Oil & Gas Companies Face Broader Exposure to FCA Liability Under COVID Stimulus Programs

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I. Introduction

Like nearly every other sector of the economy, the oil and gas industry has been severely impacted by COVID. Oil prices hit unprecedented lows in April due to plummeting demand and shortages in storage capacity, which came on top of the already existing concerns of over-production and the price wars between Saudi Arabia and Russia. Several large producers and other companies have already filed for bankruptcy, and other filings are likely on the horizon.

In an attempt to help this vital segment of the American economy, Congress included oil and gas companies as potential recipients of the various relief packages available for those impacted by COVID. While this aid could help many companies in the short term, the oil and gas industry needs to make itself aware of the potential pitfalls associated with liability under the False Claims Act (FCA) when receiving federal funds.

The FCA is a statute that previously had relatively limited application to most oil and gas companies compared to other industries, but the flood of federal financial aid to energy companies will dramatically expand its reach. Energy companies and their stakeholders must therefore understand how FCA suits can materialize and should keep in mind the following litigation tips and strategies to help avoid potential liability and successfully defend their case.

II. The FCA and Coronavirus Aid

Generally, the FCA imposes liability for individuals and companies that defraud the federal government. The government may bring a claim on its own or, more commonly, with a private citizen whistleblower as the catalyst. In the latter case, a whistleblower files a suit under seal, and the government must decide whether to intervene and prosecute the claim as a party or to instead allow the whistleblower to pursue the claim on the government's behalf as a *qui tam* relator.

In recent years, the statute has become a tool of great value to the government and the plaintiffs' bar due to the availability of treble damages, attorneys' fees, and civil penalties. Moreover, whistleblowers are entitled to receive a portion of the government's recovery, ranging from 15 to 30 percent, depending on whether the government elects to intervene. Recent high-profile damages awards and settlements have garnered significant media attention, further leading to increased FCA filings.

Historically, periods of financial distress have preceded upticks in FCA litigation. This is both due to organizational behavior in times of crisis and because, during such times, the

government often inserts itself into the private sector to provide needed relief. Anytime there are significant amounts of government dollars circulating through the private sector, there is an increased risk of FCA liability. The already passed and likely forthcoming relief packages in response to COVID will be no exception.

Government support during this pandemic has already dwarfed the support provided during the 2008 financial crisis. The CARES Act authorizes $2 trillion in direct stimulus to help small businesses and $450 billion to beef up the Exchange Stabilization Fund within the U.S. Treasury to aid distressed industries. And while energy companies are not singled out for CARES Act relief, the legislation provides significant support for certain entities within the energy sector. For example, energy companies below certain size thresholds can and have applied for loans under the Paycheck Protection Program (PPP).[1] More recent changes to the Federal Reserve's Main Street Lending Program[2] further relax eligibility standards in ways that benefit oil and gas companies. The guidelines now define "Eligible Borrowers" to include those with 15,000 or fewer employees or borrowers with 2019 revenues of $5 billion or less. These guidelines enable oil and gas companies that may not have been eligible under the PPP to take advantage of government lifelines of up to $25 million.

III. A New Risk for Oil and Gas Companies

Previously, the most common fact-patterns of FCA litigation in the oil and gas industry involved allegations of underpaying or miscalculating royalty obligations to the government, falsifying required disclosures or certifications to the government to operate on federal lands or federal waters, failing to report oil produced on government lands, or overcharging the government on contracts to manage or service energy resources. In these scenarios, the energy company is accused of somehow underpaying the government or otherwise improperly receiving government money as part of their normal operations. These types of lawsuits, for the most part, grew out of common sets of facts for oil and gas companies, which involved acts such as paying royalties, acquiring leases, and adhering to environmental laws and regulations. Thus, while FCA suits in these areas arise in the unique circumstance of having the federal government as the counterparty, the underlying issues were familiar for those practicing in the oil and gas industry.

As government dollars begin working their way through new areas of the economy under COVID relief programs, the oil and gas industry should prepare to face new allegations under the FCA outside of these common fact patterns. Specifically, allegations regarding misrepresentation of financial need, as well as noncompliance with stimulus program requirements, will likely provide fodder for a large number of new FCA suits.

One likely driver of increased FCA allegations will be the evolving and ambiguous application forms, program requirements, and other regulatory hiccups that have been associated with COVID relief programs to date. For example, under the PPP, energy companies may be eligible for government loans if their employee headcount is below the cap set forth in the Code

[1] *See* U.S. Treasury, *Paycheck Protection Program (PPP) Information Sheet: Borrowers*, Apr. 3, 2020, *available at* https://home.treasury.gov/system/files/136/PPP--Fact-Sheet.pdf.

[2] *See* U.S. Federal Reserve, *Main Street New Loan Facility*, Apr. 30, 2020, *available at* https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200430a1.pdf

of Federal Regulations. But the employee count is calculated as the sum-total of employees across the company applying for the loan, as well as their "affiliates." This is significant because affiliation can be based on ownership, management, or identity, but the contours of these concepts—even with official guidance—can often be confusing or vague. These ambiguities and the time constraints likely resulting in a rush to file for relief due to a dire need for cash create heightened FCA risks.

The current political environment can further compound these problems. Many politicians at both the state and federal level have voiced stringent opposition to oil and gas companies receiving any federal aid. Even if formal measures to restrict oil and gas relief fail to become law, dissenting lawmakers may continue to generate negative publicity for energy companies that validly availed themselves of CARES Act provisions or other federal aid. And the potential increase in layoffs, furloughs, and pay cuts will further stress the workforce, leading to possible additional whistleblowers.

In fact, given the scale of the COVID-related financial distress and the high probability of fraud, the CARES Act created three new oversight bodies to monitor the use of CARES Act funds: the Special Inspector General for Pandemic Recovery, the Congressional Oversight Commission, and the Pandemic Response Accountability Committee. Such efforts indicate that the government expects pandemic-related fraud to be significant, and oil and gas companies should work to familiarize themselves with the nature of FCA suits and sound strategies in FCA litigation.

IV. Litigation Strategies

FCA suits are not ordinary fraud cases. Defendants should therefore be aware of a number of attributes unique to FCA cases and the new and developing areas of FCA law. Below are just a few examples.

A. Sealing Requirements

One reason FCA suits create unique problems is that companies are typically in the dark about a suit's existence even after it is filed. This is because *qui tam* FCA cases are automatically sealed for at least 60 days—and sometimes for over a year—while the government investigates the whistleblower's allegations. And by the time a complaint is unsealed, the whistleblower will have gathered significant evidence, sometimes in cooperation with the DOJ. Not only does this create difficulties for the ultimate defendant, but it also deprives other companies of the opportunity to take corrective action to stamp out unknown wrongdoings because the issue remains under seal for an extended period of time. Compared to other types of civil litigation, potential defendants should therefore be aware of FCA-related litigation risks in particular.

B. DOJ Dismissal Power

At the outset of a case, a defendant should consider the so-called "Granston Memo" and the DOJ's use of its dismissal powers under the FCA.

The Granston Memo is a leaked DOJ memorandum from January 2018 written by the Director of the DOJ's Civil Fraud Section, Michael Granston. The memo advises DOJ attorneys to proactively consider seeking dismissal of *qui tam* suits under the government's dismissal authority pursuant to 31 U.S.C. § 3730(c)(2)(A). The memo provides a list of seven factors to consider in making a dismissal decision, including preserving government resources, controlling litigation brought on behalf of the United States, curbing meritless *qui tam* cases, and preventing "parasitic or opportunistic qui tam actions."[3]

Until recently, the DOJ used its power to dismiss *qui tam* FCA suits sparingly. The Granston Memo, however, has been followed by a string of occasionally controversial DOJ dismissal decisions. These decisions have highlighted outstanding questions regarding both what role, if any, the Granston Memo's guidelines will play in the DOJ's decision to wield its dismissal authority in COVID-related FCA suits and the scope of this authority in the face of objection from a *qui tam* relator. Courts are also struggling with how to address the DOJ's increased use of this authority. Some jurisdictions require the government to show "a valid government purpose," while others give the government "unfettered discretion" in making their dismissal determination.[4] So far, the Supreme Court has declined to review the scope of the government's authority in this regard.[5]

While the case law is still developing, energy companies should consider asking the DOJ to exercise its dismissal authority under Section 3730. A thorough assessment of the facts can aid litigation counsel in persuasively explaining to the government precisely how the various Granston Memo factors justify dismissal, or why the case should otherwise be dismissed.

C. Escobar and the Materiality Standard

Another emerging issue in FCA cases is whether allegedly false representations were material to the government's decision to approve a request for payment, including requests for COVID-related relief.

The key Supreme Court decision on this issue is *Universal Health Services, Inc. v. United States ex rel. Escobar*, a case in which the Supreme Court both narrowed and broadened the FCA's liability.[6] *Escobar* partially broadened FCA liability by holding that a defendant can be liable for impliedly certifying compliance with applicable legal requirements under certain circumstances, even if it did not make an express statement of compliance.[7]

But *Escobar* also limited FCA liability by making clear that the FCA maintains a "demanding" materiality requirement. Under its holding, an alleged false statement must be

[3] *See* Michael D. Granston, Factors for Evaluating Dismissal Pursuant to 31 U.S.C. 3730(c)(2)(A) (Jan. 10, 2018).

[4] *Compare United States ex rel. Sequoia Orange Co. v. Baird-Neece Packing Corp.,* 151 F.3d 1139,1141 (9th Cir. 1998), *with Swift v. United States,* 318 F.3d 250, 252–53 (D.C. Cir. 2003).

[5] *See United States ex rel. Schneider v. J.P. Morgan Chase Bank, N.A.*, 2019 WL 1060876 (D.D.C. 2019), *aff'd*, 2019 WL 4566462 (D.C. Cir. 2019) (granting government motion to dismiss applying *Swift*), *cert. denied*, 2020 WL 1668623 (U.S. 2020).

[6] *See generally,* 136 S. Ct. 1989 (2016).

[7] *See id.* at 2001 (stating that a defendant's "failure to disclose noncompliance with material statutory, regulatory, or contractual requirements makes those representations misleading half-truths.").

material to the government's payment decision to be actionable.[8] The Court clarified that materiality "cannot be found where noncompliance is minor or insubstantial," and "if the Government pays a particular claim in full despite its actual knowledge that certain requirements were violated, that is very strong evidence that those requirements are not material." Since this decision, many defendants have successfully defended against FCA allegations on the basis of the *Escobar* materiality standard.

While its exact scope is still being defined, lower courts appear to be taking the demanding materiality standard seriously post *Escobar*.[9] Oil and gas companies should ensure that counsel is apprised of all facts that either independently or in combination countenance a plaintiff's materiality arguments to successfully develop this dispositive argument at the outset of a case.

D. Public Disclosure Bar

Another unique aspect of litigating FCA cases involves what is known as the "public disclosure bar." This provision of the FCA prohibits relators from bringing claims based on allegations or transactions that have previously been publicly disclosed, unless the relator qualifies as an "original source" of the information under the terms of the statute.[10] Defendants routinely seek to dismiss FCA suits on the basis of the public disclosure bar when the allegations mirror prior lawsuits, ongoing or completed government investigations, or where the alleged wrongdoing has already been publicly disclosed through other means such as press releases or public filings.

While the public disclosure bar is a popular tool, certain aspects of its scope are still unresolved and circuit splits remain. For example, courts struggle with exactly what constitutes a "public" disclosure, whether disclosures to employees or agents of the government constitute a public disclosure, and just how similar the allegations must be between the prior public disclosure and those in the pending FCA suit. Oil and gas companies should pay attention to these cases as they work their way through the courts and provide potentially important rulings for new FCA defendants.

E. Procedural Litigation Issues and Strategies

In addition to the above substantive issues, energy companies should be alert to certain procedural issues and tactics that are unique to FCA cases.

Counterclaims, for example, are generally not allowed against whistleblowers.[11] This is in part because the FCA is perceived as a statute that empowers whistleblowers that may

[8] *See id.* at 2003.
[9] *See Abbott v. B.P. Expl. and Prod., Inc.,* 851 F.3d 384, 387–88 (5th Cir. 2017) (finding a lack of materiality in part because the government did not suspend the operation of BP's production facility in the Gulf of Mexico even after becoming aware of defendant's alleged false statements).
[10] 31 U.S.C. § 3730(e)(4).
[11] *See Mortgages, Inc. v. United States District Court for the District of Nevada,* 934 F.2d 209, 212 (9th Cir. 1991) (finding that the FCA did not allow defendants to seek indemnification or contribution through counterclaims from relators).

otherwise not come forward due to "unclean hands" given their role in the alleged wrongs.[12] But creative counsel can find ways around these roadblocks by, for example, arguing that the counterclaims should be permitted because they are based on conduct that is not dependent on the *qui tam* defendant's liability under an independent damages theory.[13] In other instances, a *qui tam* relator's share of the bounty can be significantly reduced if the defendant can show that the relator played certain key roles in the alleged fraud. Additionally, defendants can argue that the case justifies an award of attorney's fees because it is "frivolous" or "brought primarily for the purposes of harassment" under 31 U.S.C. § 3730(d).

Finally, beyond the potential government intervention and dismissal under the Granston Memo discussed above, there are other opportunities to strategically involve the government in FCA cases even when the government declines to intervene. For example, the government frequently files statements of interest on key procedural or substantive issues that are not dispositive but often persuasive to courts deciding difficult FCA questions. Maintaining a close relationship with the government attorneys assigned to a case, even if they are not appearing as a party, can therefore be a critical part of a winning defense strategy.

V. Conclusion

As the energy industry works to overcome its current obstacles, it should be prepared for FCA cases scrutinizing its decisions and representations to the government during the COVID pandemic. Defendants would do well to anticipate these suits by identifying and managing their litigation risk. Trial counsel that understands both the dynamics of an FCA suit, as well as relevant industry constraints, can be instrumental in developing and executing on an efficient winning strategy. Such experience will be critical as the energy industry faces a new risk of FCA liability in areas not previously of great concern to oil and gas companies.

[12] *Id.* at 213.
[13] *See United States ex rel. Madden v. General Dynamics Corp.*, 4 F.3d 827, 830 (9th Cir. 1993).