Government Contracts Blog

Posted at 12:38 PM on December 8, 2009 by Sheppard Mullin

Ninth Circuit Decision Emphasizes the Importance of a Well-Crafted FCA Settlement Agreement

With its recent decision in *Cell Therapeutics Inc. v. Lash Group Inc.,* 9th Cir., No. 08-35619, Nov. 18, 2009, the United States Court of Appeals for the Ninth Circuit took a dramatic step towards preserving the rights of False Claims Act (FCA) defendants. The court's ruling permits FCA *qui tam* defendants to seek recovery against third parties *vis-à-vis* contractual indemnity and independent claims after settling an FCA action with the government and an employee whistleblower (known as a "relator").

Factual Background

The case involves a cancer drug called Trisenox, which was developed by Cell Therapeutics, Inc. (CTI) and approved by the Food and Drug Administration (FDA) in September 2000. After receiving FDA approval, CTI engaged Documedics Acquisition Co. (Documedics) as a Medicare reimbursement consultant. CTI received mistaken advice from Documedics that certain "off-label" uses of the drug were reimbursable by Medicare even though the FDA had not approved such uses.

In late 2004, the government began investigating CTI and the Lash Group (Lash), Documedics' successor in interest. Approximately two years later, a CTI employee filed *qui tam* actions against both CTI and Lash. In 2007, the government intervened in the suit as to CTI but not as to Lash. CTI settled with the government and the relator shortly after the government intervened. Lash settled with the relator the following year. While the *qui tam* action was pending, CTI sued Lash in state court on several grounds.

Third Party Claims by *Qui Tam* Defendants in the Ninth Circuit

In allowing CTI to bring claims against Lash, the Ninth Circuit reversed and remanded a district court ruling that disallowed CTI's claims. The Ninth Circuit held that the district court's opinion improperly applied principles of law distilled from two previous Circuit opinions: (1) *Mortgages Inc. v. U.S. Dist. Ct.*, 934 F.2d 209 (9th Cir. 1991); and (2) *Madden v. Gen. Dynamics Corp*., 4 F.3d 827 (9th Cir. 1993).

In *Mortgages*, the Ninth Circuit directed dismissal of a *qui tam* defendant's counterclaims for indemnification against the relator. The *Mortgages* Court reasoned that there was "no right of indemnity or contribution among participants in a scheme to defraud the government in violation of the FCA." In *Madden*, the Ninth Circuit held that a *qui tam* defendant may bring independent claims (claims that do not seek indemnification or contribution) against a relator. Importantly, the *Madden* Court also held that dependent counterclaims (claims for indemnification or contribution that have the effect of "offsetting liability") should not be foreclosed until the *qui tam* defendant's liability is resolved. Premature dismissal of dependant counterclaims, reasoned the Ninth Circuit, offended procedural due process.

By failing to determine each claim's independence, the district court in *CTI* disregarded *Madden*. Similarly, the lower court ignored both *Mortgages* and *Madden* in ruling that CTI's claims against Lash were foreclosed *vis-à-vis* CTI's Settlement Agreement with the government and the relator. While neither case addressed the effect of a settlement agreement in FCA litigation, both cases relied on a finding of FCA liability as a condition precedent to dependent claim foreclosure.

The Significance of *CTI*

In a matter of first impression, the Ninth Circuit held that settlement agreements do not give rise, *ipso facto*, to a finding of FCA liability. Where, as in *CTI*, a settlement agreement lacks a "specific and clearly identified" admission of FCA liability or intent to admit FCA liability, neither *Mortgages* nor *Madden* acts to preclude claims (both dependent and independent) by *qui tam* defendants against third parties who were not parties to the agreement.

The *CTI* opinion operates, at least in the Ninth Circuit, to partially quell the anxiety that has permeated the realm of FCA litigation in the wake of the Fraud Enforcement Recovery Act of 2009 (FERA)[1]. As we noted in April, FERA's FCA amendments effect upon contractors a dramatic expansion of potential liability. As companies begin to grapple with a likely increase in post-FERA *qui tam* claims, *CTI* codifies what common sense already establishes. That is, absent a finding or stipulation of FCA liability, *qui tam* defendants are free to pursue all claims against non-relator third parties.

Given the sizeable majority of FCA cases that were settled prior to FERA's enactment, the FERA-spawned expansion of FCA liability substantially increases the likelihood that future FCA disputes will be resolved at the settlement table. In order to blunt the FCA liability sword that FERA sharpened, we suggest to contractors the following *CTI*-distilled factors be considered:

- First, identify all potential sources of indemnification at the beginning of a FCA investigation and preserve potential claims against those parties. Due to the likelihood of an indemnitor being a co-defendant, caution should be exercised in participating in joint defense agreements to avoid ethical complications;

- Second, if possible, include in any FCA-related settlement agreement to which your company is a party language that *clearly disclaims* FCA liability;

- Third, unless indemnification provisions are incorporated into the settlement, multi-party agreements should explicitly address actions between defendants; and

- Fourth, ensure that the settlement agreement *does not* release third parties against whom your company may want to file related actions.

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[1] Pub. L. No. 111-21