

# AVOIDING FCA AND SEC LITIGATION FOR GOVERNMENT CONTRACTORS

October 16, 2019



# FCA and SEC Whistleblowers

## ▶ False Claims Act (FCA)

- 31 U.S.C. §§ 3729 – 3733: can be brought by DOJ or *qui tam* relators
  - *Qui tam* path provides bounty incentive to successful relators: 15-25% (if DOJ intervenes) or 25-30% (if DOJ declines)

## ▶ SEC's whistleblower program

- 15 U. S. C. §78u–6 and 17 CFR §240.21F: Authorizes SEC to award bounty, provides for a private right of action and permits SEC to bring enforcement proceeding for whistleblower retaliation.

# FCA and SEC Whistleblowers

- **Total of 645 new FCA *qui tam* cases filed FY 2018**  
(almost two new per week)
  - 669 new *qui tam* cases filed FY 2017
  - 702 new *qui tam* cases filed FY 2016
  - 638 new *qui tam* cases filed FY 2015
  - 700 new *qui tam* cases filed FY 2014
- **DOJ recovered \$2.8 billion in FCA cases FY 2018**
  - \$2.1 billion from *qui tam* cases (75%)
  - Significant recoveries, but shows downward trend:
    - FY 2017 = \$3.7 billion (\$3.4B / 92% from *qui tam*)
    - FY 2016 = \$4.7 billion (\$2.9B / 62% from *qui tam*)
    - FY 2015 = \$3.5 billion (\$2.8B / 80% from *qui tam*)
    - FY 2014 = \$5.7 billion (\$3.0B / 50% from *qui tam*)

# FCA and SEC Whistleblowers

- **Total of 5,282 new SEC whistleblower complaints filed FY 2018**
  - 4,484 new whistleblower complaints filed FY 2017
  - 4,218 new whistleblower complaints filed FY 2016
  - 3,923 new whistleblower complaints filed FY 2015
  - 3,620 new whistleblower complaints filed FY 2014
- **SEC has Awarded \$326 million to 59 individuals since program inception**
  - FY 2018: \$168 million awarded to 13 individuals
  - As of the end of FY 2018, \$300 million available to make future awards.

# Effective Compliance & Investigations

- Tone at top
- Code of conduct
- Establish risk assessment and management procedures
- Setting up reporting methods / protocols – redundant or alternative methods
- Publicizing the reporting methods within the organization
- Set and follow document retention procedures for ordinary course business operations
- Set reporting chain of command – ensure path to highest levels of organization – define types of issue that need urgent, high-level attention
- Regular testing and audit of program effectiveness

# Effective Compliance & Investigations

- Possible SEC implications concerning control environment:
  - Internal Control Charges
    - ICFR
      - Controls designed to assure GAAP compliant reporting
      - Monday Morning Quarterback: if a violation occurred there must be a internal controls violation
    - Disclosure Controls
      - New charging trend combined with Exchange Act Section 13(a)
      - If something would be “material to investors” even without material impact on financial statements
  - Books and Records Charges
    - No error to small
  - SEC Anti-Retaliation Rules

# Hypothetical: Jenn Counsel

It's Monday morning, your favorite day of the week. You had a wonderful weekend. You're drinking a cup of coffee that's precisely the right temperature.

The company's brand new Ethics Director calls to say a report came in through the hot line overnight. The report is not signed, but it bears the markings of an employee who's known as a squeaky wheel and a gossip. However, the complaint touches upon a compliance issue with one of the companies most significant government contracts.

# Hypothetical: Jenn Counsel

The Ethics Director wonders if you should send the employee home until further notice. Should you?

Pull her personnel file?

Investigate the identity of the complaint source?

Go to the suspected source's manager and tell them about the believed source and content of the complaint?

What would you do?



# Whistleblower Issues

- **Common source of information and complaints**
- **Whistleblower retaliation considerations:**
  - Internal anti-retaliation protections and “tone at the top”
  - SEC-related protections
    - Dodd-Frank [15 U. S. C. §78u–6] prohibits discharging, harassing, or otherwise discriminating against a “whistleblower” that (1) provides the SEC information (2) testifies or assists in any SEC investigation, or (3) makes “disclosures that are required or protected under” SOX (internal reporting).
    - Report concerns any violation of the Exchange Act, the criminal anti-retaliation prohibition at 18 U. S. C. §1513(e), or “any other law, rule, or regulation subject to the jurisdiction of the Commission,” §78u– 6(h)(1)(A)(iii).
  - Awards: the SEC may pay 10-30% of the monetary sanctions collected in the enforcement action. §78u–6(b)(1)(A)–(B).
  - Direct Civil Action: Whistleblower may recover double backpay with interest, reinstatement, and compensation for litigation costs, expert witness fees, and reasonable attorneys’ fees. 18 U.S.C §78u– 6(h)(1)(C)(i), (iii)
  - SEC has brought several enforcement action for whistleblower retaliation under Rule 21F

# Whistleblower Issues

- FCA-related protections
  - 31 U.S.C. § 3730(h)(1) protects whistleblowers from retaliation in the form of their being “discharged, demoted, suspended, threatened, harassed, or in any other manner discriminated against in the terms and conditions of employment.”
    - Relief includes: (i) reinstatement; (ii) double back pay + interest; (iii) fees and costs
    - Recent decision allowed FCA retaliation protections to possibly extend beyond pure employment-based relationship – may apply to partners. *See U.S. ex rel. Kraemer v. United Dairies, L.L.P.*, 2019 WL 2524770 (D. Minn. June 19, 2019).
- State Statutes
- Sanctions for violations of anti-retaliation protections

# Manage interactions with / reaction to whistleblower – “Care and Feeding”

- Resist desire to seek out and identify
- Whistleblower protections are strict and severe
- Set protocols
  - If whistleblower known, limit ongoing contact with personnel implicated in report
  - Make clear statements— zero tolerance for retaliation against whistleblowers
- Contact with whistleblower’s counsel

# Hypothetical: Jenn Counsel

As you and the Ethics Director are reviewing the hot line report, you quickly take note that one of the allegations centers around advice the reporter claims to have received from another lawyer on the company's legal team to conceal test results showing a deliverable failed to meet contractual specifications. You are not that lawyer's manager, but you know she's just about to go on safari for three weeks. Should you call her right away?

# Reactions to initial report

- ▶ **Fix the roof while the sun is shining**
  - Set up protocols and systems in advance
- ▶ **Triage incoming complaints:**
  - Review information in report carefully
  - Selecting team / person to do review (independence needed)
  - Identify potential risk issues – especially worst-case scenarios – look for any possible red flags
  - Consider customer relationship – related to but distinct from legal issues
  - Evaluate severity, scope, internal conflicts
    - Conduct limited within organization or potentially widespread
    - Reports that involve members of organization's legal department
    - When to get outside counsel involved

# Reactions to initial report

- ▶ Reasonable and thorough process is critical
  - Set scope of review:
    - Broad enough to encompass possible acts and wrongdoers
      - Narrow enough to be efficient and avoid unnecessary distractions / fear among employees
      - Ensure credible reports of risk get thorough review
  - Interviews of relevant personnel at all levels
  - Issue appropriate document holds – gather and review documents
  - Identify and review applicable policies and procedures
  - Steps to maintain and establish privilege
  - Make necessary scope adjustments

# Reactions to initial report

- ▶ Determine output and audience for report
  - Oral or written reports
  - Follow reporting chain of command protocols
  - Consider privilege issues
- ▶ Disclosure to USG needed?
- ▶ Disclosure to customer needed?

# Hypothetical: Jenn Counsel

As you continue to work with outside counsel, it becomes apparent that, as alleged, the deliverable test results were not disclosed, but you have been told that the defect in the deliverable was corrected before final delivery, and the value of the contract is \$4.5 million. The investigation is still in progress, but you're starting to consider whether some sort of disclosure to the Customer is or will be required. Do you have enough information to decide, and if not, what's another data point that would help you come to a decision?



# Disclosures to / interactions with USG – issues to consider

- ▶ Mandatory disclosure required by FAR 52.203-13:
  - Must make “timely” disclosure to the agency when it has “credible evidence” of procurement-related federal criminal and FCA violations
  - Applies to contracts valued >\$5.5 million
  - Must be flowed down to subcontractors
  - Failure may lead to debarment

# Hypothetical: Jenn Counsel

As the investigation proceeds, you learn that the error was not corrected before shipment. There is a significant question as to the resulting value loss to the government. You also learn that the issue should have been normally been caught in the quality control process, however, the person who normally oversees the issue has been on leave. Moreover, the issue was not communicated up through management as the team on the ground thought they could correct the problem before anyone would know.

# Disclosures to / interactions with USG – issues to consider (cont.)

- Public Disclosure Issues
- Government Disclosure and Public Disclosure do not always align
  - Debarment and ITAR considerations
  - No general duty to report on yourself to government or shareholders
    - *In re Lions Gate Entm't Corp. Sec. Litig.*, 165 F. Supp. 3d 1, 11 (S.D.N.Y. 2016)
  - Public disclosure considerations
    - Public offerings
    - Retirement plans
    - Insider Trading considerations

# Disclosures to / interactions with USG – issues to consider (cont.)

## ► Disclosure to DOJ

- Balance disclosure risks with potential benefits
- DOJ cooperation credit can be significant mitigation
  - Disclosure can limit FCA damages to double (not treble), demonstrate cooperation
  - Justice Manual § 9-28.700: discusses the “value of cooperation”, states that “In order for a company to receive any consideration for cooperation under this section, the company must identify all individuals substantially involved in or responsible for the misconduct at issue, regardless of their position, status or seniority, and provide to the Department all relevant facts relating to that misconduct.”

# Disclosures to / interactions with USG – issues to consider (cont.)

## ▶ Disclosure to DOJ

- Balance disclosure risks with potential benefits
- DOJ cooperation credit can be significant mitigation
  - Privilege waiver issues. Manual vs. strategic considerations.
  - DOJ Justice Manual also says organization is not required to waive privilege to get credit, which creates challenges
  - DOJ policy not concrete guaranty of mitigation credit
  - Consider whether whistleblower forecloses any disclosure credit

# Disclosures to / interactions with USG – issues to consider (cont.)

## ▶ Disclosure to DOJ (cont.)

- Disclosure and individuals potentially involved in wrongdoing
  - Yates Memo – determine whether specific employees need to be identified to DOJ as bad actors (or risk losing cooperation credit)
  - Retain separate / pool counsel for employees?
  - Determine indemnification / fee advancement obligations

# Hypothetical: Jenn Counsel

It's been an exhausting several weeks, but the investigation was completed, the appropriate reporting was made, and the dust has settled. Can you just move on to the next crisis, or are there a broader lessons to be learned from this event, and if so, what's an example of one area to review?

# Responses to credible complaints

Regardless of disclosure decision – mitigation efforts and future risk management

- Re-evaluate risk management policies and procedures
  - Did the fail? If so, why?
  - How can they be strengthened?
  - What other parts of organization might have similar problems?
- Root cause analysis – after learning causes, ensure changes are targeted to cause(s)
- Evaluate chain of command
  - Did timely reports get delivered to empowered decision-makers?



# Responses to credible complaints (cont.)

- ▶ Mitigation efforts and future risk management (cont.)
  - Review code of conduct and SOPs for potential changes
  - Communicate outcomes as appropriate
    - Give credit to employees who acted responsibly
    - Consequences for employees who did not
  - Control testing and future audits areas of organization associated with misconduct
  - Re-evaluate reporting mechanisms – make adjustments if they failed to provide timely reporting path

# Financial Reporting Impact

- GAAP and FAR accounting are not always the same
- Materiality of Event
  - Quantitative
  - Qualitative
- Restatement v. Public SEC disclosure
- SEC Liability May Exist Even Without a Restatement
  - Disclosure controls
  - Exchange Act Section 13(a)
  - Internal controls and books and records