Legal Backgrounder

WLF Washington Legal Foundation

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Vol. 23 No. 13 March 21, 2008

ARMING GOVERNMENT CONTRACTORS WITH A STATUTORY DEFENSE AGAINST SPECULATIVE *QUI TAM* ACTIONS

by

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Qui tam actions play a vital role in the government procurement process. By encouraging private citizens to report fraud perpetrated against the U.S. government, the law serves as a deterrent and keeps dishonest contractors in check. While the *qui tam* plaintiff receives a percentage of any recovery, the bulk of recovered funds are returned to their rightful owner, the Government. When distilled to this basic premise, *qui tam* actions under the False Claims Act ("FCA") are largely an unobjectionable concept.

Qui tam actions do, however, have the potential for significant abuse in practice when they are left unchecked, as is currently the case. Because the modern-day *qui tam* action typically offers the potential for a significant monetary reward, "opportunism rather than legitimate whistle-blowing [often] motivate[s] the filing of . . . complaint[s]." *Sanderson v. HCA-The Healthcare Co.*, 447 F.3d 873, 876 (6th Cir. 2006). In fact, since 1986, *qui tam* plaintiffs personally have received over $2 billion.[1] Notably, of the concluded cases, over 73-percent have ended in involuntary dismissal.[2]

Because the FCA does not explicitly require *qui tam* plaintiffs to possess firsthand knowledge of the information underlying their allegations, many actions are filed based upon suspicion or speculation and without a sufficient basis. These lawsuits often linger on for months, or even a year or longer, before a court ultimately determines, after dismissing one or two prior complaints, that the lawsuit lacks merit and grants the defendant's motion to dismiss. The casualties of the dismissed suits are not the plaintiffs, but rather the government contractor whose reputation is tarnished and devoid of hundreds of thousands of dollars, if not more, as a result of having defended against speculative allegations.

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[1] *See* TAXPAYERS AGAINST FRAUD EDUC. FUND, FRAUD STATISTICS—OVERVIEW (2007), http://www.taf.org/stats-fy2007.pdf (hereinafter FRAUD STATISTICS).

[2] *See* FRAUD STATISTICS, *supra* note 1, for a chart entitled "Fraud Statistics Qui Tam Intervention Decisions & Case Status," showing that of the 4,381 cases that have concluded through settlement, judgment, or dismissal, 3,222 cases have ended in dismissal – over 73-percent.

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At a time when government contractors are the lifeblood of the government, from assisting our country in the fighting of a war to providing pens and paper to our federal agencies, further checks on *qui tam* actions are needed. This LEGAL BACKGROUNDER proposes the incorporation of direct knowledge and particularity requirements on *all qui tam* plaintiffs. The proposed amendments are likely to produce significant benefits including: deterring the filing of speculative suits; reducing the number of speculative suits that advance; promoting consistency in the law; freeing up government-investigative resources to focus on legitimate actions; sending a message to government contractors that the government values their business and recognizes the hardship associated with defending against speculative allegations; and providing contractors with precise allegations to prepare a defense, at the outset, before one, two, or even three complaints are dismissed without prejudice.

These potential benefits come at little expense to the government, as the proposed changes preserve the important role *qui tam* actions play in the procurement process. While plaintiffs would be required to state their allegations with more substance and precision, such requirements should not affect *qui tam* suits that have a legitimate basis. Ultimately, the likely result would be a decrease in the number of speculative suits that waste government resources and tarnish the reputations of contractors. With 356 *qui tam* actions filed in 2007 alone, the FCA needs additional refinement to discourage what appears to be growing opportunistic behavior. *See supra* note 2.

Defending Contractors in the* Qui Tam *Context. In 1986, Congress overhauled the FCA significantly in an effort "to encourage more private enforcement suits." S. REP. NO. 99-345, at 23–24 (1986), *as reprinted in* 1986 U.S.C.C.A.N. 5266, 5288–89. The 1986 amendments have been successful in fulfilling this objective. Since 1986, over 5,800 *qui tam* suits have been filed and over $12.6 billion has been paid out, in total, under settlements and judgments. *See supra* note 1. Statistics show, however, that the majority of *qui tam* actions lack merit, as more than 73 percent end in dismissal. *See supra* note 2. While there is little question that *qui tam* actions have been beneficial for the Government from a purely monetary perspective, the *qui tam* provisions are being abused by many individuals who are motivated by "opportunism" rather than legitimate "whistle-blowing." *Sanderson*, 447 F.3d at 876.

Important, however, is the fact that the FCA does little to ensure that *qui tam* actions are well founded. While the government recovers billions, many government contractors are left to fend off speculative suits while their reputations are tarnished and pockets emptied. When we consider that the FCA, also known as the Whistleblower Act, was designed to encourage corporate employees to blow the whistle—not outsiders looking to profit financially—it is evident that the FCA needs additional refinement to place a check on *qui tam* plaintiffs. *See, e.g., United States ex rel. Atkinson v. Pa. Shipbuilding Co.*, 473 F.3d 506, 523 n.23 (3d Cir. 2007). Many proposals to amend the FCA have been raised over the years. None, however, have considered the interests of those who voluntarily deal with the government, government contractors.[3]

The FCA Does Not Consider the Interests of Government Contractors. The FCA itself requires little of *qui tam* plaintiffs and offers no mechanism by which government contractors can check speculative suits at the initial stage. The *qui tam* provisions provide that private individuals may bring actions, they proscribe the procedures for initiating suit, they detail the role of the plaintiff, and they discuss the particular percentage of profit to be shared by the plaintiff. *See* 31 U.S.C. § 3730. Clearly, in 1986, when *qui tam* actions were on the decline, Congress' focus was on the federal purse and encouraging the influx of additional funds into it. Despite all this precision, the FCA fails to address a very important issue—the foundation of knowledge or basis for the *qui tam* plaintiff's allegations.

[3]In fact, members of Congress recently have introduced proposals to amend the FCA to make it easier for *qui tam* plaintiffs to pursue these actions. *See* HR 3180, the Whistleblower Recovery Act of 2007, and S. 2041, the False Claims Act Correction Act of 2007.

While the focus of the FCA need not be on protecting contractors, the FCA should, at the very least, only seek to encourage private suits that are based on legitimate allegations of fraud. The statute should recognize the economic damage that can result from unfounded allegations and require allegations to be sufficiently founded. While contractors are typically successful in fending off such allegations, the contractor is, nonetheless, left with the arduous and expensive task of repairing its reputation.

Merely being the subject of an FCA suit carries grave consequences. The notion, alone, of defrauding our country sends a message of ill repute. Reputation or image is everything, and once tarnished, is extremely difficult to restore. In addition to having their reputations tarnished, the contractors typically spend hundreds of thousands of dollars, if not more, fending off these actions. While the suit is pending, contractors are also forced to shift their focus from their business to defending against allegations of fraud. Moreover, coping with these allegations is stressful and wears on contractors, especially those that are small businesses. These huge costs may ultimately put the contractor out of business and result in a loss in jobs, cause the contractor to raise his prices, or discourage future involvement with the government. In all cases, the government, contractors, and taxpayers lose out.

Exception in the Original Source Context. In one instance, the FCA does require that the *qui tam* plaintiff possess a certain level of knowledge. Where the suit is based upon publicly-disclosed information, the *qui tam* plaintiff must be the "original source," which is defined as "an individual who has *direct and independent knowledge* of the information on which the allegations are based." 31 U.S.C. § 3730(e)(4)(B) (emphasis added). The large majority of *qui tam* actions, however, need not be based on any "direct" or firsthand knowledge. Rather, *qui tam* plaintiffs may institute actions based upon suspicion, hearsay, or simply speculation based upon their knowledge of an industry.

Rule 9(b)'s Particularity Requirement. Rule 9(b) of the Federal Rules of Civil Procedure requires that allegations of fraud be stated with "particularity." Although debated for sometime, now every federal court of appeals has determined that Rule 9(b) applies to FCA actions. *United States ex rel. Karvelas v. Melrose-Wakefield Hosp*., 360 F.3d 220, 228 (1st Cir. 2004) (citing all circuit courts). However, because Rule 9(b) provides little guidance on what is meant by "particularity," each jurisdiction treats *qui tam* plaintiffs differently depending upon the judges' interpretations of Rule 9(b) and their jurisprudential views of *qui tam* actions.

While Rule 9(b) may serve as a useful mechanism to defend against speculative suits, stating one's allegations with "particularity" is distinct from having direct or firsthand knowledge. Courts have applied Rule 9(b) because, while not required by the FCA, they recognize that something more should be required of a plaintiff alleging that a business has defrauded the government. In short, courts have been forced to fill a statutory void, and Rule 9(b) is the only available option. The application of Rule 9(b) to FCA actions and Rule 9(b)'s transformation over the years into a detailed set of complex requirements supports the policy underlying the proposal set forth below.[4]

P*roposal: The FCA Should Be Amended to Include Knowledge and Particularity Requirements*. Contractors are essential to our government, because without them, the system simply could not function. Therefore, while encouraging legitimate actions, the FCA should discourage frivolous actions based solely upon speculation and hearsay. While in a small number of cases such suits may ultimately bear fruit once the case enters discovery, the FCA should not encourage far-reaching fishing expeditions because more often than not, these are the types of suits that are dismissed after the contractor's name is dragged through the mud. Instead, the FCA should encourage only those with *actual* knowledge of fraud to come forward in the name of their government.

[4]Notably, the Private Securities Litigation Reform Act ("PSLRA") incorporates a particularity requirement. *See Greebel v. FTP Software, Inc.*, 194 F.3d 185, 193 (1st Cir. 1999) (recognizing that the PSLRA was designed "to embody in the act itself *at least the standards of Rule 9(b)"*) (emphasis added).

The FCA "has been repeatedly amended, representing 'a long history of repeated congressional efforts to walk a fine line between encouraging whistle-blowing and discouraging opportunistic behavior.'" *Sanderson*, 447 F.3d at 876. Now, at a time when nearly one FCA suit is filed each day, boundaries must be established to curtail false complaints. *See supra* note 2. Accordingly, this LEGAL BACKGROUNDER proposes a change to the FCA to require that all *qui tam* plaintiffs possess direct knowledge (statutorily defined as firsthand knowledge) of the information on which their allegations are based and that they set forth the basis of their knowledge and their allegations of fraud with "particularity."

This proposal is likely to have many tangible benefits. From a policy standpoint, the FCA, as amended, would send a positive message of reinforcement to contractors that the government values their business, their contributions, and recognizes the hardship that comes along with speculative allegations. It also indicates to the courts and to potential plaintiffs that the government does not want individuals to speculate or to dredge up allegations of fraud but rather to come forward where they have firsthand knowledge. These amendments would likely reduce the number of frivolous and speculative suits from being filed because the purported whistle-blowers and their attorneys would be less willing to risk the time, resources, and costs associated with filing their baseless suits.

Additionally, the more stringent requirements would also ensure that unsupported claims would be dismissed in the incipient stages of the litigation before significant monies have been expended and reputations tarnished. Because it would likely reduce the number of speculative suits, it would also conserve government investigative and judicial resources. By providing courts with a uniform statutory requirement, it would also provide greater consistency in the application of the law and in the treatment of all *qui tam* suits. Moreover, and as to the proposed particularity requirement, it would serve all the same purposes currently recognized by the courts. *See, e.g., Harrison v. Westinghouse Savannah River Co*., 176 F.3d 776, 784 (4th Cir. 1999) (recognizing that Rule 9(b) has several purposes). Because the particularity requirement would have the congressional stamp of approval, it is likely that the courts would apply it more consistently.

In addition, the proposed changes would provide government contractors with a strong statutory defense against speculative suits thereby allowing them to seek dismissal at the threshold stage before significant time and money has been expended. This may ultimately result in greater savings to the government in terms of their procurement acquisitions because contractors may not have to budget as much money for litigation. Given that the proposed amendments are likely to produce significant benefits, while simultaneously preserving the *qui tam* function, there should be little hesitation in supporting this proposal.

Conclusion. *Qui tam* actions play an important role in the government procurement process, as they serve as an instrument to hold dishonest contractors accountable and may serve to deter some potential wrongdoers. However, because of the large number of speculative *qui tam* lawsuits, and the harm they cause to contractors and the procurement process, a mechanism such as that proposed here is needed to enable defendants to check baseless claims at the door of the courthouse.

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