

Government Contracts Advisory

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United States Supreme Court, Congress and DOJ Consider False Claims Act Issues

Over the last week, the Supreme Court, the Senate Judiciary Committee and the Department of Justice all have considered an issue with significant ramifications for the defense industry: whether liability under the False Claims Act (FCA), 31 U.S.C. Section 3729(a)(2), which proscribes knowing false statements made to get a false claim paid or approved by the Government, requires that the false statement cause presentation of a false claim to a Government employee; or conversely, whether a knowing false statement in support of a claim for payment, made by any subtier contractor to the next contracting tier, suffices for FCA liability if the work is paid with "federal funds."

On February 26, 2008, the Supreme Court heard oral argument in *US ex rel Sanders v. Allison Engine Company*, a Southern District of Ohio case brought under the False Claims Act, in which relators alleged that second, third and fourth-tier subcontractors on the Navy's Arleigh Burke destroyer program made false statements in support of a false claim for payment under FCA Section 3729(a)(2). McKenna Long & Aldridge LLP (MLA) and two Cincinnati firms represented Allison, the second-tier subcontractor, in the district court proceedings and during appeal to the Sixth Circuit Court of Appeals. At the Supreme Court, Theodore B. Olson, former United States Solicitor General, supported by MLA, argued for Allison; and the current Assistant to the Solicitor General, Malcolm Stewart, took the laboring oar on behalf of the Government, although the Government chose not to intervene in the action.

One interesting element of the *Allison Engine* case is that the relators did not sue the Navy's prime contractors, Bath Ironworks and Ingalls Shipbuilding, nor did relators offer evidence at trial that the shipyards had made a false claim to the Navy. Instead, relators argued that under FCA Section 3729(a)(2), a subcontractor, at any level, could be held liable if it made a knowing false statement in support of a claim for payment under any contract paid with "federal funds."

After five weeks of trial in Dayton, Ohio, Allison and the other defendants filed a motion for judgment as a matter of law, on the ground that relators had failed to introduce evidence that the allegedly false statements had **caused** the prime contractor shipyards to make a false claim to the Government. In granting that motion, the Hon. Thomas Rose relied on *United States ex rel. Totten v. Bombardier Corp.*, 380 F.3d 488 (D.C. Cir. 2004), authored by then-Judge Roberts, now Chief Justice Roberts. The *Totten* court found that a subcontractor's false statement was not actionable under the FCA unless the false statement somehow caused the prime contractor to present to the Government a false claim for payment or approval.

During oral argument at the Supreme Court, the Justices' questions focused on whether the phrase, "paid or approved by the Government" in Section 3729(a)(2) implies that a claim must be made, by someone, to a government employee; or, conversely, whether Section 3729(a)(2) was intended by Congress to apply broadly to any false statement made in support of a claim for payment where the work done was funded, in whole or in part, by the federal government, however indirectly.

To emphasize this point, Chief Justice Roberts posed the following hypothetical regarding a State which receives a federal grant to build a school. In the hypothetical, the State hires a general contractor, who hires a painter, who buys paint from a paint company, who obtains chemicals for the paint from a

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chemical manufacturer, and the chemical manufacturer falsely inflates his price. Chief Justice Roberts asked Mr. Steward whether, in the Government's view, the chemical manufacturer would be liable under 3729 (a)(2). The Government's position was, yes, because the chemical manufacturer made a false claim, he was paid with funds that trickled down from the Government, and the Government's monies were not used for their intended purpose. Defendants' position was, perhaps the chemical manufacturer would be liable -- but before one reached that decision under 3729(a)(2), the plaintiff would have to show that the chemical manufacturer made a false statement about its product that actually caused a false claim for payment to be submitted for payment or approval by the Government. In other words, the plaintiff has to show a **factual nexus** between the subcontractor's false statement, and the presentation to the Government of a false claim based upon that false statement, before liability could attach under Section 3729(a)(2). Questioning by the Justices was vigorous on both sides of the issue, and a decision is expected before the end of June 2008 .

A second interesting development occurred on February 21, 2008, when the Department of Justice conveyed its views on Senate Bill 2041, the proposed False Claims Correction Act of 2007 to the Senate Judiciary Committee. That legislation is intended to eliminate the presentation requirement that *Totten* and other circuits have found is a prerequisite to liability under FCA Section 3729 (a)(2). Under the Senate bill, section (a)(2) would be revised to impose liability on any person who uses a false statement or record to get a false or fraudulent claim **for government money or property**. The statute defines "government money" as including any money that the government "provides, has provided, or will reimburse" to a contractor or grantee, "to be spent or used on the government's behalf or to advance government programs." The bill would exponentially expand the scope of the FCA, to permit lawsuits under the FCA against virtually any recipient of federal funds who is alleged to have made a false statement in support of a claim for payment.

The Department of Justice told the Senate Judiciary Committee that the Administration was "sympathetic to some of the proposed improvements," but that the Administration "cannot support the current version of the bill." With regard to the presentment issue, DOJ said that "the new definition of government money or property" is "unclear and may engender significant litigation;" and that "the FCA in its present form has worked well and there is no pressing need for major amendments." DOJ concluded that, "Although the Department has argued that the *Totten* and *Custer Battles* decisions were wrongly decided, the Department does not advocate, and would not support, application of the FCA to all acts of fraud directed at any entity that receives money from the United States."

On February 27, 2008, the Committee held a hearing attended by Sens. Grassley, Specter, Durbin and Leahy. Michael Hertz, Deputy Assistant Attorney General, Civil Division, stated that while the Department of Justice agreed that *Totten* and *Custer Battles* were "wrongly decided," DOJ would prefer to await the Supreme Court's decision in the *Sanders* case before Congress undertook to amend the FCA. Senator Grassley responded, "I've learned not to hold my breath when it comes to False Claims Act actions before the Supreme Court."

Mr. Hertz expressed two particular concerns about S. 2041. First, he said that the bill's definitions of "administrative beneficiary" and "Government money or property" were too vague and potentially too broad. He noted that DOJ has had "pretty good luck finding other avenues to go after fraud" caused by false statements under the existing statute, even in situations where there has been no presentation of a false claim to the Government itself . The Department of Justice's position was echoed by Jack Boese, appearing on behalf of the United States Chamber of Commerce, who reminded the Committee that of the \$20 billion recovered by the Government under the FCA since the FCA was amended in 1986, only 1.4% has been recovered in cases in which DOJ declined intervention.

Second, Mr. Hertz expressed strong concern that permitting government employees such as auditors and investigators to file *qui tam* suits, for private gain, based upon information obtained during the course of their official duties, would erode public trust and confidence in public officials. When questioned by Senator Durbin on this issue, Mr. Hertz stated that, unlike the first-hand knowledge of fraud that corporate whistleblowers often have, government employees typically have only "second-hand knowledge" or "derivative knowledge." Mr. Hertz suggested that conflict of interest issues, including current ethics regulations applicable to government employees, outweighed any practical benefit to the Government in permitting government employees to be *qui tam* relators. Mr. Hertz dismissed the bill's one-year cooling-off period for such suits as "illusory and impractical."

Mr. Hertz did unequivocally express support for the bill's proposed elimination of the Attorney General as gatekeeper for civil investigative demands under the FCA, and stated that the ability of investigating government attorneys to subpoena witnesses and compel depositions without first getting the AG's

approval would have a positive effect on DOJ's efficiency in clearing its backlog of nearly 1,000 sealed *qui tam* suits.

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