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Greenbacks for Green Projects

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The Obama administration's American Recovery and Reinvestment Act (ARRA) provides billions of federal dollars for green technology. Many venture firms in Silicon Valley will undoubtedly invest in startups that bid on and receive "green" dollars.

But federal money can come with strings attached. The False Claims Act (FCA), expanded by the recently enacted Fraud Recovery and Enforcement Act (FERA), together have the potential to ensnare more transactions involving the use of federal funds. We will explore both the new potential risks to contractors and subcontractors — including technology startups — using government funds and how the administration will wield the expanded FCA when dealing with the current and future distribution of government funds. In addition we will consider best practices for avoiding exposure, and how to adapt them to green venture investment.

Clean Technology

attached. The False Claims Act (FCA), expanded by the recently enacted Fraud Recovery

and Enforcement Act (FERA), together

FUNDING PROVIDED BY THE ARRA

The \$787 billion ARRA enacted on Feb. 17 provides significant funds — the administration estimates \$60 billion — dedicated to "clean energy investments."

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How companies can get federal clean-tech funds and avoid FCA penalties



PHOTOSPIN

Other estimates fluctuate depending on whether tax credit and loan guarantees are included. Through ARRA, the federal government became the world's single-largest investor in clean technology, potentially doubling the money that was available globally for green investment in 2008.

ARRA is complex. Individual agencies receive funds and then decide how grants and contracts are distributed. ARRA

fund-seekers must comply with strict application, reporting, implementation and flow-down requirements contained within both general and funding announcement specific regulatory provisions. The goals of these requirements are to minimize fraud and ensure swift fund distribution. The variety of potential recipients — from multinational corporations with sophisticated compliance infrastructure to startups lacking basic expertise and in-

stitutional knowledge — complicates the situation. The race to obtain funding and comply with project start dates, combined with varying levels of naivete, can put companies at risk of noncompliance.

DOE REQUIREMENTS UNDER ARRA

Department of Energy requirements under ARRA provide a good example of what investors and companies in green tech will be dealing with. The Department of Energy is responsible for distributing the largest portion of ARRA green funds, and can make or guarantee energy-related loans amounting to \$127 billion. In March 2009, the DOE released special provisions relating to work funded through ARRA (which are available at <http://management.energy.gov/documents/ARRAFATermsandConditions.pdf>). The provisions include a flow-down requirement, obliging recipients to comply with all federal, state and local laws *and* ensuring “subrecipients at any tier” are monitored by the recipient “to the extent necessary to ensure the recipient’s compliance with the requirements.”

DOE’s special provisions are extensive. An overview of the more notable requirements follows:

Joint funding and commingling: ARRA funds can be used alongside other federal funds, but ARRA funds must be tracked and reported separately in conformity with ARRA reporting provisions. ARRA funds cannot be commingled with other funds except for making payments for allowable ARRA project costs. Segregated accounting systems must be established, including creating safeguards within established internal systems.

False Claims Act: All recipients and subrecipients of government funds must promptly refer to the DOE, or other appropriate inspector general, any “credible evidence” of an FCA violation. The attenuation potential is troubling, particularly for those recipients involved in complex ARRA-funded projects which involve multiple tiers of subgrantees.

ARRA funds recipients are required to ensure first-tier subcontractors and subgrantees have a DUNS number (a unique number assigned by Dun & Bradstreet, which is recognized as the standard for identifying and tracking more than 100 million businesses worldwide) and are registered with the Central Contractor Registration database by the date of the first quarterly report. A federal government Web site to act as a gateway for

all of ARRA’s reporting requirements is not currently live; thus fund applicants must otherwise meet reporting demands. Although reporting requirements are different for each funding announcement, all are based on those provided for in the ARRA.

Buy American: ARRA’s Section 1605 states that funds appropriated or otherwise made available by the act and used for the construction, alteration, maintenance, or repair of a public building or public work must use only United States-produced iron, steel and manufactured goods. Clear records of all items purchased with ARRA funding should be kept; fund recipients should request specific guidance from the DOE if they have compliance uncertainties.

THE FCA AND THE FERA AMENDMENTS

The FCA is the federal government’s primary litigation tool for combating civil fraud. It provides for treble damages and substantial civil penalties from any person or entity that *knowingly* submits or causes another to submit a false or fraudulent claim to the government. In general and except for tax fraud, the FCA covers fraud involving any federally funded contract or program.

FERA expands the scope of liability under the FCA to subcontractors and subgrantees. In 2008 in a case called *Allison Engine Co. v. United States ex rel Sanders*, 128 S.Ct. 2123, the Supreme Court limited FCA liability by finding a specific intent requirement. FERA effectively overturns *Allison Engine* by clarifying that one can be liable under the FCA even without specific intent to receive funds from the federal government. In Section 3729(a)(2) the words “to get” were removed, and “material to” added, striking the language the Supreme Court found created an intent requirement for FCA liability. (The original language of Section 3729(a)(2) read “(a) Any person who ... (2) knowingly makes, uses, or causes to be made or used, a false record or statement to get a false or fraudulent claim paid or approved by the government ... is liable to the United States government for a civil penalty of not less than \$5,000 and not more than \$10,000, plus 3 times the amount of damages which the government sustains because of the act of that person.”) FERA makes the intent change provisions retroactive to June 7, 2008.

FERA allows the attorney general to delegate sign-off authority, thereby giving

the government enhanced investigative powers. The Senate Judiciary Committee Report 110-10 (2009) on FERA found the amendments were necessary because FCA effectiveness had been undermined by court decisions, particularly *Allison Engine*, which limited the scope of the act and sometimes allowed government-paid subcontractors to escape responsibility for proven frauds.

WHO COULD BE AT RISK?

Many businesses are eager to access stimulus funds to increase involvement in green technologies, but companies wishing to access these funds must assess the risks of running afoul of the FCA.

Startups may not be cognizant of the onerous reporting and accounting requirements. FERA expands the federal government’s ability to demand accountability; the removal of the intent requirement for many FCA violations increases vulnerability to prosecution. FERA’s extension of liability down the chain of employment may leave a startup liable for the actions of its subcontractors. Vulnerability areas also may include *unknowingly* retaining overpayments and commingling of federal funds. A company may not combine federal and nonfederal money, *nor* money from two federal sources, even if they’re used for the same project.

The expanded FCA will likely require more thorough diligence from companies using federal funds. This will raise the cost of ventures undertaken with these funds. Since federal money is now typically transmitted electronically, companies will have to make significant IT investments to guarantee fund security. Companies also will need to examine involvement in secondary projects and investments. Because these amendments are new, no cases have been tried under them. Thus the scope of diligence and extent of potential liability is uncertain.

Companies would be well-advised to be particularly diligent and conservative in their actions given these uncertainties. Investment in companies accepting federal funds could create exposure both because the FCA intent requirement has been removed and because indirect receipt of funds is sufficient to incur liability. Another concern for investors is the expanded provisions for conspiracy liability — formerly conspiracy liability was limited to false claims; now it includes any false statement regarding a prohibited activity under the act. Having a member

on the board of a company implicated in a potential FCA violation might bring the investment under FCA scrutiny.

Venture investors and their board members, through involvement with ARRA-funded companies, could violate DOE special provisions requiring *any* recipient of federal funds to inform either the DOE or the inspector general of any misuse of those funds. As sophisticated investors, venture capital funds could be held to a higher standard of diligence in reference to the use and accounting of federal funds, as well as tracking how those funds are used.

A separate issue under the new investigative powers of the FCA is the government's authority to release information it uncovers during the course of an investigation to private third parties including "consultants and experts." This is of particular concern to companies reliant on proprietary information for market advantage; an investigation leaves companies open both to government penalties and to loss of proprietary advantages if the government chooses to use one of the third parties as part of its action.

POTENTIAL NEXT STEPS

Startups and venture firms can take several steps to protect themselves. Both groups should create and maintain public compliance manuals and programs to

show diligent compliance with ARRA and the FCA. ARRA funds should be segregated from other funds, including other federal fund monies. Extensive examination of subcontractors and subgrantees should be routine, and the exigencies of the FCA incorporated into contract negotiations. Subcontractors and subgrantees need to have greater awareness of the source of funds they receive. Companies will likely be required to take greater responsibility for and have more oversight over both the sources from which they receive funds and subcontractors to which they delegate funds and authority. DOE's special provisions also appear to allow companies to apply for waivers for a variety of provisions. However, the process is onerous and expensive with no guarantee of success; thus these likely will rarely be pursued.

How enthusiastic the government will be in pursuing retroactive violations under FERA is unknown. The lack of past precedent in FCA/ARRA prosecutions hampers our ability to predict the outcome of future litigation. In recent years "federal prosecutors have used the filing or even the threat of filing a lawsuit under the FCA ... to extract large settlements (primarily from institutions) to resolve claims of research misconduct or malfeasance," according to Christine G. Solt in

the College and University Law Manual. This statement primarily relates to claims pursued against health care organizations; however, an examination of FCA settlements made from 2000-2008 shows the government has not restricted this tactic to health care. The newly strengthened FCA likely will be an attractive mechanism for prosecution. Companies already using federal funds — as well as those that invest in companies that do — should re-examine their accounting of those funds.

Strong legal challenges to many aspects of the expanded FCA — such as the definition of "false claim" and the constitutionality of the retroactive intent provisions — are anticipated.

CONCLUSION

Green technology-oriented ARRA funding is appealing to many companies, but requires heightened diligence that may be difficult for companies to achieve. Companies need to weigh the cost-benefits of these funds, including extensive government monitoring and potential prosecution for noncompliance. In some cases non-ARRA funds may be the less-risky option. Venture capitalists and other investors involved with companies using federal funds need to understand their exposure and how to control that exposure if they are to invest in the most profitable and efficient ways.