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False Claims Act

Application of res judicata in a False Claims Act case subsequent to a settlement in an earlier FCA case involving the same defendant usually depends on whether the same cause of action is at issue in the two cases. That analysis can be more favorable to an FCA defendant than first meets the eye.

The Preclusive Effects of FCA Settlement Agreements

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Settling a False Claims Act case can often seem like a numbers game. The parties debate the potential damages to the government, the number of penalties at issue, and, if the case was initiated by a relator, the amount of attorneys' fees and costs. Once the parties agree on a settlement figure, the drafting of the terms of the settlement agreement may seem like a formality, especially since the Department of Justice typically insists on a number of what it considers to be standard provisions, even when the government has not intervened in the case.

Relying on 31 U.S.C. § 3730(b)(1), the Fourth, Fifth, and Sixth Circuits have held that the government has the absolute right to reject any settlement in an FCA case, even when the government has declined to intervene. See *United States ex rel. Michaels v. Agape Senior Cmty., Inc.*, 848 F.3d 330, 339-40 (4th Cir. 2017); *United States v. Health Possibilities, P.S.C.*, 207 F.3d 335, 339-40 (6th Cir. 2000); *Searcy v. Philips Elecs. N. Am. Corp., 117 F.3d 154, 159-60* (5th Cir. 1997). The Ninth appears to be the only circuit that takes a different view. See *United States ex rel. Killingsworth v. Northrop Corp.*, 25 F.3d 715, 722-23 (9th Cir. 1994).

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Among the provisions usually required by the DOJ is a narrowly tailored release limited to the conduct actually alleged in the case, as opposed to allegations that were or could have been made in the case. The conduct actually alleged is typically defined in the settlement agreement as the covered conduct. Despite the DOJ's attempts to limit the release to the conduct actually alleged in the case, an FCA defendant has several arguments to maximize the *res judicata* effect of the settlement and resulting dismissal.

Under general principles of *res judicata*, a subsequent action is barred where: (1) the prior action was decided on the merits; (2) the prior action involved the same parties as the current action; and (3) the claims in the prior action were based upon the same cause of action as the claims in the current action. *See LVNV Fund-*

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ing LLC v. Harling, 852 F.3d 367, 371 (4th Cir. 2017). A dismissal with prejudice resulting from a settlement is a dismissal on the merits. *United States ex rel. Soodavar v. Unisys Corp.*, 178 F. Supp. 3d 358, 375 (E.D. Va. 2016). (Note: The authors represented Unisys Corp. in this case.) And, since the government is the real party in interest in all FCA cases, subsequent FCA actions against the same defendant will satisfy the second *res judicata* prong, even if the government declined to intervene and even if the actions were brought by different relators. *See id.*; *United States v. Health Possibilities, P.S.C.*, 207 F.3d 335, 341 (6th Cir. 2000). Thus, application of *res judicata* in an FCA case subsequent to a settlement in an earlier FCA case involving the same defendant usually depends on whether the same cause of action is at issue in the two cases. That analysis can be more favorable to an FCA defendant than first meets the eye.

The Released Conduct

A primary consideration is what is meant by ''covered conduct'' and specifically whether that term in an FCA settlement agreement refers to the underlying fraudulent scheme or to the submission of one or more particular false claims. In a typical FCA settlement agreement, the government's release language often is phrased in terms of the fraudulent scheme. Based on this notion, FCA plaintiffs argue that different fraudulent schemes are not released, even if they involve the same allegedly false claim. However, liability under the FCA attaches not to ''the underlying fraudulent activity,'' but rather to ''the claim for payment.'' *United States ex rel. Harrison v. Westinghouse Savannah River Co.*, 176 F.3d 776, 785 (4th Cir. 1999) (quotation and citation omitted); *see also United States ex rel. Clausen v. Lab. Corp. of Am.*, 290 F.3d 1301, 1311 (11th Cir. 2002) (''The submission of a claim is ... not ... a 'ministerial act,' but the sine qua non of a False Claims Act violation.''). Thus, the key conduct alleged in any FCA action is the submission of a false claim. This opens the door for defendants to argue that they cannot be subject to a second FCA suit involving the same claims, even if the claims are allegedly false for an entirely different reason.

This issue came up in one form in *United States ex rel. Barajas v. Northrop Corp.*, 147 F.3d 905 (9th Cir. 1998). The contract at issue in that case required Northrop to manufacture navigational guidance devices for cruise missiles purchased by the federal government. There were two aspects of Northrop's performance that were alleged to have been fraudulent: the improper certification of performance tests by certain Northrop employees in California, and the improper certification of device performance at certain cold temperatures by other Northrop employees in Massachusetts. *Id.* at 907. Northrop settled a *qui tam* suit with the government and the relator based on allegations of fraud relating to the California performance tests. According to the court, the government provided Northrop a ''broad form release,'' that ''released Northrop from 'any and all ... claims under the [FCA].' '' *Id.* at 908. The relator, in contrast, specifically carved out the right to bring another action based on the Massachusetts tests. *Id.*

However, when the relator attempted to bring another action based on the Massachusetts tests, Northrop argued that his claim was barred by *res judicata*. The government and the relator argued that the Massachusetts test allegations were entirely separate from the California test allegations, but the court disagreed. The court explained that the two allegedly fraudulent schemes were all part of the same transactional nucleus of fact — the ''attempt to get paid for flight data transmitters not up to specifications.'' *Id.* at 910. The court explained, ''[t]he recovery in a *qui tam* case is not for each false statement or bad act done to the government; it is for 'a false or fraudulent claim for payment or approval.' '' *Id.* (citation omitted). The court noted that the government obtained the only relief it could get as a result of the first settlement — ''the money it had paid on Northrop's false invoices, based on the testing fraud. It did not matter to the settlement and judgment whether Northrop's invoices were false for two reasons or one reason. ... Once the government recovers the money it paid on a false invoice, plus penalties, or releases its claim, there is no more to be recovered by anyone, because only the government can have a claim for a false claim made upon the government.'' *Id.*

Even without attempting to specifically preserve certain claims, other relators have argued that their subsequent actions are based on conduct that falls outside of the ''covered conduct'' released by a prior settlement agreement. In both *United States ex rel. Sarafoglou v. Weill Medical College of Cornell University*, 451 F. Supp. 2d 613 (S.D.N.Y. 2006), and *United States ex rel. Resnick v. Weill Medical College of Cornell University*, (S.D.N.Y. Jan. 21, 2001), the government intervened in actions in which a defendant was alleged to have made false statements in relation to applications for federal government grants. In both cases, the government settled and released the defendant from liability related to the ''covered conduct.'' And, in both cases, the relators attempted to argue that because the ''covered conduct'' was defined in terms of the allegations in the first action, they were free to pursue allegations based on different or greater fraudulent schemes in a subsequent action, even if those allegations involved the same allegedly false claims.

The courts rejected the relators' arguments. As the court explained in *Resnick*, ''[a]lthough [relator] asserts that her claims with respect to the Settled Grants arise from different false statements related to the Settled Grants and were excluded from the release accompanying the Settlement, they are still part of the same transaction or occurrence — the applications and progress reports for the Settled Grants.'' *See also Sarafoglou*, 451 F. Supp. 2d at 621 (''the mere fact that the plaintiff alleges greater misconduct in the amended complaint is of no consequence because ultimately all the false claims in the current complaint are based on the same nucleus of operative fact''). Under cases like

Resnick and *Sarafoglou*, FCA defendants can argue that an FCA settlement releases all possible allegations associated with the specific allegedly false claims at issue.

Differing Approaches to *Res Judicata*

The preclusive power of an FCA settlement is further complicated by another issue. Some courts view the *res judicata* effect of a dismissal with prejudice and the preclusive effects of a contractual release as independent ways of barring a claim, unless the dismissal expressly incorporates the conditions in the settlement agreement. *See, e.g.*, *Oreck Direct, LLC v. Dyson, Inc.*, 560 F.3d 398 (5th Cir. 2009) (claims barred by prior dismissal with prejudice notwithstanding terms of settlement); *Simontacchi v. Invensys, Inc.* (W.D.N.C. Jan. 11, 2008) (same). Other courts apply what is sometimes called a ''modified *res judicata*'' analysis that combines *res judicata* and the contractual release. For example, the Fourth Circuit has stated that ''[c]laim preclusion will not apply ... if the parties intended to settle only one part of a single claim and intended to leave another part open for future litigation.'' *Keith v. Aldridge*, 900 F.2d 736, 741 (4th Cir. 1990).

The relator in *Soodavar* argued that the Fourth Circuit's modified *res judicata* approach avoided the preclusive effects of a previous FCA settlement. The contract at issue in *Soodavar* was a task order that was divided into multiple line items. A prior lawsuit against the defendant had alleged a fraudulent billing scheme related to certain line items in the task order. *Id.* at 364. That lawsuit was settled and the government released the defendant ''from FCA liability for 'Covered Conduct,' which the Settlement Agreement defined as the fraudulent billing scheme under [certain line items].'' *Id.* In *Soodavar*, a different relator attempted to bring FCA claims as to different line items in the task order. The relator argued that ''by focusing on the allegedly fraudulent scheme under [certain line items],'' the prior action's ''Settlement Agreement manifest[ed] the parties' intent to cover only the conduct related to those [line items].'' *Id.* at 375. Despite that, the court found that ''the Settlement Agreement must be understood as releasing [the defendant] from liability for the claims (i.e., fraudulent invoices) it submitted, not simply from liability for the fraudulent scheme.'' *Id.* at 376. In other words, ''the United States released [the defendant] from FCA liability for the whole of the claim submitted.'' *Id.* Thus, even in jurisdictions that follow the modified *res judicata* approach, a defendant should argue that a prior settlement bars any subsequent FCA suit involving the same claims, even if a different fraudulent scheme is alleged.

In other jurisdictions, defendants should also argue that the dismissal itself has traditional *res judicata* effects, regardless of any limitations in the settlement agreement's release. Under the traditional *res judicata* analysis, claims arise under the same cause of action — and are thus barred — when they flow from the same transaction or series of connected transactions, or common nucleus of operative facts. *Harnett v. Billman*, 800 F.2d 1308, 1314 (4th Cir. 1986). Claims may share the same cause of action and therefore arise out of the same transaction or series of transactions even if they involve different harms or different theories or measures of relief. *Id.* A later claim may be barred by *res judicata* if it shares a common scope and subject matter as the prior claim, even if the factual allegations vary somewhat. *See Trustmark Ins. Co. v. ESLU, Inc.*, 299 F.3d 1265, 1270 (11th Cir. 2002) (new lawsuit alleging different violations of the same contract involved in a prior suit barred by *res judicata*). Accordingly, in jurisdictions that treat the *res judicata* effects of a dismissal with prejudice independently from the preclusive effects of the settlement agreement that led to the dismissal, an FCA defendant may have an additional argument that allegations beyond the fraudulent scheme alleged in the complaint are barred.

Conclusion

Settlement is not just about the numbers in the FCA context. In addition to advocating for as broad a release as possible, settling an FCA suit requires a nuanced understanding of a number of other issues, including what fraudulent schemes are alleged, what allegedly false claims are at issue, and whether the relevant judicial jurisdiction has adopted the traditional or modified approach to *res judicata*. These considerations are critical to an FCA defendant's ability to resolve a matter with confidence that any allegations of fraud with respect to the claims at issue are truly put to rest once the ink dries on the settlement agreement.