No. 17-_____

In the Supreme Court of the United States

MARK MCGRATH,
on Behalf of the United States of America,

Petitioner,

–v–

MICROSEMI CORP. and WHITE ELECTRONIC DESIGNS CORP., d/b/a/ MICROSEMI POWER AND ELECTRONICS GROUP,

Respondents.

On Petition for Writ of Certiorari to the United States Circuit Court for the Ninth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Did the Ninth Circuit err in holding, in contrast to three other Circuit Courts, that a scienter defense based upon a "good faith" interpretation of a statute may as a matter-of-law entitle a False Claims Act defendant to dismissal, even where the complaint alleges the government "warned away" defendants from their statutory interpretation?

2. Because a reasonable person would realize the materiality of a condition that secret military technology must remain secret from foreign enemies, did the Ninth Circuit err in finding that plaintiff could not prove scienter against a defendant who shared secret military technology on unprotected international computer servers, despite express promises by defendants to protect such data?

3. Did the Ninth Circuit err in holding that materiality cannot be found in a False Claims Act case if the government continues to pay after learning of the allegations of fraud, even where the fraudulent certifications go to the "essence of the bargain"?

PARTIES TO THE PROCEEDINGS

Pursuant to Supreme Court Rule 14.1(b), the following list identifies all of the parties appearing here and before the United States Court of Appeals for the Ninth Circuit. The Petitioner here, and Relator-Appellant below, is Mark McGrath. The Defendants here, and Defendants-Appellees below, are Microsemi Corp. ("Microsemi") and White Electronics Design Corp. ("WEDC"), doing business as Microsemi Power and Electronics Group.

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JURISDICTION

The judgment of the court of appeals was entered on May 5, 2017. A timely petition for rehearing *en banc* was filed on May 19, 2017. The order denying the petition for rehearing was entered on June 15, 2017. App.53a. The jurisdiction of this Court to review the court of appeal's judgment is conferred by 28 U.S.C. § 1254(1).

STATUTES AND REGULATIONS INVOLVED IN THE CASE

Pursuant to this Court's Rule 14, the federal statutory and regulatory provisions relevant hereto are:

- 22 U.S.C. § 2751 (Need for International Defense and Cooperation and Military Export Controls), App.55a
- 31 U.S.C. § 3729 (False Claims Act), App.72a
- 50 U.S.C. § 2401 (Establishment and Mission), App.76a

- 15 C.F.R. 734.2 (Important EAR Terms and Principles), App.78a
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- 22 C.F.R. 120.17 (Export), App.95a

INTRODUCTION

This case presents important questions regarding scienter and materiality in the context of the False Claims Act ("FCA")[1].

Secret military technology that is no longer secret is worthless. ITAR[2] and EAR[3] regulations[4] are therefore designed to protect secret technology from falling into the hands of potentially hostile foreign nationals or hostile foreign persons (hereinafter, together "foreign persons") in other countries, through a strict regulatory regime that forbids sharing technology with

[1] 31 U.S.C. § 3720 et seq.

[2] International Traffic in Arms Regulations (22 C.F.R. 120-130), which are promulgated subject to 22 U.S.C. § 2778 of the Arms Export Control Act ("AECA").

[3] Export Administration Regulations (15 C.F.R. 730-774).

[4] Together the ITAR and EAR (hereafter simply "ITAR") regulations are also known as the export control rules, which strictly regulate the sharing of technology with foreign nationals and foreign persons.

unapproved foreign persons, even within a company subsidiary, without export licenses or the express permission of the State Department. ITAR and EAR compliance is mandatory for all United States defense contractors. Penalties for failing to comply include jail, debarment as a contractor, and fines. In violation of ITAR and EAR, Defendants, who are subcontractors for Department of Defense contractors such as Raytheon Corp., freely shared secret military technology on their domestic and international computer servers accessible to thousands of unauthorized foreign persons. Defendants then lied to the government about it. Relator in this case, a former IT administrator for Defendants, brought a False Claims Act case against Defendants based upon Defendants' express and implied false certifications of compliance with ITAR and EAR.

The first question concerns scienter. Contrary to the holdings of other circuits to consider the matter, the Ninth Circuit in this case held that (1) a defendant's "good faith" interpretation of a statute can be determined at the pleading stage, and (2) the court need not consider whether the government "warned" defendant away from defendant's erroneous statutory interpretation, even where the complaint expressly alleges that such warnings were given. The Ninth Circuit's holdings are not only in conflict with other circuits, but they dangerously shift a clear question of fact – scienter – away from the factfinder and allow the unsworn *ipse dixit* of defendants' counsel in motion-to-dismiss papers to take the place of a full, factual record.

Second, since this Court's 2016 decision in *Escobar*[5], a split has arisen among courts around the country about whether an allegation of materiality in an FCA case can be defeated by a defendant's mere allegation that the government continued to pay claims despite knowledge of allegations of a defendant's wrongdoing. The Ninth Circuit, without analysis, in this case apparently adopted Defendants' reasoning that the fact that the government was allegedly informed of Defendants' wrongdoing and continued to pay, negates any evidence of or possibility that Relator could prove materiality.

There are three problems with an analysis that ends with the dismissal of an FCA case because "the government continued to pay." First, such a standard will eviscerate the FCA, which Congress has repeatedly affirmed is designed to protect not only against unscrupulous contractors, but also against untrustworthy government actors. Government actors have many reasons to continue to pay including: defendant's misrepresentations, bureaucratic indifference, or other pressures including political and financial. These factors are ignored when a complaint is dismissed simply because "the government continued to pay."

Second, such a result fails to consider that, as in this case, Relator alleges that Defendants lied to the government, which is the reason the government continued to pay.

Third, and as this Court noted in *Escobar*, materiality concerns a "reasonable person" standard.

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[5] *Universal Health Servs., Inc. v. United States,* 136 S.Ct. 1989, 2001-02 (2016).

Id. at 2001-02. Just as "a reasonable person would realize the imperative of a functioning firearm", a reasonable person would realize that it is vital that secret military technology remain secret. As pleaded in the Complaint, Defendants in this case held highly classified defense technology on their international computer servers, then knowingly opened those servers to view of thousands of potentially hostile foreign persons in the United States and in ITAR-forbidden countries, including China and the Philippines. Certainly a reasonable person would realize such ITAR violations are material to payment, especially when ITAR penalties include jail, debarment as a contractor, and heavy fines.

If this Court does not summarily reverse or otherwise grant certiorari on the question of scienter, the Court should at least grant certiorari on the question of materiality to prevent the evisceration of the FCA based on complete deference to an allegation of a government payment decision, without factual findings or consideration that the government's decision may be tainted by a defendants' fraud, government indifference, or other bureaucratic factors.

STATEMENT OF THE CASE

A. Factual Background

Petitioner/Relator (hereinafter "Relator") is a former IT administrator and ITAR expert with Respondents WEDC and Microsemi (hereinafter "Defendants" or "Microsemi"). ER 111. The ITAR "framework exists

to protect American national security by blocking the access to sensitive technologies by adverse or untrustworthy entities."[6] The Department of Defense requires all contractors or subcontractors producing ITAR-or EAR-controlled products to include within their contracts a statement that they shall comply with all applicable laws and regulations regarding export-controlled items, including items controlled by ITAR and EAR. 48 C.F.R. 252.225-7048(b), formerly 48 C.F.R. 252.204-7008(b). In addition, all contractors are required to include clauses guaranteeing that the contractor will "provide adequate security for all covered defense information on all covered contractor information systems that support the performance of work under this contract." "Covered defense information" includes information subject to ITAR and EAR export control. 48 C.F.R. 252.204-7012(a)(i)(C).

Relator discovered serious ITAR violations being committed by Defendants soon after the merger of Microsemi and WEDC in 2010. ER 111-113. The violations allowed thousands of foreign persons to access and view classified defense technology on Defendants' domestic and international computer servers. ER 111-12; 122-24. Furthermore, because Microsemi's president had been caught lying on his application for classified access, before the merger the government mandated that Microsemi sign an "excluded parent agreement" acknowledging that ITAR-controlled WEDC technology, much of which was classified, would not be

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[6] Justin Levine, *Reevaluating Itar: A Holistic Approach to Regaining Critical Market Share While Simultaneously Attaining Robust National Security*, 2 U. Miami Nat'l Sec. & Armed Conflict L. Rev. 150, 153 (2012).

shared with Microsemi and its employees. ER 129. This promise by Microsemi was necessary for WEDC to maintain its security clearance. *Id.* Nevertheless, the ITAR violations also violated the excluded parent agreement. *Id.*

Relator immediately notified Defendants of the violations and, when Defendants fought Relator's attempts to safeguard the data, Relator notified the Defense Security Service ("DSS").[7] ER 129-130. Soon afterward, DSS ordered that access be shut down and that the ITAR data be protected. ER 136-37. Other Microsemi subsidiaries later notified Relator that the domestic and international computer access to unauthorized foreign persons continued to be allowed of the subsidiaries' secret military technology. ER 127-28. Soon afterward, Relator left his employment at Defendants' IT department and filed this action. ER 111. Defendants then filed "voluntary disclosures" with DSS, which misrepresented both the scope and duration of the ITAR violations and denied, without evidence, that any foreign persons had actually accessed the data. ER 118.

B. Proceedings Below

Relator brought this action in 2013 under the *qui tam* provisions of the False Claims Act, 31 U.S.C. § 3720(b), in the United States District Court for the District of Arizona. Soon after the original complaint was unsealed in 2014, Plaintiff amended the complaint ("Complaint") as of right to add allegations concerning

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[7] DSS is a federal security agency of the United States Department of Defense ("DOD").

Defendants' fraudulent "voluntary disclosures" to the government.

Defendants then moved to dismiss the Complaint on the grounds that Relator had not sufficiently pleaded falsity, scienter or materiality, and that the Complaint did not allege its claims in sufficient detail to satisfy Fed. R. Civ. P. 9(b). ER 41.

The district court granted the motion to dismiss, accepting as true Defendants' allegations about their statutory interpretation of ITAR and finding that Relator had not and could not show materiality in that the district court held there was no evidence that ITAR compliance was material to the government's decision to pay. ER 5-38. The district court also denied Relator's leave to amend the Complaint. ER 38-39.

On appeal, the Ninth Circuit held that as a matter of law, Relator could not prove scienter because the Court found Defendants' interpretation of "the term 'disclose'[8] in [ITAR] 22 C.F.R. 120.17" was in "good faith." App.3a. The Ninth Circuit did not consider Relator's allegations that the DSS had "warned away" Defendants from their interpretation of the regulation. The court also failed to consider that a reasonable person would have known that allowing unprotected access to secret military technology on domestic and international computer servers accessible by potentially hostile foreign persons, would violate ITAR. Finally, and without analysis, the Ninth Circuit also held that there were no facts Relator could add to the Complaint

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[8] The term "disclose" does not appear in 22 C.F.R. 120.17, but the Ninth Circuit was presumably referencing the term "export" which is defined in 120.17.

"to establish that Microsemi's alleged ITAR violation was material to the Government's payment decision." 2017 WL 1829109, at *1.

REASONS FOR GRANTING THE PETITION

I. THERE IS A SPLIT OF AUTHORITY CONCERNING WHETHER AN FCA SCIENTER DEFENSE MAY BE RESOLVED ON A MOTION TO DISMISS

The Ninth Circuit's decision on scienter conflicts with the holdings of the D.C. Circuit, the Fifth Circuit and the Eleventh Circuit. These circuits have concluded that it is only appropriate to decide an issue of scienter after there is a full factual record. *United States ex rel. Purcell v. MWI Corp.*, 807 F.3d 281, 288-89 (D.D.C. 2015) (rejecting an argument that the scienter element of an FCA claim can be considered as a pure question of law); *Farmer v. City of Houston*, 523 F.3d 333, 340 (5th Cir. 2008) (scienter should be addressed only after a full factual record is developed); *United States ex rel. Phalp v. Lincare Holdings, Inc.*, 857 F.3d 1148, 1157 (11th Cir. 2017) (because there are factual questions, defendant cannot as a matter of law "preclude a finding of scienter by identifying a reasonable interpretation of an ambiguous regulation that would have permitted its conduct").

Only the Eighth Circuit has joined the Ninth Circuit in dismissing an FCA claim at the pleadings stage based, in part, a finding as a matter of law that defendants' interpretation of "any ambiguity inherent in the regulations belies the scienter necessary to

establish a claim of fraud under the FCA." *United States ex rel. Ketroser v. Mayo Found.,* 729 F.3d 825, 832 (8th Cir. 2013) ("An FCA defendant does not act with the knowledge that the FCA requires before liability can attach when the defendant's interpretation of the applicable law is a reasonable interpretation, perhaps even the most reasonable one.") (internal citations omitted); *United States ex rel. Hixson v. Health Mgmt. Sys., Inc.*, 613 F.3d 1186, 1190 (8th Cir. 2010) (determining that defendants could not have acted with scienter when "the relevant legal question was unresolved").

A. Other Courts Have Rightly Noted That Factual Considerations Preclude a "Good Faith" Statutory Interpretation at the Pleadings Stage

Unlike the Ninth Circuit, other circuits that have considered the issue of a defendant's "good faith" interpretation of a statute have taken a two-pronged approach. These circuits, including the D.C. Circuit and Eleventh Circuit, require (1) that the defendant's interpretation of an ambiguity be objectively reasonable, and (2) an analysis of whether the government attempted to "warn away" defendant from the erroneous interpretation. *E.g.*, *United States ex rel. Purcell v. MWI Corp.*, 807 F.3d 281, 288-89 (D.D.C. 2015); *United States ex rel. Phalp v. Lincare Holdings, Inc.*, 857 F.3d 1148, 1157 (11th Cir. 2017).[9]

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[9] Even the Eighth Circuit in recent decisions has considered whether a defendant was "warned away" as part of a two-part analysis of whether a defendant's statutory interpretation should be a complete defense to a showing of scienter in an FCA claim. *United States ex rel. Donegan v. Anesthesia Assocs. of Kansas City, PC,* 833 F.3d 874, 879-80 (8th Cir. 2016) ("summary

The Eleventh Circuit reasoned:

> . . . [A] court must determine whether the defendant actually knew or should have known that its conduct violated a regulation in light of any ambiguity at the time of the alleged violation. Furthermore, under the district court's [erroneous] legal interpretation, a defendant could avoid liability by relying on a 'reasonable interpretation of an ambiguous regulation manufactured post hoc, despite having actual knowledge of a different authoritative interpretation.

Lincare, 857 F.3d at 1155-56, citing *United States v. R & F Props. of Lake City, Inc.*, 433 F.3d 1349, 1358 (11th Cir. 2005); *United States ex rel. Minn. Ass'n of Nurse Anesthetists v. Allina Health Sys. Corp.*, 276 F.3d 1032, 1053-54 (8th Cir. 2002).

Lincare also cites the legislative history of the bill that added the "reckless disregard" standard of scienter to the FCA. This history confirms that the intent of Congress was to require defendants to make <u>at least</u> a limited inquiry into the accuracy of their government claims, prior to submitting them:

> Currently, in judicial districts observing an 'actual knowledge' standard, the Government is unable to hold responsible those corporate

judgment is not proper on the issue of FCA scienter if a Relator (or the United States) produces sufficient evidence of government guidance that 'warned a regulated defendant away from an otherwise reasonable interpretation' of an ambiguous interpretation"), *quoting Purcell*, 807 F.3d at 290, applying this Court's interpretation of 'reckless disregard' in *Safeco Ins. Co. v. Burr*, 551 U.S. 47, 69-70, 127 S.Ct. 2201 (2007).

> officers who insulate themselves from knowledge of false claims submitted by lower-level subordinates. This 'ostrich-like' conduct which can occur in large corporations poses insurmountable difficulties for civil false claims recoveries . . . [T]he Committee does believe the civil False Claims Act should recognize that those doing business with the Government have an obligation to make a limited inquiry to ensure the claims they submit are accurate.

S. REP. 99-345, 7, 1986 U.S.C.C.A.N. 5266, 5272.

In other words, it is not enough that Defendants were able to come up with a "reasonable" interpretation of a statute, Defendants must make inquires to determine if their interpretation is actually reasonable. The Ninth Circuit's decision at the "motion to dismiss" stage necessarily precludes any factual examination into whether Defendants made any inquiries and, if they did, what those inquires revealed.

Further, as one district court has noted, resolution on a motion to dismiss of an FCA claim based upon a defense of "reasonable interpretation of a statute" is premature for a myriad of other reasons:

> We find [defendant's] interpretation of the law focuses on its state of mind, and is properly addressed after full development of the factual record. Allergan's reasonable interpretation of the law and applicable regulatory framework may well be a defense to liability, but it is not appropriate at the motion to dismiss stage when there are reasonable interpretations to the contrary.

United States. ex rel. Nevyas v. Allergan, Inc., No. CIV.A. 09-432, 2015 WL 4064629, at *6 (E.D. Pa. July 2, 2015) .

Here, Defendants have interpreted the term "export" to mean an actual transfer of ITAR data to a foreign person, and consequently Defendants contend there cannot be an ITAR violation unless a foreign person actually looks at the data. App.38a. Granting unprotected "access" to data, in Defendants' view, is therefore not an ITAR violation until someone actually sees the unprotected data (not that Microsemi has any way to know if someone actually looked at the data). *Id.* This is akin to taking a position that posting secret ITAR military technology on a billboard at a busy intersection is not prohibited by ITAR unless someone can prove an unauthorized person actually looked at the billboard.

Such a position is not reasonable on its face, and the Ninth Circuit's very limited inquiry into a Defendants' scienter in statutory-interpretation cases wrongly allows defendants to skirt liability based solely upon unsworn statements made by a corporation's attorneys about the "reasonableness" of a defendant's interpretation.

B. Unlike Other Circuits, the Ninth Circuit Does Not Consider Whether Defendants Have Been 'Warned Away' from Their Erroneous Statutory Interpretations

In fact, the Government in this case explicitly "warned away" Defendants from their interpretation of "export" when DSS told Defendants that they were violating ITAR by merging the Microsemi and WEDC

networks and ordered Defendants to immediately separate the networks. This happened first on October 25, 2010 when DSS ordered that the databases of WEDC and Microsemi be disconnected from each other (ER 135-137,¶¶ 50-51) and then again, in an email the next day to Microsemi's Chief Executive Officer, Jim Peterson, in which DSS which "notif[ied] him of the ITAR violations and the spillage of classified information from WEDC such that it was visible to other, unauthorized Microsemi business units." ER 118-119, at ¶ 19; ER 126-128, at ¶¶ 33-34; ER 135-137 at ¶¶ 50-51. Despite these warnings, Defendants continued their behavior and fraud. *E.g.* ER 85; 127-28.

The warning away of Defendants from an erroneous statutory interpretation is fundamental to the issue of scienter, which concerns the issue of whether defendants acted either "knowingly" or with "reckless disregard." 31 U.S.C. § 3729(b). As the D.C. Circuit has rightly pointed out:

> [A] jury might still find knowledge if there is interpretive guidance that might have warned the defendant away from the view it took. In other words, even if the [provision] is ambiguous and [the defendant]'s interpretation is reasonable, there remains the question whether [the defendant] had been warned away from that interpretation. That question cannot readily be labeled as a purely legal question.

Purcell, 807 F.3d 281, 288 (emphasis added).

Unlike the D.C. Circuit, however, the Ninth Circuit does not consider anything except whether a defendant's interpretation is reasonable. Therefore the court in

this case simply found that "the complaint cannot plead facts sufficient to support an inference that Microsemi knew it had failed to comply with ITAR at the time of the representation because Microsemi's good faith interpretation of the term 'disclose' in 22 C.F.R. 120.17 at that time was reasonable."

Setting aside that the ITAR term at issue in the case was "export" and not "disclose", the Ninth Circuit's analysis also failed to consider that Microsemi's supposed "interpretation" was *post hoc*, and that the Complaint alleged Microsemi was expressly "warned away" from its interpretation by the government when DSS notified Microsemi that allowing unprotected access to international computer servers is a violation of ITAR.

Accordingly, the Ninth Circuit has adopted an erroneous standard for scienter related to the interpretation of a statute, and one that allows corporate officers to escape liability either through "ostrich-like conduct" or by inventing *post hoc* interpretations as a cover for their fraudulent claims. This Court should grant certiorari, adopt the reasoning of the D.C. and the Eleventh Circuits, and reverse the Ninth Circuit's decision in this matter.

II. SINCE *ESCOBAR*, THERE IS A CIRCUIT SPLIT REGARDING THE FCA MATERIALITY STANDARD

The objective materiality standard now embodied in the FCA requires proof that the defendants' false statements 'could have' influenced the government's payment decision or had the 'potential' to influence the government's decision, not that the false statements actually [do] so." *United States ex rel. Rigsby v. State*

Farm Fire & Cas. Co., 749 F.3d 457, 480 (5th Cir. 2015), citing 31 U.S.C. § 3729(b)(4); *Escobar*, 136 S.Ct. at 1996.

For this reason, until recently, the actions taken by agency officials after the fraud has been disclosed have generally been considered legally irrelevant. The FCA makes it clear that only decisions made by the Attorney General can affect a *qui tam* claim after the fraud is disclosed. 31 U.S.C. § 3730. Thus, the Department of Justice has emphatically rejected the notion that any other federal agency could, through its actions or decisions, either estop or compromise an FCA claim such a claim in any way. DOJ Brief, *United States Ex Rel. Edwin P. Harrison*, Plaintiff-Appellee and Cross-Appellant, *v. Westinghouse Savannah River Company*, Defendant-Appellant and Cross-Appellee., 2003 WL 25936477 (C.A.4), 15 (" . . . [F]ederal law prohibits agencies other than the Department of Justice from compromising false or fraudulent claims . . . [t]he proper approach is therefore to consider false certifications "material" where they <u>could</u> have influenced the Government's decision to pay if discovered at the time they were made) (internal citations omitted) (emphasis in original); *See, e.g.*, *United States v. Triple Canopy, Inc.*, 775 F.3d 628, 632 (4th Cir. 2015), *cert. granted*, judgment vacated sub nom. *Triple Canopy, Inc. v. United States ex rel. Badr*, 136 S.Ct. 2504, 195 L.Ed.2d 836 (2016), and opinion reinstated in part, 857 F.3d 174 (4th Cir. 2017) ("[M]ateriality focuses on the potential effect of the false statement when it is made <u>not the actual effect of the false statement when it is discovered</u>.") (emphasis in original); *United States v. Rogan*, 517 F.3d 449, 452-53 (7th Cir. 2008) (relator need not introduce evidence from a federal official

testifying that official would deny payment if he or she would have known of defendant's anti-kickback violations); *United States ex rel. Feldman v. Van Gorp*, 697 F.3d 78, 95 (2d Cir. 2012) ("[M]ateriality is determined not by what a program officer at NIH declares material, but rather [is] based on the agency's own rules and regulations.") (internal quotations omitted); *United States ex rel. Harrison v. Westinghouse Savannah River Co.*, 352 F.3d 908, 916-17 (4th Cir. 2003) (agreeing with *Triple Canopy*); *Varljen v. Cleveland Gear Co., Inc.*, 250 F.3d 426, 430 (6th Cir. 2001) ("The government's inspection and acceptance of a product does not absolve a contractor from liability for fraud under the FCA"); *United States ex rel. Anti-Discrimination Center of Metro New York, Inc. v. Westchester County, N.Y.*, 668 F.Supp.2d 548, 570 (S.D.N.Y 2009) ("[A]n individual government employee's decision to approve or continue such funding, even with full access to all relevant information or knowledge of the falsity of the applicants['] certification does not demonstrate that the falsity was not material . . . . Thus, the assertion that certain HUD bureaucrats reviewed the County's submissions and continued to grant the County funding cannot somehow make the false AFFH certifications immaterial, when the funding was explicitly conditioned on the certifications").

In the leading case *United States v. National Wholesalers*, 236 F.2d 944 (9th Cir. 1956), the defendant supplier was held liable under the FCA for providing intentionally mislabeled products despite the fact that the products worked as well as the products that were contracted for and the Army accepted the products and paid under the contract. "In

such palming off as we have here we do not believe that Congress ever intended that contracting officers should have the power to officiate the False Claims statute." *Id.* at 950. Thus, the Army's decision to pay under the contract did not affect the validity of the fraud claim.

A. The *Escobar* Materiality Standard

In *Escobar*, this Court outlined a "demanding" a materiality standard under its "common-law antecedents" of fraudulent misrepresentation. 136 S.Ct. at 1995, 2003. The *Escobar* materiality standard requires that the fraudulent omission or misrepresentation concern <u>critical facts</u> that go "to the very essence of the bargain." 136 S.Ct. at 1995, 2003 n.5 (emphasis added).

> Under any understanding of the concept, materiality 'look[s] to the effect on the likely or actual behavior of the recipient of the alleged misrepresentation.' In tort law, for instance, a "matter is material" in only two circumstances: (1) '[if] a reasonable man would attach importance to [it] in determining his choice of action in the transaction'; or (2) if the defendant knew or had reason to know that the recipient of the representation attaches importance to the specific matter 'in determining his choice of action,' even though a reasonable person would not.

136 S.Ct. 1989, 2002–03, citing 26 R. Lord, Williston on Contracts § 69:12, p. 549 (4th ed. 2003) (Williston); Restatement (Second) of Torts § 538, at 80 ("Reasonable person standard") .

The *Escobar* decision also includes guidance on the facts that would support materiality:

> Conversely, if the Government pays a particular claim in full despite its actual knowledge that certain requirements were violated, that is very strong evidence that those requirements are not material. Or, if the Government regularly pays a particular type of claim in full despite actual knowledge that certain requirements were violated, and has signaled no change in position, that is strong evidence that the requirements are not material.

Escobar, 136 S.Ct. at 2003–04.

Unfortunately, this is not the standard applied either by the Ninth Circuit or by four other Circuits around the country.

B. The Materiality Standard Applied by the Ninth Circuit

Since *Escobar*, some circuits, including the Ninth Circuit, have not considered continuing payments by the government to be mere "evidence", but have found that the government's continuing payments in light of fraud allegations can be dispositive of an FCA claim:

> . . . [A] clear trend is emerging in cases where the Government continues to pay despite having notice of the defendant's alleged or actual conduct . . . These courts may very well have been following Jerry Maguire's immortal words of "show me the money" because these courts focused on the

> Government's payment of claims in cases where the Government knew that the contractor was allegedly out of compliance with a requirement . . .
>
> Indeed, if the agency has conducted an investigation and determined that there is no misconduct or even if the agency has simply not taken any action to investigate or otherwise hold up payments in light of allegations of fraud, courts are finding that a showing of materiality has been fatally undermined.

Brian Tully McLaughlin and Jason M. Crawford, *The Government Contractor: Materiality Rules! Escobar Changes The Game*, 59 NO. 18 Govt Contractor ¶ 135 (May 10, 2017) (emphasis added).

Defendants in this case argued to the Ninth Circuit that because the government continued to pay claims after the Relator alerted the government to their fraud, Defendants' fraud was not "material" to the government's payment decision. Apparently adopting this reasoning, the Ninth Circuit found that facts to establish materiality had not been adequately pleaded by the Relator and there were no "facts [Relator] could add to the complaint to establish that Microsemi's alleged ITAR violation was material to the Government's payment decision." App.4a.

But the Complaint pleads critical facts that go "to the very essence of the bargain", *i.e.* that Microsemi failed to keep secret the classified military technology that they promised to protect, and the Complaint also alleges that Microsemi lied to the government to continue payments. But the Ninth Circuit did not

consider these allegations—its only focus was that the government continued to pay. Nor did the Ninth Circuit consider that Microsemi had fraudulently induced the very contracts mandating ITAR compliance, as Microsemi knew at the time of entering into the contracts that Microsemi was not, in fact, ITAR compliant and it had no intention of becoming ITAR compliant.

In addition to ignoring the standard set out by this Court, the Ninth Circuit's decision failed to consider the legislative history and purpose of the FCA, which Congress established to root out fraud by government contractors and to overcome the repeated failures of government to act to deter or punish such fraud.

C. The Ninth Circuit Joined Four Other Circuits in Erroneously Applying the "Government Continued to Pay" Standard

The Ninth Circuit is not alone. Since *Escobar*, the D.C. Circuit, First Circuit, Third Circuit, and Seventh Circuit have also used the "government continued to pay" standard to dismiss cases for lack of materiality. *United States ex rel. Petratos v. Genentech Inc.*, 855 F.3d 481, 492–93 (3d Cir. 2017) ("there are no factual allegations showing that CMS would not have reimbursed these claims had these [alleged reporting] deficiencies been cured"); *United States ex rel. McBride v. Halliburton Co.,* 848 F.3d 1027, 1032 (D.C. Cir. 2017) (" . . . [W]e have the benefit of hindsight and should not ignore what actually occurred: the DCAA investigated McBride's allegations and did not disallow any charged costs"); *United States ex rel. Nargol v. DePuy Orthopaedics, Inc.*, 865 F.3d 29, 35 (1st Cir. 2017) ("Here . . . there is no allegation that the FDA

withdrew or even suspended product approval upon learning of the alleged misrepresentations"); *United States v. Sanford-Brown, Ltd.*, 840 F.3d 445, 447–48 (7th Cir. 2016) (" . . . [A]s we previously noted, the subsidizing agency and other federal agencies in this case 'have already examined SBC multiple times over and concluded that neither administrative penalties nor termination was warranted' ").

D. Three Other Circuits Continue to Apply the "Reasonable Person" Standard

The Fourth Circuit, Fifth Circuit and Eighth Circuit, on the other hand, continue to apply the objective "reasonable person" standard and to consider the government's decision to pay only as "strong" but not dispositive evidence of materiality. *United States v. Triple Canopy, Inc.,* 857 F.3d 174, 178-79 (4th Cir. 2017) (Adhering to its pre-*Escobar* materiality analysis, the Fourth Circuit found no reason to alter its reasoning: "analyzing materiality, we noted that a material falsehood was one that was capable of influencing the Government's decision to pay") (emphasis added); *United States ex rel. Miller v. Weston Educ., Inc.,* 840 F.3d 494, 504 (8th Cir. 2016) (applying a "reasonable person" standard). Finally, the Fifth Circuit in *Abbott v. BP Expl. & Prod., Inc.*, viewed the government's continuing payments as "strong evidence that the requirements in those regulations were not material" and granted summary judgment only after the plaintiff could not rebut that evidence.

Giving undue deference to government bureaucrats' decisions to pay is contrary to the legislative history of the FCA which emphasizes that the FCA was enacted to empower private citizen-whistleblowers to pursue

wrongdoers because the government often fails to do so.

E. The Legislative History of the FCA Rejects Undue Deference to Government Payment Decisions

There are good reasons why the actions of agency officials after the fraud is disclosed should not be determinative in an FCA case.

> Another way to see this is to recognize that laws against fraud protect the gullible and the careless—perhaps especially the gullible and the careless—and could not serve that function if proof of materiality depended on establishing that the recipient of the statement would have protected his own interests. The United States is entitled to guard the public fisc against schemes designed to take advantage of overworked, harried, or inattentive disbursing officers; the False Claims Act does this by insisting that persons who send bills to the Treasury tell the truth.

U.S. ex rel. Feldman v. Van Gorp, 697 F.3d 78, 95 (2d Cir. 2012), *quoting United States v. Rogan*, 517 F.3d 449, 453 (7th Cir. 2008).

The language of the FCA would also be rendered superfluous if the action of a government official is determinative. If Congress had meant that an actual act of a government official—taken for unknown reasons—determines whether a statement had a "natural tendency to influence" payment, Congress would have provided that a statement is "material"

only if it actually influenced a decision maker who was aware of the statement.

Finally, the FCA was enacted because Congress recognized that federal procurement officials do not always act in the best interests of the taxpayers. *See*, *e.g.*, *United States ex rel. Marcus v. Hess*, 127 F.2d 233, 236 (3d Cir. 1942) (citing historical reference noting that "a large amount of the blame" for Civil War fraud "must go to the horde of government-paid officials who, either through criminal negligence or criminal collusion, permitted or encouraged this robbing of the government treasury."), *rev'd on other grounds*, 317 U.S. 537 (1943). When Congress expanded the FCA in 1986 in response to reports of widespread fraud perpetuated on the government, it noted that "most fraud goes undetected due to the failure of Governmental agencies to effectively ensure accountability on the part of program recipients and Government contractors."

Indeed, Congress cited a U.S. Merit System Protection Board study that found that 69% of government officials surveyed believed they had direct knowledge of illegalities but failed to report the information to their superiors, citing fear that nothing would be done and that they would be the subject of reprisals. Senate Report 99-345, 1986 WL 31937 (1986), at 5268-70.

In addition, a GAO report submitted to the Senate as part of the 1986 Congressional amendments to the FCA estimated that the Defense Department in the early 1980s was losing "from $1 to $10 billion" a year, with losses of "more than $1 billion just from fraudulent billing practices." S. REP. 99-345, 3, 1986 U.S.C.C.A.N. 5266, 5268. The reason for the continuing, pervasive

fraud was "a lack of deterrence" by government employees. *Id.* (emphasis added).

> GAO concluded in its 1981 study that most fraud goes undetected due to the failure of Governmental agencies to effectively ensure accountability on the part of program recipients and Government contractors. The study states: "For those who are caught committing fraud, the chances of being prosecuted and eventually going to jail are slim . . . The sad truth is that crime against the Government often does pay."

S. REP. 99-345, 3, 1986 U.S.C.C.A.N. 5266, 5268 (emphasis added).

Congress also referred to the history of the FCA, as noted above, which was enacted after government officials had failed to stop "the massive frauds perpetrated by large contractors during the Civil War." *United States v. Bornstein,* 423 U.S. 303, 309, 96 S.Ct. 523 (1976); S. Rep. No. 99-345, at 8, *reprinted in* 1986 U.S.C.C.A.N. 5266, 5273 ("Senate Report"). Contractors looted the federal treasury and created a "windfall profit" through fraudulent interactions with the government. *See United States ex rel. Newsham v. Lockheed Missiles & Space Co., Inc.,* 722 F.Supp. 607, 609 (N.D.Cal.1989) ("For sugar [the government] often got sand; for coffee, rye; for leather, something no better than brown paper; for sound horses and mules, spavined beasts and dying donkeys; and for serviceable muskets and pistols, the experimental failures of sanguine inventors, or the refuse of shops and foreign armories") (*quoting* Tomes, *Fortunes of War,* 29 Harper's Monthly Mag. 228 (1864)); *United*

States v. McNinch, 356 U.S. 595, 599, 78 S.Ct. 950, 952-53 (1958) ("The False Claims Act was originally adopted . . . to stop this plundering of the public treasury").

A standard that allows dismissal of an FCA claim upon the mere allegation that "the government continued to pay" invites the plundering of the public fisc by unscrupulous and dishonest contractors.

F. This Court Should Resolve the Circuit Split and Restore the "Reasonable Person" Standard

This Court has traditionally given great weight to the FCA's legislative history and legislative purpose. *Bornstein,* 423 U.S. 303, 309-10; *United States ex rel. Marcus v. Hess*, 317 U.S. 537, 547-48, 63, 63 S.Ct. 379 (1943); *Allison Engine Co. v. U.S. ex rel. Sanders*, 553 U.S. 662, 671, 128 S.Ct. 2123, 2129, 170 L.Ed.2d 1030 (2008). It is imperative to the future of the FCA that this legislative history be honored by re-instituting a materiality standard that does not unduly defer to government bureaucrats who may not act due to fear, dishonesty or pressure from corrupt contractors.

The weight of FCA legislative history necessitates restoring the "reasonable person" materiality standard and requires that the "government continued to pay standard" be relegated to its proper role as "evidence" of materiality. This is crucial to ensure the FCA is returned to its intended role in combating fraudulent claims. On its present course, the FCA will be subjugated to a toothless statute that can be circumvented by dilatory, dishonest or pre-occupied government bureaucrats or eviscerated by government contractors

who successfully mislead the government about their fraudulent activities.

CONCLUSION

For the foregoing reasons, the Court should grant the petition for certiorari.

Respectfully submitted,

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SEPTEMBER 13, 2017

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MEMORANDUM* OPINION OF THE NINTH CIRCUIT (MAY 5, 2017)

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

UNITED STATES Ex Rel. MARK McGRATH,

Plaintiff-Appellant,

v.

MICROSEMI CORPORATION; WHITE ELECTRONIC DESIGNS CORPORATION, DBA Microsemi Power and Electronics Group,

Defendants-Appellees.

No. 15-17206
D.C. No. 2:13-cv-00864-DJH

MARK MCGRATH, Ex Rel.
UNITED STATES OF AMERICA,

Plaintiff-Appellant,

v.

MICROSEMI CORPORATION; WHITE ELECTRONIC DESIGNS CORPORATION, DBA Microsemi Power and Electronics Group,

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* This disposition is not appropriate for publication and is not precedent except as provided by Ninth Circuit Rule 36-3.

Defendants-Appellees.

No. 15-17478
D.C. No. 2:13-cv-00864-DJH

Appeal from the United States District Court for the District of Arizona Diane J. Humetewa, District Judge, Presiding

Before: D.W. NELSON and IKUTA, Circuit Judges, and BURGESS,** Chief District Judge.

Mark McGrath, on behalf of the United States of America, appeals the district court's order dismissing his qui tam complaint under Rules 8(a) and 9(b) of the Federal Rules of Civil Procedure and denying leave to amend. We have jurisdiction under 28 U.S.C. § 1291.

McGrath's complaint failed to state a false certification claim under the False Claims Act (FCA), 31 U.S.C. §§ 3729-3733, because the complaint failed to plead facts plausibly alleging that compliance with the International Traffic in Arms Regulations (ITAR) was material to the Government's decision to pay White Electronic Designs Corporation and Microsemi Corporation (collectively, "Microsemi"). *Universal Health Servs., Inc. v. United States ex rel. Escobar*, 136 S. Ct. 1989, 2002-03 (2016). Moreover, even assuming that the statement "ITAR controlled" on Microsemi's receipts constituted a false representation that Microsemi was in compliance with ITAR, the complaint cannot plead facts sufficient to support an inference that Microsemi knew it had failed to comply with ITAR at the time of

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** The Honorable Timothy M. Burgess, United States Chief District Judge for the District of Alaska, sitting by designation.

the representation because Microsemi's good faith interpretation of the term "disclose" in 22 C.F.R. § 120.17 at that time was reasonable. *See Safeco Ins. Co. of Am. v. Burr*, 551 U.S. 47, 70 n.20 (2007). Because McGrath cannot establish Microsemi's scienter as a matter of law, and has not indicated what facts he could add to the complaint to establish that Microsemi's alleged ITAR violation was material to the Government's payment decision, the district court did not err in denying leave to amend. *See id.*; *Hildes v. Arthur Andersen LLP*, 734 F.3d 854, 859 (9th Cir. 2013).

Finally, McGrath waived his argument that Microsemi provided the Government worthless products by failing to raise it in his opening brief. *Martinez-Serrano v. I.N.S.*, 94 F.3d 1256, 1259 (9th Cir. 1996). To the extent McGrath is now raising the modified argument that Microsemi knowingly demanded payment for products that had lost value due to Microsemi's failure to comply with ITAR, such a claim fails for the same reasons as his false certification claim.[1]

AFFIRMED.

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[1] McGrath failed to raise his FCA claim for fraud in the inducement before the district court. We therefore decline to address this issue on appeal. *Bolker v. Comm'r of Internal Revenue*, 760 F.2d 1039, 1042 (9th Cir. 1985).

MANDATE OF THE NINTH CIRCUIT (JUNE 23, 2017)

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

UNITED STATES ex rel. MARK McGRATH,

Plaintiff-Appellant,

v.

MICROSEMI CORPORATION; WHITE ELECTRONIC DESIGNS CORPORATION, DBA Microsemi Power and Electronics Group,

Defendants-Appellees.

No. 15-17206
D.C. No. 2:13-cv-00864-DJH
U.S. District Court for Arizona, Phoenix

MARK MCGRATH, ex rel. United States of America,

Plaintiff-Appellant,

v.

MICROSEMI CORPORATION; WHITE ELECTRONIC DESIGNS CORPORATION, DBA Microsemi Power and Electronics Group,

Defendants-Appellees.

No. 15-17478
D.C. No. 2:13-cv-00864-DJH
U.S. District Court for Arizona, Phoenix

The judgment of this Court, entered May 05, 2017, takes effect this date. This constitutes the formal mandate of this Court issued pursuant to Rule 41(a) of the Federal Rules of Appellate Procedure.

FOR THE COURT:

Molly C. Dwyer
Clerk of Court

By: Craig Westbrooke
Deputy Clerk Ninth
Circuit Rule 27-7

ORDER OF THE DISTRICT COURT OF ARIZONA (SEPTEMBER 30, 2015)

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF ARIZONA

UNITED STATES OF AMERICA *Ex Rel.*
MARK McGRATH,

Relator,

v.

MICROSEMI CORPORATION, ET AL.,

Defendants.

No. CV-13-00864-PHX-DJH

Before: Honorable Diane J. HUMETEWA
United States District Judge

Pending before the Court is a Motion to Dismiss Relator's First Amended Complaint ("AC") with prejudice by defendants Microsemi Corporation and White Electronic Designs Corporation ("WEDC") (Doc. 34) pursuant to Fed.R.Civ.P. 12(b)(6) and Fed.R.Civ.P. 9(b).[1]

[1] In its discretion, because it will not aid the decisional process, the Court denies Defendants' request for oral argument. *See* Fed.R.Civ.P. 78; *see also Mahon v. Credit Bur. of Placer County, Inc.*, 171 F.3d 1197, 1200 (9th Cir. 1999); *Partridge v. Reich*, 141 F.3d 920, 926 (9th Cir. 1998).

I. Background

A. Procedural

On April 29, 2013, Relator Mark McGrath commenced this action against Defendants in the name of the United States Government pursuant to the False Claims Act ("FCA"), 31 U.S.C. § 3729 et seq. After twice extending the seal at the behest of the government, the Honorable Neil V. Wake, to whom this case was previously assigned, ordered that Relator to "be prepared to actively prosecute this case beginning March 1, 2014, if the Government does not intervene by then." Ord. (Doc. 17) at 1:22-24. As that order also required, on February 28, 2014, the government notified the Court that it would not be intervening. Not. (Doc. 18). A few days later, on March 3, 2014, Relator filed his First Amended Complaint ("AC") (Doc. 19), and on March 11, 2014, Judge Wake ordered that the case be unsealed. Ord. (Doc. 22). However, on May 23, 2014, Judge Wake subsequently ordered the resealing of the complaint, the AC and their respective attachments all be resealed. Ord. (Doc. 37). Therefore, all cites to the complaint herein are to the redacted version (Doc. 38).

B. Factual[2]

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[2] Preliminarily, the Court will address Defendants' request to take judicial notice of two documents which the FAC references. Both are letters from defendant Microsemi to the Directorate of Defense Trade Controls ("DDTC"). *See* Decl'n, exhs. 1- 2 (Doc. 34-1); *see also* AC (Doc. 38) at 17-18, ¶ 21.

"[A] as a general rule, a district court may not consider materials not originally included in the pleadings in deciding a Rule 12 motion[.]" *U.S. v. 14.02 Acres of Land More or Less*, 547 F.3d 943, 955 (9th Cir. 2008); *see also Warren v. Fox Family Worldwide, Inc.*, 328 F.3d 1136, 1141 n. 5 (9th Cir. 2003) (When deciding a Rule 12(b)(6) motion, generally a court must "refrain from considering extrinsic evidence[.]") Therefore, "[w]hen ruling on a Rule 12(b)(6) motion to dismiss, if a district court considers evidence outside the pleadings, it must normally convert the 12(b)(6) motion into a Rule 56 motion for summary judgment, and it must give the nonmoving party an opportunity to respond." *U.S. v. Ritchie*, 342 F.3d 903, 907 (9th Cir. 2003) (citations omitted). There are two exceptions to these general rules. The first is the incorporation by reference doctrine and the second is the doctrine of judicial notice. Under either of those doctrines, a court may consider certain matters beyond the complaint, without converting a motion to dismiss into a summary judgment motion. *See id.* at 908 (citations omitted).

The incorporation by reference doctrine allows a court to also "take into account documents whose contents are alleged in a complaint and whose authenticity no party questions, but which are not physically attached to the [plaintiff's] pleading." *Knievel v. ESPN*, 393 F.3d 1068, 1076 (9th Cir. 2005) (internal quotation marks and citations omitted). Taking a relatively expansive view of that doctrine, the Ninth Circuit has recognized that "[e]ven if a document is not attached to a complaint, it may be incorporated by reference into a complaint if the plaintiff refers extensively to the document or the document forms the basis of the plaintiff's claim." *Ritchie*, 342 F.3d at 908 (citations omitted). Under these circumstances, "the district court may treat such a document as part of the complaint, and thus may assume that its contents are true for purposes of a motion to dismiss under Rule 12(b)(6)." *Marder v. Lopez*, 450 F.3d 445, 448 (9th Cir.

Stripped of its rhetoric and hyperbole, the AC alleges as follows. Relator was employed with WEDC from June 2009 to May 2011. AC (Doc. 38) at 4, ¶ 1. Defendant WEDC "develops and manufactures microelectronic and display components and systems for high technology products used in military and commercial markets." (*Id.* at 9, ¶ 5). Some of those technologies are "protected from disclosure or export to foreign persons . . . by the federal International Traffic in Arms Regulation ("ITAR"),[3] 22 C.F.R. §§ 120-130, promulgated pursuant to the Arms Export Control Act ("AECA"), . . . and Export Administration Regulations ("EAR"), 15 C.F.R. §§ 730-774[.]" (*Id.*) (footnote added). "A small percentage of Microsemi's products are specifically designed for defense applications and are therefore ITAR-controlled." Decl'n (Doc. 34-1) at 8. Similarly, Defendant Microsemi, with employees world-wide, manufactures a wide range of high tech-

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2006) (internal quotation marks and citation omitted). Under either of those doctrines, a court may consider certain matters beyond the complaint, without converting a motion to dismiss into a summary judgment motion. *See id.* at 908 (citations omitted).

In the present case, because the AC "specifically relies upon Microsemi's Initial Notification of Voluntary Disclosure letter of and its supplement thereto, Defendants are requesting that the Court take "judicial notice" of both. See Mot. (Doc. 34) at 12, n. 4. Defendants are correct; paragraph 21 of the AC specifically mentions both letters. Therefore, what Defendants are actually seeking is for the Court to incorporate these letters by reference into the AC – not to take judicial notice of them. So construed, the Court will incorporate by reference both letters into the AC, especially because this request is unopposed.

[3] As more fully discussed herein, the ITAR designates certain products as defense articles or technical data and requires exporters to obtain a license or written approval to export the same.

nology products for use in a variety of markets, such as aerospace, defense and communications. AC (Doc. 38) at 5, ¶ 4. In May 2010, Microsemi completed its acquisition of WEDC, with the latter becoming a wholly owned subsidiary of the former. (*Id.* at 4-5, ¶ 3). After this acquisition, Relator was "in charge of the information technology [("IT")] team." (*Id.* at 4, ¶ 1).

During the acquisition process, some discussion ensued between Microsemi and WEDC given what Relator describes as "the extensive use of ITA documents throughout WEDC's computer network." AC (Doc. 38) at 22, ¶ 27. Microsemi informed Relator that it was "fully-versed in ITAR" due to having a "lot of facilities that perform ITAR-related work[.]" (*Id.*) nonetheless, Relator and his IT team became concerned about possible ITAR violations. (*Id.* at 22, ¶ 28). Both WEDC and Microsemi had their own separate "SharePoint" platforms. (*Id.* at 23, ¶ 29). "SharePoint is a widely used browser-based collaboration and document management platform from Microsoft." (*Id.*). On May 24, 2010, Relator was informed that Microsemi was going to start migrating "WEDC servers and personal computers to Microsemi's network domain." (*Id.* at 23, ¶ 30). Also, WEDC was going to start routing all of its e-mails through Microsemi servers." (*Id.*). On May 26, 2010, during a conference call with Microsemi, Relator expressed concern that if WEDC's "servers were migrated to Microsemi's network domain[,]" there was a risk of "unauthorized exposure" to WEDC's "ITAR-protected information[.]" (*Id.* at 24, ¶ 31). In July 2010, Relator continued to express concern to Microsemi "about data falling into unauthorized hands." (*Id.* at 24, ¶ 33).

Relator "learned[,]" in the fall of 2010, "that Microsemi domain administrators had access to all devices on the Microsemi domain and if unauthorized domain administrators in other countries or divisions had access to confidential data, it could easily be stolen without anyone knowing." AC (Doc. 38) at 26, ¶ 37. On October 5, 2010, Dan Tarantine, WEDC's President and General Manager, called Relator asking "about the status of WEDC ITAR documents and whether they were exposed to individuals in other facilities." (*Id.* at 27, ¶ 38). Relator answered in the affirmative, explaining that "WEDC was in the process of migrating its servers and computers to the Microsemi domain[,]" meaning "that all domain administrators would have access to all data on WEDC computers." (*Id.*).

The next day, Relator had a face-to-face meeting with Mr. Tarantine and WEDC's Network Administrator "to discuss network vulnerability vis-a-vis ITAR documents as a result of migrating WEDC's system to the Microsemi domain." AC (Doc. 38) at 28, ¶ 39. During this meeting, Microsemi's General Manager was contacted to discuss this "potential exposure" issue and how Microsemi "might be mitigating [it]." (*Id.* at 28, ¶ 39). The WEDC employees advised Microsemi that they had been able to access the server of a Microsemi facility in California and were "easily" able to download some of its files. (*Id.*). Additionally, servers in Ireland and Israel were accessible. (*Id.*). Among other things, Microsemi's GM advised that he would be contacting that California facility's security officer, who had previously held an IT-related position. (*Id.*)

Shortly thereafter, several government agencies became involved. On October 7, 2010, Relator, WEDC's

GM, Mr. Tarantine, and its Network Administrator, Mr. Luna, as well as Microsemi's Human Resources and Facility Security Officer, met with a Special Agent with the Federal Bureau of Investigation. This group informed the Special Agent of the allegedly "pervasive security breaches." AC (Doc. 38) at 28, ¶ 40. The next day, Relator and Messrs. Tarantine and Luna had another meeting. This time a Special Agent from the Defense Security Service ("DDS") was present, as well as representatives from the Department of Homeland Security and from Immigration and Customs Enforcement. (*Id.* at 29, ¶ 41). "The outcome was a decision that WEDC should continue operating as normal to allow time for" the Special Agent "to contact the State Department." (*Id.*)

Later in October 2010, a WEDC business analyst informed Relator that a firewall had been installed between WEDC and Microsemi. AC (Doc. 38) at 32, ¶ 47. Relator responded by sending an e-mail entitled "'Immediate Domain Separation Notification[.]'" (*Id.*) Relator cited ITAR violations as the reason for the "'physical domain separation[.]'" (*Id.*) Microsemi was displeased, believing that Relator should have contacted it prior to commencing the domain separation. (*Id.* at 33, ¶ 50). And, in any event, Microsemi did not want to maintain more than one domain. (*Id.* at 34, ¶ 50).

As part of the ongoing governmental investigation, the decision was made to shut down WEDC's server "because the firewall was not sufficient to protect the data." AC (Doc. 38) at 34, ¶ 50. On October 25, 2010, Microsemi's Chief Executive Officer received an e-mail from DDS stating "that WEDC was to immediately start the physical domain separation process." (*Id.* at 35, ¶ 51). On that same date, the three foreign nationals who could potentially access ITAR-controlled information stored on Microsemi's United States systems, "were removed as domain administrators and given a lower access level[.]" Decl'n, exh. 2 (Doc. 34-1) at 9.

By letter dated November 11, 2010, pursuant to 22 C.F.R. § 127.12(c), Microsemi submitted an "Initial Notification of Voluntary Disclosure of Microsemi[]: Relating to possible Access to Technical Data by foreign nationals[.]" Decl'n, exh. 1 (Doc. 34-1) at 4; *see also* AC (Doc. 38) at 17, ¶ 21. Microsemi provided this notification to the Office of Defense Trade Controls Compliance ("DTCC"). Microsemi informed DTCC of a "possible gap in IT systems that may have enabled there foreign national employees from Ireland, Israel and the United Kingdom to gain access to servers that contain ITAR-controlled information without authorization from [DDTC]." (*Id.*) (emphasis added). Microsemi further informed DTCC that it had "no reason to believe that violations involved proscribed countries or nationals from proscribed countries occurred, or that any foreign national actually accessed ITAR-controlled data, or that any 'deemed export' occurred with respect to such data." (*Id.*). After "conducting a full review of ITAR-related activities and [Microsemi's] IT systems[,]" Microsemi indicated that it would be submitting a

complete report "consistent with the requirements of Section 127.12." (*Id.*).

In a February 15, 2011 letter, Microsemi supplemented its initial notification to DTCC. In submitting this "voluntary disclosure of possible inadvertent [ITAR] violations[,]" Microsemi confirmed that due to an "IT gap[,] . . . three foreign national IT employees located outside the United States . . . , had access to serves in the United States that contain ITAR-controlled information." Decl'n, exh. 2 (Doc. 34-1) at 7. Microsemi informed the DTCC that "[b]ecause of their status as domain administrators on [its] IT systems, there three foreign nationals had the ability to access unclassified ITAR-controlled information residing on Microsemi servers in the United States." (*Id.*). Microsemi further informed the DTCC that after an internal review, "[a]ll available information suggest-[ed] that there was no unauthorized access[,]" and that "the gap in the IT systems was an oversight that had not been addressed in [its] policies and procedures, and specifically the technology control plans that apply to ITAR-controlled data." (*Id.* at 8).

This lawsuit ensued, wherein Relator alleges that "Microsemi violated the [FCA] by causing WEDC and other subsidiary entities or corporate divisions to make false claims for payment for shipment of ITAR- and EAR-protected components for use in numerous military programs, while Microsemi was simultaneously exporting protected technical data through a single Microsemi network domain, without legal authority." AC (Doc. 38) at 21, ¶ 26. Relator claims that during his employment with WEDC, he discovered that WEDC had violated the FCA "from at least 2009 and was continuing to do so when he departed in May 2011.

(*Id.* at 9-10, ¶ 6). Tracking the language of the FCA, Relator alleges that "[b]y knowingly seeking payment for goods where Microsemi violated the contractual and legal requirements governing the export of defense articles and services, Microsemi presented or caused false claims to be presented by WEDC, . . . , for payment or approval and used or caused to be used false statements or records material to false or fraudulent claims, all in violation of 31 U.S.C. §§ 3729(a)(l)(A) and (a)(l)(B)." (*Id.* at 11, ¶ 9). Relator alleges "actual damages to the United States from 2008 until 2011 of "approximate[ly] . . . $1.6 billion or more." (*Id.* at 41, ¶ 66).

II. Discussion

A. Governing Legal Standards

The Ninth Circuit has held that "[t]he heightened pleading standard of Rule 9(b) governs FCA claims." *Cafasso v. Gen. Dynamics C4 Sys., Inc.*, 637 F.3d 1047, 1054 (9th Cir. 2011) (citing *Bly–Magee v. California*, 236 F.3d 1014, 1018 (9th Cir. 2001)). "Rule 9(b) provides that '[i]n alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake.'" *Id.* (at 1054-1055) (quoting Fed.R. Civ.P. 9(b)). "To satisfy Rule 9(b), a pleading must identify 'the who, what, when, where, and how of the misconduct charged,' as well as 'what is false or misleading about [the purportedly fraudulent] statement, and why it is false.'" *Id.* at 1055 (quoting *Ebeid ex rel. United States v. Lungwitz*, 616 F.3d 993, 998 (9th Cir. 2010) (internal quotation marks and citations omitted)). Rule 9(b)'s particularity requirement serves several purposes. It "give[s] notice to defendants of the specific fraudulent conduct against which they must

defend[;] it also "deter[s] the filing of complaints as a pretext for the discovery of unknown wrongs[.]" *Bly-Magee*, 236 F.3d at 1018) (internal quotation marks and citations omitted). In this way, too, defendants are "protect[ed] . . . from the harm that comes from being subject to fraud charges[.]" *Id.* (internal quotations, citations and alternations omitted). Finally, Rule 9(b) "prohibits plaintiffs from unilaterally imposing upon the court, the parties and society enormous social and economic costs absent some factual basis." *Id.* (internal quotation marks and citations omitted).

"Because Rule 8(a) requires the pleading of a plausible claim," the Ninth Circuit in *Cafasso*, held "that claims of fraud or mistake—including FCA claims —must, in addition to pleading with particularity, also plead plausible allegations." *Cafasso*, 637 F.3d at 1055 (citation omitted). This is in keeping with the view that a motion to dismiss a complaint under Rule 9(b) for failure to plead fraud with the particularity, is the "functional equivalent" of a Rule 12(b)(6) motion for failure to state a claim. *Vess v. Ciba-Geiby Corp. USA*, 317 F.3d 1097, 1107 (9th Cir. 2003). For these reasons, and because Defendants are seeking dismissal under both Rule 9(b) and Rule 12(b)(6), the Court will outline the pleading standards of Rule 12 (b)(6) as well.

A motion to dismiss pursuant to Rule 12(b)(6) challenges the legal sufficiency of a complaint. *Ileto v. Glock, Inc.*, 349 F.3d 1191, 1199-1200 (9th Cir. 2003). A complaint must contain a "short and plain statement showing that the pleader is entitled to relief[.]" Fed.R.Civ.P. 8(a)(2). "All that is required are sufficient allegations to put defendants fairly on notice of the claims against them." *McKeever v. Block*,

932 F.2d 795, 798 (9th Cir. 1991). Rule 8 requires "more than an unadorned, the-defendant-unlawfully-harmed-me accusation[,]" however. *Iqbal*, 556 U.S., at 678 (citing *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 555 (2009)). A complaint that provides "labels and conclusions" or "a formulaic recitation of the elements of a cause of action will not do." *Twombly*, 550 U.S. at 555. Nor will a complaint suffice if it presents nothing more than "naked assertions" without "further factual enhancement." *Id.* at 557.

A complaint need not contain detailed factual allegations to avoid a Rule 12(b)(6) dismissal, but it must plead "enough facts to state a claim to relief that is plausible on its face." *Twombly*, 550 U.S., at 570. "A complaint has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Iqbal*, 556 U.S., at 678 (citing Twombly, 550 U.S., at 556). "The plausibility standard is not akin to a 'probability requirement,' but it asks for more than a sheer possibility that defendant has acted unlawfully." *Id.* "Where a complaint pleads facts that are merely consistent with a defendant's liability, it stops short of the line between possibility and plausibility of entitlement to relief." *Id.* (internal quotation marks and citation omitted).

"The Court may find a claim plausible when a plaintiff pleads sufficient facts to allow the Court to draw a reasonable inference of misconduct, but the Court is not required 'to accept as true a legal conclusion couched as a factual allegation.'" *Harris v. County of Orange*, 682 F.3d 1126, 1131 (9th Cir. 2012) (quoting *Iqbal*, 556 U.S., at 678 (internal quotation marks and

citation omitted)). Likewise, a complaint that provides "labels and conclusions" or "a formulaic recitation of the elements of a cause of action will not do." *Twombly*, 550 U.S., at 555. Nor will a complaint suffice if it presents nothing more than "naked assertions" without "further factual enhancement." *Id.* at 557. "Determining whether a complaint states a plausible claim for relief will, . . . be a context-specific task that requires the reviewing court to draw on its judicial experience and common sense." *Iqbal*, 556 U.S., at 679 (citation omitted). These essential *Iqbal/Twombly* pleading requirements will guide the Court's analysis "to determine whether the factual allegations, which are assumed to be true, 'plausibly give rise to an entitlement to relief.'" *Landers v. Quality Communications, Inc.*, 771 F.3d 638, 641 (9th Cir. 2014) (quoting *Iqbal*, 556 U.S., at 679), *cert. denied.*, 135 S.Ct. 1845 (April 20, 2015).

B. False Claims Act

"The FCA was enacted during the Civil War in response to overcharges and other abuses by defense contractors." *Hooper v. Lockheed Martin Corp.*, 688 F.3d 1037, 1047 (9th Cir. 2012) (internal quotation marks and citation omitted). "The purpose of the FCA was to [combat] widespread fraud by government contractors who were submitting inflated invoices and shipping faulty goods to the government." *Id.* (internal quotation marks and citation omitted). "The Supreme Court has refused to adopt a restrictive reading of the statute, however, holding that the FCA is a 'remedial statute [that] reaches beyond 'claims' which might be legally enforced, to all fraudulent attempts to cause the Government to pay out sums of money.'" *United States ex rel. Modglin v. DJO Global*

Inc., 48 F.Supp.3d 1362, 1385 (C.D.Cal. 2014) (quoting *United States v. Neifert–White Co.*, 390 U.S. 228, 233 (1968)) (other citation omitted). By the same token, however, "the FCA is not a catchall anti-fraud provision—it 'attaches liability, not to the underlying fraudulent activity or to the government's wrongful payment, but to the claim for payment.'" *United States ex. rel. Campie v. Gilead Sciences, Inc.*, 2015 WL 106255, at *14 (N.D.Cal. Jan. 7, 2015) ("*Campie I*") (quoting *Cafasso*, 637 F.3d at 1055) (other citation and internal quotation marks omitted).

"As one enforcement mechanism, the FCA authorizes private parties, known as 'relators,' to bring civil *qui tam* suits on the government's behalf against entities who have allegedly defrauded the government." *Hartpence*, 792 F.3d at 1123 Id. (quoting 31 U.S.C. § 3730(b)(1)). "In these suits, the relators seek reimbursement of the defrauded amounts on the government's behalf." *Id.* "Where, as here, the government declines to intervene in the suit, the relator stands to receive between 25% and 30% of any recovery." *Id.* (citing 32 U.S. § 3730(d)(2)).

In his one count AC, Realtor alleges that Defendants violated 31 U.S.C. §§ 3729(a)(1)(A) and (B). Those statutes "create[] liability for any person who, *inter alia*, '(A) knowingly presents, or causes to be presented, a false or fraudulent claim for payment or approval; [or] (B) knowingly makes, uses, or causes to be made or used, a false record or statement material to a false or fraudulent claim.'" *Hooper*, 688 F.3d at 1047 (quoting 31 U.S.C. § 3729(a)(1)). The FAC defines "knowingly" as having "actual knowledge of information[,]" or acting in either "deliberate ignorance" or

"reckless disregard" of the "truth or falsity of the information[.]" 31 U.S.C. § 3729(b).

"The FCA does not define false." *United States v. Bourseau*, 531 F.3d 1159, 1164 (9th Cir. 2008). "Rather, courts decide whether a claim is false or fraudulent by determining whether a defendant's representations are accurate in light of applicable law." *Id.* (citation omitted). The prerequisites for liability under 31 U.S.C. §§ 3729(a)(1)(A) and (B) "are virtually identical, with the only difference being whether Defendants submitted a false claim or made a statement material to such a claim[.]" *United States ex rel. Bailey v. Gatan, Inc.*, 2015 WL 1291384, at *4 (E.D.Cal. March 20, 2015). Therefore, in its analysis the Court will not distinguish between the two. *See id* (jointly addressing two such claims).

There are several theories of FCA liability. "The prototypical false claims action alleges a factually false claim, *i.e.*, an explicit lie in a claim for payment, such as an overstatement of the amount due." *Modglin*, 48 F.Supp.3d at 1387 (citations omitted). "Factually false claims arise when 'the government payee has submitted 'an incorrect description of goods or services provided or a request for reimbursement for goods or services never provided.''" *Guardiola*, 2014 WL 4162201, at *3 (quoting *United States ex rel. Conner v. Salina Reg'l Health Ctr., Inc.*, 543 F.3d 1211, 1217 (10th Cir .2008)) (citing *Mikes v. Straus*, 274 F.3d 687, 697 (2d Cir. 2001)). "'Factual falsity' simply means a provider may not bill for something it does not provide." *Id.*

"The False Claims Act, however, is not limited to such facially false or fraudulent claims for payment." *United States ex rel. Hendow v. University of Phoenix*, 461 F.3d 1166, 1170 (9th Cir. 2006). "Rather, the False

Claims Act is intended to reach all types of fraud, without qualification, that might result in financial loss to the Government." *Id.* (citing *Neifert–White Co.*, 390 U.S. at 232). "'[E]ach and every claim submitted under a contract, loan guarantee, or other agreement which was originally obtained by means of false statements or other corrupt or fraudulent conduct, or in violation of any statute or applicable regulation, constitutes a false claim.'" *Id.* at 1170-71 (quoting S.Rep. No. 99– 345, at 9 (1986), reprinted in 1986 U.S.C.C.A.N. 5266, 5274). In *Hendow*, the Ninth Circuit explained that "[t]he principles embodied in this broad construction of a 'false or fraudulent claim' have given rise to two doctrines that attach potential False Claims Act liability to claims for payment that are not explicitly and/or independently false: (1) false certification (either express or implied); and (2) promissory fraud[,]" or "'fraud-in-the-inducement[.]'" *Id.* at 1171(citation omitted); 1173.

In addition, "regardless of any false certification conduct[,]" the Ninth Circuit also has recognized that in an "appropriate case, knowingly billing for worthless services or recklessly doing so with deliberate ignorance may be actionable under § 3729[.]" *United States ex rel. Lee v. SmithKline Beecham, Inc.*, 245 F.3d 1048, 1053 (9th Cir. 2001). This theory is derivative of a factually false claim and is commonly referred to as a "worthless services" or "worthless products" theory of FCA liability. *See Campie I*, 2015 WL 106255, at *13-*14. Such a claim "is independent of any false certification claim." *United States ex. rel. Campie v. Gilead Sciences, Inc.*, 2015 WL 3659765, at *8 (N.D.Cal. June 12, 2015) ("*Campie II*") (citing *Mikes*, 274 F.3d at 703 ("[A] worthless services

claim is a distinct claim under the [FCA]. It is effectively derivative of an allegation that a claim is factually false because it seeks reimbursement for a service not provided.”)).

Defendants argue that due to a host of pleading defects, Relator has failed to state a FCA claim, whether such claim is based upon a theory of factual falsity, worthless products, fraud in the inducement, express false certification or implied false certification. Relator’s response addresses only two of these theories. First, Relator contends that he has pleaded factual falsity based upon a worthless products theory. Second, Relator contends that he has sufficiently alleged implied false certification. In his response, the Relator did not address the other possible theories of FCA liability which Defendants discuss in their motion. The Court deems Relator’s silence to be a concession that he is pursuing only two theories of FCA liability—worthless products and implied false certification. The Court will limit its analysis accordingly.

1. Factual Falsity

According to Relator, he has sufficiently pled factual falsity premised upon allegations that Defendants’ products were worthless. A few Circuits, including the Ninth, have adopted the “worthless services” or “worthless products” theory of FCA liability, which “allows a *qui tam* relator to bring claims for violations of the FCA premised on the theory that the defendant received reimbursement for products or services that were worthless.” *United States ex rel. Absher v. Momence Meadows Nursing Ctr., Inc.*, 764 F.3d 699, 706 (7th Cir. 2014) (citing *Mikes*, 274 F.3d at 703; *SmithKline Beecham*, 245 F.3d at 1053; *see*

also Chesbrough v. VPA, P.C., 655 F.3d 461, 468-69 (6th Cir. 2011); United States ex rel. *Roop v. Hypoguard USA, Inc.*, 559 F.3d 818, 824 (8th Cir. 2009)). As the Ninth Circuit reasoned, "assum[ing] that a party to a government contract knowingly or with deliberate ignorance charged the government for worthless services, then there would be fraud on the government that may be pursued under the FCA." *SmithKline Beecham*, 245 F.3d at 1053. In the seminal case of *Mikes*, the Second Circuit explained that "the performance of the service [must be] so deficient that for all practical purposes it is the equivalent of no performance at all." *Mikes*, 274 F.3d at 703; *see also Chesbrough*, 655 F.3d at 468 (liability exists when a medical contractor "[seeks] reimbursement for services that it were not just of poor quality but had no medical value).

"Courts applying this . . . 'worthless services' theory have interpreted it narrowly." *Campie I*, 2015 WL 106255, at *14. Fairly recently, "the Seventh Circuit noted that it is not enough to offer evidence that the defendant provided services that are worth some amount less than the services paid for. That is, a 'diminished value' of services theory does not satisfy this standard.'" *Id.* (quoting *Momence*, 764 F.3d at 710). Simply put, "[s]ervices that are 'worth less' are not 'worthless.'" *Id.* The *Momence* Court, "therefore, rejected the contention that FCA liability could be based simply on the fact that a good or service had a diminished value or was non-conforming in some respect." *Id.* (citation omitted) (emphasis added). As can be seen, "courts strictly interpret the term 'worthless' in this context." *United States ex rel. New Mexico*

v. Deming Hosp. Corp., 992 F.Supp.2d 1137, 1147 (D.N.M. 2013) (citation omitted).

Applying these principles to the AC readily shows, as Defendants argue, that Relator has not sufficiently alleged a factually false certification claim based on worthless products. In a section entitled "governing law[,]" the AC alleges that "[m]ilitary products that can be reverse engineered or whose technological information has been compromised are worse than worthless to the United States." AC (Doc. 38) at 12-13, ¶ 14. This generic, hyperbolic statement is not governing law. And, more importantly for present purposes, this allegation is nothing more than a "naked assertion" completely void of "further factual enhancement." *See Twombly*, 550 U.S., at 557. Elsewhere in the FAC, in similarly broad language, it alleges that "Microsemi caused WEDC to make false claims for payment in every invoice to a Government contractor or subcontractor for a product whose technology is ITAR- or EAR-protected; because the data were not protected from foreign disclosure, the products were worthless, rendering the claims for payment false." FAC (Doc. 38) at 39, ¶ 63 (emphasis added). This allegation, even when read together with other allegations in the FAC, does not suffice to state a worthless products claim.

Citing only to the two paragraphs just quoted, Relator asserts that he has "alleged with great particularity the circumstances that caused every product purchased by the Government from prime contractors who purchased components containing ITAR or EAR-protected data to be, at a minimum, dramatically diminished in value if not worthless." Resp. (Doc. 41) at 7:6-13 (footnote omitted) (emphasis

added). Obviously, he has not. These two paragraphs, even in combination, do not provide the requisite particularity. Nor, on their face, do these paragraphs state a plausible worthless products claim. Thus, the Court agrees with Defendants that the FAC's mere recitation of the "legal conclusion that 'the products were worthless' is no substitute for [the] well pled facts[]" which *Iqbal* demands. *See* Reply (Doc. 50) at 9:11-12 (citation omitted).

Relator cannot, as he attempts to do, salvage his worthless products claim based upon his purported "identifi[cation] [of] a number of products . . . whose technical data were <u>compromised</u> because they were visible to hundreds of unauthorized foreign persons both in and out of the United States . . . and described the confidential technologies exposed." Resp. (Doc. 41) at 7:24-3 (footnote omitted) (emphasis added). From Relator's standpoint, just because the government does not know whether any of the "protected data has been further disseminated, . . . if at all[,]" does not mean that "[t]he value to the United States of products whose ITAR- and EAR-protected technical data has been disclosed" is any "less diminished[.]" (*Id.* at 8:3-10). Based upon the foregoing, Relator maintains that he has "plausibly pleaded . . . that value of these products has been <u>compromised</u>." (*Id.* at 8:15-16) (emphasis added). Even if the Court were to accept this proposition, which it does not, it is not enough to plead that "the value of products has been compromised." (*See id.*) This is akin to the "diminished value" theory which courts have held does not suffice to support a worthless products claim.

Relator's worthless products claim fails for other reasons as well. First, generally courts have limited

the scope of a worthless products claim to the health care context. *See Campie II*, at * 8 ("To have a factually false certification claim based on worthless services, the services must be medically worthless.") (citing *Smithkline Beecham*, 245 F.3d at 1053) ("The district court . . . over-looked the allegations . . . that supported a different theory—that SmithKline violated the FCA by seeking and receiving payment for medically worthless tests.") (emphasis added); *Mikes*, 274 F.3d at 702 ("[A] worthless services claim asserts that the knowing request of federal reimbursement for a procedure with no medical_value violates the Act irrespective of any certification.") (emphasis added); *Chesbrough*, 655 F.3d at 468 ("If VPA sought reimbursement for services that it knew were not just of poor quality but had no medical value, then it would have effectively subm[]itted claims for services that were not actually provided.") (emphasis in original)); *but see United States ex rel. Badr v. Triple Canopy, Inc.*, 950 F.Supp.2d 888, 898 (E.D.Va. 2013) (citation omitted) ("worthless services" claim not sufficiently alleged, not because the context was non-medical, but because the government did not sufficiently allege that the services of Ugandan guards pursuant to a government contract, who were to provide security at a United States military installation, "were entirely devoid of value or that the noncompliance with the weapons qualification requirement caused any injury to the Government such that the guards effectively provided no service at all[]"), *aff'd in part, rev'd in part on other grounds*, 775 F.3d 628 (4th Cir. 2015), *pet. for cert. filed*, No. 14-1440 (June 8, 2015). In the absence of any authority or argument from Relator, the Court declines to broaden the scope of the worthless

products theory to encompass the AC's allegations herein.

Second, the Court agrees with Defendants that "allegations of mere regulatory nonconformance" do not suffice to state a FCA claim on a worthless products theory. Reply (Doc. 50 at 9:15) (citing *United States ex rel. Blundell v. Dialysis Clinic, Inc.*, 2011 WL 167246, at * 21 (N.D.N.Y. Jan. 19, 2011) (Plaintiff did not state a worthless services claim based upon the theory that Defendant's medical services did not conform with certain regulatory guidelines). Third, Relator's contention that "whether the products are worthless or merely diminished in value to the Government is a question of fact for the jury[]" misses the mark. See Resp. (Doc. 41) at 8:13-16. In making this contention, Relator mistakenly assumes that he has sufficiently pled a worthless products claim, but he has not. Lastly, Relator does not allege the requisite scienter under the purported "worthless products" theory, because he has not alleged that Defendants provided the government with worthless products, knowing that they were worthless when provided. *See United States ex rel. McMasters v. Northrop Grumman Ship Sys., Inc.*, 2006 WL 2884415, at *4 (N.D. Cal. Oct. 10, 2006). Accordingly, the Court finds that Relator has not adequately pled a worthless products theory of FCA liability.

2. Implied False Certification

"A claim under the FCA can be based on the allegation that a party has falsely certified compliance with a statute or regulation as a condition to government payment." *United States v. Corinthian Colleges*, 655 F.3d 984, 992 (9th Cir. 2011) (citing *Hendow*, 461

F.3d at 1171). "False certifications[4] come in two varieties—express and implied[.]" *Campie.*, 2015 WL 106255, at *8. In moving for dismissal, Defendants contend that the AC does not adequately plead either. In rejoinder Relator asserts that that he "has pleaded implied certification." Resp. (Doc. 41) at 8:18 (bold emphasis omitted) (italicized emphasis added). Given this unequivocal statement, and Relator's silence on the issue of express certification, as alluded to earlier, the Court limits its inquiry to whether the AC sufficiently alleges implied false certification.

"Implied false certification occurs when an entity has previously undertaken to expressly comply with a law, rule, or regulation, and that obligation is implicated by submitting a claim for payment even though a certification of compliance is not required in the process of submitting the claim." *Ebeid*, 616 F.3d at 998. "[T]he essential elements of" a false certification claim (express or implied) are: "(1) a false statement or fraudulent course of conduct, (2) made with scienter, (3) that was material, causing (4) the government to pay out money or forfeit moneys due." *Hendow*, 461 F.3d at 1174. Notably, with the exception of scienter, which may be generally pled, these elements must satisfy Rule 9(b)'s heightened pleading requirements. *See Corinthian Colleges*, 655 F.3d at 992.

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[4] "The term 'certification' in this context does not carry with it any talismanic significance, but is 'simply another way of describing a false statement made to the government.'" *Campie I*, 2015 WL 106255, at *3 (quoting *Gonzalez v. Planned Parenthood of L.A.*, 2012 WL 2412080, at *4 (C.D. Cal. June 26, 2012), [*affirmed on other grounds*, 759 F.3d 1112 (9th Cir. 2014), *cert. denied* 135 S.Ct. 2313 (2015)]; (citing *Hendow*, 461 F.3d at 1172 (rejecting view that the "word 'certification' has some paramount and talismanic significance")).

Very basically, Defendants contend that they are entitled to dismissal because Relator has not adequately alleged any of the four "essential elements" of an implied false certification claim.

a. Compliance as a Condition of Payment

In *Hopper United States ex rel. Hopper v. Anton*, 91 F.3d 1261 (9th Cir. 1996), an early Ninth Circuit express false certification case, the Court "held that '[v]iolations of laws, rules, or regulations alone do not create a cause of action under the FCA.'" *Ebeid*, 616 F.3d at 997 (quoting *Hopper*, 91 F.3d at 1266). As the Ninth Circuit has stressed, whether under a theory of express or implied false certification, "'[i]t is the false <u>certification</u> which creates liability when certification is a prerequisite to obtaining a government benefit.'" *Id.* (emphasis added by *Ebeid* Court) (quoting *Hopper*, 91 F.3d at 1266). "Likewise, materiality is satisfied under both theories only where compliance is 'a *sine qua non* of receipt of state funding.'" *Id.* (quoting *Hopper*, 91 F.3d at 1267). Therefore, in *Hopper*, Relator did not state a cognizable FCA claim because, quite simply, the defendant "did not have [to] comply with regulations in order to receive government funds." *United States ex rel. Holder v. Special Devices, Inc.*, 296 F.Supp.2d 1167, 1174 (C.D.Cal. 2003) (citing *Hopper*, 91 F.3d at 1267) (footnote omitted).

Defendants argue that the present case is no different than *Hopper* and its progeny. Relator has not sufficiently alleged implied false certification because "[c]ompliance with ITAR is [n]ot a [p]rerequisite to [p]amend[.]" Mot. (Doc. 34) at 8:3-4 (emphasis omitted). Relator counters more broadly that "'[c]ondi-

tion of payment' is no longer an element of FCA liability." Resp. (Doc. 41) at 9:20 (emphasis omitted). The Court gives no credence to this assertion, and further agrees with Defendants that ITAR compliance is not a condition of payment here.

Relator premises his argument that condition of payment is no longer an element of FCA liability upon the Fraud Enforcement and Recovery Act of 2009 ("FERA"). Prior to FERA, section 3729 of the FCA "did not expressly contain a materiality requirement[.]" *United States ex. rel. Putnam v. Eastern Idaho Regional Medical Center*, 696 F.Supp.2d 1190, 1197 (D.Idaho 2010). However, as Relator notes, FERA amended the FCA to include such a requirement, with "material" meaning "'having a natural tendency to influence, or be capable of influencing, the payment or receipt of money or property.'" Resp. (Doc. 41) at 10:5-7 (quoting 31 U.S.C. § 3729). Since the FERA amendments, the Ninth Circuit has not yet had occasion to "address[] the continuing viability of the 'precondition for payment requirement" under the FCA. *Id.* at 10:4-5. nonetheless, Relator posits that a "[r]ecent Ninth Circuit district court and other federal court decisions[,][5] . . . have correctly omitted or ignored 'prerequisite for payment' or 'sine qua non' as an element of . . . implied certification liability." (*Id.*) at 10:3-11 (footnote omitted) (emphasis and footnote added). Relator urges this Court to do the same. The Court declines to do so because Relator's position is problematic for several reasons.

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[5] Relator actually only cites to one other federal court decision. Use of the plural suggests that there are others, but Relator did not cite to any.

Even if the Court were to agree with Relator's view (which it does not), that post-FERA other courts have "correctly omitted or ignored" the "prerequisite for payment" element of implied false certification, this Court will not do the same. *See Resp*. (Doc. 41) at 10: 9-10 (emphasis added). This Court is not free to "omit" or "ignore" the condition of payment aspect of a false certification claim, especially in the face of the Ninth Circuit's clear pronouncements outlined above. The Court realizes that those Ninth Circuit cases were decided prior to FERA, but as Defendants soundly reason, FERA's "confirm[ation] of an existing materiality standard[6] does nothing to alter the requirement that payment be clearly conditioned on compliance with the relevant regulation." Reply (Doc. 50) at 4:15-17. Therefore, this Court will continue to rely upon *Hopper* and its progeny requiring that the certification be both "material to the payment made by the government, *Hendow*, 461 F.3d at 1171, and . . . be a prerequisite to obtaining the government benefit, *Hopper*, 91 F.3d at 1266." *See United States ex rel. Fryberger v. Kiewit Pacific Company*, 2013 WL 5770514, at *10 (N.D.Cal. Oct. 24, 2013).

By the same token though, despite Defendants' contrary assertion,[7] there is no requirement that the

[6] "Although § 3729 did not expressly contain a materiality requirement before FERA added one in 2009, the Ninth Circuit and at least five other circuit courts previously held that the government must also prove that the false statement was material." *Putnam*, 696 F.Supp.2d at 1197 (citing *Bourseau*, 531 F.3d at 1170-71).

[7] Reply (Doc. 50) at 3:7-8 (italicized emphasis added) (other emphasis omitted) ("No Claims Were False because Payment is not Expressly Conditioned on Compliance with ITAR[.]");

underlying regulation "'expressly' condition payment on compliance[,]" as Relator suggests. Resp. (Doc. 41) at 11:9-11 (footnote omitted). In Mikes, to which Defendants cite, in the Medicare context the Second Circuit did "require[] that the underlying statute 'expressly' condition payment on compliance[.]" *Ebeid*, 616 F.3d at 998 (internal quotations, citation and footnote omitted). However, the Ninth Circuit's "precedent contain no such limitation." *Id.* (citing *Hendow*, 461 F.3d at 1177) (footnote omitted). And, in *Ebeid*, the Ninth Circuit found no need to adopt the Second Circuit's "express condition" requirement because Relator's claim failed in any event. *See id.* at 998, n. 3. Thus, in the present case, Relator need not allege that there is an ITAR regulation which expressly conditions payment on compliance. This is not enough to rectify Relator's otherwise deficient implied false certification claim, though, as discussed next.

Turning to the narrower issue of whether compliance with ITAR is a condition of payment, the Court finds that it is not. The Ninth Circuit's decision in *Ebeid*, 616 F.3d 993, is instructive in terms of "distinguish[ing] between statutes and regulation which could form the basis of an implied certification theory and those which could not. *See Campie I*, 2015 WL 106255, at *10. In *Ebeid*, the relator brought a FCA lawsuit against the owner of three health care businesses alleging that they "engaged in the 'unlawful corporate practice of medicine[.]'" *Ebeid*, 616 F.3d at 995. The relator also alleged that referrals among the health care businesses were unlawful under the Stark Act, 42 U.S.C. § 1395nn(a)(1). Positing that this alleged misconduct rendered "fraudulent every claim for Medicare reimbursement" Defendants submitted, Relator

sought to hold them liable for implied false certification. *See id.*

The Stark Act limits certain physician referrals. Essentially a physician may not refer a Medicare patient to any entity in which the physician has a prohibited "financial interest." 41 U.S.C. § 1395nn(a)(1). The Stark Act unequivocally states that "[n]o payment may be made under this subchapter for a designated health service which is provided in subsection (a)(1) of this section." 42 U.S.C. § 1395nn(g)(1). Relying upon this language, the Ninth Circuit found that the alleged Stark Act violations "may provide a valid basis from which to imply certification, because [the Act] expressly conditions payment on compliance." *Ebeid*, 616 F.3d at 1000. Relator's FCA claim based upon alleged Stark violations ultimately failed though because he did not "meet the threshold requirement of particularity" as to such a claim. *Id.* at 1000 n. 6.

In *Ebeid*, Relator's alternative implied false certification theory was that the submitted Medicare claims "were false because the health care businesses were engaged in the unlawful corporate practice of medicine." *Ebeid*, 616 F.3d at 999-1000 (internal quotation marks omitted). Critically, the Relator's complaint did "not refer to any statute, rule, regulation, or contract that conditions payment on compliance with state law governing the corporate practice of medicine." *Id.* at 1000. Instead, Relator "baldly assert[ed] that had [Defendants] not concealed or failed to disclose information affecting the right to payment, the United States would not have paid the claims." *Id.* (internal quotation marks omitted). The Ninth Circuit held that this "conclusory allegation" was "insufficient under Rule 9(b)[]" to state an implied false

certification claim premised upon Defendants' alleged violation of the Arizona common law prohibition on the corporate practice of medicine. *Id.*

Relator's AC herein suffers from the same deficiency, as Defendants stress. Nowhere in his complaint does Relator "refer to any statute, rule, regulation, or contract that conditions payment on compliance with [ITAR]." *See Ebeid*, 616 F.3d at 1000. Rather much like the conclusory allegation in *Ebeid*, Relator summarily alleges that "[t]he United States paid claims that would not have been paid but for Defendants' unlawful conduct[,]" *i.e.*, alleged ITAR violations. Co. (Doc. 38) at 43, ¶ 77. Moreover, as Defendants are quick to point out, Relator concedes that "ITAR and EAR . . . are not directed[] . . . at contracts for the purchase of goods by the United States[.]" Resp. (Doc. 41) at 14:3-6. Instead, even from Relator's perspective, "the export control statutes and regulations, including ITAR and EAR are directed at protecting national security[.]" (*Id.*) at 14:10-11 (emphasis omitted). Indeed, Relator explains that "the gravamen of this complaint is that Defendants recklessly compromised national security in violation of contractual provisions in each of their contracts with a prime contractor for export-controlled goods and made false certifications of compliance with these national security protection standards." (*Id.* at 11-16). "But, 'breach of contract claims are not the same as fraudulent conduct claims, and the normal run of contractual disputes are not cognizable under the [FCA].'" *Caffasso*, 637 F.3d at 1057-1058 (quoting *United States ex rel. Wilson v. Kellogg Brown & Root, Inc.*, 525 F.3d 370, 383 (4th Cir. 2008)).

Even in the face of the foregoing, Relator insists that he has "alleged that compliance with ITAR and EAR are conditions of payment[.]" Resp. (Doc. 41) at 12:11. Relator refers to allegations in the AC pertaining the Defense Federal Acquisition Regulations ("DFAR"). *See* AC (Doc. 38) at 12, ¶ 13; 15, ¶ 16. Regulations such as these, "requir[ing] that contracts . . . involv[ing] export-controlled items, . . . contain a compliance clause," as the AC alleges, are not the equivalent of regulations conditioning payment upon compliance though. *See* AC (Doc. 38) at 15, ¶ 16; *see also id.* at 12, ¶ 13. A compliance clause requirement stands in sharp contrast to, for example, the Stark Act's unequivocal language that "[n]o payment may be made . . . for a designated health service which is provided in violation of . . . this section." See 41 U.S.C. § 1395nn(g)(1). As is plainly clear, the glaring omission here is the absence of any allegations in the AC referencing, much less identifying, a "statute, rule, regulation, or contract that condition[ed] payment on compliance with [ITAR.]" *See Ebeid*, 611 F.3d at 1000. This omission is fatal to Relator's implied false certification theory of FCA liability.

It stands to reason that ITAR compliance is not a prerequisite to payment, Defendants contend, given that "there is a robust alternative scheme for enforcing the AECA and ITAR." Mot. (Doc. 34) at 9:5-6. Permitting Relator to proceed on his FCA claim based upon alleged ITAR violations would, from Defendants' standpoint, impermissibly supplant regulatory discretion under this scheme. Relator's position, however, is that the FCA "simply provides an alternate remedy to the Government." Resp. (Doc. 41) at 15:9.

There is undoubtedly a fairly comprehensive regulatory scheme to ensure ITAR compliance, as Relator alleges. *See* AC (Doc. 38) at 14-15, ¶ 15. This scheme encompasses the imposition of civil and criminal penalties, including fines and imprisonment. *See id.* In addition, the AECA gives the Secretary of State sweeping authority to "revoke, suspend or amend licenses or other written approval whenever the Secretary deems such action to be advisable." 22 C.F.R. § 128.1. Therefore, persons who violate AECA or the regulations promulgated thereunder, such as ITAR, are subject to debarment, suspension or ineligibility. *See* AC (Doc. 38) at 14-15, ¶ 15 (citing 48 C.F.R. §§ 9.406-1, 9.406-2(a), (c), 9.407.1[,] 9.407-2(a), (c)). "The administration of the [ACEA] is a foreign affairs function[,]" the exercise of which is "highly discretionary," and as such "is excluded from review under the Administrative Procedure Act." *Id.*

The existence of this scheme, which implicates "the security and foreign policy of the United States[]" is not dispositive of this Court's finding that ITAR compliance is not a prerequisite to government payment. *See* 22 C.F.R. § 128.1. At the same time, the existence of this scheme strongly suggests that imposing FCA liability here, especially based upon alleged ITAR violations, would usurp impermissibly the discretion of those entrusted with ensuring compliance with the ACEA. *See Campie I*, 2015 WL 106255, at *12 (quoting *United States ex rel. Rostholder v. Omnicare, Inc.*, 745 F.3d 694, 702 (4th Cir. 2014) (quoting, in turn, *United States ex rel. Wilkins v. United Health Group, Inc.*, 659 F.3d 295, 307 (3d Cir. 2011)) ("When an 'agency has broad powers to enforce its own regulations, as the FDA does . . . , allowing

FCA liability based on regulatory non-compliance could 'short-circuit the very remedial process the Government has established to address non-compliance with those regulations.'"").

b. Actual ITAR Violation

Another fundamental flaw in the AC, according to Defendants, is that Relator has not "plead that Defendants falsely certified compliance because Relator has not pled a violation of ITAR[.]" Reply (Doc.50) at 7:5-6. Relator strenuously disagrees. Relator retorts that that Defendants "disclosed[] all . . . of WEDC's ITAR-EAR-protected-technical data to unauthorized persons by migrating WEDC's domain and its Share-Point environment[] to the same domain as Micro-semi and all its subsidiaries and divisions worldwide, without regard to whether individual users were U.S. persons or foreign persons pursuant to the export laws and regulations[.]" Resp. (Doc. 41) at 17:2-10 (emphasis and footnote omitted).

Essentially, ITAR regulations prohibit the "export" of certain "defense article[s] or technical data" with-out a license. 22 C.F.R. § 127.1(a)(1). ITAR regula-tions define "export" in several ways, including "sending," "taking," "transferring," or "disclosing." 22 C.F.R. §§ 120.17(a)(1)-(4). The regulations do not, however, define any of these exemplars of "exports." The regulations do define "technical data" and "defense articles" though. "[T]echnical data" subject to ITAR-restricted export "includes information in the form of blueprints, drawings, photographs, plans, instructions or documentation." 22 C.F.R. § 120.10(a)(1). "Defense articles" subject to ITAR-restricted export are, among other things, those "on the U.S. Munitions List[.]" 22

C.F.R. § 120.10(a)(2). Furthermore, ITAR regulations prohibit disclosures or transfers of such technical data to a "foreign person." 22 C.F.R. § 120.17(a)(4).

Defendants contend that Relator has not sufficiently alleged an actual ITAR violation because he has not pled with particularity "that Defendants sent, transferred, or disclosed to foreign nationals technical data . . . relating to a particular defense article." Mot. (Doc. 34) at 11:18-20. Instead, Relator alleges that during the migration of WEDC's servers and computers to the Microsemi domain, "all domain administrators[,]" authorized and unauthorized, foreign or otherwise, had "<u>avail</u>[<u>ability</u>] and <u>access</u>[]" to "protected or confidential WEDC information[.]" AC (Doc. 38) at 27, ¶ 38; 21, ¶ 26 (emphasis added). During this same timeframe, Relator advised Microsemi that "anyone with domain administrator rights <u>could</u> traverse the entire domain and <u>could</u> grant themselves additional rights." (*Id.*) at 30, ¶ 43 (emphasis added).

Conspicuously absent from the AC, however, are any allegations that a "foreign person" actually "grant[ed] themselves" such "additional rights[.]" *See* AC (Doc. 38) at 30, ¶ 43. Nor does the AC contain any allegations thereafter that an unauthorized domain administrator actually sent, took, transferred or disclosed any ITAR protected data. A theoretical ITAR violation simply cannot form the basis for a FCA claim. At most, these alleged ITAR violations amount to nothing more than "an unadorned, the-defendant-unlawfully-harmed-me accusation[,]" which is far cry from meeting *Iqbal/Twombly's* heightened pleading requirements. *See Iqbal*, 556 U.S., at 678 (citing *Twombly*, 550 U.S., at 555). Relator impermissibly

equates availability and access with unlawful exportation. *See* AC (Doc. 38) at 21, ¶ 26.

Moreover, although the AC alleges that Mircosemi "admitted" ITAR violations to the United States, AC (Doc. 38) at 16, ¶ 17; 20, ¶ 24, this is not so. Consequently, Relator cannot rely upon these purported admissions as a basis for alleging an actual ITAR violation. Microsemi's voluntary notifications to the DDTC mention "possible violations" of ITAR and "possible inadvertent violations" of ITAR–not actual ITAR violations. Decl'n (Doc. 34-1), exh. 1 at 4 (emphasis added); exh. 2 at 7 (emphasis added). In a similar vein, in its November 11, 2010, initial notification, Microsemi advised of "a possible gap in [its] IT systems, that may have enabled three foreign national employees . . . to gain access to servers that contain ITAR-controlled information without authorization from the [DDTC]." *Id.*, exh. 1 at 4 (emphasis added). Also at that time, Microsemi advised the DDTC that is had "no reason to believe that . . . any foreign national actually accessed ITAR-controlled data, or that they any 'deemed export' occurred with respect to such data." (*Id.*) After conducting its own investigation, as detailed in its February 15, 2011 supplement to its initial notification, Microsemi stated that it did "not believe that any ITAR violations have occurred in connection with the three domain administrators' access rights." (*Id.*, exh. 2 at 10). Thus, Defendants maintain, and the Court agrees, that these voluntary notifications do not support the AC's allegations that Microsemi admitted ITAR violations.

Perhaps realizing that the allegations of admissions by Microsemi are untenable, Relator is backpedaling from such allegations. Relator is now of the

view that whether or not Microsemi admitted ITAR "disclosures is not relevant to the question of whether [he] has adequately pleaded that disclosures or transferred happened." Resp. (Doc. 41) at 18:14-19:2. Relator focuses, instead, on the allegations that Microsemi migrated WEDC's servers and computers to Microsemi's own shared domain. With no analysis or explanation, Relator baldly asserts that it "is obvious that 'migrating' or moving all of WEDC's electronic information to a domain shared with all Microsemi divisions and subsidiaries constitutes a 'transfer.'" Resp. (Doc. 41) at 18:6-9. Then, relying upon one definition of "disclose" from Merriam-Webster's online dictionary, Relator strongly implies that because WEDC's electronic information was "'expose[d] to view[,]'" it was disclosed within the meaning of 22 C.F.R. § 120.17, regardless of whether such information was actually "viewed[.]" *See id.* at 18:10-11, n. 40 (citing http://www.merriam-webster.com/dictionary/disclose).

This, too, is an untenable position and is at odds with the regulation itself and the canons of regulatory construction, as Defendants argue in rejoinder. To "export" within the meaning of section 120.17(a)(4) means, *inter alia*, to "[d]isclos[e] (including oral or <u>visual</u> disclosure) or transferring technical data to a <u>foreign person</u>[.]" 22 C.F.R. § 120.17(a)(4) (emphasis added). Allegations that Microsemi migrated technical data to a shared domain, especially when unaccompanied by allegations that such data was disclosed or transferred "to a foreign person" are not sufficient to plead an ITAR violation. Indeed, Relator's strained reading of section 120.17(a) disregards the general principle that "the plain meaning of an administrative regulation controls." *See Pacific Bell Tel. Co. v.*

California Pub. Util. Comm'n, 621 F.3d 836, 848 (9th Cir. 2010) (citation omitted).

Construing "disclose" to mean exposing something to view, such as technical data, would violate another canon of regulatory construction. That is, that regulations "should be construed so that effect is given to all of its provisions, so that no part will be inoperative or superfluous, void or insignificant." *See United States v. Grandberry*, 730 F.3d 968, 981 (9th Cir. 2013) (citing *Corley v. United States*, 556 U.S. 303, 314 (2009)) (other citations and quotation marks omitted). Relator's reading renders the phrase "to a foreign person," 22 C.F.R. § 120.17(a)(4) "inoperative or superfluous, void or insignificant." *See id.* Under Relator's interpretation of section 120.17(a), the mere act of exposing technical data to view is an ITAR violation, regardless of whether the exposure was actually "to a foreign person"—an obviously critical element of this regulation. The Court cannot countenance such an interpretation. Finally, the Court is compelled to comment that in his response, Relator, albeit in the context of his worthless products arguments, seemingly concedes that he "lacks knowledge as to whether anyone actually saw, looked at, copied, or further disclosed the protected data[.]" Resp. (Doc. 41) at 8:6-7.

c. Materiality

Focusing on "'whether the false statement is the cause of the Government's providing the benefit; and . . . whether any relation exists between the subject matter of the false statement and the event triggering Government's [sic] loss[,]'" the Ninth Circuit has held that a false statement "must be material to

the government's decision to pay out moneys to the claimant." *Hendow*, 461 F.3d at 1172 (quoting *Hopper*, 91 F.3d at 1266). A false statement is material if "it has a natural tendency to influence, or [is] capable of influencing, the decision of the decisionmaking body to which it was addressed." *Bourseau*, 531 F.3d at 1171 (internal quotation marks omitted) (alteration in original). The natural tendency test "focuses on the potential effect of the false statement when it is made rather than on the false statement's actual effect after it is discovered." *Id.* Simply put, "materiality is satisfied . . . only where compliance is a '*sine qua non* of receipt of state funding.'" *Ebeid*, 616 F.3d at 998 (quoting *Hopper*, 91 F.3d at 1276).

Defendants argue that Relator's implied false certification claim is deficient because he has not adequately pled materiality. Defendants' argument substantially mirrors their argument that ITAR compliance is not a condition of payment. In his response, Relator likewise contends that "[f]or the same reasons [he] has shown that the implied false certifications were conditions of payment, [he] has adequately and plausibly alleged" materiality. Resp. (Doc. 41) at 19:16-18. Given the obviously close relationship between compliance as a condition of payment and materiality, which the parties recognize, the Court's analysis of the former is dispositive of the latter. To reiterate, because the AC does not allege that any government payment was "<u>explicitly</u> conditioned" on ITAR compliance, materiality has not been sufficiently pled here. *See Hendow*, 461 F.3de at 1175. To briefly reiterate, because the AC does not allege that any government payment was "explicitly conditioned" on ITAR compliance, the materiality stan-

dard has not been sufficiently pled. *See Ebeid*, 616 F.3 at 997. Having found that Relator did not adequately plead that certification of ITAR compliance is a condition of government payment, necessarily, the Court also finds that he has not adequately plead that the alleged ITAR violations are material to payment.

d. Submission of Claims

Even if Relator had adequately plead the other elements of an implied false certification claim, dismissal is mandated, Defendants argue, because the AC does "not pled with particularity the submission of any relevant claim for payment." Mot. (Doc. 34) at 14:6-7. Relator has not "sufficiently alleged the 'who, what, when, where, and how' needed to plead the submission of false claims." Reply (Doc. 50) at 2:23-25 Defendants further assert that Relator, likewise, "has not identified even one specific 'representative example' of a claim of reimbursement from government funds for a product linked to the alleged ITAR violation." Mot. (Doc. 34) at 14:20-21. Relator counters that his "extensive documentation . . . support[s] a reasonable inference [that] the claims were submitted to the Government by prime contractors, and no specific false claim or representative examples of those claims for payment are required." Resp. (Doc. 41) at 20:16-18 (footnote omitted).

"'It seems to be a fairly obvious notion that a False Claims Act suit ought to require a false claim.'" *Cafasso*, 637 F.3d at 1055 (quoting *United States ex rel. Aflatooni v. Kitsap Physicians Serv.*, 314 F.3d 995, 997 (9th Cir. 2002). This is because "the [FCA] attaches liability, not to the underlying fraudulent

activity or to the government's wrongful payment, but to the 'claim for payment.'" *Id.* (internal quotation marks and citation omitted). The FAC "focuses on the submission of a claim, and does not concern itself with whether or to what extent there exists a menacing underlying scheme." *Aflatooni*, 314 F.3d at 102 (citation omitted). For this submission of claim element, "[a]ll that matters is whether the false statement or course of conduct causes the government to pay out money or to forfeit moneys due." *Hendow*, 461 F.3d at 1177 (internal quotation marks and citation omitted). "[F]or a false statement or course of action to be actionable under the false certification theory of false *claims* liability, it is necessary that it involve an actual claim, which is to say, a call on the government fisc." *Id.* at 1173. "This is self-evident from the statutory language, of course, which requires a 'claim paid or approved by the Government.'" *Id.* (quoting 31 U.S.C. § 3729(a)(2)).

"To survive a Rule 9(b) motion to dismiss, a complaint alleging implied false certification must plead with particularity allegations that provide a reasonable basis to infer," among other things, that "claims were submitted." *Ebeid*, 616 F.3d at 998. While a plaintiff need not "identify representative examples of false claims to support every allegation," he must at least allege "particular details of a scheme to submit false claims paired with reliable indicia that lead to a strong inference that claims were actually submitted." *Id.* at 998-99 (internal quotation marks, citations and footnote omitted). "The Rule 9(b) standard may be satisfied by pleading with particularity a reasonable basis to infer that the government either paid money or forfeited moneys due." *Id.* at 999, n. 4. There-

fore, "[i]t is not enough . . . to describe a [fraudulent] scheme in detail but then to allege simply and without any stated reason . . . that claims requesting illegal payments must have been submitted." *Aflatooni*, 314 F.3d at 1002 (internal quotation marks and citation omitted). Yet, this is in essence what Relator has done here.

The AC sweepingly alleges as follows:

> Since 2009, Microsemi has submitted and caused WEDC to submit invoices for payment to Government contractors for ITAR- or EAR-related work totaling more than $1.6 billion, and it has caused the government's prime contractors to unwittingly submit, concurrently with Microsemi's and WEDC's ongoing ITAR violations, invoices totaling sums far greater than that amount charged for ITAR- and EAR-protected technology products manufactured by Microsemi's numerous subsidiaries, including WEDC.

AC (Doc. 38) at 41, ¶ 67. This is akin to the allegations in *United States ex rel. Sallade v. Orbital Sciences Corp.*, 2008 WL 724973 (D.Ariz. March 17, 2008), where Relator alleged that "every invoice [Defendant] submitted under the . . . contract was fraudulent." *See id.* at *3. "This kind of general allegation assumes that [Defendant] actually submitted an invoice and does not satisfy Rule 9(b)[,]" the Court held. *Id.*

In this respect, *Sallade* is indistinguishable from the present case. Relator has not alleged with the requisite particularity that Defendants actually submitted an actual claim or request for payment to the government. Likewise, the AC does not include suffi-

cient factual content from which the Court could reasonably infer the submission of a false claim. "[T]he absence that a false certification was submitted is a 'fatal defect' to an FAC claim." *Gonzalez*, 2012 WL 2412080, at *6 (quoting *Hopper*, 91 F.3d at 1267).

e. Scienter

Defendants further assert that Relator's false certification claim cannot survive this motion to dismiss because he has failed to plead any facts showing that they acted with the requisite scienter. Relator counters that the alleged facts "give rise to a reasonable inference" of scienter. Resp. (Doc. 41) at 21:2. Significantly, Relator does not reference any of those facts, noting instead that he has "pleaded that Defendants purported to be knowledgeable of ITAR[.]" *Id.* at 21:5-6. The AC does allege such purported knowledge, but that is not tantamount to scienter as the FCA defines it.

Since *Hopper*, 91 F.3d 1261, the Ninth Circuit has "emphasized the central importance of the scienter element to liability under the False Claims Act, holding that false claims must in fact be '"false when made."' *Hendow*, 461 F.3d at 1171-1172 (quoting *Hopper*, 91 F.3d at 1267) (other citation omitted). "Under the False Claim Act's scienter requirement, 'innocent mistakes, mere negligent misrepresentations and differences in interpretations' will not suffice to create liability." *Corinthian Colleges*, 655 F.3d at 996 (quoting *Hendow*, 461 F.3d at 1174 (internal citations, quotation marks, and alterations omitted)). "Instead, Relators must allege that [Defendant] knew that its statements were false, or that it was deliberately indifferent to or acted with reckless disregard of the truth of the statements." *Id.* (citing *U.S. ex rel. Hochman v. Nack-*

man, 145 F.3d 1069, 1074 (9th Cir. 1998) ("Absent evidence that the defendants knew that the . . . . Guidelines on which they relied did not apply, or that the defendants were deliberately indifferent to or recklessly disregardful of the alleged inapplicability of those provisions, no False Claims Act liability can be found.")). The Ninth Circuit has stated that "[t]he phrase 'known to be false' . . . means [known to be] 'a lie.'" *Wang v. FMC Corp.*, 975 F.2d 1412, 1421 (9th 1992), *overruled on other grounds*, *Hartpence*, 792 F.3d 1121. Unlike the "'circumstances constituting fraud or mistake[]'" which must be alleged with particularity, "conditions of a person's mind[,]" such as scienter, can be alleged generally. *See Zucco Partners, LLC v. Digimarc Corp.*, 552 F.3d 981, 990 (9th Cir. 2009) (quoting Fed.R.Civ.P. 9(b)).

Relator's allegations do not satisfy even this lower pleading threshold. The AC is void of any allegations that Defendants made a claim which they knew to be false, *i.e.*, known to be a lie. In addition, Relator has not identified any facts whatsoever, much less those supposedly "giv[ing] rise to a reasonable inference" that Defendants' acted with "knowledge or reckless disregard" in certifying ITAR compliance. *See* Resp. (Doc. 41) at 21:2-3. The Court will not scour Relator's AC looking for allegations to support this contention. Indeed, if the Court were to do so, "it would be impermissibly taking on the role of advocate, rather than impartial decision-maker." *See Mann v. GTCR Golder Rauner, L.L.C.*, 438 F.Supp.2d 884, 891 (D.Ariz. 2007).

Relator does specify allegations which in his view show that "Defendants <u>purported to be knowledgeable</u> of ITAR[.]" Resp. (Doc. 41) at 21:6; *see id.*

at 21, n. 42 (citations to complaint). For example, Relator alleges that not long after the announcement that Microsemi was acquiring WEDC, he was informed that "Microsemi has a lot of facilities that perform ITAR-related work, that Microsemi is fully versed in ITAR, and that . . . Microsemi's Senior Vice President of Operations, who was responsible for Microsemi's IT department, was an expert in ITAR." AC (Doc. 38) at 22, ¶ 27. nonetheless, the Court fails to see how such allegations plead or support a reasonable inference that Defendants certified ITAR compliance while knowingly or recklessly disregarding that they were not ITAR compliant. Furthermore, the AC does not identify a single employee of Defendants who allegedly certified ITAR compliance, much less that that person knew of or recklessly disregarded the shared domain which is the basis for Relator's claim of ITAR violations. In short, none of the facts as plead and identified by Relator supports his conclusory allegation that "Defendant [sic] knowingly caused WEDC to present false or fraudulent claims[.]" (*Id.* at 44, ¶ 75).

As the foregoing demonstrates, Relator has not adequately pled any of the elements of an implied false certification claim. The Court must, therefore, consider whether the AC "warrants an inference that false claims were part of the scheme alleged." *Cafasso*, 636 F.3d at 1056 (citation omitted). "In assessing the plausibility of an inference, [the Court] 'draw[s] on [its] judicial experience and common sense,' *Iqbal*, 129 S.Ct. at 1950, and consider[s] "obvious alternative explanation[s][.]"" *Id.* (quoting *Iqbal*, 129 S.Ct. at 1952) (quoting *Twombly*, 550 U.S. at 567)). Engaging in this assessment, this Court finds that, at most, the AC pleads the "sheer possibility" that Defendants

violated the FCA. *See Iqbal.*, 556 U.S., at 678. The AC's vague, diffuse and sweeping allegations are insufficient to cross the line from possibility to probability.

As can be seen, at most the AC alleges violations of the ITAR. The Ninth Circuit has consistently held, however, that "mere regulatory violations to not give rise to a viable FCA action." *See Hopper*, 91 F.3d at 1267. This case is no different than *Hopper* in that ITAR compliance simply is not "a *sine qua non*" of receipt of government payment. *See id.* Hence, FCA liability "cannot attach[.]" *See Ebeid*, 616 F.3d at 997. Relator seems to be operating under the misconception that "any breach of contract, or violation of regulations or law, or receipt of money from the government where one is not entitled to receive the money, automatically gives rise to a claim under the FCA[,]" but this is not so. *See Hopper*, 91 F.3d at 1265. At the end of the day, it strikes the Court that as in *Ebeid*, Relator's AC is akin to a "global indictment" of Microsemi's business practices with respect to ITAR-controlled information and products and otherwise.[8] *See Ebeid* 616 F.3d at 1000. Such an indictment does not transform the alleged conduct into a viable cause of action under the FCA, however.

C. Possible Amendment

Defendants are seeking dismissal of the AC with prejudice. Anticipating that Relator may seek leave to amend, Defendants argue that the Court should not allow amendment because it would be futile to do so.

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[8] In the AC's introduction, Relator alleges in great detail that what he characterizes as Microsemi's "aggressive[]" acquisition of a number of technologies. *See* AC (Doc. 38) at 5:7, ¶ 4, n. 1-26.

Amendment would be futile primarily because "alleged ITAR violations cannot provide a basis for FAC falsity, materiality, or scienter as a matter of law." *See* Mot. (Doc. 34) at 17 n. 5. If the Court finds, as it has, that Relator has failed to state a FCA claim, he is seeking leave to amend on the basis that he has "uncover[ed] additional information to provide additional particularity and plausibility to his Complaint." Resp. (Doc. 41) at 21:16-17. This information "preced[es] the 2010 series of events" which the AC alleges. (*Id.* at 21:19).

Federal Rule of Civil Procedure 15(a) provides that leave to amend should be freely given "when justice so requires." Hence, "[t]he standard for granting leave to amend is generous." *Corinthian Colleges*, 655 F.3d at 995 (internal quotation marks and citation omitted). However, in exercising its discretion, courts may decline to grant leave to amend upon a showing of "'undue delay, bad faith or dilatory motive on the part of the movant, repeated failure to cure deficiencies by amendments previously allowed, undue prejudice to the opposing party by virtue of allowance of the amendment, [or] futility of amendment[.]'" *Sonoma County Ass'n of Retired Employees v. Sonoma County*, 708 F.3d 1109, 1117 (9th Cir. 2013) (quoting *Foman v. Davis*, 371 U.S. 178, 182 (1962)). In assessing futility, "denial of a motion to amend is proper if it is clear 'that the complaint would not be saved by any amendment.'" *Hildes v. Arthur Andersen LLP*, 734 F.3d 854, 859 (9th Cir. 2013) (internal quotation marks and citation omitted), *cert. denied sub nom. Moores v. Hildes*, 135 S.Ct. 46 (2014).

The shortcomings in Relator's AC are many and varied, as fully discussed herein. Even if some flaws could be cured by amending "to provide additional

particularity," as Relator urges, still, the AC could not be saved by amendment. This is because Relator's two theories of liability, even with amendment, could not "plausibly give rise to an entitlement to relief" under the FCA. *See Iqbal*, 556 U.S., at 679. For the reasons set forth herein, Relator has failed to state a claim for FCA liability under a worthless products theory. This particular claim fails not due to a lack of particularity, but because it is not a legally viable claim in the first instance. Amendment as to this specific theory of FCA liability would thus be futile.

Nor can Relator's implied false certification claim be cured by amendment. This claim is fundamentally flawed at its most basic level—a flaw which amendment cannot cure. In this Circuit, "[t]he prevailing law is that 'regulatory violations do not give rise to a viable FCA action' unless government payment is expressly conditioned on a false certification of regulatory compliance." *United States ex rel. Swan v. Covenant Care, Inc.*, 279 F.Supp.2d 1212, 1221 (E.D.Cal. 2002) (citing, *inter alia, Anton*, 91 F.3d at 1266 ("It is the false certification of compliance which creates liability [under the FCA] when certification is a prerequisite to obtaining a government benefit") (emphasis in original)). As fully discussed herein, the alleged ITAR violations cannot be a predicate to FCA liability on a theory of implied false certification because compliance therewith is not a *sine qua non* of receipt of government payment. So, even if Relator could come forth with more particulars, such as identifying a Microsemi employee who affirmatively acted to gain access, and did, in fact gain access to ITAR protected data, such an amendment could not cure this fundamental flaw.

There is also a temporal aspect to the Court's finding that amendment would be futile. The AC alleges that ITAR violations occurred during the roughly six months following Microsemi's acquisition of WEDC, namely from April through late October of 2010. Yet, now Relator wants to amend his AC to include unspecified information "preceding the 2010 series of events described in the Complaint." Resp. (Doc. 41) at 21:19-20 (footnote omitted) (emphasis added). Clearly such events could not arise out of the same ITAR violations alleged herein.

In light of the foregoing, the Court finds that it would be futile to allow amendment. Consequently, in the exercise of its discretion, the Court dismisses Relator's Amended Complaint (Doc. 38) with prejudice. *See Salameh v. Tarsadia Hotel*, 726 F.3d 1124, 1133 (9th Cir. 2013) (internal quotation marks and citations omitted) ("[D]ismissal without leave to amend is proper if it is clear that the complaint could not be saved by amendment.")

IV. Conclusion

Accordingly, for the reasons set forth herein,

IT IS HEREBY ORDERED GRANTING with prejudice Defendants' Motion to Dismiss Relator's First Amended Complaint (Doc. 34).

Dated this 30th day of September, 2015.

/s/ Honorable Diane J. Humetewa
United States District Judge

ORDER OF THE NINTH CIRCUIT DENYING PETITION FOR REHEARING EN BANC (JUNE 15, 2017)

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

UNITED STATES ex rel. MARK MCGRATH,

Plaintiff-Appellant,

v.

MICROSEMI CORPORATION; WHITE ELECTRONIC DESIGNS CORPORATION, DBA Microsemi Power and Electronics Group,

Defendants-Appellees.

Nos. 15-17206, 15-17478
D.C. No. 2:13-cv-00864-DJH
District of Arizona, Phoenix

Before: D.W. NELSON and IKUTA, Circuit Judges, and BURGESS,* Chief District Judge.

The panel has unanimously voted to deny appellant's petition for panel rehearing. Judge Ikuta voted to deny the petition for rehearing en banc and Judge Nelson and Judge Burgess so recommended. The petition for rehearing en banc was circulated to the

* The Honorable Timothy M. Burgess, Chief United States District Judge for the District of Alaska, sitting by designation.

judges of the court, and no judge requested a vote for en banc consideration.

The petition for rehearing and the petition for rehearing en banc are DENIED.

RELEVANT STATUTORY PROVISIONS, EXECUTIVE ORDERS, AND REGULATIONS

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22 U.S.C.A. § 2751
Need for international defense cooperation and military export controls; Presidential waiver; report to Congress; arms sales policy

As declared by the Congress in the Arms Control and Disarmament Act [22 U.S.C.A. § 2551 et seq.], an ultimate goal of the United States continues to be a world which is free from the scourge of war and the dangers and burdens of armaments; in which the use of force has been subordinated to the rule of law; and in which international adjustments to a changing world are achieved peacefully. In furtherance of that goal, it remains the policy of the United States to encourage regional arms control and disarmament agreements and to discourage arms races.

The Congress recognizes, however, that the United States and other free and independent countries continue to have valid requirements for effective and mutually beneficial defense relationships in order to maintain and foster the environment of international peace and security essential to social, economic, and political progress. Because of the growing cost and complexity of defense equipment, it is increasingly difficult and uneconomic for any country, particularly a developing country, to fill all of its legitimate defense requirements from its own design and production base. The need for international defense cooperation among the United States and those friendly countries to which it is allied by mutual defense treaties is especially important, since the

effectiveness of their armed forces to act in concert to deter or defeat aggression is directly related to the operational compatibility of their defense equipment.

Accordingly, it remains the policy of the United States to facilitate the common defense by entering into international arrangements with friendly countries which further the objective of applying agreed resources of each country to programs and projects of cooperative exchange of data, research, development, production, procurement, and logistics support to achieve specific national defense requirements and objectives of mutual concern. To this end, this chapter authorizes sales by the United States Government to friendly countries having sufficient wealth to maintain and equip their own military forces at adequate strength, or to assume progressively larger shares of the costs thereof, without undue burden to their economies, in accordance with the restraints and control measures specified herein and in furtherance of the security objectives of the United States and of the purposes and principles of the United Nations Charter.

It is the sense of the Congress that all such sales be approved only when they are consistent with the foreign policy interests of the United States, the purposes of the foreign assistance program of the United States as embodied in the Foreign Assistance Act of 1961, as amended [22 U.S.C.A. § 2151 et seq.], the extent and character of the military requirement, and the economic and financial capability of the recipient country, with particular regard being given, where appropriate, to proper balance among such sales, grant military assistance, and economic assistance as well as to the impact of the sales on

programs of social and economic development and on existing or incipient arms races.

It shall be the policy of the United States to exert leadership in the world community to bring about arrangements for reducing the international trade in implements of war and to lessen the danger of outbreak of regional conflict and the burdens of armaments. United States programs for or procedures governing the export, sale, and grant of defense articles and defense services to foreign countries and international organizations shall be administered in a manner which will carry out this policy.

It is the sense of the Congress that the President should seek to initiate multilateral discussions for the purpose of reaching agreements among the principal arms suppliers and arms purchasers and other countries with respect to the control of the international trade in armaments. It is further the sense of Congress that the President should work actively with all nations to check and control the international sale and distribution of conventional weapons of death and destruction and to encourage regional arms control arrangements. In furtherance of this policy, the President should undertake a concerted effort to convene an international conference of major arms-supplying and arms-purchasing nations which shall consider measures to limit conventional arms transfers in the interest of international peace and stability.

It is the sense of the Congress that the aggregate value of defense articles and defense services—

(1) which are sold under section 2761 or section 2762 of this title; or

(2) which are licensed or approved for export under section 2778 of this title to, for the use, or for benefit of the armed forces, police, intelligence, or other internal security forces of a foreign country or international organization under a commercial sales contract;

in any fiscal year should not exceed current levels.

It is the sense of the Congress that the President maintain adherence to a policy of restraint in conventional arms transfers and that, in implementing this policy worldwide, a balanced approach should be taken and full regard given to the security interests of the United States in all regions of the world and that particular attention should be paid to controlling the flow of conventional arms to the nations of the developing world. To this end, the President is encouraged to continue discussions with other arms suppliers in order to restrain the flow of conventional arms to less developed countries.

EXECUTIVE ORDERS

Executive Order No. 11501

Ex. Ord. No. 11501, Dec. 22, 1969, 34 F.R. 20169, as amended by Ex. Ord. No. 11685, Sept. 25, 1972, 37 F.R. 20155, which related to the administration of this chapter, was revoked by Ex. Ord. No. 11958, Jan. 18, 1977, 42 F.R. 4311, set out as a note under this section.

Executive Order No. 11958

Executive Order No. 11958, Jan. 18, 1977, 42 F.R. 4311, as amended by Ex. Ord. No. 12118, Feb. 6, 1979, 44 F.R. 7939; Ex. Ord. No. 12163, Sept. 29,

1979, 44 F.R. 56673; Ex. Ord. No. 12210, Apr. 16, 1980, 45 F.R. 26313; Ex. Ord. No. 12321, Sept. 14, 1981, 46 F.R. 46109; Ex. Ord. No. 12365, May 24, 1982, 47 F.R. 22933; Ex. Ord. No. 12423, May 26, 1983, 48 F.R. 24025; Ex. Ord. No. 12560, May 24, 1986, 51 F.R. 19159; Ex. Ord. No. 12680, July 5, 1989, 54 F.R. 28995; Ex. Ord. No. 12738, Dec. 14, 1990, 55 F.R. 52033; Ex. Ord. No. 13030, Dec. 12, 1996, 61 F.R. 66187; Ex. Ord. No. 13091, June 29, 1998, 63 F.R. 36153; Ex. Ord. No. 13118, Mar. 31, 1999, 64 F.R. 16595, Ex. Ord. No. 13284, Sec. 13, Jan. 23, 2003, 68 F.R. 4076, which related to the administration of this chapter, was revoked by Ex. Ord. No. 13637, § 4, Mar. 8, 2013, 78 F.R. 16129, set out in a note under this section.

Executive Order No. 13637
<March 8, 2013, 78 F.R. 16129>

Administration of Reformed Export Controls

By the authority vested in me as President by the Constitution and the laws of the United States of America, including the Arms Export Control Act, as amended (22 U.S.C. 2751 et seq.) (the "Act"), and section 301 of title 3, United States Code, it is hereby ordered as follows:

Section 1. Delegation of Functions

The following functions conferred upon the President by the Act, and related laws, are delegated as follows:

(a) Those under section 3 of the Act (22 U.S.C. 2753), with the exception of subsections (a)(1), (b), (c)(3), (c)(4), and (f) (22 U.S.C. 2753(a)(1),

(b), (c)(3), (c)(4), and (f)), to the Secretary of State. The Secretary of State, in the implementation of the delegated functions under sections 3(a) and (d) of the Act (22 U.S.C. 2753(a) and (d)), is authorized to find, in the case of a proposed transfer of a defense article or related training or other defense service by a foreign country or international organization not otherwise eligible under section 3(a)(1) of the Act (22 U.S.C. 2753(a)(1)), whether the proposed transfer will strengthen the security of the United States and promote world peace.

(b) Those under section 5 (22 U.S.C. 2755) to the Secretary of State.

(c) Those under section 21 of the Act (22 U.S.C. 2761), with the exception of the last sentence of subsection (d) and all of subsection (i) (22 U.S.C. 2761(d) and (i)), to the Secretary of Defense.

(d) Those under sections 22(a), 29, 30, and 30A of the Act (22 U.S.C. 2762(a), 2769, 2770, and 2770a) to the Secretary of Defense.

(e) Those under section 23 of the Act (22 U.S.C. 2763), and under section 7069 of the Department of State, Foreign Operations, and Related Programs Appropriations Act, 2012 (Public Law 112-74, Division I) and any subsequently enacted provision of law that is the same or substantially the same, to the Secretary of Defense to be exercised in consultation with the Secretary of State and, other than the last sentence of section 23(a) (22 U.S.C. 2763(a)), in consultation with the

Secretary of the Treasury, except that the President shall determine any rate of interest to be charged that is less than the market rate of interest.

(f) Those under sections 24 and 27 of the Act (22 U.S.C. 2764 and 2767) to the Secretary of Defense. The Secretary of Defense shall consult with the Secretary of State and the Secretary of the Treasury in implementing the delegated functions under section 24 (22 U.S.C. 2764) and with the Secretary of State in implementing the delegated functions under section 27 (22 U.S.C. 2767).

(g) Those under section 25 of the Act (22 U.S.C. 2765) to the Secretary of State. The Secretary of Defense shall assist the Secretary of State in the preparation of materials for presentation to the Congress under that section.

(h) Those under section 34 of the Act (22 U.S.C. 2774) to the Secretary of State. To the extent the standards and criteria for credit and guaranty transactions are based upon national security or financial policies, the Secretary of State shall obtain the prior concurrence of the Secretary of Defense and the Secretary of the Treasury, respectively.

(i) Those under section 35(a) of the Act (22 U.S.C. 2775(a)) to the Secretary of State.

(j) Those under sections 36(a) and 36(b)(1) of the Act (22 U.S.C. 2776(a) and (b)(1)), except with respect to the certification of an emergency as provided by subsection (b)(1) (22 U.S.C. 2776(b)(1)), to the Secretary of Defense. The

Secretary of Defense, in the implementation of the delegated functions under sections 36(a) and (b)(1) (22 U.S.C. 2776(a) and (b)(1)), shall consult with the Secretary of State. With respect to those functions under sections 36(a)(5) and (6) (22 U.S.C. 2776(a)(5) and (6)), the Secretary of Defense shall consult with the Director of the Office of Management and Budget.

(k) Those under section 36(b)(1) with respect to the certification of an emergency as provided by subsection (b)(1) and under sections 36(c) and (d) of the Act (22 U.S.C. 2776(b)(1), (c), and (d)) to the Secretary of State.

(l) Those under section 36(f)(1) of the Act (22 U.S.C. 2776(f)(1)) to the Secretary of Defense.

(m) Those under sections 36(f)(2) and (f)(3) of the Act (22 U.S.C. 2776(f)(2) and (f)(3)) to the Secretary of State.

(n) Those under section 38 of the Act (22 U.S.C. 2778) to:

(i) the Secretary of State, except as otherwise provided in this subsection. Designations, including changes in designations, by the Secretary of State of items or categories of items that shall be considered as defense articles and defense services subject to export control under section 38 (22 U.S.C. 2778) shall have the concurrence of the Secretary of Defense. The authority to undertake activities to ensure compliance with established export conditions may be redelegated to the Secretary of Defense, or

to the head of another executive department or agency as appropriate, who shall exercise such functions in consultation with the Secretary of State;

(ii) the Attorney General, to the extent they relate to the control of the permanent import of defense articles and defense services. In carrying out such functions, the Attorney General shall be guided by the views of the Secretary of State on matters affecting world peace, and the external security and foreign policy of the United States. Designations, including changes in designations, by the Attorney General of items or categories of items that shall be considered as defense articles and defense services subject to permanent import control under section 38 of the Act (22 U.S.C. 2778) shall be made with the concurrence of the Secretary of State and the Secretary of Defense and with notice to the Secretary of Commerce; and

(iii) the Department of State for the registration and licensing of those persons who engage in the business of brokering activities with respect to defense articles or defense services controlled either for purposes of export by the Department of State or for purposes of permanent import by the Department of Justice.

(o) Those under section 39(b) of the Act (22 U.S.C. 2779(b)) to the Secretary of State. In carrying out such functions, the Secretary of State shall consult with the Secretary of

Defense as may be necessary to avoid interference in the application of Department of Defense regulations to sales made under section 22 of the Act (22 U.S.C. 2762).

(p) Those under the portion of section 40A of the Act added by Public Law 104-164 (22 U.S.C. 2785), to the Secretary of State insofar as they relate to commercial exports licensed under the Act, and to the Secretary of Defense insofar as they relate to defense articles and defense services sold, leased, or transferred under the Foreign Military Sales Program.

(q) Those under the portion of section 40A of the Act added by the Antiterrorism and Effective Death Penalty Act of 1996 (Public Law 104-132) (22 U.S.C. 2781), to the Secretary of State.

(r) Those under sections 42(c) and (f) of the Act (22 U.S.C. 2791(c) and (f)) to the Secretary of Defense. The Secretary of Defense shall obtain the concurrence of the Secretary of State and the Secretary of Commerce on any determination considered under the authority of section 42(c) of the Act (22 U.S.C. 2791(c)).

(s) Those under section 52(b) of the Act (22 U.S.C. 2795a(b)) to the Secretary of Defense.

(t) Those under sections 61 and 62(a) of the Act (22 U.S.C. 2796 and 2796a(a)) to the Secretary of Defense.

(u) Those under section 2(b)(6) of the Export-Import Bank Act of 1945, as amended (12 U.S.C. 635(b)(6)) to the Secretary of State.

Section 2. Coordination

(a) In addition to the specific provisions of section 1 of this order, the Secretary of State and the Secretary of Defense, in carrying out the functions delegated to them under this order, shall consult with each other and with the heads of other executive departments and agencies on matters pertaining to their responsibilities.

(b) Under the direction of the President and in accordance with section 2(b) of the Act (22 U.S.C. 2752(b)), the Secretary of State, taking into account other United States activities abroad, shall be responsible for the continuous supervision and general direction of sales and exports under the Act, including the negotiation, conclusion, and termination of international agreements, and determining whether there shall be a sale to a country and the amount thereof, and whether there shall be delivery or other performance under such sale or export, to the end that sales and exports are integrated with other United States activities and the foreign policy of the United States is best served thereby.

Section 3. Allocation of Funds

Funds appropriated to the President for carrying out the Act shall be deemed to be allocated to the Secretary of Defense without any further action of the President.

Section 4. Revocation

Executive Order 11958 of January 18, 1977, as amended, is revoked; except that, to the extent consistent with this order, all determinations, authorizations, regulations, rulings, certificates, orders, directives, contracts, agreements, and other actions made, issued, taken, or entered into under the provisions of Executive Order 11958, as amended, and not revoked, superseded, or otherwise made inapplicable, shall continue in full force and effect until amended, modified, or terminated by appropriate authority.

Section 5. Delegation of Functions under the International Emergency Economic Powers Act

Executive Order 13222 of August 17, 2001, is amended as follows:

(a) Redesignate section 4 as section 6.

(b) Insert the following new sections 4 and 5 after section 3: "Sec. 4. The Secretary of Commerce shall, to the extent required as a matter of statute or regulation, establish appropriate procedures for when Congress is to be notified of the export of firearms that are subject to the jurisdiction of the Department of Commerce under the Export Administration Regulations and that are controlled for purposes of permanent import by the Attorney General under section 38(a) of the Arms Export Control Act (22 U.S.C. 2778(a)) and appropriate procedures for when Congress is to be notified of the export of Major Defense

Equipment controlled for purposes of permanent export under the jurisdiction of the Department of Commerce.

Sec. 5.

(a) The Secretary of State is hereby authorized to take such actions and to employ those powers granted to the President by the Act as may be necessary to license or otherwise approve the export, reexport, or transfer of items subject to the jurisdiction of the Department of Commerce as agreed to by the Secretary of State and the Secretary of Commerce.

(b) Notwithstanding subsection (a) of this section, items licensed or otherwise approved by the Secretary of State pursuant to this section remain subject to the jurisdiction of the Department of Commerce."

Section 6. General Provisions

(a) Nothing in this order shall be construed to impair or otherwise affect:

  (i) the authority granted by law to an agency, or the head thereof; or

  (ii) the functions of the Director of the Office of Management and Budget relating to budgetary, administrative, or legislative proposals.

(b) This order shall be implemented consistent with applicable law and subject to the availability of appropriations.

(c) This order is not intended to, and does not, create any right or benefit, substantive or

procedural, enforceable at law or in equity by any party against the United States, its departments, agencies, or entities, its officers, employees, or agents, or any other person.

Barack Obama

DETERMINATION OF PRESIDENT

Determination of President No. 96-23
<Apr. 30, 1996, 61 F.R. 26029>

Suspending Prohibitions on Certain Sales and Leases Under the Anti-Economic Discrimination Act of 1994

Memorandum for the Secretary of State

Pursuant to the authority vested in me by Section 564 of the Foreign Relations Authorization Act ("the Act"), Fiscal Years 1994 and 1995, Public Law 103-236, as amended [set out as a note under this section], I hereby:

(1) determine and certify that the following countries do not currently maintain a policy or practice of sending letters to United States firms requesting compliance with, or soliciting information regarding compliance with, the Arab League secondary or tertiary boycott of Israel:

Jordan and Mauritania;

(2) determine that extension of suspension of the application of Section 564(a) of the Act to the following countries until May 1, 1997, will promote the objectives of Section 564 [set out as a note under this section]:

Algeria, Bahrain, Bangladesh, Kuwait, Lebanon, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.

You are authorized and directed to report this determination to the appropriate committees of the Congress and to publish it in the FEDERAL REGISTER.

William J. Clinton

MEMORANDA OF PRESIDENT

Delegation to the Secretary of State
of the Responsibilities Vested in the President
by Section 564 of the Foreign Relations Authorization Act, Fiscal Years 1994 and 1995 (Public Law 103-236), as Amended
<Apr. 24, 1997, 62 F.R. 24797>

Memorandum for the Secretary of State

By the authority vested in me by the Constitution and laws of the United States of America, including section 301 of title 3 of the United States Code, I hereby delegate to you the functions vested in the President by section 564 of the Anti-Economic Discrimination Act of 1994 (AEDA) (title V of the Foreign Relations Authorization Act, Fiscal Years 1994 and 1995, Public Law 103-236, as amended) [set out as a note under this section].

Any reference in this memorandum to section 564 of the AEDA shall be deemed to include references to any hereafter-enacted provision of law that is the same or substantially the same as such section.

The functions delegated by this memorandum may be redelegated as appropriate.

You are authorized and directed to publish this memorandum in the Federal Register.

William J. Clinton

THE WHITE HOUSE,
Washington, April 24, 1997.

31 U.S.C.A. § 3729—False Claims

(a) Liability for certain acts.—

(1) In general.—Subject to paragraph (2), any person who—

(A) knowingly presents, or causes to be presented, a false or fraudulent claim for payment or approval;

(B) knowingly makes, uses, or causes to be made or used, a false record or statement material to a false or fraudulent claim;

(C) conspires to commit a violation of subparagraph (A), (B), (D), (E), (F), or (G);

(D) has possession, custody, or control of property or money used, or to be used, by the Government and knowingly delivers, or causes to be delivered, less than all of that money or property;

(E) is 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;

(F) 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 property; or

(G) knowingly makes, uses, or causes to be made or used, a false record or statement material to an obligation to pay or transmit money or property to the Government, or knowingly conceals or knowingly and improperly avoids or decreases an obligation to pay or transmit money or property to the Government,

is liable to the United States Government for a civil penalty of not less than $5,000 and not more than $10,000, as adjusted by the Federal Civil Penalties Inflation Adjustment Act of 1990 (28 U.S.C. 2461 note; Public Law 104-410[1]), plus 3 times the amount of damages which the Government sustains because of the act of that person.

(2) Reduced damages.—If the court finds that—

(A) the person committing the violation of this subsection furnished officials of the United States responsible for investigating false claims violations with all information known to such person about the violation within 30 days after the date on which the defendant first obtained the information;

(B) such person fully cooperated with any Government investigation of such violation; and

(C) at the time such person furnished the United States with the information about the violation, no criminal prosecution, civil action, or administrative action had commenced under this title with respect to

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[1] So in original. Probably should read "Public Law 101-410".

such violation, and the person did not have actual knowledge of the existence of an investigation into such violation,

the court may assess not less than 2 times the amount of damages which the Government sustains because of the act of that person.

(3) Costs of civil actions.—A person violating this subsection shall also be liable to the United States Government for the costs of a civil action brought to recover any such penalty or damages.

(b) Definitions.—For purposes of this section—

(1) the terms "knowing" and "knowingly"—

(A) mean that a person, with respect to information—

(i) has actual knowledge of the information;

(ii) acts in deliberate ignorance of the truth or falsity of the information; or

(iii) acts in reckless disregard of the truth or falsity of the information; and

(B) require no proof of specific intent to defraud;

(2) the term "claim"—

(A) means any request or demand, whether under a contract or otherwise, for money or property and whether or not the United States has title to the money or property, that—is presented to an officer, employee, or agent of the United States; or

(i) is presented to an officer, employee, or agent of the United States; or

(ii) is made to a contractor, grantee, or other recipient, if the money or property is to be spent or used on the Government's behalf or to advance a Government program or interest, and if the United States Government—

(I) provides or has provided any portion of the money or property requested or demanded; or

(II) will reimburse such contractor, grantee, or other recipient for any portion of the money or property which is requested or demanded; and

(B) does not include requests or demands for money or property that the Government has paid to an individual as compensation for Federal employment or as an income subsidy with no restrictions on that individual's use of the money or property;

(3) the term "obligation" means an established duty, whether or not fixed, arising from an express or implied contractual, grantor-grantee, or licensor-licensee relationship, from a fee-based or similar relationship, from statute or regulation, or from the retention of any overpayment; and

(4) the term "material" means having a natural tendency to influence, or be capable of influ-

encing, the payment or receipt of money or property.

(c) Exemption from disclosure.—Any information furnished pursuant to subsection (a)(2) shall be exempt from disclosure under section 552 of title 5.

(d) Exclusion.—This section does not apply to claims, records, or statements made under the Internal Revenue Code of 1986.

[(e) Redesignated (d)]

50 U.S.C.A. § 2401—Establishment and Mission

(a) Establishment

There is established within the Department of Energy a separately organized agency to be known as the National Nuclear Security Administration (in this chapter referred to as the "Administration").

(b) Mission

The mission of the Administration shall be the following:

(1) To enhance United States national security through the military application of nuclear energy.

(2) To maintain and enhance the safety, reliability, and performance of the United States nuclear weapons stockpile, including the ability to design, produce, and test, in order to meet national security requirements.

(3) To provide the United States Navy with safe, militarily effective nuclear propulsion plants

and to ensure the safe and reliable operation of those plants.

(4) To promote international nuclear safety and nonproliferation.

(5) To reduce global danger from weapons of mass destruction.

(6) To support United States leadership in science and technology.

(c) Operations and Activities to be Carried Out Consistently with Certain Principles

In carrying out the mission of the Administration, the Administrator shall ensure that all operations and activities of the Administration are consistent with the principles of—

(1) protecting the environment;

(2) safeguarding the safety and health of the public and of the workforce of the Administration; and

(3) ensuring the security of the nuclear weapons, nuclear material, and classified information in the custody of the Administration.

15 C.F.R. § 734.2
Important EAR Terms and Principles

(a) Subject to the EAR—Definition.

(1) "Subject to the EAR" is a term used in the EAR to describe those items and activities over which BIS exercises regulatory jurisdiction under the EAR. Conversely, items and activities that are not subject to the EAR are outside the regulatory jurisdiction of the EAR and are not affected by these regulations. The items and activities subject to the EAR are described in § 734.2 through § 734.5 of this part. You should review the Commerce Control List (CCL) and any applicable parts of the EAR to determine whether an item or activity is subject to the EAR. However, if you need help in determining whether an item or activity is subject to the EAR, see § 734.6 of this part. Publicly available technology and software not subject to the EAR are described in § 734.7 through § 734.11 and Supplement No. 1 to this part.

(2) Items and activities subject to the EAR may also be controlled under export-related programs administered by other agencies. Items and activities subject to the EAR are not necessarily exempted from the control programs of other agencies. Although BIS and other agencies that maintain controls for national security and foreign policy reasons try to minimize overlapping jurisdiction, you should be aware that in some instances you may have to comply with more than one regulatory program.

(3) The term “subject to the EAR” should not be confused with licensing or other requirements imposed in other parts of the EAR. Just because an item or activity is subject to the EAR does not mean that a license or other requirement automatically applies. A license or other requirement applies only in those cases where other parts of the EAR impose a licensing or other requirement on such items or activities.

(b) Export and reexport—

(1) Definition of export. “Export” means an actual shipment or transmission of items subject to the EAR out of the United States, or release of technology or software subject to the EAR to a foreign national in the United States, as described in paragraph (b)(2)(ii) of this section. See paragraph (b)(9) of this section for the definition that applies to exports of encryption source code and object code software subject to the EAR.

(2) Export of technology or software. (See paragraph (b)(9) for provisions that apply to encryption source code and object code software.) “Export” of technology or software, excluding encryption software subject to “EI” controls, includes:

(i) Any release of technology or software subject to the EAR in a foreign country; or

(ii) Any release of technology or source code subject to the EAR to a foreign national. Such release is deemed to be an export to the home country or countries of the

foreign national. This deemed export rule does not apply to persons lawfully admitted for permanent residence in the United States and does not apply to persons who are protected individuals under the Immigration and Naturalization Act (8 U.S.C. 1324b(a)(3)). Note that the release of any item to any party with knowledge a violation is about to occur is prohibited by § 736.2(b)(10) of the EAR.

(3) Definition of "release" of technology or software. Technology or software is "released" for export through:

(i) Visual inspection by foreign nationals of U.S.-origin equipment and facilities;

(ii) Oral exchanges of information in the United States or abroad; or

(iii) The application to situations abroad of personal knowledge or technical experience acquired in the United States.

(4) Definition of reexport. "Reexport" means an actual shipment or transmission of items subject to the EAR from one foreign country to another foreign country; or release of technology or software subject to the EAR to a foreign national outside the United States, as described in paragraph (b)(5) of this section.

(5) Reexport of technology or software. Any release of technology or source code subject to the EAR to a foreign national of another country is a deemed reexport to the home country or countries of the foreign national. However,

this deemed reexport definition does not apply to persons lawfully admitted for permanent residence. The term “release” is defined in paragraph (b)(3) of this section. Note that the release of any item to any party with knowledge or reason to know a violation is about to occur is prohibited by § 736.2(b)(10) of the EAR.

(6) For purposes of the EAR, the export or reexport of items subject to the EAR that will transit through a country or countries or be transshipped in a country or countries to a new country or are intended for reexport to the new country, are deemed to be exports to the new country.

(7) If a territory, possession, or department of a foreign country is not listed on the Country Chart in Supplement No. 1 to part 738 of the EAR, the export or reexport of items subject to the EAR to such destination is deemed under the EAR to be an export to the foreign country. For example, a shipment to the Cayman Islands, a dependent territory of the United Kingdom, is deemed to be a shipment to the United Kingdom.

(8) Export or reexport of items subject to the EAR does not include shipments among any of the states of the United States, the Commonwealth of Puerto Rico, or the Commonwealth of the Northern Mariana Islands or any territory, dependency, or possession of the United States. These destinations are listed in Schedule C, Classification Codes and Descrip-

tions for U.S. Export Statistics, issued by the Bureau of the Census.

(9) Export of encryption source code and object code software.

(i) For purposes of the EAR, the export of encryption source code and object code software means:

(A) An actual shipment, transfer, or transmission out of the United States (see also paragraph (b)(9)(ii) of this section); or

(B) A transfer of such software in the United States to an embassy or affiliate of a foreign country.

(ii) The export of encryption source code and object code software controlled for "EI" reasons under ECCN 5D002 on the Commerce Control List (see Supplement No. 1 to part 774 of the EAR) includes downloading, or causing the downloading of, such software to locations (including electronic bulletin boards, Internet file transfer protocol, and World Wide Web sites) outside the U.S., or making such software available for transfer outside the United States, over wire, cable, radio, electro-magnetic, photo optical, photoelectric or other comparable communications facilities accessible to persons outside the United States, including transfers from electronic bulletin boards, Internet file transfer protocol and World Wide Web sites, unless the person making the soft-

ware available takes precautions adequate to prevent unauthorized transfer of such code. See § 740.13(e) of the EAR for notification requirements for exports or reexports of encryption source code and object code software considered to be publicly available consistent with the provisions of § 734.3(b)(3) of the EAR.

(iii) Subject to the General Prohibitions described in part 736 of the EAR, such precautions for Internet transfers of products eligible for export under § 740.17 (b)(2) of the EAR (encryption software products, certain encryption source code and general purpose encryption toolkits) shall include such measures as:

(A) The access control system, either through automated means or human intervention, checks the address of every system outside of the U.S. or Canada requesting or receiving a transfer and verifies such systems do not have a domain name or Internet address of a foreign government end-user (e.g., ".gov," ".gouv," ".mil" or similar addresses);

(B) The access control system provides every requesting or receiving party with notice that the transfer includes or would include cryptographic software subject to export controls under the Export Administration Regulations, and anyone receiving such a transfer

cannot export the software without a license or other authorization; and

(C) Every party requesting or receiving a transfer of such software must acknowledge affirmatively that the software is not intended for use by a government end-user, as defined in part 772, and he or she understands the cryptographic software is subject to export controls under the Export Administration Regulations and anyone receiving the transfer cannot export the software without a license or other authorization. BIS will consider acknowledgments in electronic form provided they are adequate to assure legal undertakings similar to written acknowledgments.

22 C.F.R. § 127.1—Violations

(a) Without first obtaining the required license or other written approval from the Directorate of Defense Trade Controls, it is unlawful:

(1) To export or attempt to export from the United States any defense article or technical data or to furnish or attempt to furnish any defense service for which a license or written approval is required by this subchapter;

(2) To reexport or retransfer or attempt to reexport or retransfer any defense article, technical data, or defense service from one foreign end-user, end-use, or destination to another foreign end-user, end-use, or destina-

tion for which a license or written approval is required by this subchapter, including, as specified in § 126.16(h) and § 126.17(h) of this subchapter, any defense article, technical data, or defense service that was exported from the United States without a license pursuant to any exemption under this subchapter;

(3) To import or attempt to import any defense article whenever a license is required by this subchapter;

(4) To conspire to export, import, reexport, retransfer, furnish or cause to be exported, imported, reexported, retransferred or furnished, any defense article, technical data, or defense service for which a license or written approval is required by this subchapter; or

(5) To possess or attempt to possess any defense article with intent to export or transfer such defense article in violation of 22 U.S.C. 2778 and 2779, or any regulation, license, approval, or order issued thereunder.

(b) It is unlawful:

(1) To violate any of the terms or conditions of a license or approval granted pursuant to this subchapter, any exemption contained in this subchapter, or any rule or regulation contained in this subchapter;

(2) To engage in the business of brokering activities for which registration and a license or written approval is required by this subchapter without first registering or obtaining

the required license or written approval from the Directorate of Defense Trade Controls. For the purposes of this subchapter, engaging in the business of brokering activities requires only one occasion of engaging in an activity as reflected in § 129.2(b) of this subchapter.

(3) To engage in the United States in the business of either manufacturing or exporting defense articles or furnishing defense services without complying with the registration requirements. For the purposes of this subchapter, engaging in the business of manufacturing or exporting defense articles or furnishing defense services requires only one occasion of manufacturing or exporting a defense article or furnishing a defense service.

(c) Any person who is granted a license or other approval or acts pursuant to an exemption under this subchapter is responsible for the acts of employees, agents, brokers, and all authorized persons to whom possession of the defense article, which includes technical data, has been entrusted regarding the operation, use, possession, transportation, and handling of such defense article abroad. All persons abroad subject to U.S. jurisdiction who obtain custody of a defense article exported from the United States or produced under an agreement described in part 124 of this subchapter, and regardless of the number of intermediate transfers, are bound by the regulations of this subchapter in the same manner and to the same extent as the original owner or transferor.

(d) A person who is ineligible pursuant to § 120.1 (c)(2) of this subchapter, or a person with knowledge that another person is ineligible pursuant to § 120.1(c)(2) of this subchapter, may not, directly or indirectly, in any manner or capacity, without prior disclosure of the facts to and written authorization from the Directorate of Defense Trade Controls:

(1) Apply for, obtain, or use any export control document as defined in § 127.2(b) for such ineligible person; or

(2) Order, buy, receive, use, sell, deliver, store, dispose of, forward, transport, finance, or otherwise service or participate in any manner in any transaction subject to this subchapter that may involve any defense article, which includes technical data, defense services, or brokering activities, where such ineligible person may obtain any benefit therefrom or have any direct or indirect interest therein.

(e) No person may knowingly or willfully attempt, solicit, cause, or aid, abet, counsel, demand, induce, procure, or permit the commission of any act prohibited by, or the omission of any act required by 22 U.S.C. 2778, 22 U.S.C. 2779, or any regulation, license, approval, or order issued thereunder.

22 C.F.R. § 127.12—Voluntary Disclosures

(a) General policy

The Department strongly encourages the disclosure of information to the Directorate of Defense Trade Controls by persons (see § 120.14 of this subchapter)

that believe they may have violated any export control provision of the Arms Export Control Act, or any regulation, order, license, or other authorization issued under the authority of the Arms Export Control Act. The Department may consider a voluntary disclosure as a mitigating factor in determining the administrative penalties, if any, that should be imposed. Failure to report a violation may result in circumstances detrimental to U.S. national security and foreign policy interests, and will be an adverse factor in determining the appropriate disposition of such violations.

(b) Limitations

(1) The provisions of this section apply only when information is provided to the Directorate of Defense Trade Controls for its review in determining whether to take administrative action under part 128 of this subchapter concerning a violation of the export control provisions of the Arms Export Control Act and these regulations.

(2) The provisions of this section apply only when information is received by the Directorate of Defense Trade Controls for review prior to such time that either the Department of State or any other agency, bureau, or department of the United States Government obtains knowledge of either the same or substantially similar information from another source and commences an investigation or inquiry that involves that information, and that is intended to determine whether the Arms Export Control Act or these regulations, or any other license, order, or other authorization issued

under the Arms Export Control Act has been violated.

(3) The violation(s) in question, despite the voluntary nature of the disclosure, may merit penalties, administrative actions, sanctions, or referrals to the Department of Justice to consider criminal prosecution. In the latter case, the Directorate of Defense Trade Controls will notify the Department of Justice of the voluntary nature of the disclosure, although the Department of Justice is not required to give that fact any weight. The Directorate of Defense Trade Controls has the sole discretion to consider whether "voluntary disclosure," in context with other relevant information in a particular case, should be a mitigating factor in determining what, if any, administrative action will be imposed. Some of the mitigating factors the Directorate of Defense Trade Controls may consider are:

(i) Whether the transaction would have been authorized, and under what conditions, had a proper license request been made;

(ii) Why the violation occurred;

(iii) The degree of cooperation with the ensuing investigation;

(iv) Whether the person has instituted or improved an internal compliance program to reduce the likelihood of future violation;

(v) Whether the person making the disclosure did so with the full knowledge and authorization of the person's senior management.

(If not, then the Directorate will not deem the disclosure voluntary as covered in this section.)

(4) The provisions of this section do not, nor should they be relied on to, create, confer, or grant any rights, benefits, privileges, or protection enforceable at law or in equity by any person in any civil, criminal, administrative, or other matter.

(5) Nothing in this section shall be interpreted to negate or lessen the affirmative duty pursuant to §§ 126.1(e), 126.16(h)(5), and 126.17(h)(5) of this subchapter upon persons to inform the Directorate of Defense Trade Controls of the actual or final sale, export, transfer, reexport, or retransfer of a defense article, technical data, or defense service to any country referred to in § 126.1 of this subchapter, any citizen of such country, or any person acting on its behalf.

(c) Notification

(1) Any person wanting to disclose information that constitutes a voluntary disclosure should, in the manner outlined below, initially notify the Directorate of Defense Trade Controls immediately after a violation is discovered and then conduct a thorough review of all defense trade transactions where a violation is suspected.

(i) If the notification does not contain all the information required by 127.12(c)(2) of this section, a full disclosure must be submitted within 60 calendar days of the

notification, or the Directorate of Defense Trade Controls will not deem the notification to qualify as a voluntary disclosure.

(ii) If the person is unable to provide a full disclosure within the 60 calendar day deadline, an empowered official (see § 120.25 of this subchapter) or a senior officer may request an extension of time in writing. A request for an extension must specify what information required by § 127.12(c)(2) of this section could not be immediately provided and the reasons why.

(iii) Before approving an extension of time to provide the full disclosure, the Directorate of Defense Trade Controls may require the requester to certify in writing that they will provide the full disclosure within a specific time period.

(iv) Failure to provide a full disclosure within a reasonable time may result in a decision by the Directorate of Defense Trade Controls not to consider the notification as a mitigating factor in determining the appropriate disposition of the violation. In addition, the Directorate of Defense Trade Controls may direct the requester to furnish all relevant information surrounding the violation.

(2) Notification of a violation must be in writing and should include the following information:

(i) A precise description of the nature and extent of the violation (e.g., an unauthor-

ized shipment, doing business with a party denied U.S. export privileges, etc.);

(ii) The exact circumstances surrounding the violation (a thorough explanation of why, when, where, and how the violation occurred);

(iii) The complete identities and addresses of all persons known or suspected to be involved in the activities giving rise to the violation (including mailing, shipping, and e-mail addresses; telephone and fax/facsimile numbers; and any other known identifying information);

(iv) Department of State license numbers, exemption citation, or description of any other authorization, if applicable;

(v) U.S. Munitions List category and subcategory, product description, quantity, and characteristics or technological capability of the hardware, technical data or defense service involved;

(vi) A description of corrective actions already undertaken that clearly identifies the new compliance initiatives implemented to address the causes of the violations set forth in the voluntary disclosure and any internal disciplinary action taken; and how these corrective actions are designed to deter those particular violations from occurring again;

(vii) The name and address of the person making the disclosure and a point of

contact, if different, should further information be needed.

(3) Factors to be addressed in the voluntary disclosure include, for example, whether the violation was intentional or inadvertent; the degree to which the person responsible for the violation was familiar with the laws and regulations, and whether the person was the subject of prior administrative or criminal action under the AECA; whether the violations are systemic; and the details of compliance measures, processes and programs, including training, that were in place to prevent such violations, if any. In addition to immediately providing written notification, persons are strongly urged to conduct a thorough review of all export-related transactions where a possible violation is suspected.

(d) Documentation

The written disclosure should be accompanied by copies of substantiating documents. Where appropriate, the documentation should include, but not be limited to:

(1) Licensing documents (e.g., license applications, export licenses, and end-user statements), exemption citation, or other authorization description, if any;

(2) Shipping documents (e.g., Electronic Export Information filing, including the Internal Transaction Number, air waybills, and bills of laden, invoices, and any other associated documents); and

(3) Any other relevant documents must be retained by the person making the disclosure until the Directorate of Defense Trade Controls requests them or until a final decision on the disclosed information has been made.

(e) Certification

A certification must be submitted stating that all of the representations made in connection with the voluntary disclosure are true and correct to the best of that person's knowledge and belief. Certifications should be executed by an empowered official (See § 120.25 of this subchapter), or by a senior officer (e.g. chief executive officer, president, vice-president, comptroller, treasurer, general counsel, or member of the board of directors). If the violation is a major violation, reveals a systemic pattern of violations, or reflects the absence of an effective compliance program, the Directorate of Defense Trade Controls may require that such certification be made by a senior officer of the company.

(f) Oral presentations

Oral presentation is generally not necessary to augment the written presentation. However, if the person making the disclosure believes a meeting is desirable, a request should be included with the written presentation.

(g) Send voluntary disclosures to the Office of Defense Trade Controls Compliance, Directorate of Defense Trade Controls. Consult the Directorate of Defense Trade Controls Web site at http://www.pmddtc.state.gov for the appropriate street address.

22 C.F.R. § 120.17—Export

(a) Except as set forth in § 126.16 or § 126.17, export means:

(1) An actual shipment or transmission out of the United States, including the sending or taking of a defense article out of the United States in any manner;

(2) Releasing or otherwise transferring technical data to a foreign person in the United States (a "deemed export");

(3) Transferring registration, control, or ownership of any aircraft, vessel, or satellite subject to the ITAR by a U.S. person to a foreign person;

(4) Releasing or otherwise transferring a defense article to an embassy or to any of its agencies or subdivisions, such as a diplomatic mission or consulate, in the United States;

(5) Performing a defense service on behalf of, or for the benefit of, a foreign person, whether in the United States or abroad; or

(6) A launch vehicle or payload shall not, by reason of the launching of such vehicle, be considered an export for purposes of this subchapter. However, for certain limited purposes (see § 126.1 of this subchapter), the controls of this subchapter may apply to any sale, transfer or proposal to sell or transfer defense articles or defense services.

(b) Any release in the United States of technical data to a foreign person is deemed to be an export

to all countries in which the foreign person has held or holds citizenship or holds permanent residency.

48 C.F.R. 252.204–7012
Safeguarding Covered Defense Information and Cyber Incident Reporting (OCT 2016)

As prescribed in 204.7304c, use the following clause:

(a) Definitions

As used in this clause—

ADEQUATE SECURITY means protective measures that are commensurate with the consequences and probability of loss, misuse, or unauthorized access to, or modification of information.

COMPROMISE means disclosure of information to unauthorized persons, or a violation of the security policy of a system, in which unauthorized intentional or unintentional disclosure, modification, destruction, or loss of an object, or the copying of information to unauthorized media may have occurred.

CONTRACTOR attributional/proprietary information means information that identifies the contractor(s), whether directly or indirectly, by the grouping of information that can be traced back to the contractor(s) (e.g., program description, facility locations), personally identifiable information, as well as trade secrets, commercial or financial information, or other commercially sensitive information that is not customarily shared outside of the company.

CONTROLLED TECHNICAL INFORMATION means technical information with military or space application that is subject to controls on the access, use, reproduction, modification, performance, display, release, disclosure, or dissemination. Controlled technical information would meet the criteria, if disseminated, for distribution statements B through F using the criteria set forth in DoD Instruction 5230.24, Distribution Statements on Technical Documents. The term does not include information that is lawfully publicly available without restrictions.

COVERED CONTRACTOR INFORMATION SYSTEM means an unclassified information system that is owned, or operated by or for, a contractor and that processes, stores, or transmits covered defense information.

COVERED DEFENSE INFORMATION means unclassified controlled technical information or other information, as described in the Controlled Unclassified Information (CUI) Registry at http://www.archives.gov/cui/registry/category-list.html, that requires safeguarding or dissemination controls pursuant to and consistent with law, regulations, and Government wide policies, and is—

(1) Marked or otherwise identified in the contract, task order, or delivery order and provided to the contractor by or on behalf of DoD in support of the performance of the contract; or

(2) Collected, developed, received, transmitted, used, or stored by or on behalf of the contractor in support of the performance of the contract.

CYBER INCIDENT means actions taken through the use of computer networks that result in a compro-

mise or an actual or potentially adverse effect on an information system and/or the information residing therein.

FORENSIC ANALYSIS means the practice of gathering, retaining, and analyzing computer-related data for investigative purposes in a manner that maintains the integrity of the data.

INFORMATION SYSTEM means a discrete set of information resources organized for the collection, processing, maintenance, use, sharing, dissemination, or disposition of information.

MALICIOUS SOFTWARE means computer software or firmware intended to perform an unauthorized process that will have adverse impact on the confidentiality, integrity, or availability of an information system. This definition includes a virus, worm, Trojan horse, or other code-based entity that infects a host, as well as spyware and some forms of adware.

MEDIA means physical devices or writing surfaces including, but is not limited to, magnetic tapes, optical disks, magnetic disks, large-scale integration memory chips, and printouts onto which covered defense information is recorded, stored, or printed within a covered contractor information system.

OPERATIONALLY CRITICAL SUPPORT means supplies or services designated by the Government as critical for airlift, sealift, intermodal transportation services, or logistical support that is essential to the mobilization, deployment, or sustainment of the Armed Forces in a contingency operation.

RAPIDLY REPORT means within 72 hours of discovery of any cyber incident.

TECHNICAL INFORMATION means technical data or computer software, as those terms are defined in the clause at DFARS 252.227–7013, Rights in Technical Data—Noncommercial Items, regardless of whether or not the clause is incorporated in this solicitation or contract. Examples of technical information include research and engineering data, engineering drawings, and associated lists, specifications, standards, process sheets, manuals, technical reports, technical orders, catalog-item identifications, data sets, studies and analyses and related information, and computer software executable code and source code.

(b) Adequate security

The Contractor shall provide adequate security on all covered contractor information systems. To provide adequate security, the Contractor shall implement, at a minimum, the following information security protections:

(1) For covered contractor information systems that are part of an information technology (IT) service or system operated on behalf of the Government, the following security requirements apply:

(i) Cloud computing services shall be subject to the security requirements specified in the clause 252.239–7010, Cloud Computing Services, of this contract.

(ii) Any other such IT service or system (*i.e.*, other than cloud computing) shall be subject to the security requirements specified elsewhere in this contract.

(2) For covered contractor information systems that are not part of an IT service or system operated on behalf of the Government and therefore are not subject to the security requirement specified at paragraph (b)(1) of this clause, the following security requirements apply:

(i) Except as provided in paragraph (b)(2)(ii) of this clause, the covered contractor information system shall be subject to the security requirements in National Institute of Standards and Technology (NIST) Special Publication (SP) 800–171, "Protecting Controlled Unclassified Information in nonfederal Information Systems and Organizations" (available via the internet at http://dx.doi.org/10.6028/NIST.SP.800–171) in effect at the time the solicitation is issued or as authorized by the Contracting Officer.

(ii)

(A) The Contractor shall implement NIST SP 800–171, as soon as practical, but not later than December 31, 2017. For all contracts awarded prior to October 1, 2017, the Contractor shall notify the DoD Chief Information Officer

(CIO), via email at osd.dibcsia@mail.mil, within 30 days of contract award, of any security requirements specified by NIST SP 800–171 not implemented at the time of contract award.

(B) The Contractor shall submit requests to vary from NIST SP 800–171 in writing to the Contracting Officer, for consideration by the DoD CIO. The Contractor need not implement any security requirement adjudicated by an authorized representative of the DoD CIO to be nonapplicable or to have an alternative, but equally effective, security measure that may be implemented in its place.

(C) If the DoD CIO has previously adjudicated the contractor's requests indicating that a requirement is not applicable or that an alternative security measure is equally effective, a copy of that approval shall be provided to the Contracting Officer when requesting its recognition under this contract.

(D) If the Contractor intends to use an external cloud service provider to store, process, or transmit any covered defense information in performance of this contract, the Contractor shall require and ensure that the cloud service provider meets security requirements equivalent to those established by the Government for the Federal

Risk and Authorization Management Program (FedRAMP) Moderate baseline (https://www.fedramp.gov/resources/documents/) and that the cloud service provider complies with requirements in paragraphs (c) through (g) of this clause for cyber incident reporting, malicious software, media preservation and protection, access to additional information and equipment necessary for forensic analysis, and cyber incident damage assessment.

(3) Apply other information systems security measures when the Contractor reasonably determines that information systems security measures, in addition to those identified in paragraphs (b)(1) and (2) of this clause, may be required to provide adequate security in a dynamic environment or to accommodate special circumstances (e.g., medical devices) and any individual, isolated, or temporary deficiencies based on an assessed risk or vulnerability. These measures may be addressed in a system security plan.

(c) Cyber incident reporting requirement

(1) When the Contractor discovers a cyber incident that affects a covered contractor information system or the covered defense information residing therein, or that affects the contractor's ability to perform the requirements of the contract that are designated as operationally critical support and identified in the contract, the Contractor shall—

(i) Conduct a review for evidence of compromise of covered defense information, including, but not limited to, identifying compromised computers, servers, specific data, and user accounts. This review shall also include analyzing covered contractor information system(s) that were part of the cyber incident, as well as other information systems on the Contractor's network(s), that may have been accessed as a result of the incident in order to identify compromised covered defense information, or that affect the Contractor's ability to provide operationally critical support; and

(ii) Rapidly report cyber incidents to DoD at http://dibnet.dod.mil.

(2) Cyber incident report. The cyber incident report shall be treated as information created by or for DoD and shall include, at a minimum, the required elements at http://dibnet.dod.mil.

(3) Medium assurance certificate requirement. In order to report cyber incidents in accordance with this clause, the Contractor or subcontractor shall have or acquire a DoD–approved medium assurance certificate to report cyber incidents. For information on obtaining a DoD –approved medium assurance certificate, see http://iase.disa.mil/pki/eca/ Pages/index.aspx.

(d) Malicious software

When the Contractor or subcontractors discover and isolate malicious software in connection with a reported cyber incident, submit the malicious

software to DoD Cyber Crime Center (DC3) in accordance with instructions provided by DC3 or the Contracting Officer. Do not send the malicious software to the Contracting Officer.

(e) Media preservation and protection

When a Contractor discovers a cyber incident has occurred, the Contractor shall preserve and protect images of all known affected information systems identified in paragraph (c)(1)(i) of this clause and all relevant monitoring/packet capture data for at least 90 days from the submission of the cyber incident report to allow DoD to request the media or decline interest.

(f) Access to additional information or equipment necessary for forensic analysis

Upon request by DoD, the Contractor shall provide DoD with access to additional information or equipment that is necessary to conduct a forensic analysis.

(g) Cyber incident damage assessment activities

If DoD elects to conduct a damage assessment, the Contracting Officer will request that the Contractor provide all of the damage assessment information gathered in accordance with paragraph (e) of this clause.

(h) DoD safeguarding and use of contractor attributional/proprietary information

The Government shall protect against the unauthorized use or release of information obtained from the contractor (or derived from information obtained from the contractor) under this clause that includes contractor attributional/proprietary infor-

mation, including such information submitted in accordance with paragraph (c). To the maximum extent practicable, the Contractor shall identify and mark attributional/proprietary information. In making an authorized release of such information, the Government will implement appropriate procedures to minimize the contractor attributional/proprietary information that is included in such authorized release, seeking to include only that information that is necessary for the authorized purpose(s) for which the information is being released.

(i) Use and release of contractor attributional/ proprietary information not created by or for DoD

Information that is obtained from the contractor (or derived from information obtained from the contractor) under this clause that is not created by or for DoD is authorized to be released outside of DoD—

(1) To entities with missions that may be affected by such information;

(2) To entities that may be called upon to assist in the diagnosis, detection, or mitigation of cyber incidents;

(3) To Government entities that conduct counterintelligence or law enforcement investigations;

(4) For national security purposes, including cyber situational awareness and defense purposes (including with Defense Industrial Base (DIB) participants in the program at 32 CFR part 236); or

(5) To a support services contractor ("recipient") that is directly supporting Government activi-

ties under a contract that includes the clause at 252.204–7009, Limitations on the Use or Disclosure of Third–Party Contractor Reported Cyber Incident Information.

(j) Use and release of contractor attributional/ proprietary information created by or for DoD

Information that is obtained from the contractor (or derived from information obtained from the contractor) under this clause that is created by or for DoD (including the information submitted pursuant to paragraph (c) of this clause) is authorized to be used and released outside of DoD for purposes and activities authorized by paragraph (i) of this clause, and for any other lawful Government purpose or activity, subject to all applicable statutory, regulatory, and policy based restrictions on the Government's use and release of such information.

(k) The Contractor shall conduct activities under this clause in accordance with applicable laws and regulations on the interception, monitoring, access, use, and disclosure of electronic communications and data.

(l) Other safeguarding or reporting requirements

The safeguarding and cyber incident reporting required by this clause in no way abrogates the Contractor's responsibility for other safeguarding or cyber incident reporting pertaining to its unclassified information systems as required by other applicable clauses of this contract, or as a result of other applicable U.S. Government statutory or regulatory requirements.

(m) Subcontracts

The Contractor shall—

(1) Include this clause, including this paragraph (m), in subcontracts, or similar contractual instruments, for operationally critical support, or for which subcontract performance will involve covered defense information, including subcontracts for commercial items, without alteration, except to identify the parties. The Contractor shall determine if the information required for subcontractor performance retains its identity as covered defense information and will require protection under this clause, and, if necessary, consult with the Contracting Officer; and

(2) Require subcontractors to—

(i) Notify the prime Contractor (or next higher-tier subcontractor) when submitting a request to vary from a NIST SP 800–171 security requirement to the Contracting Officer, in accordance with paragraph (b)(2)(ii)(B) of this clause; and

(ii) Provide the incident report number, automatically assigned by DoD, to the prime Contractor (or next higher-tier subcontractor) as soon as practicable, when reporting a cyber incident to DoD as required in paragraph (c) of this clause.

48 C.F.R. 252.225–7048—Export–Controlled Items (JUN 2013)

As prescribed in 225.7901–4, use the following clause:

(a) Definition

"EXPORT-CONTROLLED ITEMS," as used in this clause, means items subject to the Export Administration Regulations (EAR) (15 CFR Parts 730–774) or the International Traffic in Arms Regulations (ITAR) (22 CFR Parts 120–130). The term includes—

(1) "Defense items," defined in the Arms Export Control Act, 22 U.S.C. 2778(j)(4)(A), as defense articles, defense services, and related technical data, and further defined in the ITAR, 22 CFR Part 120; and

(2) "Items," defined in the EAR as "commodities", "software", and "technology," terms that are also defined in the EAR, 15 CFR 772.1.

(b) The Contractor shall comply with all applicable laws and regulations regarding export-controlled items, including, but not limited to, the requirement for contractors to register with the Department of State in accordance with the ITAR. The Contractor shall consult with the Department of State regarding any questions relating to compliance with the ITAR and shall consult with the Department of Commerce regarding any questions relating to compliance with the EAR.

(c) The Contractor's responsibility to comply with all applicable laws and regulations regarding export-controlled items exists independent of, and is not established or limited by, the information provided by this clause.

(d) Nothing in the terms of this contract adds, changes, supersedes, or waives any of the require-

ments of applicable Federal laws, Executive orders, and regulations, including but not limited to—

(1) The Export Administration Act of 1979, as amended (50 U.S.C. App. 2401, et seq.);

(2) The Arms Export Control Act (22 U.S.C. 2751, et seq.);

(3) The International Emergency Economic Powers Act (50 U.S.C. 1701, et seq.);

(4) The Export Administration Regulations (15 CFR Parts 730–774);

(5) The International Traffic in Arms Regulations (22 CFR Parts 120–130); and (6) Executive Order 13222, as extended.

(e) The Contractor shall include the substance of this clause, including this paragraph (e), in all subcontracts.

SENATE REPORT NO. 99–345
(JULY 28, 1986)

S. Rep. No. 345, 99TH Cong., 2ND Sess. 1986, 1986 U.S.C.C.A.N. 5266, 1986 WL 31937, S. REP. 99-345 (Leg.Hist.) P.L. 99–562, FALSE CLAIMS AMENDMENTS ACT OF 1986 DATES OF CONSIDERATION AND PASSAGE Senate August 11, October 3, 1986 House September 9, October 7, 1986 Senate Report (Judiciary Committee) No. 99–345, July 28, 1986 [To accompany S. 1562] House Report (Judiciary Committee) No. 99–660, June 26, 1986 [To accompany H.R. 4827] Cong. Record Vol. 132 (1986) The Senate bill was passed in lieu of the House bill. The Senate Report is set out below.

The Committee on the Judiciary, to which was referred the bill (S. 1562) to amend the False Claims Act, and title 18 of the United States Code regarding penalties for false claims, and for other purposes, having considered the same, reports favorably thereon with an amendment in the nature of a substitute and recommends that the bill, as amended, do pass.

I. Purpose of the Bill

The purpose of S. 1562, the False Claims Reform Act, is to enhance the Government's ability to recover losses sustained as a result of fraud against the Government. While it may be difficult to estimate the exact magnitude of fraud in Federal programs and procurement, the recent proliferation of cases among some of the largest Government contractors indicates that the problem is severe. This growing pervasiveness of fraud necessitates modernization of the Government's

primary litigative tool for combatting fraud; the False Claims Act (31 U.S.C. 3729, 3730). The main portions of the act have not been amended in any substantial respect since signed into law in 1863. In order to make the statute a more useful tool against fraud in modern times, the Committee believes the statute should be amended in several significant respects.

The proposed legislation seeks not only to provide the Government's law enforcers with more effective tools, but to encourage any individual knowing of Government fraud to bring that information forward. In the face of sophisticated and widespread fraud, the Committee believes only a coordinated effort of both the Government and the citizenry will decrease this wave of defrauding public funds. S. 1562 increases incentives, financial and otherwise, for private individuals to bring suits on behalf of the Government.

The False Claims Reform Act also modernizes jurisdiction and venue provisions, increases recoverable damages, raises civil forfeiture and criminal penalties, defines the mental element required for a successful prosecution and clarifies the burden of proof in civil false claims actions.

II. Background Statement

A. Need for Legislation

Evidence of fraud in Government programs and procurement is on a steady rise. In 1984, the Department of Defense conducted 2,311 fraud investigations, up 30 percent from 1982. Similarly, the Department of Health and Human Services has

nearly tripled the number of entitlement program fraud cases referred for prosecution over the past 3 years.

Detected fraud is, of course, an imprecise measure of how much actual fraud exists. The General Accounting Office in a 1981 study found that 'most fraud goes undetected.'[1] Of the fraud that is detected, the study states, the Government prosecutes and recovers its money in only a small percentage of cases.

Fraud permeates generally all Government programs ranging from welfare and food stamps benefits, to multibillion dollar defense procurements, to crop subsidies and disaster relief programs.[2] While fraud is obviously not limited to any one Government agency, defense procurement fraud has received heightened attention over the past few years. In 1985, the Department of Defense Inspector General, Joseph Sherick, testified that 45 of the 100 largest defense contractors, including 9 of the top 10, were under investigation for multiple fraud offenses.[3] Additionally, the Justice Department has reported that in the last year, four of the largest defense contractors, General Electric, GTE, Rockwell and Gould, have been convicted of criminal offenses while another, General Dynamics, has been indicted and awaits trial.[4]

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[1] GAO Report to Congress, 'Fraud in Government Programs: How Extensive is it? How Can it be Controlled?', 1981.

[2] See *Id.* at 8-15.

[3] Hearings on Federal Securities Laws and Defense Contracting before the Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce, House of Representatives, 99th Congress, 1st session (1985).

[4] Hearings on White Collar Crime before the Senate Committee

No one knows, of course, exactly how much public money is lost to fraud. Estimates from those who have studied the issue, including the General Accounting Office, Department of Justice, and Inspectors General, range from hundreds of millions of dollars to more than $50 billion per year.

The 1981 GAO report on fraud estimated that loss to the Government from 77,000 reported cases over 2 1/2 years would total between $150 and $200 million. But the report went on to note:

> These losses are only what is attributable to known fraud and other illegal activities investigated by the Federal agencies in this study. It does not include, of course, the cost of undetected fraud which is probably much higher because weak internal controls allow fraud to flourish.[5]

The Department of Justice has estimated fraud as draining 1 to 10 percent of the entire Federal budget.[6] Taking into account the spending level in 1985 of nearly $1 trillion, fraud against the Government could be costing taxpayers anywhere from $10 to $100 billion annually.

In the Defense Department procurement budget alone, we may be losing anywhere from $1 to $10 billion

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on the Judiciary, 99th Congress, 2d session (1985).

[5] GAO Report, at 1.

[6] Hearings on the Departments of State, Justice and Commerce before the Subcommittee on the Departments of State, Justice and Commerce, the Judiciary and Related Agencies of the House Committee on Appropriations, 96th Congress, 2d session (1980).

if the Justice Department estimate is accurate. Defense Department Inspector General Joseph Sherick estimated that DOD loses more than $1 billion just from fraudulent billing practices.[7]

The cost of fraud cannot always be measured in dollars and cents, however. GAO pointed out in its 1981 report that fraud erodes public confidence in the Government's ability to efficiently and effectively manage its programs.[8] Even in the cases where there is no dollar loss—for example where a defense contractor certifies an untested part for quality yet there are no apparent defects—the integrity of quality requirements in procurement programs is seriously undermined. A more dangerous scenario exists where in the above example the part is defective and causes not only a serious threat to human life, but also to national security.

Fraud is perhaps so pervasive and, therefore, costly to the Government due to a lack of deterrence. GAO concluded in its 1981 study that most fraud goes undetected due to the failure of Governmental agencies to effectively ensure accountability on the part of program recipients and Government contractors. The study states:

> For those who are caught committing fraud, the chances of being prosecuted and eventually going to jail are slim . . . The sad

[7] Hearings on Federal Securities Laws and Defense Contracting before the Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce, House of Representatives, 99th Congress, 1st session (1985).

[8] GAO Report, at 19.

> truth is that crime against the Government often does pay.[9]

Many changes have been made since 1981 which have brought about some encouraging improvements in the Government's efforts against fraud. With the inception of Inspectors General, an increased number of fraud allegations are being addressed. However, available Department of Justice records show most fraud referrals remain unprosecuted and lost public funds, therefore, remain uncollected.[10]

In 1984, the Economic Crime Council of the Department of Justice targeted two major Federal programs—defense procurement and health care benefits—as economic crime areas in which stronger enforcement and deterrence were needed. In the Council's April, 1985 report to the Attorney General, it concluded that while some progress had been made, the level of enforcement in defense procurement fraud remains inadequate.[11]

Through hearings and research on Government fraud, the Committee has sought and is continuing to seek out the reasons why fraud in Government programs is so pervasive yet seldom detected and

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[9] GAO Report, at cover.

[10] Department of Justice Civil Division records show 2,850 fraud referrals in fiscal year 1984 and just 21 complaints filed and 70 settlements or judgments. In fiscal year 1985, the Division received 2,734 fraud referrals, filed 36 complaints and obtained 54 settlements or judgments.

[11] Report of the Economic Crime Council to the Attorney General, 'Investigation and Prosecution of Fraud in Defense Procurement and Health Care Benefits Programs', April 30, 1985.

rarely prosecuted. It appears there are serious roadblocks to obtaining information as well as weaknesses in both investigative and litigative tools. In an effort to correct some of those weaknesses, the Committee has reviewed the Government's remedies against false claims and developed the legislative improvements embodied in S. 1562.

The False Claims Act currently permits the United States to recover double damages plus $2,000 for each false or fraudulent claim. Enacted in 1863 in response to cases of contractor fraud perpetrated on the Union Army during the Civil War, this statute has been used more than any other in defending the Federal treasury against unscrupulous contractors and grantees. Although the Government may also pursue common law contract remedies, the False Claims Act is a much more powerful tool in deterring fraud.

Since the act was last amended in 1943, several restrictive court interpretations of the act have emerged which tend to thwart the effectiveness of the statute. The Committee's amendments contained in S. 1562 are aimed at correcting restrictive interpretations of the act's liability standard, burden of proof, *qui tam* jurisdiction and other provisions in order to make the False Claims Act a more effective weapon against Government fraud.

Detecting fraud is usually very difficult without the cooperation of individuals who are either close observers or otherwise involved in the fraudulent activity. Yet in the area of Government fraud, there appears to be a great unwillingness to expose illegalities.

In 1983, the U.S. Merit Systems Protection Board conducted a survey of approximately 5,000 Federal Government employees to determine to what extent observed fraud, waste, and abuse was going unreported. The Merit Systems Board reported that 69 percent of those who believed they had direct knowledge of illegalities failed to report the information. Those employees who chose not to report fraud were then asked why they failed to come forward. The most frequently cited reason given (53 percent) was the belief that nothing would be done to correct the activity even if reported. Fear of reprisal was the second most cited reason (37 percent) for nonreporting.[12]

In hearings before the Subcommittee on Administrative Practice and Procedure, individuals who had 'blown the whistle' on their Government contractor employers offered several reasons for what one termed the 'conspiracy of silence' among contractor employees.[13]

Robert Wityczak, a triple-amputee veteran who exposed mischarging practices at Rockwell International, said his 'ethical principles' were tested to the limit when faced with the difficult choice of either keeping quiet about mischarging he witnessed or risking the loss of his job.

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[12] 'Blowing the Whistle in the Federal Government', Report of the United States Merit Systems Protection Board, Oct. 1984.

[13] Hearing on S. 1562, the False Claims Reform Act, before the Subcommittee on Administrative Practice and Procedure of the Senate Committee on the Judiciary, 99th Congress, 1st session, September 17, 1985.

I agonized over my decision to step forward. I have a wife, five children and a house mortgage * * * Yet once I made the decision to tell the truth about what was going on, I found no one inside or outside the company willing to act on the information.[14]

Wityczak said his initial efforts to report the mischarging started what was to result in a long-term harassment campaign by his superiors which finally resulted in Wityczak being discharged. Wityczak said:

> I told my supervisors * * * I would no longer mischarge on my time cards. They reacted angrily, calling me antimanagement, anti-Rockwell, and a pain in the ass * * * Gradually, I was squeezed out of the work I was doing. I was stripped of my confidential security, my access to documents was limited, I was excluded from meetings and was put to work doing menial tasks outside my job description, such as sweeping, making coffee and cleaning a 50 gallon coffee pot.[15]

Wityczak said he has concluded not only from his own experience but from talking to his fellow workers that there is 'absolutely no encouragement or incentive' for individuals working in the defense industry to report fraud. Instead, he said, there is a great disincentive due to employer harassment and retaliation. 'Contractor employees are generally all for exposing fraud, but most individuals just simply

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14 *Id.* at 80.

15 *Id.* at 81.

cannot and will not put their head on the chopping block,' Wityczak said.[16]

Wityczak's comments were echoed by Mr. John Gravitt, another witness who testified in regard to time card mischarging at a General Electric plant in Ohio. Gravitt agreed that most individuals working in defense contractor plants are afraid to expose fraud. Gravitt also pointed out that without cooperating employees, Government auditors would rarely detect abuses. Gravitt explained that notice of an impending audit normally travels through the contractor plant 'like wildfire' and 'everybody straightens up their act.' Wityczak said his experience with Government audits was similar in that all departments were put on 'red alert' when auditors came through.[17]

The Committee believes changes are necessary to half the so-called 'conspiracy of silence' that has allowed fraud against the Government to flourish. John Phillips, co-director of the Center for Law in the Public Interest, a nonprofit law firm specializing in assisting 'whistleblowers', testified that more effective fraud detection will only occur if changes are made at the basic employee level. Phillips said people who are unwilling participants in fraudulent activity must be given an opportunity to speak up and take action without fear and with some assurance their disclosures will lead to results.[18]

Hearing testimony also suggested that the collection of information which leads to successful

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[16] *Id.* at 85.

[17] *Id.* at 82.

[18] *Id.* at 87.

fraud recoveries is hampered by the Government's inadequate investigative tools. Justice Department witnesses stated that as in all complex white-collar fraud matters, investigative tools are critical to successful prosecutions. Mr. Jay Stephens, Associate Deputy Attorney General, testified that in civil false claims cases the Department's civil attorneys rely in large part on FBI reports and information gathered by the various Inspectors General,[19] but that civil investigative capacity is often hampered, however, in two ways. First, the civil attorneys themselves have no authority to compel production of documents or depositions prior to filing suit. Currently, some cases are weeded out and not filed because information is missing—information that might have turned up through pre-suit investigation if the tools were available.[20]

Second, information is often incomplete due to the existence of a prior grand jury investigation resulting in evidence protected by Rule 6(e) of the Federal Rules of Criminal Procedure. On June 30, 1983, the Supreme Court ruled in *United States v. Sells Engineering, Inc.*, 103 S. Ct. 3133[20a] (1983), that Department of Justice attorneys handling civil cases are not 'attorneys for the government' for the purposes of Rule 6(e) of the Federal Rules of Criminal Procedure. Therefore, they may not obtain grand jury materials that pertain to their cases without a court order; and such an order may be

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19 *Id.* at 39.

20 *Id.* at 39.

20a 463 U.S. 418, 77 L.Ed.2d 743.

granted only upon a showing of 'particularized need.' The court further held that the 'particularized need' standard was not satisfied by a showing that non-disclosure would cause lengthy delays in litigation or would require substantial duplication of an investigation already conducted by the Government using scarce investigative and audit resources.

Compounding the investigative problems are also various litigative hurdles. As a civil remedy designed to make the Government whole for fraud losses, the civil False Claims Act currently provides that the Government need only prove that the defendant knowingly submitted a false claim. However, this standard has been construed by some courts to require that the Government prove the defendant had actual knowledge of fraud, and even to establish that the defendant had specific intent to submit the false claim,[21] for example, *United States v. Aerodex, Inc.*, 469 F.2d 1003 (5th Cir. 1972). The Committee believes this standard is inappropriate in a civil remedy and presently prohibits the filing of many civil actions to recover taxpayer funds lost to fraud.

The Committee's interest is not only to adopt a more uniform standard, but a more appropriate standard for remedial actions. Currently, in judicial districts observing an 'actual knowledge' standard, the Government is unable to hold responsible those corporate officers who insulate themselves from knowledge of false claims submitted by lower-level subordinates. This 'ostrich-like' conduct which can

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[21] *Id.* at 34.

occur in large corporations poses insurmountable difficulties for civil false claims recoveries.

The Committee is firm in its intention that the act not punish honest mistakes or incorrect claims submitted through mere negligence. But the Committee does believe the civil False Claims Act should recognize that those doing business with the Government have an obligation to make a limited inquiry to ensure the claims they submit are accurate.

The burden of proof in civil false claims cases has also evolved through caselaw into an ambiguous standard. Some courts have required that the United States prove a violation by clear and convincing, or even clear, unequivocal and convincing evidence, *United States v. Ueber*, 299 F.2d 310 (6th Cir. 1962), which the Justice Department has testified is the 'functional equivalent of a criminal standard.'[22]

In addition to detection, investigative and litigative problems which permit fraud to go unaddressed, perhaps the most serious problem plaguing effective enforcement is a lack of resources on the part of Federal enforcement agencies. Unlike most other types of crimes or abuses, fraud against the Federal Government can be policed by only one body —the Federal Government. State and local law enforcement are normally without jurisdiction where Federal funds are involved.

Taking into consideration the vast amounts of Federal dollars devoted to various complex and highly regulated assistance and procurement programs, Federal auditors, investigators, and attorneys

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22 *Id.* at 35.

are forced to make 'screening' decisions based on resource factors.[23] Allegations that perhaps could develop into very significant cases are often left unaddressed at the outset due to a judgment that devoting scarce resources to a questionable case may not be efficient. And with current budgetary constraints, it is unlikely that the Government's corps of individuals assigned to anti-fraud enforcement will substantially increase.

An additional problem noted by hearing witnesses, exists when large, profitable corporations are the subject of a fraud investigation and able to devote many times the manpower and resources available to the Government. This resource mismatch was recognized by DOD Inspector General Joseph Sherick who said that in far too many instances the Government's enforcement team is overmatched by the legal teams major contractors retains.[24]

The Committee believes that the amendments in S. 1562 which allow and encourage assistance from the private citizenry can make a significant impact on bolstering the Government's fraud enforcement effort. The idea of private citizen aid in false claims actions is, of course, not a new one, but dates back to the original enactment of the False Claims Act in 1863. Additionally, in other areas of enforcement such as antitrust and securities violations, the number of

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[23] Hearings on Defense Procurement Fraud Law Enforcement before the Subcommittee on Administrative Practice and Procedure of the Senate Committee on the Judiciary, 99th Congress, 1st session (1985).

[24] *Id.* at 18.

private enforcement actions far exceeds those brought by the Government.[25]

B. History of the False Claims Act and Court Interpretations

The False Claims Act was adopted in 1863 and signed into law by President Abraham Lincoln in order to combat rampant fraud in Civil War defense contracts. Originally the act provided for both civil and criminal penalties assessed against one who was found to knowingly have submitted a false claim to the Government. The civil penalty provided for payment of double the amount of damages suffered by the United States as a result of the false claim, plus a $2,000 forfeiture for each claim submitted.

In its present form, the False Claims Act empowers the United States to recover double damages from those who make, or cause to be made, false claims for money or property upon the United States, or who submit false information in support of claims. In addition the United States may recover one $2,000 forfeiture for each false claim submitted in support of a claim. The imposition of this forfeiture is automatic and mandatory for each claim which is found to be false. The United States is entitled to recover such forfeitures solely upon proof that false claims were made, without proof of any damages. *Fleming v. United States*, 336 F.2d 475, 480 (10th Cir. 1964), *cert. denied*, 380 U.S. 907 (1965). A forfeiture may be recovered from one who submits a false claim though no payments were

[25] See United States Department of Justice Source Book of Criminal Justice Statistics, 1981 at 431.

made on the claim. *United States v. American Precision Products Corp.*, 115 F. Supp. 823 (D. N.J. 1953). The False Claims Act reaches all parties who may submit false claims. The term 'person' is used in its broad sense to include partnerships, associations, and corporations—*United States v. Hanger One, Inc.*, 563 F.2d 1155, 1158 (5th Cir. 1977); *United States v. National Wholesalers, Inc.*, 236 F.2d 944 (9th Cir. 1956)—as well as States and political subdivisions thereof. *Cf. Ohio v. Helvering*, 292 U.S. 360, 370 (1934); *Georgia v. Evans*, 316 U.S. 153, 161 (1942); *Monell v. Department of Social Services of the City of New York*, 436 U.S. 658[25a] (1978).

The False Claims Act is intended to reach all fraudulent attempts to cause the Government to pay our sums of money or to deliver property or services. Accordingly, a false claim may take many forms, the most common being a claim for goods or services not provided, or provided in violation of contract terms, specification, statute, or regulation. For example, *United States v. Bornstein*, 423 U.S. 303[26] (1976); *United States v. National Wholesalers*, 236 F.2d 944 (9th Cir. 1956), *cert. denied*, 353 U.S. 930 (1957); *Henry v. United States*, 424 F.2d 677 (5th Cir. 1970). A false claim for reimbursement under the Medicare, Medicaid or similar program is actionable under the act, *Peterson v. Weinberger, supra*, as is a false application for a loan from a Government agency, *United States v. Neifert-White Co.*, 390 U.S. 228 (1968), or a false claim in connection with a sale financed by the Agency for International Develop-

[25a] 98 S.Ct. 2018, 56 L.Ed.2d 611.

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ment or Export-Import Bank, *United States v. Chew*, 546 F.2d 309 (9th Cir. 1978), and such claims may be false even though the services are provided as claimed if, for example, the claimant is ineligible to participate in the program, or though payments on the Government loan are current, if by means of false statements the Government was induced to lend an inflated amount. A false claim may take other forms, such as fraudulently cashing a Government check, which was wrongfully or mistakenly obtained. *United States v. Veneziale*, 268 F.2d 504 (3rd Cir. 1956). A fraudulent attempt to pay the Government less than is owed in connection with any goods, services, concession, or other benefits provided by the Government is also a false claim under the act. See *Smith v. United States*, 287 F.2d 299 (5th Cir. 1961); *United States v. Garder*, 73 F. Supp. 644 (N.D. Ala. 1947). For example, the Committee considers a false application for reduced postal rates to be a false claim for postal services, and agrees with the well-reasoned decision in *United States ex rel. Rodriguez v. Weekly Publications, Inc.*, 68 F. Supp. 767, 770 (S.D. N.Y. 1946), that whether such benefits are received by means of a reduction in the amount paid by the Government or by means of subsequent claims for reimbursement is a matter of bookkeeping rather than of substance, and therefore, rejects the contrary result reached in *United States v. Marple Community Record, Inc.*, 335 F. Supp. 95 (E.D. Pa. 1971); see also, *United States v. Howell*, 318 F.2d 162 (9th Cir. 1963).

Each separate bill, voucher or other 'false payment demand' constitutes a separate claim for which a forfeiture shall be imposed, see, for example,

United States v. Bornstein, 423 U.S. 303[25b] (1976), *United States v. Collyer Insulated Wire Co.*, 94 F. Supp. 493 (D.R.I. 1950), and this is true although many such claims may be submitted to the Government at one time. For example, a doctor who completes separate Medicare claims for each patient treated will be liable for a forfeiture for each such may be submitted to the entries even though several such forms may be submitted to the fiscal intermediary to one time. Likewise, each and every claim submitted under a contract, loan guarantee, or other agreement which was originally obtained by means of false statements or other corrupt or fraudulent conduct, or in violation of any statute or applicable regulation, constitutes a false claim. For example, all claims submitted under a contract obtained through collusive bidding are false and actionable under the act—*Murray & Sorenson, Inc. v. United States*, 207 F.2d 119 (1st Cir. 1953); *United States ex rel. Marcus v. Hess*, 317 U.S. 537 (1943)—as are all Medicare claims submitted by or on behalf of a physician who is ineligible to participate in the program. *Peterson v. Weinberger, supra*.

A claim upon any Government agency or instrumentality, quasi-governmental corporation, or nonappropriated fund activity is a claim upon the United States under the act. In addition, a false claim is actionable although the claims or false statements were made to a party other than the Government, if the payment thereon would ultimately result in a loss to the United States. *United States v. Lagerbusch*, 361 F.2d 449 (3rd Cir. 19666); *Murray &*

[25b] 96 S.Ct. 523, 46 L.Ed.2d 514.

Sorenson, Inc. v. United States, 207 F.2d 119 (1st Cir. 1953). For example, a false claim to the recipient of a grant from the United States or to a State under a program financed in part by the United States, is a false claim to the United States. See, for example, *United States ex rel. Marcus v. Hess*, 317 U.S. 537 (1943); *United States ex rel. Davis v. Long's Drugs*, 411 F. Supp. 1114 (S.D. Cal. 1976).

The original False Claims Act also contained a provision allowing private persons, or 'relators', to bring suit under the act. After providing for general subject matter jurisdiction and venue for all actions brought under the act, the statute provided that a suit 'may be brought and carried on by any person, as well for himself as for the United States.' The 1863 law, R.S. 3492, provided that:

> the (action) shall be at the sole cost and charge of such person, and shall be in the name of the United States, but shall not be withdrawn or discontinued without the consent, in writing, of the judge of the court and the district attorney, first filed in the case, setting forth their reasons for such consent.

The original statute also provided that the private relator who prosecuted the case to final judgment would be entitled to one half of the damages and forfeitures recovered and collected. If successful, the relator would also be entitled to an award of his costs.

Therefore, under the provisions of the original act, suits to redress fraud against the Government could be instituted as easily by a private individual,

as by the Government's representative. Moreover, once the action was commenced by the relator, no one could interfere with its prosecution. The act contained no provision for the Government to take over the action and, in fact, the relator's interest in the action was viewed, at least in one instance, as a property right which could not be divested by the United States if it attempted to settle the dispute with the defendant. *United States v. Griswold*, 30 Fed. Reg. 762 (Cir. Ct., D. Ore. 1887).

In the early 1940s, several *qui tam* actions were brought regarding World War II defense procurement fraud. Some suits brought by private citizens appeared to be based on criminal indictments brought by the Government. In one such suit, *United States ex rel Marcus v. Hess*, 317 U.S. 537 (1943), the Government contended that an action brought by an informer who based his civil action on a criminal indictment should be barred under the provisions of the False Claims Act because he brought no information of his own to the suit, thereby thwarting the spirit of the act. The Government also contended that such suits created a race to the courthouse between the Government's civil lawyers and private parties, and infringed upon the Attorney General's control over criminal and civil fraud actions. The Court rejected the Government's contentions and ruled that the statute, as then written, did not require the relator to bring original information to the suit or that the Attorney General should have exclusive control over the Government's civil fraud litigation. Writing for the Court, Justice Black stated that *qui tam* suits have been 'frequently permitted by

legislative action and have not been without defense by the courts.' *Id.* at 541.

Justice Black also referred to an earlier decision, *United States v. Griswold*, 24 F. 361, 366 (D. Ore. 1885) in which the Court said:

> The statute is a remedial one. It is intended to protect the Treasury against the hungry and unscrupulous host that encompasses it on every side, and should be construed accordingly. It was passed upon the theory, based on experience as old as modern civilization, that one of the least expensive and most effective means of preventing frauds on the Treasury is to make the perpetrators of them liable to actions by private persons acting, if you please, under the strong stimulus of personal ill will or the hope of gain. Prosecutions conducted by such means compare with the ordinary methods as the enterprising privateer does to the slow-going public vessel.

The factual issue of whether the private relator in *Marcus v. Hess* had actually performed an independent investigation or merely copied a criminal indictment in order to bring his suit, was never reached by the Court. The Court did fund that:

> Even if * * * the petitioner has contributed nothing to the discovery of this crime, he has contributed much to accomplishing one of the purposes for which the Act was passed. The suit results in a net recovery to the government of $150,000, three times as much as fines imposed in the criminal pro-

ceedings. *Id.* at 545.

The *Marvus v. Hess* decision prompted then Attorney General Francis Biddle to request that Congress repeal the *qui tam* provisions of the act. The House of Representatives passed repeal legislation, but the Senate passed an amendment to the House bill providing for the retention of *qui tam* suits, with restrictions. The Senate debated at length regarding the advisability of leaving all Government fraud cases solely in the hands of the Attorney General. Senator Langer of North Dakota vehemently objected to any amendments to the *qui tam* law, citing Government delay in fraud cases and resource constraints for adequate enforcement. Langer argued:

> I submit that the present statute now on the books is a most desirable one. What harm can there be if 10,000 lawyers in America the assisting the Attorney General of the United States in digging up war frauds? In any case, the Attorney General can protect himself by filing a (civil) lawsuit at the time when he files the indictment. 89 Cong. Rec. 7607 (Sept. 17, 1943).

The Senate specifically provided that jurisdiction would be barred on *qui tam* suits based on information in the possession of the Government unless the relator was the original source of that information. Without explanation, the resulting conference report dropped the clause regarding original sources of allegations and courts have since adopted a strict interpretation of the jurisdictional bar as precluding any *qui tam* suit based on information in the Government's possession, despite the source. That jurisdic-

tional bar, however, has been applied only to private *qui tam* suits, and not those suits taken over by the Government. *United States v. Pittman*, 151 F.2d 851 (5th Cir. 1946).

Despite considerable judicial adherence to the plain language of the jurisdictional bar in the statute, it is unclear whether Congress fully understood the clause that had been fashioned through the conference committee compromise. Senator Van Nuys who was chairman of the Senate Judiciary Committee which proposed the Senate amendments and who also served on the conference committee, stated in floor debate that the proposal 'protects the honest informer as nearly we can do it by statute (and) * * * would not prevent an honest informer from coming in.' 89 Cong. Rec. 7609 (1943). Similarly, Representative William Kefauver in summarizing the final proposal on the House floor stated, '(If) the average, good American citizen * * * has the information and he gives it to the Government, and the Government does not proceed in due course, provision is made here where he can get some compensation.' 89 Cong. Rec. 10846 (1943).

The conference committee bill went on to provide that in the event the Government took over an action brought by a relator, the Court could award, out of the proceeds collected, fair and reasonable compensation, not to exceed 10 percent of the proceeds, to the relator for his disclosure of information and evidence not in the possession of the United States when the suit was brought. In suits not carried on by the United States, the court could award the person who brought the action and prosecuted it up to 25 percent of the proceeds.

The conference report was accepted by both House of Congress without amendment, and signed by President Roosevelt on Dec. 21, 1943. The provisions of the statute were codified at 31 U.S.C. 232 which has recently been recodified along with the entirely of the False Claims Act at 31 U.S.C. 3729-3731.

The jurisdictional bar prohibiting suits based on information in the possession of the Government has been invoked several times over the past four decades. Once a *qui tam* litigant has been found an improper relator due to this jurisdictional bar, he is no longer a part of the litigation and is precluded not only from receiving a portion of the proceeds, but also forfeits any rights to challenge the Government's 'reasonable diligence' or object to settlements and dismissals. Courts have also found the jurisdictional bar to apply even if the Government makes no effort to investigate or take action after the original allegations were received, *United States ex rel Lapin v. International Business Machines Corp.*, 490 F. Supp. 244 (D. Hi. 1980).

Additionally, in *United States ex rel State of Wisconsin v. Dean*, 729 F.2d 1100 (7th Cir. 1984), the Court refused to allow the State of Wisconsin to act as a *qui tam* relator in a Medicaid fraud action even though the investigation had been conducted solely by the State of Wisconsin. The Court found that the Federal Government was in possession of the information due to the State disclosures of the fraud to the Department of Health and Human Services. The State was required to make such disclosures under Federal law government Medicare programs. Interestingly, the Federal Government in this case

not only declined to intervene and take over the suit, but filed a brief with the Court indicating its belief that Wisconsin was a proper relator. In rejecting the views of both the Federal Government and the State of Wisconsin, the Court noted that:

> If the State of Wisconsin desires a special exemption to the False Claims Act because of its requirement to report Medicaid fraud to the federal government, then it should ask Congress to provide the exemption. *Id.* at 1106.

The National Association of Attorneys General adopted a resolution in June of 1984 stating that 'to prohibit sovereign states from becoming *qui tam* plaintiffs because the U.S. Government was in possession of information provided to it by the State and declines to intercede in the State's lawsuit, unnecessarily inhibits the detection and prosecution of fraud on the Government.' The resolution goes on to strongly urge that Congress amended the False Claims Act to rectify the unfortunate result of the *Wisconsin v. Dean* decision.

III. History of S. 1562

The False Claims Reform Act, S. 1562, which was introduced on August 1, 1985 by Senators Charles E. Grassley (R, Ia.), Dennis DeConcini (D, Az.), and Carl Levin (D, Mich.), contains in large part amendments to the False Claims Act first proposed by the U.S. Department of Justice in 1979 and once again in the Department's Anti-Fraud Enforcement Package announced by Attorney General Edwin Meese III in September of 1985. As reported by the Committee, S. 1562 amends the civil False Claims

Act, 31 U.S.C. 3729 and 3730, to increase forfeiture and damages for those found liable by a 'preponderance of the evidence'. The standard for liability is clarified as one who 'knows or has reason to know' that the claim submitted to the Government is false. The bill also allows a *qui tam*, or private citizen relator, increased involvement in suits brought by the relator but litigated by the Government. Additionally, the relator could receive up to 30 percent of any judgment arising from his suit and is afforded protection from retaliation for his actions.

Senator DeConcini had sponsored a related measure, S. 1981, in the 96th Congress. While that legislation was reported favorably by the Senate Judiciary Committee in 1980, it failed to receive consideration by the full Senate before the adjournment of the 96th Congress. Evidence of rampant fraud in Government programs since that time has renewed the effort to legislate a more effective statute.

On September 17, 1985, the Senate Judiciary Committee's Subcommittee on Administrative Practice and Procedure held a hearing on S. 1562 and S. 1673, a similar bill proposed by the administration. Testifying at that hearing were Jay Stephens, Associate Deputy Attorney General, Department of Justice accompanied by Stuart E. Schiffer, Deputy Assistant Attorney General for the Civil Division, Department of Justice; John R. Phillips, Co-Director, Center for Law in the Public Interest; D. Wayne Silby, Business Executives for National Security; and three individuals, Mr. John Michael Gravitt; Mr. James B. Helmer, Jr.; and, Mr. Robert Wityczak.

All of these witnesses expressed strong support for amendments to the False Claims Act. Mr. John

Phillips, testifying on behalf of the Center for Law in the Public Interest, focused his remarks on the necessity for enhancing the *qui tam* provisions under the False Claims Act, saying that an effective vehicle for private individuals to disclose fraud is necessary both for meaningful fraud deterrence and for breaking the current 'conspiracy of silence' among Government contractor employees.

Two individuals who had exposed mischarging at defense contractor plants also expressed support for the amendments contained in S. 1562. Mr. John Gravitt, who filed a *qui tam* false claims suit against General Electric, testified that the changes in S. 1562 were necessary to encourage workers directed to participate in fraudulent schemes to expose that wrongdoing. Mr. Robert Wityczak, a former Rockwell International employee who also exposed falsification of time cards, stated that the false claims reforms in S. 1562 are imperative 'to encourage employees like myself who know firsthand of fraudulent misconduct to step forward.'

Mr. D. Wayne Silby, testifying on behalf of Business Executives for National Security, said the business association supports S. 1562 because the bill 'is supportive of improved integrity in military contracting. The bill adds no new layers of bureaucracy, new regulations, or new Federal police powers. Instead, the bill takes the sensible approach of increasing penalties for wrongdoing, and rewarding those private individuals who take significant personal risks to bring such wrongdoing to light.'

Mr. Jay Stephens, testifying for the Justice Department, stated that the Department was very supportive of False Claims Act reforms and would

recommend the consideration of supplemental provisions included in the administration-proposed S. 1673. Additionally, Stephens expressed some concern regarding the broadness of the *qui tam* amendments contained in S. 1562, but added that the Justice Department was willing to work with the Committee on developing a 'practical solution' for legislation giving 'long overdue weapons to deal with the problem of fraud.'

In response to Justice Department concerns, S. 1562, and specifically the *qui tam* provision, was significantly revised at the subcommittee level and a substitute bill was reported favorably to the full Judiciary Committee on November 7, 1985. The S. 1562 substitute contained several provisions adopted from S. 1673:

First, the original constructive knowledge standard defined as 'acting in reckless disregard of the truth' was changed to the S. 1673 definition of 'reason to know that the claim or statement was false or fictitious.' While the two definitions are very similar, the Justice Department suggested that the definition from S. 1673 provided greater clarity and was better crafted to address the problem of the 'ostrich-like' refusal to learn of information which an individual, in the exercise of prudent judgment, had reason to know.

Second, the subcommittee adopted a provision allowing the full litigation of False Claims Act counterclaims asserted against an offender who initiates a case in U.S. Claims Court.

Third, the subcommittee added a provision permitting the United States to bring an action against a

member of the armed forces, as well as civilian employees. The military has been excluded from False Claims Act liability since 1863 when the Government had available more severe military remedies. The subcommittee agreed, however, that military code remedies are inadequate to ensure full recoveries for fraudulent acts by servicepersons and such persons should therefore not be exempt from False Claims Act coverage.

Fourth, the subcommittee added a clarification that an individual who makes a material misrepresentation to avoid paying money owed the Government should be equally liable under the Act as if he had submitted a false claim. The Justice Department testified that recent court rulings had produced an ambiguity as to whether such 'reverse false claims' were covered by the False Claims Act, and the subcommittee agreed that such matters should be addressable under the Act.

Fifth, the subcommittee added a new uniform remedy to permit the Government to seek preliminary injunctive relief to bar a defendant from transferring or dissipating assets pending the completion of a false claims action. Currently, the Government's prejudgment attachment remedies are governed by State law and the subcommittee agreed that a uniform Federal standard would significantly enhance the Government's remedies as well as avoid inconsistent results.

Sixth, the subcommittee adopted a provision allowing the Federal Government to sue under the False Claims Act to prosecute frauds perpetrated on certain grantees, States and other recipients of Federal financial assistance. A recent decision, *United*

States v. Azzarelli Construction Co., 647 F.2d 757 (7th Cir. 1981), created some confusion with respect to whether the Federal Government may recover in grant cases where the Federal contribution is a fixed sum. The subcommittee agreed with the Justice Department's recommendation that it be made clear the United States may bring an action whether the grant obligation is open-ended or fixed.

Seventh, the subcommittee added a modification of the statute of limitations to permit the Government to bring an action within 6 years of when the false claim is submitted (current standard) or within 3 years of when the Government learned of a violation, whichever is later. The subcommittee agreed that because fraud is, by nature, deceptive, such tolling of the statute of limitations is necessary to ensure the Government's rights are not lost through a wrongdoer's successful deception.

Eighth, the subcommittee adopted a provision granting Civil Investigative Demand, or CID, authority to the Justice Department Civil Division to aid in the investigation of False Claims Act cases. The subcommittee noted that the CID authority from S. 1673 is nearly identical to that available to the Antitrust Division under the Hart-Scott-Rodino Act of 1976, 15 U.S.C. 1311-1314. The subcommittee agreed with the Justice Department suggestion to add this carefully crafted investigative tool in an effort to produce more efficient and complete Government investigations.

Finally, the subcommittee agreed to several changes in the *qui tam* provisions of S. 1562:

First, in response to Justice Department

> concerns that *qui tam* complaints filed in open court might tip off targets of ongoing criminal investigations, the subcommittee adopted a 60-day seal provision for all *qui tam* complaints.
>
> Second, the Justice Department expressed concerns that the broadening of *qui tam* provisions under S. 1562 might provoke a greater number of frivolous suits and specifically a greater number of actions filed merely for political purposes. The subcommittee agreed to an amendment which limits the application of *qui tam* suits against political officials to only those cases involving information not already in the government's possession. As a further prevention of frivolous actions, the subcommittee adopted attorneys fees sanctions to be charged against any *qui tam* plaintiff who brings a clearly frivolous or vexatious suit. Additionally, the subcommittee amendment specifically provides that where an action appears to be brought in bad faith the court may half the litigation pending assurances that the *qui tam* plaintiff can make payment of any legal fees and expenses the court may award.

Also in response to Department of Justice concerns that three levels of *qui tam* award portions would provoke additional litigation, the subcommittee adopted a simplified two-tier approach allowing 10-20 percent awards if the Government takes over the action and 20-30 percent if the *qui tam* plaintiff proceeds alone. In addition, so as to prevent any 'wind-

falls' for persons who may not have had direct involvement with investigating or exposing alleged false claims that are the basis of a *qui tam* suit, in the very limited area where the *qui tam* action is brought at least 6 months after a public disclosure, the Government has failed to act, and the suit succeeds, the individual who brought the action would only receive 'up to 10 percent' depending on his role in advancing the case to litigation.

The subcommittee substitute also added a provision authorizing the Attorney General to grant awards to informants who contribute to successful false claims suits. And finally, in response to comments from the National Association of Attorneys General, the subcommittee adopted a provision allowing State and local governments to join State law actions with False Claims Act actions brought in Federal district court if such actions grow out of the same transaction or occurrence.

On November 7, the Subcommittee on Administrative Practice and Procedure met and voted to report favorably to the full Senate Judiciary Committee S. 1562 as amended by a subcommittee substitute offered by Chairman Grassley. The subcommittee voted 4 to 0 to report S. 1562 with Chairman Grassley and Senators Heflin, Specter and East voting in favor of the bill.

While the original S. 1562, as well as the subcommittee substitute, contained amendments to Rule 6(e) of the Federal Rules of Criminal Procedure regarding access to grand jury information, Chairman Grassley announced at the November 7 markup that the full Senate Judiciary Committee would be addressing that issue separately and that Rule

6(e) amendments would be removed from S. 1562. On December 14, 1985, the full Senate Judiciary Committee voted by unanimous consent to favorably report S. 1562 to the Senate floor with the following amendments which came in response to suggestions offered by other Committee members and then offered by Senator Grassley:

> First, as already noted, grand jury access amendments were removed.
>
> Second, language was added to further define the constructive knowledge definition so that it paralleled that found in S. 1134, the Program Fraud and Civil Penalties Act as reported favorably from the Governmental Affairs Committee. While the standards were already ready very similar, S. 1134 contained further clarifying language and the Committee thought it unwise to allow the possibility of confusion and the lack of a uniformly applied standard in administrative and judiciary civil false claims actions.
>
> Third, the Committee adopted new language under the whistleblower protection provision to ensure that remedies afforded under the act will not be abused by employees acting in bad faith or who are discharged, demoted, etc. for legitimate reasons unrelated to any whistleblowing activity.

And finally, the CID authority was amended to require that other agencies seeking access to information obtained through CIDs must demonstrate to the appropriate Federal district court that they have

a 'substantial need' for the information rather than allowing the Justice Department alone to determine outside agency access.

IV. Section-by-Section Analysis

Section 1

Section 1 of the bill amends section 3729 of title 31, United States Code, in several respects.

31 U.S.C. 3729, Subsection (a)

Section 1, paragraphs (1) and (2) of the bill create a new subsection (a) of section 3729 and amend section 3729 to raise the fixed statutory penalty for submitting a false claim from $2,000 to $10,000. The $2,000 figure has remained unchanged since the initial enactment of the False Claims Act in 1863. The Committee reaffirms the apparent belief of the act's initial drafters that defrauding the Government is serious enough to warrant an automatic forfeiture rather than leaving fine determinations with district courts, possibly resulting in discretionary nominal payments.

Section 1, paragraph (3) of the bill amends section 3729 to increase the Government's recoverable damages from double to treble. The Committee adopts the treble damage level to comport with legislation passed earlier in the 99th Congress (P.L. 99–145, Department of Defense Authorization Act, 1986) which established treble damage liability for false claims related to contracts with the Department of Defense.

Section 1, paragraph (4) of the bill amends section 3729 to permit the United States to bring an action against a member of the armed forces as well as against civilian employees. When the Act was first enacted, in 1863, the military was excluded because the Government had available more severe military remedies. Under the 1863 statute, Act of March 2, 1863, chapter 62, section 1, any person in the Army, Navy, or militia who was charged with submitting a false claim could be held for trial by a court-martial and, if found guilty, punished by any level of fine or imprisonment felt proper. Only the death penalty was precluded. However, currently, while the Government might institute court-martial proceedings against a member of the armed services found guilty of fraud, it cannot seek monetary recovery under the False Claims Act and must instead rely on less effective common law remedies.

Section 1, paragraphs (5) and (6) of the bill make technical changes in section 3729 of title 31.

Section 1, paragraph (7) of the bill amends section 3729 to provide that an individual who makes a material misrepresentation to avoid paying money owed the Government would be equally liable under the Act as if he had submitted a false claim to receive money.

The question of whether the False Claims Act covers situations where, by means of false financial statements or accounting reports, a person attempts to defeat or reduce the amount of a claim or potential claim by the United States against him, has been the subject of differing judicial interpretations. Although it is now apparent that the False Claims Act does not apply to income taxes cases, and the Committee does

not intend that it should be so used, the act's earlier history serves to illustrate the problem which has come to be known as the 'reverse false claim;' *i.e.*, claims to avoid a payment to the Government. Thus, courts have held that there is no violation of the False Claims Act by the filing of a fraudulent Federal tax return (seeking to avoid payment of income tax) as distinguished from a fraudulent claim for a tax refund (seeking to obtain an inflated refund payment). *Olson v. Mellon*, 4 F. Supp. 947, 948 (W.D. Pa. 1933), *aff'd sub nom., United States ex rel. Knight v. Mellon*, 71 F.2d 1021 (3d Cir.), *cert. denied*, 293 U.S. 615 (1934). *Cf. United States ex rel. Roberts v. Western Pac. R. Co.*, 190 F.2d 243, 247 (9th Cir. 1951), *cert. denied*, 342 U.S. 906 (1952). In the few contract or lease arrangement cases in which the issue arose, several courts have applied the same rationale, with the result that a person's fraudulent attempt to reduce the amount payable by him to the United States was considered not to constitute a violation of the False Claims Act. *United States ex rel. Kessler v. Mercut Corp.*, 83 F.2d 178 (2d Cir.), *cert denied*, 299 U.S. 576 (1936); *United States v. Howell* 318 F.2d 162 (9th Cir. 1963), *aff'g* on this point, *United States v. Elliott*, 205 F. Supp. 581 (N.D. Cal. 1962); *United States v. Brethauer*, 222 F. Supp. 500 (W.D. Mo. 1963).

A better reasoned result was reached in *Smith v. United States*, 287 F.2d 299 (5th Cir. 1961). In that case, a nonprofit housing project was operated by a municipal housing authority under a lease from the U.S. Public Housing Administration as lessor. The lessee (housing authority) was obligated to remit quarterly to PHA as rent the excess of the lessee's

revenues from the project over its operation expenses and PHA was obligated to advance to the lessee such funds as might be necessary to cover anticipated deficits if the project's revenues were insufficient to defray expenses. Quarterly reports of the project's revenues and expenses were required to be submitted by the lessee to PHA. The manager of the local housing authority fraudulently inflated the project's operating expenses in each of two quarterly reports filed with PHA. The report for the first quarter showed a deficit in the project operations and the PHA paid the amount of such deficit to the local housing authority. The report for the second quarter showed a surplus in the project operations and the amount of such surplus was remitted by the local housing authority to PHA. The United States sued the project manager under the False Claims Act, demanding a forfeiture for each false report and asserting as its damage (subject to doubling) the amount of the fraudulent inflation of the project's operating expenses in each of the two quarterly reports. The Fifth Circuit affirmed judgment for the United States for double damages and forfeitures with respect to both reports, declaring that the False Claims Act was violated (a) by the fraud in the first report, but for which the Government 'would have made a lesser payment,' and (b) by the fraud in the second report, but for which the Government 'would have received more rent.' 287 F.2d, at 304. This same rationale was adopted in the more recent case of *United States v. Peter Vincent Douglas*, 626 F. Supp. 621 (E.D.Va. 1985).

The Supreme Court's opinion in *United States v. Neifert-White Co*, 390 U.S. 228 (1968), indicated that

the False Claims Act 'was intended to reach all types of fraud, without qualification, that might result in financial loss to the Government.' The Committee strongly endorses this interpretation of the act and, to remove any ambiguity, has included this amendment to resolve the current split in the caselaw relating to such material misrepresentations.

Section 1, paragraph (7) of the bill also amends section 3729 to permit the Government to recover any consequential damages it suffers from the submission of a false claim. For instance, where a contractor has sold the Government defective bearings for use in military aircraft, the Government could recover not only the cost of new ball bearings, but the much greater cost of replacing the defective ball bearings. *See, United States v. Aerodex, Inc.*, 469 F.2d 1003 (5th Cir. 1972). The court's conclusion in that case was based on a narrow and form-bound interpretation of the act:

Upon careful analysis, we hold that the language of the False Claims Act does not include consequential damages resulting from delivery of defective goods. The statute assesses double damages attributable to the 'act,' which in this case is the submission of the false vouchers. The submission of these vouchers was not the cause of the government's consequential damages. The delivery and installation of the bearings in the airplanes, not the filing of the false claims, caused the consequential damages. *Id.* at 1011.

31 U.S.C. 3729, Subsection (b)

New paragraph (1) of subsection (b) of the statute includes damages that the Government

would not have sustained but for its entry into a grant or contract as a result of a material false statement. When the Government changes its position, and commits its financial resources based upon a material false statement, it should be able to recover the resulting losses, but, under some court interpretations, it may not. For instance, in *United States v. Hibbs*, 568 F.2d 347 (3rd Cir. 1977), the FHA agreed to insure a mortgage based upon a representation, which was false, that the residence was habitable and in compliance with the housing code. The Government will not issue insurance to a non-code-conforming house. However, the court ruled that the default on the mortgage occurred because the borrower lost his job, and therefore could not meet his monthly payments—that the default was not related to the false statement. While the court may have been technically correct, the Committee believes that this position is unsound public policy. The act should cover representations which cause the Government to change its position and pledge its full faith and credit, including the risk of insurable loss, based upon another, but material false statement. This provision is not intended, however, to provide additional penalties where only a false statement has occurred.

31 U.S.C. 3729, Subsection (c)

New subsection (c) of section 3729 clarifies the standard of intent for a finding of liability under the act. This language establishes liability for those 'who know, or have reason to know' that a claim is false. In order to avoid varying interpretations, the Committee further defined the standard as making liable those who have 'actual knowledge that the

claim is false, fictitious, or fraudulent, or acts in gross negligence of the duty to make such inquiry as would be reasonable and prudent to conduct under the circumstances to ascertain the true and accurate basis of the claim.'

While it is clear that actual knowledge of a claim's falsity will confer liability, courts have split on defining what type of 'constructive knowledge', if any, is rightfully culpable. In fashioning the appropriate standard of knowledge for liability under the civil False Claims Act, S. 1562 adopts the concept that individuals and contractors receiving public funds have some duty to make a limited inquiry so as to be reasonably certain they are entitled to the money they seek. A rigid definition of that 'duty', however, would ignore the wide variance of circumstances under which the Government funds its programs and the correlating variance in sophistication of program recipients. Consequently, S. 1562 defines this obligation as 'to make such inquiry as would be reasonable and prudent to conduct under the circumstances to ascertain the true and accurate basis of the claim.' Only those who act in 'gross negligence' of this duty will be found liable under the False Claims Act.

The standard in S. 1562 is identical to that in S. 1134, the Program Fraud and Civil Remedies Act which was reported favorably by the Senate Governmental Affairs Committee in November of 1985 and is probably indistinguishable from the knowledge standard found in H.R. 4560, reported favorably from the House Judiciary Subcommittee on Administrative Law and Governmental Relations in May of 1986. The Committee believes that the definition of

knowledge under the False Claims Act should not differ from the definition of knowledge for any administrative adjudications regarding false claims. In both bills, the constructive knowledge definition attempts to reach what has become known as the 'ostrich' type situation where an individual has 'buried his head in the sand' and failed to make simple inquiries which would alert him that false claims are being submitted. While the Committee intends that at least some inquiry be made, the inquiry need only be 'reasonable and prudent under the circumstances', which clearly recognizes a limited duty to inquire as opposed to a burdensome obligation. The phrase strikes a balance which was accurately described by the Department of Justice as 'designed to assure the skeptical both that mere negligence could not be punished by an overzealous agency and that artful defense counsel could not urge that the statute actually require some form of intent as an essential ingredient of proof.'

31 U.S.C. 3729, Subsection (d)

New subsection (d) clarifies that the statute permits the Government to sue under the False Claims Act for frauds perpetrated on Federal grantees, including States and other recipients of Federal funds.

Some courts have concluded that once the United States has made the grant to the State, local government unit, or other institution, it substantially relinquishes all control over the disposition of the money or commodities and requires only that the grantee shall make periodic reports of its disbursements and activities. Where this is the case,

the judicial determination may follow that a fraud against the grantee does not constitute a fraud against the Government of the United States with the result that the False Claims Act is inapplicable. *Cf. United States ex rel. Salzman v. Salant & Salant, Inc.*, 41 F. Supp. 196 (S.D.N.Y. 1938) (fraud against the Red Cross).

More recently, the question has arisen whether claims under the Medicare and Medicaid programs are claims 'upon or against the Government of the United States or any department or officer thereof.' Under the Medicare program, claims are not submitted directly to the Federal agency, but rather to private intermediaries—usually insurance companies—which are subsequently reimbursed by the United States. However, false Medicare claims have been uniformly held to be within the ambit of the False Claims Act, though the claims were actually filed with, and paid by insurance companies. See *Peterson v. Weinberger*, 508 F.2d 45 (5th Cir. 1975), *cert. denied*, 423 U.S. 830 (1975). Numerous cases involving criminal False Claims Act (18 U.S.C. 287) prosecutions hold to the same effect. For example, in *United States v. Beasley*, 550 F.2d 261, 271 (5th Cir. 1977), the court, relying on *United States ex. rel. Marcus v. Hess*, 317 U.S. 537 (1942), stated:

> Case law supports federal jurisdiction and a violation of Federal criminal law when false claims are presented to the United States by an intermediary.

See also the extensive discussion at pages 272-273 relating to analogous situations under HUD and

other programs; and *United States v. Catena*, 5000 F.2d 1319 (3d Cir. 1974).

Although the Federal involvement in the Medicaid program is less direct, claims submitted to State agencies under this program have also been held to be claims to the United States under the False Claims Act. In *United States ex rel. Davis v. Long's Drugs, Inc.*, 411 F. Supp. 1144, 1146-1147 (S.D. Cal. 1976), the Court held that, although Medical (California's Medicaid program) is administered by the State, and only 50 percent of the funds are obtained from the United States, the Federal funding and extensive Federal regulations and control are sufficient to bring claims submitted to Medical within the False Claims Act, stating:

> Although the California Medical program is administered by a state agency, this program and all state programs which qualify for Federal funds have substantial contacts with the Federal Government. As indicated above, Medical was apparently enacted so that California could qualify for Federal Medicaid funds * * * Disbursements to state medical assistance programs through Medicaid are subject to a myriad of Federal regulations. * * *

Further evidence that the Federal Government has significant contacts with claims submitted under state Medicaid programs is given by the fact that Congress has made it a crime to submit false Medicaid claims (42 U.S.C. § 1396h) * * * It is difficult to perceive why false Medicaid claims, where 50 percent of the funds originate with the Federal Government, should not constitute claims against

the United States when Congress has seen fit to designate the same conduct as a Federal crime.

Similar reasoning should apply in other circumstances where claims are submitted to State, local, or private programs funded in part by the United States where there is significant Federal regulation and involvement.

Finally, in *United States v. Azzarelli Construction Co.*, 647 F.2d 757 (7th Cir. 1981), the court held that because the Federal contribution to highway construction was a fixed sum rather than open-ended (as is the case with Medicare and Medicaid), the Federal Government could not sue the contractors who had engaged in a bid-rigging conspiracy. This narrow reading of the act throws the entire burden of prosecuting fraud on State officials who may not have the powerful remedies available to the United States under the False Claims Act or the sophisticated investigative resources necessary to even establish the fraud. Thus, the Committee intends the new subsection (d) to overrule *Azzarelli* and similar cases which have limited the ability of the United States to use the act to reach fraud perpetrated on federal grantees, contractors or other recipients of Federal funds.

31 U.S.C. 3729, Subsection (e)

Section 2729 is amended to add new subsection (e), providing for uniform provisional remedies in False Claims Act suits. Under Rule 64, Federal Rules of Civil Procedure, the Government's prejudgment attachment remedies are governed by State law in the district in which the district court is held. A uniform Federal standard for the employment of

these remedies in cases brought under the False Claims Act would significantly enhance the Government's litigating ability in this area, by avoiding the whims and vagaries of the widely varying State procedures for attachment. The bill contains effective remedies to prevent a potential defendant's dissipation of assets pending litigation. These remedies flow from the district court's inherent power to grant injunctions.

The bill is not intended to exclude the Government's utilization, where appropriate, of other existing prejudgment remedies. While the bill provides for provisional remedies comparable to those provided for under Rule 65, Federal Rules of Civil Procedure, it is intended that the Government shall be required only to show likelihood of success on the merits as a precondition to obtaining relief. Other traditional prerequisites to granting equitable relief, such as adequacy of remedy at law, irreparable harm and the like, shall not be required.

Section 2

Section 2 of the bill rewrites section 3730 of title 31, United States Code.

31 U.S.C. 3730, Subsection (a)

Subsection (a) of 3730, which authorizes the Government to bring a civil action for violations of section 3729, remains unchanged.

31 U.S.C. 3730, Subsection (b)

Subsection (b)(1) of 3730, under current law, authorizes a 'person' to bring a civil action for a violation of section 3729 on behalf of the Government.

Additionally, current law provides that when a private person brings an action under this subsection, the action will be dismissed only if the court and the Attorney General consent to the dismissal. Subsection (b)(1) remains unchanged except for those portions of the paragraph dealing with jurisdiction and venue which are amended and incorporated into a new section 3732 of this title.

Subsection (b)(2) of section 3730 provides, as under current law, that the Government be served with a copy of the complaint filed by a person under this subsection as well as 'substantially all material evidence.' Paragraph (2) is amended to impose a new requirement that all *qui tam* actions will be filed in camera and remain under seal for at least 60 days, and to clarify that the 60 day period does not begin to run until both the complaint and material evidence are received—a point of some, albeit minor, confusion previously.

The Committee's overall intent in amending the *qui tam* section of the False Claims Act is to encourage more private enforcement suits. The Justice Department raised a concern, however, that a greater number of private suits could increase the chances that false claims allegations in civil suits might overlap with allegations already under criminal investigation. The Justice Department asserted that the public filing of overlapping false claims allegations could potentially 'tip off' investigation targets when the criminal inquiry is at a sensitive stage. While the Committee does not expect that disclosures from private false claims suits would often interfere with sensitive investigations, we recognize the necessity for some coordination of disclosures in civil pro-

ceedings in order to protect the Government's interest in criminal matters.

Keeping the *qui tam* complaint under seal for the initial 60-day time period is intended to allow the Government an adequate opportunity to fully evaluate the private enforcement suit and determine both if that suit involves matters the Government is already investigating and whether it is in the Government's interest to intervene and take over the civil action. Nothing in the statute, however, precludes the Government from intervening before the 60-day period expires, at which time the court would unseal the complaint and have it served upon the defendant pursuant to Rule 4 of the Federal Rules of Civil Procedure.

By providing for sealed complaints, the Committee does not intend to affect defendants' rights in any way. Once the court has unsealed the complaint, the defendant will be served as required under Rule 4 of Federal Rules of Civil Procedure and will not be required to respond until 20 days after being served. This also corrects a current anomaly, under which the defendant may be forced to answer the complaint 2 days after being served, without knowing whether his opponent will be a private litigant or the Federal Government. The initial 60-day sealing of the allegations has the same effect as if the *qui tam* relator had brought his information to the Government and notified the Government of his intent to sue. The Government would need an opportunity to study and evaluate the information in either situation. Under this provision, the purposes of *qui tam* actions are balanced with law enforcement needs as the bill allows the *qui tam* relator to both start the judicial

wheels in motion and protect his own litigative rights. If the individual who planned to bring a *qui tam* action did not file an action before bringing his information to the Government, nothing would preclude the Government from bringing suit first and the individual would no longer be considered a proper *qui tam* relator. Additionally, much of the purpose of *qui tam* actions would be defeated unless the private individual is able to advance the case to litigation. The Committee feels that sealing the initial private civil false claims complaint protects both the Government and the defendant's interests without harming those of the private relator.

Subsection (b)(3) of section 3730 establishes that the Government may petition the Court for extensions of both the 60-day evaluatory period and the time during which the complaint remains under seal. Extensions will be granted, however, only upon a showing of 'good cause'. The Committee intends that courts weigh carefully any extensions on the period of time in which the Government has to decide whether to intervene and take over the litigation. The Committee feels that with the vast majority of cases, 60 days is an adequate amount of time to allow Government coordination, review and decision. Consequently, 'good cause' would not be established merely upon a showing that the Government was overburdened and had not had a chance to address the complaint. While a pending criminal investigation of the allegations contained in the *qui tam* complaint will often establish 'good cause' for staying the civil action, the Committee does not intend that criminal investigations be considered an automatic bar to proceeding with a civil fraud suit.

The Committee believes that if an initial stay is granted based on the existence of a criminal investigation, the court should carefully scrutinize any additional Government requests for extensions by evaluating the Government's progress with its criminal inquiry. The Government should not, in any way, be allowed to unnecessarily delay lifting of the seal from the civil complaint or processing of the *qui tam* litigation.

Subsection (b)(4) of section 3730 restates current law which provides that within the initial 60-day period, or before expiration of any stays granted by the court, the Government must indicate whether it will intervene and proceed with the action or decline to enter. If the Government takes over the civil false claims suit, the litigation will be conducted solely by the Government. If the Government declines, the suit will be litigated by the individual who brought the action.

Subsection (b)(5) of section 3730 further clarifies that only the Government may intervene in a *qui tam* action. While there are few known instances of multiple parties intervening in past *qui tam* cases, *United States v. Baker-Lockwood Manufacturing Co.*, 138 F.2d 48 (8th Cir. 1943), the Committee wishes to clarify in the statute that private enforcement under the civil False Claims Act is not meant to produce class actions or multiple separate suits based on identical facts and circumstances.

31 U.S.C. 3730, Subsection (c)

Subsection (c)(1) of section 3730 allows the private individual who brought the false claims suit to take a more active role in the litigation if he

chooses. Current law presents an often times self-defeating 'all or nothing' proposition both for the person bringing the action and for the Government. If the Government intervenes and takes over the suit within the 60-day period, the action is controlled solely by the Government. The person who brought the action has virtually no guaranteed involvement or access to information about the false claims suit.

The Committee recognizes that in many cases, individuals knowing of fraud are unwilling to make disclosures in light of potential personal and financial risk as well as a lack of confidence in the Government's ability to remedy the problem. Witnesses in hearings on S. 1562 testified that incentives for exposing false claims against the Government would be enhanced if individuals who make disclosures are able to more directly participate in seeing that the fraud is remedied.

Subsection (c)(1) provides *qui tam* plaintiffs with a more direct role not only in keeping abreast of the Government's efforts and protecting his financial stake, but also in acting as a check that the Government does not neglect evidence, cause unduly delay, or drop the false claims case without legitimate reason. Specifically, paragraph (1) provides that when the Government takes over a privately initiated action, the individual who brought the suit will be served, upon request, with copies of all pleadings filed as well as deposition transcripts. Additionally, the person who brought the action may formally object to any motions to dismiss or proposed settlements between the Government and the defendant.

Any objections filed by the *qui tam* plaintiff may be accompanied by a petition for an evidentiary hear-

ing on those objections. The Committee does not intend, however, that evidentiary hearings be granted as a matter of right. We recognize that an automatic right could provoke unnecessary litigation delays. Rather, evidentiary hearings should be granted when the *qui tam* relator shows a 'substantial and particularized need' for a hearing. Such a showing could be made if the relator presents a colorable claim that the settlement or dismissal is unreasonable in light of existing evidence, that the Government has not fully investigated the allegations, or that the Government's decision was based on arbitrary and improper considerations.

Subsection (c)(1) also provides that the *qui tam* plaintiff may request that the court allow him to take over the suit if the Government has not proceeded with 'reasonable diligence' within 6 months of intervening in the action. While this provision reflects current law, the Committee reaffirms the right of the *qui tam* plaintiff to intervene if the Government fails to adequately pursue the individual's allegations of false claims. To date, there is no known caselaw guidance on how courts should evaluate 'reasonable diligence' in civil false claims suits. The Committee believes 'reasonable diligence' should be evaluated in light of the amount of Government investigative and prosecutive activity in relation to the length of time the Government has been aware of the allegations as well as the magnitude of the alleged fraud. Additionally, courts should weight the resources willing to be devoted by both the Government and the individual who brought the action as well as the relative experience and expertise possessed by each party. While in most cases the Government's resources

will likely appear to exceed the *qui tam* plaintiff's resources, the Committee recognizes that the often heavy, sporadic workload of Government attorneys may create a situation where a *qui tam* plaintiff is better able to conduct the litigation in a timely manner.

Subsection (c)(2) of section 3730, provides that the person who brought the false claims action may proceed with the litigation if the Government elects not to intervene and take over the suit within the 60-day time period. Under current law, the Government is barred from reentering the litigation once it has declined to intervene during this initial period. The Committee recognizes that this limited opportunity for Government involvement could in some cases work to the detriment of the Government's interests. Conceivably, new evidence discovered after the first 60 days of the litigation could escalate the magnitude or complexity of the fraud, causing the Government to reevaluate its initial assessment or making it difficult for the *qui tam* relator to litigate alone. In those situations where new and significant evidence is found and the Government can show 'good cause' for intervening, paragraph (2) provides that the court may allow the Government to take over the suit. Upon request, the Government may also be served with copies of all pleadings and depositions associated with any *qui tam* action it declines to take over.

Subsection (c)(3) of section 3730 clarifies that the Government, once it intervenes and takes over a false claim suit brought by a private individual, may elect to pursue any alternate remedy for recovery of the false claim which might be available under the administrative process. The Department of Health

and Human Services is currently authorized to use administrative proceedings for the recovery of some false claims. Earlier in this Congress, the Senate Government Affairs Committee favorably reported S. 1134, the Program Fraud Civil Penalties Act, which would extend this type of administrative mechanism for addressing false claims to all Executive agencies. The Committee intends that if civil monetary penalty proceedings are available, the Government may elect to pursue the claim either judicially or through an administrative civil penalty proceeding. In the event that the Government chooses to proceed administratively, the *qui tam* relator retains all the same rights to copies of filings and depositions, to objections of settlements or dismissals, to taking over the action if the Government fails to proceed with 'reasonable diligence', as well as to receiving a portion of any recovery. If the Government proceeds administratively, the district court shall stay the civil action pending the administrative proceeding and any petitions by the relator, in order to exercise his rights, will be to the district court. While the Government will have the opportunity to elect its remedy, it will not have an opportunity for dual recovery on the same claim or claims. In other words, the Government must elect to pursue the false claims action either judicially or administratively and if the Government declines to intervene in a *qui tam* action, it is estopped from pursing the same action administratively or in a separate judicial action.

31 U.S.C. 3730, Subsection (d)

Subsection (d) of section 3730 delineates the *qui tam* relator's right to a portion of any recovery result-

ing from a successful false claims suit initiated by the relator.

Subsection (d)(1) provides that when the Government has intervened, taken over the suit, and produced a recovery either through a settlement agreement or a judgment, the relator will receive between 10 and 20 percent of the recovery.

Subsection (d)(2) provides that if the relator has litigated the false claims action successfully and the Government did not take over the suit, the relator will be awarded between 20 and 30 percent of the judgment or settlement proceeds.

Current law allows relator awards of up to 10 percent in suits the Government takes over, and up to 25 percent where the relator litigates without the Government. The new percentages found in subsection (d)(1) and (2) do not substantially increase the possible recovery available to a *qui tam* relator, but do create a guarantee that relators will receive at least some portion of the award if the litigation proves successful. Hearing witnesses who themselves had exposed fraud in Government contracting, expressed concern that current law fails to offer any security, financial or otherwise, to persons considering publicly exposing fraud. If a potential plaintiff reads the present statute and understands that in a successful case the court may arbitrarily decide to award only a tiny fraction of the proceeds to the person who brought the action, the potential plaintiff may decide it is too risky to proceed in the face of a totally unpredictable recovery.

The Committee acknowledges the risks and sacrifices of the private relator and sets a minimum

10 percent or 20 percent level of recovery depending on whether the Government or the relator litigates the action. The setting of such a definite amount is sensible and can be looked upon as a 'finder's fee' which the person bringing the case should receive as of right. The Government will still receive up to 90 percent of the proceeds—substantially more than the zero percent it would have received had the person not brought the evidence of fraud to its attention or advanced the case to litigation.

The Committee does not, however, believe that the court should be left without discretion on the percentage of award granted a *qui tam* relator. Obviously, the contribution of one person might be significantly more or less than the contribution of another. Consequently, we have staged the allowable percentages of recovery so that courts may take various factors into consideration and use discretion in determining awards within those ranges.

Subsection (d)(3) specifies factors courts should take into account when determining recoveries as follows:

(A) the significance of the information provided to the Government;

(B) the contribution of the person bringing the action to the result obtained; and

(C) whether the information which formed the basis for the suit was known to the Government.

Subsection (d)(4) provides that a court may award up to 10 percent of an action's proceeds to persons bringing suits based on public information.

The award ranges specified in (d)(1) and (2) do not apply to *qui tam* relators whose false claims disclosures were derived solely from public hearings, reports, or the news media. New subsection (e)(4) of section 3730 prohibits a suit based solely on previous public disclosures unless the Government has failed to act within 6 months of the public disclosure. The Committee recognizes that guaranteeing monetary compensation for individuals in this category could result in inappropriate windfalls where the relator's involvement with the evidence is indirect at best. However, in the event an action of this type results in a Government recovery, subsection (d)(4) provides that the court may award up to 10 percent of the proceeds, taking into account the significance of the information and the role of the person in advancing the case to litigation. The Committee believes a financial reward is justified in these circumstances if but for the relator's suit, the Government may not have recovered.

Subsection (d)(5) of section 3730 provides that prevailing *qui tam* relators may be awarded reasonable attorneys fees in addition to any other percentage of award recovered. The existing False Claims Act does not contain a specific authorization for fees. Such fees will be payable by the defendant in addition to the forfeiture and damages amount. Unavailability of attorneys fees inhibits and precludes many private individuals, as well as their attorneys, from bringing civil fraud suits. Paragraph (5) also clarifies that the Government will in no way be liable for fees or expenses incurred by a private individual who brings a civil false claims action.

Subsection (d)(6) provides that the prevailing defendants in a civil False Claims Act case brought by a party other than the Government, may also be eligible for reasonable attorneys fees if the court finds that the private plaintiff's action was 'clearly frivolous, vexatious, or brought for purposes of harassment.' This standard reflects that which is found in section 1988 of the Civil Rights Attorneys Fees Awards Act of 1976. The Committee added this language in order to create a strong disincentive and send a clear message to those who might consider using the private enforcement provision of this Act for illegitimate purposes. The Committee encourages courts to strictly apply this provision in frivolous or harassment suits as well as any applicable sanctions available under the Federal Rules of Civil Procedure. Additionally, where the court determines that the private plaintiff is motivated by bad faith or bringing a clearly frivolous action, the court shall require the plaintiff to make assurances that payment of legal fees and expenses can be made before allowing the litigation to proceed.

Subsection (d)(7) requires the relator to apply for any award under this act within 60 days of the final judgment or settlement. The same 60-day time period applies where the Government has chosen to pursue its claim through an administrative civil money penalty proceeding. All petitions shall be filed with the appropriate Federal district court.

31 U.S.C. 3730, Subsection (e)

Subsection (e)(1) of section 3730 prohibits *qui tam* actions among members of the armed services where such actions arise out of any such persons'

service in the armed forces. This provision only prohibits servicemen and women from suing each other under the False Claims Act and in no way exempts them from liability under the act if the government brings an action against them.

Subsection (e)(2) disallows *qui tam* actions against members of Congress, the Judiciary, or Senior Executive branch officials when the Government is already aware of the allegation on which the action is based. This provision actually reflects current law in that any *qui tam* suit based on information already known to the Government is currently without jurisdiction. While S. 1562 repeals that jurisdictional bar for most suits, the Committee, at the request of the Justice Department, retained the bar for those suits which might be politically motivated. The Committee acknowledges that a statutory remedy for wrongdoing by public officials does exist under the Ethics in Government Act (28 U.S.C. 591). Paragraph (2) does not excuse the class identified from suits brought by the Government for violation of the False Claims Act or for suits based on information not in the possession of the Government.

Subsection (e)(3) defines 'senior executive branch officials' as those listed in section 201(f) of Appendix IV of title 5.

Subsection (e)(4) prohibits *qui tam* suits based on allegations which are already the subject of a civil suit brought by the Government. Additionally, paragraph (4) disallows jurisdiction for *qui tam* actions based on allegations disclosed in a criminal, civil or administrative hearing, a congressional or General Accounting Office report or hearing, or from the news media, unless the action is brought 6 months after

the public disclosure and the Government has failed to take any action.

31 U.S.C. 3730, Subsection (f)

Subsection (f) of section 3730 grants jurisdiction in Federal district court for any action arising under State law for the recovery of money paid by State or local governments if that action grows out of the same transaction or occurrence as an action brought by either the Government or a *qui tam* plaintiff under the False Claims Act.

31 U.S.C. 3730, Subsection (g)

Subsection (g) of section 3730 authorizes the Attorney General to grant awards to persons who assist in successful civil recoveries under this section or successful criminal convictions under 18 U.S.C. 286, 18 U.S.C. 287, or 18 U.S.C. 1001. The Committee strongly encourages private individuals to come forward with any information regarding fraud against the Government, regardless of the forum in which they make their disclosures. For those individuals who do not wish to entangle themselves in litigation by bringing a civil false claims suit, but instead disclose their allegations directly to the Government, the Committee believes they too should be granted some reward for their efforts. Further, incentives for exposing fraud should be available in as many forms as is possible. The awards under this section will be made at the discretion of the Attorney General and reported to Congress on an annual basis.

Section 3

31 U.S.C. 3731, subsection (a) remains unchanged by the bill.

31 U.S.C. 3731, Subsection (b)

Subsection (b) of section 3731 of title 31, as amended by section 3 of the bill, would include an explicit tolling provision on the statute of limitations under the False Claims Act. The statute of limitations does not begin to run until the material facts are known by an official within the Department of Justice with the authority to act in the circumstances.

31 U.S.C. 3731, Subsection (c)

Section 3 of the bill amends section 3731 by adding a new subsection (c) to make clear that in civil fraud actions, the Government is required to prove all essential elements of the cause of action by a preponderance of the evidence. Traditionally, the burden of proof in a civil action is by a preponderance of the evidence. However, this point is not expressly addressed in the current act, and the caselaw is fragmented and inconsistent. Inasmuch as False Claims Act proceedings are civil and remedial in nature and are brought to recover compensatory damages, the Committee believes that the appropriate burden of proof devolving upon the United States in a civil False Claims Act suit is by a preponderance of the evidence. *United States v. Gardner*, 73 F. Supp. 644 (N.D. Ala. 1947).

Some courts have required that the United States prove its case by clear and convincing, or even

by clear, unequivocal and convincing evidence. *United States v. Ueber*, 299 F.2d 310 (6th Cir. 1962), which is the functional equivalent of a criminal standard. This line of authority, beginning in the early case of *United States v. Shapleigh*, 54 Fed 126 (8th Cir. 1893), is predicated on its premise that the civil False Claims Act is penal in nature. The Supreme Court's rejection of the underlying premise in *United States ex rel Marcus v. Hess*, 317 U.S. 537 (1943), necessarily carried with it the repudiation of that conclusion as the burden of proof, and the subsequent decisions under the False Claims Act have generally rejected the criminal standard of 'beyond a reasonable doubt.'

The 'preponderance of the evidence' standard of proof in S. 1562 is, according to the Justice Department, the standard applied in most civil and administrative litigation. The Eighth Circuit recently held in *Federal Crop Insurance Corp. v. Hester*, 765 F.2d 723 (8th Cir. 1985) that 'preponderance of the evidence' is the appropriate standard for the False Claims Act, stating: 'Because the Act neither requires a showing of fraudulent intent nor is punitive in nature, we find no justification for applying a burden of proof higher than a preponderance of evidence.' In testimony before the Senate Judiciary Committee on September 17, 1985, Jay Stephens, Associate Deputy Attorney General, stated that 'because the False Claims Act is basically a civil, remedial statute, the traditional 'preponderance of evidence' standard of proof is appropriate.'

Thus, notwithstanding the fact that the act permits a treble recovery, it would be governed by the traditional civil burden of proof. The Committee

notes in support of this proposition that the U.S. Supreme Court has upheld such a burden in the areas of securities fraud and antitrust violations, which involve related forms of misconduct and civil remedies. *Herman & McLean v. Huddleston*, 459 U.S. 375, 388–89[25c] (1983).

31 U.S.C. 3731, Subsection (d)

Section 3 of the bill amends section 3731 of title 31 by adding a new subsection (d) providing that a *nolo contendere* plea in a criminal fraud case shall have collateral estoppel effect in a subsequent civil fraud action. Without this amendment, the well-settled rule that a *nolo* plea would have no collateral estoppel effect in related civil proceedings would apply. This common law principle is now embodied in Rule 410, Federal Rules of Evidence, and in Rule 11 (e)(6), Federal Rules of Criminal Procedure, which states:

> * * * evidence of * * * a plea of nolo contendere * * * is not admissible in any civil or criminal proceedings against the person who made the plea or offer.

The Committee feels that given the high priority which should be afforded to the effective prosecution of procurement fraud cases, an exception to this general rule should be made for False Claims Act cases. Moreover, even when the criminal prosecutor wants to pursue his case fully and gain a guilty verdict, the court could still accept a *nolo* plea over the Government's objection, thus requiring the Civil Division to relitigate the issue. The Committee

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[25c] 103 S.Ct. 683, 74 L.Ed.2d 548.

believes that this would be an unacceptable result; individuals who cheat the Government should not be able to hide behind a *nolo* plea.

Section 4

31 U.S.C. 3732, Subsection (a)

Section (4) of the bill adds a new section 3732 of title 31 to modernize the jurisdiction and venue provisions of the False Claims Act, by recognizing the existence of multi-defendant and multi-district frauds against the Government. The bill provides that jurisdiction and venue in suits under the False Claims Act shall be proper in any district in which either: (a) any defendant resides, transacts business, is doing business, or can be found; or (b) in any district in which any of the following acts occurred: (i) the false claim was made or presented, or (ii) any other act constituting a violation of the False Claims Act occurred.

Under existing law, a False Claims Act suit must be commenced in the district where the defendant can be 'found'. This considerably hinders the Government's litigative effort in cases involving multiple defendants. Many suits brought under the Act involve several defendants and only infrequently can all defendants be 'found' in any one district. Many False Claims Act suits are brought after criminal litigation involving the same or similar conduct. Typically, for a variety of reasons, the individuals involved have moved from the area where the wrongdoing occurred and where they once were 'found'. This, in turn, may force the Department of Justice to file multiple suits involving the same

scheme or pattern or fraudulent conduct against each defendant in the district in which he or she may be found at the time suit is commenced. Multiple suits, of course, increase the cost to the Government to pursue these cases and have a comparable impact upon the judicial resources required for a complete adjudication.

This expansion of jurisdiction and venue is made with a view to more effective litigation by the Government as well as convenience and fairness. It is basically a form of long-arm statute with many familiar counterparts in State law. However, the Committee is aware of the potential for abuse of this section. Choice of venue could turn more upon which court had provided a previous favorable decision to the Government than upon other factors of convenience or fairness. The Committee will remain sensitive to these potential abuses. Of course, a defendant could always move to transfer a case where appropriate 'in the interest of justice and for the convenience of the parties' (28 U.S.C. 1404).

31 U.S.C. 3732, Subsection (b)

Subsection (b) of new section 3732 provides that the Claims Court shall have jurisdiction over any False Claims Act suit brought by the United States by way of a counterclaim. This provision will promote the economy of judicial resources by facilitating the resolution of all aspects of a given contract dispute—including any Government fraud claims—in a single judicial proceeding.

Section 5

31 U.S.C. 3733, Subsection (a)

Section 5 of the bill adds a new section 3733 to title 31 which would authorize the Justice Department to issue Civil Investigative Demands (CID) for documents or testimony relevant to a False Claim Act investigation. This authority is nearly identical to that currently available to the Justice Department's Antitrust Division under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (15 U.S.C. 1311-14).

Currently, the Civil Division of the Department relies primarily on two sources for investigation of civil fraud cases: the work of agency Inspectors General (IGs) and material developed in criminal investigations, usually through the use of grand jury subpoenas. However, since the Supreme Court's decision in *United States v. Sells Engineering Co.*, 31 S. Ct. 3133[25d] (1983), interpreting Rule 6(e) of the Rules of Criminal Procedure, the Civil Division has been largely unable to gain access to the information developed before the grand jury. Therefore, in addition to supplementing the investigative powers of the IGs, CID authority would permit the Civil Division to gain access to evidence of fraud which might currently be unavailable to it due to the Supreme Court's interpretation of Rule 6(e).

With the single exception of sharing information with other agencies (discussed below), the CID authority granted by the bill is identical to that available to the Antitrust Division, and the Committee intends that the legislative history and caselaw

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[25d] 463 U.S. 418, 77 L.Ed.2d 743.

interpreting that statute (15 U.S.C. 1311-14), fully apply to this bill. Briefly, the CID statute would work as follows. Where the responsible Assistant Attorney General believes that an individual or corporation has access to information relating to a False Claims Act investigation, he may, prior to the institution of litigation, issue a CID. The demand may require the production of documents, written answers to interrogatories and/or oral testimony. The standards governing subpoenas and ordinary civil discovery shall apply to protect against disclosure of information subject to a privilege, such as those privileges recognized by the Federal Rules of Civil Procedure and the Federal Rules of Evidence, and those recognized by *Hickman v. Taylor*, 329 U.S. 495 (1946), and its progeny. The Department may enforce compliance with the CID in district court and its order shall be final and hence, subject to appeal under 28 U.S.C. 1291.

The Committee notes that the use of CID authority has long been upheld against constitutional challenges. *Hyster Company v. United States*, 338 F.2d 183 (9th Cir. 1964); *Petition of Gold Bond Stamp Company*, 221 F. Supp. 391 (D. Minn. 1963), *aff'd* 325 F.2d 1018 (8th Cir. 1964).

The single noteworthy difference from the Hart-Scott-Rodino Act is subsection 3733(j)(3)(c), which authorizes the Department to share information obtained through a CID with any other agency of the United States for use by that agency in furtherance of its statutory responsibilities. However, such information could only be provided if the requesting agency, acting through the Department of Justice, obtained a court order upon a showing of substantial need. This proceeding would be conducted *ex parte*.

The Committee feels that this protection will be adequate to ensure that only agencies with legitimate interests in fulfilling their most significant statutory responsibilities would have access to the information.

Section 6

31 U.S.C. 3734

Section 6 of the bill establishes a new section 3734 under the False Claims Act to provide for ‘whistleblower’ protection.

The Committee recognizes that few individuals will expose fraud if they fear their disclosures will lead to harassment, demotion, loss of employment, or any other form of retaliation. With the provisions in section 3434, the Committee seeks to halt companies and individuals from using the threat of economic retaliation to silence ‘whistleblowers’, as well as assure those who may be considering exposing fraud that they are legally protected from retaliatory acts.

In forming these protections, the Committee was guided by the whistleblower protection provisions found in Federal safety and environmental statutes including the Federal Surface Mining Act, 30 U.S.C. 1293, Energy Reorganization Act, 42 U.S.C. 5851, Clean Air Act, 42 U.S.C. 7622, Safe Drinking Water Act, 42 U.S.C. 300j–9, Solid Waste Disposal Act, 42 U.S.C. 6971, Water Pollution Control Act, 33 U.S.C. 1367, Comprehensive Environmental Response, Compensation and Liability Act, 42 U.S.C. 9610, and Toxic Substances Control Act, 15 U.S.C. 2622.

New section 3734 provides ‘make whole’ relief for anyone who is ‘discharged, demoted, suspended, threatened, harassed, or in any other manner discriminated against’ by his employer due to his involvement with a false claims disclosure. The ‘protected activity’ under this section includes any ‘good faith’ exercise of an individual ‘on behalf of himself or others of any option afforded by this Act, including investigation for, initiation of, testimony for, or assistance in an action filed or to be filed under this act.’ Consequently, the Committee believes protection should extend not only to actual *qui tam* litigants, but those who assist or testify for the litigant, as well as those who assist the Government in bringing a false claims action. Protected activity should therefore be interpreted broadly.

As is the rule under other Federal whistleblower statutes as well as discrimination laws, the definitions of ‘employee’ and ‘employer’ should be all-inclusive. Temporary, blacklisted or discharged workers should be considered ‘employees’ for purposes of this act. Additionally, ‘employers’ should include public as well as private sector entities.

Section 3734 provides relief only if the whistleblower can show by a preponderance of the evidence that the employer’s retaliatory actions resulted ‘because’ of the whistleblower’s participation in a protected activity. Under other Federal whistleblower statutes, the ‘because’ standard has developed into a two-pronged approach. One, the whistleblower must show the employer had knowledge the employee engaged in ‘protected activity’ and, two, the retaliation was motivated, at least in part, by the employee’s engaging in protected activity. Once these elements have

been satisfied, the burden of proof shifts to the employer to prove affirmatively that the same decision would have been made even if the employee had not engaged in protected activity. *Deford v. Secretary of Labor*, 700 F.2d 281, 286 (6th Cir. 1983); *Mackwiak v. University Nuclear Systems, Inc.*, 735 F.2d 1159, 1162-1164 (9th Cir. 1984); *Consolidated Edison of N.Y. Inc. v. Donovan*, 673 F.2d 61, 62 (2nd Cir. 1982).

Additionally, as in the Safe Drinking Water Act, Clean Air Act, and Federal Water Pollution Act, the employer would not have to be proven in violation of the False Claims Act in order for this section to protect the employee's actions. However, the actions of the employee must result from a 'good faith' belief that violations exist.

Section 3734 provides 'make whole' relief including 'reinstatement with full seniority rights, backpay with interest, and compensation for any special damages sustained as a result of the discrimination, including litigation costs and reasonable attorneys fees.' In addition, the court could award double back pay, special damages or punitive damages if appropriate under the circumstances.

Jurisdiction for any actions under section 3734 of the False Claims Act shall be in Federal district court.

Section 7

Section 7 of the bill raises criminal penalties as well as possible imprisonment for criminal violations involving false claims. Subsection (a) of the bill amends section 286 of title 18, conspiracy to defraud the Government with respect to claims, and increases

the penalty from $10,000 to $1 million. Subsection (b) of the bill amends section 287 of title 18, false, fictitious or fraudulent claims, and increases the $10,000 penalty to $1 million as well as increases the allowable prison sentence from 5 years to 10 years. Earlier in the 99th Congress, a $1 million level was set for submitting false claims related to contracts with the Department of Defense (P.L. 99–145, Department of Defense Authorization act, 1986). The amendments in section 7 of this bill would apply that criminal penalty level across-the-board to any criminal false claims violations.

Section 8

Section 8 of the bill establishes that the amendments made by this act will be effective upon the date of enactment.

V. Agency Views

U.S. Department of Justice,
Office of Legislative And Intergovernmental Affairs,
Washington, DC, December 11, 1985
Hon. STROM THURMOND,
Chairman, Committee on the Judiciary, U.S. Senate,
Washington, DC

DEAR MR. CHAIRMAN: This is to express the Justice Department's strong support for the False Claims Act amendments contained in S. 1562 as reported out of the Subcommittee on Administrative Practice and Procedure on November 7. We believe that these amendments will provide a significant enhancement to our ability to detect and prosecute economic crime.

As stated in our previous testimony, the Department does not believe that any changes are necessary in the '*qui tam*,' or citizen suit, portions of the False Claims Act. However, the current language of S. 1562, a result of negotiations between representatives of the Department and subcommittee staff, is not objectionable in the context of the bill's other beneficial amendments to the False Claims Act.

However, the Department continues to oppose any amendment to Rule 6(e) of the Federal Rules of Criminal Procedure that would permit congressional access to grand jury information. We also recommend that administrative agencies be permitted to obtain access to grand jury information only at the request of an attorney for the Department of Justice on a showing of substantial need. Therefore, in an effort to expedite action on this vital anti-fraud initiative, we would urge the Committee to act to report out the False Claims Act amendments contained in S. 1562 separate from the grand jury reforms, which would seem to require more deliberation and discussion. Prompt action by your Committee may be crucial to ensuring ultimate passage of some anti-fraud legislation in the 99th Congress.

Additionally, we urge you to take action on the other Administration anti-fraud bills pending in the Committee. In particular, S. 1675, the Bribes and Gratuities Act, is directly related to the False Claims Act amendments, and would provide a valuable supplement to the enhanced anti-fraud remedies contained in S. 1562.

The Administration remains prepared to work with the Committee on this initiative and compli-

ments you and Senator Grassley on your leadership in this area.

The Office of Management and Budget advises us that there is no objection to the submission of this report from the standpoint of the Administration's program.

Sincerely,

Phillip D. Brady,
Acting Assistant Attorney General

VI. Cost Estimate

The Congressional Budget Office has reviewed S. 1562 and does not expect the bill to result in any additional costs to the Government.

U.S. Congress, Congressional Budget Office,
Washington, DC, June 12, 1986
Hon. STROM THURMOND,
Chairman, Committee on the Judiciary, U.S. Senate,
Dirksen Senate Office Building, Washington, DC

DEAR MR. CHAIRMAN: The Congressional Budget Office has reviewed S. 1562, a bill amending the False Claims Act, and Title 18 of the United States Code regarding penalties for false claims, as ordered reported by the Senate Committee on the Judiciary, December 12, 1985.

S. 1562 would increase penalties and damages to which defendants under the False Claims Act are liable, broaden the scope of liability under that act, give the Department of Justice the authority to issue investigative demands prior to filing a complaint, and make a number of procedural changes for the

conduct of false claims suits. These amendments are expected to involve no significant costs to the federal government or to state or local governments. The federal government may receive increased revenues as a result of increased penalties and damages authorized by this bill, but the amount cannot be estimated with precision.

Section 1 of S. 1562 increases the liability for false claims from $2,000 plus two times the damages sustained by the government to $10,000 plus three times the damages sustained by the government. According to the Department of Justice, collections of penalties and damages under the False Claims Act currently average about $40 million each year, although this amount fluctuates widely. The imposition of treble damages could potentially increase this amount by 50 percent. The increase might be lower, however, due to the possible reluctance of courts to impose more severe penalties. Conversely, collections could be even greater due to provisions in this bill making it easier for the government to win convictions for false claims, encouraging individuals to initiate false claims suits and establishing a uniform federal prejudgment standard. Because the provisions of the bill would apply only to claims made subsequent to enactment, no revenues would be realized until 1989 or 1990.

We expect that other sections of S. 1562 could affect costs of the Department of Justice. Section 5 of the bill gives Justice Department civil attorneys the authority for discovery of evidence prior to a complaint. The new authority may reduce duplication of investigative time and effort, and result in cost savings. Increased costs for litigation would offset

some of the increased revenues produced by this bill, if it results in an increased number of false claims actions, particularly those brought by individuals.

If you wish further details on this estimate, we will be pleased to provide them.

With best wishes,

Sincerely,

Rudolph G. Penner
Director.

VII. Regulatory Impact Statement

Pursuant to the requirements of paragraph 11(b) of Rule XXVI of the Standing Rules of the Senate, the Committee finds that no significant regulatory impact or paperwork impact will result from the enactment of S. 1562.

VIII. Vote of Committee

The Committee favorably reported S. 1562, as amended, by unanimous consent on December 12, 1985.