Portfolio Media. Inc. | 860 Broadway, 6th Floor | New York, NY 10003 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

When The Government Knows Too Much For Its Own Good

Law360, New York (September 9, 2011) -- Liability under the federal False Claims Act ("FCA") (31 U.S.C. §§ 3729 et seq.) hinges upon the "knowing" submission of a false or fraudulent claim, which means that the person presenting or causing presentation of the claim "(i) has actual knowledge of the information; (ii) acts in deliberate ignorance of the truth or falsity of the information; or (iii) acts in reckless disregard of the truth or falsity of the information." 31 U.S.C. §3729(b).

But what happens when the government has advance knowledge of all the elements of a claim that renders it false and invites submission of the claim anyway? Would presenting that claim to the government still be deemed a "knowing" submission of a false claim creating liability under the statute? That dilemma is the rationale for the "government knowledge inference" — also referred to by the misnomer "government knowledge defense" — and why facts sufficient to trigger the inference can serve to negate the mental state required for liability under the FCA.

Before the FCA was amended in 1986, the statute provided that a relator could not pursue a qui tam action if the government was already in possession of the evidence or information forming the basis of the allegations in the complaint.[1] That jurisdictional bar was eliminated in the 1986 amendments. Today, the FCA is principally concerned only with certain qualifying "public disclosures" of information that can result in dismissal of the action unless the relator is deemed to be an "original source" of the information as defined in the statute.[2] Even absent such "public disclosures," however, government knowledge of facts underlying a false claim remains relevant to whether an action under the FCA may be successfully maintained.

There is wide agreement in the case law that prior government knowledge of the facts underlying a false claim, together with other government conduct implicitly or explicitly approving submission of the claim, can negate the scienter required for an FCA violation. While often referred to as the "government knowledge defense," it is not, in actuality, an affirmative defense to an FCA action, but rather refers to factual circumstances that impede the government's ability to carry its burden of proving a "knowing" submission of a false claim.

Application of the rule is sui generis, and is predicated on the unique facts of a given case that can give rise to an inference that, due to specific government knowledge and behavior, a defendant's submission of an allegedly false or fraudulent claim cannot be deemed "knowing" under the statute.[3] As explained by the Tenth Circuit in United States ex rel. Burlbaw v. Orenduff, 548 F.3d 931, 951-952 (10th Cir. 2008):

"The 'government knowledge inference' helps distinguish, in FCA cases, between the submission of a false claim and the knowing submission of a false claim — that is, between the presence and absence of scienter. ... This inference arises when the government knows and approves of the facts underlying an allegedly false claim prior to presentment. ... The classic example is when the government, with knowledge of the facts underlying an allegedly false claim, authorizes the contractor to make that claim. ... In such a situation, an inference arises that the contractor has not 'knowingly' presented a fraudulent or false claim.

Orenduff involved allegations that past administrators of New Mexico State University had falsely certified that the university was a minority institution eligible for U.S. Department of Defense contract grants. The Tenth Circuit applied the inference to facts showing that the defendant had relied upon government "assurances and invitations in certifying NMSU as a minority institution" and that, therefore, both "governmental knowledge and governmental cooperation [in the submitted claims were] present." Id. at 953.

Other federal courts around the country likewise have recognized that the government's advance knowledge and approval of the particulars underlying an allegedly false or fraudulent claim can negate liability under the FCA.[4] The law is still evolving regarding "who" within the government must possess such prior knowledge, but a recent appellate decision in the Fourth Circuit suggests that application of the inference does not require that the government employees with knowledge be from the same agency that pays the claims or oversees the contracts under which claims are submitted.[5]

A government knowledge inference is not appropriate, however, where a defendant is not "'forthcoming' with the government about the contractual failures and billing inflations that formed the basis for the false claims."[6] Further, as the cited cases illustrate, a government knowledge inference is not justified by facts reflecting only government knowledge of falsity,[7] without additional evidence reflecting open communication with the defendant concerning the specifics of the claim,[8] or indicating that the government in some way invited or provided advance approval to the allegedly false particulars underlying the claim submission.[9]

In other words, application of a government knowledge inference requires government knowledge of falsity plus other facts showing that the government in some way orchestrated or was otherwise responsible for the claim submission, either through explicit directions or through other conduct from which the defendant could have reasonably believed that the government approved the very elements of the claim alleged to be false.

The case of United States v. Guy, 257 Fed. Appx. 965, 2007 (6th Cir. 2007) is instructive. In Guy, the United States initiated a FCA lawsuit against the defendant, a medical record transcription monitor employed by the U.S. Department of Veterans Affairs, seeking damages based on false claims for overtime compensation. The defendant had claimed, over a four-month period, to have worked 739.5 hours of regular time and 1,223 hours of overtime, and her time sheets showed that she was averaging 17-hour days during the week and 14-hour days on the weekend.

An internal investigation by the VA, however, revealed that the defendant had only worked 325 overtime hours over this period. A jury found for the government, and defendant appealed, arguing that her supervisors had known of her irregular work schedule, that this fact negated scienter under the FCA and that the district court erred in not instructing the jury on the government knowledge inference. The Sixth Circuit disagreed, stating:

"Government knowledge may negate scienter under the FCA where it is used 'to demonstrate that what the defendant submitted was not actually false but rather conformed to a modified agreement with the Government.' United States ex rel. A+ Homecare Inc. v. Medshares Mgmt. Group Inc., 400 F. 3d 428, 454 n.21 (6th Cir. 2005). Guy contends that her supervisors' knowledge of her irregular work schedule is sufficient to negate scienter under the FCA, but knowledge of her irregular schedule does not equate with knowledge that she claimed overtime for hours not actually worked. Because Guy could not reasonably believe the Government had agreed to pay her overtime compensation for hours she did not work, the 'government knowledge' defense is inapplicable in this case." Guy, 257 Fed. Appx. at 968, 2007 at **3.

The court in United States v. Menominee Tribal Enterprises, 601 F. Supp. 2d 1061 (E.D. Wis. 2009) applied similar reasoning in rejecting application of a government knowledge inference in an action under the FCA brought by the United States against Menominee Tribal Enterprises ("MTE"), the business arm of the Menominee Tribe of Wisconsin, and two of its employees. The government alleged that the defendants had submitted invoices to the Bureau of Indian Affairs ("BIA") seeking payment for work that was not actually performed. Specifically, MTE submitted various invoices to the BIA seeking payment for road grading and for clearing flammable trees and brush as part of a fire prevention project.

When the BIA became concerned that the work had not been performed and MTE could not provide supporting documentation, MTE indicated that the invoices would be canceled and resubmitted. At one point, a BIA official had even drafted an internal memo requesting advice on how to proceed with the "fraudulent billings" that MTE had submitted. Around the same time, the BIA implemented a new policy requiring that invoices be signed by a responsible tribal official certifying that the invoices accurately reflected the expenditures on the project.

The MTE invoices were eventually resubmitted with the required certifications, but field inspections conducted by the BIA confirmed that much of the work described in the resubmitted invoices had either not been performed at all or had been performed incompletely. As a result of the inspections, most of the invoices were not paid. The government sought damages under the FCA for the paid invoices.

The defendants argued that the government knew that the invoices were false before they were presented and had adopted the new certification policy with MTE's invoices in mind, hoping that the new certification policy would result in corrected invoices or a decision not to file them at all, neither of which ultimately occurred. When the invoices were resubmitted containing the same false information, the defendants argued the BIA was "on notice that they were false." Id. at 1073. The court rejected this argument and refused to apply a government knowledge inference:

"MTE relies on United States ex rel. Durcholz v. FKW Inc., 189 F.3d 542 (7th Cir. 1999). But that case does not hold that advance Government knowledge of falsity somehow renders that invoice true or insulates the defendant from liability. In Durcholz, a government agency needed a contract performed quickly. In order to fast-track the process, Government officials instructed bidders to bid using excavation line-items in their bids when in fact everyone knew the project was expected to be a dredging project. ... Under such unique circumstances, it would be impossible to claim the Government was defrauded by the very actions it orchestrated. This narrow exception is not applicable here. Even if ... BIA officials suspected certain of MTE's invoices were false, they did not encourage or order [MTE] to resubmit the invoices with that false data. It was not their idea to submit invoices with false amounts of work performed. In fact, according to MTE itself, the new certification rule was implemented specifically with a view towards discouraging MTE from submitting the invoices with the false data. ...In short, even if the BIA officials suspected or knew certain information was false, that does not preclude applicability of the FCA." Menominee Tribal Enterprises, 601 F. Supp. 2d 1073-74.

Notwithstanding that the rule is triggered by particular evidentiary circumstances, even the potential availability of a government knowledge inference is a powerful weapon that can deter the government from proceeding with an investigation. Given competing investigative priorities that can drain limited resources, the government is far less likely to initiate an investigation of a whistleblower's claim if it believes that, down the road, it may be vulnerable to an argument that the government's knowledge and course of conduct support a government knowledge inference negating the scienter required for liability under the FCA.

Moreover, the government may wish to avoid a contretemps over facts revealing prior knowledge of, and acquiescence in, an alleged fraud that could create significant embarrassment and public scrutiny regarding the activities of government officials. Accordingly, where the facts are favorable enough to support even a colorable argument in support of the inference, companies targeted by the government would do well to wield that argument like a club in an effort to nip an incipient investigation in the bud or to secure a more favorable resolution. The bottom line is that even if the government does not to agree with the defense argument, it still may not be willing to test its own interpretation of the facts in court, and may be forced to factor the risk of losing the argument into how it approaches the case.

--By Geoffrey R. Kaiser, Anderson Kill & Olick PC

Geoffrey Kaiser is a shareholder in Anderson Kill's New York office, a member of the firm's corporate and commercial litigation practice group and the former chief of health care fraud prosecutions in the United States Attorney's Office for the Eastern District of New York. His practice concentrates in business frauds, internal investigations, white collar crime, the False Claims Act, health care fraud and anti-counterfeiting, and brand protection. He can be reached at (212) 278-1806 or gkaiser@andersonkill.com.

The opinions expressed are those of the author and do not necessarily reflect the views of the firm, its clients, or Portfolio Media, publisher of Law360. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

[1] 31 U.S.C. § 232(C) (1976); 31 U.S.C. § 3730(b)(4) (1982); see Discussion of legislative history in United States v. Southland Management Corp., 288 F. 3d 665, 685 n. 23 (5th Cir. 2002);United States ex rel. Lujan v. Hughes Aircraft Co., 243 F.3d 1181, 1184 n.3 (9th Cir. 2001); United States ex rel. Shaw v. AAA Engineering & Drafting Inc., 213 F.3d 519, 534 (10th Cir. 2000); and United States ex rel. Butler v. Hughes Helicopters Inc., 71 F.3d 321, 326 (9th Cir. 1995).

[2] 31 U.S.C. § 3730(e)(4)(B).

[3] Liquidating Trustee Ester Duval of KI Liquidation Inc. v. United States, 89 Fed. Cl. 29, 41 n.11 (2009) ("To be more precise, the 'government knowledge defense' is not a defense after the 1986 amendment of the FCA; knowledge and its effect on [the government's] ability to prove fraud under the FCA is an inquiry (often treated as an inference) that is made on a case-by-case basis.")

[4] See, e.g., United States ex rel. Becker v. Westinghouse Savannah River Company, 305 F.3d 284, 289 (4th Cir. 2002) (relator alleged that contractor operating federally-owned nuclear installation spent government funds for unauthorized purpose and concealed fact with false records; court applied government knowledge inference because contractor followed instructions of the U.S. Department of Energy and "DOE's full knowledge of the material facts underlying any representation implicit in Westinghouse's conduct" negated contractor's scienter), cert. denied, 538 U.S. 1012 (2003); United States ex rel. Shaw v. AAA Engineering & Drafting Inc., 213 F.3d 519, 534 (10th Cir. 2000) (There may be occasions "when the government's knowledge of or cooperation with a contractor's actions is so extensive that the contractor could not as a matter of law posses the requisite state of mind to be liable under the FCA."); United States ex rel. Durcholz v. FKW Inc., 189 F.3d 542, 545 (7th Cir. 1999) (relator alleged fraud in government dredging project and court applied government knowledge inference where contractor followed government's instructions in submitting claim; "If the government knows and approves of the particulars of a claim for payment before that claim is presented a presenter cannot be said to have knowingly presented a fraudulent or false claim. ... We decline to hold FKW liable for defrauding the government by following the government's explicit directions."); United States ex rel. Butler v. Hughes Helicopters Inc., 71 F.3d 321, 327 (9th Cir. 1995) ("[I]f the district court correctly found that the only reasonable conclusion a jury could draw from the evidence was that [the contractor] and the Army had so completely cooperated and shared all information during the testing that [the contractor] did not 'knowingly' submit false claims, then we must affirm the directed verdict.") (citing United States ex rel. Hagood v. Sonoma County Water Agency, 929 F.2d 1416 (9th Cir. 1991) and Wang v. FMC Corp., 975 F.2d 1412 (9th Cir. 1992)); United States ex rel. Kriendler & Kreindler v. United Technologies Corp., 985 F.2d 1148, 1156-57 (2d Cir.) (Recognizing that "government knowledge may be relevant to a defendant's liability" where a contractor "'has fully disclosed all information to the government'" and "government officials knew of the contractor's actions"), cert. denied, 508 U.S. 973 (1993); In re Pharmaceutical Industry Average Wholesale Price Litigation, 685 F. Supp. 2d 186, 205 (D. Mass. 2010) ("To prevail on a government knowledge defense, Defendants must produce admissible evidence that New York or its agencies knew the actual true facts, and that they ordered, asked for, approved, or decided as a policy matter to acquiesce in the Defendant's reporting of false prices."); United States ex rel. Longhi v. Lithium Power Technologies, 513 F. Supp. 2d 866, 883-884 (S.D. Tex. 2007) (where relator alleged that defendant had misrepresented its prior experience in contract proposals, court acknowledged that government knowledge could sometimes negate scienter but held that inference did not apply since defendant was required to show that "the government not only knew about the Army Phase I & II proposal, but that it directed [contractor] to disregard the solicitation instructions and not disclose the prior related work.").

[5] United States ex rel. Ubl v. IIF Data Solutions, 2011 at *6 (4th Cir. 2011) (holding that knowledge of National Guard Bureau, which worked closely with contractor on task orders issued under government contracts, was relevant to contractor's intent even though contracts were awarded by General Service Administration ("GSA") and GSA paid claims; "We see no reason why the government's knowledge would become irrelevant simply because the employees with the knowledge do not work for the particular agency that happens to pay the contractor's invoices.")

[6] Ordenduff, 548 F. 3d at 953 (citing AAA Engineering & Drafting Inc., 213 F.3d at 534, in which court refused to apply government knowledge inference, noting that plaintiff and not contractor told government about failure to perform contract requiring removal of silver from film solution and that "[defendant] was not forthcoming about silver recovery and repeatedly evaded government employees' questions on the subject").

[7] See United Technologies Corp., 985 F.2d at 1156 (emphasizing that "the statutory basis for an FCA claim is the defendant's knowledge of the falsity of its claim ... which is not automatically exonerated by any overlapping knowledge by government officials."); United States ex rel. Hagood v. Sonoma County Water Agency, 929 F.2d 1416, 1421 (9th Cir. 1991) ("That a defendant has disclosed all the underlying facts to the government may ... show that the defendant had no intent to deceive. But what constitutes the offense is not intent to deceive but knowing presentation of a claim that is either 'fraudulent' or simply 'false.' ... The requisite intent is the knowing presentation of what is known to be false. That the relevant government officials know of the falsity is not in itself a defense.").

[8] See United States ex rel. Costner v. URS Consultants Inc. et al., 317 F.3d 883, 888 (8th Cir.) ("A contractor that is open with the government regarding problems and limitations and engages in a cooperative effort with the government to find a solution lacks the intent required by the Act.") (citing United States ex rel. Butler v. Hughes Helicopters Inc., 71 F.3d 321, 327 (9th Cir. 1995)), cert. denied, 540 U.S. 875 (2003); Wang v. FMC Corp., 975 F.2d 1412, 1421 (9th Cir. 1992) (rejecting FCA claim against defense contractor based on internal memo acknowledging that engineering work was faulty and of low quality; "The memorandum relied on by Wang was part of a dialogue with the army. The government knew of all the deficiencies identified by Wang, and discussed them with FMC. The fact that the government knew of FMC's mistakes and limitations, and that FMC was open with the government about them, suggests that while FMC might have been groping for solutions, it was not cheating the government in the effort.").

[9] Orenduff, 548 F.3d at 951-52; United States v. Guy, 2007 at **3 (6th Cir. 2007); FKW Inc., 189 F.3d at 545; United States v. Menominee Tribal Enterprises, 601 F. Supp. 2d 1061, 1073-74 (E.D. Wis. 2009); Lithium Power Technologies, 513 F. Supp. 2d at 884.

All Content © 2003-2011, Portfolio Media, Inc.