



COMMERCIAL INSURANCE

EMPLOYEE BENEFITS

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RISK MANAGEMENT

SURETY

THE FALSE CLAIMS ACT AND CIVIL CYBER-FRAUD INITIATIVE

What Government Contractors Need to Know

In 2022, the U.S. Department of Justice (DOJ) recovered an average settlement of \$6.2 million from companies and individuals found to have committed fraud against a federal government department of agency. Of this total, the amount collected through whistleblower (qui tam) suits filed by individuals without the participation of the DOJ was the highest ever recorded.¹

AN OVERVIEW OF THE HISTORY OF QUI TAM AND THE FALSE CLAIMS ACT

Qui tam statutes grant private citizens who have evidence of an entity committing fraud against the government the ability to sue on behalf of the government. The term is an abbreviation of the Latin phrase translated, “he who brings an action for the king as well as himself.” The legal concept originated in early Roman and Anglo-Saxon law and was carried from Britain to the American colonies.

During the Civil War, Congress enacted provisions that allowed soldiers to blow the whistle on those who intentionally defrauded the government and jeopardized the war effort. Reportedly, unscrupulous suppliers were shipping boxes of sawdust instead of weapons, delivering rotting ships and even selling the same horses multiple times to different parties.

Qui tam was an essential element of the 1863 False Claims Act that stated that any person or organization found guilty of knowingly making or conspiring to make false financial claims or submitting false statements to the U.S. Government could be found liable for treble (three times) damages incurred by the government, plus punitive penalties.

The FCA was amended in 1943, 1986, 2009, 2010 and, finally, in 2021 with the Civil Cyber Fraud Initiative discussed further below. One of the most important amendments was in 1986 to increase incentives for whistleblowers to file qui tam suits, a legislative effort spearheaded by Senator Charles Grassley of Iowa.

“Going after waste, fraud, and abuse without whistleblowers is about as useful as harvesting acres of corn with a pair of rusty old scissors.”

Senator Charles Grassley, Chairman of Senate Judiciary Committee,
speech given on National Whistleblower Day (July 30, 2018)

SEVEN CATEGORIES OF VIOLATIONS UNDER THE FCA

1. **FALSE CLAIMS:** Seeking approval for a false payment for goods and services sold to the government.
2. **FALSE STATEMENTS:** Using or compelling others to use false documents in the context of a false claim to the government.
3. **CONSPIRACY:** Conspiring to violate the FCA.
4. **CONVERSION:** Failing to return government property as required.
5. **FALSE RECEIPTS:** Submitting a receipt to the government that has not been documented to be accurate.
6. **UNLAWFUL PURCHASE OF GOVERNMENT PROPERTY:** Purchasing government property from a government employee not authorized to sell it.
7. **REVERSE FALSE CLAIMS:** Using false information in the context of an obligation to pay money owed to the government.

GOVERNMENT CONTRACTORS SHOULD BE AWARE OF KEY PROVISIONS OF THE FCA

- + The DOJ can collect treble damages – i.e., three times the amount of the damages it incurred.
- + The DOJ can impose penalties of between \$13-25 thousand (an amount periodically adjusted for inflation) for each act of causation – for example each defective item or each fraudulent invoice).
- + A whistleblower can be awarded as much as 30% of settlements collected by the DOJ.
- + The statute of limitations extends six years beyond the date of the violation and three years past the date the government should have known about the violation.
- + A whistleblower who files a qui tam suit against their own organization is protected from employer retaliation, including firing and demotion.
- + It's not uncommon for the Department of Justice to hold these cases under seal for several years.

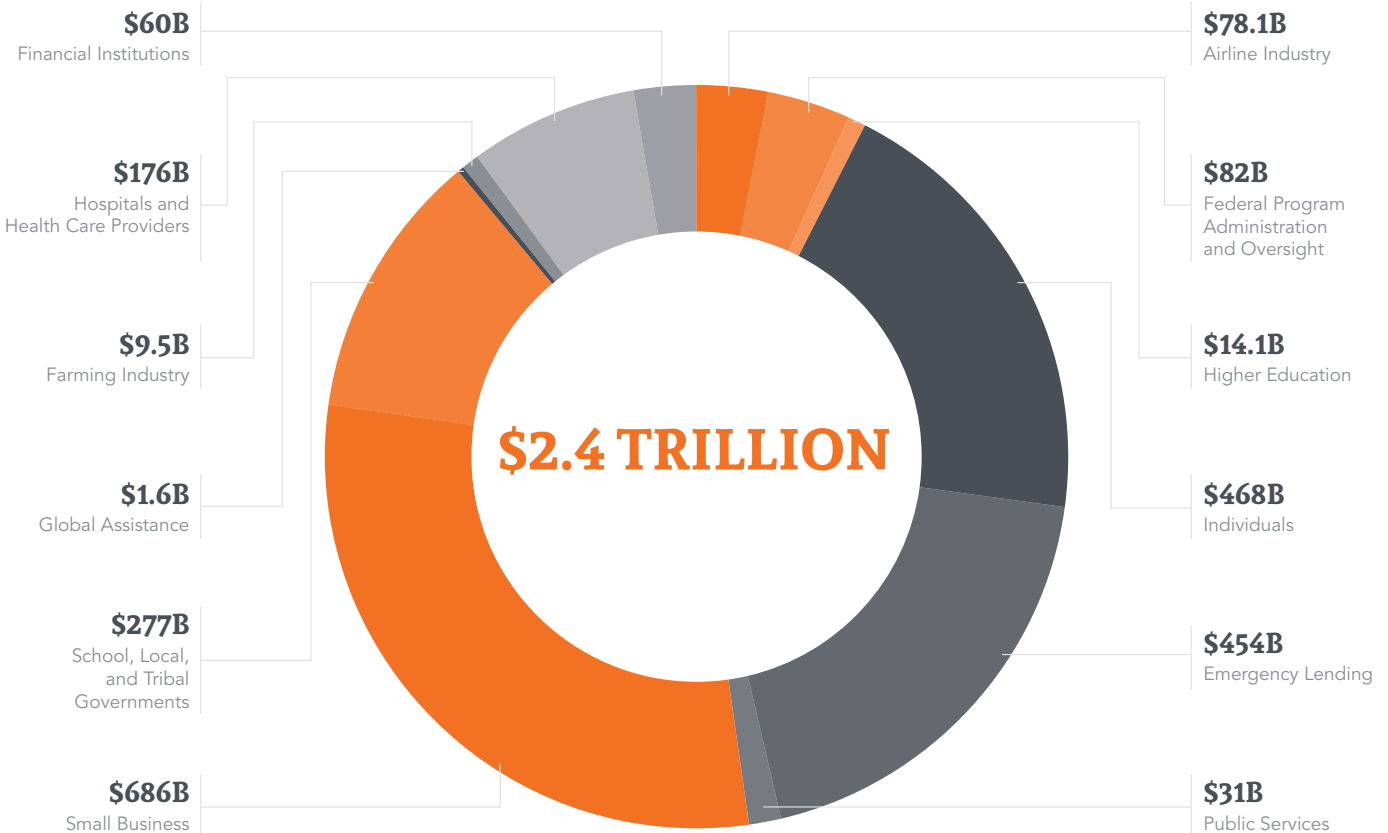


THE BROADENING SCOPE AND APPLICATION OF THE FCA

The 2020 Coronavirus Aid, Relief, and Economic Security (CARES) Act opened the door for FCA claims against companies in nearly every business sector as for the first time ever they had access to, applied for and received a portion of the more than \$2.4 trillion in COVID-related federal financial assistance.

The False Claims Act applies not only to government contractors and commercial firms that received CARES Act PPP Loans, but also the private equity and venture capital firms that own them.

CARES ACT AND OTHER COVID ASSISTANCE RECIPIENTS BY INDUSTRY



SOURCE: False Claims Act Liability in the Age of COVID-19 | Paul, Weiss (paulweiss.com)

While FCA actions have historically been directed at defense contractors, of the \$2.2 billion in FCA recoveries in 2022, more than \$1.7 billion were from healthcare companies.² 2022 was the fourteenth consecutive year that FCA recoveries exceeded \$2 billion, and it was the eleventh year out of the last 12 with 600+ qui tam filings. The DOJ paid out \$489 million to whistleblowers that year.³

The courts and the DOJ have broadly interpreted the FCA, resulting in increasingly greater utilization of this enforcement mechanism. It also enjoys widespread political support, even within the Supreme Court, where justices recently ruled unanimously against efforts to weaken the “knowing” standard.⁴

Whistleblower qui tam activity also saw a boost in late 2021 with the implementation of the DOJ’s Civil Cyber Fraud Initiative, which utilizes the FCA to pursue cybersecurity-related fraud by government contractors and grant recipients. As the DOJ explained at the time, “The initiative will hold accountable entities or individuals that put U.S. information or systems at risk by knowingly providing deficient cybersecurity products or services, knowingly misrepresenting their cybersecurity practices or protocols, or knowingly violating obligations to monitor and report cybersecurity incidents and breaches.”⁵

Already, there have been settlements against three companies under the Civil Cyber Fraud Initiative – a provider of global medical services,⁶ an aviation government contractor⁷ and a medical software provider.⁸ The DOJ’s National Security Division for Corporate Crime is reportedly staffing additional specialized prosecutors and therefore there is an expected increase in investigations and litigation in 2023 and 2024.

BEST PRACTICES TO PRE-EMPT FCA SUITS

The stakes are high when it comes to contracting with federal government departments and agencies. Companies active in these areas should assume employees and contractors are very aware of the financial windfall they could receive by successfully pursuing an FCA fraud case.

But even companies with the highest levels of integrity may find themselves defending an FCA-related qui tam suit – whether the circumstances are legitimate or misrepresented. Specific leadership and organizational best practices can minimize this risk:

- + Create a culture of accuracy and emphasize there is no leniency for fraudulent acts or conspiracy.
- + Create an anonymous internal reporting protocol and create a culture where self-disclosure is expected and rewarded.
- + Ensure the organization’s cyber hygiene meets all federal cybersecurity requirements and ensure robust and effective compliance.
- + If FCA allegations arise, immediately hire special counsel and freeze all evidence.
- + Cooperate and comply with the DOJ, in consultation with hired counsel.

UNDERWRITING CONSIDERATIONS

Companies with FCA exposure should work with a broker that has the requisite Directors & Officers (D&O) Liability expertise as well as experience crafting coverage for this unique risk. Many D&O carriers may look to restrict coverage exposure, and without tailored language, there is a strong possibility your D&O policy will not cover a False Claims Act claim. D&O brokers experienced in the Government Contracting space closely track regulation, litigation, and carrier updates of FCA exposure and work to tailor coverage under defense costs where available.

2023 is a pivotal year in government contracting. Proving innocence in an FCA claim will likely be an exhaustive and expensive endeavor for an organization embroiled in FCA-related investigations or litigation. A specialized government contracting broker will review a policy for outright exclusions of FCA or regulatory claims, but then also check multiple sections of the policy, such as key definitions, notice provisions, conduct exclusions, insured-versus-insured clauses and other germane details.

Do you know how your Directors & Officers Liability will respond?



SOURCES

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- 4 <https://www.scotusblog.com/2023/06/supreme-court-maintains-focus-on-defendants-subjective-beliefs-in-false-claims-act-cases/>
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