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FEATURE COMMENT: Substantial Increase In False Claims Act Penalties Impacts The Landscape Of Litigation

Over the last several years, Congress' inability to act has hampered the nation. Budgets and funding have been delayed, judicial seats have sat empty, and we have suffered through "sequestration" because the parties can barely agree on anything. Yet, despite being characterized as the most ineffective Congress in U.S. history, Republicans and Democrats have continued to work together to pass legislation that fortifies the Government's arsenal in the so-called "War on Fraud." To keep up with inflation, Congress has directed the Department of Justice to ratchet up civil penalty amounts under the federal False Claims Act, 31 USCA § 3729 (FCA). Empowered by its Congressional mandate, last month DOJ issued an interim final rule nearly doubling the penalty range for violations under the FCA. Taken together with other aggressive enforcement efforts—increased referrals and heightened enforcement of suspension and debarment, additional mandatory disclosure requirements, a new emphasis on criminal prosecution of individuals, and hot pursuit of civil FCA actions—the increased FCA penalties are yet another threatening Government weapon for contractors to fear. As DOJ implements this new rule in the coming months, responsible businesses may wonder how it may affect Government contracting.

This article explores how the significantly increased penalty ranges will impact FCA actions from inception to end. We first explain the background of the recent law and DOJ's new rule, which results in sudden and substantial increases to the penalty amounts assessed under the FCA. Next, we assess how the increased penalties are likely to lead to more suits being filed, including in cases where actual damages may be low or even nonexistent. We then discuss how the increased penalties allow the Government (and potentially relators, too) to extract more and larger FCA settlements from contractors daunted by potentially gargantuan fines. Finally, we provide an analysis on constitutional challenges to exorbitant FCA penalties under the Eighth Amendment's Excessive Fines Clause, and assess how litigation may be prolonged by post-judgment challenges to the heightened penalty amounts.

Penalties Provision Under the False Claims Act—As Government contractors are aware, when a person is liable for the knowing submission of a false claim to the Government, the FCA provides for an award of three times the damages sustained by the Government. 31 USCA § 3729(a). The statute also mandates the application of a civil penalty for each false claim submitted. For more than a decade, the civil penalty amount has ranged from not less than $5,500 to not more than $11,000 for each false claim submitted. 28 CFR § 85.3(a)(9). As the false claims often appear in the form of regular contract invoices, the number of civil penalties and the total amount of those penalties can add up quickly. And now, the individual penalty ranges are set to almost double.

Legislation and Interim Final Rule—On Nov. 2, 2015, the president approved the Federal Civil Penalties Inflation Adjustment Improvements Act of 2015 (FCPIAIA) requiring DOJ and other agencies to issue interim final rules adjusting the civil monetary penalties applicable to numerous federal laws, including the FCA. Bipartisan Budget Act of 2015, P.L. 114-74, Nov. 2, 2015, 129 Stat. 584, 599. Under the FCPIAIA, agencies had to issue the rule by July 1, 2016, and the rule must take effect no later than Aug. 1, 2016. Id. at 599. The initial adjustment was based on a comparison between the cost of living in October 2015 and October of the year in which each penalty was established or last adjusted.

81 Fed. Reg. 42493. Under the FCPIAIA, the adjusted penalties cannot exceed 2.5 times the amount of the current penalty, and the adjustment applies only to civil monetary penalties assessed after the date the increase takes effect. Id. The FCPIAIA also requires agencies to issue additional yearly adjustments based on the difference between the Consumer Price Index of the October preceding the new adjustment and the prior year. Id. at 42492–42493.

On June 30, 2016, the *Federal Register* published DOJ's interim final rule adjusting the civil monetary penalties for inflation, including FCA penalties. 81 Fed. Reg. 42491. Under the new rule, any person who violates the FCA is liable for a civil penalty of not less than $10,781 and not more than $21,563 for each false claim. Id. at 42494. The rule nearly doubles the current penalties of $5,550–$11,000. In accordance with the FCPIAIA, DOJ based the adjustments on the Bureau of Labor Statistics' Consumer Price Index for October 2015, and the interim rule is subject to a 60-day period for public comment after publication. Id. at 42498. Per the FCPIAIA, the interim rule also requires agencies to make subsequent "cost-of-living" adjustments annually, a marked change from past practice with respect to the FCA. Id. at 42492–42493.

Notably, the increased penalties will not apply retroactively, at least not for the most part. The interim final rule provides that the "adjusted civil penalty amounts are applicable only to civil penalties assessed after August 1, 2016, whose associated violations occurred after November 2, 2015," the date the FCPIAIA was approved. 81 Fed. Reg. 42498. Violations occurring on or before Nov. 2, 2015, are not subject to the increased penalties. Id at 42500. Likewise, assessments made before Aug. 1, 2016, even with associated violations occurring after Nov. 2, 2015, are not subject to the increased penalties. Id. As such, the interim final rule does not appear to raise any significant constitutional concerns about retroactivity.

Impact on Pending and Future Cases—The increased penalties will likely affect FCA suits at every stage of legal proceedings, including the determination to file suit and the number of suits filed, the negotiation process over whether a suit will settle or proceed through litigation, and even in post-judgment proceedings where there may be more challenges to the constitutionally of the penalties assessed.

Increase in FCA Suits, Irrespective of Actual Damages: At the filing stage, we can expect the heightened penalties to incentivize both the Government and qui tam relators (also known as whistleblowers) to bring more FCA suits. We saw this trend even before Congress increased the penalties, largely due to DOJ's intensified enforcement efforts. Fiscal year 2015 was the sixth consecutive year in which the Federal Government's recoveries from FCA settlements or judgments exceeded $3 billion. It was also the sixth consecutive year in which the Government and relators filed more than 700 new FCA matters. DOJ issues an annual press release touting its enormous recoveries, the additional resources it is allocating to FCA enforcement and the expanding reach of its enforcement measures outside the traditional industries of procurement/defense contracts and healthcare. The large recovery trends have galvanized potential whistleblowers as well. Relators are bringing more suits and proceeding with suits in which the Government declines to intervene, and they stand to recover as much as 30 percent of any amounts awarded, including penalties. 31 USCA § 3730(d). All in all, the potential for financial reward incentivizes more FCA actions. An increase in penalties only ups the stakes and creates a greater draw for filing.

The significantly heightened penalty amounts are a boon to the Government and relators alike in cases where the absence of significant actual damages may otherwise have deterred them from bringing an action. Because the penalty provision is punitive in nature, a contractor can be assessed penalties for liability under the FCA even if the Government has suffered no tangible harm. Where the number of claims is high, the significant increase in the penalties range may provide incentive where previously little to no actual damages would have deterred suit. In many instances, the Government or relator alleges violations over large periods of contract performance, or the entire duration of the contract. With the potential to recover exorbitant penalties (at the high end of the new scale, $21,563 for every invoice ever submitted under a contract), the Government and relators may be more willing to bring an action even if the statute's treble damages provision would not entice such an action. Hence, the incentive to file suit increases.

Settlement Leverage: Perhaps the most significant impact of increased penalties will be the substantial additional leverage it provides the Government (and relators, too) to favorably resolve those suits. Recently, DOJ has not shied away from using maximum penalty amounts as a major bargaining

chip in FCA settlement negotiations. Blockbuster settlements against pharmaceutical companies, defense contractors and even the banking industry have been a highlight of DOJ's FCA press releases. But small and mid-sized contractors also find themselves across the negotiating table from Government lawyers exercising their mandate to enforce the Government's so-called principal anti-fraud weapon—the FCA. These smaller contractors have fewer resources, fewer connections and even less bargaining power than their larger competitors. Faced with the Government's dual anvils of treble damages and automatic penalties, defendants often elect settlement rather than risk litigation, even when they believe the allegations against them are unsubstantiated. The increased penalty ranges only strengthen the Government's disproportionate bargaining power. While these higher penalties are purportedly designed to keep pace with inflation, the reality is that they give the Government more leverage to compel contractors into settlements. Risk-averse defendants may find themselves all too weary of not only the financial loss, but also the risk of bankruptcy, and the loss of their business and livelihood. With the increased penalty amounts, the popular option of settlement just got more popular. One may wonder, to what extent are the merits of the case taken into account?

Eighth Amendment Challenges, the Number of Claims, and Judicial Discretion: Significantly higher penalties may also impact the FCA legal landscape post litigation. Defendants found liable for FCA violations will be assessed greater individual and aggregate penalties than ever before. As the increase in penalties incentivizes the Government and relators to bring more FCA suits, and galvanizes them to do so even where the Government has suffered little to no harm, judgments with greater discrepancies between damages and penalties will follow. In the past, contractors have challenged disproportionate outcomes under the Eighth Amendment's Excessive Fines Clause. FCA penalty awards have rarely been stricken as unconstitutional in such cases, but contractors facing new increased penalty assessments have little to lose by making the challenge. The viability of these Eighth Amendment challenges may gain potential in cases with low damages or a high number of claims.

A penalty is unconstitutional under the Excessive Fines Clause of the Eighth Amendment only if it is "grossly disproportional to the gravity of [the] offense." *U.S. ex rel. Drakeford v. Tuomey*, 792 F.3d 364, 387 (4th Cir. 2015). In making this determination, courts consider whether the penalties assessed will have the necessary and appropriate deterrent effect in light of the gravity of the defendant's conduct. *U.S. ex rel. Bunk v. Gosselin World Wide Moving, N.V.*, 741 F.3d 390, 408 (4th Cir. 2013). The Supreme Court has noted that "an award of more than four times the amount of compensatory damages might be close to the line of constitutional impropriety." *State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. 408, 425 (2003). Yet, courts have upheld penalties in FCA cases that greatly exceeded this ratio. See, e.g., *U.S. v. Mackby*, 221 F. Supp. 2d 1106, 1108 and 1115 (N.D. Cal. 2002), aff'd, 68 F. App'x 776 (9th Cir. 2003) (upholding penalties totaling $555,000, which is 9.5x the actual damages of $58,151.64); *U.S. v. Byrd*, 100 F. Supp. 2d 342, 343, 346 (E.D.N.C. 2000) (upholding civil penalties of $1,320,000, which is 15.5x the actual damages of $85,012).

One of the most notable Eighth Amendment challenges in the FCA context in recent years is the *Bunk* case. 741 F.3d at 390. In *Bunk*, defendant was found liable under the FCA for its role in a price-fixing scheme that involved a contract for transportation of goods. Id. at 400. There were 9,136 false claims at issue, corresponding to the number of invoices stipulated by the parties to have been submitted under the contract. Id. The relator chose to forgo proof of damages and therefore sought none, suing only for civil penalties. Id. at 399, 402-403. Multiplying the number of claims by the statutory minimum penalty of $5,500 would have resulted in a cumulative penalty of $50,248,000. Id. at 401. The district court concluded that this amount would be unconstitutionally excessive and, instead, awarded no civil penalties. *U.S. ex rel. Bunk v. Birkart Globistics GmbH & Co.*, 2012 WL 488256, at *15 (E.D. Va. Feb. 14, 2012); 54 GC ¶ 74. The issue on appeal was whether the district court erred in awarding no penalties based on its determination that any award under the FCA, even applying the statutory minimums, would necessarily exceed $50 million. 741 F.3d. at 395. The relator was willing to accept a voluntary remittitur to $24 million to bring the total arguably within constitutional limits. Id. at 405. Although there were no actual damages awarded, the Fourth Circuit held that a judgment of $24 million would not constitute an excessive fine under the Eighth Amendment because it appropriately reflected the gravity of the defendant's offenses and provided a deterrent effect. Id. at 409. Though *Bunk*

represents an uncommon instance in which the court reduced the penalties award to less than what the statute specifies (made more uncommon by the relator's action to voluntarily accept such a reduction), the constitutional challenge was only partly successful given the substantial award.

There have been few other successful Eighth Amendment challenges in cases where there were little to no actual damages. In *U.S. v. Advance Tool Co.*, 902 F. Supp. 1011 (W.D. Mo. 1995), aff'd, 86 F.3d 1159 (8th Cir. 1996), the Government found a supplier of tools liable under the FCA based on his misrepresentation of the quality of tools he supplied to the Government. The Government failed to show any actual damages, but argued that, based on 686 false claims, it was entitled to $3,430,000 in civil penalties. Id. at 1018. After examining the plaintiff's conduct, the court found that such an award would be unconstitutionally excessive under the Eighth Amendment. Id. Thus, the court decreased the amount of false claims to 73 for a penalty award of $365,000 to bring it within constitutional limits. Id at 1018-19. Other courts have also reduced or refused to award penalties under the Eighth Amendment where penalties were disproportionately greater than damages. See *U.S. ex rel. Smith v. Gilbert Realty Co.*, 840 F. Supp. 71, 74–75 (E.D. Mich. 1993) (holding that a civil penalty of $290,000 for FCA violations that resulted in actual damages of only $1,630 was unconstitutionally excessive, and would be reduced to $35,000); *U.S. ex rel. Stearns v. Lane*, 2010 WL 3702538, at *4 (D. Vt. Sept. 15, 2010) (holding that civil penalties ranging from $66,000 to $132,000 were unconstitutionally excessive under the Eighth Amendment where the damages were only $828).

The near doubling of FCA penalties may also affect how courts receive defense challenges to what constitutes a "claim" for purposes of counting the number of claims that comprise the penalty award. Given the new penalties range, how many "claims" there are is more important than ever before. Courts sympathetic to the potential for excessive penalties are likely to be precise in their determination of the "claims" at issue. There is some precedent for careful counting. For instance, in *Advance Tool Company,* discussed above, the court elected to count the number of false claims based on the 73 different *types* of tools that were not of the type of quality requested by the Government, even though it had found 686 invoices for those tools to be knowingly false. 902 F. Supp. at 1018. See also *U.S. v. Krizek*, 111 F. 3d 934, 940, 943 (D.C. Cir. 1997) (noting that that the Government's definition of claim permitted it to seek "an astronomical $81 million worth of damages for alleged actual damages of $245,392" and remanding to district court to recalculate civil penalty based in part on district court error in defining the claim as each medical billing code rather than each payment form on which billing codes were contained); 39 GC ¶ 388 (Note 1). For purposes of aggregating penalties, these cases illustrate the Government's and relators' incentive to cast broadly the definition of a false claim, while defendants may seek to narrow that definition. Accordingly, the increased penalties will likely result in more litigation over what constitutes a false claim.

Irrespective of the actual number of claims, courts may also exercise greater discretion in applying the new, higher penalty amounts in a given FCA case. Indeed, in at least a few cases, courts have decreased or even denied civil penalties without finding it necessary to invoke the Eighth Amendment, even though the FCA does not appear to provide courts with such discretion. For example, in *Peterson v. Weinberger*, 508 F.2d 45 (5th Cir. 1975), the district court found that the defendants had submitted 120 false claims to the Government, yet it only assessed civil penalties based on 50 of those claims. Id. at 48–49. On appeal, the Government argued that the district court should have assessed penalties on the full 120 false claims, but the Fifth Circuit held that the court could exercise discretion where penalties were excessive and out of proportion to the damages sustained. Id. at 55. The Fifth Circuit further noted that the penalties "should reflect a fair ratio to damages to insure that the Government completely recoups its losses." Id.; see also *U.S. v. Cabrera-Diaz*, 106 F. Supp. 2d 234, 242 (D.P.R. 2000) (holding that no civil penalties would be assessed because they would have been excessive where 455 false claims totaled between $2,275,000 and $4,550,000).

Nevertheless, courts are generally quite reluctant to find FCA penalties excessive and have persisted in upholding fines totaling hundreds of millions of dollars. For instance, in *U.S. ex rel. Drakeford v. Tuomey*, decided by the Fourth Circuit just last year, relators brought an action against a health care provider alleging that the provider knowingly submitted 21,730 false claims to Medicare for reimbursement. 792 F.3d at 370. Actual damages from the false claims amounted to $39,313,065, the civil penalties totaled $119,515,000, and the resulting judgment was for

a resounding $237,454,195. Id. at 384. Despite this considerable award, the defendant's Fifth and Eighth Amendment challenges were unsuccessful. Id at 390. The ratio of punitive damages to compensatory damages was approximately 3.6-to-1, which falls just under the ratio the Court deems constitutionally suspect. Id. at 389. The Fourth Circuit acknowledged the severity of the penalties, but explained that it was appropriate in light of the fraud that the defendant had perpetrated on the Federal Government and held that the award was not unconstitutional. Id.

With penalties set to increase so dramatically, defendants are likely to pursue more Eighth Amendment challenges, particularly in zero or low damages cases where the disparity between the amount of damages and penalties is likely to be steep. Increased penalties may also modify the nature of litigation over penalty awards. The parties are likely to have more disputes over what constitutes a claim, and how to count claims for purposes of determining the penalty award. Defendants may be emboldened in their requests for courts to exercise discretion in applying the FCA's penalties provision, and, more than ever before, courts may be amenable to creative solutions that avoid excessive penalties.

Conclusion—Enabled by recent legislation, DOJ's interim rule substantially increasing FCA penalties is yet another show of force against businesses contracting with the Government. The Government and relators will be more apt to bring suit, with less consideration of the merits or actual damages, and more consideration of financial reward and publicity for success in the so-called war on fraud. Apprehensive contractors unwilling to risk litigation will be more apt to settle, even in cases lacking significant damages, so long as the number of claims (and therefore the potential total penalties) is high. Under this enhanced penalties regime, those contractors that go forward with litigation and are found liable may have grounds for challenging the constitutionality of penalties awarded as excessive, but the current state of the law does not offer much hope of success except in the most extreme circumstances absent some additional exercise of discretion by the courts. Overall, Congress and DOJ's actions are certain to incentivize relators and the Government alike to bring more FCA suits and defendants to settle more quickly. Whether this also means that contractors will truly be deterred from fraudulent conduct remains to be seen. One thing that is clear—the Government has yet again intensified its leverage under the FCA against contractors.

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This Feature Comment was written for The Government Contractor by Brian Tully McLaughlin, Mana Elihu Lombardo, and Sigourney Haylock of Crowell & Moring LLP. Mr. McLaughlin is a partner in the Washington, D.C. office and Ms. Lombardo is a counsel in the Los Angeles office. Mr. McLaughlin and Ms. Lombardo are members of the firm's Government Contracts group and experienced False Claims Act litigators, handling cases both at trial and on appeal. Ms. Haylock is a summer associate in the firm's Los Angeles office.

