

5th Circ. Kickback Ruling Further Squeezes Contractors

By Dietrich Knauth

Law360, New York (July 29, 2013, 8:55 PM ET) -- A recent Fifth Circuit ruling allows the government, for the first time, to punish companies for Anti-Kickback Act violations committed by their employees and subcontractors, a decision that will ramp up the already intense pressure on contractors' ethics and compliance programs.

The Fifth Circuit ruled on July 19 that the federal government can recover enhanced civil penalties from KBR Inc. under the Anti-Kickback Act, reversing a lower court decision that had ruled out punitive damages against KBR based on kickbacks that KBR employees allegedly took in connection with U.S. military subcontracts in the Middle East.

While the lower court ruling would have allowed the government to recover a smaller civil penalty equal to the amount of the kickbacks, the appeals court's ruling allowed the government to pursue double the amount of the kickbacks, plus up to \$11,000 per violation.

Attorneys say the ruling gives the government another tool to squeeze companies for Anti-Kickback Act violations, even violations by employees who are acting outside the scope of their employment and not acting for the benefit of the company.

"It certainly broadens the potential risk exposure for companies and provides new opportunities for qui tam plaintiffs to raise these kinds of allegations," said David Nadler, a partner at Dickstein Shapiro LLP. "It also demonstrates the need for comprehensive compliance programs and training, because companies can be responsible now for the bad acts of their employees. Compliance programs and training programs become that much more important."

To trigger the Anti-Kickback Act's doubled damages, a "person" must "knowingly" violate the law's ban on any payment made for the purpose of inducing the award of a federal contract or subcontract. The Fifth Circuit found that KBR was a "person" according to the law's definition, and it "knowingly" violated the law when its employees accepted meals, tickets to sporting events and other gifts from companies attempting to win subcontracts under KBR's massive contract for logistics support in the Iraq war.

A concurring opinion by Judge E. Grady Jolly agreed with the court's result, but not its reasoning, saying that the lower court will have to perform a more fact-intensive analysis to determine whether KBR should be liable for "knowingly" violating the law.

"This analysis will likely involve developing the evidence, both factual and expert, regarding the employees' job titles, their actual responsibilities, and their overall place within the company, among other things," Judge Jolly wrote.

The majority opinion's willingness to find that the company knowingly violated the law, based on its employees' knowledge and actions, will be a concern for contractors going forward, according to Susan Cassidy, a partner at Covington & Burling LLP.

"Under this decision, it could be a low-level accounting clerk that knows something, and the company could be liable for that," Cassidy said. "I think this issue is the one that is the most problematic for contractors, and I think we'll see further cases on this."

The decision underscores how seriously contractors must take their training and ethics compliance responsibilities for all employees, according to Ronald Schechter and William Spyro Speros of Arnold & Porter.

"You have to be particularly vigilant in encouraging internal reporting of potential misconduct within a company, so that the company can try to avoid having these situations arise," Schechter said. "And if they do arise, companies can use internal reporting policies to argue that the wrongdoing of the employee shouldn't be attributed to the company."

The decision's impact will likely be felt hardest in former combat areas like Iraq and Afghanistan, and in other nations where bribery is relatively common, cash is king, and local governments have less effective oversight, Speros said.

"In these high-risk areas, it is a lot more difficult to oversee the actions of your local subcontract employees. In areas like that, there's a little more wheeling and dealing," Speros said. "It just calls for much more stringent compliance programs and training of your employees — not only of your U.S. employees, but also of your foreign nationals and subcontractors, to make sure that they know there will be no tolerance for this kind of behavior."

Although it is a clear sign of more aggressive government enforcement, the ruling's practical reach is hard to measure, because the government already has a more powerful tool to fight most contract fraud in the False Claims Act, which allows for trebled damages, according to Andy Liu of Crowell & Moring LLP.

"It remains to be seen how much of an impact this will have, given that the conduct in Anti-Kickback Act cases will often fall under the False Claims Act as well," Liu said. "They often go hand in hand. If you look at a lot of the kickback cases, especially those that are coming out of the wars in Iraq and Afghanistan, many of those cases are brought under both statutes."

But the ruling gives the Department of Justice another way to pressure settlements out of contractors, who often choose to avoid protracted litigation to save themselves time, money and damage to their reputations, Schechter said.

"Once these cases proceed to litigation, regardless of merit, there's a lot of pressure on companies to resolve the issue. This case really makes it a lot easier, frankly, for the government to recover on what I consider to be weaker cases against a company," Schechter said. "We are in a very aggressive environment here and government contractors don't have many friends."

Originally filed under the False Claims Act, the qui tam suit brought in 2004 said Swiss logistics provider Panalpina Weltransport Holding AG and Eagle Global Logistics Inc. provided kickbacks and gifts in an effort to win work on KBR's LOGCAP III contract.

Eagle agreed in 2008 to pay \$5 million to settle the claims in the suit, and Panalpina agreed in August 2010 to pay \$375,000 to settle the claims it faced.

The government intervened in May 2010, arguing that KBR had accepted kickbacks from its subcontractors in violation of federal law and KBR's contract with the government. KBR's motion to dismiss the AKA claims was granted in February 2011.

Judges E. Grady Jolly, Fortunato Benavides and Stephen A. Higginson sat on the Fifth Circuit panel.

KBR is represented by Marie Roach Yeates, Michael A. Heidler, Craig D. Margolis and Karl S. Stern of Vinson & Elkins LLP.

The case is U.S. v. Kellogg Brown & Root Inc., case number 12-40447, in the U.S. Court of Appeals for the Fifth Circuit.

--Editing by John Quinn and Jeremy Barker.

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