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The Decline Of The Collective Knowledge Doctrine

Law360, New York (May 10, 2011) -- Whether a corporation can be held liable under the False Claims Act is an increasingly important issue in today's FCA enforcement environment. The government at times seeks to establish the necessary knowledge in an FCA case by assembling the "collective knowledge" of the corporation's various employees.

Very few courts had actually weighed in on this issue over the years, generally being not too warm to the idea, but not entirely closing the door either: the law was unclear. Last December, however, the D.C. Circuit in United States v. Science Applications Int'l Corp., 626 F.3d 1257, 1274 (D.C. Cir. 2010), decidedly rejected its application in the FCA context.[1]

This March, the U.S. Supreme Court then cited Science Applications as evidence of a broader circuit split on whether the collective knowledge doctrine is even viable more generally, not just in the FCA context. Analyzed against the broader backdrop of the doctrine's evolution, it is clear the D.C. Circuit's decision carries important implications for corporate liability both in the FCA context and in other analogous contexts.

It offers a compelling argument for why the doctrine should not apply to the FCA, particularly as the FCA continues to expand in its coverage, and it could usher wider rejection of the doctrine in this context and others, or it could lead to a broader circuit split.

The "Knowing" Standard for Liability Under the False Claims Act and the Broadening Application of the FCA

The FCA generally requires a defendant to have "knowingly" submitted a false claim or made a false statement material to a false claim. The FCA defines "knowingly" as including "actual knowledge," as well as "deliberate ignorance" or "reckless disregard" of the truth or falsity of the information, and further provides that "no proof of specific intent to defraud is required.[2]

As the FCA is being applied in more circumstances involving ever more complex transactions, the government and/or qui tam relators are more frequently seeking to use indirect theories of FCA liability such as the "implied certification" theory.

Under these types of indirect theories, a defendant can be held liable not just for submitting a false certification that expressly certifies compliance with some law or regulation, but also for submitting claims for payment in the absence of such express certification but where the company's conduct runs afoul of various underlying laws or regulations, compliance with which is still deemed to be a "condition of payment" and/or material to the government's decision to pay.

In these scenarios, FCA liability is more likely to implicate conduct within multiple departments within a corporation. Simply put, the issue becomes: to what extent can the "knowing" standard for liability under the FCA be satisfied when no single person had the requisite scienter about the submission of claims in violation of that underlying law or regulation? By piecing together the collective knowledge of different individuals within that corporation can the trier of fact conclude that the broader corporation itself had such knowledge?

The "Collective Knowledge" Doctrine for Corporate Liability

The seminal case that established the collective knowledge doctrine was United States v. Bank of New England, a First Circuit case from 1987 involving criminal violations of the Currency Transaction Reporting Act.[3] The act imposed criminal liability if a financial institution "willfully" violated currency reporting requirements, interpreted as requiring "proof of the defendant's knowledge of the reporting requirements and his specific intent to commit the crime."

The court upheld a jury instruction that instructed: "[A] [financial institution's] knowledge is the sum of the knowledge of all of the employees. That is, the bank's knowledge is the totality of what all of the employees know within the scope of their employment. So, if Employee A knows one facet of the currency reporting requirement, B knows another facet of it, and C a third facet of it, the bank knows them all."[4]

After Bank of New England, some circuits declined to allow it in analogous contexts. For example, in 1996 the D.C. Circuit held that it could not be applied to show two corporations engaged in "willful misconduct" under the Warsaw Convention.[5]

That case involved goods in transport being damaged due to the combined conduct of the packaging employees in two different companies on different continents coupled with unforeseen weather events at the point of destination. The court explained, "[w]ithin either corporation, of course, the negligent acts of employees can be fairly imputed to the corporation. Individual acts of negligence on the part of employees — without more — cannot, however, be combined to create a wrongful corporate intent ... the agency relationship cannot transform negligence into willfulness."

Earlier Attempts to Apply the "Collective Knowledge" Doctrine to False Claims Act Cases

Following Bank of New England, a few courts considered applying the collective knowledge doctrine in the FCA context, but with somewhat mixed and confusing results.

In 1999, a district court in Connecticut rejected its application, but only on the facts of the case, seeming to leave open the possibility of its application in other FCA cases.[6] The case involved a government contractor that failed to comply with the Truth in Negotiations Act by not disclosing cost or pricing information to the government contracting entity.

The court held it did not believe "the facts of this case" justified application of the doctrine because the cost information did not flow to the individual certifying compliance or to the government due to an "honest mistake" and not a scheme to mislead. In light of this evidence, the court also held there could be no liability "[e]ven if the corporate knowledge doctrine were to apply in this case."

In 2003, the Fourth Circuit appeared more open to applying the doctrine to an FCA case, but only in a narrower and more restricted form.[7] That case involved an express certification by a government contractor that no organizational conflicts of interest existed between it and its subcontractor. The court held the doctrine should not be permitted to allow proof of scienter "by piecing together scraps of 'innocent' knowledge held by various corporate officials, even if those officials never had contact with each other or knew what others were doing in connection with a claim seeking government funds."

Specifically, the court would not allow piecing together different individuals' knowledge to show corporate knowledge of the organizational conflict itself. However, so long as one person had knowledge of that organizational conflict, the court would allow piecing together that knowledge with someone else's knowledge about the certification of no such conflict to find broader corporate knowledge sufficient for FCA liability.

Although the court stated it did not believe this really involved the application of the collective knowledge doctrine, such piecing together of the defendant corporation's knowledge both of the underlying wrongful conduct and the certification about that conduct would appear to be just that.

Then, in 2004, a district court in Massachusetts briefly considered the doctrine in an FCA case, but disposed of the issue not by stating the doctrine does not apply as a matter of law, but because the employees were found not to have acted within the scope of their employment, a precondition for application of the doctrine.[8]

The D.C. Circuit's Recent, Clear Rejection in Science Applications of the Doctrine in FCA Cases

In contrast to these past murky waters, in December 2010, the D.C. Circuit unequivocally held that the collective knowledge doctrine is not appropriate for FCA cases.[9] That case also involved a government contractor conflict of interest, however, it was a pure "implied certification." Nowhere did the contractor expressly certify that it had no such conflict, nor was compliance with these conflict of interest requirements even designated within the contract itself.

Particularly cognizant of the implications of expanding the FCA over implied false certification cases like this, the court vacated the jury trial's verdict on the FCA claims on the grounds the jury instruction on collective knowledge should not have been given.

The court faulted the instruction because it allowed "a plaintiff to prove scienter by piecing together scraps of innocent knowledge held by various corporate officials, even if those officials never had contact with each other or knew what others were doing in connection with a claim seeking government funds" and further because the instructions drew "no distinction between the knowledge of corporate officers and that of potentially thousands of ordinary employees, including the knowledge of all employees in the 'collective pool' of information imputed to the corporation."

The court drew on its prior precedent in non-FCA contexts to explain that the circuit had generally been skeptical about applying the doctrine. Despite noting that the FCA, unlike the standard involved in these other cases, expressly requires "no proof of specific intent," the court nonetheless held that the collective knowledge doctrine was inappropriate for the FCA context "because it effectively imposes liability, complete with treble damages and substantial civil penalties, for a type of loose constructive knowledge that is inconsistent with the [FCA's] language, structure and purpose," which it summarized as being to punish and deter fraud, not honest mistakes or negligence.

That said, the court also acknowledged that the collective knowledge doctrine would not be necessary to prove corporate knowledge and liability in the scenario of an ostrich burying its head in the sand: "If a plaintiff can prove that a government contractor's structure prevented it from learning facts that made its claims for payment false, then the plaintiff may establish that the company acted in deliberate ignorance or reckless disregard of the truth of its claims."

Explanations, Implications and Predictions

The D.C. Circuit's recent decision in Science Applications represents a significant and persuasive clarification that the collective knowledge doctrine is inappropriate in FCA cases. The roots of this decision likely lie in the D.C. Circuit's prior skepticism of the doctrine in other contexts, and its desire to bring the FCA jurisprudence closer in line with these other cases.

But they also lie in the fact that this particular case represented a vivid attempt to push the boundaries of the FCA, and the court understood that applying the collective knowledge doctrine in this situation would effectively unmoor the FCA from its fundamental purpose of being a tool for punishing and deterring fraud.

Given this backdrop, the implications of this decision will likely be widespread. It could pave the way for broader and clearer confirmation within other circuits that the collective knowledge doctrine simply has no place in the FCA corporate liability context.

Or, it could generate a loud split in the circuits, with one split being over whether the doctrine applies at all, or another being whether it can only apply in a narrower form, along the lines of the Fourth Circuit's decision (permitting corporate liability where one person knew of the underlying violation but not the certification, and another knew about the certification but not the underlying violation).

As the Supreme Court has already cited the case as evidence of a broader split over whether the doctrine applies generally (not just in the FCA context), those who have cases where this issue is implicated will want to pay attention to this split and assert any appropriate objections to preserve the issue for appeal.

Regardless, as courts increasingly grapple with whether to find FCA liability in ever more complex or nuanced circumstances, the decision will no doubt serve as an important and instructive analysis of how and where to draw the line for corporate liability.

For example, Deutsche Bank may soon have the opportunity to apply Science Applications in the recently filed FCA case in New York (United States v. Deutsche Bank AG and MortgageIT Inc, 11 CIV 2976.).

Finally, there is no reason why we should not continue to see a rejection of the collective knowledge theory of corporate liability in other contexts involving similar scienter requirements of "willfulness," "deliberate ignorance" or "reckless disregard" standards.

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[1] Staub v. Proctor Hospital, __ U.S. __, 131 S.Ct. 1186, 1191 (2011).

[2] 31 U.S.C. § 3729(b)(1).

[3] United States v. Bank of New England, 821 F.2d 844 (1st Cir. 1987).

[4] Id., at 855.

[5] Saba v. Compagnie Nationale Air France, 78 F.3d 664 (D.C. Cir. 1996).

[6] United States v. United Technologies, Corp., 51 F.Supp.2d 167 (1999).

[7] United States ex rel. Harrison v. Westinghouse Savannah River Co., 352 F.3d 908 (4th Cir. 2003).

[8] United States v. President and Fellows of Harvard College, 323 F.Supp.2d 151, 192 n.33 (D. Mass. 2004).

[9] Science Applications Int'l Corp., 626 F.3d at 1274.