



# Federal Contractors Guide to the False Claims Act and Internal Investigations

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Very few scenarios are as concerning for a federal contractor than a False Claims Act investigation. They can be time consuming, expensive, and have wide-ranging collateral consequences. Contractors need to employ strategies to standardize an internal investigation protocol to effectively gather information and minimize potential exposure.

## I. History and Impact of The False Claims Act

The False Claims Act, 18 U.S.C. §§3729-3733, was enacted in 1863 to prevent contractors from defrauding the Army in the Civil War by selling items such as sawdust instead of gunpowder, rotting ships with fresh paint, and lame horses.

The False Claims Act has evolved from its wartime roots and is now the government's primary litigation tool for recovering fraud losses. In 2019, the Department of Justice recovered over \$3 billion from False Claims Act cases, with total recoveries since the Act was amended in 1986 of more than \$62 billion. The 2018 recoveries were \$2.9 billion, 2017 was \$3.4 billion, and 2016 was a significant \$4.9 billion. Of the 2019 recoveries, \$2.6 billion related to the health care industry. The defense industry accounted for \$250 million in 2019, \$100 million in 2018, and \$220 million in 2017.

## II. False Claims Act Elements

False Claims Act liability requires that a contractor "knowingly present, or cause to present, a false or fraudulent claim for payment or approval," or to "knowingly make, use or cause to be used, a false record or statement material to a false or fraudulent claim." The False Claims Act also prohibits a "reverse False Claim," or knowingly making a false record in connection with an obligation to pay the government. The False Claims Act also prohibits conspiring to commit the violations.

The term "knowingly" is defined as having (1) actual knowledge of the information; (2) acting in deliberate ignorance of the truth or falsity of the information, or (3) acting in reckless disregard of the truth and falsity of the information. A "claim" is a demand for money or property made directly to the government or to a contractor if the money is to be spent on the government's behalf.

Regarding civil penalties, the False Claims Act was revitalized in 1986 with amendments, including raising the applicable penalties

from \$2,000 to \$5,000 to \$10,000. The penalties have steadily increased over the years and are adjusted annually for inflation. The civil penalties for 2020 are a minimum of \$11,463 and a maximum of \$23,331 per false claim. Each invoice or claim for payment a contractor makes to the government can be considered a false claim, thus a contractor can face significant civil penalties when involved in a False Claims Act investigation.

The amendments also increased the applicable damages from doubling the amount of the government's damages to trebling (tripling) the amount. If the contractor settles the claim with the government, the civil penalties and damages can be negotiated, with a typical reduction of treble damages to 1.5/2/2.5x damages, which can be a significant reduction.

The amendments also incentivized whistleblowers, or "relators" to come forward with fraud allegations against former employers or companies those individuals have a working relationship with. The False Claims Act also protects whistleblowers in that they cannot be discharged or discriminated against because of acts performed concerning the False Claims Act allegation. A contractor can be subject to damages including reinstatement, back pay, and attorneys' fees for adverse actions towards whistleblowers. It is critical that a contractor consult with counsel before any action is taken concerning a whistleblower, including interviewing the whistleblower.

Although not discussed in depth in this guide, also federal statutes that are potentially impacted by a false claim to the government include the Criminal False Claims Act (18 U.S.C. §287), the Major Fraud Act of 1988 (18 U.S.C. §1031), and the Anti-Kickback Act of 1986 (41 U.S.C. §51-58).

## III. Government Intervention

Although the government may institute a False Claims Act case on its own, typically a False Claims Act case is instituted by a whistleblower/relator, who files a lawsuit on the government's behalf. These suits are called "*qui tam*" actions and the government can elect to intervene and take over the prosecution of the claim or decline to intervene and the relator prosecutes the claim on their own. In 2019, 633 *qui tam* actions were filed, for an average of 12 new cases each week.



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The complaint is filed in federal court under seal. The initial sealing period is 60 days, and the government conducts an investigation to determine whether or not it will intervene. The government can seek extensions of time for the case to remain under seal, and those extensions are usually granted for reasonable time frames. After approving some extensions, the Court may set a hard deadline for the government to decide whether to intervene.

In connection with the government's intervention investigation, it may issue Civil Investigative Demands, including requests to produce documents, to answer written interrogatories, and for company representatives to give oral testimony.

The government intervenes in approximately **one in five cases**. This decision by the government is critical as it will determine whether the contractor has to defend against a suit prosecuted by the government or the whistleblower and his or her counsel. In many cases, the most important work done in a False Claims Act investigation is convincing the government not to intervene.

If the government intervenes, it has responsibility for prosecuting the case, including the ability to settle the case or dismiss it. The government can also settle a case over a relator's objection, so long as the relator has an opportunity to be heard. Even when the government does not intervene and the contractor has to defend the case against the whistleblower, the government will not be far away – it will monitor the case, may attend depositions, and will be involved in any settlement discussions and must approve of any proposed settlement.

Intervention will determine the financial award to the relator. If the government intervenes, the relator will receive from 15% to 25% of the amount recovered by the government. If the government does not intervene, the relator will receive 25% to 30% of the recovery. If the suit is successful, attorneys' fees and expenses can also be recovered by the relator. As the False Claims Act has evolved, numerous plaintiffs' firms have specialized in bringing *qui tam* suits based on the significant amount of potential awards from a successful case.

## IV. Mandatory Disclosure

A unique aspect of government contracting is the FAR's mandatory disclosure requirements and how that impacts intra-government

referrals to institute investigations.

The mandatory disclosure rule requires Federal contractors, in contracts of more than \$5 million and likely to take more than 120 days to complete, to disclose in writing situations for which they have credible evidence of a potential violation of the civil False Claims Act or Federal criminal law involving fraud, conflict of interest, bribery, or gratuity.

The FAR requires that the contractor make disclosures to the respective OIG for the agency or department that was party to the contract or order. In addition, contractors are also required to disclose credible evidence of "significant overpayments." FAR Clause 52.203-13 ("the rule"), 48 CFR §52.203-13. This requirement lasts for three years after final payment on the contract. Failure to comply with this requirement is cause to suspend or debar the contractor.

## V. Types of False Claims Act Cases

Although the traditional false claim is a false bill or invoice to the government for goods or services, the scope of a false claim is far broader and encompasses many aspects of government contracts. False Claims Act cases can be based on any of the following:

- Inflated material costs
- Inflated/mischarged personnel costs
- Improper cost allocation
- Non-conforming materials, parts, or work
- Unapproved product substitution
- Falsifying testing records or not complying with testing protocols
- Concealing defective work
- Counterfeit parts
- Buy American Act violations or sourcing requirements
- Trade and Export Compliance (ITAR/EAR)

Additionally, an emerging aspect of False Claims Act cases are false certifications concerning government contracting programs. Examples include:

- Set-aside programs (women-owned small business, 8(a), SDVOSB, HUBZone)
- Business size



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- Past performance
- Experience
- Affirmative action plans
- Cost and pricing data

When investigating a False Claims Act allegation, it is critical to look beyond traditional types of claims to reviewing all aspects of the subject contract to determine the specific allegation.

## **VI. Internal Investigations – Why Should You Conduct One?**

When a company becomes aware that there is a whistleblower who has made an allegation, a Civil Investigative Demand or subpoena is issued to the company, or a search warrant is conducted at a business location, it is often out of the blue and causes shock waves. In that moment, a contractor faces a critical decision as to whether to conduct an internal investigation and, if so, what the scope of that investigation should be. The contractor needs to be guided by a pre-existing, standard internal investigation protocol to effectively gather information and minimize risk. Although there is not a “one size fits all” investigation, having a standardized protocol in place to institute, track, and report an investigation is critical.

A thorough internal investigation is important for many reasons, including compliance with the FAR mandatory compliance rule including whether to self-report, and to demonstrate a good faith effort to the government that the contractor has a company culture that takes fraud allegations seriously. The internal investigation can also mitigate wrongdoing by firing bad employees or enhancing policies and procedures. These mitigating steps will give the contractor significant arguments concerning minimizing potential penalties, as well as defenses in connection with any suspension and debarment proceeding that results from the government's investigation.

Timing is also critical – the contractor needs to gather relevant facts while they are still fresh on employees' minds and gather electronic documents before those documents are destroyed purposefully or by routine document destruction. Additionally, if the suspected whistleblower remains employed by the company, the company may want to interview that employee, memorialize the issues raised, and potentially diffuse the issues before a suit is filed. As noted above, the False Claims Act contains anti-retaliation provisions so any interactions with the whistleblower should be handled cautiously.

Contractors will have to decide promptly whether to conduct the investigation by in-house counsel or outside counsel. There are benefits to both, and in a smaller, routine investigation, in-house counsel should conduct the investigation. If the investigation is more wide-ranging or the misconduct more serious, outside counsel may be a better option in order to preserve internal resources and to provide a more objective review of the allegation. In-house or outside counsel should also consider hiring experts, such as forensic accountants, specifically when there is an issue of false or miscoded billing.

Whether or not in-house or outside counsel conduct the investigation, a critical aspect of the investigation is to preserve the attorney-client privilege in all communications. Preservation of the privilege is essential but it should not be overused – merely placing a lawyer on a cc line on an e-mail that does not seek legal advice will generally not preserve the privilege.

## **VII. Standard Forms to Issue Immediately in an Internal Investigation**

It is critical for contractors to have standard forms prepared for immediate distribution when an investigation begins. The forms include a notice to employees, and a preservation notice.

### **A. Notice to Employees**

A sample notice to employees regarding a governmental investigation should include clear direction about the investigation and company expectations. A model notice is included as Exhibit 1. The notice should include:

- General statement regarding the investigation
- Contact information for legal counsel or point person
- Direction to not remove or destroy documents, including computer files with a reference to the Preservation Notice
- Protocol for requests by government agents for documents – immediately contact legal counsel or point person and do not provide documentation without direction by legal counsel
- Protocol for requests by media – immediately contact legal counsel or point persona and do not provide information on the record or on background



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- Protocol for agent contact to employees – inform them that agents may seek to contact employees at home or office for an interview
  - Employees are not required to speak with the government
  - Employees have the right to speak with an attorney first
  - Legal counsel can be provided for employees

## B. Preservation Notice

A sample preservation notice should also clear direction on gathering relevant information. A model preservation notice is included as Exhibit 2. The notice should include:

- Identification of the relevant employees who may have responsive documents regarding the investigation
- Description of the subpoena and the scope of the investigation
- Direction to preserve all relevant documents
- Suspension any routine document destruction policies
- Direction that responsive documents may be located in the company office, off-site storage facilities, or at employees' homes and those location should be searched and documents preserved
- Direction that if there are any subordinates who may have responsive documents to provide the preservation notice
- Direction not to discuss the subpoena outside of the scope of employees who are impacted, and to only discuss with legal counsel, not with any third parties

## VIII. Establishing Scope of Work, Gathering Facts and Reporting

After a decision is made to conduct an internal investigation, the most important next step is to define the scope of the investigation and memorialize a work plan. Tasks can be assigned, benchmarks can be set, and progress can be mapped so in-house and outside counsel know the progress of the investigation. A model work plan should be prepared and made available immediately after an investigation is begun.

The internal investigation will include seeking documents from

relevant employees, and interviewing those employees. Identifying relevant document custodians is critical and an information technology vendor or in-house employee should be mobilized to image devices if needed, to assist in gathering all necessary data, and host the data on a reviewable platform.

Interviewing witnesses is the most critical aspect of any internal investigation. Prioritization of the most important witnesses should take place immediately, with a focus on those employees who are closest to the allegations.

Prior to the interview, it is necessary for in-house counsel or outside counsel to state, clearly and unambiguously, that the counsel represents the company and not the individual, and the attorney-client privilege belongs to the company, not the individual. This "*Upjohn*" warning should contain standard language that is said at the beginning of each interview, and if a memorandum is prepared of the interview, the delivery and acknowledgment of the *Upjohn* warning should be reflected.

A model *Upjohn* warning should reflect some form of the following language:

I am the lawyer for Company ABC. I am the lawyer for ABC and not you personally. If you would like legal advice, you can consult your own counsel. I am conducting an interview to gather facts to provide legal advice to ABC. The interview concerns an investigation regarding (summary of allegation like "false billing" or "submission of counterfeit parts") to advise ABC how to proceed.

Your communications are covered by the attorney-client privilege. But the privilege belongs solely to ABC, not you. That means that ABC alone may waive the privilege and reveal our discussion to third-parties, including federal or state agencies.

In order to keep this discussion privileged, it must be kept in confidence. With the exception of your counsel, you may not disclose the substance of this interview with third-parties. You may discuss the facts of the investigation but not our discussion.

Do you understand this? Are you prepared to proceed?



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After the investigation is concluded, in-house or outside counsel should decide whether to write a report or orally brief the relevant company personnel. The written or oral report should include potential liabilities as well as potential remedial measures for the company to consider. The remedial measures should be directed to the appropriate company personnel for implementation and follow-up for accountability.

Once that report is completed, the contractor should consider whether an obligation exists to disclose the alleged violation pursuant to the Mandatory Disclosure Rule. The contractor should consult with counsel as to the form and content of that disclosure and be prepared to provide documents and information concerning the disclosure if a Civil Investigative Demand results.

#### **IV. Recent Trends – False Claims Act**

The False Claims Act continues to evolve, with three recent trends of particular importance to contractors. First is the impact of *Universal Health Services v. Escobar*, 136 S.Ct. 1989 (2016), in which the Supreme Court held that a misrepresentation in a False Claims Act case must be “material” to the government’s payment decision, and declared it to be a “rigorous” and demanding standard.

The Court held that: “[n]ot every undisclosed violation of an express condition of payment automatically triggers liability,” and the False Claims Act is not a “vehicle for punishing garden-variety breaches of contract or regulatory investigations.” As a result of Escobar, \$1 billion of judgments in False Claims Act suits were reversed.

In addition to *Escobar*, DOJ issued an internal memorandum (the “Granston Memo”), which directs government lawyers evaluating whether to intervene in *qui tam* lawsuits to consider dismissing meritless suits over a relator’s objection. The DOJ has “an important gatekeeper role in protecting the FCA.” Since 2018, DOJ has dismissed two dozen cases.

Finally, DOJ issued guidance on awarding credit to companies who cooperate with the Department during a False Claims Act investigation. The DOJ Manual was updated to include the guidance. The Manual states:

An entity or individual that seeks to earn maximum credit in a False Claims Act matter generally should undertake a timely self-disclosure that includes identifying all individuals substantially involved in or responsible for the misconduct, provide full cooperation with the government’s investigation, and take remedial steps designed to prevent and detect similar wrongdoing in the future.

Credit will take the form of a reduction in the damages multiplier and civil penalties, as well as informing relevant agencies of a companies’ cooperation in connection with administrative remedies.

#### **X. Conclusion**

The False Claims Act can present significant challenges for contractors, but a proactive contractor with a standard internal investigation protocol in place will enable the contractor to effectively gather information and address the allegations, determine whether disclosure is required, and mitigate risk. ■

## EXHIBIT 1

### Sample Notice to Employees

CONFIDENTIAL – NOT TO BE DISTRIBUTED OUTSIDE COMPANY

DO NOT FORWARD TO THIRD PARTIES

To: Relevant Employees

From: In-House Counsel/Compliance Officer

The company received a Civil Investigative Demand (CID)/Subpoena from the United States government, Department of (insert agency here) (or reference the execution of a search warrant at a location). The company will fully cooperate with the investigation. This notice will provide you with some guidance regarding the potential next steps and contact information for those in charge of the investigation at the company.

The company representatives in charge of the investigation at the company are \_\_\_\_\_ and \_\_\_\_\_. Please contact them anytime with any questions at \_\_\_\_\_ (e-mail and mobile number).

As an initial matter, please **do not** delete any e-mails or electronic documents, or delete any hard copy documents that are in your possession. Also please **suspend** all routine document destruction policies, whether electronic or in hard copy. If it is determined that you may have documents responsive to the CID/subpoena, the company will be in contact with you to provide a document preservation memorandum and instructions to review and provide such documents.

Government agents may seek to contact you regarding your work at the company and the investigation. You are not required to speak with the agents, and you have the right to respectfully decline to be interviewed and say you want to confer with counsel and schedule any interview at a mutually convenient time. Depending on the circumstances, the company may provide counsel to you to accompany you to an interview. If you are contacted by government agents, please contact \_\_\_\_\_.

Finally, members of the news media may also seek to contact you. Please refer any media members to \_\_\_\_\_ and do not provide any statements to them.

Thank you for your attention to this important matter.

## **EXHIBIT 2**

### **Sample Preservation Notice/Hold Notice**

CONFIDENTIAL – NOT TO BE DISTRIBUTED OUTSIDE COMPANY

DO NOT FORWARD TO THIRD PARTIES

To: Relevant Employees

From: In-House Counsel/Compliance Officer

The company received a Civil Investigative Demand (CID)/Subpoena from the United States government, Department of (insert agency here). The company will fully cooperate with the CID/subpoena and the investigation. The categories of documents which are covered by the CID/subpoena is attached to this Notice. Please do not share this Notice or the document categories with third parties except as set forth in this Notice.

This preservation notice will provide you with some guidance regarding the document collection efforts and contact information for those in charge of the investigation at the company.

The company representatives in charge of the investigation at the company are \_\_\_\_\_ and \_\_\_\_\_. Please contact them anytime with any questions at \_\_\_\_\_ (e-mail and mobile number).

As an initial matter, please do not delete any e-mails or electronic documents, or delete any hard copy documents that are in your possession. Also please suspend all routine document destruction policies, whether electronic or in hard copy, including not overwriting any electronic back-up tapes.

This Notice applies to all electronic documents, but also documents held in hard copy in your office or at your home, or any applicable storage facilities.

If you have direct reports who may have responsive documents, please provide them with a copy of this Notice. If you are aware of others outside of your line of supervision who may have responsive documents, please notify \_\_\_\_\_ and he/she will provide that individual with a copy of the Notice.

You will be contacted by your designated document collection liaison (who may be an outside document collection vendor) who will work with you concerning the document collection process.

Thank you for your attention to this important matter.