

## II. The Basic Legal Principles of the False Claims Act

### A False Claim: The Fraud against the Government

The full text of the False Claims Act as amended, Title 31 Sections 3729, 3730 and 3731 are found at **VIII The False Claims Act**

#### A) LIABILITY

The drafters begin with an exhaustive list of the conduct which makes a person liable for such dishonesty:

- §3729 (a) (1)(A) and (B) starts with liability for any person who knowingly presents, or causes to be presented a false or fraudulent claim for payment or approval; or knowingly makes, uses, or causes to be made or used, a false record or statement material to a false or fraudulent claim paid by the Government.
  - this definition includes both the entity presenting the claim and any other entity such as a sub-contractor who may have caused the submission of the false claim
- § 3729 (a)(1)(C) extends liability to any person who conspires to violate any provision of the act, even if they did not make the presentation of the false claim.
- § 3729 (A)(1)(G) which is referred to as the reverse false claims section provides liability where a person acts to avoid or decrease amounts owed to the Government.

#### B) KNOWLEDGE

The mere submitting of a claim that is false to the Government does not cause a violation. Since this is a civil remedy not a criminal one, the person must have acted knowingly:

- § 3729 (b)(1)(A) states that knowing and knowingly means that the person has actual knowledge of the information; acts in deliberate ignorance of the truth or falsity of the information; or acts in reckless disregard of the truth or falsity of the information.
- §3729 (b)(1)(B) “requires no proof of specific intent to defraud.”

- §3729 (b)(4) states that material (as in statement material to get the false claim paid) means having a natural tendency to influence or be capable of influencing, the payment or receipt of money or property.

Defendants often attempt to use Government knowledge as an affirmative defense, but the Government's knowledge is not generally relevant to whether the defendant acted knowingly. The defendant is liable if the claims are false or fraudulent even if the Government officials know of the falsity. Since there may be various individuals at the Government with some knowledge of the contractors' activities, defendants frequently attempt to use this as a defense in the proceedings. The contracts frequently state that no official can waive or amend the contract. Mere knowledge by some Government official of an aspect of the situation, as opposed to a full disclosure of all of the facts, does not eliminate the liability under the Act. In fact, even if the Government accepts equipment or waives its right to inspect goods, the contractor is still responsible if it furnishes equipment that did not meet the contract specifications. As one judge stated it, if "the Government inspector doesn't do his or her job [it] does not protect any contractor who in fact would file a false claim."<sup>‡</sup>

While some courts have held that Government knowledge may in some cases be relevant to the Defendant's state of mind, the mere fact that the Government had knowledge of the false claim is not a defense to liability.

### C) THE CLAIM

The FCA defines the term 'claim' broadly as a demand for money or property made either directly to the Federal Government or to a contractor, grantee, or other recipient if the money is to be spent on the Government's behalf.

- §3729 (b)(2)(ii) states that 'claim' includes any request or demand for payment if the money requested is spent or used on the Government's behalf or to advance a Government program or interest. If the Government provided any portion of the money or property requested or demanded or will in the future reimburse an entity for any portion of the money or property which is requested or demanded, then this constitutes a claim.

### D) THE DAMAGES AND PENALTIES FOR VIOLATING THE FALSE CLAIMS ACT

The Statute provides that a person who is liable for violating the False Claims Act with the requisite knowledge must pay both a civil penalty and double or treble damages for the harm done to the Government.

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<sup>‡</sup> *United States ex rel. Steven v. Ashland Petroleum Co.* No C-1-93-442 (S. D. Ohio, 1966).

- §3729 (a)(1) states that the liability includes a civil penalty of not less than \$5,000 and not more than \$10,000, (as adjusted by the Federal Civil Penalties Inflation Adjustment Act of 1990) plus three times the amount of damages which the Government sustains because of the act of the liable person.
- §3729 (a)(2) provides for damages to be reduced to two times the amount of damages if the liable person had come forward within 30 days of discovering the violation and cooperated with the Government investigation and no remedial action had been commenced against such person.

#### E) MEASURE OF DAMAGES FOR HARM TO THE GOVERNMENT

The general rule is that the measure of damages would be the amount that the Government paid out by reason of the false statements over and above what it would have paid if the claims had been truthful.<sup>§</sup> While consequential damages are not provided for in the Act, courts have allowed damages that are the direct result of the fraud. The application of these rules, however, varies by the type of fraud:

- **Charging the Government the wrong amount**
  - If the claim such as an invoice or bill is for goods or services that were not delivered or if the product was of a lower quality, then the damages are the amount that the Government paid above what they would have paid if there was not a fraud. Such cases often become problematic if the inferior goods are not of use to the Government and thus the damages could be the entire amount paid.
- **Cheating the Government in the process of securing the contract**
  - If the defendant secures the contract by bid rigging or giving Government employees or prime contractor employees kickbacks, or by making false pricing or cost statements to the Government the damages are again the amount the Government overpaid. This is often difficult to calculate since the Government received the goods and services and determining what it might have paid with adequate truthful information is somewhat conjectural. Some cases have taken the amount of the bribes or kickbacks as a part of the damages but have allowed additional damages for the harm to the Government's negotiating and contracting process.\*\* An alternative damage amount

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<sup>§</sup> *United States v. Woodbury*, 359 F. 2d 370, (9<sup>th</sup> Cir. 1966).

<sup>\*\*</sup> *United States v. Education Development Network, Inc.*, 884 F. 2d 737, (3<sup>rd</sup> Cir. 1993).

could of course be the total amount of the contract payment based on the theory that the contract would not have been awarded if the Government knew of the fraudulent behavior.

- Making false statements or certifications about the goods and services delivered
  - The damages in such cases vary, depending upon the facts from small amounts based on the actual losses occasioned by the false statements to very large amounts based on the theory that “but for” the false statements the Government would have not dealt with the contractor at all.
- Product substitution and poor quality goods and services
  - In these situations the Government received a good or service which was not what it bargained for but which may still be of value to the Government. The damages vary from the total amount of the contract, if the good or service was unsafe or dangerous or not useable,<sup>††</sup> to a lesser sum, measured by the difference in value between the quality and poor quality item, if the item had value and was in fact used by the Government.<sup>##</sup>
- Reverse False Claims under §3729 (a)(1)(G)
  - In situations where the defendant conceals, avoids or decreases an obligation to pay the Government the measure of damages is the difference between what they should have paid and what they did pay.

## F) ASSESSMENT OF PENALTIES

The False Claims Act provides for civil penalties in addition to the treble damages based on harm to the Government. The rationale for the penalty scheme is that it deters fraud and provides remediation to the Government for the cost of enforcement. Most importantly, it provides a remedy when there has been a fraud but not an actual or particularly large damage to the Government which nevertheless does significant damage to the integrity of the system of Government contracting.

- The penalties under the Act are mandatory.

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<sup>††</sup> Failure to test products made them valueless in *United States ex rel. Compton v. Midwest Specialties Inc.* 142 F. 3d 296, (6<sup>th</sup> Cir. 1998).

<sup>##</sup> *U.S. v. Bornstein*, 423 U. S. 303, 96 S. Ct. 523, 46 L. Ed. 2d 514, (1976).

- The language of the Act makes it clear that the civil penalty is not discretionary to the judge. This automatic forfeiture has a deterrent effect against a person who may think that if there is no harm then there is no foul.
- Determining the level of penalties.
  - The authorized range of penalties is for between \$5,000 to \$10,000 (adjusted by statute, and is currently \$5,500 to \$11,000) per false claim. The Federal courts have assigned penalties across the spectrum based on a variety of rationales.
- Determining the number of penalties.
  - The Courts have determined that the section authorizes multiple penalties for a course of conduct involving multiple submissions of fraudulent claims.

#### G) PROTECTIONS AGAINST RETALIATION AGAINST THE WHISTLEBLOWER

The Statute also provides for legal protections for individuals who suffered retaliation for efforts to stop violations of the False Claims Act.

- §3730 (h) states that any employee, contractor or agent who is discharged, demoted, suspended, threatened, harassed, or in any other manner discriminated against in the terms and conditions of employment shall be entitled to relief which shall include reinstatement and two times the amount of back pay and other compensation. It also provides for special damages.

These anti-retaliation provisions to protect whistleblowers both include a double damages provision and are merely ancillary to the overall purpose of the FCA of allowing private actions.

#### H) MEASURE OF DAMAGES IN RETALIATION

- Back Pay
  - The wrongfully terminated employee receives two times his pack pay and interest on the back pay. If the employee quickly finds new employment such mitigation may decrease or eliminate any such damages. Special damages have included emotional distress.

## I) ATTORNEY'S FEES AND COSTS AND EXPENSES

The Act provides that the Relator (not the Relator's Attorney), in both cases where the Government has intervened and cases where the Relator prosecutes the civil action, "shall also receive an amount for reasonable expenses plus reasonable attorney's fees and costs" and this sum is to be paid by the defendant directly to the Relator.

- **Lodestar Approach**
  - The amount of attorney's fees is either settled between the defendant and the Relator or is set by the judge who has overseen the False Claims Act case based on a "lodestar," which is defined as reasonable hours times a reasonable rate<sup>§§</sup>. The hourly rate is based on prevailing market rates in that relevant legal community. This requires an analysis of the experience and skill of the Relator's attorney and a comparison to the rates of similar attorneys in that market. In certain circumstances of exceptional complexity and superior results some judges have increased the lodestar by some percentage.
  
- **Attorney's Fees for post judgment proceedings.**
  - Under the case law, the Relator is also entitled to fees for most post judgment efforts such as appeals and fee petitions and collection proceedings.
  - Under the case law, there is an exception to this when the post judgment appeals involve only a dispute between the Relator and the Government concerning the payment of Relator share out of the Governments recovery.

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<sup>§§</sup> The etymology of the word lodestar is Middle English, meaning "a star that leads or guides" (Merriam-Webster Online). In U.S. courts the lodestar method was first used in *Lindy Bros. Builders, Inc. v. Am. Radiator & Stnd. Sanitary Corp.*, 487 F. 2d 161 (3d Cir. 1973) and now is so-called as this method has become jurisprudence to "guide" courts when deciding attorney's fees ("Cases: Lodestar," *California Attorney's Fees*. AlvaradoSmith APC. Web. 27 Jan 2014).

- Expenses

- The statute authorizes recovery of expenses from the defendant under the case law. Reasonable expenses include those out of pocket expenses that would be charged to a fee paying client such as expert fees, travel costs and copying costs or the costs of preparing trial exhibits.

- Costs

- The statute provides that costs are recoverable from the defendant and under the case law this includes court filing fees and transcript costs.

J) STATUTE OF LIMITATIONS

The Qui Tam actions brought under § 3730 must be filed within six years of the date on which the violation is committed or if the fraud is hidden then within three years of its discovery, but in no event more than 10 years after the date on which the violation was committed. §3731 (b)

K) BURDEN OF PROOF

Since this is a civil remedy the essential element of the cause of action including damages must be proved by a preponderance of the evidence. §3731 (d)

L) LIMITING IMPROPER USE OF THE FCA

Over the 150 year life of the False Claims Act there have been a number of issues raised by opponents of the Act asserting that the Act could be abused or result in false denunciations. As the Act has been written and rewritten, many of these issues have been addressed and specifically addressed within the statute:

- Frivolous, vexatious or harassment

- One concern expressed was that the Act could be used as a tool by unscrupulous Relators to harass defendants or to extort funds from them.
- §3730 (d)(4) specifically grants the defendant the right to receive reasonable attorneys' fees and expenses if the defendant prevails and the court finds that the claim was clearly frivolous, clearly vexatious or brought primarily for purposes of harassment.

- **Parasitic actions**
  - Another concern has been that complaints would be based solely on Government investigations or freely available public information. Such actions would burden the Government departments and the Department of Justice and unearth no new frauds against the Government.
  - Unless the person filing the complaint is the original source of the information §3730 (e)(4) specifically instructs “the court to dismiss an action or claim unless opposed by the Government, if substantially the same allegations or transactions as alleged in the action or claim were publically disclosed (i) in a Federal criminal, civil, or administrative hearing in which the Government or its agent is a party (ii) in a congressional, Government Accountability Office, or other Federal report, hearing, audit or investigation or (iii) from the news media, unless the action is brought by the Attorney General or the person bringing the action is an original source of the information.”
- **When the Government is already pursuing a case**
  - Another possible abuse would be for the person to bring an action based on an already filed civil suit or administrative civil money penalty proceeding.
  - §3730 (e)(3) prohibits such actions in which the Government is already a party.
- **Collusion with the Defendant**
  - A third concern was that the Relator and the Defendant could collude to settle the claim at some lower amount than justified with some behind the scene unknown payments.
  - Once the claim has been filed, under §3730 (b)(1) even if the Government does not intervene and take over the case, the action may be dismissed only if the court and the Attorney General give written consent to the dismissal and their reasons for consenting.



- Use of Act against members of the Government or members of the armed forces
  - A concern was that either fellow members of the military would file actions against each other or that action would be brought against members of Congress, the Judiciary or a senior executive branch official.
  - §3730 (e)(1) prohibits actions by a former or present member of the armed forces against any other member of the armed forces arising out of such persons service in the armed forces.
  - §3730 (e)(2) prohibits actions against members of Government if the action is based on evidence or information known to the Government when the action was brought.
- Use of the Act with regard to Internal Revenue Code violations
  - The Internal Revenue Code is based on self-reporting by the tax payers and the corresponding protection of the taxpayers' confidentiality.
  - The Act specifically excludes any complaint based on the Internal Revenue Code. As we will discuss below, the False Claims Act has created an interest in similar provisions under other statutory schemes and there is now a provision in the Internal Revenue Code for a whistleblower reward system, but not a Qui Tam system.