A Reduction in the Utility of Civil Investigative Demands and the Interpretive Narrowing of “Person” under the False Claims Act

Executive Summary: False Claims Act actions against government contractors are on the rise. But two recent decisions offer potential limitations to false claims exposure, and may aid defendants in future FCA litigation.

FCA Background

The FCA makes it unlawful for companies to knowingly make false claims for payment to the federal Government. Companies also are prohibited from making false records or statements that are material to receiving payment from the Government. Liability under the FCA arises when companies knowingly make false claims, which may include actual knowledge of the falsity, deliberate ignorance of the falsity, or reckless disregard of the falsity. Claims may be brought by the Government, but often are brought by whistle-blowers (or “relators”) filing qui tam suits.

FCA actions against Government contractors have surged recently. State and federal FCA penalties eclipsed $9 billion in FY2012, more than double the amount recovered the previous fiscal year. The Government’s representatives assert that the “historic figures” recovered through the civil FCA makes it the “government’s most potent civil weapon in addressing fraud against the taxpayers.”

The FCA allows the Government to recover treble damages in addition to statutory penalties, so the value of the claims at issue can escalate quickly. The recent emphasis on enforcement, as reflected in the FY2012 penalties, demonstrates the Government’s aggression in pursuing and prosecuting fraud. Tightened agency budgets have only added to the incentives, forcing contractors to take more steps to avoid even the appearance of fraud or FCA violations.

Two recent cases, however, appear to limit the exposure of companies to the FCA for very different reasons.

Civil Investigative Demands

The FCA’s time frame to issue Civil Investigative Demands is limited to the period before commencing a civil proceeding. A recent verdict in Maryland upholds and clarifies this limitation.

The FCA was amended in 1986 to allow the Justice Department to issue Civil Investigative Demands (“CID”) during FCA investigations but “before commencing a civil

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proceeding” under 31 U.S.C. § 3730(a) or related false claims law.3 The CID requires a person who may possess information relevant to the investigation to produce evidence in the form of documents, written interrogatory responses, or oral testimony. The FCA has since been amended, making it easier to issue CIDs, but none of the amendments changed the time limit governing when CIDs can be used in cases brought or joined by the United States.

A recent case in the District Court of Maryland, United States v. Kernan Hosp., illustrates how clear the requirement to issue CIDs prior to commencing or joining a FCA case is.4 The defendant in Kernan was investigated for, and ultimately faced charges of, an “upcoding” scheme used to increase reimbursements under federal health care programs. The government issued CIDs seeking documents and deposed the hospital’s director of health information management. Based on nearly 20,000 documents and the deposition testimony, the government filed an FCA case against the hospital. The hospital, however, had the case successfully dismissed for failure to state a claim under Rule 9(b) of the Federal Rules of Civil Procedure.

After the complaint was dismissed without prejudice, the government issued new CIDs seeking additional documents. The hospital filed proper motions to set aside the CIDs because § 3733(a)(1), which grants the government the right to issue CIDs, limits issuance of CIDs to that time frame “before commencing a civil proceeding.” The government argued that no suit was actually pending because the complaint had been dismissed and therefore, under the statute, it should be allowed to issue CIDs.

The judge rejected both of the government’s arguments, finding instead that the language in § 3733(a)(1) is clear and does not include instances where the government has filed a complaint, had the complaint dismissed without prejudice, but has yet to file a new complaint. The judge also rejected any policy arguments, citing to the legislative history which supports the notion that while the government can issue CIDs prior to commencing a law suit or joining a qui tam suit, once litigation commences, the Federal Rules of Evidence govern discovery and the remarkable advantage the government enjoys prior to filing dissipates.

“Person” under the False Claims Act

The FCA imposes liability on “any person” who knowingly tries to defraud the government. But state agencies are not considered persons under this law, according to recent rulings.

The FCA is undoubtedly the government’s most powerful tool against federal fraud because it imposes liability on “any person” who knowingly presents a fraudulent claim to the government. The FCA, however, does not define “any person” in the statutory section, leaving that task to the courts. In Vt. Agency of Natural Res. v. United States ex rel. Stevens, 529 U.S.

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3 31 U.S.C. § 3733(a)(1). The statute also requires issuance of the CID prior to making an election under § 3730(b).
765 (2000), the Supreme Court held that a state or state agency is not a “person” for purposes of FCA liability.

Several important federal student aid program cases have arisen. Most recently, *United States, ex rel. Jon H. Oberg v. Pa. Higher Educ. Auth.*, Civil Action No. 01:07-cv-960 (E.D. Va. 2012) involved several entities created by different states for the purpose of generating higher education opportunities for students through federal aid programs. The complaint alleged that defendants submitted fraudulent claims under the Federal Family Education Loan Program in order to obtain 9.5% special allowance payments.

The case was dismissed by the district court because it found that that the entities were state agencies. Subsequently, the United States Court of Appeals for the Fourth Circuit remanded the case and directed the district court to re-examine the issue under the context of the Constitution's Eleventh Amendment “arm-of-the-state” analysis. The Fourth Circuit remanded the case because it had previously ruled that the “arm-of-the-state” framework is the proper test to determine whether an entity is a person under the FCA. Using the “arm of the state” analysis, the United States District Court for the Eastern District of Virginia was required to evaluate four factors to determine whether the defendants were subject to an amount of state control to render them part of the state. The Fourth Circuit's test, aligning it with several other circuit courts of appeal involves these four factors:

1. whether any judgment against the entity as defendant will be paid by the State or whether any recovery by the entity as plaintiff will inure to the benefit of the State; 2. the degree of autonomy exercised by the entity, including such circumstances as who appoints the entity’s directors or officers, who funds the entity, and whether the State retains a veto over the entity’s actions; 3. whether the entity is involved with state concerns as distinct from non-state concerns, including local concerns; and 4. how the entity is treated under state law, such as whether the entity’s relationship with the State is sufficiently close to make the entity an arm of the State.

The entities at issue in *Pa. Higher Educ.* were created by state statutes, acting within the defined powers delineated by the statutes. All of the entities either have funds that are subject to state control, deposit money into the state treasury, or would require a redirection or re-appropriation of funds in order to pay a judgment. The entities were also collectively found to be subject to state control by drawing attention to the agencies’ boards of directors appointed by state officials or statutory language designating the entity as an instrumentality of the state. All of the defendants were also found to exercise their powers to address the states’ concerns for their citizens, rendering each entity heavily involved with state-wide concerns. Finally, all entities were found to have a relationship with the state itself to render them sufficiently close to make them an entity of the respective states.

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6 *Id.* at 580.
For the reasons discussed in the Opinion, the district court dismissed the complaints against each defendant because none were a “person” who may be sued by a *qui tam* relator under the FCA.

If you have any questions about this alert, please contact Womble Carlyle Government Contracts attorneys Jim Kearney, Holly Svetz or Steve Cave.

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