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PRATT'S
**GOVERNMENT
CONTRACTING
LAW**
REPORT



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Steven A. Meyerowitz

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REGULATIONS ON PAID SICK LEAVE
FOR FEDERAL CONTRACTORS**

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What Must the Government Prove to Establish That a Defendant Recklessly Interpreted a Statute or Regulation in Violation of the False Claims Act?—Part I

*By Robert S. Salcido**

In this two-part article, the author discusses the implications of the U.S. Supreme Court's ruling in Safeco Ins. Co. v. Burr to the False Claims Act, and provides a detailed analysis of court decisions applying the Supreme Court's precedent to determine when a party's reading of a statutory term is "reckless." This first part of the article analyzes the Court's decision in Safeco and discusses the U.S. Court of Appeals for the D.C. Circuit's application of the Court's Safeco rule. The second part of the article, which will appear in an upcoming issue of Pratt's Government Contracting Law Report, examines other court applications of the Safeco doctrine in recent False Claims Act cases.

Any company conducting business with the government must master a wide array of rules and regulations. And, certainly, companies are duty bound to comply with all the government's rules and regulations when they conduct business with the government.¹

Indeed, to ensure compliance, the government frequently requires that the company affirmatively certify that it is operating in compliance with all the government's rules and regulations. This certification, in turn, provides fertile ground for False Claims Act ("FCA") actions. The FCA is an attractive vehicle to enforce regulatory compliance, because it provides the plaintiff, if successful, with treble damages and the prospect of obtaining massive civil penalties.² Additionally, private plaintiffs (known as "relators") may enforce the govern-

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¹ See, e.g., *Heckler v. Community Health Servs. of Crawford Cnty., Inc.*, 467 U.S. 51, 63–64 (1984) ("As a participant in the Medicare program, respondent had a duty to familiarize itself with the legal requirements for cost reimbursement.")

² The FCA imposes liability on those who "knowingly" submit false claims or statements. "Knowingly" is defined to reach, at a minimum, those who act in "reckless disregard" or in "deliberate ignorance" of the truth or falsity of their claims. See 31 U.S.C. § 3729(b).

ment's rules and regulations and receive a substantial bounty of up to 30 percent of the government's recovery.

However, notwithstanding a company's obligation to adhere to the government's rules and regulations, what happens when the government's rules and regulations are inherently vague and ambiguous? As one judge noted in the Medicare context, "Medicare regulations are among the most completely impenetrable texts within human experience."³ The government's propensity to write ambiguous rules is not limited to the Medicare program.

In light of this, from an FCA perspective, several questions arise, such as, if the defendant develops a contemporaneous, reasonable interpretation of an ambiguous regulation, can it "knowingly" submit a false claim in violation of the FCA? What if the defendant's conduct merely conforms with a reasonable interpretation, but the defendant never formally reviewed the regulation until an FCA lawsuit was filed, does the answer change? And if the defendant demonstrates that it acted within a reasonable, plausible interpretation of a regulation, what evidence must the government or relator produce to demonstrate that notwithstanding the reasonable interpretation, the defendant "knowingly" submitted a false claim?

Three recent FCA cases—*United States ex rel. Purcell v. MWI Corp.*,⁴ *United States ex rel. Saldivar v. Fresenius Med. Care Holdings, Inc.*,⁵ and *United States ex rel. Donegan v. Anesthesia Assocs. of Kansas City, PC*—shed important light on these questions. These cases, either expressly or tacitly, rely upon the U.S. Supreme Court's ruling in ⁶*Safeco Ins. Co. v. Burr*.⁷ In *Safeco*, the Court, in determining whether the defendant had recklessly interpreted the Fair Credit Reporting Act, ruled that the defendant's interpretation was not reckless, both because the interpretation was not "objectively unreasonable," even though the Court disagreed with the defendant's interpretation, and because there was no formal, authoritative guidance—such as an official government agency interpretation or a court decision—that might have "warned" the defendant away from the view it took.⁸

To better understand the implications of the *Safeco* precedent to the FCA, set forth below is a discussion of that case and a detailed analysis of court decisions

³ *United States v. Medica-Rents Co.*, 285 F. Supp. 2d 742, 770 (N.D. Tex. 2003).

⁴ 807 F.3d 281 (D.C. Cir. 2015).

⁵ No. 1:10-CV-1614, 2015 U.S. Dist. LEXIS 156924 (N.D. Ga. Oct. 30, 2015).

⁶ No. 4:12-CV-0876, 2015 U.S. Dist. LEXIS 74239 (W.D. Mo. June 9, 2015).

⁷ 551 U.S. 47 (2007).

⁸ *Id.* at 70.

applying the Supreme Court's precedent in *MWI Corp., Fresenius*, and *Anesthesia Assocs.* What this review illustrates is that, just as the defendants have a duty to understand the law and follow it, the government has an equal and reciprocal duty to promulgate and publish clear rules and regulations to guide and inform those who elect to do business with the government.⁹

What the recent case law demonstrates is that FCA litigation should not be a “gotcha” game, where the government or relator announces a novel interpretation of a regulation in the course of FCA litigation where the plaintiff is seeking to impose treble damages and substantial civil penalties on the defendant for failing to adhere to a rule or regulation that has never been published. In these cases, courts have sensibly informed the government and relators that, if they seek treble damages and substantial civil penalties and brand defendants as fraudsters, then they had better be able to demonstrate that the government proffered clear guidance that legitimately would warn the defendant away from its reasonable interpretation of the law.

U.S. SUPREME COURT PRECEDENT

Although *Safeco* is not an FCA case, multiple courts, in FCA actions, have expressly relied upon the Supreme Court's decision in *Safeco Ins. Co. v. Burr*¹⁰ to determine when a party's reading of a statutory term is “reckless.”¹¹ In *Safeco*, in formulating a rule regarding when an interpretation is reckless, the Court

⁹ See generally *United States v. Cooperative Grain and Supply*, 476 F.2d 47, 60 (8th Cir. 1973) (noting in FCA action that “[o]bviously a citizen cannot digest all the manifold regulations, nor can the Government adequately and individually inform each citizen about every regulation, but there is a corresponding duty to inform and be informed”).

¹⁰ 551 U.S. 47 (2007).

¹¹ In addition to *MWI Corp.* and *Fresenius*, discussed here, see, e.g., *United States ex rel. K&R Ltd. P'ship v. Mass. Hous. Fin. Agency*, 530 F.3d 980, 983 (D.C. Cir. 2008) (granting summary judgment to defendant because relator “never explains why [defendant's] interpretation . . . was unreasonable, much less why its interpretation constituted reckless disregard. While the unreasonableness of [defendant's] interpretation is merely evidence, the absence of which does not preclude a finding of knowledge, . . . [the relator] points to nothing else ‘that might have warned [the defendant] away from the view it took’”) (quoting *Safeco Ins. Co. of Am. v. Burr*, 551 U.S. 47, 70 (2007)); *United States ex rel. Streck v. Allergan, Inc.*, 894 F. Supp. 2d 584, 592–93 (E.D. Pa. 2012) (same); *United States ex rel. Pritzker v. Soldexho, Inc.*, No. 03-6003, 2009 U.S. Dist. LEXIS 51469, at *53–54 (E.D. Pa. Mar. 6, 2009) (“[L]ack of clarity regarding the proper interpretation of the regulations indicates that no basis exists for imposing FCA liability on [d]efendants, who merely adopted a reasonable interpretation of regulatory requirements which favored their interests.”) (citing *Safeco Ins. Co. of Am. v. Burr*, 551 U.S. 47 (2007)), *aff'd*, 364 F. App'x 787 (3d Cir. 2010). See generally, *United States ex rel. Hixson v. Health Mgmt. Sys., Inc.*, 613 F.3d 1186, 1191 (8th Cir. 2010) (citing *Safeco*).

ruled that an objective standard should be employed: “[w]hile the term recklessness is not self-defining, the common law has generally understood it in the sphere of civil liability as conduct violating an objective standard: action entailing an unjustifiably high risk of harm that is either known or so obvious that it should be known. . . . It is this high risk of harm, objectively assessed, that is the essence of recklessness at common law.”¹² The Court ruled, in applying this standard, that “a company subject to [the Fair Credit Reporting Act] does not act in reckless disregard of it unless the action is not only a violation under a reasonable reading of the statute’s terms, but shows that the company ran a risk of violating the law substantially greater than the risk associated with a reading that was merely careless.”¹³

The Court ruled that the defendant’s reading was not “objectively unreasonable,” because, (a) even though the Court disagreed with the defendant’s interpretation, the defendant’s reading had a foundation in the statutory text sufficient that the district court had agreed with it, and (b) the court of appeals and Federal Trade Commission had not offered contrary guidance “that might have warned it away from the view it took.”¹⁴ “Given this dearth of guidance and the less-than-pellucid statutory text, [defendant’s] reading was not objectively unreasonable, and so falls well short of raising the ‘unjustifiably high risk’ of violation the statute necessary for reckless liability.”¹⁵

RECENT D.C. CIRCUIT AUTHORITY

The D.C. Circuit applied the Supreme Court’s *Safeco* rule to the FCA in *United States ex rel. Purcell v. MWI Corp.*¹⁶

In *MWI Corp.*, the defendant submitted certifications to the Export-Import Bank to secure loans of \$74.3 million to finance the defendant’s sale of water pumps to Nigeria.¹⁷ The defendant was required to certify in a Supplier’s Certificate that it had not paid “any discount, allowance, rebate, commission, fee or other payment in connection with the sale,” except “[r]egular commissions or fees paid or to be paid in the ordinary course of business to [its] sales agents.”¹⁸

¹² 551 U.S. at 68 (internal, citations and footnote omitted).

¹³ *Id.* at 69.

¹⁴ *Id.* at 70.

¹⁵ *Id.* (footnote omitted).

¹⁶ 807 F.3d 281 (D.C. Cir. 2015).

¹⁷ *Id.* at 283.

¹⁸ *Id.* at 284.

The government alleged that the certification was false because *nonregular* commissions had been paid, pointing to \$28 million in commissions—more than 30 percent of the loan amount—that the defendant had paid to its long-term (more than 12 years) Nigerian sales agent, Alhaji Indimi. The government alleged that those commissions were so great that the defendant should have disclosed them to the government as payments other than “regular commissions.”¹⁹

The court ruled that the precise legal question regarding the meaning of “regular commissions” is ambiguous and that the defendant’s interpretation was reasonable.²⁰ The court noted that the term “regular commission” could imply at least three different inquiries: What is a regular commission industrywide? What is a regular commission for the company? What is a regular commission as to the company and the specific agent it used?²¹ The court found that the defendant’s interpretation—that the regular commission it had paid this particular agent over their long-standing (12 years) relationship was the appropriate benchmark—was objectively reasonable.²² The court noted that the defendant only learned that the government possessed a different interpretation once the government announced the term’s meaning in the litigation.

Once the court found that the interpretation was objectively reasonable, it turned, under the *Safeco* test, to the second inquiry: whether the government set forth sufficient evidence that the defendant was warned away from its interpretation. The court found that the government could not satisfy this test. The government failed to identify guidance from the court of appeals or the relevant agency, and it was undisputed that the government had never published any written guidance on what the term meant.²³

The government did point to other evidence that it believed “warned” the defendant away from its interpretation, but the court ruled that the information the government identified was insufficient. Specifically, the government pointed

¹⁹ *Id.*

²⁰ *Id.* at 288.

²¹ *Id.*

²² *Id.* at 284, 288–89. The court noted that “the definition of ‘regular’ makes clear that something can be ‘regular’ either because it is not unusual in relation to societal norms or because it is not unusual for that individual. See, e.g., *The American Heritage Dictionary of the English Language* (5th ed. online 2015). Consequently, [the defendant] could reasonably have concluded that Indimi’s commissions were regular because they were consistent with what [the defendant] had been paying him for over twelve years and were calculated using the same formula [the defendant] used to determine commissions for all of its agents.” *Id.* at 288–89.

²³ *Id.* at 289.

to informal guidance the company had received from an agency employee that the commission should be around five percent, but the court found that this type of informal guidance was insufficient to warn a regulated defendant away from an otherwise reasonable interpretation that it adopted.²⁴ The government also pointed to the testimony of defendant employees who stated that they knew the company had applied the wrong definition, and expressed concerns about disclosing the agent's commission to the government. But the court responded that, in "the face of an undefined and ambiguous regulatory requirement, it is no wonder that employees of the regulated entity were concerned."²⁵ Moreover, the court noted that, even if that testimony demonstrated that the defendant held its interpretation in bad faith, under the Supreme Court's test in *Safeco*, "subjective intent—including bad faith—is irrelevant when a defendant seeks to defeat a finding of knowledge based on its reasonable interpretation of a regulatory term." Instead, under "the FCA's knowledge element, . . . the court's focus is on the objective reasonableness of the defendant's interpretation of an ambiguous term and whether there is any evidence that the agency warned the defendant away from that interpretation."²⁷

Finally, the court rejected the viewpoint that the defendant acted recklessly by failing to seek a legal opinion to determine what constituted a regular commission.²⁸ The court noted that there was no guidance from the government that would provide the defendant with any "particular reason to formally inquire about these commissions."²⁹ Ultimately, the court reasoned that, if the

²⁴ *Id.* at 289–90.

²⁵ *Id.* at 290.

²⁷ *Id.* (citation omitted).

²⁸ *Id.* (citation omitted).

²⁹ *Id.* Other courts have similarly rejected the notion that defendants have a duty to seek legal advice whenever they act in accordance with a reasonable interpretation of an ambiguous regulation. See, e.g., *United States ex rel. K&R P'ship v. Mass. Hous. Fin. Agency*, 530 F.3d 980, 984 (D.C. Cir. 2008) (rejecting relator's position that defendant's failure to obtain a legal opinion or prior HUD approval showed that defendant acted recklessly because relator pointed to no "evidence of anything that might have given [the defendant] reasons to do so" and defendant had "made no secret of the [issue] and during a HUD audit the next year [defendant] specifically brought the [issue] to HUD's attention, albeit for a somewhat different issue . . . There is no evidence HUD expressed any concerns and, in fact, HUD continued (and continues) to pay [defendant] even after [relator] filed this lawsuit. Although the fact that the government continues to pay claims might not preclude a finding of knowledge, here that fact at least suggests [defendant] did not act with reckless disregard"); *United States ex rel. Quirk v. Madonna Towers, Inc.*, 278 F.3d 765, 768 (8th Cir. 2002) (holding that "failing to secure a legal opinion, without more, is not the type of deliberate ignorance that can form the basis for an FCA lawsuit"); *United*

government wanted a particular interpretation of its rule, then it could have defined the term, but if it failed to do so because it desired flexibility, “then the FCA may cease to be an available remedy if the government concludes after the fact that a particular commission is not ‘regular’ because it is too high.”³⁰

* * *

The second part of this article will appear in an upcoming issue of *Pratt’s Government Contracting Law Report*.

States ex rel. Rose v. E. Tex. Med. Ctr., No. 2:05 CV 216, 2008 U.S. Dist. LEXIS 65660 at *23 (E.D. Tex. Aug. 25, 2008) (rejecting relator’s contention that defendant should have sought outside legal advice regarding the legality of its participation in the program when it relied upon the advice of statewide advocacy and leadership organization, which the state had selected to implement the program, because, even though statewide organization had a financial interest in advising defendant, its “failure to seek independent legal advice under the facts [did] not rise to the level of reckless disregard needed for an FCA claim,” but, at most, “would constitute negligence, which is insufficient to assert a claim under the FCA”).

³⁰ *Id.* at 291.