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False Claims Act Litigation and Implications for D&O and Professional Liability Insurers

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The Federal False Claims Act – 31 U.S.C. §§ 3729-3733 (the "FCA") permits private plaintiffs to pursue claims on behalf of, and sometimes with the intervention of, the U.S. Department of Justice ("DOJ"), against those presenting fraudulent claims for payment to the government. In recent years, FCA suits and the associated penalties are on the rise. In 2016 alone, over 800 new FCA cases were filed (the second-highest number to date), the DOJ recovered $4.7 billion, and penalties were doubled. Key industries historically affected by these suits include: healthcare (Medicare/Medicaid billing issues), education (student loans/grants), banking (mortgages and government-funded lending programs), and government defense contracts. However, these claims can involve any organization receiving payment for goods or services provided to the government. Noteworthy settlements and recoveries in 2016 include a $513 million payment by a hospital network, a $145 million payment by a nursing facility, a $125 million payment by energy department contractors, and a $92 million award against mortgage originators. The DOJ, consistent with the directives in the September 2015 Yates Memo, is focusing on individual wrongdoers and has secured multi-million dollar recoveries from those personally involved in the fraud.

With the increasing frequency and severity of FCA litigation, it is no surprise that companies look to their various insurance policies to help cover costs associated with these claims. FCA lawsuits present a number of issues for insurance coverage under Directors & Officers and Professional Liability lines of coverage, as highlighted in several noteworthy decisions.

1. General Background on the FCA

Key provisions in the FCA provide liability for any individual or organization that knowingly presents or conspires to present a false or fraudulent claim for payment to the government or uses a false record or statement that is material to such claim.[1]

Because it would be impossible and prohibitively expensive to monitor all government transactions, the *qui tam* provisions of the statute allow whistleblowers, also known as relators, to pursue claims on behalf of the government and reap part of the recovery obtained. Relators file complaints under seal in federal court, at which point the DOJ investigates and decides whether to intervene in the case. If the DOJ intervenes, it leads the litigation, but the relator still remains involved. If the government declines to intervene, the relator may continue to litigate on behalf of the government. As a reward, the relator will receive 15% to 30% of any government recovery, even if the DOJ intervenes.

The statute allows for recovery of treble damages, civil penalties,[2] and all attorney fees and costs in pursuit of the claim, which incentivizes plaintiffs' counsel to pursue these claims.

In addition to the FCA, many states and some municipalities have similar provisions, some of which are limited to the healthcare

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[1] 31 U.S.C. §§ 3729(a)(1)(A, B, C).

[2] Claims for violations prior to August 1, 2016 are entitled to penalties of $5,500 to $11,000 per violation. Claims for violations after August 1, 2016 have increased to $10,781 to $21,564 per violation.

sector while others parallel the Federal statute to recover any payments made by the government on a fraudulent premise.[3]

2. "Knowing" Violations and Intentional Conduct

A defendant must "knowingly" violate the FCA in order to be liable. The statute defines knowingly to mean that a person has actual knowledge of the information, and acts in deliberate ignorance of the truth or falsity of the information *or* acts in reckless disregard of the truth or falsity of the information. The statute states that "knowingly" does not require specific intent to defraud.

Some FCA suits naturally involve a clear intent to defraud the government. Most insurance policies exclude liability for fraudulent acts perpetrated by insureds. Often, these exclusions carve out defense costs and insurers will defend their insureds or advance costs until there is a final adjudication of liability against the insured. However, other policies broadly exclude liability for fraud with no final determination of fault requirement before application. A 2014 decision in federal court in Illinois highlights insurance implications that can arise from the "fraud" components of FCA suits. In *Gen. Star Nat'l Ins. Co. v. Adams Valuation Corp.,* 2014 WL 479759 (N.D. Ill. Feb. 6, 2014), the court held that a policy exclusion in the insured's errors and omissions policy for claims "arising out of a dishonest, fraudulent … act or omission, or intentional misrepresentation" precluded coverage for an FCA suit. The underlying case involved allegations that the insured defrauded the Federal Deposit Insurance Corporation by overstating property values that secured loans made by the bank, thereby reducing the bank's liability for insurance assessments. The court held that claims were precluded by the exclusion pursuant to the elements for establishing civil liability under the FCA. The exclusion did not require a final adjudication of liability and thus, the court held that the insurer had no duty to defend.

Courts across the country have also recognized the uninsurability of intentional conduct for public policy considerations and the need to avoid an individual or organization reaping a benefit from insurance recovery for their willful conduct. By allowing insurance coverage for intentional conduct, courts reason that an insured does not face the consequences of that conduct and acts with reassurance that it will be insulated by insurance. Some states, like California, have gone further and codified this restriction by statute.[4]

The prohibition on insurance coverage for an insured's willful conduct raised issues in a recent case under the California False Claims Act. In *Office Depot, Inc. v. AIG Specialty Insurance Company*, Case No. 15-02416-SVW-LPRx (C.D. Cal. Jan. 4, 2017), the court analyzed whether an insurer had a duty to defend an underlying *qui tam* lawsuit alleging that Office Depot overcharged public entities in violation of the California False Claims Act. Office Depot settled the suit in 2014 for $77.5 million and sued its insurer, AIG, in 2015, claiming that AIG must reimburse Office Depot for the settlement and defense costs. AIG argued that the claims necessarily involved "willful acts" under California Insurance Code Section 533 ("Section 533"). Office Depot countered by emphasizing the "reckless disregard" element of the "knowing" requirement in the statute. Agreeing with AIG, the court held that coverage was precluded by Section 533 because the scienter requirement of specific intent to induce reliance required intent or knowledge such as to fall within the scope of Section 533.

While the FCA provides that the government need not prove specific intent to defraud, courts have recognized that the statute does not find culpability for "innocent mistakes and negligence."[5] This creates an inherent inconsistency with most professional liability policies which provide coverage for an insured's negligent acts, errors, and omissions. A 2008 decision in the Tenth Circuit Court of Appeals emphasizes the incompatibility of professional services policies for an insured's fraudulent billing practices. In *Zurich Am. Ins.*

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[3] A majority of states and the District of Columbia have enacted their own false claims acts, including Arkansas, California, Colorado, Connecticut, Delaware, Florida, Georgia, Hawaii, Illinois, Indiana, Iowa, Louisiana, Maryland, Massachusetts, Michigan, Minnesota, Montana, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Carolina, Oklahoma, Rhode Island, Tennessee, Texas, Vermont, Virginia, Washington, Wisconsin, and Wyoming. Additionally, several municipalities have comparable statutes, including Broward County, Florida; Chicago, Illinois; Allegheny County, Pennsylvania; the District of Columbia; Miami-Dade County, Florida; New York City, New York; and Philadelphia, Pennsylvania.

[4] Section 533 provides: An insurer is not liable for a loss caused by the wilful act of the insured; but he is not exonerated by the negligence of the insured, or of the insured's agents or others.

[5] *U.S. ex rel. Oliver v. Parsons Co.*, 195 F.3d 457 (9th Cir. 1999) (holding that innocent mistakes and negligence are not offenses under the FCA).

Co. v. O'Hara Reg'l Ctr. For Rehab., 529 F.3d 916 (10th Cir. 2008), the court found that there was no insurance coverage under the insured's professional liability policy for alleged overbilling for Medicaid and Medicare services because "the government's injury was not caused by [the insured]'s failure to provide professional services, but instead resulted from [the insured]'s submission of false and fraudulent claims for reimbursement." In reaching its holding, the court reasoned that processing Medicare and Medicaid claims and billing generally was not a professional service within the scope of the insured nursing facility's policy.

While some cases involve clear intent to defraud the government by overbilling or submitting receipts for services that were not rendered, an insured's intent is not always clear when the underlying regulations are complex such that compliance is debatable. Thus, the application of fraud exclusions and public policy limitations for willful acts may vary significantly pursuant to the individual facts of each claim and the specific policy language at issue.

3. "Damages" and Restitution

The FCA provides for civil penalties and treble damages. For public policy considerations, many insurance policies specifically exclude penalties from the definition of Damages or Loss payable under the policy. Numerous courts have confirmed that damages or recovery intended to punish a defendant are also not insurable so as to maintain the deterrent effect.[6]

As discussed above, the FCA aims to recover amounts wrongly paid by the government as a result of fraud. Case law across the country, including at the United States Supreme Court, further confirms that the statute aims to obtain restitution for the government.[7] Many courts across the country have held that restitution is uninsurable as a matter of law and public policy.[8] With the stated purpose of the statute in contrast with public policy considerations for insurance coverage, questions may arise as to whether the "damages" available under the FCA are insurable.

4. Other Applicable Exclusions & Limitations

Recent case law illustrates the potential trigger of regulatory exclusions, prior and pending date exclusions, and professional services exclusions.

Regulatory Exclusion: In *Certain Underwriters at Lloyd's London Subscribing to Policy No. QK0903325 v. Huron Consulting Group, Inc.,* 127 A.D.3d 663 (N.Y. App. Ct. 2015), the court held that a policy's exclusion for claims brought on behalf of any governmental entity barred coverage of a *qui tam* action asserting claims under the FCA and the New York False Claims Act for excessive Medicare and Medicaid billing. The exclusion precluded coverage for any "Damage, Penalties or Claim in connection with or resulting from any claim … brought by or on behalf of … any federal, state, local or foreign governmental entity, in such entity's regulatory or official capacity." The insured argued that the exclusion did not apply because the case was initiated and maintained by a relator, not the government. Rejecting this argument, the court stated that "[w]hile relators indisputably have a stake in the outcome of FCA qui tam cases that they initiate, the Government remains the real party in interest in any such action … [because] [a]ll of the acts that make a

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[6] *See*, e.g. *Soto v. State Farm Ins. Co.*, 635 N.E.2d 1222, 1224 (N.Y. 1994) (punitive damages are not insurable under New York's public policy); *PPG Indus., Inc. v. Transamerica Ins. Co.*, 975 P.2d 652, 657-58 (Cal. 1999) (public policy prohibits indemnification for punitive damages); *Country Manors Ass'n v. Master Antenna Sys.*, 534 So.2d 1187, 1195 (Fla. Dist. Ct. App. 1989) (holding coverage for punitive damages is prohibited by public policy if imposed as a result of direct liability, but not for vicarious liability); and *Beaver v. Country Mut. Ins. Co.*, 420 N.E.2d 1058, 1061 (Ill. App. Ct. 1981) (public policy prohibits coverage for punitive damages arising from insured's own misconduct, but it is not against public policy for an employer to insure against punitive damages arising from vicarious liability).

[7] *United States v. Bornstein*, 423 U.S. 303, 314 (1976) (quoting *United States ex rel. Marcus v. Hess*, 317 U.S. 537, 551-52 (1942) ("We think the chief purpose of the (Act's civil penalties) was to provide for restitution to the government of money taken from it by fraud … ."); *U.S. ex rel. Modglin v. DJO Glob., Inc.*, 114 F. Supp. 3d 993 (C.D. Cal. 2015) ("Originally enacted to punish and prevent massive frauds perpetrated by large contractors during the Civil War, the FCA's chief goal was to provide for restitution to the government of money taken from it by fraud."); *United States v. Northrop Corp.* 59 F.3d 953 (9th Cir. 1995) ("We recognize that the FCA aims at achieving deterrence as well as restitution."); *San Francisco Unified Sch. Dist. ex rel. Contreras v. Laidlaw Transit, Inc.*¸182 Cal.App.4th 438 (2010).

[8] See e.g., *Bank of the West v. Superior Court*, 2 Cal.4th 1254 (1992) ("It is well established that one may not insure against the risk of being ordered to return money or property that has been wrongfully acquired. Such orders do not award 'damages' as that term is used in insurance policies."); *Level 3 Comms., Inc. v. Federal Ins. Co.*, 272 F.3d 908 (7th Cir. 2001) (holding that loss does not include restoration of an ill-gotten gain); *JP Morgan Securities, Inc. v. Vigilant Ins. Co.*, 992 N.E.2d 1076 (N.Y. 2013)

person liable under the FCA focus on the fraud to secure payment from the government."

Prior and Pending Date Exclusion/Claims Made Issues: Many professional lines of insurance coverage only provide coverage for claims that are first made during the Insured's policy period and timely reported to the carrier in compliance with the policy's notice provisions. Because FCA suits are filed under seal while the DOJ investigates, determining when the insured first learns of the suit such that the policy is triggered can prove problematic. In *Amerisource Bergen Corp. v. Ace American Ins. Co.*, 100 A.3d 283 (Pa.Ct.Sup. 2014), the court held that a prior and pending litigation exclusion could apply to preclude coverage for a false claims act suit even though the complaint was filed under seal and not served upon the Insured until years later. Because the prior and pending litigation exclusion applied to suits "filed" or "commenced" by the enumerated date, the court reasoned the filing date of the suit must apply rather than the service date.

Other coverage issues may arise in determining when the "Claim" was "first made" against an insured or when an insured could have reasonably expected a "Claim" pursuant to earlier communications and investigative efforts or subpoenas from the DOJ.

Professional Services Exclusion: A 2016 case out of federal court in California highlights limitations for D&O coverage pursuant to professional services exclusions. In *HotChalk, Inc. v. Scottsdale Ins. Co.*, 2016 WL 6818760 (N.D. Cal. Nov. 15, 2016), the court held that a FCA suit against an insured academic solutions company for false certifications to the Department of Education regarding compliance with Title IV of the Higher Education Act necessarily involved the insured's professional services within the meaning of the professional services exclusion in the insured's policy. The court reasoned that absent the insured's professional services, it would not have been subject to the Higher Education Act's incentive compensation ban, the law that the insured allegedly violated in the FCA action. *HotChalk* emphasizes the intersection that can occur between an insured's professional services and FCA suits, potentially creating incompatibility with insurance coverage under D&O policies, most of which include professional services exclusions. The decision in *HotChalk* is currently on appeal.

5. Conclusion

As the frequency and severity of claims, penalties, and exposure under the FCA increase, there are likely to be many insurance coverage implications for various provisions of corporate policies.

Underwriters analyzing risk exposure in industries involved with government contracting are likely to evaluate potential FCA liability for their insureds, including reviewing safeguards put in place to prevent liability under the FCA. Additional questions may be raised about pending DOJ investigations or subpoenas received by insureds, which may have FCA aspects to them. As case law further addresses certain exclusions for FCA claims under D&O and professional liability policies, insureds seeking coverage for these claims may face more limitations to coverage. Further, the insurability of damages and specific carve-outs from Loss definitions will likely have an impact an insured's ability to obtain indemnity coverage for FCA claims. The continuing development of law on the FCA may also present novel challenges for insurers and insureds as plaintiffs test new boundaries of the law in efforts to obtain substantial recoveries.

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