

SCHOOL OF HARD KNOCKS: UNCERTAINTY IN FCA DAMAGES AWARDS LOOMS FOR UNIVERSITIES

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I. INTRODUCTION

In the past two years, the Department of Justice has recovered more than \$5 billion in settlements and judgments under the False Claims Act (“FCA”).¹ In 2006, *qui tam* suits accounted for \$1.3 billion of the total \$3.1 billion recovered;² and, in 2007, *qui tam* suits accounted for \$1.45 billion of the \$2 billion recovered.³ This boom in whistleblower litigation has extended the FCA’s reach beyond the traditional areas of defense contracting and health care fraud into other realms — including nonprofit organizations and universities.⁴ In these areas, a straightforward FCA damage analysis is not always feasible or appropriate. Uncertainty over how damages will be calculated is leaving universities vulnerable, perhaps to the point that some defendants have settled rather than risk disproportionately large damage awards.

In this article, we focus on evolving damages theories under the FCA, and on what these developments might mean for universities and research institutions confronting FCA liability. We also suggest strategies to avoid exposure to these uncertain damages.

The environment in which universities and research institutions operate creates particular challenges. They may receive multiple grants from a single sponsor, with interim charges and cost transfers to grants with periodic drawdowns. Moreover, accounting departments are decentralized (with each school within a university having an accounting department even though the university has a central post-award accounting office), and, in a culture in which professors and researchers do not track their time with precision, there is difficulty in estimating and tracking work efforts. This, coupled with a lack of understanding of the ever-increasing reach of the FCA and the novel theories that have helped to extend that reach, has set the stage for a rash of *qui tam* actions. As these actions progress, it becomes apparent that calculating damages is complex and uncertain.

II. CALCULATION OF DAMAGES UNDER THE FCA

The FCA exists to make the government “completely whole.”⁵ How a court will calculate single, or actual, damages depends on the type of fraud at issue. Generally, in product substitution or defective product cases, courts use the “benefit of the bargain” rule; *i.e.*, damages are the difference between the market value of the product delivered and the market value of the product promised.⁶ Courts calculate damages in collusion and certification cases as the amount the government would **not** have paid, had it known the true facts.⁷ Damages add up quickly under the FCA. Any person who violates the FCA is liable to the United States Government for up to “3 times the amount of damages which the Government sustains because of the act of that person”[.]⁸

III. CASES INVOLVING RESEARCH GRANTS TO UNIVERSITIES

Damages in procurement cases – the traditional subject of FCA claims – are easily defined. In contrast, damages in the types of cases that involve universities are less easily defined. Most cases against universities involve the use of federal grant funds. In most universities, the person in charge of the grant (the principal investigator, or “PI”) is a professor or research scientist who is not steeped in arcane knowledge of the Federal Acquisition Regulations. Many PIs are also full-time professor who are simultaneously juggling research, writing, and academic projects. In addition, most universities have decentralized accounting departments. As a practical matter, the PI and the accounting personnel working on a grant may never meet.

An early *qui tam* case involving grant funds, *U.S. ex rel. Hass v. South Carolina State University*, would today be considered a “slam dunk.” In that case, South Carolina State University received funds under several Department of Agriculture grant programs. The university used grant funds intended for agricultural research and forestry extension services to fund a construction project, which use was explicitly prohibited by the Food and Agriculture Act. The contractor filed a *qui tam* action in the United States District Court for the District of South Carolina. The university paid \$140,000 to settle the suit; of that amount, the relator received \$21,000.⁹ The damages in *Hass* were not difficult to calculate.

More recent FCA claims involving grant funds are less clear cut than was *Hass*. Many involve issues of effort reporting and cost transfers – areas that inherently lack precision.

A. Effort Reporting

The Office of Management and Budget (“OMB”) requires that universities that receive federal grants certify the effort and salary that are directly and indirectly allocated to a given project.¹⁰ OMB Circular A-21 is dense and sets forth a multitude of requirements. By way of example, OMB Circular A-21 provides that

[a]t least annually a statement will be signed by the employee, principal investigator, or responsible official(s) using suitable means of verification that the work was performed, stating that salaries and wages charged to sponsored agreements as direct charges, and to residual F&A [facilities and administrative, or indirect] costs or other categories are reasonable in relation to work performed.¹¹

Universities implement their own internal procedures to ensure compliance with these requirements. The University of Alabama at Birmingham’s Office of Grants and Contracts Administration, for example, maintains a website that contains the relevant policies and procedures. The University of Alabama at Birmingham requires researchers to provide quarterly Effort Reports to its accounting department.¹² Reporting of percent of effort is not intuitive. The percent of effort dedicated to a given grant is not necessarily the same as the percent of salary that is funded by that grant. Two possible scenarios under which this would be the case include a PI whose salary exceeds an applicable salary cap¹³ and a PI who agrees to commit a percent of

his or her effort to support a junior colleague's research without salary support.¹⁴ In addition, percent of effort is estimated prospectively. If an individual's percent of effort devoted to a National Institutes of Health grant will change by 25% or more from the approved level, the university must notify the National Institutes of Health.¹⁵

In certain instances, effort may be subject to cost sharing. Cost sharing, or matching, means that the university uses its funds to supplement the grant; cost sharing can be mandatory or voluntary.¹⁶ Cost sharing of effort is to be reported on the certified effort report and charged to a cost sharing account.¹⁷

A related issue is support from other sources. Grant applications require a university to report any support received from any other source. In one case, the Third Circuit reversed a grant of summary judgment, concluding that there was genuine issue of fact regarding whether the PI knowingly submitted a false claim when he failed to disclose on a grant application that he received pharmaceutical industry funding.¹⁸

B. Cost Transfers

“Cost transfer” refers to the act of charging an expense to a grant by way of an accounting journal entry.¹⁹ Transfers should be made promptly because “auditors [and the government] will often assume that a late transfer into an underexpended grant account from an overexpended grant account was made simply to cover the overexpenditure.”²⁰ In the current environment, such an untimely transfer could give rise to an FCA claim. To avoid problems, a complete explanation of the reason for the transfer also is required. If the transfer will include previously certified effort, both documentation supporting the transfer and a recertified effort report will be required.²¹

In some instances, work funded by one grant is so closely related to work funded by another grant that a cost can be transferred from one grant to the other.²² The sponsor of the grant to which the cost will be transferred must provide prior written approval of the cost transfer and several conditions must be met, including the following: the projects must be scientifically and technically related, under the supervision of a single PI, and funded by the same sponsor; there must not be any change in scope of either project; the transfer will not have a negative effect on the work performed under either grant; and the transfer will not circumvent the terms and conditions of either grant.²³

C. Notable Settlements

In many cases, when a *qui tam* relator files an action alleging a false claim in a grant case, the named university will settle so as to achieve some measure of certainty and finality. In particular, when the Department of Justice (“DOJ”) elects to intervene in a case, the university must consider that the DOJ may seek to use an extrapolation method to determine damages (as it does in many healthcare fraud cases). The possibility that the DOJ may calculate damages based on a university's entire federal research funding base undoubtedly drives settlements. Examples of notable settlements include the following:

1. *Northwestern University: Percentage of Work Effort.*

In February 2003, Northwestern University paid \$5.5 million to resolve FCA claims arising out of medical research grants that it had received from the National Institutes of Health and other federal agencies. Northwestern was alleged to have overstated the percentage of work effort that researchers would be able to devote to the grants and to have knowingly failed to comply with federal government requirements that a specified percentage of the researchers' effort be devoted to the grants. The relator received \$907,500.²⁴

2. *University of Alabama at Birmingham: Percentage of Work Effort and Double Billing.*

In April 2005, the University of Alabama at Birmingham paid \$3.39 million to resolve FCA claims arising out of medical research grants that it had received from the National Institutes of Health and other federal agencies and claims that it submitted to Medicare. The university was alleged to have overstated the percentage of work effort that the researchers were able to devote to the grant and to have billed both Medicare and the research grants sponsor for same clinical research trials. Two relators split \$395,000.²⁵

3. *The Mayo Clinic: Improper Transfers of Direct Costs.*

In May 2005, the Mayo Foundation paid \$6.5 million to resolve FCA claims arising out of charges that the Mayo Clinic made under federal research grants. The relator, an accounting associate at the Mayo Clinic alleged that the clinic did not keep separate the costs for each of the hundreds of grants it received each year from the National Institutes of Health and other government agencies for specific research projects but, rather, transferred direct costs from overspent grants and internal cost centers to underspent grants. The relator received \$1.3 million.²⁶

4. *University of Connecticut: Incorrect/Overstated Anticipated Expenses, Improper Accounting, and Failure to Provide Matching Funds.*

In January 2006, the University of Connecticut paid \$2.5 million to settle allegations that, between July 1997 and October 2004, it submitted false claims on roughly 500 federal grants awarded by the Department of Defense, the Environmental Protection Agency, the National Science Foundation, and the National Aeronautics and Space Administration, among others. The government alleged that the university submitted grant applications with incorrect or overstated anticipated expenses; charged certain expenses that were not properly chargeable; failed to properly set and revise its billing rate structure; improperly calculated compensation for additional work; and failed to provide cost sharing or matching funds for grants that required them. In this instance, there was no *qui tam* relator. The settlement comprised \$1.7 million in actual damages and \$800,000 in penalties. The University of Connecticut also entered into a compliance agreement.²⁷

IV. THE FALSE CLAIMS CORRECTION ACT OF 2007

The situation may get worse before it gets better. In February, the United States Senate Committee on the Judiciary held hearings regarding S. 2041, the False Claims Correction Act of 2007, which would amend the FCA in several significant respects. In early April, the Judiciary Committee approved the bill and submitted it for mark up. Days before the Committee met to mark up the bill, the Association of American Universities wrote to Senator Patrick Leahy “to express the reservations of the university community about unintended consequences” of the False Claims Correction Act of 2007.²⁸ In particular, the group was concerned that S. 4021 may result in “multiple and unduly punitive recoveries” when the defendants involved are colleges and universities.²⁹ Two areas of concern identified by the Association of American Universities – damages and overcharges – merit a closer look because they raise myriad issues for research universities.

Under S. 4021, the government would recover three times the total paid on a false claim, even if a substantial portion of the total represented valid charges. This presents a problem for research universities, which “usually obtain funding . . . through periodic large ‘drawdowns’ covering all grants from single sponsor.”³⁰ The Association of American Universities posits that “[i]f each drawdown is a claim, even a \$5 overcharge in a \$5 million drawdown might result in a \$15 million recovery.”³¹ Although this scenario is farfetched, it illustrates the difficulties that recipients of federal research grants will encounter if the FCA is amended in this fashion.

Because of the way this drawdown system works, universities may make “literally thousands” of charges to a grant between drawdowns.³² Under the current system, it is understood that undercharges and overcharges may occur but that, when detected, they are adjusted “through cost transfers or otherwise” and that a final review of charges will take place when the grant is closed out.³³ Given this method of reconciling charges, a temporary overcharge that would have been identified and corrected by the university in the ordinary course might give rise to an FCA claim.

V. HOW TO AVOID FCA CLAIMS IN THE FIRST PLACE

In light of these issues, universities and other research institutions would be well-advised to institute robust institutional compliance programs to avoid FCA claims and the specter of enormous damages awards. Some ideas include the following:

A. Get Early and Complete Buy-in from PIs

Because the tone is set at the top, it is essential that PIs take seriously the need to comply with OMB Circular A-21 and internal accounting policies and procedures, as they will be responsible for communicating the rules to other researchers and for certifying effort reports. A PI will be motivated to understand and comply with regulations and policies if he or she understands that a *qui tam* action could name the PI personally as a defendant, along with the university, and that he or she will certainly be named in any press reports. Researchers will recognize the importance of protecting their reputations, as well as those of the institutions that support their work.

By way of example, the University of Minnesota requires PIs to complete a core curriculum on the responsible conduct of research, which also has a continuing education component; the curriculum includes a workshop on “Fiscal Responsibilities for a Sponsored Project.”³⁴ The fiscal responsibilities workshop covers the following topics: initiating a project; receiving an award; managing a project; and terminating a project.³⁵ The university’s policy is that research “funds will not be released [to a PI] until all the educational requirements are met.”³⁶

B. Establish a Whistleblower Program with a Confidential Reporting Method

Universities should provide an internal mechanism for reporting suspected fraud. Researchers, students, and employees need to know that they should report suspected irregularities internally, and that they will be protected from reprisal if they do so. In addition, confidential reporting should be an option, either through a hotline, website, or both.³⁷

C. Educate, Educate, Educate

Universities must develop educational materials geared to each subset of the community involved in any aspect of sponsored research. Materials geared toward the specific responsibilities of PIs, graduate students, department heads, accounting professionals, and others should be prepared and disseminated. In addition to attending in-person training sessions, individuals need to be able to access the materials via the university’s website, so that they are available for reference when issues arise. The University of Pennsylvania’s Office of Audit, Compliance and Privacy, for example, maintains a webpage that provide links to the university’s (and its health system’s) policies, statements, and guidelines relating to responsible conduct in research.³⁸ Princeton University’s Office of Research and Project Administration’s Grant and Contract Administration webpage similarly contains a wealth of materials.³⁹ The University of Nevada at Reno’s Office of Sponsored Projects webpage page includes information regarding upcoming workshops on such topics as “Cost Sharing De-Mystified” and links to online tutorials on subjects ranging from “Budgeting Policies, Forms, Regulations, Cost Share and F&A” to “Reporting, Close-Out, Audits.”⁴⁰

It is not enough to make these materials available. Universities would be wise to require individuals involved in sponsored projects to acknowledge that they received and reviewed the relevant materials. The wisest institutions will go one step further, as the University of Minnesota did, and make the release of grant funds contingent on the completion of a curriculum that includes a piece on financial responsibilities.

Given the number of grant awards that universities receive each year from diverse federal agencies and entities and the many accounting nuances involved in administering those grants, issues that could trigger FCA liability **will** arise. Those universities that have developed meaningful institutional compliance programs will be best positioned to avoid a bank-breaking damages award or settlement.

¹ Michael Hertz, Deputy Assistant Attorney General, Civil Division; U.S. Department of Justice, Testimony before the United States Senate Committee on the Judiciary Hearing on the

False Claims Act Corrections Act of 2007 (S. 2041) (Feb. 27, 2008) (transcript available at http://judiciary.senate.gov/testimony.cfm?id=3161&wit_id=6991).

² Press Release, Department of Justice, “Justice Department Recovers Record \$3.1 Billion in Fraud and False Claims in Fiscal Year 2006” (Nov. 21, 2006).

³ Press Release, Department of Justice, “Justice Department Recovers \$2 Billion for Fraud Against the Government in FY 2007; More Than \$20 Billion Since 1986” (Nov. 1, 2007).

⁴ Recent *qui tam* cases have been filed against such entities as Oakland Livingston Legal Aid (Michigan), Easter Seals UPC (North Carolina), and George Mason University (Virginia), to name but a few. See John T. Boese, Written Statement of the Chamber of Commerce and the U.S. Chamber Institute for Legal Reform in Opposition to S. 2041 The False Claims Corrections Act of 2007, p. 7 (Feb. 27, 2008) (available at http://judiciary.senate.gov/print_testimony.cfm?id=3161&wit_id=6994) (noting that “[t]hese non-profit institutions and public entities cannot, in many cases, afford to defend themselves against the treble damages and oppressive penalties assessed under the FCA, but they must divert valuable resources to do so because failing to do so would expose them to the very real risk of bankruptcy.”)

⁵ *United States ex rel. Roby v. Boeing Co.*, 302 F.3d 637, 646 (6th Cir. 2002).

⁶ *United States v. Bornstein*, 423 U.S. 303, 316 n.13 (1976) (“[t]he Government’s actual damages are equal to the difference between the market value of the tubes it received and retained and the market value that the tubes would have had if they had been of the specified quality.”); *United States v. Woodbury*, 359 F.2d 370, 379 (9th Cir. 1966) (“Ordinarily the measure of the government’s damages would be the amount that it paid out by reason of the false statements over and above what it would have paid if the claims had been truthful.”)

⁷ See generally, *United States ex rel. Marcus v. Hess*, 317 U.S. 537 (1943).

⁸ 31 U.S.C. § 3729(a).

⁹ Press Release, Department of Justice, “United States Settles False Claims Act Case Against South Carolina State University” (June 28, 2001).

¹⁰ See generally, OMB Circular A-21 (rev’d May 10, 2004).

¹¹ *Id.* at J.10.c.(1)(e).

¹² See UAB Office of Financial Affairs, “Effort Reporting and Other Support” (available at <http://main.uab.edu/show.asp?durki=47743>).

¹³ Awards made by the National Institutes of Health have a salary cap (currently, it is \$161,200), so PIs who earn in excess of the salary cap must provide a departmental cost-sharing account for any difference. *Id.*

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ See UAB Office of Financial Affairs, “Cost Sharing” (available at <http://main.uab.edu/show.asp?durki=14358>).

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- ¹⁷ See UAB Office of Financial Affairs, “Grant Cost Transfers” (available at <http://main.uab.edu/show.asp?durki=14361>).
- ¹⁸ *United States ex rel. Cantekin v. University of Pittsburgh*, 192 F.3d 402 (3d Cir. 1999), *cert. den’d.*, 531 U.S. 880 (2000).
- ¹⁹ See UAB Office of Financial Affairs, “Effort Reporting CAS Manual” (available at <http://main.uab.edu/show.asp?durki=14359>).
- ²⁰ *Supra* note 18.
- ²¹ *Id.*
- ²² *Id.*
- ²³ *Id.*
- ²⁴ Press Release, Department of Justice, “Northwestern University Will Pay \$5.5 Million to Resolve False Claims Act and Common Law Allegations” (Feb. 6, 2003).
- ²⁵ Press Release, Department of Justice, “University of Alabama-Birmingham Will Pay U.S. \$3.39 Million to Resolve False Billing Allegations” (Apr. 14, 2005).
- ²⁶ Press Release, Department of Justice, “Parent Organization of Mayo Clinic Pays U.S. \$6.5 Million to Settle Grant Fraud Investigation” (May 26, 2005).
- ²⁷ Press Release, Department of Justice, “UConn Agrees to Pay 42.5 Million to Settle False Claims Allegations” (Jan. 26, 2006).
- ²⁸ March 31, 2008 letter from Robert M. Berdahl, President of the Association of American Universities, to the Honorable Patrick J. Leahy, Chairman, United States Senate Committee on the Judiciary (available at www.aau.edu/research/Ltr_Berdahl_Leahy_FCA_33108.pdf).
- ²⁹ *Id.* (attachment at p. 1).
- ³⁰ *Id.*
- ³¹ *Id.*
- ³² *Id.*
- ³³ *Id.*
- ³⁴ See Office of the Vice President for Research, “Principal Investigator (PI) Eligibility” (available at <http://www.research.umn.edu/first/ExistFac.htm>).
- ³⁵ See <http://www.research.umn.edu/fiscal/index.htm>.
- ³⁶ *Supra* note 34.
- ³⁷ For example, the University of Maryland Medical System’s policy provides “[t]o report a concern, individuals should contact any member of senior management, the Compliance Office[,] . . . the Compliance Hotline[,] . . . or www.reportit.net.” University of Maryland Medical System, False Claims Act and Whistleblower Protection Education Policy (available at www.umms.org/contracting/UMMS%20DRA%20Policy.pdf). DePaul University established an Office of Institutional Compliance with both a confidential hotline and website. See <http://compliance.depaul.edu>.

³⁸ *See* http://www.upenn.edu/audit/oacp_principles4.htm (note that the links themselves are available only to members of the university community with a user identification and password).

³⁹ *See* <http://www.princeton.edu/orpa/grants.shtml#FMI>.

⁴⁰ *See* <http://www.unr.edu/ospa>.