollars of federal stimulus funds to companies and local governments, practitioners predict a notable increase of FCA cases in coming years.

Our panel of experts from Northern and Southern California discusses these issues, as well as the state's unique insurance anti-fraud statute, and the potential impacts of a state court of appeal decision in *San Francisco Unified School District ex rel. Manuel Contreras v. Laidlaw Transit*. They are Shawn Hanson of Akin Gump Strauss Hauer & Feld; Mark R. Troy of Crowell & Moring; Robert J. Nelson of Lief Cabraser Heimann & Bernstein; and Steven J. Saltiel of the U.S. Attorney's Office for the Northern District of California. *California Lawyer* moderated the roundtable, which was reported by Krishanna DeRita of Barkley Court Reporters.

Moderator: What are the most significant changes to the FCA as part of FERA?

Troy: The first key change is that previously, the courts and the FCA itself required that for a claim to be actionable, it had to have been presented directly to a representative of the U.S. government. One of the FERA amendments did away with that "presentment" requirement. Under the new law, a claim is actionable if it is made to another contractor or federal grantee, as long as the money originated from the government. This amendment effectively reversed the U.S. Supreme Court decision in *Allison Engine (Allison Engine Co. v. United States ex rel. Sanders, 128 S. Ct. 2123 (2008))*, which required proof that a subcontractor intended its false statement to be relied upon by the government itself.

The amendments also clarified that false statements must be material—they must have "a natural tendency to influence or be capable of influencing" payment. That is, they must matter to the people who are deciding to pay the claim. This is an important defense against cases premised on violations of other regulations. Some of those violations are material to contract performance, and some are not. The amendments also changed the standard for what is considered a reverse false claim, which now includes liability for retaining overpayments from the government.

The other significant change to the act is the expanded use of Civil Investigative Demands (CIDs), which is a tool unique to government prosecutors that allows them to conduct ex parte discovery in a qui tam case before the defendant either knows about the existence of the case or is in a position to engage in the litigation.

Saltiel: The old rule made CIDs essentially impractical to use because we had to get the Attorney General to sign off on a CID. With the amendments, that authority has been delegated to the head of the U.S. Department of Justice's civil division, and that authority has further been delegated to the U.S. attorneys, which makes it easier to issue a CID. But we have many tools of investigation—Office of Inspector General (OIG) and Health Insurance Portability and Accountability Act (HIPAA) subpoenas, and so forth. CIDs are just another tool.

Nelson: Each of the legislative changes that Mark [Troy] described is important. The fact that a false claim does not need to be presented directly to a federal official is going to have a significant impact in the procurement arena, where subcontractors often may not deal directly with a government official. The changes regarding reverse false claims are going to impact health care providers, as overpayments frequently occur. It's important to emphasize that the reason Congress was so supportive of the amendments is that we, as a nation, are in an unprecedented situation in which we are fighting two wars and funding a stimulus package involving hundreds of billions of dollars. Accountability is needed, and Congress looked to the FCA. It was a perfect storm that led to these amendments.

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Robert J. Nelson, a partner in Lief Cabraser's San Francisco office, served as lead trial counsel in a false claims case against the University of Phoenix that settled for \$78.5 million—among the largest FCA settlements where the government did not intervene. A 2008 and 2010 CLAY Award recipient, he currently serves as lead counsel in several qui tam cases. He has served as court-appointed class counsel in dozens of state and nationwide class actions, and led the firm's landmark litigation against the tobacco industry.
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Hanson: I understand the proposed financial regulation legislation may have a significant false claims component to it, which will in theory extend the reach into a brand new area involving banking and securities. [Editor's note: As of press time the bill had not passed.]

Saltiel: I will add that the FCA can be used in a mortgage fraud context, when there's fraud leading to the issuance of a mortgage that is guaranteed by the Federal Housing Administration (FHA), and it has to pay out on it. The government also has tools under the Financial Institutions Reform, Recovery and Enforcement Act, which was passed during the Savings and Loan Crisis, and is now being revived in mortgage fraud situations. We are starting to see some activity there.

Troy: Going back to the amendment to the presentment requirement, the most significant aspect is the impact on subcontractors, or companies who are doing work for municipalities and other grant recipients. Those companies may not even know that they are being paid with federal funds, and the removal of the presentment requirement basically puts all of those companies within the enforcement circle of the FCA. Without the presentment requirement, subcontractors could be liable under the FCA when there has been no impact on the Federal Treasury.

Saltiel: From my perspective, those kinds cases have existed in the past. There was a short window after the *Allison Engine* case where the case law was different and an additional element of intent applied to subcontractors who had no direct contact with a federal agency, but there were plenty of cases that were already filed or in the pipeline that involved subcontractors for false claims violations. And I'm not sure I agree that there are no damages in those situations. An impact on the public fisc is not a requirement under the FCA, but if funds are disbursed from the public fisc and to a prime contractor, and a subcontractor is submitting a false claim and receiving that money, it does affect the Treasury.

Troy: Even if the prime contractor finds out about the problem and corrects it before billing the government?

Saltiel: That may affect damages. If there's a voluntary disclosure, part of the FCA addresses that, but I'm not sure if that's fraud. If there's a false statement and that is discovered and disclosed, then that affects the resolution.

Hanson: A good example of a kind of "contractualization" of false claims, which Mark [Troy] is legitimately concerned about, can be found in the recent state court of appeal decision in *Laidlaw* under the California FCA (*San Francisco Unified School District ex rel. Manuel Contreras v. Laidlaw Transit, Inc.*, 2010 WL 670944 (February 26, 2010)).

Troy: *Laidlaw* is an example of run-of-the-mill breach of contract allegations that have now found their way into California FCA fraud enforcement. The basic allegation is that the contractor failed to perform the terms of its contract. The court held that the contractor impliedly certified its compliance with all of its contract terms, and that implied certification was what constituted the false statement in the case. That's where the court expanded the reach of the FCA because in the very act of signing a contract, you are impliedly certifying that you are going to follow it. Under this decision, any contract infraction that is done "knowingly"—a standard that is broader than that of common law fraud—subjects the contractor to FCA enforcement. And I think that's where the courts have overreached in applying the FCA.

Hanson: I see similar sets of problems in the health care area, which are pretty heavily regulated. It's a vexing problem and it's more acute of an issue now, in terms of determining when a violation of a regulation under emerging law trips over into the FCA. This is certainly an issue for the defense, or for someone trying to get counsel, and in terms of deciding whether to make a voluntary disclosure or not.

Nelson: I agree that *Laidlaw* is important because it shows that those who do business with governmental entities must be in compliance with their contractual obligations, and face California FCA liability if they are not. I suggest the more interesting question in *Laidlaw* going forward will be what the court or jury determines to be the proper measure of damages. But I would say that *Laidlaw*-type cases remain the exception. Most relator's counsel only get seriously interested in prosecuting a case if there is some kind of smoking gun document that speaks to scienter.

Troy: Robert [Nelson], you mentioned that you were an attorney for the plaintiff in the *Hendow* case, which involved the way student recruiting was done for the University of Phoenix. How did you assess the materiality factor, that is, whether the regulatory violation really mattered to the government?

Nelson: By way of background, in the *Hendow* case (*United States ex rel. Hendow, et al. v. University of Phoenix*, Case No. CIV S-03-0457 GEB DAD (E.D. Cal.)), the University of Phoenix receives upwards of a billion dollars a year in federal student aid monies pursuant to the Higher Education Act. To be eligible for such monies, a university must certify that it is in compliance

with various provisions of the Higher Education Act, including its ban on incentive compensation to student recruiters. The Ninth Circuit agreed with us that such certifications of compliance could constitute a false statement under the FCA. Compliance with the incentive compensation was material to certification and being able to participate in the student aid program. That said, we struggled with the question of how extensive the violation of the incentive compensation plan had to be in order to argue effectively that the university should return all of its student aid monies to the government. Did all of the thousands of University of Phoenix recruiters have to be paid improperly, or just some? This is closely related to the concept of materiality.

Moderator: What legal trends and questions do you see arising in terms of FCA and health care reform and policy?

Hanson: I have my eye on the Patient Protection and Affordable Care Act, which creates health care exchanges at the state level and then incorporates the Federal FCA into the provision that creates those exchanges. You could have a pretty healthy debate about how that's all going to work in the end, but the way the statute reads right now is that payments made through, or in connection with, the exchange are subject to the FCA. I don't know that I would have ever thought that payments made through a health care exchange would necessarily evolve into a false claim. But it's an interesting new feature to the FCA area for health care providers or insurers.

Saltiel: How is that different than the application of the FCA to Medicaid?

Hanson: The exchanges are between employers and individuals on the one hand, and private health insurers on the other, but some of the money that may be swirling through those exchanges has a tax credit feature to it, or perhaps a direct subsidy. I think it's a step away from what I have historically thought of as a Medicaid false claims. It's just another way in which I'm seeing business activities that used to seem relatively distinct from the FCA appearing to now involve the government and the public fisc.

And now that the federal health care reform legislation has passed, regulations are being discussed, and a lot of the health insurers are advocating for certain expenses relating to the detection of fraud to be counted as a medical loss expense. So insurers are possibly going to be incentivized by these regulations to spend a greater amount of money than they have historically toward looking at health care fraud.

What's interesting for California is that we have one of the few insurance-related anti-fraud statutes (California Insurance Code Section 1871.7). It's regulated by the state Department of Insurance, and those who can bring those cases are the Department of Insurance itself, the insurance companies, and interested persons. The term "interested persons" hasn't been interpreted under the statute, so we are eventually going to have some interesting discussions about what an interested person means.

The California insurance statute's been around a long time, but combined with the fact that there's a lot of money that could begin to swirl through to insurers if they want to expand the definition of a medical loss expense in order to detect fraud, then there may be a whole new set of plaintiffs in this area.

Nelson: My office has just brought our first case (*People of the State of California, ex rel. Rockville Recovery Associates, Ltd. v. Multiplan, Inc., et al.*) under this California insurance anti-fraud statute. We are suing a number of hospitals based on their overcharging insurance companies for anesthesia services. In terms of damages sought, it likely will be the biggest case ever brought under this statute, and it's going to be an interesting bellwether as to how this statute gets interpreted.

But getting back to the FCA and the FERA amendments, it seems to me that the reverse false claims, when there are overpayments from the government, would be particularly problematic for health care providers, who often receive overpayments given the extraordinary volume of government payments to them. If I were advising these companies, I would want them to be very familiar with the new FCA amendments.

Hanson: What's unusual about health care is just the sheer volume of transactions, and there are consequences to that. But it sounds like no one thinks that merely getting an overpayment, absent something more intentional, necessarily implicates the core issues related to false claims concerns. Because it's not inconceivable that there are overpayments and underpayments when you are talking about such a high number of transactions.

Moderator: What are some of the practical issues that frequently arise between government lawyers, defense counsel, and relator's counsel in FCA cases?

Saltiel: Although we do litigate cases, the majority of our cases under the FCA are resolved before intervention, *qui tams* in particular. Looking at *qui tams*, our first contact is with the relator and the relator's counsel. We often will start with an interview of the relator, and that

raises a host of practical issues. For the most part, relators are forthcoming and we want them to be, but then again, you have to make it clear to the relator that they have their own representation, and we, the government attorneys, play a different role.

Once we get into negotiation, and when we are going back and forth with the company that is being investigated, I like to get the relator's input. We make our decisions and then the relator has the right to agree or not agree. Ultimately they have the right to object to a settlement if they don't like it.

Troy: I've seen the government exercise its statutory right to dismiss the relator's case only about four or five times. It's always been a disappointment to me that the government generally doesn't move to dismiss a case when their investigation reveals it doesn't have merit.

Saltiel: If we decline, we do explain our reasoning to the relator. We can also suggest that the relator dismiss the case. But seeking dismissal is a powerful statutory right that we have; we don't even have to articulate a reason. Given that, we have to be somewhat judicious in exercising that power.

I personally have suggested to relator's counsel that they should dismiss. Quite frankly, more often than not, if we decline, the relator's counsel will dismiss.

Nelson: Relators are realistic and they know that if the government declines intervention, it says something about their chances of ultimately succeeding. But that's not to say that you can't succeed without the government. The *Hendow* case is a classic case where the government did decline intervention, but we were able to get a handsome recovery.

The tension that I sometimes have with relators is they are sometimes less interested in money than in changing a corporate practice. For example, in the *Hendow* case, the reality is that the University of Phoenix is still collecting substantial federal monies and the relators might hypothetically say, "You didn't change the university's way of compensating recruiters." But an FCA case is about money, ultimately. The DOJ is quick to remind relator's counsel that the FCA is not about injunctive relief, but only about damage to the Treasury.

Saltiel: So I've talked about the relator's side, but in terms of the companies that are being investigated, the first time we have contact with the defendant's counsel in a qui tam may be after the issuance of an OIG or HIPAA subpoena, and that starts the process. And the company will have to respond fully to the subpoena, but then we get into a conversation with the company's counsel, and in the best scenario, we lay out what it is that we have to do to complete the investigation, which will often include conducting interviews. The more cooperation we get, the better. I understand the position of defense counsel as an advocate, but everybody's interests are furthered if we achieve some cooperation in the investigation.

Troy: I find that most companies want to cooperate. But when there is an OIG subpoena, and it appears that there may be a whistleblower, I usually ask the prosecutor whether there is a qui tam case, and if there is, to share the complaint with me. Do you think you have to go to the court for permission to share the complaint?

Saltiel: There's a debate about that, but out of an excess of caution, we get an order from the court allowing us to share both the existence of the qui tam and the contents of the allegations. We'd also check in with the relator's counsel, and we would do some redacting to protect the relator's identity. We wouldn't just hand over the complaint.

Hanson: I've had a slight variation on this problem. I'm starting to see qui tams that are filed against multiple corporate defendants in the same industry. That presents some interesting problems about what you tell a client about the matter against them, what they are told about who else is involved in the case, how that redaction of the complaint is accomplished, what the government attorney feels comfortable with in terms of multiple defense lawyers coming to talk to them, or how they feel about defense attorneys talking amongst themselves.

Saltiel: I've had one of those kinds of cases. It does create some issues, and it may also create issues with respect to the share that we negotiate with the relator.

Moderator: **What are some of the most notable FCA cases, settlements or decisions of the past year and what are the cases to watch?**

Nelson: I do think *Hendow* is an interesting case because it demonstrates that despite the obvious defenses that are available, and despite the government's reluctance to intervene in these FCA cases, that they can be pursued successfully. Going forward, it will be interesting to see how the FERA amendments and the FCA will adapt to the amazing circumstances we find ourselves in: fighting two wars, paying hundreds of billions in stimulus monies, and overhauling health care. Each of these certainly has potential to result in a considerable uptick of FCA cases.

Troy: There are a couple of false certification cases where the damages awards far exceed the

financial harm to the government, and I worry about the precedent they set. One was a qui tam case (*United States ex rel Longhi v. Lithium Power Technologies, Inc.*, 575 F.3d 459 (5th Cir. 2009)), and the other was brought by the government (*United States v. Science Applications Int'l Corp.*, 653 F.Supp.2d 87 (D.D.C. 2009)). In both cases, the companies performed the work perfectly, and they gave the government the product and service that it wanted. But in both cases, the companies were found liable because of a false certification—Lithium Power certified it was a small business, and SAIC certified that it complied with conflict-of-interest regulations. The damages were every penny paid under the contract, multiplied by three. Those decisions tell us a lot about where FCA enforcement is headed, and damage awards like that are a huge motivator, both to qui tam plaintiffs and to the government.

Saltiel: There's a lot of law on this. If they are going to get the full value of the contract in damages, it's usually a false statement or misrepresentation as to their eligibility to enter into the contract from the get-go.

Troy: That's right, but in prior cases, like *Ab-Tech (Ab-Tech Constr., Inc. v. U.S.*, 31 Fed.Cl. 429 (1994)), which involved a company that falsely certified itself as a small business, the court said the government doesn't get any damages because the company performed the contract properly. It did get a penalty for each request for payment that was submitted under the contract, which is a more suitable result than giving the government a windfall.

Hanson: I would say the case to watch is *Laidlaw*. Even with the changes to the federal statute, it could change the practice under the California FCA dramatically if that case stays as it is, and as it could be interpreted, shall we say. I think that it is a remarkable extension of the classic understanding of the California FCA.

Saltiel: The big story in Federal FCA practice continues to be the pharmaceutical fraud cases: Pfizer, Eli Lilly, and Novartis, which all resulted in significant settlements. These are the cases that get the relators interested because they are bringing the numbers, although admittedly, they are rare.

My office also recently settled a case against APL Ltd. concerning the shipping of cargo to Iraq and Afghanistan as part of the military efforts there. It's the largest settlement to come out of military operations in Iraq and Afghanistan, but there are other cases in the pipeline.

And then there is the stimulus package and the flow of federal money, which is only going to continue to generate activity in this practice area.

