

## Bad Mules Revisited: The Modern False Claims Act

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**T**he Federal False Claims Act (“FCA”)<sup>1</sup> was enacted in part because of bad mules. During the Civil War unscrupulous early day defense contractors sold the Union Army decrepit horses and mules in ill health, faulty rifles and ammunition, and rancid rations and provisions among other unscrupulous actions.



**Figure 1 – Civil War Mules**

These frauds caused President Abraham Lincoln to urge Congress to pass the original FCA in 1863 commonly known as the “Informer’s Law” or the “Lincoln Law”.<sup>2</sup>

The FCA made it illegal for someone (the “claimant”) to present false statements in writing (“claims”) to the United States (“Government”) to

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<sup>1</sup> 31 USCA §§ 3729 *et seq.*, hereafter all sections refer to the FCA unless otherwise noted.

<sup>2</sup> Still earlier dating back to at least as early as 1692, the American colonies allowed citizens to sue on behalf of the Government but the FCA in its current form originated in the Civil War. Claire M. Sylvia, *The False Claims Act: Fraud Against the Government* (West, 2004) § 2:5, hereafter “**Sylvia**”.

improperly obtain more money from (or in some cases pay less money to) the Government than actually owed by the Government (or due from the claimant).

In recent years False Claims Act cases have been filed against companies that have dumped radioactive waste on public land, companies that have manufactured defective weapons systems that endangered soldiers in the field, and hospitals that have manipulated organ donor roles in order to increase profit margins. These frauds and crimes reminds one of a series of recent Dilbert cartoons.

Larry D. Lahman  
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Larry D. Lahman<sup>4</sup>

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*"Worse than traitors in arms are the men who pretend loyalty to the flag, feast and fatten on the misfortunes of the nation while patriotic blood is crimsoning the plains of the south and their countrymen are moldering in the dust."*

Abraham Lincoln<sup>5</sup>

### I. Introduction

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The massive waste of tax dollars commands great public attention and in the 1980s, reports of extravagant Pentagon contracts to purchase \$500 hammers and \$900 coffee makers resulted in escalating criticism of the President's defense budget.<sup>6</sup> To deflect this criticism of defense spending, then Attorney General Edwin Meese III advanced a program to fight fraud on the Government. In 1986, Congress passed a key section of Meese's program: amendments to reinvigorate

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<sup>3</sup> Portions of this paper originally appeared in the April 9, 2005, issue of the Oklahoma Bar Journal, Larry D. Lahman, "Bad Mules: A Primer on the Federal False Claims Act", 76 OBJ 901.

<sup>4</sup> © 2005, 2006, 2007 by Larry D. Lahman

<sup>5</sup> Search the key terms on the Internet and you will find numerous references ascribing these words to Lincoln but none say where or when – or at least the author has not seen them – so perhaps this is urban legend. Few articles on the FCA fail to offer this quote but perhaps the better authority or source may actually be the United States Congress. In reporting to Congress, on March 3, 1863, the House Select Committee on Government Contracts, after submitting testimony regarding the numerous and pervasive frauds on the Government, concluded:

Many frauds have been exposed, the Government relieved from many unconscionable contracts, and millions of dollars saved to the treasury. Yet it is a matter of regret that punishment has not been meted out to the basest class of transgressors. They to whom this duty belonged seemed sadly to have neglected it. ***Worse than traitors in arms are the men pretending loyalty to the flag, who feast and fatten on the misfortune of the nation, while patriot blood is crimsoning the plains of the South, and bodies of their countrymen are moldering in the dust.*** The leniency of the Government towards these men is a marvel which the present cannot appreciate, and history never explain." [Emphasis added.] House Reports, Committees and Courts of Claims, Third Session, Thirty-seventh Congress, 1862-63, Report No. 50:47.

<sup>6</sup> In a 1984 interview, President Reagan expressed his determination to expose defense contract fraud: "All these figures about \$500 hammers and wrenches and so forth, it's all true. But nobody has pointed out that we're providing those figures. This is what has been going on, and this Defense Department is finding [fraud] and correcting it." Interview with Tom Winter & Joseph Baldachino, Jr., of Human Events, Pub. Papers of President Reagan: 1984, Book II 1891 (Dec. 6, 1984).

and strengthen a century old anti-fraud statute called the False Claims Act ("FCA").<sup>7</sup>

The FCA prohibits false or fraudulent claims for the payment of federal monies. The Act empowers the Government to sue contractors for three times the amount of a false claim plus fines and court costs. In addition, the FCA includes a *qui tam*<sup>8</sup> provision that allows private citizens to sue on behalf of the Government and to collect a substantial bounty. Historically, the FCA has been used against defense contractors, yet the FCA embraces fraudulent claims involving any Government-funded program.<sup>9</sup>

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<sup>7</sup> For an eminently readable book on the history of the modern FCA and experiences of whistleblowers under the new law, the Giant Killers: The Team and the Law That Help Whistleblowers Recover America's Stolen Billions by Henry Scammell, Atlantic Monthly Press (New York, 2004) is highly recommended. It reads like a John Grisham book but it's true. Giant Killers outlines the involved history of the 1986 Amendments to the FCA and discusses the many non politicians who played a major effort in the passage of the amendments.

<sup>8</sup> *Qui tam* describes any legal action brought by an individual on behalf of the Government and the individual. *Qui tam* is the shortened form of the Latin phrase "*qui tam pro domino rege quam pro si ipso in hac parte sequitur*" (translated as "[w]ho sues on behalf of the King as well as for himself"). Black's Law Dictionary 1251 (6th ed. 1990). *Qui tam* plaintiffs are often called relators or informers.

<sup>9</sup> See *United States v. Neifert-White Co.*, 390 U.S. 228 (1968) (holding that the FCA applies to all fraudulent attempts to obtain money from the Government).

**FRAUD STATISTICS - OVERVIEW**  
 October 1, 1986 - September 31, 2005  
 Civil Division, U.S. Department of Justice

FY	NEW MATTERS <sup>1</sup>		SETTLEMENTS AND JUDGMENTS <sup>2</sup>				RELATOR SHARE AWARDS <sup>3</sup>			
	NON QUI TAM	QUI TAM	NON QUI TAM <sup>2</sup>	QUI TAM			TOTAL QUI TAM AND NON QUI TAM	WHERE U.S. INTERVENED OR OTHERWISE PURSUED	WHERE U.S. DECLINED	TOTAL
			TOTAL	WHERE U.S. INTERVENED OR OTHERWISE PURSUED	WHERE U.S. DECLINED	TOTAL				
1987	361	66	86,479,949	0	0	0	86,479,949	0	0	0
1988	246	60	172,843,696	355,000	35,431	390,431	173,234,127	88,750	8,638	97,388
1989	236	95	197,202,180	15,111,719	0	15,111,719	212,313,899	1,446,770	0	1,446,770
1990	256	82	193,239,367	40,483,367	75,000	40,558,367	233,797,734	6,590,936	20,670	6,611,606
1991	243	90	270,945,467	69,705,771	69,500	69,775,271	340,720,738	10,667,537	18,750	10,686,287
1992	357	119	136,862,236	134,099,447	994,456	135,093,903	271,956,139	24,196,648	259,784	24,456,432
1993	329	132	187,234,076	171,438,383	5,978,000	177,416,383	364,650,459	25,636,134	1,756,902	27,393,036
1994	291	222	706,187,897	379,646,074	1,822,323	381,468,397	1,087,656,294	70,112,579	538,897	70,651,476
1995	236	277	279,522,866	245,463,627	1,813,200	247,276,827	526,799,693	46,475,379	517,238	46,992,617
1996	187	363	247,357,271	124,565,203	14,033,433	138,598,636	385,955,907	22,193,539	3,896,058	26,089,597
1997	185	533	468,549,359	622,666,381	7,136,144	629,802,525	1,098,351,884	65,938,921	1,981,346	67,920,267
1998	119	470	151,585,794	432,813,410	29,225,385	462,038,795	613,624,589	69,660,944	8,527,750	78,188,694
1999	141	481	196,613,009	454,268,984	62,509,047	516,778,031	713,391,040	49,414,054	17,593,462	67,007,516
2000	96	367	367,887,197	1,202,552,907	1,814,847	1,204,367,754	1,572,254,951	183,600,387	391,733	183,992,120
2001	88	309	494,496,974	1,175,104,715	125,726,963	1,300,831,678	1,795,328,652	187,475,850	30,294,843	217,770,693
2002	63	320	113,692,470	1,066,606,748	29,866,186	1,096,472,934	1,210,165,404	159,198,889	5,593,086	164,791,975
2003	93	334	703,003,368	1,429,086,502	87,140,070	1,516,226,572	2,219,229,940	308,280,386	19,322,900	327,603,286
2004	113	415	115,656,023	556,072,685	9,474,879	565,547,564	681,203,587	109,627,498	2,433,638	112,061,136
2005	100	394	276,794,983	1,119,347,507	22,396,229	1,141,743,736	1,418,538,719	160,199,544	6,175,933	166,375,477
TOTAL	3,740	5,129	5,366,154,182	9,239,388,430	400,111,093	9,639,499,523	15,005,653,705	1,500,804,745	99,331,628	1,600,136,373

**Figure 2 -- FCA Recoveries FY 1987 thru FY 2005. Source Civil Division, US Department of Justice**

The Corporate Crime Reporter recently released a list of the 100 largest FCA recoveries since 1863 through 2003 and in each the whistleblower relator's share was more than \$1 million – in one case over \$70 million. Fifty-six of the top 100 false claims settlements were with health care corporations, while 23 were defense contractors.

The largest FCA settlement in history – until June of 2006 – was the December 2000 recovery from HCA formerly known as Columbia HCA. HCA, the largest for-profit hospital chain in the United States, pled guilty to criminal conduct and agreed to pay more than \$840 million in criminal fines, civil penalties and damages for unlawful billing practices. Of this amount, \$731 million was recovered under the False Claims Act.

HCA's frauds on the taxpaying public included: billing for lab tests that were not medically necessary and not ordered by physicians, "upcoding" medical problems in order to get higher reimbursements for more serious medical issues, billing the Government for advertising under the guise of "community education," and billing the Government for non-reimbursable costs incurred in the purchase of home health agencies around the country.

The second largest settlement on the list was also against HCA for \$631 million in June 2003. Rounding out the top five settlements were TAP Pharmaceuticals for \$559 million in October 2001, Abbott Labs for \$400 million in July 2003 and Fresenius Medical Care for \$385 million in January 2000.<sup>10</sup>

But as Ron Popeil would say: “Wait. There’s more!” At the current pace the Government will collect over \$2.5 billion from FCA recoveries during Fiscal Year 2006 and topping the list is a \$900 million settlement with Tenet Healthcare Corporation announced by the Department of Justice in June 2006.

So much fraud. So little time.

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<sup>10</sup> “Top 100 False Claims Act Settlements”, Corporate Crime Reporter, December 30, 2003, <http://www.corporatecrimereporter.com/fraudrep.pdf>.

## II. History of the False Claims Act

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### **A. The 1863 Original FCA**

Enacted during the Civil War, the FCA<sup>11</sup> was intended to root out rampant fraud by the contractors that supplied the Union Army.<sup>12</sup> The legislative history suggests congressional concern focused on corruption in the military procurement process.<sup>13</sup> While the FCA targeted defense contractors, the statute's language was broad enough to embrace any fraud that resulted in financial loss to the federal Government.<sup>14</sup> According to an early opinion by the United States District Court for the District of Oregon, Congress enacted the FCA "to protect the Treasury against the hungry and unscrupulous host that encompasses it on every side."<sup>15</sup>

President Lincoln rightly understood that the federal Government acting alone could not counter or control corrupt defense contractors. As a result Lincoln required that the FCA include a *qui tam* provision to compensate those who assist the Government in ferreting out and controlling fraud and corruption. Absent a significant financial incentive Lincoln and his allies in the congress understood that informers would not come forward.<sup>16</sup> The 1863 version of the FCA granted half of the damages recovered to the informer.<sup>17</sup> Because the FCA doubled the damages, the Government was still made whole and the *qui tam* relator was entitled to recover reasonable expenses and costs from the defendant.

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<sup>11</sup> Act of March 2, 1863, ch. 67, § 6, 12 Stat. 696.

<sup>12</sup> Elletta S. Callahan & Terry M. Dworkin, Do Good and Get Rich: Financial Incentives for Whistle-blowing and the False Claims Act, 37 Vill. L. Rev. 273 (1992).

<sup>13</sup> Note, *Qui tam* Suits Under the Federal False Claims Act: Tool of the Private Litigant in Public Actions, 67 NW. U. L. Rev. 446 (1972). Senator Howard, the sponsor of the bill, spoke to the urgency of fraud prevention:

[T]he bill has been prepared at the urgent solicitation of the officers who are connected with the administration of the War Department and the Treasury Department. The country, as we know, has been full of complaints reflecting the frauds and corruptions practiced in obtaining pay from the Government during the present war . . . further legislation is pressingly necessary to prevent this great evil.

<sup>14</sup> M. Russell Kruse, Jr., Note, False Claims Act -- The Civil War Antitrust Sword: *United States v. Beatrice Foods Co.*, 25 SW. L.J. 764 (citing Cong. Globe, 37th Cong., 3d Sess. 952 (1863)).

<sup>15</sup> *United States v. Griswold*, 24 F.361, 366 (D. Or. 1885) (denying Government motion to satisfy judgment because motion would deprive *qui tam* relator of his share of the judgment still owed by defendant).

<sup>16</sup> Senator Howard of Michigan declared that the FCA's *qui tam* provision followed from "the old-fashioned idea of holding out a temptation and 'setting a rogue to catch a rogue.'" Cong. Globe, 37th Cong., 3d Sess. 955-56 (1863).

<sup>17</sup> Act of March 2, 1863, ch. 67, § 6, 12 Stat. 698.

## **B. The 1943 Amendments Cripple the FCA**

Following perceived abuses by a number of so called “parasitic” FCA lawsuits filed by plaintiffs relying on information already in the Government’s possession or public knowledge, the FCA was crippled by Congressional amendment in 1943 (“1943 Amendments”).

The 1943 Amendments greatly reduced the relator’s share and eliminated *qui tam* lawsuits when the Government had prior knowledge of the fraud – even when the Government had taken no action after a number of years and obviously intended to take no action to stop the fraud.

The 1943 Amendments stopped virtually all *qui tam* cases and fraud against the Government increased. The 1943 Amendments teach us that the Government itself far too often does not want to expose fraud for many reasons.<sup>18</sup>

In the case that resulted in the evisceration of the FCA, the Supreme Court heard an appeal by electrical contractors that defrauded the Public Works Administration through collusive bidding. After Hess was indicted for criminal behavior, Marcus filed a *qui tam* action based largely on what he had read in the newspaper and court files and received one-half of a \$315,000 judgment. Notwithstanding that Marcus likely had not provided any new evidence against the defendant, the Supreme Court held that the FCA did not preclude civil suits based on information from a prior indictment.<sup>19</sup>

Following the *Marcus* decision, Congress debated sweeping amendments to restrict *qui tam* relators. Legislators questioned the wisdom of allowing private citizens to profit from the prosecution of crimes known to the Government. While the House of Representatives attempted to repeal *qui tam*, the Senate supported the retention of *qui tam* suits, with restrictions. Congress ultimately barred *qui tam* suits that utilize information possessed by the Government, even in cases where the relator discovered the alleged fraud. In addition, Congress instituted a notice requirement that compelled *qui tam* plaintiffs to advise the Government of their claims and to disclose significant evidence. The amendments allowed the United States to join *qui tam* suits and to control the litigation strategy.<sup>20</sup>

The 1943 amendments also reduced relator awards. If the Government successfully prosecuted an action begun by a relator, the amendments authorized the court to grant the relator a "reasonable" award not to exceed 10% of the recovery. If the Government did not intervene, the amendments authorized the court to award a "reasonable" sum not to exceed 25%. Regardless the law failed to provide a minimum or floor amount and the court could provide little or no compensation to the relator.

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<sup>18</sup> Sylvia § 2:8.

<sup>19</sup> *United States ex rel. Marcus v. Hess*, 317 U.S. 537, 539 (1943).

<sup>20</sup> Paul W. Morenberg, “Comment: Environmental Fraud by Government Contractors: A New Application of the False Claims Act”, 22 B.C. Env’tl. Af. L. Rev. 623 (1995).

One writer suggested that the amendments resulted in an "ice age" for FCA *qui tam* that lasted more than four decades. Potential relators feared the Government's power to intervene in *qui tam* lawsuits, to control the litigation strategy and to reduce the relator's financial stake in any judgment.<sup>21</sup>

Another reason for the *qui tam* ice age was strict judicial enforcement of the FCA's jurisdictional bar against private actions arising from information in the Government's possession. This jurisdictional bar applied to cases in which the Government took no action.<sup>22</sup> The bar even applied to cases where the prospective relator was the original source of the Government's information.<sup>23</sup>

### **C. The 1986 Amendments Reinvalidate the FCA**

In the early 1980s, Government officials began to have increased concern over the rise in fraud in both defense and human services programs. Department of Defense fraud investigations increased greatly. Testifying before a House of Representatives subcommittee in 1985, Department of Defense Inspector General Joseph Sherick testified that nine of the ten largest defense contractors were under investigation. The problem of rising fraud plagued many federal programs but military procurement fraud dominated the headlines.

Reports of expensive toilet seats and hammers aroused Congressional ire and in August, 1985, Senator Charles Grassley of Iowa introduced the False Claims Reform Act and in language reminiscent of Civil War legislators, Grassley and his supporters resolved to punish crooked contractors that cheat the taxpayer and Government. Grassley's amendments expanded the FCA definition of fraud and increased statutory fines and damages as well as liberalizing the requirements for standing and enhancing relator awards in an attempt to promote *qui tam* suits.

In October of 1986 the Congress unanimously passed the False Claims Reform Act resulting in a rapid increase in *qui tam* litigation and recoveries by the Government. About six *qui tam* cases were filed annually before the 1986 Amendments but over a hundred *qui tam* cases were filed in 1989. The United States recovered only \$27 million under the FCA in Fiscal Year 1985; twenty years after the 1986 Amendments the Government will receive about \$2.5 billion in Fiscal year 2006.<sup>24</sup>

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<sup>21</sup> Valeri R. Park, "The False Claims Act, *Qui tam* Relators, and the Government: Which is the Real Party to the Action?", 43 Stan. L. Rev. 1061 (1991).

<sup>22</sup> *United States ex. rel Lapin v. International Business Machines Corp.*, 490 F. Supp. 244 (D. Haw. 1980) (disallowing a *qui tam* action even after the Government failed to investigate or prosecute alleged FCA violations).

<sup>23</sup> *United States ex rel. Wisconsin v. Dean*, 729 F.2d 1100 (7th Cir. 1984) (forbidding Wisconsin to act as *qui tam* relator because Federal law required states to disclose evidence of Medicaid fraud to the Department of Social Services).

<sup>24</sup> Paul W. Morenberg, "Comment: Environmental Fraud by Government Contractors: A New Application of the False Claims Act", 22 B.C. Env'tl. Af. L. Rev. 623 (1995).

The 1986 Amendments vastly strengthened the FCA as a tool for fighting profiteering and fraud against the Government. The 1986 Amendments increased the relator's share<sup>25</sup>, provided for treble damages<sup>26</sup>, granted employees whistleblower protection<sup>27</sup>, extended the statute of limitations<sup>28</sup> and reduced the level of proof for fraud to "actual knowledge" "deliberate ignorance" or "reckless disregard".<sup>29</sup>

Significantly the current FCA allows the Government to recover treble the amount it is due as well as penalties<sup>30</sup> and fees for the relator's attorneys in *qui tam* cases.<sup>31</sup> Its impact on the Federal "fisc" has been enormous resulting in the recovery of over \$2 billion in 2003 and about \$18 billion since 1986. In recent years typically about three fourths of the total recovery comes from relator initiated *qui tam* lawsuits.<sup>32</sup>

Because wrongdoers now face the threat of having to repay more than the amount stolen under its treble damage provisions, the FCA silently deters untold fraud against the Government by its mere presence. It has a major impact on deterring fraud on the taxpayers and has been largely unchanged since 1986 despite periodic attempts by those it targets to gut it.<sup>33</sup>

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<sup>25</sup> 31 USCA § 3730(d).

<sup>26</sup> 31 USCA § 3729(a).

<sup>27</sup> 31 USCA § 3730(h).

<sup>28</sup> 31 USCA § 3731(b).

<sup>29</sup> 31 USCA § 3729(b).

<sup>30</sup> Prior to September 29, 1999, the FCA imposed penalties of at least \$5,000 and up to \$10,000 ("penalties") at the discretion of the judge. 31 USCA § 3729(a)(1)-(7). These sums increased to \$5,500 and \$11,000 effective September 29, 1999. 28 CFR § 85.3(a)(7).

<sup>31</sup> 31 USCA § 3730(d)(2).

<sup>32</sup> Sylvia Appendix D.

<sup>33</sup> Sylvia § 2:11.

### III. The Modern False Claims Act

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#### **A. Elements of a False Claim**

There are three central elements of an FCA action: (i) a claim for payment by the United States Government; (ii) that is false or fraudulent; and (iii) that is knowingly presented. The FCA encompasses claims in a wide variety of payment contexts, including contracts for military procurement, construction or other services; benefit payments for health care and welfare; Government loans; and housing subsidies.

#### **1. Claims against the United States**

The FCA defines a "claim" as any request for money or property by a contractor, grantee or other recipient, to-wit:

[A]ny request or demand, whether under contract or otherwise, 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 or property which is requested or demanded, or if the Government will reimburse such contractor, grantee, or other recipient for any portion of the money or property which is requested or demanded.<sup>34</sup>

This definition applies to any transaction where the United States "provides any portion of the money or property" and so any program directly funded by the federal Government including state, local and private programs that receive federal reimbursement is covered.

#### **2. False or Fraudulent Claims**

The FCA outlines seven different practices that constitute a false claim:

- (1) knowingly presents, or causes to be presented, to an officer or employee of the United States Government or a member of the Armed Forces of the United States a false or fraudulent claim for payment or approval;
- (2) knowingly makes, uses, or causes to be made or used, a false record or statement to get a false or fraudulent claim paid or approved by the Government;
- (3) conspires to defraud the Government by getting a false or fraudulent claim allowed or paid;
- (4) has possession, custody, or control of property or money used, or to be used, by the Government and, intending to defraud the Government or willfully to conceal the property, delivers, or causes to

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<sup>34</sup> 31 USCA § 3729(c).

be delivered, less property than the amount for which the person receives a certificate or receipt;

(5) authorized to make or deliver a document certifying receipt of property used, or to be used, by the Government and, intending to defraud the Government, makes or delivers the receipt without completely knowing that the information on the receipt is true;

(6) knowingly buys, or receives as a pledge of an obligation or debt, public property from an officer or employee of the Government, or a member of the Armed Forces, who lawfully may not sell or pledge the property; or

(7) knowingly makes, uses, or causes to be made or used, a false record or statement to conceal, avoid, or decrease an obligation to pay or transmit money or property to the Government.<sup>35</sup>

The most common is the presentation of a "false or fraudulent claim for [Government] payment or approval." Significantly the Government need not incur an actual financial loss to litigate a false claim for payment.<sup>36</sup>

The FCA does not define the phrase "false or fraudulent claim". The statute covers acts of error, oversight, and mismanagement as well as acts of deliberate fraud. Accordingly a false claim can be prosecuted for the claim's mere "falseness" without any evidence of fraudulent conduct. The distinction between false and fraudulent claims reflects the FCA's requirement that a false claim be "knowing" but that no specific intent to defraud is required.

In addition to outlawing false or fraudulent payment requests, the FCA forbids related forms of fraud. By way of example the FCA prohibits conspiracies to obtain payment of a false claim and also forbids fraud in the management and disposition of federal property and money that causes the Government to receive less value.

Importantly the 1986 amendments included an additional type of false claim known as "reverse false claim" that cover actions to reduce or avoid paying the Government what it is due. Congress intended that the statute cover a broad array of attempts to defraud the Government and since 1986, relators and the Government have successfully pursued a number of attempts to defraud the Government including:<sup>37</sup>

***a. Claims for Services that Are Improperly Provided***

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<sup>35</sup> 31 USCA § 3729(a).

<sup>36</sup> *United States v. Kensington Hosp.*, 760 F. Supp. 1120 (E.D. Pa. 1991) (concluding that the Government can recover without proving an injury resulted from fraudulent Medicare or Medicaid claims); *Thevenot v. National Flood Ins. Program*, 620 F. Supp. 391 (W.D. La. 1985) (holding that Government may recover statutory penalty without paying out any funds).

<sup>37</sup> Paul W. Morenberg, "Comment: Environmental Fraud by Government Contractors: A New Application of the False Claims Act", 22 B.C. Envtl. Af. L. Rev. 623 (1995).

A request for Government funds to reimburse services that were not properly delivered is perhaps the most basic form of fraud covered by the FCA. It is not uncommon for health care providers to bill the Government for medical supplies or services that are not provided or unnecessary.<sup>38</sup> Courts have ruled that under Medicaid every medical procedure that is falsely billed constitutes a separate false claim.<sup>39</sup> Accordingly multiple civil penalties for each fraudulent claim or report submitted to the Government may be recovered and where current penalties range from \$5,500 to \$11,000 the ultimate amount can be enormous.

#### ***b. Product Defects and Product Substitutions***

Government suppliers delivering defective or inferior products may become obligated for fraud under the FCA. When contractors knowingly violate contract specifications, the contractors submit false claims for payment. In *Faulk v. United States*, the United States Court of Appeals for the Fifth Circuit concluded that a dairy producer committed fraud under the FCA in providing the Air Force with recombined milk rather than fresh milk, which the contract specified.<sup>40</sup> In *United States v. Aerodex*, the Fifth Circuit similarly affirmed an FCA judgment against a defendant that did not provide the specific model of ball bearings that the Navy requested.<sup>41</sup>

#### ***c. False Pricing***

The Truth in Negotiations Act ("TINA") requires suppliers to certify that cost estimates are current, accurate and complete<sup>42</sup> but when the Government solicits bids for specialized services that few contractors can provide, contractors often inflate prices. So if a contractor knowingly submitted old, inaccurate or incomplete pricing data, that claim may be actionable under the FCA. The FCA has been used to combat such "false pricing" schemes by Government contractors.

### **3. Knowledge Requirement**

Before the 1986 amendments, the FCA required that the Government establish a defendant's "actual knowledge" of fraud. In applying this ambiguous standard, some courts asserted that the Government must demonstrate a defendant's specific intent to submit a false claim.<sup>43</sup> Congress feared that such readings of the FCA enabled corporate leaders to avoid liability by distancing

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<sup>38</sup> *United States v. Campbell*, 845 F.2d 1374 (6th Cir.) (holding that the provision of unnecessary services to a Medicare patient constitutes a false claim because billing form certifies that services were "medically indicated and necessary"), cert. denied, 488 U.S. 908 (1988).

<sup>39</sup> *United States v. Diamond*, 657 F. Supp. 1204 (S.D.N.Y. 1987) (holding doctor liable for civil penalties assessed for each false Medicare claim submitted).

<sup>40</sup> *Faulk v. United States*, 198 F.2d 169 (5th Cir. 1952).

<sup>41</sup> *United States v. Aerodex*, 469 F.2d 1003 (5th Cir. 1972).

<sup>42</sup> 10 USC § 2306a.

<sup>43</sup> *United States v. Aerodex*, 469 F.2d 1003 (5th Cir. 1972).

themselves from the management of Government contracts. Legislators argued that the amended FCA should reach the "'ostrich-like' conduct which can occur in large corporations."

The 1986 amendments enumerate three mental states that constitute knowledge of a false claim and clarify the scienter requirement of the FCA: (i) actual knowledge; (ii) deliberate ignorance of truth or falsity; or (iii) reckless disregard of truth or falsity.<sup>44</sup> The FCA declares that proof of "specific intent to defraud" is never required.<sup>45</sup> Therefore, contractors owe the Government a duty of "limited inquiry" when submitting claims for payment. Under this standard, employers can be found liable for false claims known to their employees.<sup>46</sup>

#### **4. Damages**

##### ***a. Civil Penalties***

The FCA provides for civil penalties between \$5,500 and \$11,000 for each violation of the Act.<sup>47</sup> According to the legislative history, these "forfeiture" penalties are "automatic and mandatory for each claim which is found to be false" and so it is possible for civil penalties to be rather large in complicated transactions.<sup>48</sup> By way of illustration if a supplier submits 100 false invoices, the civil penalties could exceed \$1 million.

##### ***b. Civil Damages***

The FCA also provides for treble damages imposed on the Government's loss from a false claim.<sup>49</sup> Such damages may only be recovered after a demonstration of an actual financial loss to the Government.<sup>50</sup> In the rare case where the defendant promptly provides the Government with all information pertaining to the violation and cooperates fully with the Government's investigation, the FCA provides for lesser double damages.<sup>51</sup>

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<sup>44</sup> 31 USCA § 3729(b).

<sup>45</sup> *United States v. Oakwood Downriver Medical Ctr.*, 687 F. Supp. 302 (E.D. Mich. 1988); *SGW, Inc. v. United States*, 20 Cl. Ct. 174 (1990).

<sup>46</sup> *United States v. O'Connell*, 890 F.2d 563 (1st Cir. 1989) (holding corporation liable for fraud of its agent even when corporation received no benefit from fraud); *Grand Union Co. v. United States*, 696 F.2d 888 (11th Cir. 1983) (ruling that where cashiers accepted food stamps for ineligible items, cashiers' knowledge can be imputed to defendant company).

<sup>47</sup> Prior to September 29, 1999, the FCA imposed penalties of at least \$5,000 and up to \$10,000 ("penalties") at the discretion of the judge. 31 USCA § 3729(a)(1)-(7). These sums increased to \$5,500 and \$11,000 effective September 29, 1999. 28 CFR § 85.3(a)(7).

<sup>48</sup> *United States v. Board of Educ.*, 697 F. Supp. 167 (D.N.J. 1988) (finding 16 separate civil penalties for nine false claims, six false reports, and conspiracy).

<sup>49</sup> 31 USCA § 3729(a).

<sup>50</sup> *United States v. DiBona*, 614 F. Supp. 40 (E.D. Pa. 1984) (holding that Government must prove financial loss to collect more than the forfeiture penalty).

<sup>51</sup> 31 USCA § 3729(a).

The FCA is silent on the specific method for calculating the damages and so computing damages will vary depending of the facts in a particularly case. Where there has been collusive bidding, damages typically consist of the difference between the actual contract price and the estimated fair market value of the contract if the bidding process had been open and competitive.<sup>52</sup> Where goods were priced at an impermissibly high rate, the court found damages to be the difference between the actual contract price and the reasonable value of the goods delivered.<sup>53</sup>

### **c. Consequential Damages**

Some plaintiffs have sought "consequential damages" for repair costs and other expenses incurred by the Government over and above "actual" damages. In a case that predates the 1986 Amendments *Marcus v. Hess*, the Supreme Court held that the Government was adequately compensated through the double damages provision.<sup>54</sup> The United States Court of Appeals for the Fifth Circuit rejected consequential damages awarded by the district court in *United States v. Aerodex*. In *Aerodex*, the Navy expended \$27,000 for defective bearings, which it replaced at a cost of over \$160,000. The court ruled that the Government's costs were fully compensated by double damages of \$54,000 – twice the contract price of \$27,000.<sup>55</sup>

Although the *Aerodex* court firmly rejected consequential damages, other courts have awarded "repair" expenses in similar cases. In *United States v. Ekelman & Associates, Inc.*,<sup>56</sup> the defendants falsified applications for loans guaranteed by the Veterans Administration or insured by the Federal Housing Authority. After the loans went into default, the Government expended funds to maintain the property until the property's resale. In *Ekelman*, the United States Court of Appeals for the Sixth Circuit awarded the Government not only its losses due to the default but also its maintenance and repair costs after foreclosure.<sup>57</sup>

## **5. Statute of Limitations**

Under the 1986 Amendments plaintiffs may file suit before the later of two deadlines: (i) six years after the violation; or (ii) three years after the violation is known, or should have been known, provided that not more than ten years have

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<sup>52</sup> *United States v. Killough*, 848 F.2d 1523 (11th Cir. 1988) (dictum) (stating that the FCA provides "no set formula" to calculate actual damages).

<sup>53</sup> *United States v. Aerodex*, 469 F.2d 1003 (5th Cir. 1972).

<sup>54</sup> *Marcus v. Hess*, 317 U.S. 537 (1943).

<sup>55</sup> *United States v. Aerodex*, 469 F.2d 1003 (5th Cir. 1972).

<sup>56</sup> *United States v. Ekelman & Associates, Inc.*, 532 F.2d 545 (6th Cir. 1976).

<sup>57</sup> *United States v. Ekelman & Associates, Inc.*, 532 F.2d 545 (6th Cir. 1976).

elapsed since the violation. The purpose of this flexible standard is to discourage defendants from concealing evidence of wrongdoing.<sup>58</sup>

## **B. Defenses to FCA Actions**

### **1. Government Acquiescence**

If a contractor can establish that the Government approved of business practices that were later challenged as FCA violations, the contractor can assert a defense of Government acquiescence.<sup>59</sup> The Government cannot demonstrate detrimental reliance on the accuracy of a claim if the Government knew of the alleged fraudulent conduct.

### **2. Innocent Mistake or Negligence**

The Government or *qui tam* plaintiff must prove that the defendant knowingly submitted false or fraudulent claims meaning the plaintiff must demonstrate the defendant's actual or constructive knowledge of a false claim.<sup>60</sup> For this reason defendants may escape FCA liability by asserting a defense of negligence or innocent mistake.<sup>61</sup> To assert this defense, defendants may be required to prove that they made a limited inquiry into the accuracy of the claims and that this inquiry failed to uncover the fraud.<sup>62</sup>

### **3. Substantial Compliance**

Given the complexity of many Government contracts, contractors may believe they have abided by the terms of their contracts. In FCA actions, contractors can assert a defense of substantial compliance provided that the contractors reasonably believed they followed the contract terms and that any deviations are minor and correctable. In assessing the reasonableness of a contractor's belief in compliance, courts have examined the number of defects in the product, as well as the contractor's inspection and testing procedures.

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<sup>58</sup> 31 USC § 3731(b).

<sup>59</sup> *United States ex rel. Hagood v. Sonoma County Water Agency*, 929 F.2d 1416 (9th Cir. 1991) (holding that Government knowledge of falsity is not defense in itself but that "[s]uch knowledge may show that the defendant did not submit its claim in deliberate ignorance or reckless disregard of the truth").

<sup>60</sup> *United States v. Oakwood Downriver Medical Ctr.*, 687 F. Supp. 302 (E.D. Mich. 1988); *United States v. DiBona*, 614 F. Supp. 40 (E.D. Pa. 1984); *SGW, Inc. v. United States*, 20 Cl. Ct. 174 (1990).

<sup>61</sup> *United States ex rel. Hagood v. Sonoma County Water Agency*, 929 F.2d 1416 (9th Cir. 1991).

<sup>62</sup> *United States v. O'Connell*, 890 F.2d 563 (1st Cir. 1989) (holding corporation liable for fraud of its agent even when corporation received no benefit from fraud); *Grand Union Co. v. United States*, 696 F.2d 888 (11th Cir. 1983) (ruling that where cashiers accepted food stamps for ineligible items, cashiers' knowledge can be imputed to defendant company).

#### 4. Double Jeopardy

Contractors that violate the FCA can be prosecuted civilly and criminally. The Supreme Court reviewed the constitutionality of FCA civil and criminal prosecutions concerning Medicare fraud in *United States v. Halper*.<sup>63</sup>

Halper, the manager of a medical laboratory, fraudulently submitted sixty-five Medicare claims for a total of \$585. In criminal proceedings, the defendant received a two-year sentence and a \$5,000 fine. When the Government requested \$130,000 in civil fines, the defendant argued that such a penalty would represent a second punishment in violation of double jeopardy. The Court held that a civil penalty which is "sufficiently disproportionate" to the Government's actual losses represents an unconstitutional second punishment.<sup>64</sup> Thus, defendants to FCA civil actions may challenge proposed civil penalties that are excessive.

But after the *Halper* ruling, the courts have continued to allow both criminal and civil penalties provided that the proposed damages bear some rational relationship to the Government's loss.<sup>65</sup>

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<sup>63</sup> *United States v. Halper*, 490 U.S. 435 (1989).

<sup>64</sup> *United States v. Halper*, 490 U.S. 435 (1989).

<sup>65</sup> *United States v. Pani*, 717 F. Supp. 1013 (S.D.N.Y. 1989) (allowing civil damages and penalties connected to three criminal counts of Medicare fraud because proposed civil judgment was related to Government's loss).



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## IV. The False Claims Case

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### **A. The Relator**

Importantly the FCA authorized a private citizen (the “relator”) acting as a “private attorney general” – as well as the Government – to sue the claimant to recover the amount actually due the Government plus a multiplier and penalties. A key provision of the original FCA was to award 50% of the recovery to encourage and reward relators (the “relator’s share”) for exposing and prosecuting the fraud.<sup>66</sup>

An action filed by a private relator on behalf of the Government is known as a “*qui tam*” action – roughly translated as one who sues for the King<sup>67</sup>, because *qui tam* actions are found in the early English common law. The relator files an FCA civil action “in the name of the Government.”

These *qui tam* lawsuits are commonly known to the public as “whistleblower” lawsuits and in fact the current FCA contains protections for the relator against retaliation from his employer when FCA allegations are made in good faith.<sup>68</sup>

Suits filed by the Government do not involve a relator and are known simply as False Claims Act cases *sans qui tam*.

### **B. Disclosure**

The relator must serve the Government with a copy of the complaint and disclose “all material evidence and information.” This required “disclosure” is normally done in the form of a “disclosure statement”. The lawsuit is then filed in secret or under “Seal” and only the Government is notified of the action so that it can investigate the merits of the relator’s allegations.<sup>69</sup>

### **C. The Seal**

During this “Seal Period”, which can be extended by the court for “cause” for long periods, the Government investigates and decides whether the case has sufficient merit to justify “Intervening” and taking over prosecution of the case. While the initial Seal Period is 60 days, cases have remained under Seal for nearly a decade while the Government investigates.<sup>70</sup>

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<sup>66</sup> Act of March 2, 1863, ch. 67, § 6, 12 Stat. 698.

<sup>67</sup> More fully *qui tam pro domino rege quam pro se ipso in hac parte sequitur* or “he who brings the action for the king as well as for himself”. 3 Sir William Blackstone, Commentaries on the Laws of England 161.

<sup>68</sup> 31 USCA § 3730(h).

<sup>69</sup> 31 USCA § 3730(b)(2).

<sup>70</sup> 31 USCA § 3730(b)(3).

#### **D. Government Intervention**

The Government does not frequently assert its right to take over or “intervene” in *qui tam* civil actions and typically occurs in about one-quarter of all *qui tam* actions, see Figure 4.

If the Government intervenes, the Department of Justice (“DOJ”) takes over the *qui tam* case from the relator and his attorneys and prosecutes it as any other.<sup>71</sup> Large cases are managed by DOJ from the Civil Division of the Attorney General’s office in Washington and United States Attorneys (“USA”) assist locally. Smaller cases are apt to be controlled in large measure by the local USA with final authority in Washington.

Once the Government opts to intervene, the case is “unsealed” and the defendant claimant is served which is normally the first formal notice the claimant receives of the action.<sup>72</sup>

The relator and his attorneys can and typically do remain involved in varying degrees in an intervened case but the Government through the DOJ controls the case. The Government can settle the case if “fair, adequate, and reasonable”, but the relator is entitled to notice and to be heard.<sup>73</sup>

In *Gravitt v. General Electric*, relator John Gravitt opposed a \$234,000 settlement negotiated by General Electric and the DOJ. The Court agreed with the relator that the settlement was inadequate in light of the defendant’s potential liability under the FCA for defense contract overcharges. General Electric eventually settled for \$3.5 million, and John Gravitt received \$770,000.<sup>74</sup>

The relator typically seeks Government intervention because of the greater resources that the Government can theoretically bring to bear on a case if it so chooses such as FBI interviews, wiretaps and reviews of internal Government documents. This is so even though the relator’s share is reduced in intervened cases because the relator believes that a smaller slice of a larger pie is better.

A tool available to the DOJ somewhat unique to the FCA known as a Civil Investigative Demand (“CID”) is also a possibility and is similar to a subpoena.<sup>75</sup>

Because of its ability to “cherry pick” by intervening only in good cases, withdrawing from a case which develops problems and getting back in when the case gets better,<sup>76</sup> the Government’s track record is “Ruthian” and in fact the Government rarely loses intervened cases. This remarkable record of success also results from the specter of penalties and treble damage provisions. The Government’s willingness to waive penalties and accept less than triple damages

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<sup>71</sup> 31 USCA § 3730(c)(1).

<sup>72</sup> 31 USCA § 3730(c).

<sup>73</sup> 31 USCA § 3730(c)(2)(B).

<sup>74</sup> *Gravitt v. General Electric*, 680 F. Supp. 1162 (S.D. Ohio 1988).

<sup>75</sup> 31 USCA § 3733.

<sup>76</sup> 31 USCA § 3730(c)(3).

or even less than “doubles” is a powerful inducement to settle for a claimant caught with his hand in the cookie jar.

### **E. Government Declination**

Conversely, the Government may provide notice that it “declines” to intervene for a variety of reasons including lack of merit. In such cases the relator and his counsel must decide whether to dismiss or prosecute the case on behalf of the Government.<sup>77</sup>

Should the Government decline to intervene and the relator opts to proceed with the litigation, the case is “unsealed” and the defendant claimant served which is often the first formal notice the claimant receives of the action as in an intervened case.

The relator proceeds with the case on behalf of the Government and the DOJ remains involved in varying degrees receiving notice of filings. The relator can attempt to settle the case but the Government is clearly entitled to notice and to be heard. If the settlement is substantial, the Government will almost certainly intervene to get “credit” for the settlement and to attempt to reduce the relator’s share which seems to be at variance with Congressional intent to reward whistleblowers who risk much to help the Government.

#### **1. Original Source Requirement**

*Qui tam* relators have two major jurisdictional obstacles to initiating a false claims case. First, relators may not file an FCA complaint arising from allegations that the Government is already litigating civilly or administratively.<sup>78</sup> In other words, relators lack jurisdiction to sue whenever the Government has taken legal action through the FCA or a related remedy. Second, relators may not prosecute an FCA complaint that is based on publicly disclosed allegations unless the relator is an “original source” of the allegations.<sup>79</sup> The FCA defines an original source as an “individual who has direct and independent knowledge of the information on which the allegations are based.”<sup>80</sup>

The original source language of the 1986 amendments relaxes the FCA's longstanding ban on *qui tam* suits that utilize information possessed by the Government. Before 1986, the FCA barred private actions even when the Government possessed evidence of fraud provided by a relator. Under the standard under the 1986 Amendments, relators who are the original source of allegations may always file suit unless the DOJ has already commenced legal action.

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<sup>77</sup> 31 USCA § 3730(c)(3).

<sup>78</sup> 31 USCA § 3730(e)(3).

<sup>79</sup> 31 USCA § 3730(e)(4)(A).

<sup>80</sup> 31 USCA § 3730(e)(4)(B).

## 2. Government Employees

The FCA does not specifically cover whether Government employees can qualify as *qui tam* plaintiffs. Courts have held that the FCA does not specifically prohibit Government employees from filing *qui tam* actions.<sup>81</sup> The United States Court of Appeals for the Ninth Circuit has held that a Government auditor who discovers evidence of fraud qualifies as an original source.<sup>82</sup>

Other circuit courts have ruled otherwise and disqualified Government employees whose job responsibilities enable them to uncover fraud. In a case where a former Government employee filed a *qui tam* suit with evidence that he obtained as a Quality Assurance Specialist the United States Court of Appeals for the First Circuit concluded that such employees cannot file *qui tam* actions because they do not qualify as "original sources" within the meaning of the FCA.<sup>83</sup>

## 3. No *Qui Tam* against State

The Supreme Court's 2000 decision in *Vermont Agency of Natural Resources v. United States ex rel. Stevens*<sup>84</sup> is best remembered for its ruling upholding the constitutionality of the *qui tam* provisions of the False Claims Act under Article III of the federal Constitution. But the Stevens Court also resolved an important statutory construction issue by ruling that, in a pure *qui tam* action brought under the FCA – that is, an action brought by a private party and pursued without the Government's intervention – a State is not a "person" subject to suit within the meaning the Act.<sup>85</sup> Simply put: No *qui tam* action may be brought against a state.

But *Stevens* left open the viability of straight FCAs brought by the DOJ against a state without a relator. Most observers believe such actions are permitted.<sup>86</sup>

But another question raised by *Stevens* has been resolved. Following *Stevens* many counties and municipalities assumed that they, too, enjoyed immunity from FCA liability but in 2003 the Supreme Court with a unanimous

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<sup>81</sup> *United States ex rel. Williams v. NEC Corp.*, 931 F.2d 1493 (11th Cir. 1991) (stating that the FCA permits any person to file suit "subject to four exceptions" and that these exceptions do not exclude all Government employees); see also *United States ex rel. Hagood v. Sonoma County Water Agency*, 929 F.2d 1416 (9th Cir. 1991).

<sup>82</sup> *United States ex rel. Fine v. Chevron*, 39 F.3d 957 (9th Cir. 1994). Noting that the 1986 amendments sought to encourage Government employees to disclose evidence of fraud, the court ruled that it would be "incongruous . . . to bar a Government employee who has gone to his supervisors to report fraud from bringing a *qui tam* action."

<sup>83</sup> *United States ex rel. LeBlanc v. Raytheon*, 913 F.2d 17 (1st Cir. 1990).

<sup>84</sup> *Vermont Agency of Natural Resources v. United States ex rel. Stevens*, 120 S. Ct. 1858 (2000).

<sup>85</sup> 31 USCA § 3729(a) subjecting to suit "[a]ny person" who presents a false claim to the United States Government, and making any such "person" "liable to the United States Government" for treble damages and penalties.

<sup>86</sup> Dayan, "The Impact of *Stevens* on False Claims Act Suits Against States Brought or Joined by the United States", 20 TAF Quarterly Review 18 (October 2000).

decision in *Cook County, Illinois vs. United States ex rel. Chandler*<sup>87</sup> resolved a split among the Circuit Courts of Appeal, slamming the door on local Governments aspiring themselves to be "non-persons," and subjecting them to FCA treble damages and penalties. Under the FCA, "[a]ny person", who, among other things, "knowingly presents, or causes to be presented, to an officer or employee of the United States Government . . . a false or fraudulent claim for payment or approval," 31 U.S.C. §3729(a)(1), is amenable to suit under the FCA.

Alleging that Cook County had submitted false statements and reports in connection with a \$5 million federal grant to Cook County Hospital, relator Dr. Janet Chandler brought a *qui tam* action under the FCA. Following the Supreme Court's decision in *Stevens*, the district court in Illinois dismissed Chandler's action, holding that a County, like a State, could not be subjected to treble damages. The Seventh Circuit reversed, however, in conflict with the Third Circuit and Fifth Circuit, all leading up to the Supreme Court's decision to impose FCA liability on cities and counties.

#### **F. Relator's Share**

At the heart of the FCA is the relator's entitlement to a sizable portion the recovery which has caused some wrongdoers to refer to the FCA as the "Bounty Hunter's Law". To be sure the possibility of "doing well while doing good" is a major reason for reinvigorating the FCA under the 1986 Amendments.

Significantly the relator is entitled to 15% to 25% of the recovery in intervened cases<sup>88</sup> and 25% to 30% in declined cases<sup>89</sup> and since this includes trebled damages, the relator's share can be sizable. These percentages are calculated on the "proceeds of the action or settlement."<sup>90</sup> Although not defined in the FCA Courts including the Tenth Circuit have held that "proceeds of the action or settlement" includes both forfeiture penalties and damages.<sup>91</sup>

The FCA authorizes the court to reduce awards in cases where the relator participated in the presentation of a false claim, which applies whether or not the Government intervenes in the action. In addition, the amended FCA declares that persons convicted of FCA criminal violations are not eligible for any award.<sup>92</sup>

Some complain these bountiful rewards are unjustified and harm the Federal treasury; however, as the Government can recover treble damages plus penalties, the net to the Government will nearly always exceed what has been

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<sup>87</sup> *Cook County, Illinois vs. United States ex rel. Chandler*, 123 S. Ct 1239 (2003).

<sup>88</sup> 31 USCA § 3730(d)(1).

<sup>89</sup> 31 USCA § 3730(d)(2).

<sup>90</sup> 31 USCA § 3730(d)(1).

<sup>91</sup> *United States ex rel. Woodward v. Country View Care Center, Inc.*, 797 F.2d 888 (10th Cir. 1986). The court stated that the district court correctly computed the *qui tam* award as a percentage of both damages and forfeitures and remanded the case for recalculation of the damages portion of the judgment.

<sup>92</sup> 31 USCA § 3730(d)(3).

taken from it even after the relator's share is deducted. Said another way, the relator makes the Government whole for fraud the Government knew nothing about, did nothing about or both.

### **G. Legal Fees and Expenses**

The FCA grants relators attorneys' fees and reasonable expenses against the defendant only in successful actions.<sup>93</sup> In unsuccessful *qui tam* actions, the relator may be required to pay the defendant's reasonable fees and expenses if the claim is "clearly frivolous, clearly vexatious, or brought primarily for purposes of harassment" and the Government has not intervened in the action.<sup>94</sup>

### **H. Whistleblower Protection**

The 1986 Amendments also provide protection to *qui tam* relators who become whistleblowers against their employers. Relators who experienced employer retaliation before 1986 were forced to seek relief under state laws, which provide mixed results.

The FCA now provides a uniform federal remedy for whistleblowers who have been subjected to retaliation because of their involvement in an FCA lawsuit. This section not only protects *qui tam* plaintiffs but also individuals who investigate, testify, or otherwise provide assistance in an FCA action. The law authorizes Courts to order the reinstatement of whistleblowers and to provide double back pay, interest on back pay, and other special damages including litigation fees.<sup>95</sup>

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<sup>93</sup> 31 USCA § 3730(d)(1),(2).

<sup>94</sup> 31 USCA § 3730(d)(4).

<sup>95</sup> 31 USCA § 3730(h).

## V. Federal Contract Law and the FCA

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Compliance with federal contract law primary determines contractor liability under the FCA and a huge number of statutes and regulations make up federal contract law. The Federal Acquisition Regulation (“FAR”) is the foundation of federal contract law and outlines the obligations of Government contractors. The following will provide a brief overview of the elements of federal contract law.<sup>96</sup>

### **A. Types of Government Contracts**

The FAR classifies federal contracts is a number of different ways and each impose significantly different obligations on Government contractors. Payment method and procurement method are the major ones encountered.

#### **1. Procurement Methods**

Federal agencies can solicit contractual services through two procurement methods: (i) sealed bids or (ii) negotiation. In sealed bid contracts, the Government provides precise specifications describing the required goods or services. After the Government issues an “Invitation for Bids”, offerors submit a bid that meets Government specifications. A bid that deviates from these specifications is usually rejected as "non-responsive." Among the bids that are responsive, the contracting officer must determine which bidders satisfy the "responsibility" requirement. Responsible bidders must have the financial, managerial, and technological capacity to perform the contract. The contracting officer then selects the lowest bid that is both responsive and responsible.<sup>97</sup>

For contracts in which the Government cannot provide exact specifications – for example, contracts for the development of new military technologies – the Government engages contractors through negotiation.<sup>98</sup> To negotiate a contract, the Government first issues a "request for proposals" or "request for quotations."<sup>99</sup> The request outlines the Government need in general terms, enabling the offeror to suggest the best method to perform the contract. Agencies enjoy great latitude in setting selection criteria.<sup>100</sup> During the selection process, the agency

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<sup>96</sup> In the preparation of this section the author has relied heavily on Paul W. Morenberg, “Comment: Environmental Fraud by Government Contractors: A New Application of the False Claims Act”, 22 B.C. Envtl. Af. L. Rev. 623 (1995).

<sup>97</sup> James F. Nagle, ABA. Sec. Gen. Prac., How to Review a Federal Contract (1990).

<sup>98</sup> James F. Nagle, ABA. Sec. Gen. Prac., How to Review a Federal Contract (1990).

<sup>99</sup> 48 CFR § 15.402(a).

<sup>100</sup> 48 CFR § 15.605. Although price and quality are typically considered, the agency may select the proposal that "offers the greatest value to the Government in terms of performance and other factors."

may negotiate with the offeror to modify subcontracting arrangements<sup>101</sup> and pricing.<sup>102</sup>

## **2. Payment Methods**

There are two primary ways in which contractors are paid for their services: (i) fixed-price payment and (ii) cost-reimbursement. In fixed-price contracts, the Government and contractor agree to a final price in advance of performance. Fixed-priced agreements are most appropriate for contracts that include exact specifications that allow the bidder to compute its bid and so most sealed bid contracts include a fixed-price agreement.

The Government estimates a total cost that is subject to modifications in cost-reimbursement contracts. The estimate of total costs constitutes a maximum that the contractor may not exceed without the Government's approval. The Government uses reimbursement contracts when it does not have precise specifications. As a consequence most negotiated contracts are paid through cost reimbursement. As with fixed-cost contracts, the Government may select different payment options for reimbursement contracts.

The Government imposes significant restrictions on reimbursement contracts because of the great potential for waste. For example, cost contracts are only awarded to contractors with sophisticated accounting systems that can accurately identify contract related expenses and contractors are only reimbursed for costs that are deemed "allowable" business expenses directly related to contract performance. Lastly, the Government retains the right to inspect and audit records until three years after final payment.<sup>103</sup>

### **B. Solicitation and Bidding Requirements**

The FAR prohibits any form of collusion among contractors that develop prices for an offer. Most Government contracts require the offeror to sign a "Certificate of Independent Price Determination." This certificate requires offerors to pledge that they did not communicate or negotiate with other offerors in setting prices. In both sealed bidding and negotiation, offerors may not disclose their prices to other offerors. Moreover offerors may not attempt to restrict competition by inducing other offerors to submit or not to submit bids.<sup>104</sup>

In addition to prohibiting collusion among bidders, the FAR prohibits the use of fees, gratuities and kickbacks intended to secure favorable treatment in contract procurement.<sup>105</sup> Contractors may not provide gifts or entertainment to

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<sup>101</sup> 48 CFR §§ 15.700-.708.

<sup>102</sup> 48 CFR §§ 1 5.800-.814.

<sup>103</sup> Paul W. Morenberg, "Comment: Environmental Fraud by Government Contractors: A New Application of the False Claims Act", 22 B.C. Env'tl. Af. L. Rev. 623 (1995).

<sup>104</sup> 48 CFR § 52.203-2.

<sup>105</sup> 48 CFR §§ 52.203-3 to -5, 52.203-7 to -13.

Government employees involved with contract selection.<sup>106</sup> Likewise, subcontractors may not provide kickbacks to prime contractors "as an inducement of acknowledgment" for subcontracts.<sup>107</sup>

The FCA has been used to combat fraud in the procurement of contracts. In *United States v. Killough*, two Government officials allegedly solicited kickbacks from contractors seeking to provide disaster relief services.<sup>108</sup> The United States Court of Appeals for the Eleventh Circuit upheld an award of damages that exceeded the amount of the kickbacks. The court stated that the fact finder must determine the Government's potential savings if the bidding had been open, fair and competitive.<sup>109</sup>

### **C. Accurate, Complete and Current Pricing**

For negotiated contracts where few bidders can provide the needed services, the Government often demands the submission of pricing data.<sup>110</sup> The Truth in Negotiations Act (TINA) requires the government to obtain pricing data for contracts that are not awarded through sealed bids.<sup>111</sup> Contractors must certify that their prices are accurate, complete and current and disclose all factual information that supports the computation of contract prices.<sup>112</sup> Until the parties conclude a pricing agreement, contractors are required to update their data and factual information. TINA defines defective pricing as any data that is "inaccurate, incomplete, or non-current" as of the date of the agreement.<sup>113</sup> If the Government overpays for a contract due to defective pricing, the Government may obtain price reductions and penalties.<sup>114</sup>

The Government may prosecute "defective pricing" under the FCA as well as under TINA. The FAR requires the contractor to sign a "Certificate of Current Cost or Pricing Data" in Contracts where pricing data is required.<sup>115</sup> In addition, the cover sheet for most federal contract bids requires a certification that pricing

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<sup>106</sup> 48 CFR § 52.203-5.

<sup>107</sup> 48 CFR §§ 3.502-3, 52.203-7.

<sup>108</sup> *United States v. Killough*, 848 F.2d 1523 (11th Cir. 1988).

<sup>109</sup> *United States v. Killough*, 848 F.2d 1523 (11th Cir. 1988).

<sup>110</sup> David O. Stewart, Recent Developments in the False Claims Act, 20 Pub. Cont. L.J. 386 (1991).

<sup>111</sup> 10 USC § 2306a(a)(1)(A). The submission of pricing data can be waived if the contract price reflects "adequate price competition"; "established catalog or market prices of commercial items"; "prices set by law or regulation"; or "in an exceptional case when the head of the agency determines." Id. § 2306a(b).

<sup>112</sup> 10 USC § 2306a(g) (pricing data includes all facts that "a prudent buyer or seller would reasonably expect to affect price negotiations significantly").

<sup>113</sup> 10 USC § 2306a(d)(1)(B).

<sup>114</sup> 10 USC § 2306a(e).

<sup>115</sup> 48 CFR § 15.804-4.

information "reflects our best estimates and/or actual costs."<sup>116</sup> When contractors falsely certify the accuracy of pricing data, the effect is to submit a false claim for payment.

#### **D. Allowable Costs**

The Government must still scrutinize contract expenditures to determine if they are allowable even if contractors provide accurate pricing data. Contractors cannot legally charge the Government for extravagant or unneeded services. The two principal elements of allowability are (i) reasonableness and (ii) allocability. Moreover, allowable costs also must comply with the terms of the contract, applicable accounting standards and other FAR cost standards.<sup>117</sup>

##### **1. Reasonable Costs**

A cost is reasonable under the FAR if it would be incurred by a prudent person engaged in competitive business. If an investigation suggests that a cost may not be reasonable, the contractor has the burden of proving its reasonableness. Four factors are used to determine reasonableness: (i) whether the cost is ordinary and necessary; (ii) whether the cost reflects sound business practices and applicable laws; (iii) whether the cost is consistent with the contractor's responsibilities to the Government, other customers, and the public; and (iv) whether the cost deviates from the contractor's established practices.<sup>118</sup>

##### **2. Allocable Costs**

The contractor must show that the cost is "allocable" to its Government contract as well as demonstrating its reasonableness. Allocable costs must be "assignable or chargeable" to the contract and the FAR establishes three different tests that satisfy allocability: (i) a cost is allocable if the cost specifically supports the contract; (ii) a cost is allocable if the cost supports both the contract and other work (if so, the contractor must determine the portion of the cost that benefits the contract) and (iii) a cost is allocable if the cost supports "the overall operation of the business."<sup>119</sup>

##### **3. Unallowable Costs**

The FCA can be used to sue contractors that seek to charge the Government for costs that are unreasonable, improperly allocated or otherwise unallowable and so contractors that overcharge the Government for the cost of labor can be

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<sup>116</sup> David O. Stewart, "Recent Developments in the False Claims Act", 20 Pub. Cont. L.J. 386 (1991).

<sup>117</sup> 48 CFR § 31.201-1, *et seq.*

<sup>118</sup> 48 CFR § 31.201-1, *et seq.*

<sup>119</sup> 48 CFR § 31.201-1, *et seq.*

sued under the FCA.<sup>120</sup> Further, contractors that utilize federal funds to support expenses that do not benefit the Government can also be sued.<sup>121</sup>

### **E. Contract Certifications**

Although the federal procurement process is designed to secure needed goods and services at a reasonable cost, the Government also considers a variety of social and economic policy goals in awarding contracts. Some of these goals include support for small businesses owned by women, promotion of equal employment opportunities and compliance with federal environmental laws. When the Government requires contractors to certify compliance with certain laws, regulations and policies, failure to comply with those laws, regulations and policies constitutes a material breach of the prime contract.

Violation of socioeconomic certifications can lay a basis for an FCA suit and even when contractors otherwise comply with contract terms, they may be sued for breaching a contract certification. In *United States v. Rule Industries*,<sup>122</sup> a Government contractor certified that its steel hacksaw blades satisfied the Buy American Act. The United States Court of Appeals for the First Circuit held the contractor liable for fraud even though the contractor provided high quality blades. As the Government suffered no financial loss due to the substitution, the Government could not collect treble damages against the defendant but the Government could obtain civil penalties for each fraudulent substitution.<sup>123</sup>

### **F. Contract Specifications**

Government agencies utilize detailed specifications to control the spending practices of contractors. Specifications include written instructions, industry standards, drawings and prints in addition to reviewing the allowability of contractor expenses.<sup>124</sup> While some specifications provide exacting technical descriptions, others use a "size range or performance minimum."<sup>125</sup> Contractors cannot deviate from contract specifications without first obtaining Government approval.

The FCA can be used to sue contractors that bill the Government for services that fail to meet contract specifications. In *United States v. Aerodex*,<sup>126</sup> the defendant provided the Navy with "nonconforming" ball bearings at a cost of \$27,000. While the contract required delivery of "P/N 17185" bearings, the

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<sup>120</sup> *United States v. Isenberg*, 110 F.R.D. 387 (D. Conn. 1986).

<sup>121</sup> David C. Hsia, "Symposium on Qui Tam Litigation: An Overview and Introduction", 14 J. Legal Med. 265 (providing example of false claim in which shipyard charges U.S. Navy for work performed on commercial ship).

<sup>122</sup> *United States v. Rule Industries*, 878 F.2d 535 (1st Cir. 1989).

<sup>123</sup> *United States v. Rule Industries*, 878 F.2d 535 (1st Cir. 1989).

<sup>124</sup> James F. Nagle, ABA. Sec. Gen. Prac., How to Review a Federal Contract (1990).

<sup>125</sup> James F. Nagle, ABA. Sec. Gen. Prac., How to Review a Federal Contract (1990).

<sup>126</sup> *United States v. Aerodex*, 469 F.2d 1003 (5th Cir. 1972).

defendant furnished "P/N 117971" bearings. The United States Court of Appeals for the Fifth Circuit concluded that the defendant had violated the FCA by failing to meet Government specifications and said that the Government need not prove that nonconforming goods are inferior.

The Government's loss was found to be the difference between contract price and the reasonable value of the goods provided. The court concluded that the contract price of \$27,000 represented the Government's loss subject to then existing double damage award since the defective goods were useless to the Navy.<sup>127</sup>

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<sup>127</sup> *United States v. Aerodex*, 469 F.2d 1003 (5th Cir. 1972).

## VI. Targets of FCA Litigation

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Beginning with the Civil War and continuing with the 1986 Amendments, the FCA primarily targeted defense contractor fraud<sup>128</sup>; however, it is increasingly used to recover for Medicare and Medicaid fraud.<sup>129</sup> In 1987, medical fraud comprised 12% of *qui tam* cases but in ten years had increased to 54% of the cases.<sup>130</sup> Today its about 80%.

In recent years the oil and gas industry has been subject to the FCA in cases where the producer failed to pay the Government its full share of royalties from Government owned lands.<sup>131</sup> This illustrates the “Reverse False Claim” where a claimant submits a false document to the Government attempting to reduce the amount paid to the Government rather than increase the amount the claimant is paid by the Government.<sup>132</sup>

Other Reverse False Claims include bulk or mass mailers certifying that their mailing is eligible for fourth class postage rather than third class that carries a higher rate. Actual recovery in the bulk mailing FCA’s have been in the millions.

In the 20 years since the 1986 Amendments total recoveries under the False Claims Act have exceeded \$17 billion and in excess of \$10 billion was recovered in *qui tam* actions with nearly \$2 billion paid to relators. The FCA widely applies to almost any situation where federal dollars are found. The range of FCA cases has grown and will continue to grow limited only by the relator’s ingenuity and creativity. They include but are certainly not limited to:

### **A. Defense Contractors**

From its earliest days during the Civil War in the 1860s, the defense industry was the primary impetus for enactment of the original False Claims Act. The Congress was concerned not only about the threat to the federal treasury but also the impact on the military and the lives of the soldiers themselves that resulted from the sale of defective goods by unscrupulous contractors. Over a century later the same concerns resulted in the 1986 revisions to the FCA.

Following the enactment of the 1986 Amendments, the majority of the FCA cases were initially brought against defense contractors. But over time a small number of false claims cases involving the health care industry grew to become the bulk of the false claims cases. Even though the number of cases involving

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<sup>128</sup> Sylvia § 2:13.

<sup>129</sup> Sylvia § 2:14.

<sup>130</sup> 12 False Claims Act & Qui tam Q. Rev. 41 (Jan 1998).

<sup>131</sup> Sylvia § 2:17.

<sup>132</sup> 31 USCA § 3729(a)(7).

defense contractors has declined as a percentage of the overall number of FCA cases brought, defense contractor fraud remains significant.

### **B. Health Care**

In 1986 when Congress contemplated revising the False Claims Act, it envisioned that health care fraud would be one of the areas in which the FCA would prove useful. Since the 1986 Amendments health care fraud has become the largest single source of recovery to the federal Government under the act. In the year following the 1986 Amendments health care fraud cases accounted for about 12% of *qui tam* recovery under the False Claims Act. But two decades later, health care fraud has provided 80% of the net recoveries under the FCA.

Health care fraud has encompassed a wide spectrum of improper contract reads ranging from over billing to workup coding to fraudulent cost reporting by providers to simply billing for services not provided or failure to provide the required quality of care. The health care industry has been the source of many of the largest recoveries, most recently a recovery of \$900 million from Tenet and earlier HCA Columbia paid over \$840 million to settle allegations of Medicare fraud.

Fraudsters in the Medicare and medical industry fought the False Claims Act vigorously claiming that was never intended to be used against health services industry; however, the massive recovery from the health and medical industry should dispel any thought that fraud is not widespread and massive.

"The scale of fraud in the prescription drug arena is breathtaking," notes Jim Moorman, President of Taxpayers Against Fraud, a group set up by *qui tam* plaintiff lawyers to track and defend the law. "Only 14 cases have been settled so far, but they have returned over \$3.44 billion to the U.S. Government. Over 150 cases, involving more than 500 drugs, are now under investigation."

Fiscal Year 2006 was jump started with a \$704 million settlement with Serono Inc. for the illegal marketing of an anti-AIDS wasting drug called Serostim. Other large False Claims Act cases in the first three months of FY 2006 include a \$124 million settlement with King Pharmaceuticals, a \$40 million settlement with Erlanger Medical Center in Tennessee and a \$62 million settlement with Tenet Healthcare.<sup>133</sup>

With another settlement of \$900 million involving Tenet in June of 2006, Tenet has become known as the "clown car" of medical fraud. This latter settlement involves an esoteric scheme on the Medicaid "Outlier" reimbursement system demonstrating the great creativity and resourcefulness of the medical fraudsters.

Recall that penalties up to \$11,000 may now be imposed for each false claim even where no damages are proven.<sup>134</sup> When these penalties are aggregated because of many false claims for small amounts, the resulting FCA

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<sup>133</sup> 20 Corporate Crime Reporter 5(4), January 24, 2006.

<sup>134</sup> *Varljen vs Cleveland Gear Co.*, 250 F3d 426 (6<sup>th</sup> Cir. 2001).

recovery can be sizable. This is particularly true in medical fraud where the claims are small but the number is large.

### **C. Environment**

Environmental regulation is an area well suited to the False Claims Act and *qui tam* actions in particular. Regulation of the environment involves a major investment of federal funds and a number of violations are difficult for the Government to detect. False claims in the environmental field can involve major costs to health and safety as well as financial cost just like in the defense and health care industries.

Many environmental statutes already provide a manner in which private citizens can sue wrongdoers. But these so-called citizen suits are subject to a number of limitations that do not apply to *qui tam* actions. Much of the relief available in citizen suits is prospective and does not alleviate past harm. Importantly the applicable statutes of limitations for citizen suits are often times shorter than for False Claims Act cases. An important advantage to the False Claims Act case is that the Government is under some obligation to investigate *qui tam* cases while oftentimes environmental statutes do not require the Government to take any action. Finally, as with many other areas subject to *qui tam* cases, the financial rewards to a potential relator to bringing a *qui tam* case are often far larger.

There are two theories in general, of liability that may be used for False Claims Act cases. First one is fraud in the provision of environmental services to the Government. Government spends substantial amounts of money on environmental cleanup, and much of this money is paid to contractors. The second possible area for false claims cases involves general Government contracts arising from violations of environmental laws.

In 2003 the DOJ intervened in a *qui tam* case filed in Kentucky by the Natural Resources Defense Council, et al., against Lockheed Martin involving its management of Department of Energy (“DOE”) nuclear facilities.<sup>135</sup> The unsealed Amended Complaint in that case provides a roadmap for possible recovery under Government contract law in the FCA arena. This case remains pending.

### **D. Financial Services**

The False Claims Act can also play a significant role in the financial services industry. Although a significant amount of the misconduct in the financial services industry involves abuse of private funds, a False Claims Act lawsuit may exist if federal funds are involved.

In a pre 1986 Amendments case *United States v. Ekelman & Associates, Inc.*,<sup>136</sup> the defendants falsified applications for loans guaranteed by the Veterans

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<sup>135</sup> *United States ex rel Natural Resources Defense Council, et al. vs Lockheed Martin Corporation, et al.*, United States District Court for the Western District of Kentucky, CIV-5:99CV00170-M.

<sup>136</sup> *United States v. Ekelman & Associates, Inc.*, 532 F.2d 545 (6th Cir. 1976).

Administration or insured by the Federal Housing Authority. After the loans went into default, the Government expended funds to maintain the property until the property's resale. In *Ekelman*, the United States Court of Appeals for the Sixth Circuit awarded the Government not only its losses due to the default but also its maintenance and repair costs after foreclosure.<sup>137</sup>

In the late 1990s, a series of False Claims Act cases involving so-called “yield burning” against multiple defendants was eventually settled for about \$180 million. The yield burning scheme was dependent upon the way in which the municipal bond market is regulated. Local Governments issue tax-exempt bonds to fund public works like schools, bridges and roads. The tax-exempt nature of the bonds lowers the interest rate paid to the holders of bonds, which in turn lowers the cost of financing to the municipalities because of the tax benefit. The federal Government imposed strict regulations on such bonds regarding yield or profit and a requirement that any excess profits had to be paid to the federal Government. The yield burning scheme involved artificially lowering the bonds’ yield by pricing the security in excess of its fair market value and as a result decreasing the amount paid to the Government, hence the term “yield burning”.

More recently in January of 2006 a \$42 million settlement was reached with ABN AMRO Mortgage Group and a \$25 million settlement was announced involving four national accounting firms that had been pocketing travel rebates that should have gone back to the U.S. Government.<sup>138</sup>

See also the fraud on the USDA by Gold Bank and Farmers Exchange Bank discussed below under the section “Agriculture and the False Claims Act”.

### **E. Oil & Gas**

Leases for the extraction of oil, gas and minerals from public lands have resulted in a number of False Claims Act cases. The Minerals Management Service (“MMS”) of the United States Department of the Interior administers federal leases. Companies that lease federal lands for those purposes are required to report monthly the amount and value of oil or other resources generated from public lands. In turn, those companies are obligated to pay royalties to the United States based on the production from the resources that they report.

*Qui tam* lawyers and the Government have sued under the False Claims Act in a number of cases claiming that oil companies with such leases failed to report truthfully and honestly. “Big Oil” underreported total volume of oil and gas produced on those lands and in turn the royalties owed to the United States. A total of \$440 million has been recovered by the United States in such cases for the underpayment of royalties.

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<sup>137</sup> *United States v. Ekelman & Associates, Inc.*, 532 F.2d 545 (6th Cir. 1976).

<sup>138</sup> 20 Corporate Crime Reporter 5(4), January 24, 2006.

## **F. Scientific Research**

The federal Government pays a large amount for scientific research. The False Claims Act comes into play in this arena when false statements are made in applications for grants for the scientific research, the expenditure of funds in violation of applicable regulations, breach of contract requirements and finally falsifying scientific data.

There have been a number of successful FCA cases in which the Government has pursued for scientific research fraud. In the early 1990s a former laboratory research assistant filed a *qui tam* action against the University of Utah and the University of California as well as a former faculty member at both schools. The lawsuit claimed that the former faculty member falsely reported research data on the causes of immune system suppression after burn injury. This false data formed the basis for both universities obtaining funding from the National Institutes of Health (“NIH”). Both universities were aware that the researcher’s data was false and failed to monitor or correct the work involved. In 1994, both universities agreed to pay the Government a total of \$1.575 million to settle these claims.

## **G. Education**

The August 4, 2006, issue of The Chronicle of Higher Education outlines three major pending false claims cases that are illustrative of possible problems in the educational industry.

In the *United States v. the University of Phoenix* the complaint asserts that the institution certified that it was in compliance with all Department of Education regulations when it was paying recruiters based on how many applicants they enrolled, a direct violation of law. This complaint was dismissed in the United States District Court but is now on appeal to the United States Court of Appeals for the Ninth Circuit. The amount of money in play in this case is thought to be in the neighborhood of \$1 billion – that’s with a “B”.<sup>139</sup>

In the *United States v. Oakland City University* the complaint is similar to that in the *University of Phoenix* case. It is considered a precedent because the United States Court of Appeals for the Seventh Circuit ruled that the University knew it was illegal to pay recruiters and “lied to the Department of Education in order to obtain a certification of eligibility” to receive federal funds. The Seventh Circuit remanded the case to the United States District Court for trial in October of 2005 which is expected to begin in May of 2007.<sup>140</sup>

In the *United States v. Chapman University* the complaint says the institution, as a part of the accreditation process, certified that it was giving the required amount of classroom instruction in its academic programs, when it was not. If it had revealed the truth, the complaint alleges, Chapman would not have been accredited and would be ineligible to receive federal grants and student

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<sup>139</sup> The Chronicle of Higher Education, August 4, 2006.

<sup>140</sup> The Chronicle of Higher Education, August 4, 2006.

loans. The case is active before the United States District Court in California and in May of 2006 the judge denied a motion to dismiss.<sup>141</sup>

The Chronicle says that “[b]illions of federal dollars go to colleges each year, making them a ripe target for whistle-blower suit.”<sup>142</sup>

#### **H. Other Government Programs**

FCA cases cut across a range of Government programs and industries. Federal housing programs have resulted in a number of False Claims Act cases. Not only do these programs involve significant federal powers but they also have important social goals that are undermined by misuse of program resources and fraud.

Computer and software manufacturers have been defendants in False Claims Act suits normally involving the failure to inform the Government of discounts made available to commercial customers. For example Gateway Computers paid a settlement of \$9 million in 2000 for such conduct. Because the computer industry is a growing one and its share of federal contracting dollars increasing, it is likely to be a fast growing source of False Claims Act cases.

And of course there is ample fraud involving farmers and agriculture that is discussed in the following section.

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<sup>141</sup> The Chronicle of Higher Education, August 4, 2006.

<sup>142</sup> The Chronicle of Higher Education, August 4, 2006.

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## VII. Agriculture and the False Claims Act

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Fraud is pervasive in all areas of the Government and agriculture is no exception; however, agriculture has barely been on the FCA radar screen since the 1986 Amendments. That may be changing. Some of the known areas in which the FCA has been used include:

### **A. Defective Goods**

In *Faulk v. United States*, the United States Court of Appeals for the Fifth Circuit concluded that a dairy producer committed fraud under the FCA in providing the Air Force with recombined milk rather than fresh milk, which the contract specified.<sup>143</sup>

One of the reasons for the 1863 original FCA was contractors delivering shoddy goods to the Union Army. Some things never change.

### **B. Subsidy Payments**

Probably the largest FCA case involving subsidy payments by the United States Department of Agriculture (“USDA”) was filed in December 2003 against Lamont Peterson and others in the United States District Court of Minnesota. The complaint alleges that the defendants created a fraudulent scheme to avoid Congress’ mandate to cap the amount of farm subsidies a person can receive each year. From 1996 to 2002, the defendants conspired to circumvent farm program payment caps by claiming to the USDA that Peterson Farms, Keywest Farms, and Division III Farms were three separate and distinct farming operations when in fact they were not and by claiming to the USDA that certain persons affiliated with the three partnerships were actively engaged in farming when in fact they were not.

The complaint asserts that by providing such false information to the USDA, the defendants were able to fraudulently increase their annual payments from one to nine under five separate federal farm programs. During the course of the scheme, the defendants submitted 176 false claims to the USDA, totaling over \$4 million in farm subsidies. The court docket reflects that the case was settled in June 2006 but the settlement agreement has not yet been filed.

### **C. Federal Crop Insurance**

In 1994 an approved insurance provider represented that raisins in the Fresno, California, area were unable to be reconditioned because of rain damage, causing the Federal Crop Insurance Corporation (“FCIC”) to reinsure the claims paid. Those raisins were then reconditioned and sold at full market value. The case also alleged the duplication, falsification and fabrication of documents by

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<sup>143</sup> *Faulk v. United States*, 198 F.2d 169 (5th Cir. 1952).

the approved insurance provider. The case was settled for \$10 million which was then the largest recovery under the False Claims Act in the history of the FCIC.<sup>144</sup>

More recently on March 30, 2006, the United States Attorney announced that William Jesse Moore and Bobby Elbridge Moore, of Crowell, Texas, the general partners of Moore Farms, paid \$900,000 to the Government to settle a civil lawsuit filed in August 2004 under the False Claims Act alleging the defendants filed false insurance claims for the 1998 crop year. Wendell Mints was convicted in February 2004 on 25 counts of an indictment that charged him with operating an elaborate scheme in which he “worked the system” to falsify crop insurance loss documents and collected insurance money for thousands of acres of cotton and wheat sorghum fields he did not plant – defrauding the Government of nearly \$500,000. Mints was also ordered to pay restitution. Moore Farms was one of Wendell Mints Insurance Agency’s larger clients.<sup>145</sup>

#### **D. Guaranteed Loans**

The largest FCA settlement in Oklahoma announced in August 2004 was for \$16 million in a Western District of Oklahoma case.<sup>146</sup> In this case farmer and then law student Roger Ediger discovered what he believed to be a problem with interest assist (“IA”) subsidy payments made to Gold Bank by the USDA Farm Service Agency (“FSA”). These IA payments were intended to benefit farmers with FSA Guaranteed Loans (“GL”) at Gold Bank.

Ediger, acting as relator, and his attorneys successfully prosecuted the FCA action in the Western District of Oklahoma resulting in the \$16 million recovery for the Government. The settlement also included statutory attorney fees for Ediger’s attorneys.<sup>147</sup> At the time of settlement Ediger was among the 100 largest recoveries in the 140 year history of the FCA.

What is thought to be the next largest FCA recovery in Oklahoma was a second settlement involving an identical fraud on the FSA GL program. This settlement was announced in the spring of 2006 for \$2.1 million again in a Western District of Oklahoma case.<sup>148</sup> In this case farmer Ronald Jenlink and Greg Boruff filed an FCA against the Farmers Exchange Bank of Cherokee,

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<sup>144</sup> *Risk Management Agency Program Compliance and Integrity Annual Report to Congress June 2000 – December 2001*, April 2002.

<sup>145</sup> Press Release by the United States Attorney for the Northern District of Texas, March 31, 2006, [http://www.usdoj.gov/usao/txn/PressRel06/moore\\_farms\\_settlement.html](http://www.usdoj.gov/usao/txn/PressRel06/moore_farms_settlement.html).

<sup>146</sup> *USA ex rel. Roger Ediger vs. Gold Banc, et al.*, CIV-02-1493-R, United States District Court for the Western District of Oklahoma.

<sup>147</sup> In the interest of full disclosure the author and his firm prosecuted Ediger with Susman Godfrey of Dallas, Texas. The Government intervened for settlement purposes a month after the \$16 million settlement was negotiated by Ediger’s attorneys. Ediger is now a member of the author’s firm.

<sup>148</sup> *USA ex rel. Ronald Jenlink and Greg Boruff vs. Farmers Exchange Bancorporation, Inc., et al.*, CIV-03-1424-R, United States District Court for the Western District of Oklahoma.

Oklahoma because of its scheme to skim FSA IA subsidy payments that should have been passed on to its farmer customers.<sup>149</sup>

Defendants nearly always claim that they did nothing wrong or that the suit was based on a hyper technical violation of some hard to understand law. That is seldom if ever true. To illustrate in *Ediger*, under the interest assist subsidy the FSA paid Gold Bank 4% interest that the bank knew was all to be passed on and credited to its farmer borrower. A Senior Vice President of Gold Bank often explained the scheme to his farmer customers to induce them to participate in the program as follows: “Let me tell you how the program works. The Government give us 4%. You get 2%. The bank gets 2%.” This high level official of Gold Bank has recently served as the President of the Oklahoma Bankers Association.

*Ediger* was the first known use of the FCA in the FSA GL program and is an example of the creative uses of the FCA that can be expected to grow in the coming years.

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<sup>149</sup> The author’s firm likewise handled *Jenlink*.



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## VIII. Miscellaneous

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### **A. Taxpayers Against Fraud**

The single most valuable resource to a *quit tam* plaintiff's attorney is the Taxpayers Against Fraud Education Fund ("TAF") – a nonprofit, public interest organization dedicated to combating fraud against Government through the promotion and use of the Federal False Claims Act and its *qui tam* provisions.

TAF maintains a website of incalculable value at [www.taf.org](http://www.taf.org) and also publishes the False Claims Act and Qui tam Quarterly Review.

While the American Bar Association annually conducts a seminar on the False Claims Act, the weapon of choice for the TAF plaintiff's bar is the annual TAF FCA Conference held in Washington, DC each year in the late summer or fall.

### **B. Library Resources**

While it's been around since Civil War, the FCA does not occupy a lot of shelf space in law libraries; however, there are four primary treatises:

- ❑ Claire M. Sylvia, The False Claims Act: Fraud Against the Government (West, 2004) is current, complete, balanced, helpful and readable.
- ❑ James B. Helmer, Jr., False Claims Act: Whistleblower Litigation (LexisNexis, 3<sup>rd</sup> Edition, 2002) is another very readable current publication written from the angle of the relator. It's been around quite some time since it's about to go into its 4<sup>th</sup> edition. It offers a good deal of helpful commentary. Helmer has been one of the most respected and preeminent FCA lawyers in the country for decades.
- ❑ John T. Boese), Civil False Claims and Qui tam Actions (Aspen Law & Business, 2<sup>nd</sup> ed. Supp. 2003-2) is written from the viewpoint of one who represents defendants in FCA cases. While often cited, it is not the first place most plaintiff's *qui tam* lawyers look for authority.
- ❑ Joel M. Androphy, Federal False Claims Act and Qui tam Litigation (Law Journal Press, 1<sup>st</sup> Edition, 2006) has just been released and this author has not seen a copy.

There is no FCA "reporter" or service. About the closest thing would be the TAF website at [www.taf.org](http://www.taf.org) which is available to the public but also contains a section only available to TAF members and supporters. Again TAF publishes the False Claims Act and Qui tam Quarterly Review which is available for public subscription.

### **C. Debarment and Criminal Provisions**

While not a part of the FCA, the Government has the authority to prohibit corporations and individuals guilty of fraud from doing business with the federal

Government. This “Debarment” or exclusion authority is considered the equivalent of the death penalty, because for major health care corporations and defense contractors which rely on federal contracts, denying them federal contracts effectively puts them out of business.<sup>150</sup> The Government rarely exercises this authority – although it could more often to deter an ongoing pattern of criminal fraud.

Violation of the FCA also has criminal ramifications that the Government can in theory pursue without regard to the civil aspects of the FCA.<sup>151</sup>

#### **D. State FCAs**

Beginning with California in 1987, a number of states have enacted state FCAs with Michigan the most recent addition. Most of these state FCAs are modeled on the federal FCA, but several are limited to contractor or medical fraud. There are important differences in even the broader form of state FCAs. For example most state FCAs – like the federal FCA – exclude claims for income tax or revenue; however, a few states do permit FCAs based on their income tax or revenue laws.

At last count 16 states plus the District of Columbia have some version of an FCA: Arkansas<sup>152</sup>, California<sup>153</sup>, Delaware<sup>154</sup>, District of Columbia<sup>155</sup>, Florida<sup>156</sup>, Hawaii<sup>157</sup>, Illinois<sup>158</sup>, Louisiana<sup>159</sup>, Massachusetts<sup>160</sup>, Michigan<sup>161</sup>, Montana<sup>162</sup>, New Mexico<sup>163</sup>, Nevada<sup>164</sup>, Tennessee<sup>165</sup>, Texas<sup>166</sup>, Utah<sup>167</sup> and

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<sup>150</sup> The authority and procedure required for debarment is found in a number of places in federal and state law. Lists of debarred entities are likewise numerous.

<sup>151</sup> 18 USCA § 287.

<sup>152</sup> ARK. CODE ANN. Sec 20-77-901 *et seq.* (2000). [Medicaid].

<sup>153</sup> CAL. Gov’t Code Sec 12650 *et seq.* (DEERING 2000). [General].

<sup>154</sup> DEL. CODE. ANN. tit. 6, Sec 1201 *et seq.* (2000). [General].

<sup>155</sup> D.C. CODE ANN. Sec 1-1188.13 *et seq.* (2000). [General].

<sup>156</sup> FLA. STAT. 68.081 *et seq.* (2000) [General].

<sup>157</sup> HAW. REV. STAT. Sec 661-22 *et seq.* (2000). [General].

<sup>158</sup> 740 ILL. COMP. STAT. ANN. Sec 175/1 *et seq.* (2000). [General].

<sup>159</sup> LA. REV. STAT. ANN. Sec 46:439.1 *et seq.* (2000). [Medical Assistance].

<sup>160</sup> MASS ANN. LAWS CH. 12, Sec 5(A)-(O).

<sup>161</sup> MI Public Act 337 Public Acts of 2005.

<sup>162</sup> Mont. Code, CH. 465, HB 146 (2005).

<sup>163</sup> Signed by Governor *Effective May 19, 2004.*

<sup>164</sup> NEV. REV. STAT. Sec 357.010 *et seq.* (1999). [General].

<sup>165</sup> TENN. CODE. ANN. Sec 71-5-181 *et seq.* (2000). [Medicaid].

<sup>166</sup> TEX. HUM. RES. CODE Sec 36.001-36.117.

<sup>167</sup> UTAH CODE ANN. Sec 26-20-1 *et seq.* (2000). [Medicaid].

Virginia<sup>168</sup>. FCA legislation is pending in a number of other states and has even been enacted by some cities like Chicago and New York City.

Efforts since at least 2000 to pass such legislation in Oklahoma <sup>169</sup> have been unsuccessful. Experience elsewhere is that a State FCA would increase revenue to the state and local Governments and provide immeasurably improved Government at all levels. Honest merchants, tradesmen and contractors who deal with Government prefer a level playing field and not be forced to compete against a dishonest competitor. The taxpayer greatly benefits directly because of recoveries and indirectly because of the mere presence of the FCA.

One only needs to read Oklahoma history about scandals involving the County Commissioners in the 1970s, the State Health Department in the 1990s and the Tax Commission in the 2000s to see how an FCA in Oklahoma would be useful.<sup>170</sup>

### **E. Qualifying State FCAs**

The federal False Claims Act only applies to fraud against the Federal Government, not the States, and therefore does not cover the States' share of Medicaid spending. In February 2006, Congress sought to close this loophole by enacting section 6031 of the Deficit Reduction Act of 2005, S. 1932, which added section 1909(b) to the Social Security Act to encourage the states without "qualifying" FCAs to pass their own versions of the federal False Claims Act.

Simply in those states that have enacted a qualifying FCA, the state receives a larger share of any FCA recovery from fraud on the Medicaid program.<sup>171</sup> Those states are entitled to an increase of ten percentage points in their share of any amounts recovered under the Act. For example, if a State's federal Medicaid matching rate is 57 percent, it would typically receive only 43 percent of the amount recovered from the fraudfeasor. With a qualifying state FCA, its share would increase by ten percentage points to 53 percent of any FCA Medicaid recovery.

As a result several states have introduced and some have passed qualifying state FCAs.

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<sup>168</sup> VIRGINIA Fraud Against Taxpayers Act, effective Jan. 1, 2003.

<sup>169</sup> Oklahoma has a *qui tam* law but it has little similarity to the Federal FCA or the False Claims Acts found in other states, 62 OS §§ 372-373.

<sup>170</sup> "If individuals who violate the law are required to pay more than the actual harm they impose, the sanctions should have a deterrent effect, even if the risk of getting caught is low." Sylvia § 1:3 summarizing Garry S. Becker, "Crime and Punishment, An Economic Approach", 76 J. Political Economy 169 (1968).

<sup>171</sup> 42 USC § 1396h(b). Taxpayers Against Fraud has researched and developed a Model State False Claims Act that will qualify for sharing under this provision and published it in booklet form.



## IX. Summary

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While the amount of money recovered under the FCA annually benefiting state and federal Governments cannot be underestimated, what should not be overlooked is the deterrent to corporate criminals whose misdeeds harm the sick, infirm<sup>172</sup> and elderly; students and young people; and the policemen, firemen, soldiers, sailors and airmen who risk their lives to defend all of us.

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<sup>172</sup> A part of a deposition of a nurse employed at a nursing home demonstrates that these cases are not about minor technical violations of trivial regulations. The nurse's employer had been sued under the FCA for failure to comply with federal regulations on required levels of staffing, supervision and care of its patients necessary to receive federal money:

MR. DOLLAR: And the issue, as I heard your testimony about ants and what you've seen in other facilities is that in other facilities you would see – and this is probably true in every house in America from time to time an ant here or a specific, you know, a couple of ants, right?

WITNESS [NURSE]: Uh-huh. I mean –

Q. Is that a yes?

A. Yes, it is.

Q. In this facility we're not talking about that; are we?

MR. WENDLER: Objection, form. Not talking about that is vague and indefinite, and she obviously was, because she testified that the ants were no worse in this facility than they were in any other, outside the infestation.

MR. DOLLAR: That's not true.

Q. (By Mr. Dollar) You didn't testify to that; did you?

A. No.

Q. Mr. Wendler's wrong about that?

A. No, I didn't

MR. WENDLER: Well, we'll read the record back.

Q. (By Mr. Dollar) The ant problem you saw in this facility was worse than any other situation?

A. Than I had ever seen. I've never seen –

MR. WENDLER: Oh, okay. I'll agree with that.

A. I never seen ants like that crawling on anybody.

Q. (By Mr. Dollar) And when we're talking about [Elderly Nursing Home Resident], we're talking about a situation in which she was literally covered in ants?

A. Covered.

Q. From head to toe?

A. Yes. She had ants everywhere.

Q. They were swarming all over her body?

A. Yeah.

To put a human face on the FCA consider:

- How many farmers on the financial edge were forced into bankruptcy or had to liquidate because of fraud on the FSA GL program by dishonest banks.
- How many service members were killed or injured because of the knowing sale of defective military equipment by defense contractors.
- How many poor people were deprived of medical care because of the theft of literally billions of dollars from Medicaid by hospital and drug companies.
- How many policemen have been killed or injured because they wore defective bulletproof vests sold by unscrupulous manufacturers.

To be sure these things occurred in spite of the FCA but those who practice in the area like to think that some of the FCA recoveries at least cause a few potential fraudsters to think about the consequences. The \$18 million plus recovery from Oklahoma banks in the *Ediger* and *Jenlink* cases has directly caused the Oklahoma Bankers Association to conduct what were known as “Ediger Prevention Seminars” and to alert members that they should clean up their files and follow the law governing FSA GLs.

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Q. Is that right?

A. Uh-huh. That's true.

Q. And are you aware that her daughters came into the facility to visit their mother and walked into the room and found their mother completely covered in ants?

MR. WENDLER: Let me show an objection to the theatrics in asking the question and to the leading nature. You know, if we're putting on a play, fine, but you've been getting – going a little bit overboard with the theatrics.

A. It's gross.

Q. (By Mr. Dollar) It's what?

A. It's gross. I mean they were crawling in areas that theatrics were needed.

Q. Well, tell me about that. What do you mean?

A. It was bad.

# ***OKLAHOMA BANKER Direct***

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June 8, 2006

P.O. Box 18246, Oklahoma City, OK 73154-0246 (405) 424-5252 [www.oba.com](http://www.oba.com)

## **Urgent information for FSA Guaranteed lenders!**

As you know, Gold Bank and the Farmers Exchange Bank in Cherokee have recently been forced to settle lawsuits filed by Enid attorney Roger Ediger. The total amount of the two settlements exceeds \$18 million.

Ediger filed the suits under the provisions of a rarely-used federal "whistleblower" statute. The suits alleged the banks violated provisions of the Farm Service Agency's Guaranteed Loan Program because the rates for these borrowers were higher than the "average" rates charged to the banks' "average" ag borrowers.

A few minutes ago we were told that, pursuant to a court order, Ediger obtained all the records in the possession of Eddie Adams from Pawnee. Adams is a large third-party processor and packager of FSA Guaranteed loan applications. Adams, we're told, processes and packages these guaranteed loans for a number of banks in Oklahoma and Kansas.

If your bank has done business with Adams in the past, your bank's records could be among the documents that are now in Ediger's possession.

We encourage you to continue your review of any and all FSA Guaranteed loans in your bank's loan portfolio and make certain they are in compliance with the program's requirements.

Please feel free to call Roger Beverage at the OBA if you have questions about this information.

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**Figure 3 – Oklahoma Bankers Association “Emergency” eMail to Clean Up Files**

With the epidemic in corporate wrongdoing, the FCA is vital to those concerned about profiteering, fraud and integrity in Government. It presents a unique opportunity for those with knowledge of fraud to do well by doing good. So too, does the FCA provide a largely untapped practice area to Oklahoma lawyers likewise disposed to **“do well by doing good”**.



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