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YOUR STANDARD LIABILITY POLICY DOESN'T COVER FCA CLAIMS

In health care, actions under the False Claims Act ("FCA") typically allege conduct that is knowingly in violation of one or more of Medicare's conditions of payment—part of an amorphous contract between a government agency and a provider—that results in a fraudulently obtained overpayment to the provider for services rendered.

Last week, the Ninth Circuit affirmed that a liability insurance policy did not cover claims under California's False Claims Act alleging fraud based on the knowing disregard of contractual obligations to the government. In *Office Depot, Inc. v. AIG Specialty Insurance Company*,[1] Office Depot argued that AIG owed a duty under two policies to defend and indemnify it against claims that it overcharged for office supplies sold under contract to hundreds of public entities. The Ninth Circuit found no potential coverage that triggered AIG's duty to defend, and because the duty to defend is broader than the duty to indemnify, any liability wouldn't be indemnified.

UNDERLYING FCA CLAIM

In 2009, David Sherwin, a former employee of Office Depot and a *qui tam* relator, filed an action in state court under the California False Claims Act ("CFCA"), alleging that over 60 public school districts and regional government agencies were overcharged for supplies purchased from Office Depot under two consecutive Master Agreements spanning from 2001-2011.[2] An amended complaint filed in 2012 alleged that Office Depot's fraud continued through the entire period that the contracts were in effect.

The complaint generally alleged that Office Depot flouted its obligation to offer contract parties the lowest price it offered to any other governmental entity; switched parties between two price plans in the contract to maximize rather than minimize its charges; inflated the cost of products offered "at cost" under the contract; raised list prices more frequently than permitted; and removed items from a steeply discounted "core" supply list.[3]

In 2015, Office Depot settled the CFCA lawsuit for $77.5 million.[4]

COVERAGE UNDER AIG'S POLICIES

Office Depot argued that two liability policies issued by AIG provided coverage for the relator's CFCA allegations. The District Court for the Central District of California disagreed for several reasons.

First, the policies covered acts that "first occurred" during the policy period, but Office Depot's fraud allegedly began six years before the first policy took effect.[5]

Second, a "prior acts" exclusion precluded coverage of any series of acts or related acts where the first act began prior to the policy period. Thus, even if Office Depot had successfully argued that at least some individual acts occurred during the policy period, this exclusion tied those acts back to 2001 and precluded coverage.[6]

Third, the policy contained a "contract" exclusion for "any claim alleging, arising out of or resulting, directly or indirectly, from any liability or obligation under any contract or agreement or out of any breach of contract," which facially included the CFCA claims based on Office Depot's noncompliance with its contract pricing obligations.[7]

Fourth, an exception to the contract exclusion did not reinstate coverage. The exception applied to claims arising from Office Depot's liabilities or obligations existing outside the contract, which Office Depot argued included claims under the CFCA. But, because Office Depot's conduct could not have violated the CFCA absent its contractual obligation, the exception to the exclusion did not apply.[8]

Finally, a "government agency" exclusion precluded coverage for claims asserted by or on behalf of certain named federal agencies or any other federal, state, local or foreign government agency. The court found the only reasonable interpretation of this term included claims brought by the state itself pursuing statutory claims, as was the case here, and not merely an agency pursuing regulatory or administrative claims, as Office Depot argued.[9]

Office Depot appealed all of these findings, but the Ninth Circuit only needed to find one of them valid to affirm the holding. It chose to affirm based on the contract exclusion.

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PRACTICAL TAKEAWAYS FOR HEALTH CARE PROVIDERS

- Contract exclusions are commonly found in commercial liability policies. In the health care realm, nearly all FCA claims are rooted in the contract between CMS and a provider and would, therefore, be excluded from coverage under most iterations of this term.
- Even if the alleged conduct is not rooted in contract, other exclusions may apply, e.g., to claims asserted by or on behalf of the government.
- In the post-COVID-19 environment, many sources are predicting that FCA whistleblower suits will skyrocket, and the cost of defending these claims—even when successful—can be unexpectedly high.
- While public policy (and good sense) precludes insuring against your own fraudulent conduct, many insurers offer policies or riders that cover the costs to defend—but not indemnify—against FCA claims. Depending on your risk, it may be wise to consider such a policy, if you don't have one already.

If you have any questions, please contact:

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- Your regular Hall Render attorney.

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[references]

[1] *Office Depot, Inc. v. AIG Specialty Ins. Co.*, No. 19-55819, 2020 WL 6690619, at *1 (9th Cir. Nov. 13, 2020).

[2] *Office Depot Inc. v. AIG Specialty Ins. Co*., No. 215CV02416SVWJPR, 2019 WL 4570011, at *2–3 (C.D. Cal. June 21, 2019).

[3] *Id.* at *3.

[4] *Id.*

[5] *Id.* at *5.

[6] *Id.* at *6.

[7] *Id.* at *5.

[8] *Id.* at *5–6.

[9] *Id.* at *7.

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