



FEDERAL CONTRACTS



REPORT

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FCR's "Viewpoint" feature provides a forum for an exchange of views on developments affecting the federal contracting community. Opinions expressed in this section are those of the authors, not of BNA or FCR.

Here, a False Claims Act litigator argues that pending bills to "correct" the act take the wrong approach, and that any changes to the FCA should aim to modify the behavior of contractors and whistleblowers rather than to encourage litigation. The bills were the subject of earlier stories in FCR (88 FCR 235, 9/18/07; 89 FCR 5, 1/8/08).

Amending the Civil False Claims Act: An Alternative Proposal

BY MICHAEL L. WALDMAN *

The Civil False Claims Act ("FCA"), 31 U.S.C. 3729 *et seq.*, has a laudable goal: to encourage whistleblowers with knowledge of fraud against the United States to come forward so that the federal government can recover overcharges and punish the wrongdoer. Revitalized through the 1986 Amendments, the FCA has spurred whistleblowers to bring numerous lawsuits in recent years alleging that the federal government was defrauded by its contractors. In a Novem-

ber 2007 press release, the Justice Department announced that it had obtained more than \$20 billion dollars in settlements and judgments under the FCA since passage of the 1986 Amendments. More than \$12.61 billion of that amount was associated with suits initiated by whistleblowers, known as "relators," under the Act's qui tam provisions. By almost any measure, the FCA has been enormously successful in accomplishing its goal of incentivizing whistleblowers to come forward with information about contractor fraud against the Government.

In the last months of 2007, two bills were introduced in Congress to modify the FCA. Sen. Charles Grassley (R-Iowa) has offered S. 2041, entitled the "False Claims Act Corrections Act of 2007," and Rep. Howard Berman (D-Calif.) has introduced a more expansive bill, H.R. 4854, with the same title. There are probably very few government laws that could not use "corrections," and few would argue that the FCA as currently constituted is always a model of clarity. Nevertheless, it is hard to see how the proposed revisions to the current FCA ad-

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vocated by Sen. Grassley and Rep. Berman would actually serve the goal of rooting out fraud by encouraging insiders with knowledge of fraud to come forward.

For example:

- The bills would largely eliminate the “public disclosure” defense to an FCA lawsuit. The current FCA seeks to prevent “parasitic” lawsuits by those who are not true whistleblowers by allowing defendants to seek dismissal of qui tam relators whose allegations were already “publicly disclosed” through media reports or government lawsuits, audits, or investigations. The Act has an exception for the “original source” of the allegations—that is, a relator with “direct and independent knowledge” of the allegations may proceed with his or her lawsuit even if the allegations have been publicly disclosed. The need for this proposed change is baffling — true insiders should not be discouraged by the current law’s provision for dismissal of lawsuits brought by relators who lack any direct and independent knowledge of the alleged wrongdoing.
- The bills would expand the statute of limitations from 6 years to 10 years. Rather than encourage whistleblowers to come forward, this proposed amendment appears to encourage delay and procrastination on the part of whistleblowers.
- Rep. Berman’s bill would prevent courts from dismissing FCA allegations that are lacking in specificity or detail under Federal Rule of Civil Procedure 9(b). This proposed amendment would allow a relator to avoid dismissal even though he or she knows nothing about the actual invoices paid by the Government. However, one would expect a true insider with knowledge of fraud against the government to have information about the inflated bills sent the government and have no need for this proposed amendment.
- The bills would allow private lawsuits by government employees, including government auditors. These government officials are already obligated, by virtue of working for the federal government, to identify and raise fraud allegations. One must ask why these government employees need further incentive beyond their government salaries to report fraud by contractors against their government employer.

These bills call for procedural changes that will allow the marginal lawsuit – *not* brought by a true insider with knowledge of real fraud – to survive early dismissal. These proposed changes to the current Act would benefit qui tam relators who have weak or non-existent claims of fraud by allowing them an opportunity to: (i) extract a nuisance settlement from corporate defendants who do not want to incur the time and expense of discovery; and/or (ii) engage in discovery fishing expeditions in the hope of finding evidence of some fraud somewhere. However, the “plaintiff’s lawyer wish list” reflected in the bills now before Congress does not seem to do much to further the true goals of the FCA and its qui tam provisions.

If Congress is planning to revise the FCA, it should adopt provisions that will modify real-world behavior of government contractors and whistleblowers in a positive way. Rather than focus on procedural changes that encourage the litigation of weak claims, such as modifying the statute of limitation periods to preserve stale claims and tinkering with Federal Rule of Civil Procedure 9(b) to assist plaintiffs without detailed knowledge

of the alleged false claims, changes to the FCA should focus on encouraging government contractors themselves to avoid and correct any overcharging to the government without resort to litigation. Changes to the FCA also should seek to encourage relators to come forward as early as possible and to allow the legal system to focus on those cases that involve the greatest threat to the federal government fisc.

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With the objective of affecting real world behavior in a way that will advance these aims, the following are my suggestions for amending the FCA:

A. Amend the FCA to reward strong corporate compliance programs. The current FCA mandates treble damages and a minimum penalty of \$5,500 per false claim for violations of the Act. A company will be hit with these mandatory damages and penalties, regardless of its commitment and record in regard to business ethics. This is directly contrary to the criminal context, where prosecutors in charging decisions and courts in sentencing decisions expressly consider the strength of a corporation’s compliance program. Companies should be encouraged to invest in strong corporate compliance programs. A company’s superior record for business ethics and first rate compliance program should be taken into account by the FCA.

One possible approach would be to amend the FCA to provide that companies should not be held liable under the Act for wrongdoing by rogue employees undertaken in contravention of the company’s express policy and rigorous compliance program efforts. Alternatively, the FCA could be amended to give the courts discretion to lower the damages to double (or even single) damages and lower the penalties below \$5,500 (even to zero), based on the strength of a company’s compliance program.

B. Amend the FCA to encourage voluntary disclosure by companies. The current FCA purports to encourage voluntary disclosure on the part of companies, but the reality is far different. The time frame for the voluntary disclosure is unrealistic: the FCA requires the company to disclose the overcharging within 30 days of “the date on which the defendant first obtained the information.” Because the nature of most government contracting fraud is often complex and can take months for a company to investigate and unravel, the 30-day period is impractical. For example, the Justice Department frequently takes several years while a case is under seal to determine whether to intervene in a qui tam action.

Moreover, the “benefit” that the FCA provides for voluntary disclosure – double, rather than treble, damages – is limited. Given that most government contracting overcharge issues have shades of gray, companies are reluctant to voluntarily disclose possible mischarging when the reward is merely double damages. The rational calculation of companies (assuming that they could ever meet the FCA 30-day time limit) may be that

the advantage of “double” damages for a voluntary disclosure is not sufficient incentive for disclosure, given that the company may argue that it is not mischarging, that the Government may never learn of the arguable overcharge, and that, even if the Government does learn of the arguable overcharge, the settlement in litigation will likely be in the double damages range because of the government’s litigation risks.

Consequently, the FCA could be improved by a revision that provides real incentives and realistic time frames for voluntary disclosures.

C. Amend the FCA to encourage whistleblowers to bring complaints to the company’s compliance program. The two proposals above reflect the bias that it is best to have companies prevent and correct overcharges themselves, rather than rely on expensive after-the-fact litigation. Requiring whistleblowers to bring their allegations of fraud to the company’s compliance program would be consistent with this approach. The Sarbanes-Oxley Act mandates upwards internal reporting for financial misdeeds. The FCA already has provisions providing extensive protections to whistleblowers who are the subject of retaliation for raising allegations of fraud and, if necessary, these provisions could be enhanced.

There are substantial advantages in having companies fix any mischarging problems on their own. Amending the FCA to require whistleblowers to bring their overcharging concerns to companies will create powerful incentives for companies to police themselves and end any overcharges at their inception.

D. Amend the FCA to encourage whistleblowers to come forward with their FCA lawsuits as early as possible. The current FCA creates perverse incentives for whistleblowers to delay bringing ongoing fraud to the Government’s attention. Because the relator shares in the Government’s total recovery, his or her incentive is for the damages number to be as high as possible. Thus, in the case of ongoing fraud, the relator may seek to have the alleged fraud continue so that the damages (which are then trebled) will continue to increase.

It has been infuriating for government contractors to be sued by insiders who not only do not bring the alleged fraud to the attention of the company’s compliance program, but who also wait several years to file

the qui tam lawsuit until the alleged damages have been maximized. Under the current FCA, a relator is entitled to a minimum share of 15 percent; amending the FCA to allow a court to lower the relator’s share to zero if he does not file suit promptly would avoid rewarding relators for delaying filing their qui tam lawsuit.

E. Amend the FCA to encourage focusing on those cases with significant monetary loss to the federal government. The FCA currently has penalties of between \$5,500 to \$11,000 per false claim. This \$5,500 minimum is arbitrary and can lead to aberrational results — in some cases involving a small overcharge on each item, the actual damages to the Government may be miniscule but the possible penalties are huge. For example, in a case against Koch Industries, after an 11-week trial and 141 witnesses, the jury found overcharges over a five year period totaling \$553,000 but identified almost 25,000 invoices as false. The result was the tail wagging the dog — relatively small government damages but potentially huge penalties of up to \$250 million.

The potential for this type of outcome can skew the allocation of resources, requiring inordinate litigation fees and costs to be devoted to cases involving little harm to the Government. Consequently, the FCA should be amended to eliminate the \$5,500 minimum and thereby ensure proportionality between the actual Government damages and the FCA penalties.

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Procedural changes to the FCA that focus on increasing litigation of marginal cases will do little to prevent government contracting fraud. Moreover, litigation is inherently inefficient. The “transaction costs” involved in FCA lawsuits are especially significant, with costly legal fees and substantial contractor, government, and judicial resources expended in the litigation process. Few could deny that it is preferable to have government contractors police themselves and correct overcharging problems without government or judicial intervention. Unlike the proposed bills before Congress, the changes to the FCA proposed in this article have the potential to change real-world behavior in positive ways by encouraging the use of company compliance programs and promoting the early reporting of contractor fraud.