Statement of the U.S. Chamber Institute for Legal Reform

ON: Oversight of the False Claims Act

TO: U.S. House of Representatives Committee on the Judiciary Subcommittee on the Constitution and Civil Justice

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Improving the False Claims Act

Originally enacted during the Civil War, the False Claims Act (FCA) remains one of the government's most important tools for combating fraud in government programs. With critical amendments in the 1980s, it is innovative and unique in many ways. As interpreted and currently employed, however, the FCA is also less effective than it could be at reducing fraud and too often a spur for specious litigation and coercive out-of-court settlements.[1] Its unique features can be improved to enhance its core mission while reducing its negative side-effects.

Deterring genuine fraud in government programs is an absolutely critical public mission; recouping moneys lost to fraud is as well. I am proud to have contributed to those missions when I oversaw False Claims Act litigation for the Justice Department as head of the Civil Division in the Clinton Administration and again as Deputy Attorney General in the Obama Administration. Today, I am testifying on behalf of the U.S. Chamber Institute for Legal Reform ("ILR"). ILR is an affiliate of the U.S. Chamber of Commerce dedicated to making our nation's overall legal system simpler, fairer, and faster for all participants. The U.S. Chamber of Commerce is the world's largest business federation representing the interests of more than three million businesses and organizations of every size, sector, and region and dedicated to promoting, protecting, and defending America's free enterprise system. I also wish to make clear that the views I am expressing today are my own and based on my experience.

[1] My testimony draws on the analysis and recommendations in U.S. Chamber of Commerce, Institute for Legal Reform, "Fixing the False Claims Act: The Case for Compliance-Focused Reforms," a white paper I co-authored with several colleagues. The paper is *available at* http://www.instituteforlegalreform.com/uploads/sites/1/Fixing_The_FCA_Pages_Web.pdf.

Indeed, the FCA has long been a focus for me. As Assistant Attorney General I met with representatives of both the relators' bar and the defense bar to try to get a better understanding of its operation and effects, and to try to ensure it was as effective and fair as possible. I personally defended the constitutionality of its *qui tam* provisions in oral argument before an *en banc* court of appeals.[2] As Deputy Attorney General, I worked with colleagues at the Departments of Justice and Health and Human Services to create and implement the Healthcare Fraud Prevention and Enforcement Action Team program, or "HEAT," which has targeted hardcore fraud using both criminal and civil enforcement tools. On the defense side, I have also defended and succeeded in obtaining dismissals of *qui tam* actions brought by relators against my clients in the federal courts when the United States has chosen not to intervene, and have helped resolve federal investigations of other clients. So I have seen the Act in operation from different perspectives and I very much believe, based upon some experience, that False Claims Act investigations and litigation are critically important anti-fraud tools but also cause serious problems.

Both proponents and detractors of the law would agree, I think, that it is unique and powerful. One of its great virtues is the incentive it creates for individuals with knowledge of fraud to come forward with that information. True whistleblowers do a great service, sometimes at significant personal risk. The statute encourages them to come forward and great good comes from that. I believe we can and must preserve this function. Similarly, the Act creates a powerful deterrent against defrauding the government, and any reform of the Act must retain that powerful deterrent effect. We can and must do that. But at the same time, we can and must

[2] *Riley v. St. Luke's Episcopal Hospital*, 252 F.3d 749 (5th Cir. 2001) (en banc) (noting intervention of United States to defend the constitutionality of the FCA).

reduce the perverse incentives for non-meritorious claims to clog our courts and burden the Department of Justice, replace the irrational penalty structure that in some cases coerces unjust settlements, and provide greater protections for true whistleblowers in the workplace.

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Understanding the FCA requires understanding its uniqueness, because the good and harm it does both stem from its several unique features. First, virtually nowhere else in the law today is a person who cannot claim personal injury permitted to file suit to remedy the injury to someone else—here, the United States. The requirement that one have been injured as a condition of filing suit—and leaving it to injured persons to vindicate their own rights—generally serves the important goal of regulating use of the courts and limiting it to real parties in interest, which obviously reduces the potential harms of duplicative or vexatious litigation. The FCA, through its *qui tam* mechanism, jettisons that fundamental limitation, opening the courts to hundreds of suits by private citizens who have not been harmed by the conduct they complain of. In most of those cases, the government declines to intervene, typically deeming them unworthy of government lawyers' time. Fully ninety percent of the cases in which the government declines to intervene are dismissed or abandoned, reflecting the fact that a great many of these hundreds of new *qui tam* suits each year are meritless. Yet these suits impose costs on the government, which must consider whether to intervene, and on private enterprise, which must address and defend them, and on our courts.

Second, just as the *qui tam* feature is virtually unique, other federal statutes generally do not create civil liability for mandatory penalties without regard to the size of the plaintiff's injury, the defendant's wrongful benefit, or the wrongfulness of the conduct. But the FCA requires courts to impose not only three times the government's injury but additional civil

monetary penalties of between $5,500 and $11,000 per false claim that can make the effective fine literally thousands of times greater than the harm or improper benefit and potentially many multiples of the federal dollars originally at stake, with the result that the punishment very frequently does not fit the offense. Courts have interpreted the penalty provision as requiring a separate penalty for each invoice submitted to the government, even if there was only one false statement in a more general contracting document, and regardless of the value of the individual invoices. Because each invoice or prescription can constitute a "claim" under this interpretation, the total penalty mandated by the FCA can easily reach hundreds of millions of dollars, even if the violation is technical and the government has sustained little actual harm.[3]

To cite just two examples:

- In *Gosselin World Wide Moving v. United States ex rel. Bunk*,[4] the Fourth Circuit approved a $24 million penalty against the defendant even though the relator did not even seek to prove any actual damages at trial.
- In *United States ex rel. Smith v. Gilbert Realty Co.*,[5] a case involving government housing, the mandatory penalties amounted to 178 times the damages proven.

Of course, in addition, violations of the FCA carry the risk of debarment or exclusion from government programs, a consequence that would ruin many businesses or individuals.

Other places in our law also do not impose such draconian penalties without the typical hallmarks of fraud, such as making a *knowingly* false statement or omission. But at the urging of

[3] Edward P. Lansdale, *Used As Directed? How Prosecutors Are Expanding the False Claims Act to Police Pharmaceutical Off-Label Marketing*, 41 NEW ENG. L. REV. 159, 177 (2006) ("While actual damages collected by the government might be relatively modest, the sheer volume of prescriptions written along with attendant reimbursement requests, which easily number in the tens of thousands, can quickly translate into hefty fines.").

[4] 741 F.3d 390 (4th Cir. 2013), *petition for cert. filed* (May 15, 2014).

[5] 840 F. Supp. 71, 74-75 (E.D. Mich. 1993).

relators and the Justice Department, some courts have dramatically expanded the so-called "implied certification" theory of liability, whereby these enormous penalties are attached when a defendant has arguably violated a regulation and had little or no reason to know that non-compliance would be deemed to be a fraud. Under this theory, any violation of any fine-print regulatory requirement can provide a basis for treble damages and these enormous penalties, even if compliance with the regulatory requirement was never stated in the contract or invoice to be material to the government's willingness to pay. As one federal court of appeals has declared, the problem with this theory—aggressively pursued by the government in many cases—is that "the FCA is not an appropriate vehicle for policing technical compliance with administrative regulations. The FCA is a fraud prevention statute."[6] Regulatory violations have their own enforcement schemes, and the government should rely on those schemes to deal with such violations, rather than turning them into an enormous windfall having little to do with traditional notions of fraud.

Finally, few if any laws, and no law with such draconian penalties, operate without any statute of limitations. But some courts have held that the FCA's statute of limitations is stayed so long as the use of military force is authorized with respect to Al Qaida or the Taliban, even if the claims have nothing to do with those military actions. As a result, according to some federal courts, FCA claims may be pursued however stale they are or however unavailable necessary

[6] *United States ex rel. Lamers v. City of Green Bay*, 168 F.3d 1013, 1019 (7th Cir. 1999) ("[V]iolations of [f]ederal . . . regulations" should not be treated as "fraud unless the violator knowingly lies to the government about them."); *see also United States ex rel. Steury v. Cardinal Health, Inc.*, 625 F.3d 262, 268 (5th Cir. Tex. 2010) (internal quotation marks omitted) (the FCA was not intended to be "a general enforcement device for federal statutes, regulations, and contracts."); *United States ex rel. Hopper v. Anton*, 91 F.3d 1261, 1265 (9th Cir. 1996).

evidence may have become, and the traditional safeguard of fairness represented by statutes of limitations is abandoned.[7]

Some of these unique features contribute to incentivizing whistleblowers and earning just compensation for the government. But all of them have also combined to create a uniquely litigious environment, in which many valuable but also a great many frivolous claims are filed. Serious frauds are addressed, of course. But it is also true that borderline regulatory violations are bootstrapped into enormous settlements and these settlements accomplish little, contribute to a perception of unfairness in our legal system, and unnecessarily raise the costs of products to consumers and the government alike. The coercive threat of outsize judgments and related risks such as debarment drive settlements of even these borderline claims, which deprives courts of the critical ability to check the power of the executive or to contribute to a sound development of the law. As one court explained, "[b]ecause the risk of loss in a False Claim Act case carries potentially devastating penalties, however, unlike most litigation or even an administrative recoupment action," defendants are discouraged from even attempting to defend themselves in court.[8]

And it is also true that relators incentivized by the prospect of huge financial rewards file extraordinarily weak claims, which must be investigated and litigated (sometimes at length) before they are finally dismissed. "Qui tam relators are . . . incentivized to file suit even if their case is weak and unlikely to succeed at trial. FCA suits frequently end in settlement because of

[7] *United States ex rel. Carter v. Halliburton*, 710 F.3d 171, 180-81 (4th Cir. 2013), *cert. granted* (July 1, 2014) (applying Wartime Suspension of Limitations Act, 18 U.S.C. § 3287, to suspend the statute of limitations even on civil claims brought by private *qui tam* plaintiffs, apparently even as to claims that do not involve war-related fraud).

[8] *Ohio Hosp. Ass'n v. Shalala*, 978 F. Supp. 735, 740 n.6 (N.D. Ohio 1997), *aff'd in part, rev'd in part*, 201 F.3d 418 (6th Cir. 1999); *see id.* (litigating in court "is a risk the hospitals feel they cannot take—even if they believe their chances of prevailing would be great").

the heavy penalties and potential for disqualification from federally funded programs, such as Medicare and Medicaid."[9] The result is that companies "lack the benefit of precedent and reliable information on which to base decisions about the legitimacy of the DOJ's use of the False Claims Act" against them.[10]

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For all of these reasons, I hope in my testimony today to suggest relatively modest changes that would preserve the False Claims Act's virtues, correct the Act's flaws, and improve its effectiveness at preventing fraud before it happens. These proposals have the goal of preserving the FCA's incentives to come forward with evidence of fraud and preserving severe punishments for true fraud, while also promoting maximally effective corporate compliance, corporate protection and encouragement of internal whistleblowers, and corporate self-reporting. This should mean less fraud and less harm to the government. As Stuart F. Delery, my successor as head of the Justice Department's Civil Division and a fine former colleague and friend, made clear not long ago: "[l]itigation to recover the costs of fraud is a far inferior option to preventing fraud in the first place." Businesses, he urged, should adopt "forward-looking compliance measures" and "join with the [government] in establishing structures that help prevent fraud—

[9] Sharon Finegan, *The False Claims Act and Corporate Criminal Liability: Qui Tam Actions, Corporate Integrity Agreements and the Overlap of Criminal and Civil La*w, 111 PENN ST. L. REV. 625, 674 (2007).

[10] Vicki W. Girard, *Punishing Pharmaceutical Companies for Unlawful Promotion of Approved Drugs: Why the False Claims Act Is the Wrong Rx*, 12 J. HEALTH CARE L. & POL'Y 119, 153 (2009); *see also* Nicole Huberfeld, *Pharma on the Hot Seat*, 40 J. HEALTH L. 241, 245 (2007) ("From an industry perspective, one major disadvantage of settlements (as opposed to judgments) is that the precedential and informational function that case law serves in a common law system is largely absent. . . . [E]ach new investigation presents legal uncertainty for the company subject to inquiry because the bounds of the law remain unknown.").

and the need for lawsuits to combat it—in the first instance."[11] The FCA should encourage such measures.

Presently, the Act focuses more on punishment and deterrence than compliance, but with modest adjustments, the Act could preserve its deterrent functions, while incentivizing strong and effective compliance. The government has recently recognized the emergence of a health care compliance industry.[12] And extensive study, including by the Ethics Resource Center, has identified the components of meaningful compliance and ethics programs, as well as ways to assess the effectiveness of programs as a whole.[13]

Although many companies have good programs, with appropriate guidance and strong incentives, there are opportunities to improve compliance within companies and across industries. The FCA should, and can, create incentives to adopt the hallmarks of a truly effective system: one that promotes a culture of compliance, encourages whistleblowing and protects whistleblowers, and promotes early correction and self-reporting of violations. And it can do so in a form that removes some of the most counterproductive elements of the current FCA.

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[11] Stuart F. Delery, Acting Assistant Attorney General, U.S. Department of Justice, "Acting Assistant Attorney General Stuart F. Delery Speaks at the American Bar Association's Ninth National Institute on the Civil False Claims Act and Qui Tam Enforcement" (June 7, 2012), *available at* www.justice.gov/iso/opa/civil/speeches/2012/civ-speech-1206071.html.

[12] Inspector General Office Health and Human Services Department, Request for Information and Recommendations: Non-Binding Criteria for Implementing Permissive Exclusion Authority under Section 1128(b)(7) of the Social Security Act, *available at* http://www.regulations.gov/#!documentDetail;D=HHSIG_FRDOC_0001-0397 (requesting comment regarding, among other things, whether guidelines for permissive exclusion should consider a defendant's existing compliance program).

[13] *See, e.g.*, ERC's National Business Ethics Surveys, *available at* http://www.ethics.org/.

To accomplish this, ILR has proposed, and I suggest you consider here, a few adjustments to the FCA and its enforcement—each predicated on a company's adoption and maintenance of a gold standard, certified, compliance program:

- Ensure that for companies with certified compliance programs, a factor in considering damages would be the relative culpability of the company;
- Encourage companies with certified compliance programs to report misconduct to the government to reduce exposure to inefficient *qui tam* actions;
- Incentivize whistleblowers to report internally through certified compliance programs before filing a *qui tam* action, allowing companies to respond quickly and comprehensively; and
- Preserve the prophylactic remedies of debarment and exclusion for companies likely to pose continuing harm to government programs—those without certified compliance programs or individuals with personal involvement in fraud—but appropriately limit their use against companies that do have certified compliance programs.

Let me briefly describe each incentive and the problem it is designed to address.

Adding Fairness to Damages: Currently, a company that violates the FCA is liable for three times the amount of damages the government sustained. This is so regardless of whether the company deliberately intended to defraud the government or was later found to have been reckless, or whether the company had programs in place designed to prevent fraud.

For companies with certified compliance programs, the FCA should instead differentiate among (1) companies that are truly bad actors and have intentionally defrauded the government, which would still face treble damages; (2) companies whose employees have engaged in misconduct that does not rise to the level of intentional fraud, which would be liable for double

damages; and (3) companies that promptly disclose any wrongdoing to the government, which would face 1.5 times actual damages. For companies who adopt state-of-the-art compliance, this approach would maintain the deterrent and punitive aspects of the FCA, while also creating industry wide incentives for investment in meaningful compliance programs and prompt self-disclosure. [14]

Incentivizing Self-Reporting: Under the current FCA, a *qui tam* plaintiff who files suit after the defendant has already disclosed the same conduct to an agency inspector general is nevertheless entitled to proceed with the suit and receive a full bounty. This possibility exists even though the disclosure has been made to the government authority responsible for investigating fraud and even though the party making the disclosure is typically required to cooperate fully in the investigation. When a corporation has made a disclosure of fraud to an agency inspector general or other investigative office, the FCA should clearly foreclose later *qui tam* actions based on the same allegations of fraud. Making this amendment available only to companies with certified compliance programs would provide a further strong incentive to companies to develop and maintain programs that encourage discovery and disclosure of wrongdoing.

At the same time, this "self-disclosure bar" would leave open critical avenues for whistleblowers to file *qui tam* lawsuits. First, the self-disclosure provision advocated here would not foreclose actions filed by whistleblowers that provide the government with information about fraud before a corporation makes a self-disclosure. Second, the proposed self-disclosure bar

[14] This approach would also bring the FCA into alignment with the graduated damages structures of many other penal regimes—including Internal Revenue Service penalties for fraudulent and negligent errors on tax returns; U.S. Customs and Border Protection enforcement of import controls under the Tariff Act of 1930; and the Model Penal Code—in imposing its harshest punishment for the most reprehensible conduct, namely actions undertaken with specific intent to defraud.

would not foreclose *qui tam* actions when the corporation had made a disclosure to any government employee other than an inspector general or other investigative office. This would address any concern that companies could make sham disclosures of information to a non-investigative government official or office that is unlikely to act on the information or vindicate the government's interests. Third, the proposed self-disclosure bar would not interfere with an employee-relator's ability to file a *qui tam* action even after a company's self-reporting to the government, so long as the employee reported internally first and waited at least 180 days before going to court. Fourth, the bar would not apply in situations in which a relator comes forward with valuable *new* information related to a company's activities after the company has disclosed its violation to the government.

Finally, this change would have no impact with respect to companies lacking certified compliance programs.

Incentivizing Internal Reporting, Optimal Whistleblower Protection: The FCA currently provides no incentive for employees to report concerns about potential fraud to their employers. To the contrary, the Act contains a structural disincentive to internal reporting in the form of the "first-to-file" provision, which specifies that only the first relator who files suit is eligible for a bounty. This provision—which is necessary to prevent multiplicitous litigation—also creates a "race to the courthouse," with the problematic effect that a potential relator has no incentive to take the extra step of reporting internally first since doing so might reveal information to other employees, one of whom might beat the initial discoverer of the problem to court. The FCA thus encourages employees to "circumvent internal reporting channels altogether." [15]

[15] Michael D. Greenberg, RAND Corp., *For Whom the Whistle Blows: Advancing Corporate Compliance and Integrity Efforts in the Era of Dodd-Frank* 18 (2011) *available at* http://www.rand.org/pubs/conf_proceedings/CF290.html.

Moreover, the current approach misses a valuable opportunity to incentivize companies across all industries to develop and maintain certified compliance programs that encourage internal reporting and provide meaningful protections to whistleblowers. In addition, the FCA's disincentives for prompt internal reporting are out of sync with modern statutory and regulatory mechanisms that encourage internal reporting and more robust corporate compliance programs. To be sure, dispensing with internal reporting may certainly be justifiable where an employee reasonably fears retaliation for making an internal report. But where a certified compliance program is in place with substantial protections for whistleblowers, a prerequisite for this proposal, that rationale falls away.

So to align the FCA with modern approaches, and to maximize the FCA as a means of prevention through effective compliance, the Act could be modified as follows: If an employee of a company with a certified compliance program (or any other individual with a contractual or legal obligation to make reports to such a company) fails to report the alleged misconduct internally at least 180 days before filing a *qui tam* suit, that court would be required to dismiss the action. The 180-day window would afford the employer sufficient time to investigate the allegations and make a determination whether to self-disclose a violation to the government and/or take corrective action.

In order to ensure that a person who uses the internal reporting mechanism is not disadvantaged, a person who reports internally and triggers a prompt disclosure by the company to the government should still be eligible for up to 10 percent of any government recovery that results from the company's disclosure, by following administrative procedure to be established by the U.S. Department of Justice. If the whistleblower reports internally, but the company does not promptly self-disclose and the whistleblower proceeds with a *qui tam* action, then the

whistleblower will be deemed to have filed an action for purposes of the FCA's "first-to-file" bar dating back to the time of the internal report. This change would ensure that an employee's internal reporting would not disadvantage the employee in the "race to the courthouse."

Focusing Exclusion and Debarment: The government has the enormous authority to exclude or debar companies from government reimbursement or contracting. For companies in the healthcare space, for example, exclusion may effectively be a death penalty given the enormous market share of federal healthcare programs. For many government contractors, a prohibition on contracting with the federal government is similarly threatening. With the threat of exclusion and debarment, the government has generated huge settlements from health care, pharmaceutical, and government contractors. But it is appropriate to question whether the current system is fair or effective. As the government has acknowledged, debarment may not "deter or punish wrongdoing," and in the case of mandatory debarment, may be actively counterproductive because it likely "decrease[s] incentives for companies to make voluntary disclosures, remediate problems, and improve . . . compliance systems."[16]

Exclusion and debarment may be necessary as preventative measures with respect to companies that pose continuing risks to federal programs, or pose a particularly high risk of recidivism. That rationale no longer holds, however, when a company diminishes these risks through the implementation of a certified compliance program. Exclusion and debarment should be limited to companies that have failed to institute certified compliance programs.

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[16] Examining Enforcement of the Foreign Corrupt Practices Act: Hearing Before the Subcomm. on Crime and Drugs of the S. Comm. on the Judiciary, 111th Cong. 25 (2010) (written responses of Assoc. Deputy Att'y Gen. Greg Andres, Criminal Div., U.S. Dep't of Justice, to Sen. Coons' questions for the record).

Two final reforms that would make the False Claims Act more fair and more effective in its application to all companies would focus the severe penalties in the FCA on real fraud—where entities and individuals knowingly make false statements or omissions of clearly material facts—by clarifying that the FCA should not be extended to regulatory or contract violations not stated in advance to be material to the government's willingness to pay; and would eliminate the irrational windfalls driven by civil monetary penalties in cases where multiple damages are also recovered.

As noted above, the False Claims Act has been interpreted very broadly to impose liability not only when a claim is false on its face but also when the claimant has "impliedly certified" compliance with regulatory requirements and failed to comply with these requirements. To ensure that the statute remains focused on true fraud on the government, the FCA should include a new definition of "false or fraudulent claim" that would impose FCA liability only when a claim is "materially false or fraudulent on its face," or when a claim is presented or made "when the claimant has knowingly violated a requirement that is expressly stated by contract, regulation, or statute to be a condition of payment of the claim." This approach would reserve FCA liability for true frauds on the government and not apply them to contractual, regulatory or statutory violations that do not rise to that level. Such violations of course would be punishable under existing administrative or judicial regimes that establish proportional and appropriate penalties for such violations.

And finally, civil monetary penalties should be available only where the government has sustained no damage, and thus where multiple damages are not also imposed. And in any event, where the government has not been harmed the civil monetary penalties should never exceed the size of the benefit wrongfully obtained by the defendant from the government.

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I end this testimony where I began—I have long supported the False Claims Act and congratulate those who framed and improved it over the years. Even more, I admire the dedication and courage of true whistleblowers. I believe that we can preserve the best of the FCA and many of its unique aspects, while also increasing dramatically its power to encourage companies to adopt and maintain certified compliance programs and making it more fair. Recouping moneys lost to fraud after the fact is of course critically important. But preventing fraud from happening in the first place should be a far more central feature of federal policy than it has been to this point.

I appreciate the opportunity to testify on this important subject and look forward to your questions.