

The expanded
False Claims Act:
FERA creates new risks



The federal Fraud Enforcement and Recovery Act of 2009 (FERA), enacted in May, significantly expands the scope of the False Claims Act (FCA), the statute that imposes liability on businesses for making false statements or false claims for government funds.

Companies receiving federal funds, either directly as a government contractor or grantee, or indirectly in any way, can benefit from understanding the changes to the FCA. The act's new provisions make it more important for such businesses to have effective compliance programs and processes in place to help avoid violations and temper the consequences of a violation.

The FCA: A quick recap

A statute dating back to the Civil War, the FCA is widely used to root out fraud and abuse in government contracting and Medicare/Medicaid programs. Liability is imposed when a company makes a false or fraudulent claim, and either knows the claim is false or acts with deliberate indifference or reckless disregard as to whether the claim is false. If liability is imposed, a company must pay treble damages plus additional penalties of \$5,500 to \$11,000 for each false claim submitted.

The U.S. Department of Justice uses the FCA to pursue a broad variety of violations, including misrepresentations made to secure contracts and grants; presenting inflated claims for payment; and providing substandard products or services. The FCA has been used to combat fraud in a broad swath of industries, including defense contracting, health care, pharmaceutical, oil and gas, and construction.

The FCA also can be enforced by private individuals acting on behalf of the government, known as *qui tam* plaintiffs or "relators." A relator can file an action on behalf of the United States, under seal, and the government then must decide whether to intervene in the case. If it does not, the relator can then prosecute the action. A successful relator usually stands to recover between 15 and 30 percent of the total recovery, providing a very ample incentive for *qui tam* lawsuits.

The changes made by FERA may result in an increase in FCA cases asserted by the government and relators. The Obama administration has strongly stated its intention to root out fraud, abuse, and waste related to the stimulus program and other government spending, in part as a means to fund priorities such as healthcare reform, and has increased funding for fraud investigators. The Department of Justice can be expected to use the additional tools that FERA has provided, and *qui tam* plaintiffs and their attorneys can be expected to push for expansive interpretations of the FCA.

Changes in the FCA

The FERA amends the FCA in a number of ways, four of which should be of particular interest to business executives. First, it expands the universe of companies potentially liable for FCA violations. Second, it dramatically increases the consequences of failing to return overpayments to the government. Third, it extends whistleblower protections to non-employees and seeks to expand the scope of whistleblower protections. Finally, it revives the government's ability to use Civil Investigative Demands (CIDs), which are powerful investigative tools.

Expansion of liability

Prior to passage of FERA, several court rulings culminating in the Supreme Court's 2008 decision in *Allison Engine Co. v. United States ex rel. Sanders* had narrowed the circumstances in which a company would face FCA liability. A false claim either had to be directly "presented" to the federal government, or a false statement had to be presented to an intermediary, such as a prime contractor or state or local government, with the "intent" of using the false statement to get the federal government to pay a false claim.

In the wake of the Supreme Court decision, the U.S. Congress was concerned that the “presentment” requirement and the “intent” standard would mean the FCA was not broad enough to cover false claims submitted to intermediate entities receiving Recovery Act and Troubled Asset Relief Program (TARP) funds. As a result, FERA includes several changes that have the effect of extending FCA liability not only to claims presented directly to the United States, but also to claims presented to intermediaries dispensing government funds, as long as the funds are to be used to advance a federal program or interest.

This expansion of liability is likely to have limited effect on federal government contractors and subcontractors that are already subject to the FCA. However, the FERA amendments now extend liability to companies and entities that do business with federal grantees such as state governments, local governments and universities. As long as the grantees are dispensing federal money on the government’s behalf, claims seeking such funds are now clearly actionable under the FCA.

New overpayment liability

A controversial provision of FERA with dramatic implications relates to overpayments from the government, which are routine occurrences in almost all government programs. FERA expressly provides that retention of an overpayment is the basis for “reverse false claims” liability under the FCA if it is done knowingly and improperly, or if an overpayment is knowingly concealed.

Guidance provided by lawmakers at the time of FERA passage directs that liability should not be imposed for retaining overpayments pending their return through normal processes, including contract, grant, and other reconciliation processes. However, someone would be liable who falsified information during a reconciliation period or otherwise acted knowingly and improperly to avoid repayment. Also, it is unclear whether failure to return an overpayment during an administrative or judicial appeal might be actionable under the FCA.

A troubling aspect of FERA is the lack of any definition of “overpayment.”

A troubling aspect of FERA is the lack of any definition of “overpayment.” *Qui tam* plaintiffs’ attorneys are likely to argue for expansive interpretations of what an overpayment means, including, for example, funds that are paid earlier than due, or funds that are provisionally paid based on estimated future costs that turn out to be higher than actual future costs.

The impact of the new overpayment provisions will become clearer as cases wend through the courts. It is likely that *qui tam* attorneys will seek to broaden liability for overpayment reverse false claims in the years ahead.

Expanded “whistleblower” protection

Before FERA, the FCA included a “whistleblower” protection provision that protected employees from retaliation by their employers for taking action in support of an FCA *qui tam* action. The FERA amends this provision to protect non-employees as well as employees, and to provide protection even when no *qui tam* action is filed, but any kind of attempt is made to “stop” a violation.

The implications of this change are potentially far reaching. Now, not only employees, but independent contractors, subcontractors, and anyone else for that matter, can file suit alleging discrimination for attempting to “stop” an FCA violation. A subcontractor could file a *qui tam* action against a prime contractor and, if subsequently terminated, have a cause of action. In addition, companies can now file *qui tam* actions against a competitor with the knowledge that they can sue should the competitor retaliate in some fashion.

Considerations for corporate counsel regarding CIDs

Since 1986, the FCA has included provisions that permit the U.S. attorney general to issue Civil Investigative Demands (CIDs) to investigate fraud allegations before filing an FCA action or joining a *qui tam* action. In the past, CID issuances were rare because the FCA did not allow the attorney general to delegate authority to issue CIDs and because evidence obtained through a CID generally could not be shared with a relator.

FERA amends the FCA to allow the attorney general to delegate the authority to issue CIDs. FERA also specifies that any information obtained by the attorney general or a designee may be shared with any relator if deemed necessary to the investigation. Also, any information obtained through a CID can now be used in any subsequent investigation or court proceeding.

The DOJ is likely to use CIDs in many cases, particularly because they provide for pre-intervention depositions and interrogatories. Companies receiving CIDs will have had limited time to prepare employees for deposition, while government attorneys will likely have already spent significant time and resources investigating the potential violation. They also may have the benefit of information and evidence provided by a relator.

Given these realities, corporate counsel will need to move quickly to gather information and prepare employees for depositions, as well as seek to extend the time available for preparation.

Preparing for the expanded FCA

Companies receiving federal dollars should consider taking steps to avoid FCA liability, and to prepare for potential actions brought under the FCA.

Understanding your exposure

It is important to identify all circumstances in which your company is receiving federal money, some of which may not be apparent. The potential for liability under the FCA is obvious when a company is serving as a prime contractor or subcontractor on a government project. It is less obvious when the company is performing work for a university laboratory that is receiving federal funds. A careful, companywide review will help determine which lines of business and which projects are subject to the FCA.

Evaluating your compliance profile

Once FCA exposure has been identified, it is important to evaluate how well you are meeting the compliance requirements related to government work. Robust compliance programs need to be in place to address all relevant regulatory, statutory, and contractual requirements. At the same time, advance preparation for the possibility of an FCA action can be beneficial.

Addressing overpayments

The costs of knowingly retaining overpayment can be steep. The FCA mandates the award of treble damages and penalties of up to \$11,000 per violation, costs that can add up quickly. A \$100 overpayment spread over 1,000 invoices — 10 cents per invoice — could result in \$300 in damages and \$11 million in penalties. “Detect, report, and return” overpayments must become watchwords for all companies receiving federal funds, and all such companies will need to ensure they have effective programs in place to make these watchwords a reality.

It's a whole new world — be ready

The changes to the FCA have raised the stakes for companies receiving federal funds. More than ever, companies must take steps to have effective and comprehensive compliance programs in place and to avoid noncompliance with government regulations and contract requirements. Companies must also ensure they are prepared for potential FCA actions by understanding the full breadth of their exposure and aggressively identifying and remedying instances in which they have been overpaid by the government.

This article was first published as *ForThoughts*, the Deloitte Forensic Center's newsletter highlighting the trends and issues in fraud, corruption, and other complex business issues. To subscribe to *ForThoughts*, visit www.deloitte.com/forensiccenter or send an e-mail to dfc@deloitte.com.

Yvonne Craver is a partner in the Forensic & Dispute Services practice of Deloitte Financial Advisory Services LLP. Ms. Craver can be reached at ycraver@deloitte.com.

Peter B. Hutt II is a partner at Akin Gump Strauss Hauer & Feld LLP. In June 2008, he testified before Congress concerning proposed amendments to the False Claims Act. Mr. Hutt can be reached at phutt@akingump.com.

The views expressed in this publication are solely those of the authors and not necessarily those of Deloitte Financial Advisory Services LLP. This publication contains general information only and Deloitte Financial Advisory Services LLP, its affiliates and related entities are not, by means of this publication, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This publication is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. Deloitte Financial Advisory Services LLP, its affiliates and related entities shall not be responsible for any loss sustained by any person who relies on this publication.

Deloitte Forensic Center

The Deloitte Forensic Center is a think tank aimed at exploring new approaches for mitigating the costs, risks and effects of fraud corruption, and other issues facing the global business community.

The Center aims to advance the state of thinking in areas such as fraud and corruption by exploring issues from the perspective of forensic accountants, corporate leaders, and other professionals involved in forensic matters. The Deloitte Forensic Center is sponsored by Deloitte Financial Advisory Services LLP. For more information, visit www.deloitte.com/forensiccenter.

As used in this document, "Deloitte" means Deloitte Financial Advisory Services LLP, a subsidiary of Deloitte LLP. Please see www.deloitte.com/us/about for a detailed description of the legal structure of Deloitte LLP and its subsidiaries. Copyright © 2009 Deloitte Development LLC. All rights reserved.

Member of Deloitte Touche Tohmatsu