Portfolio Media. Inc. | 111 West 19th Street, 5th Floor | New York, NY 10011 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Duke Deal Signals FCA Dangers Faced By Federal Grantees

By **Derek Adams and Christopher Frisina** (March 27, 2019, 5:23 PM EDT)

Derek Adams

Christopher Frisina

On Monday, the U.S. Department of Justice announced a $112.5 million settlement with Duke University stemming from allegations that Duke falsified research in grant applications and progress reports to the National Institutes of Health and to the U.S. Environmental Protection Agency.[1]

The case was brought by a former Duke employee, Joseph Thomas, under the qui tam provisions of the False Claims Act.[2] Thomas, a laboratory research analyst, conducted experiments for the pulmonary division of Duke's department of medicine. Through his work, Thomas uncovered alleged discrepancies in research conducted by Erin Potts-Kant, a clinical research coordinator also working in the pulmonary division. On May 17, 2013, Thomas filed a qui tam complaint against Duke, Potts-Kant and her supervisor Dr. William M. Foster.[3]

Potts-Kant's work involved operating several machines that measured and assessed pulmonary physiology, along with performing laboratory assays. Foster alleged that Potts-Kant knowingly falsified or fabricated research data, co-authored dozens of publications in scientific journals with Foster based on that fraudulent data and that Duke made numerous misrepresentations to the NIH and EPA in grant applications and grant progress reports that served as a basis for grant funding.

On Aug. 9, 2016, the United States declined to intervene, and the relator proceeded with the litigation. Because of the DOJ's declination and the relator's continuation of the action, he is entitled to 25 percent to 30 percent of the ultimate recovery. In this case he will receive 30 percent of Monday's $112.5 million settlement.

Other University Settlements

The $112.5 million settlement is the largest False Claims Act recovery to date in connection with federal research grants, an area that has seen increased DOJ attention in recent years. While novel in size, this settlement is one in a line of cases focused on misconduct by universities and other federal grantees. Just last week, the University of Wisconsin-Madison agreed to pay $1.5 million to settle claims that it violated the FCA by failing to properly account for rebates and credits to reduce costs allocable to federal grants and awards.[4]

Several universities also have paid large settlements in the last several years for their alleged failure to comply with the long-standing requirements of federal grantees to keep and maintain documentation showing that employees charged to a particular grant actually worked on that grant — the "time and effort" requirement.[5] Many grantees continue to struggle with monitoring compliance with their time and effort systems.

Universities are particularly susceptible to time and effort failures because of their size and diversity of funding. Researchers may work on a variety of projects in any given day and be unaware of the importance of accurately allocating their time among funding sources. This can be a costly mistake as personnel expenses are often a grant's largest budget item, and the potential for treble damages and penalties under the FCA only magnifies the risk.

University failures in time and effort and other billing practices have led to several recent DOJ settlements under the FCA. Last year, the University of North Texas Health Sciences Center paid $13 million after self-disclosing that, from January 2011 through February 2016, it had failed to ensure that its time and effort reports related to certain grants were accurately and timely certified.[6] In 2016, Columbia University paid $9.5 to settle allegations that it had impermissibly applied its "on-campus" indirect-cost rate, instead of its much lower "off-campus" rate when seeking federal reimbursement, even though the research had been primarily conducted off-campus in facilities owned by New York and New York City.[7] And in 2015, the University of Florida paid nearly $20 million to settle allegations that it had improperly charged the salary costs of its employees to grant funds when it did not have documentation supporting the level of time and effort claimed on those grants.[8]

Grantees Face Harsh Damages Awards

As exemplified by the Duke settlement, universities should be aware of the potential for large damage awards in instances of grant fraud. The calculation of damages in many FCA cases is based on a benefit-of-the-bargain calculation — the same test applied in a typical breach of contract case. For example, in a case in which a defense contractor builds a ship for the U.S. Navy and fraudulently cuts corners during the project, damages would be the difference in value between the ship delivered and the ship as promised. On the other hand, a grantee that lies during the grant application process, as alleged in the Duke case, potentially faces a damages calculation that is based on the entire amount paid under the grant.

This is because a grant, unlike a procurement contract, arguably does not provide a direct benefit to the government. Rather, it provides an indirect benefit as the grantee carries out a public purpose of support or stimulation authorized by law, designed to benefit third-party recipients. If a grantee makes misrepresentations to obtain or maintain grant funds, the government may argue that it has lost the true value of its agreement, regardless of the monetary value of the research, goods or services provided by the grantee.

The Second, Fifth and Eleventh Circuits all have concluded that, in instances of grant application fraud, damages are the entirety of grant money paid to the defendant. In U.S. ex rel. Longhi v. Lithium Power Technologies Inc. et al., the government alleged that defendants engaged in a pattern of false statements to secure research grants from the federal government available to "eligible deserving" small businesses under the Small Business Innovation Research program. The SBIR program was established to enable small businesses to undertake and obtain the benefits of research and development to maintain and strengthen the competitive free enterprise system and the national economy.[9]

The defendants were awarded grants for research that could lead to the development of thin rechargeable batteries for potential use by the U.S. Department of Defense. There was no dispute that defendants engaged in research contemplated by the grants, however, the government asserted that defendants made false statements in connection with their grant proposals, such as statements regarding their facilities and equipment. The district court granted summary judgment for the government, held that damages were the entire amount of the grants it paid to the defendants — $1,657,455 — and awarded treble damages of $4,972,365.[10]

On appeal, the defendants argued that the government suffered no injury and no damages because it received research contemplated by the grants. The government, on the other hand, argued that the defendants' false statements caused it to award more than $1.6 million in grants to a company with "dubious qualifications" and that the funding should have gone to a better-qualified candidate. The U.S. Court of Appeals for the Fifth Circuit sided with the government, concluding that the purpose of the grant program was to award money to eligible deserving small businesses and that the opportunity to do so was lost because of the defendants' fraud. The court held that, "where there is no tangible benefit to the government and the intangible benefit is impossible to calculate, it is appropriate to value damages in the amount the government actually paid to the Defendants."[11]

The U.S. Court of Appeals for the Second Circuit reached the same conclusion in U.S. ex rel. Feldman v. Willfred van Gorp and Cornell Univ. Medical College. In Feldman, the defendants received a research training grant by the NIH to conduct research into the neuropsychology of patients with HIV/AIDS. A jury returned a verdict for the government finding FCA liability based on several of the defendants' renewal applications and awarded $855,714 in damages — plus $602,898 in attorney fees.[12] The $855,714 represented the full value of three years' worth of grants — $285,238 — trebled.

As in Longhi, on appeal the defendants argued that damages should be the difference between the value of the research provided versus that promised. The Second Circuit rejected this argument, explaining that "the government receives nothing of measurable value when the third-party to whom the benefits of a governmental grant flow uses the grant for activities other than those for which funding was approved" and that "the government has entirely lost its opportunity to award the grant money to a recipient who would have used the money as the government intended."[13]

The U.S. Court of Appeals for the Eleventh Circuit considered the issue of grant fraud damages in U.S. v. Anghale, a case in which a former University of Florida professor and his wife made false statements to win four contracts for research funding awarded through the SBIR and the Small Business Technology Transfer programs. As in Longhi and Feldman, the court analyzed the purpose of the federal programs and determined that the government had not received any tangible benefit from the defendants' research. As a result, it upheld the district court's award of $2,746,631 in damages — three times the grants — plus a civil penalty[14] of $231,000.[15]

Conclusion

Universities must be cognizant of the potential risks under the FCA and implement appropriate compliance programs to detect, mitigate and prevent fraud in connection with their use of federal grants. As part of Monday's settlement, Duke announced that it would immediately implement a series of steps to improve the quality and integrity of research conducted on campus, including the creation of an executive oversight committee, a new Advisory Panel on Research Integrity and Excellence, and a new leadership structure for research.[16] Had Duke taken these steps earlier, it might have prevented, or at least mitigated, the reputational and financial harm resulting from Monday's settlement.

Derek Adams is a partner at Feldesman Tucker Leifer Fidell LLP. Prior to joining the firm, he served as a trial attorney with the U.S. Department of Justice, Civil Fraud Section.

Christopher Frisina is an associate with the firm.

[1] https://www.justice.gov/opa/pr/duke-university-agrees-pay-us-1125-million-settle-false-claims-act-allegations-related.

[2] 31 U.S.C. Section 3730(b).

[3] Complaint, Filed May 17, 2013, Civil Action No. 4:13-cv-00017 (W.D.VA.)

[4] https://www.justice.gov/usao-wdwi/pr/university-pay-15-million-settle-false-claims-act-allegations.

[5] See 2 CFR Section 200.430 (i) (Standards for Documentation of Personnel Expenses).

[6] https://www.justice.gov/usao-ndtx/pr/university-north-texas-health-science-center-pay-13-million-settle-claims-related.

[7] https://www.justice.gov/usao-sdny/pr/manhattan-us-attorney-announces-95-million-settlement-columbia-university-improperly.

[8] https://www.justice.gov/opa/pr/university-florida-agrees-pay-19875-million-settle-false-claims-act-allegations.

[9] See 15 U.S.C. Section 638(a).

[10] U.S. ex rel. Longhi v. Lithium Power Techs. Inc., 530 F. Supp. 2d 888 (S.D. Tex. 2008).

[11] U.S. ex rel. Longhi v. Lithium Power Techs. Inc., 575 F.3d 458, at 473 (5th Cir. 2009).

[12] A successful qui tam relator may obtain reasonable attorneys' fees and costs. 31 U.S.C. Section 3730(d).

[13] U.S. ex rel. Feldman v. van Gorp et al., 697 F.3d 78, 87-88 (2nd Cir. 2012).

[14] The FCA provides for civil penalties per false claim of $5,000 to $10,000, adjusted upward periodically for inflation. 31 U.S.C. Section 3729(a)(1)(G). The current penalty is $10,781 to $21,563 per false claim.

[15] United States v. Anghaie, 633 Fed. Appx. 514 (11th Cir. 2015).

[16] https://today.duke.edu/2019/03/duke-and-us-government-reach-settlement.