FCA LIABILITY: SOME COMMON LAW AND CONTRACTUAL LIMITATIONS

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I. INTRODUCTION

The government often refers to the False Claims Act ("FCA" or "Act")[1] as its most effective tool to combat fraud in federal programs. The club of trebled damages and penalties provides significant incentive for the investigation and settlement of cases, and for corporate investment in expensive compliance programs to minimize exposure. Clearly, the statute goes beyond mere restitution and provides for significant punishment and deterrence of future conduct. Recent recognition of the punitive nature of the False Claims Act remedies has led various courts to consider the extent to which common law and contract principles limit the potential liability under the Act.

This paper discusses these trends. First, we examine some common law limitations on punitive damage remedies that may affect FCA liability. Second, we discuss two recent cases addressing the impact of contractual provisions on FCA liability.

II. COMMON LAW LIMITS ON LIABILITY FOR PUNITIVE DAMAGES

One of the most significant recent developments under the FCA was the Supreme Court's affirmation in *Vermont Agency of Natural Resources v. United States ex rel. Stevens*[2] that the FCA is "essentially punitive in nature." In doing so, the Court undercut the rationale of a number of prior decisions that had been premised upon prior characterizations of the FCA as primarily remedial. In particular, the Court opened the door to further consideration of whether common law limitations on the award of punitive damages should also apply to the FCA. To assess the impact of *Vermont Agency* on FCA liability, we first analyze the decision itself, second, its potential impact on vicarious liability for FCA offenses, and lastly its impact on other liability issues where, at common law, the result may differ depending on whether the action is for compensatory or punitive damages.

A. VERMONT AGENCY OF NATURAL RESOURCES V. UNITED STATES EX REL. STEVENS

The narrow issue in *Vermont Agency* was whether a state could be sued in a *qui tam* action under the FCA where the United States had not intervened. The Supreme Court answered that question definitively no. The Court relied first on the longstanding interpretive assumption that the word "person" in federal statutes does not include other sovereigns such as states. It found nothing in the circumstances surrounding the enactment of the statute or in the text itself to overcome this presumption. To the contrary, it noted several factors about the FCA which further supported its conclusion that states could not be sued. Principal among these factors was that "the current version of the FCA imposes damages that are essentially punitive

in nature, which would be inconsistent with state *qui tam* liability in light of the presumption against imposition of punitive damages on governmental entities."[3]

We will first examine the support cited by the Court in concluding that the current FCA is "punitive in nature," and then briefly preview the issue of municipal liability, which has brought the issue again before the Court.

1. Analysis of *Vermont Agency*'s Conclusion That FCA Damages Are Punitive

The cases cited by the Court in *Vermont Agency* persuasively demonstrate not only that the nature of the FCA is punitive, but also that common law governmental immunity and other common law limitations on award of punitive damages should apply to the FCA.

The Court began its analysis with *City of Newport v. Fact Concerts, Inc.*[4] where it recognized a presumption against imposing punitive damages against governmental entities. In *City of Newport*, the Court held a municipality could not be held liable for punitive damages under 42 U.S.C. §1983, a provision first enacted in 1871, roughly contemporaneously with the FCA. It reached that result by surveying the common law approach to awarding punitive damages current at the time of enactment. Significantly, for analysis of FCA punitive damages in this survey, the Court did not distinguish between punitive damages awarded by a jury and those assessed by operation of a statute providing a multiple of actual damages.[5] The Court concluded that there was no evidence Congress had intended to disturb this "settled common-law immunity," and further noted that "[p]unitive damages by definition are not intended to compensate the injured party, but rather to punish the tortfeasor . . . and to deter him and others from similar extreme conduct."[6] Neither of these goals would be furthered by visiting large punitive damage awards upon innocent taxpayers.

The Court in *Vermont Agency* then acknowledged that some of its prior opinions had suggested that FCA damages were remedial, but emphasized that the current version of the FCA provided for treble damages and penalties of up to $10,000 per claim. Quoting from its decision in *Texas Industries, Inc. v. Radcliff Materials, Inc.*, the Court reiterated that "[t]he very idea of treble damages reveals an intent to punish past, and to deter future, unlawful conduct, not to ameliorate the liability of wrongdoers."[7] The Court also cited Chief Justice Rehnquist's dissent in *Smith v. Wade*[8] in which he had noted that even the prior statute providing for double damages in $2,000 penalty per claim was a "punitive damage remedy."[9]

The Court did not seek to reconcile its prior decisions emphasizing the remedial nature of the FCA with *Vermont Agency*, but close examination of those cases reveals that they do not undercut the conclusion that the FCA provides for punitive damages. For example, the majority in *Smith v. Wade,* while suggesting that the original FCA was not "a punitive damages remedy as such," nonetheless acknowledged it had created a form of "punitive civil remedies."[10] For application of governmental immunity and other common law limitations on award of punitive damages, that characterization should be enough since the damages are not merely compensating the victim.

In *U.S. ex rel. Marcus v. Hess*[11] the question was whether the double damages and penalties under the FCA at that time constituted "punishment" for purposes of the Double Jeopardy clause. Again, whether a damage provision violates the Double Jeopardy clause is very different from whether the provision provides for civil punitive damages. As Professors Kircher and Wiseman have reported in their treatise on punitive damages, the overwhelming

majority of states permit recovery of punitive damages in civil suits even where separate criminal sanctions are available or obtained.[12] Similarly, while concluding that the "chief purpose" of FCA double damages and $2,000 penalties was restitution, the Court emphasized that even had the recovery been for trebled damages, as was permitted under the antitrust laws, it was well within the common law tradition to obtain both punitive damages under a civil statute and criminal punishment for the same offense.[13] As the Court subsequently made clear in *United States v. Halper,*[14] for Double Jeopardy purposes, it is only where the amount of the FCA recovery becomes so extreme that it is "no longer fairly characterized as remedial, but only as deterrent or retribution," that it is punishment.[15] In short, the common law has long recognized that there can be civil punitive damage remedies that fall short of being punishment for Double Jeopardy purposes.

Similarly, in *United States v. Bornstein,*[16] the Court did not hold that double damages under the FCA were solely remedial. There, the issue was how to calculate the damages for which a subcontractor was liable where the government had already received payment from the prime contractor. The Court concluded that the actual damages should first be doubled before credit was provided for the payment. Citing the restitution purpose identified in *Marcus*, the Court stated this approach would best assure that the government was made completely whole. Importantly, however, the Court also emphasized that this approach would "maximize the deterrent impact of the double-damages provision . . ."[17] As *City of Newport* made clear, deterrence is a key interest advanced by exemplary or punitive damages – not a goal of compensatory damages.

What makes the FCA damages "punitive in nature" is that they go beyond mere restitution. That was true under the original Act, and, even though the restitution aspect predominated, the damages still could be (and as we will see below, were) considered punitive for some purposes. Since the 1986 Amendments, there is no question that the punitive and deterrent aspects predominate, thereby underscoring the common law protection against imposing punitive damages in certain situations.

2. Municipal Liability After *Vermont Agency*

Even before *Vermont Agency*, some courts had concluded that the dramatic increase in the damage remedy and penalties had made the FCA punitive in nature.[18] Since *Vermont Agency*, a number of courts have addressed the implication of the Court's characterization of the FCA damages provision. Most of these decisions have arisen in the context of cases seeking FCA damages from local government or municipal entities.

The majority of courts have held that local governmental entities may not be sued under the FCA.[19] These courts rely primarily on (a) the presumption – set forth in *City of Newport* – that governmental entities are not subject to punitive damages provisions and (b) the *Vermont Agency* conclusion that FCA damages are punitive. At least one court upholding local government immunity from the FCA, however, has relied solely on the meaning of "person" at the time of the original 1863 FCA without relying on the 1986 amendments that unequivocally resulted in the current punitive nature of the Act.[20]

A minority of cases have acknowledged the punitive nature of the current FCA, but nonetheless concluded that local government or municipal entities are "persons" which can be sued under the FCA.[21] These courts, citing to *Monell v. Dep't of Soc. Serv.,*[22] have relied on a presumption that municipalities and other lower level governmental entities, unlike state governments, are usually included within the definition of "person." For example, the Seventh

Circuit, in *United States ex rel. Chandler v. Cook County, Illinois*, noted that this presumption meant that the 1863 Congress must have anticipated liability for municipal entities, and none of the more recent amendments to the Act have evidenced a Congressional desire to restrict the scope of the Act, particularly since "[b]illions of dollars flow from the federal government to municipalities each year."[23]

To resolve this conflict between the circuits, the Supreme Court has granted certiorari in *Chandler*, with oral arguments scheduled for January 14, 2003. While it is possible to resolve the municipal immunity issue without addressing the punitive nature of the FCA, it seems unlikely. In its brief as amicus,[24] the government acknowledges that the 1986 amendments added a "punitive component" to the FCA, but argues that in doing so Congress did not evidence an intent to oust coverage of local government entities. Specifically, the government emphasizes that the FCA recovery is sufficiently different from traditional punitive damages that the presumption applied in *City of Newport* should not apply in the FCA context. According to the government, FCA punitive damages do not create a windfall for a private party (ignoring, of course, the relator's recovery), but rather go to the federal government. Second, the amount is finite and not left to the whim of a jury that might be motivated by a government's taxing power to award disproportionately large punitive damages. Finally, the government argues that a presumption against FCA liability would result not only in relieving municipalities from the punitive aspect of the FCA, but the compensatory as well.[25]

While we hesitate to predict how the Supreme Court will resolve *Chandler*, a number of observations can be made. First, there is little support for distinguishing between punitive damage regimes based upon whether the jury sets the amount or the amount is bounded by a statutory multiple. As the Court implicitly recognized in *City of Newport,* the common law did not distinguish between punitive damage remedies based upon how the amount was established.[26] Second, as the Court observed in *Vermont Agency*, neither the language of the original FCA (referencing "any person not in the military"), nor the historical context suggests that the 1863 Congress contemplated including local government entities within the definition of person. In any event, we will undoubtedly know by the end of June how the Supreme Court will weigh and reconcile, in the context of the FCA, the presumption that municipalities are included in the definition of person against the Court's presumption that governmental agencies are not liable for punitive damages.

B. VICARIOUS LIABILITY

Unless in addressing local government liability under the FCA the Supreme Court retreats from its assessment of the punitive nature of the FCA, it is likely that courts will continue to consider the impact of this conclusion in a number of areas. Perhaps most significant will be application of the different common law standards for imposing liability vicariously for compensatory damages and for punitive damages. In this section, we will first review the different common law standards of vicarious liability, the Supreme Court's approach to vicarious liability in various contexts and finally the potential implication for the FCA.

1. The Common Law

It is well established that generally an employer or other principal is liable for the torts of its employee or agent committed when acting within the scope of their employment. This vicarious liability rule best ensures that the injured victim is fully compensated and also encourages employers to appropriately supervise their employees.

However, application of vicarious liability is more limited when punitive damages are sought. The common law rule is set forth in the *Restatement (Second) of Agency*, Section 217C, which provides:

> Punitive damages can properly be awarded against a master or other principal because of an Act by an agent if, but only if:
>
> > (a) the principal authorized the doing and the manner of the act, or
> >
> > (b) the agent was unfit and the principal was reckless in employing him, or
> >
> > (c) the agent was employed in a managerial capacity and was acting in the scope of employment, or
> >
> > (d) the principal or a managerial agent of the principal ratified or approved the act.

In Comment c to Section 217C, the reporter indicated the *Restatement* took no position with respect to whether this rule applied to special statutes "such as those giving triple damages."[27]

The rationale for this more restrictive view of the application of vicarious liability for punitive damages was best expressed by then Circuit Judge Scalia in a case involving application of District of Columbia law:

> As the name suggests, the purpose of punitive damages is to punish a wrongdoer, and thus to deter similar action in the future. That purpose is not served by the imposition of such charges upon a person who is responsible for the tort only vicariously, without any personal blame. Thus, in the District of Columbia, a principal will not be held liable for punitive damages for his agent's conduct without a showing that he "participated in the doing of such wrongful act or had previously authorized or subsequently ratified it with full knowledge of the facts." [citation omitted].[28]

Professors Kircher and Wiseman identify the *Restatement*'s rule as the "conservative view," but report that some version of it has been expressly adopted in 24 states.[29] The more liberal view, according to Professors Kircher and Wiseman, is to permit vicarious liability for punitive damages for acts taken within the scope of employment. Eighteen states have decisions suggesting this more liberal view, but Kircher and Wiseman caution that those cases may not be predictive of how those courts would decide the issue today because they dealt with common carrier or other special situations.[30]

In short, while not universally true, most jurisdictions impose a higher standard for the vicarious imposition of punitive damages than for compensatory damages.

2. Application of the Common Law Rule To Federal Causes of Action

The Supreme Court has addressed vicarious liability for punitive damages in a number of contexts. Over a century ago, the Court, in *Lake Shore & M. S. RY. CO. v. Prentice,*[31] held that liability of a common carrier railroad corporation for exemplary damages should not be a question of local law, but rather, "in the absence of express statute regulating the subject, will exercise its [the Court's] own judgment, uncontrolled by the decisions of the courts of the several states." It then reviewed the nature and rationale for exemplary or punitive damages and determined that while a principal is liable to make compensation for the harms of its agent, it should not be liable to be punished by exemplary damages based upon intentional conduct in which it did not participate. While acknowledging "that there's a wide divergence in the decisions of the state Courts upon this question,"[32] the Court concluded that for federal purposes the rule would be as quoted from a Rhode Island case:

> No man should be punished for that of which he is not guilty. Where the proof does not implicate the principal, and however wicked the servant may have been, the principal neither expressly nor impliedly authorizes or ratifies the act, and the criminality of it is as much against him as against any other member of society, we think it is quite enough that he shall be liable in compensatory damages for the injury sustained in consequence of the wrongful act of a person acting as his servant.[33]

More recently, in *American Society of Mechanical Engineers, Inc. v. Hydro Level Corp.,*[34] the Court addressed whether a nonprofit organization could be vicariously liable for treble damages under the antitrust laws for acts taken by agents with apparent authority. In that case, the American Society of Mechanical Engineers ("ASME") promulgated codes and set standards in various areas of engineering and industry. One of the volunteers in the organization manipulated the committee that established boiler standards in order to disparage a competing product. The Court, over a vigorous dissent (that included then Justice Rehnquist), held that ASME could be liable for treble damages.

The Court declined to apply the *Restatement*'s view of traditional agency law as accepted by the Court in *Lake Shore*. While it noted that punishment was part of the purpose of the antitrust treble damage remedy, it was also designed to deter future violations and the private right of action was primarily a remedy for the victim. Trebling the damages was a means to "counter balancing the difficulty of maintaining the private lawsuit."[35] The Court also noted that it had previously refused to permit "broad common-law barriers to relief to constrict the antitrust private right of action."[36] The dissent argued that trebled damages were unquestionably punitive, and that, while not dispositive of the issue, it was significant that the common law would not permit vicarious attribution of punitive or vindictive damages against a principal.[37]

Most recently, in *Kolstad v. American Dental Ass'n*,[38] the Supreme Court addressed vicarious liability for punitive damages under the Civil Rights Act of 1991. The Court first noted that traditional common law agency principles limit vicarious liability for punitive awards, an approach that the Court had historically endorsed (citing *Lake Shore*). It then reviewed the *Restatement*'s definition of the general common law to determine its applicability to this federal statute. Interestingly, the Court held that the *Restatement*'s limitation on vicarious liability for punitive damages was not sufficiently strict to accomplish the objectives of Title VII. Because the *Restatement* would permit vicarious liability for acts by managerial agents when acting

within the scope of employment, the Court concluded that this element would reduce the incentive for employers actually to implement anti-discrimination programs. It therefore modified the *Restatement* rule "to avoid undermining the objectives underlining Title VII," and held that "in the punitive damages context, an employer may not be vicariously liable for the discriminatory employment decisions of managerial agents where these decisions are contrary to the employer's 'good faith efforts to comply with Title VII.'"[39]

While these decisions are not entirely consistent, some principles can be extracted. First, the extent to which FCA liability can be imposed vicariously will be based upon federal common law standards (as embodied by the *Restatement*) taking into account the purposes of the statute. Second, the purposes of punitive damages are primarily to punish and deter, goals that are not furthered by imposing liability vicariously on a principal that was neither involved in, nor ratified, the wrongful acts. While the treble-damage antitrust statute at issue in *Kolstad* is superficially similar to the FCA, it was decided by a narrow five-justice majority. Furthermore, the Second Circuit (whose decision the Supreme Court affirmed) had distinguished the FCA (and its then double damages) as "comparatively more punitive" because of the mandatory penalties and the absence of a requirement to prove any damages.[40]

3. Vicarious Liability Under the False Claims Act

Even prior to *Vermont Agency* and the Court's recent decisions addressing vicarious liability under various federal statutes, some courts considered whether conduct of an agent could be imputed to the principal for purposes of FCA liability. We will first discuss the state of the law prior to *Vermont Agency*, and then discuss two more recent cases that have taken opposite views on vicarious liability for punitive FCA damages.

a. The Traditional View

In the partnership context, courts have fairly consistently held that while the acts of the partner may be attributable to the partnership, they cannot be imputed to innocent partners who did not participate. Thus, for example, in *United States v. Toepleman,*[41] the court held that a partner – who may have been careless in his attitude toward partnership affairs – could not however be held liable for false claims submitted on the partnership's behalf by the guilty partner.[42] The court noted that "partnership assets might possibly be applied to the payment of the forfeitures and damages" against the guilty partner.[43] The basic rationale for these decisions is that the FCA required a knowing submission of a false claim and the knowledge of one partner could not be imputed to the unwitting nonparticipating partner.[44] Significantly, the Fifth Circuit also suggested that the "harsh" penalty provisions of the statute were part of the rationale for not imputing knowledge of fraud to unknowing participants.[45]

In the corporate context, courts have been much more divided on the standard under which liability for FCA damages should be imputed to the employer. The Fifth Circuit has been the most restrictive in the imputation of liability vicariously. In *United States v. Ridglea State Bank*,[46] for example, an officer (consecutively at two different banks) had approved loan applications for Federal Housing Authority insured loans. Those applications contained material misrepresentations, and the officer later had received some portion of the loan proceeds. The issue for the court was whether the banks could be liable under the False Claims Act for this officer's misconduct. The court did not discus *Restatement* Section 217C, but focused on whether the agent was acting within the scope of his employment when he was really acting for his own personal benefit. The Fifth Circuit noted that the False Claims Act with its forfeitures in double damages fell "somewhere between the usual areas of operation" of the liberal vicarious

liability rules applicable to civil actions and the more restrictive rule applicable to criminal cases. Nonetheless, because the $2,000 forfeitures were mandatory and did not require any additional finding that the submission of the false claim had been "particularly heinous," the court held that "the knowledge or guilty intent of an agent not acting with a purpose to benefit his employer, will not be imputed to the employer, when the latter is sought to be held liable under a statute requiring knowledge or guilty intent."[47]

Other courts have been more liberal in imputing the acts of even low level employees to the corporation. Thus, for example, in *Grand Union Co. v. United States*,[48] the Eleventh Circuit held that Grand Union could be liable for the submission of false claims based upon its cashiers' knowing acceptance of food stamps for non-food items.[49] In *United States v. O'Connell*,[50] the First Circuit held that "a corporation should be held liable under the False Claims Act for the fraud of an agent who acts with apparent authority even if the corporation received no benefit from the agent's fraud."[51] The First Circuit specifically applied the approach from *American Society of Mechanical Engineers* that liability for multiple damages should be vicariously imposed where it serves the purposes of the federal statute. The court found that there was nothing in the FCA proscribing vicarious liability and that the purposes of restitution and deterrence were consistent with imposing vicarious liability to the corporation. Of course, as discussed above, deterrence is actually a goal of punitive remedies and not generally furthered by imposing liability on the innocent principal.

b. Recent Cases

There have been two cases that have addressed the appropriate imposition of vicarious liability in the context of the False Claims Act and punitive damages. These cases have reached opposite results.

The first case, *United States v. Southern Maryland Home Health Services, Inc.,*[52] actually pre-dated *Vermont Agency* by a few weeks. Nonetheless, the court noted that various courts had held that FCA damages were punitive, and it declined to impute liability to the corporation for acts by a lower level employee who had misrepresented that she was a licensed physical therapist. The court assumed, for purposes of the government's motion for partial summary judgement, that SMH was not negligent in hiring the employee. After reviewing "general principles of agency law," as embodied in the *Restatement,* and the recent Supreme Court decisions on vicarious liability, the court concluded that *Kolstad* significantly restricted the reach of *American Society of Mechanical Engineers*. It held that:

> at least when the recovery sought by the Government is substantially higher than its actual losses, an employer is not vicariously liable under the FCA for wrongful acts undertaken by a non-managerial employee unless the employer had knowledge of her acts, ratified them, or was reckless in its hiring or supervision of the employee.[53]

The court essentially adopted the *Restatement* view of vicarious liability for punitive damages.

In contrast, in *United States v. Williams Building Corp.,*[54] the court concluded that even though *Vermont Agency* defined the FCA as "essentially punitive in nature," it did not follow that *Kolstad* required a stricter standard for imputing vicariously liability under the FCA. It noted that the goals of Title VII were very different from the objectives of the FCA, which were more in line with private causes of action under the antitrust laws; *i.e.*, seeking to encourage private citizen involvement in exposing those types of fraud that might result in financial loss due to the

government. The court did not, however, address why the *Restatement* rule – rather than the *Kolstad* modification – would not have been sufficient to accomplish the purposes of the FCA.

In short, the extent to which FCA liability may be imposed vicariously remains unsettled. The government will undoubtedly continue to emphasize the compensatory component and is concerned that a stricter standard of vicarious liability will limit the potential defendants that may be sued under the Act. One area where the circuit courts addressing municipal liability have agreed is that if municipalities are immune from punitive FCA damages, they must be dismissed as parties, not simply sued for single damages.[55] These concerns, however, do not dictate deviation from general agency law principles for imputing liability vicariously. Unlike the antitrust private right of action at issue in *American Society of Mechanical Engineers*, which created a new cause of action, the FCA is a punitive statutory remedy that coexists with numerous common law causes of action whereby the government can be fully compensated under the general civil standard for vicarious liability. While there are certainly policy reasons to favor the stricter liability standard approved in *Kolstad* to the FCA, even the *Restatement* rule – as applied in *Southern Maryland Home* – would dramatically reduce the instances where an employer is punitively liable for acts by employees that the employer never instigated nor ratified and may well have been against express company policy.

C. OTHER COMMON LAW PRINCIPLES AFFECTED BY VERMONT AGENCY'S CONCLUSION THAT FCA DAMAGES ARE PUNITIVE

There are a number of other areas where common law liability rules differ, depending on whether the action is for compensatory or punitive damages. Perhaps the most significant of these is the issue of successor liability when an acquiring corporation purchases only the assets of a company. Other issues include the survivability of the action upon the death of either the relator or the defendant, and whether insurance coverage is obtainable. We will look briefly at the common law rules applicable to each of these issues and how the punitive nature of the FCA may affect the application of those rules in the FCA context.

1. Successor Liability

Generally, when one company acquires manufacturing or other assets from another company, it does not assume the liabilities (compensatory or punitive) associated with prior production and contract activities. There are a number of exceptions to this general rule for compensatory damages:

(1) where the buyer expressly or impliedly agreed to assume any or all debts;

(2) where the transaction constitutes a de facto merger;

(3) where the successor is a mere continuation of the company from whom the assets were acquired; and

(4) where the transaction is a conveyance made in an attempt to fraudulently evade liability.[56]

Where there was an agreement (exception 1 above) or a fraudulent conveyance (exception 4), punitive damages – like compensatory damages – would likely follow the successor corporations. In the other areas, the rationale for imposing punitive damages

on the successor is less clear. As one court explained in declining to impose punitive damages on a successor corporation, the goal of punitive damages is to punish and deter; the plaintiff has already been made whole.[57] As discussed above in connection with vicarious liability, this goal is not served by imposing liability on innocent successors.

In their treatise, Professors Kircher and Wiseman note that there is substantial disagreement in the courts over the extent to which a successor corporation is liable for punitive damages for the conduct of the prior owner of the purchased assets.[58] At least one commentator has argued that the rule for imposing punitive damage liability on successor corporations should be the same as the rule for imposing such liability vicariously; *i.e.*, only where the successor corporation is somehow complicit in the wrongful acts by having, by its subsequent actions, "ratified" the earlier conduct.[59]

So far courts have not addressed whether the punitive nature of the FCA will alter the extent to which FCA liability will be imposed on successor corporations. In one recent case, *United States ex rel. Fisher v. Network Software Associates, Inc.*,[60] the court, in denying a motion to dismiss, held a successor corporation could be liable under the FCA where the complaint alleged the successor and predecessor corporations were controlled by the same person who was also alleged to have been involved in the scheme that formed the basis of the alleged false claims. This result might well have been the same had the court applied a more limited view of successor liability for punitive damages, but the issue was not discussed. Instead, the court applied an exception to the general rule of no liability that the Seventh Circuit has applied to cases "arising from a violation of federal rights."[61]

Under this rule, a successor corporation may be liable for acts of the prior asset owner where two conditions are met: (a) the successor had notice of the claim at the time of purchase, and (b) there was substantial continuity in the operation of the business before and after the sale. The Seventh Circuit had noted, however, that the origin of this departure from the common law rule of no successor liability was "a little elusive."[62] Its primary purpose was to ensure in employment cases that the corrective action could be directed at the affected workers. That goal was less important in a "pure money case," but it had been applied in such cases previously, "and the defendants [did] not challenge that application."[63] Nothing in the Seventh Circuit's decision would support further extension of this exception to the general rule to punitive damage cases such as the FCA.

2. Survivability of FCA Claims

The survivability of claims is another area where the result depends on whether the action seeks compensatory or punitive damages. Generally, remedial actions survive the death of the plaintiff (or the defendant), while punitive actions do not.[64] Prior to *Vermont Agency*, the Eleventh Circuit held, over the United States' objection, that the FCA was remedial even as to a *qui tam* relator and hence the estate of the relator was entitled to a share of the government's settlement.[65] The court emphasized that a whistle blowing relator took significant risks and suffered potential harm that was compensated by her share of the recovery. Recently, a court reached the opposite conclusion and dismissed a *qui tam* suit where the relator had died.[66] There, the court questioned whether the Eleventh Circuit's analysis survived the conclusion in *Vermont Agency* that FCA damages were punitive and noted that, in any event, the claim did not include any allegation of personal or substantial harm to the relator.

At common law, a similar rule would apply to the death of an individual defendant. One court has held, however, that at least where the United States has intervened, 28 U.S.C. § 2404 precludes dismissal of the defendant's estate because the action remains "[a] civil action for damages commenced by or on behalf of the United States" despite the punitive nature of the damage provision.[67]

3. Insurance Coverage

Finally, there is one area where *Vermont Agency*'s conclusion that FCA damages are punitive could actually be detrimental to potential defendants. As Professors Kircher and Wiseman point out, there is a substantial split of authority over whether insurance coverage for punitive damages is void as a matter of public policy.[68] As a recent decision from California reminds us, however, this may not be a significant issue. There the court (following precedent from other jurisdictions) concluded that coverage for "professional services" for a health care provider did not include the submission of bills (*i.e.,* claims) for those services.[69] Accordingly, the insurer was not required to defend against a FCA complaint alleging fraudulent billing.

III. LIMITING FCA CLAIMS BY AGREEMENT

Another area that has received significant recent attention is the extent to which contract terms may limit the government's ability to pursue FCA claims in whole or in part. As might be expected, the government resists any suggestion that its ability to bring a FCA case and obtain the full statutory discovery can be restricted in any way by a mere contractual clause. That two recent Circuit court opinions addressing this issue have reached contradictory results in 2-1 split decisions suggests this is an area that will continue to provoke considerable debate. A close examination of the opinions, however, demonstrates that the government has failed to show any legal or policy reason why a valid contractual provision should not be given full force and effect, even if it limits a defendant's exposure or liability to a FCA claim.

A. *United States v. Bankers Insurance Co.*

In *Bankers Insurance,*[70] the Fourth Circuit addressed whether the government could be compelled to engage in non-binding arbitration with respect to a FCA claim arising out of the defendant's performance of a Financial Assistance/Subsidy Arrangement ("Arrangement") with two government agencies. The Arrangement included the standard terms from the form agreement published by the agency in the Code of Federal Regulations, including an arbitration clause. The government resisted application of the arbitration clause on a number of grounds including that the clause made the arbitration non-binding at least as to the government and that the Attorney General was not bound by the Arbitration clause in light of his exclusive statutory authority to enforce the FCA.

The Fourth Circuit rejected each of the government's arguments and held that the FCA case be stayed pending completion of the arbitration. First, the court recognized that resort to arbitration might weaken the government's bargaining position and that it was always free to reject an unfavorable arbitration award. Nonetheless, the defendant was bound, and the court presumed that the government would act rationally and accept a favorable award. Accordingly, it could not be said that resort to the arbitration would be futile.[71]

The court was less sympathetic with the government's claim that the FCA provided the Attorney General grounds to ignore the Arbitration clause. It noted that the Attorney General's claim was derivative of the underlying contract (which included the arbitration clause) and that

the Supreme Court had recognized statutory claims could be the subject of arbitration. It concluded:

> the Government has no special right to ignore its contract responsibilities. The Government should comply with its contract obligations, and it cannot avoid them merely by invoking a statutory civil claim, such as one contemplated under the FCA.[72]

In short, *Bankers Insurance* stands for the proposition that contract terms may limit the government's rights under the FCA.[73]

B. United States ex rel. Roby v. Boeing Co.

In *Roby,*[74] a panel in the Sixth Circuit reached the opposite conclusion with respect to whether a contract provision limited the defendant's liability under the FCA. The case is complicated by the unusual way the issue was presented. Accordingly, we will first present a brief summary of the facts and procedural posture and then discuss the analytical problems with the Sixth Circuit's approach.

1. Background

Boeing had a contract with the Army to "remanufacture" Chinook helicopters to the CH-47D configuration. Presumably, the Army delivered to Boeing the existing helicopters as government furnished equipment and Boeing was required to deliver back to the Army upgraded helicopters with a 200 flight hour warranty (or 24 months, whichever was less). The amount Boeing received for each "remanufactured" helicopter was significantly less than the value of a new helicopter. The contract also contained the standard FAR 252.246-24 Limitation of Liability – High Value Item clause ("HVI clause"), which limited Boeing's liability for loss or damage to the aircraft after acceptance, except where the defect or deficiency causing the loss resulted from willful misconduct or lack of good faith of senior managerial employees.

The relator brought suit under the FCA alleging that the helicopters contained a defective flight-critical gear manufactured by a subcontractor, and the government intervened. Unfortunately, during the warranty period, one of the helicopters crashed in Saudi Arabia while performing low-level maneuvers resulting in the total loss of the aircraft, but fortunately, no loss of life. The government and the relator asserted that the total value of the aircraft was an element of the damage to be trebled under the FCA. Boeing sought summary judgment on this point based, *inter alia*, upon the express limitation of liability in the HVI clause. The district court ruled that the HVI clause provided no defense.[75] Boeing subsequently settled the case with the final amount contingent on the outcome of an appeal of this issue (as well as on the threshold issue of whether the government could recover under the FCA damages for loss of the helicopter).

2. **The Sixth Circuit Opinion**

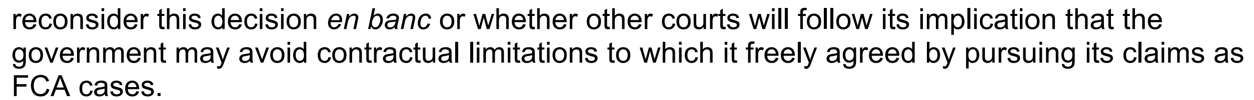
The Sixth Circuit held both (a) that the government was entitled to recover the full value of the lost helicopter (even though that amount substantially exceeded any claim submitted by Boeing)[76] and (b) that the HVI clause did not apply to limit the government's recovery of statutory damages under the FCA. With respect to this latter conclusion, the majority had to distinguish the Eighth Circuit's decision in *United States v. United States Cartridge Co.*[77] In that case, the court faced a contract clause that required the government to indemnify and hold the contractor harmless for "liability of any kind whatsoever" in the operation of a government-owned munitions plant, except where the liability resulted from the "personal failure" of corporate officers.[78] While acknowledging the relaxed civil standard for imputing liability to corporate employers, the court nonetheless found the clause to be within the contracting agency's authority, and further concluded that no policy reason existed – given the war time exigencies and government control over the plant – to refuse to enforce the clause to preclude FCA liability for defective ammunition delivered from the plant.[79]

The court in *Roby* acknowledged that "the dispute in this case is essentially the same as the one in *United States Cartridge,*" but distinguished it on the factual circumstances (war time, and government control) that were not present in Boeing's case.[80] The majority emphasized that while the loss of the helicopter "resulted from" the defective gear, "it was actually caused by Boeing's initial misrepresentation." The majority also appeared concerned that if the HVI clause were enforced in this context it would essentially immunize contractors from all FCA liability except penalties. It thus refused to read the HVI clause "as an agreement by the [g]overnment to assume the risk of damages to high-value items that it sustains because of FCA violations."[81]

As the dissent in *Roby* pointed out, the majority appears to have been motivated by a perceived conflict between the purpose of the HVI clause and the FCA; a conflict that does not actually exist.[82] The HVI clause and the FCA can easily be read in harmony. The clause simply means that the government is foreclosed from seeking damages from the loss of the high value item; the government remains free to seek other damages and penalties under the FCA. As the Fourth Circuit had held in *Bankers Insurance*, the government cannot avoid its contractual obligations simply by invoking a statutory civil claim under the FCA.

Furthermore, as the dissent also pointed out, both the language and the history of the HVI clause clearly show that it was intended to relieve contractors from the potential exposure resulting from lower level employees even intentionally delivering defective material that caused loss or damage to a high value item. Not only is the HVI clause mandated by regulation (after publication for notice and comment), but also it reflects longstanding government policy applied in various contexts. For example, the Energy Board of Contract Appeals recently held, under an indemnification provision similar to the one in *United States Cartridge Co.*, that the costs incurred by the contractor for the Rocky Flats Nuclear Weapons Plant to respond to a federal search warrant and defend against the subsequent criminal investigation (and certain civil litigation) were allowable for purposes of recovery under its cost-reimbursement contract.[83] The Board noted that the sole exception to the Department of Energy's broad indemnification was – similar to the HVI clause in *Roby* – "willful misconduct or lack of good faith on the part of the contractor's officers, directors or supervising representatives."[84]

In short, the *Roby* decision is subject to criticism on a number of grounds. Perhaps most troubling, is the lack of any recognition that enforcing the HVI clause in the context of a FCA action would essentially be the equivalent of contractual agreement to the vicarious liability rule for punitive damages discussed above. It remains to be seen whether the Sixth Circuit will



reconsider this decision *en banc* or whether other courts will follow its implication that the government may avoid contractual limitations to which it freely agreed by pursuing its claims as FCA cases.

IV. CONCLUSION

The FCA is a powerful tool, but not without its limits. Courts now recognize it as a punitive statutory remedy, the purpose of which extends far beyond merely compensating the government for its financial loss to punishing the offender and deterring future offenders. As the common law has long recognized – and the Supreme Court has affirmed in the context of federal statutory causes of action – the goals of punishment and deterrence are inconsistent with imposition of vicarious liability on an employer or other principal unless there is some conduct to show that the principal has participated or ratified the wrongful conduct. Because numerous common law causes of action exist to compensate and make the government whole for its loss from any fraudulent transaction, no purpose of the FCA dictates that a lesser, more lenient, standard of vicarious liability apply. It is likely as well that courts will also need to consider whether the "punitive nature of the FCA" requires modification of the principles applicable to successor liability and other issues as well.

Similarly, when the government's FCA claim is based upon a contract, there is no sound basis not to require the government to comply with those contractual provisions to which it freely assented – particularly where those provisions are required by statute or regulation. As the Fourth Circuit pointed out in *Bankers Insurance*, the Attorney General is always free to request agencies to reserve the government's rights in its contracts,[85] but there is no policy of the FCA that is offended by requiring the government to fulfill its contractual commitments.

ENDNOTES

[1] 31 U.S.C. §§ 3729-3732 (2002).

[2] 529 U.S. 765 (2000).

[3] *Id.* at 784-85.

[4] 453 U.S. 247 (1981)

[5] *Id.* at 261 discussing *Hunt v. City of Boonville*, 65 Mo. 620 (1877) where "the Missouri Supreme Court held that a municipality could not be found liable for treble damages under a trespass statute, notwithstanding the statute's authorization of such damages against 'any person.'"

[6] *Id.* at 266-67.

[7] 451 U.S. 630, 639 (1981).

[8] 461 U.S. 30, 85 (1983).

[9] 529 U.S. at 785.

[10] 461 U.S. at 36 n.5.

[11] 317 U.S. 537 (1943).

[12] 1 John Jay Kircher and Christine M. Wiseman, *Punitive Damages: Law & Practice*, § 3.2 (2d ed. 2000) (hereinafter "*Punitive Damages: Law & Practice*").

[13] *Id.* at 550-51.

[14] 490 U.S. 435 (1989).

[15] 490 U.S. at 448-49.

[16] 423 U.S. 303 (1976).

[17] *Id.* at 317.

[18] *See U.S. ex rel. Long v. SCS Business & Technical Institute, Inc.*, 173 F.3d 870, 877-78 (D.C. Cir. 1999); *U.S. ex rel. Graber v. City of New York,* 8 F. Supp. 2d 343, 349 (S.D.N.Y. 2000) ("although the False Claims Act is a "remedial" statute to the extent it seeks to recoup monetary loses suffered by the federal government through fraud, … [citation omitted], it also is punitive in nature.")

[19] *See, e.g.*, *U.S. ex rel. Dunleavy v. County of Delaware,* 279 F.3d 219 (3d Cir. 2002), *petition for cert. filed, 70 U.S.L.W. 3742 (May 20, 2002) (No. 01-1711)*; *U.S. Garibaldi v. Orleans Parish School Board*, 244 F.3d 486 (5th Cir. 2001), *cert. denied, 122* S. Ct. 808 (2002).

[20] *U.S. v. Erie County Medical Center*, 2002 WL 31655004 (W.D.N.Y. Oct. 30, 2002). Star 4.

[21] *See, e.g., U.S. ex rel. Chandler v. Cook County, Illinois*, 277 F.3d 969 (7th Cir. 2002), *cert. granted,* 122 S. Ct. 2657 (2002).

[22] 436 U.S. 658, 685-89 (1978).

[23] 277 F.3d at 979.

[24] Brief for the United States as Amicus Curiae Supporting Respondent at 20, *Cook County, Ill v. U.S. ex rel. Chandler* (S. Ct. No. 01-1572).

[25] Brief of United States at 22-24.

[26] 453 U.S. at 261; *see also* C. McCormick, *Law of Damages*, § 77 at 277 (1935) (civil multiple damage remedies are a type of "punitive or exemplary" damages).

[27] 2 *Restatement (Second) of Agency* (1958) at 473-74.

[28] *Jordan v. Medley*, 711 F.2d 211, 216 (D.C. Cir. 1983).

[29] 2 *Punitive Damages: Law & Practice*, § 24:02 and table 24-1.

[30] *Id.* § 24:07.

[31] 147 U.S. 101 (1893).

[32] *Id.* at 117.

[33] *Id.* at 115.

[34] 456 U.S. 556 (1982).

[35] *Id.* at 574-75.

[36] *Id.* at 569.

[37] *Id.* at 583-89.

[38] 527 U.S. 526 (1999).

[39] *Id.* at 545.

[40] *Hyrdolevel Corp. v. American Society of Mechanical Engineers, Inc.*, 635 F.2d 118, 126 (2d Cir. 1980).

[41] 141 F. Supp. 677 (E.D.N.C. 1956), *aff'd in part, rev'd in part, on other grounds, sub nom. U.S. v. McNinch,* 242 F.2d 359 (4th Cir. 1957), *aff'd in part, rev'd in part, on other grounds*, 346 U.S. 595 (1958).

[42] *Id.* at 682.

[43] *Id.*

[44] *See United States v. Priola,* 272 F.2d 589, 593-94 (5th Cir. 1959).

[45] *Henry v. United States*, 424 F.2d 677, 679 (5th Cir. 1970).

[46] 357 F.2d 495 (5th Cir. 1966).

[47] *Id*. at 499-500.

[48] 696 F.2d 888 (11th Cir. 1983).

[49] The dissent noted that the majority was simply applying the ordinary civil action rule which permitted imputation of the employee's knowledge for purposes of compensating the injured party for its actual loss. "In a False Claims Act case the Government seeks what are in effect punitive damages." 696 F.2d at 891.

[50] 890 F.2d 563 (1st Cir. 1989).

[51] *Id*. at 569.

[52] 95 F. Supp. 2d 465 (D. Md. 2000).

[53] *Id*. at 468-69.

[54] 158 F. Supp. 2d 1001 (D.S.D. 2001).

[55] *See Chandler*, 277 F.3d at 979; *Garibaldi* at 244 F.3d at 492-93; *Dunleavy* 279 F.3d at 222.

[56] Joel Slawotsky, *The Impropriety of Levying Punitive Damages on Innocent Successor Corporations*, 28 Duq. L. Rev. 49, 51-52 (Fall 1999) (hereinafter cited as "Slawotsky"). In some product liability cases, courts have expanded the exceptions to include (a) continuing the enterprise even where there is no continuity of ownership, (b) continuation of the product line, and (c) duty to warn. *Id.* at 56-61.

[57] *See In re Related Asbestos Cases*, 566 F. Supp. 818, 822 (N.D. Cal. 1983) (applying California law).

[58] 2 *Punitive Damages: Law & Practice* § 22:01.

[59] Slawotsky at 74-75.

[60] 180 F. Supp. 2d 192 (D.D.C. 2002).

[61] *Id.* at 747, *quoting EEOC v. G-K-G, Inc.*, 39 F.3d 740, 747-48 (7th Cir. 1994).

[62] 39 F.3d at 748.

[63] *Id.*

[64] *See Schreiber v. Sharpless*, 110 U.S. 76, 80 (1884).

[65] *United States ex rel. Neher v. NEC Corp.*, 11 F.3d 136 (11th Cir. 1994).

[66] *United States ex rel. Harrington v. Sisters of Providence in Oregon*, 209 F. Supp. 2d 1085 (D. Or. 2002).

[67] *Klaczak, Individually and ex rel. United States v. Consolidated Medical Transport, Inc.*, 2002 WL 31010850 (N.D. Ill. Sept 9, 2002).

[68] *See Punitive Damages: Law & Practice*, § 7.12 (jurisdictions holding such coverage is not against public policy) and § 7.13 (jurisdictions holding such coverage is against public policy).

[69] *Horizon West Inc. v. St. Paul Fire & Marine Insurance Co.*, 214 F. Supp. 2d 1074 (C.D. Ca.), *aff'd by unpublished decision,* 2002 WL 2022102 (9th Cir. Sept. 3, 2002).

[70] 245 F.3d 315 (4th Cir. 2001).

[71] *Id.* at 322.

[72] *Id.* at 324.

[73] The dissent argued that the government's FCA claim did not arise out of the Arrangement and thus whether the claim was arbitrable should be ascertained from the text of the statute which she concluded vested sole discretion with the Attorney General as to how to pursue such claims. *Id.* at 326. The Sixth Circuit recently dismissed an interlocutory appeal that presented the question of whether the FCA prevents enforcement of an arbitration provision and thereby permits consideration of a 31 U.S.C. § 3730(h) claim in federal court. *Nguyen v. City of Cleveland*, 312 F.3d 72 (6th Cir. 2002). The appeal was dismissed because the district court had failed to make a factual determination that an enforceable arbitration agreement actually existed.

[74] 302 F.3d 637 (6th Cir. 2002). Boeing has filed a request for rehearing *en banc,* which is pending.

[75] *U.S. ex rel. Roby v. United States*, 73 F. Supp. 2d 897 (S.D. Ohio 1999).

[76] This issue is beyond the scope of this article, but it should be noted that this aspect of the *Roby* decision is also questionable. It has long been ruled that consequential damages are not recoverable under the FCA. *United States v. Aerodex, Inc.*, 469 F.2d 1002 (5th Cir. 1972). Furthermore, as numerous courts (including the Sixth Circuit) have recognized, the FCA injury "results from" the submission of the claim, not from the underlying conduct. *See, e.g., M/G Transport Servs., Inc. v. Water Quality Ins. Syndicate*, 234 F.3d 974, 978 (6th Cir. 2000); *U.S. ex rel. Hopper v. Anton*, 91 F.3d 1261, 1266 (9th Cir. 1996). The loss of the helicopter did not result from Boeing's submission of a claim, but rather from the underlying conduct.

[77] 198 F.2d 456 (8th Cir. 1952).

[78] *Id.* at 461.

[79] *Id*. at 464-65.

[80] 302 F.3d at 644-45.

[81] *Id.* at 645.

[82] *Id.* at 649-50.

[83] *Rockwell Int'l Corp.*, EBCA Nos. C-9509187, C-9509220 & C-9509221, 02-2 BCA ¶ 32,018 (Oct. 31, 2001).

[84] *Id.* at 158,223.

[85] 245 F.3d at 324, n.12.