Bloomberg BNA

BNA's
Health Care Fraud Report™

Subcontractor Liability Under the False Claims Act: Congress and the Sixth Circuit Establish Clarity

BY JAMES B. HELMER JR. AND ROBERT M. RICE

While the proper scope of liability under the False Claims Act has been continually litigated over the years, two recent restrictions on government subcontractor liability lived very short lives: (1) The requirement that subcontractor false claims must be ''presented'' to a government employee in order to trigger False Claims Act liability; and (2) The need for proof that a subcontractor ''intended'' that its fraudulent conduct would be used by a prime contractor to get payment from the government.

The first restriction came in 2004 from the District of Columbia Circuit, but within a mere four years the U.S. Supreme Court unanimously rejected the ''presentment'' requirement (following a U.S. Court of Appeals for the Sixth Circuit decision holding likewise).

The second restriction came from the Supreme Court's ''presentment'' opinion itself—in which the court set the new ''intent'' standard for subcontractor liability—but Congress acted in less than a year to amend the statute and clarify that neither subcontractor ''presentment'' nor ''intent'' is required. And Congress went further.

Helmer is senior partner and president of Helmer, Martins, Rice & Popham Co. LPA in Cincinnati. He has represented whistleblowers in False Claims Act cases for 30 years and is the author of False Claims Act: Whistleblower Litigation (6th ed. BNA 2012). Rice is a partner at Helmer, Martins, Rice & Popham and has represented False Claims Act whistleblowers for nearly 14 years.

To avoid any application of the Supreme Court's new ''intent'' standard, Congress applied the amendments retroactively on that issue by having them take effect two days before the Supreme Court's decision.

Despite this congressional clarity, though, the Supreme Court's ''intent'' standard for subcontractor liability has not been completely nullified. This is because two challenges to the retroactivity of the False Claims Act amendments have been raised with limited success.

First, as a matter of statutory construction, courts have split over whether Congress meant the retroactive provisions to apply to all False Claims Act *cases* that were pending before the Supreme Court's decision, or whether they apply only to pending *claims for payment*.

Second, as a constitutional matter, one trial court decided that the False Claims Act is a ''punitive'' statute and, therefore, retroactive application of any amendments would violate the *ex post facto* clause of the Constitution.

On these two issues, the Sixth Circuit is the only appellate court to have analyzed them in detail. And the Sixth Circuit upheld retroactive application for all pending False Claims Act cases.

Soon the Supreme Court will be asked to resolve the retroactivity issue. But if it does not, or if it disagrees with the Sixth Circuit, the ''intent'' standard for subcontractor False Claims Act liability may yet have limited application.

This article tracks the brief history of the issue and describes the potential reach of the new ''intent'' standard.

Restricting FCA Subcontractor Liability Begins With 'Presentment' Issue

Prior to 2004, no court had ever held that a government subcontractor's false claims had to be ''presented'' to a government employee to trigger False Claims Act liability, but a split panel of the U.S. District Court for the District of Columbia Circuit, in an opinion authored by then-Circuit Judge John G. Roberts, announced such a restriction in *United States ex rel. Totten v. Bombardier Corp.*, 380 F.3d 488 (D.C. Cir. 2004).

Totten involved false claims submitted to Amtrak by two companies for defective rail cars. Amtrak paid the false claims, at least in part, with federal funds that Amtrak received in annual block-grants from the gov-

 ISSN 1092-1079

ernment. Amtrak submitted no claim of its own to the government for the defective rail cars, and Amtrak did not re-submit the contractor claims to the government.

According to the majority opinion in *Totten*, since the false claims at issue were not submitted directly to a government employee, the subcontractor claims could not support FCA liability under any provision of the Act.

To arrive at this decision, the *Totten* majority relied only on its reading of the ''plain text'' of the statute. Specifically, Section (a)(1) of the FCA (prior to the 2009 amendments) involved liability for ''presenting'' false claims to a government employee. Section (a)(2), in contrast, contained no ''presentment'' language, instead, basing liability on using false records or statements ''to get'' false claims paid ''by the government.''

For the *Totten* majority, though, a ''presentment'' requirement had to be inferred in Section (a)(2) because the court felt that claims for payment could not be paid ''by the government'' unless those invoices are physically handed (''presented'') to a government employee.

Thus did *Totten* establish a blanket ''presentment'' requirement throughout the FCA.

Two years later, the Sixth Circuit specifically considered and rejected the *Totten* logic in *United States ex rel. Sanders v. Allison Engine Co.*, 471 F.3d 610 (6th Cir. 2006). *Sanders* (which is being prosecuted by the authors of this article) involved allegations that four companies working as subcontractors in the manufacture of the United States Navy's new fleet of *Arleigh Burke* class destroyers made false claims for shoddy workmanship in making the electric generators for the ships.

Although all money paid to these defendants for their work came from the Navy, the defendants did not send their invoices directly to the Navy. Instead, the defendants' claims for payment were submitted up the subcontract chain, reaching no higher than the prime contractor shipyards.

Under *Totten*, such invoices could not trigger FCA liability. The *Sanders* District Court decided to follow the *Totten* logic. The U.S. Court of Appeals for the Sixth Circuit Sixth Circuit disagreed.

While the Sixth Circuit agreed that ''presentment'' of false claims to the government was the explicit basis for liability under Section (a)(1) of the FCA, the Sixth Circuit held that adding a blanket ''presentment'' requirement in the FCA sections where there was no explicit requirement improperly restricted subcontractor liability.

Noting first that congressional intent and Supreme Court precedent called for a broad construction of the Act to effectuate its remedial purpose, the Sixth Circuit then held that the Act's explicit and unique definition of actionable false ''claims'' was dispositive.

For purposes of liability, the FCA defined false ''claims'' as ''any request or demand . . . for money or property which is made to a contractor, grantee or other recipient . . . if the United States Government provides any portion of the money . . . which is requested or demanded.''

For the Sixth Circuit, that definition was inconsistent with a requirement that a subcontractor's invoices had to be given to a government employee. It was enough, instead, to show that such invoices were paid with ''government funds.''

Supreme Court Adds a New 'Intent' Standard

With a clear circuit split, the Supreme Court granted *certiorari* to resolve the ''presentment'' issue. In *Allison Engine Co. v. United States ex rel. Sanders*, 533 U.S. 662 (2008), the court (including Chief Justice Roberts) rejected the *Totten* logic and unanimously agreed with the Sixth Circuit—''presentment'' of false claims to a government employee is an element only in Section (a)(1) of the Act and not a blanket requirement for subcontractor liability under other sections.

But the Supreme Court expressed concern about the Sixth Circuit's broad construction of the Act as reaching all fraudulent efforts to obtain ''government funds.''

Without identifying any examples, the court said it thought the Act might somehow be misused to redress private fraud among private entities rather than fraud against the public fisc —that perhaps the FCA would be implicated solely because a private entity had received some money that had originated in the U.S. Treasury.

So, the court addressed its illusory concern.

The Supreme Court determined that it needed to protect the FCA from ''private'' abuse by establishing a new element of liability to ensure that there was an appropriate ''relationship'' between the fraud and the payment decisions of the government.

However, since neither the Act's legislative history nor any judicial precedent shared or addressed the Supreme Court's concern regarding ''private'' abuse of the Act, the Supreme Court was forced to create its new standard without guidance. Section (a)(2), the court noted, concerned liability for those who make false records and false statements ''to get'' false claims paid by the government.

For the court, this ''to get'' language was the vehicle to establish a new standard: A person who wants ''to get'' a false claim paid by the government must have a specific ''intent'' that the government actually pay the claim, rather than a private entity making the payment decision.

Thus, the court decided that subcontractors who do not ''present'' false claims directly to a government employee can still be liable if they make false records or statements that they ''intend'' the prime contractor to use to get payments from the government. No further clarification, nor examples of such ''intent,'' was given.

Accordingly, the Supreme Court vacated the Sixth Circuit opinion, thus allowing the *Sanders* Relators to demonstrate upon remand that the defendants did, in fact, intend their false records and statements to affect payment by the government.

Congress Legislatively Overrules the Supreme Court

Congress acted quickly (and overwhelmingly) to overrule the Supreme Court's addition of an ''intent'' requirement into Section (a)(2) of the FCA. As part of the Fraud Enforcement and Recovery Act of 2009 (''FERA''), Congress amended the False Claims Act to clarify that FCA was always intended to reach false claims for government funds notwithstanding the ''intent'' of the false claimant.

With FERA, Congress rejected the Supreme Court's new interpretation of the False Claims Act as against the text and legislative history. Congress essentially

  HFRA ISSN 1092-1079

clarified that the Sixth Circuit's interpretation of the FCA, and not the Supreme Court's, was correct.

In addition to correcting the Supreme Court, Congress also determined to eliminate the impact of the opinion. Congress decided that its clarifications to Section (a)(2)—that false claims for government funds are actionable without regard for a defendant's ''intent''—would be retroactive and effective as though enacted two days *before* the Supreme Court's decision.

This retroactivity would ''apply to all claims under the False Claims Act'' pending on that date. Quite obviously, then, Congress meant for the ''intent'' requirement in that opinion to have no impact on any False Claims Act case ever. Despite this clarity, though, some courts have refused to apply FERA's clarifications to False Claims Act Section (a)(2) retroactively.

There are two reasons for this refusal.

First, for nearly all the courts that have decided not to apply the retroactivity provision, this issue has been statutory construction. They say that Congress did not intend that the Section (a)(2) clarifications should apply to all False Claims Act litigation that was pending two days before the Supreme Court's decision, even though this is the language used in FERA.

Instead, these courts have looked at the operative language—that retroactivity is for ''claims under the False Claims Act''—and decided that the word ''claims'' does not mean *civil causes of action* under the False Claims Act. Instead, these courts have borrowed the unique definition of ''claim'' found in the liability section of the False Claims Act (which means ''claim for payment'') and applied it to FERA's retroactivity provision.

Thus, these courts say that retroactivity applies only to *claims for payment* that were pending with the government two days before the Supreme Court's opinion. Of course, ''claims'' for payment ''under the False Claims Act'' makes no sense because claims for payment of federal funds are made pursuant to a contract or some other appropriations vehicle—not ''under the False Claims Act.''

Second, as an alternative to the statutory construction issue, one court—the trial court in the *Sanders* litigation after it was remanded from the Supreme Court—decided that no matter how Congress meant the retroactivity provision to apply, Congress was powerless to enact *any* such provision. According to this court, the civil False Claims Act is a ''punitive'' statute, and retroactive application of a ''punitive'' statute is ineffective because it violates the *ex post facto* clause of the Constitution.

In contrast to these courts, many others have reached the opposite conclusion and applied the retroactivity provisions to pending False Claims Act cases. These courts have read the phrase ''claims under the False Claims Act'' as it is naturally understood—that it means retroactivity applies to False Claims Act *lawsuits* pending two days before the Supreme Court's decision.

These courts find no justification to borrow a unique definition of ''claim'' from an entirely different statutory provision enacted by a different Congress many years earlier.

Finally, these courts have seen no basis to pass on the constitutionality of the retroactivity provision.

There is thus a divided view of the FERA retroactivity provision. As a result, whether the Supreme Court's new ''intent'' standard for subcontractor liability is applicable to any individual cases depends entirely on location.

Helpfully, the Sixth Circuit—in the most thorough analysis to date by any court—recently addressed (and canvassed the divergent decisions for) both the statutory construction and constitutional issues.

Sixth Circuit Provides Comprehensive Guidance on Retroactivity

In its recent decision, the Sixth Circuit set forth the legal framework governing both the statutory construction and constitutional issues (*United States ex rel. Sanders v. Allison Engine Co.*, 703 F.3d 930 (6th Cir. 2012)).

For statutory construction, the court found that the FERA text was entirely straightforward: Claims pending ''under the False Claims Act'' plainly refers to a civil litigation claim brought pursuant to the identified federal statute. It does not refer to an invoice submitted by a federal contractor to the government ''for payment.''

Indeed, claims submitted for payment to the government are not submitted ''under the False Claims Act.'' They are submitted ''for payment'' under the terms of their respective contracts and subcontracts. The term ''claim,'' of course, is a commonly used term throughout the Federal Rules of Civil Procedure to refer to a civil cause of action.

The Sixth Circuit next considered and rejected the conclusion by other courts that the word ''claim'' in the FERA retroactivity provision must have the same unique meaning that it has in the liability provisions of the False Claims Act.

Again, the False Claims Act defines ''claim'' as a request for government funds or property, but hat unique definition is explicitly limited in its application to the False Claims Act's liability provisions. (''Definitions. *For purposes of this section . . . the term 'claim' . . . means. . .*'').

Since the retroactivity provisions of FERA are not part of those liability provisions, the unique definition of ''claim'' is inapplicable, and the Sixth Circuit further noted that the word ''claim'' is used in other sections of the False Claims Act to mean civil legal claim, not claim for payment.

So, the conclusion was clear: Congress used the word ''claim'' interchangeably with ''claim for relief'' or legal ''case'' throughout the False Claims Act, except in the liability provisions—where a unique definition was mandated.

Turning next to the constitutional challenge, the Sixth Circuit carefully addressed the legal framework for deciding whether a federal civil statute should be considered ''punitive'' or ''remedial.''

If the former, then retroactive application of its provisions would violate the *ex post facto* clause of the Constitution, which prohibits Congress from enacting laws that punish conduct that was not punishable at the time it was committed. A remedial statute, though, is not punishment and can be applied retroactively.

As the Sixth Circuit noted, there is a two-step inquiry: First, the court needed to determine if Congress meant for the False Claims Act to establish a civil, rather than criminal, scheme. Clearly, the False Claims Act is a civil statute.

Second, notwithstanding Congress's stated civil intent, retroactive application can still violate the *ex post facto* clause if the civil statute is so ''punitive'' in either purpose or effect as to negate congressional intent. On this score, the Sixth Circuit rejected the notion that the civil False Claims Act has such a ''punitive'' character.

The factors considered by the court are well-developed in the case law: ''[w]hether the sanction involves an affirmative disability or restraint, whether it has historically been regarded as a punishment, whether it comes into play only on a finding of scienter, whether its operation will promote the traditional aims of punishment—retribution and deterrence, whether the behavior to which it applies is already a crime, whether an alternative purpose to which it may rationally be connected is assignable for it, and whether it appears excessive in relation to the alternative purpose assigned.''

The Sixth Circuit found that, while not all of these factors weighed in favor of treating the False Claims Act as remedial, the ''balance'' clearly did:

- The False Claims Act does not involve any form or disability or restraint that in the form of classic criminal punishments such as imprisonment;
- Historically, the imposition of monetary sanctions alone has not been viewed as a classic form of ''punishment'';
- The False Claims Act does involve proof of scienter, but the types of ''knowing'' conduct are lower forms of mens rea than criminal statutes;
- While the False Claims Act does have a deterrence aspect, such a purpose serves civil as well as criminal goals;
- The behavior targeted by the False Claims Act is also subject to criminal penalties, but the civil scheme covers more (non-criminal) conduct;
- The sanctions contained in the False Claims Act do serve an alternative and decidedly remedial purpose, as the Supreme Court has consistently held;
- Though the False Claims Act does provide for trebling damages, this does not necessarily mean they are excessive in individual cases.

In short, the Sixth Circuit refused to override the explicitly civil nature of the False Claims Act statutory scheme. As such, retroactive application of the FERA amendments, which Congress clearly intended, is appropriate. The court's decision in this regard stands uncontested—no other court, beyond the trial court in *Sanders*, has refused to apply the FERA amendments retroactively based upon the *ex post facto* clause.

Conclusion

The foregoing recent history regarding government subcontractor liability under the False Claims Act makes two things clear.

First, there is no requirement in any jurisdiction that subcontractor false claims must be ''presented'' to a government employee to face False Claims Act liability.

Second, some jurisdictions will require proof of the Supreme Court's new ''intent'' standard for claims brought under Section (a)(2) of the False Claims Act—that the subcontractor ''intended'' their false records or statements would be used by the prime contractor to affect the government's payment decision.

In this second category, though, the types of cases implicated will be narrow. Assuming the jurisdiction requires such a showing, the ''intent'' standard will apply only to subcontractor cases filed before the FERA amendments and will become an issue only if there is no ''presentment'' of the false claims to the government—conduct that is covered under Section (a)(1).

Ultimately, then, the lifespan of the ''intent'' standard will be quite short.

Of course, it will be eliminated altogether should the Supreme Court accept the *Sanders* appeal and affirm the Sixth Circuit's well-reasoned opinion.

The defendants' Petition For Writ Of Certiorari was filed Feb. 22.

  HFRA ISSN 1092-1079