MANDATORY DISCLOSURE FOR GOVERNMENT CONTRACTORS

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I. OVERVIEW OF MANDATORY DISCLOSURE REQUIREMENTS ("MDR")

A. The MDR's Implementation

The Mandatory Disclosure Rule, published by the FAR Council on November 12, 2008, requires Government contractors to disclose to the Government certain potential violations of criminal and civil law as well as instances of significant overpayment. *See* 73 Fed. Reg. 67064; 50 No. 46 GC ¶ 439 (Dec. 17, 2008). The Rule included a new FAR clause addressing business ethics and conduct, applicable to certain covered contracts and requiring disclosure of potential wrongful conduct. The Rule also included a new definition of "present responsibility," which provides that federal contractors and subcontractors, regardless of whether they are subject to the new FAR clause, can be suspended or debarred for failure to timely disclose potential wrongful conduct or significant overpayments. Eight years have passed now since the Rule took effect on December 12, 2008, yet many questions and issues still remain regarding the Rule's application.

B. Overview Of Mandatory Disclosure Obligations

1. Clause 52.203-13, "Contractor Code of Business Ethics and Conduct," which sets forth the mandatory disclosure obligations, must be included in all federal contracts and subcontracts that are expected to exceed $5.5 million (increased from $5 million, effective on 10/1/15) and take 120 days or more to perform. A failure to comply with, i.e., a failure to make a mandatory disclosure, therefore results in a breach of contract.

2. The clause imposes several requirements with respect to the Code of Business Ethics and Conduct, including (1) a requirement to have a written code of business ethics and conduct and make a copy of the code available to each employee engaged in performance of the contract; (2) a requirement to exercise due diligence to prevent and detect criminal conduct and a requirement to promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law; and (3) a requirement to timely disclose, in writing, to the agency Office of Inspector General (OIG), with a copy to the Contracting Officer, whenever the contractor has "credible evidence" that a principal, employee, agent, or subcontractor has committed certain violations of law.

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3. The MDR, as implemented in FAR 52.203-13(b), requires disclosure, to the OIG and CO, of "credible evidence" of the following conduct "***in connection with award, performance, or closeout***" of a federal Government contract (or subcontract at any tier): (A) a violation of federal criminal laws involving fraud, conflict of interest, bribery, or gratuity violations found in U.S.C. Title 18—most commonly, 18 U.S.C. §§ 287 (false claims), 1001 (false statements), 1031 (major fraud against the United States), 371 (conspiracy); or (B) a violation of the civil ***False Claims Act*** ("FCA").

4. The MDR, implemented in FAR 52.203-13(c), also requires (with certain exceptions for small businesses and awards for commercial items) that, within 90 days after contract award, the contractor shall establish (1) an ongoing business ethics awareness and compliance program and (2) an internal control system, each with specific requirements. For example, the compliance program must include an effective training program, and the internal control system must include an internal reporting mechanism, such as a hotline, which allows for anonymous reporting by employees of suspected instances of improper conduct.

5. As explained below, the MDR, as implemented in FAR 9.406-2 and 9.407-2, also imposes an obligation to timely disclose, to the Government, credible evidence of a significant overpayment.

6. Debarment and Suspension (Present Responsibility) considerations in FAR 9.406-2 and 9.407-2, as articulated in FAR 3.1003(a), impose obligations on contractor principals to timely disclose credible evidence of relevant violations (including credible evidence of a significant overpayment).

II. OPERATION OF THE MDR PROGRAM TO DATE

A. Number Of Disclosures (DOD And GSA)

1. DOD IG reported in its two Semiannual Reports to Congress dated May 31, 2016 and December 6, 2016 that it received a total of 245 disclosures in FY 2016. Labor mischarging issues continue to account for the vast majority of disclosures (162), making up 66% of the total disclosures. Other recurring issues include false certifications (12), significant overpayments (10), false claims (9), nonconforming parts (6), and conflicts of interest (6). *See* Office of Inspector Gen. U.S. Dep't of Defense, Semiannual Report to Congress (Dec. 6, 2016); Office of Inspector Gen. U.S. Dep't of Defense, Semiannual Report to Congress (May 31, 2016).

2. GSA IG reported in its two Semiannual Reports to Congress dated April 29, 2016 and October 31, 2016 that it received a total of 28 disclosures in FY 2016. The IG concluded its evaluation of 29 existing disclosures resulting in $7.2 million in settlements and recoveries to the Government, a sharp decrease from the $39.2 million recovered from the conclusion of 17 disclosures in FY 2015. Issues included the following: billing errors, bribery, fraud, misclassified business type, failure to comply with contract requirements related to commercial sales practices disclosures and price reduction monitoring, unauthorized charges, Trade Agreements Act noncompliance, subcontracting plan and report deficiencies, unallowable costs, and services not performed. *See* Office of Inspector Gen. U.S. Gen. Servs. Admin., Semiannual Report to Congress (Oct. 31, 2016); Office of Inspector Gen. U.S. Gen. Servs. Admin., Semiannual Report to Congress 30 (April 29, 2016).

B. DOJ Recoveries[2]

1. Total FCA recoveries in FY 2016: $4.7 billion.

a. This amount marks the fifth consecutive year of recoveries in excess of $3.5 billion and brings the fiscal average to nearly $4 billion since FY 2009.

b. Total FCA recoveries since January 2009: $31.3 billion.

2. Health care fraud recoveries in FY 2015: $2.5 billion.

a. Includes drug companies, medical device companies, hospitals, nursing homes, laboratories, and physicians.

b. Marks the seventh consecutive year the Department's civil health care fraud recoveries have exceeded $2 billion.

3. Housing and mortgage fraud recoveries in FY 2016: $1.7 billion.

4. *Qui tam* recoveries.

a. *Qui tam* recoveries accounted for more than $2.9 billion of the total $4.7 billion recovered.

b. *Qui tam* suits filed in FY 2016: 702 (average of 13.5 cases per week).

c. Whistleblower recoveries: $519 million.

d. Total *qui tam* recoveries since 2009: $24 billion.

e. Total whistleblower recoveries in 2009: $4 billion.

5. Other fraud recoveries in FY 2016 include environmental recoveries from violations of safe drilling practices, procurement fraud recoveries, education recoveries from for-profit

[2] Statistics obtained from DOJ Press Release, U.S. Dep't Justice, *Justice Department Recovers Over $4.7 Billion From False Claims Act Cases in Fiscal Year 2016*, Dec. 14, 2016, available at https://www.justice.gov/opa/pr/justice-department-recovers-over-47-billion-false-claims-act-cases-fiscal-year-2016.

schools for illegal schemes to procure federal education funds, customs fraud recoveries, and recoveries from individuals accountable for corporate wrongdoing.

C. Civil Penalty Increase

1. In connection with the November 2015 Federal Civil Penalties Inflation Adjustment Act, DOJ issued a rule nearly doubling penalties for FCA violations.

2. Prior to the adjustment, civil penalties ranged from $5,500–$11,000 per claim, plus treble damages. As of August 1, 2016, civil penalties increased to $10,781.40–$21,562.80 per claim, plus treble damages.

3. The adjusted amounts apply only to civil penalties assessed after August 1, 2016 for violations that occurred before November 2, 2015.

D. Managing Contractor Employees

1. On December 5, 2016, Congress has passed a new bill strengthening whistleblower protections for contractor and grantee employees. The bill, S. 795, permanently extends legal protections to employees of federal contractors, subcontractors, and grantees who report fraud, waste, and abuse first established in an earlier pilot program. The program hopes to ensure that civilian contractor employees are protected from retaliation, specifically mandating that anyone exposing the misuse of federal funds may not be demoted, discharged, or discriminated against because of the disclosure. The bill also extends these protections to personal services contractors working on defense or civilian contracts or grants.

III. CONTINUING ISSUES FOR THE GOVERNMENT CONTRACTS COMMUNITY

A. Developments In Individual Liability For Corporate Wrongdoing Following The Yates Memo

1. On September 9, 2015, Deputy Attorney General ("DAG") Sally Quillian Yates issued a Memorandum ("Yates Memo" or "Memo") to the Attorneys General for the six divisions of the Department of Justice (Antitrust, Civil, Criminal, Environment and Natural Resources, National Security and Tax), the Directors of the FBI and Executive Office for the United States Trustees, and all United States Attorneys that provided new instruction and amplified instruction regarding prior policies, ***directing the attorneys to substantially increase their focus on individuals, and not merely companies, in resolving both criminal and civil matters.***

2. Major questions regarding the Mandatory Disclosure program emerge from the set of policies articulated in the Memo, including (1) what, if any, effect will these policies have on agency Inspectors General and agencies in their pursuit and resolution of contractor Mandatory Disclosures; and (2) what, if any, effect will these policies have on how companies are required (or find it necessary) to conduct internal investigations? The Yates Memo appears to have changed little regarding how Inspectors General, and DOJ, have been investigating and resolving disclosures under the MDR scheme. However, many attorneys think that may change, following renewed emphasis on the principles in the Yates Memo by Yates and DOJ colleagues and some noteworthy civil settlements with company CEOs an executives.

3. The Yates Memo states six principles that articulate specifics regarding DOJ's renewed focus on individuals.

a. The Memo's Preamble states in part: "The guidance in this memo will also apply to civil corporate matters…. Thus, civil attorneys investigating corporate wrongdoing should maintain a focus on the responsible individuals, recognizing that holding them to account is an important part of protecting the public fisc in the long term…. The guidance in this memo will apply to all future investigations of corporate wrongdoing. ***It will also apply to those matters pending as of the date of this memo, to the extent it is practicable to do so.***"

b. **Principle 1**: To be eligible for any cooperation credit, corporations must provide to the Department all relevant facts about the individuals involved in corporate misconduct.

c. **Principle 2**: Both criminal and civil corporate investigations should focus on individuals from the inception of the investigation.

d. **Principle 3**: Criminal and civil attorneys handling corporate investigations should be in routine communication with one another.

e. **Principle 4**: Absent extraordinary circumstances, no corporate resolution will provide protection from criminal or civil liability for any individuals.

f. **Principle 5**: Corporate cases should not be resolved without a clear plan to resolve related individual cases before the statute of limitations expires and declinations as to individuals in such cases must be memorialized."

g. **Principle 6**: Civil attorneys should consistently focus on individuals as well as the company and evaluate whether to bring suit against an individual based on considerations beyond that individual's ability to pay.

4. Additional Developments Since Issuance of the Yates Memo—Changes Coming?

a. The Effects of the Yates Memo on the MDR Process to Date

i. Most practitioners state that the Yates Memo has, to this point, had limited impact on how companies and counsel are conducting internal investigations and how Inspectors General and DOJ are resolving disclosures. However, white collar defense attorneys, DOJ prosecutors, and civil attorneys are telling a different story.

During a recent speech, DAG Yates described a new practice that defense attorneys are observing in which they are presenting, at the outset of investigations, "Yates binders" of information regarding involvement of individuals in the matters under investigation. Typically, these binders contain copies of emails to and from persons of interest DOJ attorneys and investigators have identified. Recent speeches by Yates and DOJ Official Bill Baer demonstrate the Department's resolve to emphasize and enforce the Yates Memo principles in FCA and other civil matters. However—the sixty-four thousand dollar question is, as it is with so many current Government policies—will the Yates Memo and its principles survive the arrival of the Trump Administration?

b. The Baer Speeches and Prominent FCA Settlements with Individuals—High Level Company Executives

i. The Baer Speeches

Mr. Baer has been out sounding the Yates Memo horn in various locations, including on June 9 and September 29 of 2016. As with many of DAG Yates' comments in the past few months, Baer's June 9 comments speech focused on the "stick" aspect of the Yates Memo principles—*you had better comply, or else…*—rather than the "carrot" aspect—*you will receive a downward adjustment of FCA damages and penalties if you comply.* In his more recent September 9 comments, Baer has focused more on the benefits companies can receive if they comply, and what does, and does not, constitute compliance. Specifically, in addressing the concept of what DOJ will consider to be "full cooperation" by companies, Baer commented that (1) cooperation needs to be proactive and should materially assist DOJ; (2) cooperation must be timely, early in DOJ's investigation; (3) cooperation should involve company identification of facts that will enable DOJ to "net greater recoveries;" and (4) cooperation *does not* include responding to a subpoena, forcing the Government to build the case "from the ground up," or "one-sided presentations urging the department to decline an enforcement action."

Defense counsel have expressed concern that legitimate efforts to defend a company could be interpreted by DOJ as failure to cooperate, and also, that it appears that DOJ is asking, if not requiring, defense counsel themselves to build DOJ's cases for DOJ.

ii. CEO and Executive Personal Settlements of FCA Allegations

Mr. Baer's September speech was followed immediately by two high profile DOJ settlements of FCA allegations not only with companies but also with highly placed company executives. On September 19, 2016, DOJ announced that North American Health Care ("NAHC") had agreed to pay $28.5 million and that its chairman of the board and vice president agreed to pay $1 million and $500,000 respectively, to settle FCA allegations. The settlement released only the company and the two executives, not any other individuals, and required the individuals to cooperate in any further investigation of the matters.

On September 27, 2016, DOJ announced settlement of FCA allegations with the former CEO of Tuomey Healthcare, two years after his departure from company and a year after the company had settled. The settlement requires the former CEO to pay $1 million and refrain from participating in any federal health care programs or programs paid for by federal health care programs. The settlement also requires the former CEO to release Tuomey from any indemnification claims he may have had against the company.

c. New Yates Comments and Renewed DOJ Emphasis on the Yates Memo Principles

i. A New "Yates Memo" Website and FAQ Sheet

DAG Yates has also offered recent comments signaling more intense application of the Yates Memo principles in civil matters going forward. Yates noted that while it might seem that DOJ has been slow to apply the principles, it often takes months and years for investigations to unfold, and DOJ attorneys have been diligently following the principles. She predicts that upcoming settlements and cases will demonstrate this. Yates also announced new tools for DOJ attorneys to implement the principles, including a website, https://www.justice.gov/dag/individual-accountability, and FAQ sheet, https://www.justice.gov/dag/individual-accountability/faq. The first six questions and answers in the FAQ deal with criminal cases; only the seventh question and answer address civil matters, and only cursorily:

> "7. Does the 'all facts' cooperation requirement apply in civil matters as well?
>
> Yes. If a company wishes to receive cooperation credit in a civil matter, it must disclose the relevant facts regarding the individuals involved in the misconduct."

Counsel for companies point out that DOJ offers little to explain how companies will receive downward credit (reduction in FCA settlement amounts) and how that credit will be calculated.

ii. Revisions to the United State Attorney Manual ("USAM")

DAG Yates has also recently highlighted revisions to the USAM that are specifically designed to provide greater guidance to DOJ attorneys regarding application of the "Filip factors," which parallel the Yates Memo principles. The revisions include a new section in the USAM civil actions chapter regarding the principles.

5. Questions and Issues Relating to Mandatory Disclosure

a. Effect on resolution of mandatory disclosures

i. The policies in the Memo and Speech technically apply only to DOJ proceedings; however, the Memo and Speech make clear that the policies may well affect resolution of any form of civil or administrative proceeding. E.g., the Memo, at 5, specifically mentions suspension and debarment considerations. What, if any, effect will these policies have on agency Inspectors General and agencies in their pursuit and resolution of contractor mandatory disclosures? In addition, what, if any, effect will these policies have on how companies are required to conduct internal investigations?

b. Merging of criminal and civil/administrative considerations

i. The Memo, at 3, stresses the need for constant contact between/among criminal and civil attorneys. The Speech, at 4, invites "defense lawyers" to "pick up the phone and discuss [the matter] with the prosecutor." These are concepts in the realm of mandatory disclosures.

ii. The Speech, at 2, references the advantages of "an inside cooperating witness, preferably one identified early enough to wear a wire." Will contractors be expected to wire employees as part of internal investigations?

iii. Links drawn in the Memo and Speech between criminal investigation and civil proceedings are rather direct in places. For example, the Memo, at 3, instructs contractors to "provide inside information against individuals higher up the corporate hierarchy." The NYU Speech, at 3, references expectations that companies will "give up" or "cough up" higher-level executives. The Speech analogizes that "[a] drug trafficker can decide to flip against his co-conspirators. He can proffer to the government the full scope of the criminal scheme. He can take the stand for the government and testify against a dozen street-level dealers. But if he has information about the cartel boss and declines to share it, we rip up his cooperation agreement and he serves his full sentence. The same is true here. A corporation should get no special treatment as a cooperator simply because the crimes took place behind a desk."

c. Preservation of company and individual legal privileges and concepts of confidentiality

i. The gist of the Memo is that contractors must provide ***ALL*** information regarding the identity and level of participation of individuals in matters disclosed. Many in the bar predict that individuals may "lawyer up" if the Yates principles are applied to Mandatory Disclosure proceedings. The potential complications for Mandatory Disclosure proceedings include the following:

ii. Time—This could substantially retard resolution, and even the ability of contractors to investigate, matters;

iii. Stretch DOJ and Contractor Resources—This could significantly increase the resources needed to resolved these matters;

iv. Enormous tension between (a) the protection of legal privileges for individuals and (b) the contractor's need to obtain and disclose all relevant information regarding the involvement of individuals. This could potentially lead to allegations of non-cooperation against both contractors and individuals; and

v. Settlements—This could increase the complexity of attempting to settle civil FCA matters, and attempting to close out Mandatory Disclosure matters, due to the competing interests of individuals, the contractor, the agency, IG, DOJ criminal, DOJ civil.

6. What's next, Mr. Trump, et al.?

At one of her recent speeches Yates commented that the question she is most frequently asked is "one that I can't fully answer": "In 51 days, a new team will be running the department, and it will be up to them to decide whether they want to continue the policies that we've implemented in recent years. But I'm optimistic. Holding individuals accountable for corporate wrongdoing isn't ideological; it's good law enforcement. . . . There are, of course, a significant number of corporate investigations that began after we issued the Memo last September and won't result in public filings until well into the next administration. And in those cases, we know that the agents and prosecutors are hard at work determining which, if any, individuals should be subject to criminal or civil penalties. I expect that, in coming months and years, when companies enter into high-dollar resolutions with the Justice Department, you'll see a higher percentage of those cases accompanied by criminal or civil actions against the responsible individuals."

B. Developments Regarding Implied Certification

1. Implied Certification and the Supreme Court's Decision in *United Health Services, Inc. v. United States ex rel. Escobar*, 136 S.Ct. 1989 (2016).

a. In recent years, many courts have weighed in on "implied certification," establishing different standards that have diverged in the circuits. The basic premise underlying the implied certification theory is that, even where a contractor does not expressly certify its compliance with a certain contract requirement when it submits a request for payment to the Government, it impliedly certifies that it has complied with all contractual and regulatory requirements that are a prerequisite to payment – or, alternatively, all contractual and regulatory requirements that are material to the Government's decision to pay the claim.

b. The decisions adopting implied certification theories have had the practical effect of imposing FCA liability for what might otherwise have been characterized as contractual disputes and/or violations of statutes and regulations, many of which have other remedies. While it is unclear how implied certification theories would be treated by Government enforcement officials considering application of the MDR, these theories should be taken into account by contractors when analyzing disclosure obligations under the MDR, and when considering whether there exists "credible evidence" of a violation of the civil False Claims Act.

c. In 2016, the Supreme Court addressed the implied certification issue head-on in *Escobar*, 58 No. 24 GC ¶ 219 (Jun. 22, 2016), which validated the implied certification theory, but articulated important limits. In *Escobar*, the relators alleged that a subsidiary of United Health Services submitted false claims for reimbursement to the Massachusetts Medicaid program because the company's counselors were not properly licensed or authorized to provide the services that were provided and charged. Although the claims did not expressly state that they were contingent on compliance with these particular state regulations, the relators argued that under the implied certification theory, UHS certified compliance with the regulations by submitting its claims for reimbursement. The Court decided two questions in *Escobar*: (1) whether the implied certification theory is a valid theory of liability under the FCA; and (2) whether a violation of a legal requirement must also be an express condition to payment in order to impose liability under the FCA.

d. The Court held that implied certification *can be* a valid basis for FCA liability if the certification is *material*. The Court articulated that an omission or misrepresentation must relate to "specific representations about the goods or services provided" and that the "failure to disclose non-compliance with material statutory, regulatory, or contractual requirements makes those representations misleading half-truths." The Court further rejected the "express condition to payment" standard in favor of a broader and more fact-intensive materiality requirement.

2. Interpreting Materiality.

a. Since the ruling in *Escobar*, courts have taken varying positions on materiality. Contractors should pay close attention to what courts consider material, given that it will impact the contractor's decision to disclose violations that may otherwise impose FCA liability if they are, in fact, material.

b. On remand at the First Circuit in *United States ex rel. Escobar v. Universal Health Services, Inc.*, 842 F.3d 103 (1st Cir. 2016), the court, applying the materiality test set forth in by the Supreme Court, again found that the omissions at issue were material and sufficiently stated a claim under the FCA using the implied certification theory. The First Circuit expanded on the Supreme Court's analysis, noting that the Supreme Court opinion "makes clear that courts are to conduct a holistic approach to determining materiality in connection with a payment decision, with no one factor being necessarily dispositive." The court found that the "centrality of the licensing and supervision requirements in the MassHealth regulatory program" went "to the 'very essence of the bargain.'" Importantly the court focused on the knowledge of the paying entity, not the state regulators, when analyzing whether payment despite government knowledge showed "non-materiality," noting that there was "no evidence that MassHealth continued to pay the claims despite actual knowledge of the violations."

c. A case currently on appeal at the Eleventh Circuit deals directly with the post-*Escobar* interpretation of materiality as it applies in the MDR context. In March 2016, the N.D. Alabama dismissed a case brought by relators alleging that the failure to disclose instances of bribery and unethical conduct under FAR 52.203-13 (Contractor Code of Business Ethics and Conduct) amounted to a violation of the FCA under the implied certification theory. *See United States ex rel. Marsteller v. Tilton*, No. 5:13-cv-830, 2016 WL 1270586 (N.D. Ala. Mar. 31, 2016), *appeal docketed*, No. 16-11997 (11th Cir. Apr. 28, 2016). The district court based its dismissal largely on the fact that compliance with FAR 52.203-13 was not an express condition to payment (an argument that was squarely rejected in the *Escobar* decision that followed in June 2016). The district court further examined whether compliance with FAR 52.203-13 "was a 'material contractual requirement,'" and noted that the relators did not plead "any particularized facts tending to show the existence of 'objective requirements' in the contract that MD 'failed to provide'" or that the defendants "continued to bill the Government with the knowledge that [they were] not providing the contract's requirements." Given that the district court's analysis relied mainly on pre-*Escobar* reasoning that has now been called into question, DOJ (through an amicus brief) has urged the Eleventh Circuit to overturn the case on appeal, arguing that the defendants' failure to make proper mandatory disclosures can be misleading and influence the government's decision to pay under the contract.

d. In the Seventh and Eighth Circuits, there may be an emerging split over materiality. In *United States ex rel. Nelson v. Sanford-Brown, Ltd.*, 840 F.3d 445 (7th Cir. 2016); 58 No. 41 GC ¶ 388 (Nov. 2, 2016), the Seventh Circuit re-examined its prior ruling after the Supreme Court vacated and remanded the case to be decided in light of the *Escobar* ruling. In the original opinion, the Seventh Circuit found that entry into a Program Participation Agreement (PPA) with the Secretary of Education was not an implied certification that the defendant complied with the Department of Education's regulations, and that therefore the defendant's alleged subsequent failure to comply with the agreement did not support an action under the FCA. On remand from the Supreme Court, the Seventh Circuit affirmed its earlier ruling, finding that even under the *Escobar* analysis, the relator failed to show that the government's decision to pay "would likely or actually have been different had it known of SBC's alleged noncompliance with Title IV regulations." In a similar decision from the Eighth Circuit, the court found that similar noncompliance with Title IV regulations was material. In *United States ex rel. Miller v. Weston Educational, Inc.*, 840 F.3d 494 (8th Cir. 2016); 58 No. 41 GC ¶ 389 (Nov. 2, 2016), the Eight Circuit found that the government "expressly conditioned" participation in Title IV "on compliance with the record keeping requirement." The court further found that though the conditioning of the requirement was not "automatically dispositive of materiality" the requirement was actually "triple condition[ed]" through the regulatory scheme and through the government's actions, which showed it was a material requirement. The court noted that the government had previously terminated "otherwise eligible institutions for falsifying student attendance and grade records." Thus, the Eighth Circuit found the alleged violations of the Title IV requirements to be material here.

e. The varying interpretation of the *Escobar* materiality analysis underscores how fact specific the analysis is and how hard it will continue to be for contractors to properly interpret it. Robust analysis of the particular factual situation will be required for contractors to ensure that they are keeping up with issues that may require disclosure.

3. Interpreting Knowledge and Falsity.

a. Since the ruling in *Escobar*, courts have taken varying positions on the knowledge and falsity elements of a false claim. Such variances will affect a contractor's analysis of whether a violation rises to the level of a potential false claim. Contractors and counsel should be aware of such variances when assessing whether a mandatory disclosure may be required.

b. For instance, in *Rose v. Stephens Institute*, No. 09-cv-05966, 2016 WL 5076214 (N.D. Cal. Sept. 20, 2016), the district court rejected the notion that *Escobar* established a mandatory two-part falsity test for implied certification claims and found that misstatements may be material even if the government did not deny payment when made aware of them. The relators there claimed that the Academy of Art University ("AAU") violated the "incentive compensation ban" ("ICB"), which prohibited incentive payments for securing student admissions. *See* 20 U.S.C. § 1094(a)(20); 34 C.F.R. § 668.14(b)(22). AAU would then, allegedly in violation of the FCA, request funds for loans for these enrolled students. Initially, the district court noted that *Escobar* did not, as a matter of law, establish a rigid "two-part test" for falsity, as the Supreme Court stated that it "need not resolve whether all claims for payment implicitly represent that the billing party is legally entitled to payment." 136 S. Ct. at 2000. Even if this were not the case, the court reasoned, the relators raised a triable issue of fact because AAU's request for funds certified that its request was for an "eligible" student in an "eligible" program, which includes compliance with the ICB. Thus, the court concluded that these were "specific representations" that constituted "misleading half-truths" that met the *Escobar* standard.

c. In contrast, the court in *United States ex rel. Handal v. Center for Employment Training, et al.*, No. 2:13-cv-01697, 2016 WL 4210052 (E.D. Cal. Aug. 9, 2016), found that a relator *must* meet *Escobar*'s two-prong falsity test when alleging a claim for implied certification, where the defendant has previously made an express certification of compliance. In that case, former students filed a quit tam lawsuit against the Center for Employment Training ("CET"). The complaint indicated that CET's program participation agreement with the Department of Education expressly conditioned the school's continuing eligibility for funding on compliance with applicable statutory and regulatory provisions. The relators claimed that CET did not accurately disclose employment and/or job placement rates as the regulations required and, thus, falsely certified compliance. Reviewing CET's motion to dismiss, the district court applied the two-pronged falsity test from *Escobar* and found that CET had falsely represented its compliance, as "[t]he submission of a claim for payment following initial approval of a grant funding agreement is an implicit reaffirmation of compliance" and constitutes an implied certification claim. *Id.* at *5. Based on the relators' pleadings, the court declined to dismiss, concluding that the relators alleged specific instances of violations and that CET and two individuals had the requisite knowledge of the falsity. This case might be read as expanding the materiality requirement in relation to what could be considered a false representation. However, it is certainly early in the case and only based on a motion to dismiss. The merits could reflect a different interpretation.

d. The "knowledge" element of FCA cases was also discussed over the past year, with specific reference to the *government's* knowledge. Two cases in particular could lay down some more bright lines about payment in spite of government knowledge of alleged wrongdoing and its effects on a materiality analysis.

i. In *City of Chicago v. Purdue Pharma L.P.*, No. 14-4361, 2016 WL 5477522 (N.D. Ill. Sep. 29, 2016), the City of Chicago filed suit against various pharmaceutical companies, claiming that they had utilized a deceptive and unfair marketing campaign to encourage the use of opioids for chronic pain management, while downplaying the long term dangers of its use. The City alleged the defendants were liable under a theory of implied false certification, asserting that had it known about the true long term consequences of opioid use, it would have refused to authorize payment for them. Relying on *Escobar*, the district court concluded that the City may validly assert a theory of implied false certification. However, the defendants demonstrated that the City had continued paying for opioid prescriptions even *after* it had filed the lawsuit. The court reasoned that such actions indicated continued payment despite knowledge. The court dismissed the implied false certification claim but granted the City permission to refile based on the new *Escobar* standard.

ii. In *United States ex rel. McBride v. Halliburton*, No. 15-7144, (D.C. Cir. Filed Nov. 25, 2015), the D.C. Circuit added its two cents on this topic. There, a former Kellogg Brown & Root ("KBR") employee filed a quit am lawsuit against KBR, alleging that KBR misrepresented the number of people utilizing its recreation centers operated under a contract with the U.S. military. The employee argued that the headcounts related to increased cost structure and performance incentive fees, both of which were reimbursable by the government. KBR pointed out that the government had already investigated the relator's allegations and declined to disallow or recoup payment. The D.C. Circuit has yet to decide this case.

e. Over the past year, there have been further statutory developments of the "knowledge" requirement. In *United States ex rel. Harper v. Muskingum Watershed Conservancy Dist.*, 842 F.3d 430 (6th Cir. 2016), the Sixth Circuit discussed an amendment to the statutory scienter requirement for reverse false claims, which raises the bar for relators attempting to demonstrate "knowledge" by defendants. The court concluded that the new statutory language indicates that "unless the circumstances of a case show that a defendant knows of, or 'acts in deliberate ignorance' or 'reckless disregard' of, the fact that he is involved in conduct that violates a legal obligation to the United States, the defendant cannot be held liable under the FCA." *Id.* at 437.

i. In this case of first impression, a deed required Muskingum Watershed Conservancy District ("MWCD") to revert its land to the United States if it should cease using the land for recreation, conservation, and reservoir development or if it alienated or attempted to alienate the land (the "reverter clause"). Three interested Ohio residents filed a qui tam lawsuit, alleging that private fracking leases that the MWCD had executed violated the reverter clause and that, accordingly, the MWCD was knowingly withholding property from the federal government in violation of the FCA. Reviewing the district court's decision dismissing the complaint, the Sixth Circuit observed that in 2009, Congress amended the scienter requirement for reverse false claims. Previously, the scienter requirement required that a defendant "mak[e], us[e], or caus[e] to be made or used, a false record or statement." *Id.* at 436. Under the amendment, anyone who "knowingly and improperly avoids or decreases an obligation to pay money or transmit money or property to the Government" is civilly liable. 31 U.S.C. § 3729(a)(1)(G).

ii. The Sixth Circuit determined that the new requirement "should be interpreted to apply to both the existence of a relevant obligation and the defendant's own avoidance of that obligation." *Id.* at 436. Under its interpretation of the new scienter requirement, the Sixth Circuit held that the relators' amended complaint did not state a claim for relief. Although the relators demonstrated the WMCD's obligations under the reverter clause, they failed to demonstrate that it, in fact, believed that the restrictions applied and that it was knowingly avoiding that obligation. Thus, the court dismissed the relators' claims.

4. Cases Favoring Defendants on Dismissal.

a. Several post-*Escobar* circuit decisions have held that despite a new articulation of materiality, relators must still provide a sufficient factual nexus to support an FCA claim. In the Third and Fifth Circuits, two recent cases were dismissed under the Fed. R. Civ. P. 9(b) standard, with the courts holding that *Escobar* did not change the analysis required under 9(b). In *United States ex rel. Whatley v. Eastwick College*, 657 F. App'x 89 (3rd Cir. 2016), the relator alleged that several for-profit colleges had falsely certified compliance with various regulations in order to receive federal financial aid. The court affirmed dismissal of the claims under rule 9(b), finding that the complaint did not provide any details regarding the "time, place, and contents of the false representations or omissions" nor did the complaint identify a "person" who made the misrepresentations. The court noted that even under the implied certification standard, more than "conclusory assertions" are needed to avoid dismissal.

b. The Fifth Circuit reached a similar conclusion in *United States ex rel. Gage v. Davis S.R. Aviation, LLC*, 658 F. App'x 194 (5th Cir. 2016), *petition for cert. docketed*, No. 16-694 (U.S. Nov. 25, 2016). In *Gage* the relator's complaint alleged that the defendants "used defective parts in repairing and maintaining military aircraft" and that claims for payment under the contract imposed FCA liability. The case was dismissed because the court found that the complaint "fatally neglected to 'alleg[e] with particularity the *who, what, when, where*, and *how* of the . . . fraudulent scheme . . . ." On appeal, the relator argued that *Escobar* changed the pleading standard for violations of the FCA. The court found that *Escobar* had not changed the pleading standard, and that the relators still needed to "plead their claims with plausibility and particularity."

c. The Fourth Circuit also recently affirmed the dismissal of a post-*Escobar* FCA case under Fed. R. Civ. P. 12(b)(6), noting that *Escobar* held that "a relator can proceed under an implied certification theory" and that under the *Escobar* standard "[t]he relevant question is whether the defendant knowingly violated a requirement that the defendant knows is material to the government's decision to pay a claim." *United States ex rel. Garzione v. PAE Gov. Servs., Inc.*, No. 16-1349, 2016 WL 6518539 (4th Cir. Nov. 3, 2016). The court also noted that even under the standard as articulated in *Escobar*, the relator must still provide the "'who, what, when, where, and how of the alleged fraud'" and that the district court did not err in finding that the relator here failed to state a claim under that standard.

C. Public Disclosure

1. In *State Farm Fire & Casualty Co. v. United States ex rel. Rigsby*, No. 15-513, 2016 WL 7078622 (U.S. Dec. 6, 2016), the Supreme Court concluded that violations of the public disclosure bar do not require an automatic dismissal. There, relators alleged that an insurance provider defrauded the federal government in violation of the FCA. The insurance company asserted that the court lacked jurisdiction pursuant to the FCA's public disclosure bar, as the relators' previous lawyer had leaked some information about the circumstances surrounding the lawsuit to the press. The Supreme Court noted that the public disclosure bar does not outline any remedy, and thus, dismissal is only one of various remedial tools the district court has at its disposal.

2. After the relators in *United States ex rel. Beauchamp v. Academi Training Ctr., LLC*, 816 F.3d 37 (4th Cir. 2016); 58 No. 3 GC ¶ 81 (Mar. 9, 2016) had filed suit, two former employees filed a wrongful termination suit against the same defendant, noting additional circumstances supporting the relators' claims. A news article noted both lawsuits. The relators subsequently amended their complaint to reflect additional details of the scheme, and the defendant claimed that the relators' amended complaint was prohibited under the public disclosure bar. The Fourth Circuit disagreed, holding that "the public-disclosure bar is governed by the date of the first pleading to particularly allege the relevant fraud and not by the timing of any subsequent pleading." *Id.* at 46.

3. In *United States ex rel. Mateski v. Raytheon Co.*, 816 F.3d 565 (9th Cir. 2016), an engineer filed a qui tam lawsuit against Raytheon, claiming that it had improperly billed the government on a project. Raytheon contended that the project's mismanagement and delays was publicly disclosed, as it had been discussed in news articles. The Ninth Circuit held that the news articles did not constitute public disclosure, as they only discussed general mismanagement and delays, not specific enough encompass the fraud alleged.

D. Overpayments And Reverse False Claims

1. Under the MDR, the failure to disclose evidence of a "significant overpayment" can result in suspension or debarment (and potentially FCA liability), where the defendant fails to disclose and return the overpayment in a "timely" manner. Overpayments are also covered by the "reverse false claim" provision of the FCA, which allows for recovery by the government where someone "knowingly conceals or knowingly and improperly avoids or decreases an obligation to pay or transmit money or property to the Government." *See* 31 U.S.C. § 3729(a)(1)(G).

2. Two cases from the Eighth Circuit this year addressed the question of compliance with an ambiguous regulatory scheme and the creation of overpayments resulting in reverse false claims. *See United States ex rel. Estate of Donegan v. Anesthesia Assocs. of Kan. City, PC*, 833 F.3d 874 (8th Cir. 2016); *United States ex rel. Olson v. Fairview Health Servs., of Minn.*, 831 F.3d 1063 (8th Cir. 2016). In both cases, the court ruled that a defendant does not act with reckless disregard when it adopts a reasonable interpretation of an ambiguous law.

3. In *Donegan*, questions arose over when "emergence" occurs during the implementation of an anesthesia plan and whether all requirements of the regulation were met by the anesthesiologists at the particular facility. The relator alleged that defendant failed to comply with the "emergence" portion of the regulation because the anesthesiologist was not present during "emergence." The relator claimed that "AAKC knowingly violated the FCA by seeking reimbursement at the Medical Direction rate despite its noncompliance with this regulatory requirement." The district court granted summary judgment to AAKC because the term "emergence" was not defined and was ambiguous and AAKC's interpretation of the term was reasonable, thus it "belies the scienter necessary to establish a claim of fraud under the FCA." The Eighth Circuit upheld the dismissal, finding that the relator failed to provide any evidence that "the government had warned AAKC that the agency interpreted [emergence] differently." Thus, the court found that the requisite scienter was not present where the ambiguous term was reasonably interpreted by the defendant and the government provided no warnings to the contrary at the time of payment.

4. In *Olson*, the Eight Circuit went one step further, applying similar reasoning from *Donegan* in the overpayment context. In this case, the relator alleged that the defendant had fraudulently induced the Minnesota Department of Human Services to overpay for Medicaid services, where there was a question over whether defendant's facility qualified for an exemption in the law for children's hospitals (which resulted in additional money being paid out on the defendant's claims). Defendant had lobbied the state government to have its children's units included under the law and eventually the state legislature amended the law to retroactively include them. The court disagreed with relator's position that the defendant had an "obligation" to pay back the money received for the exemption because there was only the potential for liability at the time the payments were made given that the legal question over whether the exemption applied was unresolved. In analyzing the standard under the FCA, the court noted that the FCA was designed to cover certain "fraudulent conduct" only and that "[i]f the FCA is not meant to cover all types of fraud, it would be unreasonable to assume that it covers both fraudulent and nonfraudulent conduct." The court found that the FCA's reverse false claims provision requires fraudulent action, not simply negligence, when it makes a mistake in construing the law related to overpayments stemming from billing rates for health care services.

IV. NEW FRONTIERS IN FEDERAL DISCLOSURE REQUIREMENTS

A. Cybersecurity Disclosure Requirements

1. FAR 252.204-7012 Safeguarding Covered Defense Information and Cyber Incident Reporting requires disclosure of data breaches and sets forth standards for securing information. Recent thought leadership suggests breaches of this provision could be the basis for a false claim, discussing the implications of *United States ex rel. Sheldon v. Kettering Health Network*, 816 F.3d 399 (6th Cir. 2016), where the court rejected an FCA claim for alleged non-compliance with the HITECH act (related to healthcare data security). *See* 58 No. 5 GC ¶ 34.

2. A final rule, Network Penetration Reporting and Contracting for Cloud Services, DFARS Case 2013-D018, builds on current requirements for cyber reporting. The final rule changes the proposed definition of covered defense information to bring it in line with the existing definition. The final rule also clarifies subcontractor reporting requirements, allowing subcontractors to report straight to DOD while simply providing the prime with an incident report number to track. *See* 58 No. 41 GC ¶ 387 (Nov. 2, 2016).

B. Fair Pay and Safe Workplaces

1. Disclosure requirements under the Fair Pay and Safe Workplaces Executive Order (EO 13673) remain in a state of flux. On August 25, 2016, the FAR Council released a final rule implementing requirements of EO 13673. *See* 58 No. 33 GC ¶ 304 (Aug. 31, 2016). The rule required prospective and existing contractors on covered contracts to disclose administrative determinations, arbitral awards, and civil judgments from the preceding three years finding—or in some circumstances merely alleging—violations of 14 enumerated labor laws and state law equivalents. The final rule provided an effective date of October 25, 2016; however, on October 24, 2016, the U.S. District Court for the Eastern District of Texas issued a preliminary injunction to prevent certain provisions of the regulations from taking effect. The Trump Administration's purported plan to revoke certain Obama Administration executive orders adds to the uncertainty surrounding Fair Pay and Safe Workplaces disclosure requirements.

C. Strengthening Protections Against Trafficking in Persons in Federal Contracts

1. On December 8, 2016, the Office of Federal Procurement Policy published draft guidance developed in coordination with the Office to Monitor and Combat Trafficking in Persons in the Department of State and the Department of Labor. *See* 81 Fed. Reg. 88707 (Dec. 8, 2016). The draft guidance addressed anti-trafficking risk management best practices and mitigation considerations, designed to help an agency determine if a contractor is taking adequate steps to meet its anti-trafficking responsibilities. The "corrective actions" section specifically addresses the rule's reporting requirements: "The entity has developed targeted corrective action plans for addressing identified risks, and monitored progress through reporting, direct monitoring, and follow-up audits for any sites identified as being in nonconformance. It also works with suppliers to implement information reporting processes for high-risk sites, such as through self-audit reports and supplier-conducted employee surveys." Also with regard to reporting requirements, the draft guidance reiterates the requirement to report "credible" information of a violation, and also notes that "Agencies should encourage their contractors to remediate issues that fall outside the scope of FAR 52.222-50(b), and as circumstances warrant, to report to law enforcement and/or call an appropriate local NGO or hotline with any information about the violation." The draft guidance also sets forth the steps taken by a contracting officer after receiving credible information of a violation.

D. Disclosures Pursuant To DFARS Anti-Counterfeit Parts Rules

1. On May 6, 2014, the DOD issued its final anti-counterfeit rule, amending the DFARS. Contractors subject to the rule must establish and maintain a counterfeit electronic part detection and avoidance system in compliance with the new rule. Among the 12 criteria that a contractor must address in its system to detect and avoid counterfeit electronic parts, the new regulation states that "reporting is required to the Contracting Officer and to the Government-Industry Data Exchange Program." This reporting obligation is triggered when the contractor has "reason to suspect" that any electronic parts purchased by the DOD, or to be delivered to the DOD, contain counterfeit electronic parts. The preamble to the rule in the Federal Register noted that some, but not all, counterfeit or suspect counterfeit parts may need to be reported to the DOD IG under separate and pre-existing mandatory fraud disclosure requirements. 79 Fed. Reg. 26103; Contractor Counterfeit Electronic Part Detection and Avoidance System, 48 C.F.R. § 252.246-7007(c)(6); 56 No. 25 GC ¶ 215 (July 9, 2014).

2. On August 2, 2016, DOD issued a final rule, "Detection and Avoidance of Counterfeit Parts—Further Implementation." *See* 58 No. 30 GC ¶ 279 (Aug. 10, 2016). The rule addressed required sources of electronic parts for contractors and subcontractors. The rule, implemented at DFARS 252.246-7008, Sources of Electronic Parts, requires defense contractors and subcontractors who are not the original manufacturer of an electronic component to notify the contracting officer if it is not possible to obtain the part from a "trusted" supplier. If a contract obtains electronic parts from a company that is not a trusted supplier, the rule puts the onus on the contractor for inspection, testing, and authentication of the parts.

3. On August 30, 2016, DOD issued a final rule implementing a safe harbor for contractors that inadvertently use counterfeit or suspected counterfeit parts in defense procurements. The rule, "Costs Related to Counterfeit Electronic Parts," is codified at DFARS 231.205-71. The safe harbor covers contractors only if they have a counterfeit parts detection and avoidance system in place previously approved by DOD, and if they notify DOD within 60 days of becoming aware of the counterfeits. *See* 58 No. 34 GC ¶ 312 (Sept. 14, 2016).

E. Developments In Voluntary Disclosure Program For Export Control Violations

1. An October 31, 2016 proposed rule may have a chilling effect on current disclosure programs for contractors. The rule, "Withholding of Unclassified Technical Data and Technology from Public Disclosure," states that when a DOD component receives "substantial and credible information" that a contractor has violated export control laws, DOD will temporarily, and perhaps ultimately permanently, revoke that contractor's qualifications for access to controlled technical data and technology. *See* 81 Fed. Reg. 75352 (Oct. 31, 2016); 58 No. 42 GC ¶ 396 (Nov. 9, 2016). Because contractors are encouraged to voluntarily self-disclose export violations under International Traffic in Arms Regulations as well as under the civil FCA to the extent the violation results in a false claim for payment, contractors now risk that such self-disclosure will result in the loss of access to needed technical data and technology. It is therefore possible that contractors faced with such an issue will decide that the risk of non-disclosure does not outweigh the risk of losing access to such necessary information.