Phillips

SUMMARY OF TESTIMONY OF JOHN R. PHILLIPS
REGARDING H.R. 3317 AND H.R. 3828 (AMENDMENTS TO THE
FALSE CLAIMS ACT) BEFORE THE U.S. HOUSE OF REPRESENTATIVES
COMMITTEE OF THE JUDICIARY, SUBCOMMITTEE ON
ADMINISTRATIVE LAW AND GOVERNMENT RELATIONS
February 6, 1986, at 10:00 a.m.

With these amendments, the False Claims Act can become once again an important tool to combat fraud against the government. Amendments to the False Claims Act made in 1943 had the unintended result of greatly diminishing and undercutting its effectiveness. The procedural and substantive adjustments proposed by H.R. 3317 and H.R. 3828 will update the 123 year-old law and apply marketplace incentives to ferret out fraud and overcharges against the government. And it will not add one single employee to the government payroll.

These amendments will: protect employees against retaliation by their employers when they file charges under this Act; ensure that once allegations of fraud are disclosed that an investigation will be conducted and appropriate remedial action taken; provide for a minimum amount of recovery for the person responsible for exposing the fraud. Taken together, the False Claims Act as amended will provide strong incentives for employees of government contractors and others to expose corruption and fraud against the government.

These proposed amendments will make the False Claims Act self-executing and self-enforcing, calling upon the American people to join in the fight to root out fraud against the government. And it will provide a powerful disincentive to some government contractors who have, in the past, forced their own employees, by a conspiracy of silence, to be reluctant witnesses of fraudulent and illegal schemes designed to overcharge the government. The only people or companies who will be hurt by these amendments will be those who cheat the government.

TESTIMONY OF JOHN R. PHILLIPS

REGARDING H.R. 3317 and H.R. 3828

AMENDMENTS TO THE FALSE CLAIMS ACT

BEFORE THE U. S. HOUSE OF REPRESENTATIVES

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ADMINISTRATIVE LAW AND GOVERNMENT RELATIONS

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I. INTRODUCTION

My name is John Phillips, and I am an attorney and co-director of the Center for Law in the Public Interest, a non-profit charitable organization based in Los Angeles that provides legal representation without charge to various unrepresented interests.

We first became interested in the False Claims Act several years ago when, after public disclosure of fraudulent overcharges within the defense industry, the Center received anonymous calls from employees of defense contractors who were aware of improper and illegal practices, but were not sure what they should do or where they should turn with this information. These potential "whistleblowers" did not believe they could go to the government -- they lacked confidence that anything would be done; nor could they go to the top officers of their employers for fear of retaliation. As a result of these calls the Center conducted research into the area of legal rights and remedies available to such people and discovered a little used 122-year old Act, the False Claims Act.

My testimony is limited to the amendments to what is commonly referred to as the qui tam ("he that sues as well for the state as for himself") provision of the False Claims Act contained in H.R. 3317 and H.R. 3828.

II. BRIEF BACKGROUND OF THE FALSE CLAIMS ACT

The original False Claims Act was passed in 1863 to combat the widespread fraud, corruption and misuse of federal funds that occurred during the Civil War. At that time, the

F.B.I. did not exist and the U.S. Attorney General's staff was very small. The Department of Defense (then the War Department) lacked investigators to check on its various contractors and suppliers. Thus, the Government was largely dependent upon information received from private individuals concerning false claims or fraud against the Government.

The False Claims Act created civil liability for persons who made false claims against the federal government. The Act provides that any person who knowingly makes false claims against the Government shall be subject to a $2,000 civil penalty and double the amount of damages sustained.

One portion of the Act, referred to as the qui tam section, was designed to encourage individuals to come forward and bring suit on behalf of the Government against the perpetrators of the fraud. In return for bringing suit, the person received half of the civil penalty, half of the damages, and all court costs.

More than four decades ago a court decision in 1943 resulted in amending legislation that severely undercut the impact of the False Claims Act. In 1943, the Supreme Court ruled in United States ex rel. Marcus v. Hess that a private person could sue under the Federal Claims Act on behalf of the U.S. Government, even though the action was based solely on information acquired from the Government. Following that decision, numerous "parasitic" law suits were filed based solely on information they obtained from court indictments, newspaper stories, and congressional investigations, without providing any new information. While the literal wording of the Act permitted

this type of action, it was obviously not consistent with the intent of the Act.

In the same year, in reaction to these suits, Congress amended the statute. The amended Act provides that the court shall dismiss an action brought by a person on discovering the action was "based on evidence or information the Government had when the action was brought." The qui tam plaintiff's recovery was also changed. Instead of receiving one-half of the recovery, the plaintiff was entitled to up to 10% of the recovery (with no guarantee of any recovery) if the Government intervened in the suit. If the Government did not intervene in the suit, the plaintiff was entitled to up to 25% of the recovery.

III. BENEFITS OF THE EXISTING FALSE CLAIMS ACT

The False Claims Act is the best tool available to private citizens for attacking an important problem plaguing the nation today -- namely the millions of taxpayer dollars that are paid out to private corporations based on fraudulent claims made on government contracts. The purpose behind the enactment of the False Claims Act in 1863 -- to encourage individuals to aid the Government in ferreting out fraud against the Government -- is even more critical today, where the federal government is spending billions of dollars on federal contracts with private corporations in areas such as defense, aerospace, medicine, and construction. All one has to do is read the headlines to know mischarging practices are prevalent in the industry. The Justice Department does not have unlimited resources and should benefit from the additional non-governmental resources brought to bear to

develop and pursue instances of false claims submitted to the government. Moreover, the critical element -- knowledge of such practice -- is uniquely in the possession of people within the industries which have government contracts. The False Claim Act encourages those people to reveal such information.

The False Claims Act benefits everyone: The government, because it recovers the amount of damages sustained because of the false claim; the person bringing the suit, because he can receive a substantial monetary award for doing his patriotic duty of exposing fraud against the government; and taxpayers, because they see that their dollars are not being squandered by fraudulent practices perpetrated by companies doing business with the Government.

A False Claims suit brought by an individual puts the machinery of the courts in motion to determine whether false claims have occurred. Once the suit is filed, the government cannot ignore the charges for political or administrative reasons, including lack of resources or low priority.

IV. DISADVANTAGES OF THE EXISTING FALSE CLAIMS ACT

Despite its wide application, the existing Act is not utilized by potential plaintiffs because it is flawed both substantively and procedurally, creating problems for both individuals and the U.S. Attorney's Office. First, the individuals who have the information of fraudulent practices are very reluctant to risk their jobs and livelihood to expose fraud without a guarantee of adequate protection. There are many risks and personal sacrifices involved in filing a False Claims Act

suit, or testifying in such a suit. These risks include, first and foremost, being fired by an employer, being harassed or threatened by employers or co-workers, and if fired, being blackballed from within the industry in which they work.

These fears have a basis in fact, for "whistleblowers" have historically not been treated well within our system. They have divulged their information and then lost their jobs. Even if they were able to bring suit against their employer for a retaliatory firing, the cases might take years to prosecute and are a big drain on personal resources, without any guarantee of success.

In order for the False Claims Act to be truly effective in encouraging individuals to expose fraudulent claims against the Government, the Act must contain both employment and personal safeguards for those persons filing the suits or testifying in such suits. Moreover, the Act must contain strong measures to deter and punish an employer who violates the Act and retaliates against an employee for fulfilling his patriotic and ethical duty.

Another problem with the False Claims Act as presently written is that some provisions create harsh and unreasonable obstacles for both the individual plaintiff and the Government. These provisions effectively defeat the objectives of the Act and create disincentives for an individual to file suit. These obstacles include the following:

-- the opportunity for an individual's suit to be dismissed if the Government already has the information upon which the suit is based, even if the information

is not being acted upon or analyzed in any way. This provision is unclear and courts have interpreted it differently. For example, a suit could be dismissed if the information was in unanalyzed storage files of unconnected government agencies.

-- the chance that an individual who files a case can be completely removed from the suit if the U.S. Attorney enters the case, leaving the individual unable to ensure the case's effective and speedy prosecution on its merits;

-- the chance that an individual plaintiff will receive a small percentage (or even no percentage) of the recovery, due to the completely discretionary nature of the award and the fact that the person must pay the attorneys' fees out of the recovery amount awarded;

There is also a need to amend the Act to provide the Government with more flexibility in a case. The existing Act provides that once the U.S. Attorney's Office decides not to enter the case, the case is completely prosecuted by the individual filing the suit. What if new material information is uncovered which was not known by the Government when making its decision not to enter the case?

The proposed amendments to the False Claims Act contained in H.R. 3317 and H.R. 3828 would remedy these unintended disincentives in the Act and fulfill the true purpose of the Act -- to encourage people with knowledge of false claims to step forward and see that the claims are prosecuted on behalf of the United States government.

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V. EFFECT OF H.R. 3317 and H.R. 3828 AMENDMENTS

(A) Protection of Plaintiff and Witnesses

The existing False Claims Act does not provide any protection whatsoever for the person bringing a lawsuit on behalf of the Government. After filing a suit, such person might be immediately fired by his employer, threatened or harassed by supervisors or co-workers, and blackballed from the industry in which he works. Thus, most individuals would be very reluctant to risk their jobs, their livelihood, and their personal security to expose either through filing a lawsuit or providing testimony the fraudulent practices of their employer or former employer in a False Claims Act suit.

The proposed amendment is essential to help alleviate the fears of a potential plaintiff or witness in a False Claims Act suit, and is reasonable and just given the many risks the plaintiff assumes in stepping forward. The effect of the proposed amendment is twofold: first, it will encourage a person to do his patriotic duty and expose a false claim with reduced fear of being left stranded without a job or personal security; and second, it will allow punishment - and hence deterrence - of an employer who engages in retaliatory action against such person.

The new provision carefully details examples of possible job discrimination outside of employee discharge, including threats, demotions, suspension, and harassment. The examples are given to deter the situation where an employee isn't fired outright, but is treated in an inferior manner by his company. The amendment also protects witnesses and those

assisting in a False Claims Act investigation or lawsuit who might otherwise be afraid to testify on behalf of the prosecution.

The phrase "discriminated against... in whole or in part..." is included because an employer might offer another reason why the employee was fired, when in fact, the initiation or participation in a False Claims Act suit was an element in the employee's discharge.

The relief portion is designed to make the person whole again, whether that includes restitution with full seniority rights, back pay with interest, or compensation for any special damages sustained as a result of the discrimination.

To resolve the problem of a potential plaintiff being unable to bring a suit because of prohibitive attorneys' fees, the provision provides litigation costs and reasonable attorneys' fees as part of the plaintiff's recovery.

The provision also provides stiff penalties against employers found guilty of retaliatory action. An employer is liable to the employee for twice the amount of back pay and special damages, and if warranted, is liable for punitive damages.

This new provision would go far in ending the "conspiracy of silence" which often surrounds a company and intimidates its employees into compromising their ethical standards.

(B) Government "Acting" on Information

The purpose behind the existing Section -- 3730 (4) was to eliminate the former practice of "parasitic" law suits. Back in the early 1940s, private individuals were filing False Claims suits based on information they obtained from court indictments and congressional investigations without providing any new information. In 1943, the section was amended to prevent this abuse by allowing the court to dismiss an action brought by a person on discovering the action was "based on evidence or information the Government had when the action was brought."

The serious problem with the existing language is that it places no responsibility on the Government to have developed the information or evidence in any way before the private citizen's suit is completely precluded. The evidence can just exist in a government file or within several disconnected government agencies without any analyses or connection being made for the suit to be dismissed.

The proposed amendment strikes a balance between closing the loopholes which lead to "parasitic" lawsuits and more reasonably and clearly defining what information or evidence is sufficient to warrant a case's dismissal by the court.

Under the proposed language, if a person bases a lawsuit on information or evidence that the Government has already disclosed in a prior administrative, civil, or criminal proceeding, the person's suit is to be dismissed. Moreover, if a person bases the lawsuit on specific information disseminated by any news media or disclosed during the course of a congressional investigation, the person's suit is to be dismissed. In this

way, a person is foreclosed from merely "piggybacking" their lawsuit on to a prior or existing investigation into the facts alleged.

On the other hand, the U.S. Attorney's office would not be granted unlimited time to investigate the evidence or information disclosed. If the Government has not initiated a civil action within six months of becoming aware of such evidence, the court shall not dismiss the action brought by the person. If, however, the Government has been diligently pursuing the information but still has not had sufficient time to investigate the facts and bring a lawsuit, the Government can be granted additional time by the Court upon a showing of good cause. This time limit assures the person who carried the burden of initiating the action that if the lawsuit has merit, it will proceed, despite the Government's reluctance to act on its information for whatever reasons.

(C) Active Involvement of Plaintiff

The existing language of the Act (Section 3730 (3) and (4)) present a harsh, ineffective and self-defeating "all or nothing" proposition both for the person bringing the action and for the Government. If the Government proceeds with the action within the designated time limits, then according to existing Section (3), the action is conducted only by the Government. Thus, the person who often faces substantial hardships and considerable personal risk in bringing the action is forced out of the suit entirely, unable to have any role to ensure that the case will be vigorously prosecuted.

The proposed language in Section (3) would allow the person who brought the action to continue in the action as a full party on the person's own behalf, even if the Government proceeds with the action. The government would have primary responsibility for prosecuting the case but the person would continue to have a direct stake in the outcome, ensuring that once the Government takes over in the case, the Government doesn't "sit" on the evidence, drag out the case, or let it drop for administrative or political reasons.

Since the person bringing the case often has risked their job and livelihood, if not his or her safety, in order to expose the fraud, it is only fair as a matter of public policy to allow the person to continue as a party to see that the case proceeds forward on its merits. Moreover, this furthers the primary purpose of the False Claims Act - to encourage private parties to expose fraud that they are otherwise discouraged from exposing. The Government, however, will not be bound by an act of the person bringing the action and will still be in the position of controlling the litigation.

(D) Guarantees of Monetary Awards

These provisions deal with the amount of recovery a person may receive for bringing a civil action under Section 3730. The amounts a court currently may award are quite undefined and discretionary.

In the existing Act, if the Government proceeds with the action, the person may receive "no more than 10 percent of the proceeds of the action or settling of a claim," if the

Government does not proceed with an action, the person bringing the action or settling the claim may receive no more than 25 percent of the proceeds of the action or settlement.

The problem with such an undefined and discretionary amount is that it discourages people from bringing a false claims action because there is no guarantee that they will be awarded anything even if there is a substantial recovery. There are many risks involved in bringing such an action. First, a person must find the courage and the confidence to step forward and personally testify to the fraudulent practices of his employer, for example. This can immediately lead to being fired from the job, being blackballed from the industry, and being harassed and threatened by employers and co-workers.

In addition, court cases generally take a long time to try and are fraught with continuances and delay tactics on the part of the defendant. The person bringing the case will be forced to spend a tremendous amount of time on the case, and assuming he is fired, must find alternate sources of income to support a family and/or himself. Thus, the case becomes a substantial investment of time, money, energy, and emotion.

If a possible plaintiff reads the present statute and understands that in a successful case the court may arbitrarily decide to award only a tiny fraction of the proceeds (or nothing at all) of the action or settlement to the person bringing the action, the person may decide it is too risky to lose a job over a totally unpredictable recovery.

The proposed amendments take into account the risks and sacrifices of the plaintiff and offer minimum monetary incentives

to induce individuals to step forward and expose fraudulent practices. If the Government proceeds with the action within 60 days of being notified, the person bringing the action shall receive between ten and twenty percent of the proceeds of the action or settlement of a claim, based on having brought the important information or evidence to the Government's attention.

The setting of such a range is sensible and can be looked upon as a "finders fee" which the person bringing the case should receive as of right. The Government will still be more than made whole receiving between 80 and 90 percent of the proceeds based on double damages -- substantially more than the zero percent it would have received had the person not brought the evidence of fraud to its attention.

Additionally, if the person bringing the action substantially contributes to the prosecution of the action, the person shall receive at least 20 percent of the proceeds of the action or settlement. This award can be looked upon as a "performance fee" based on contributions made in the litigation itself. The more substantial award encourages the person to contribute and participate in the suit through his lawyers in a positive, constructive way and to keep the pressure on the Government to effectively try the case.

Where the Government does not proceed with an action within 60 days of being notified, the person bringing the action or settling the claim shall receive an amount not less than 25 percent and no more than 30 percent of the proceeds of the action or settlement. In this case, the person is principally responsible for the lawsuit and should be well compensated based

on having the primary role of prosecuting the case. Another important change made in the existing provisions involves attorneys' fees awards. If the Government does not proceed with an action, under the existing Act, the person bringing the action may receive "reasonable expenses the court finds to have been necessarily incurred." No express reference is made, however, to attorneys' fees.

Assuming the case involves a defendant with substantial resources, the litigation will be hard fought, with the plaintiff facing a phalanx of well financed defendant's lawyers with motions, discovery disputes and continuances. In a case involving a $200,000 claim, for example, the attorneys' bills alone (based on hours spent) in a case such as this could easily reach $100,000 or more. Since under the existing provisions, attorneys' fees are to be paid out of a person's recovery, it works as a disincentive for persons to bring a suit involving smaller cases of fraud, i.e., cases of 1/2 million or less. In almost all cases a plaintiff will have to offer the lawyer a percentage of the recovery available to the plaintiff. If there is a formidable array of lawyers on the other side, the plaintiffs' attorney could be required to spend enormous amounts of time for a relatively small financial reward. This would discourage attorneys from agreeing to take the case even though there may be strong evidence of fraud. Thus, reasonable attorney's fees, as defined by the courts, should be paid separately by the guilty defendant and is a fair apportionment of the cost incurred in discouraging the illegally obtained money.

Under existing court procedures, these fees would be based on hours reasonably spent times a reasonable hourly rate.

In the proposed amendments, a person who contributes to the prosecution of the action along with the government, or who prosecutes the action alone, may receive an amount for reasonable attorneys' fees and costs awarded against the defendant.

These proposed monetary awards will serve two main purposes: to provide a person with the incentive to bring a false claims case against a powerful defendant with substantial resources, and to adequately compensate the person for all the resources expended during the course of prosecuting the case.

(E) Government's Ability to Re-Enter the Case

The existing provision of Section 3730 (2) (A) also works an extremely unreasonable hardship on the government, for it bars the government from entering the case if it does not enter by the end of the 60-day period. What if new material evidence comes to light after that period which would have altered the government's initial decision not to enter the case?

The most reasonable solution is to allow the government in such a case to enter so it can bring its considerable resources to bear on the case. This is especially true in a complex case with a great deal at stake, where the resources of the defendant are tremendous and the person initiating the action on behalf of the government is almost inevitably put at a great disadvantage. It is thus in the interest of justice to ensure that the government may enter the case when it knows of new

material evidence which will expose the fraud and substantiate the claims filed.

The proposed amendment solves this problem because the government now has a chance to enter in the case at a later date even if it did not proceed with the action within the 60-day period after being notified, if it can show the court that it now has new material evidence or information it did not have within the 60-day period after notice. The limitation as to situations where the government has "new" material evidence is to assure that the 60-day limit for the government's initial decision whether to enter the case is meaningful.

While allowing the government to enter so that it can play a significant role in the case, the language also ensures that the person who bore the burden of initiating the case and developing it into a strong one is not just pushed aside. The status and rights of the person are retained and protected so that the person remains a formal party to the action.

V. CONCLUSION

Adoption of H.R. 3317 and H.R. 3828 will make available a new and significant tool to combat a serious problem facing the nation today -- fraud against the government. It offers this potential without any additional costs or additional government personnel and does not create any new government enforcement bureaucracy. It will be self-executing and self-enforcing, calling upon its own citizens to join in the fight to protect the public fisc. And, it will provide a powerful disincentive to government contractors who have in the past forced their

employees to either witness or participate in fraudulent and illegal schemes designed to overcharge the government. The only losers from this amendment will be those who cheat the government.

Mr. GLICKMAN. Thank you, Mr. Phillips. Why don't you stay there, we have a second vote here on the rule and we will be back in about 12 to 15 minutes.

[Recess.]

Mr. GLICKMAN. I apologize for these delays, but they are unavoidable once we are in session; and it has taken a little longer than what we had anticipated.

Mr. Phillips, I think you were finished.

Mr. PHILLIPS. Yes, I was. I had completed my statement.

Mr. GLICKMAN. Let me ask you a couple of questions. How do you deal with the situation where the employee could be accused of retaliating against an employer or harassing an employer by filing a qui tam suit? Some critics have alleged this kind of thing would happen.

Mr. PHILLIPS. I think there are very serious deterrents against such a person taking such action. First, to file a lawsuit presumbly you would have to retain counsel to review the act's requirements, make a determination based on the credibility of the information that he has and then be willing to file a Federal court action which is a fairly serious undertaking. If the counsel has any reason to believe that his motives are based on sour grapes or seeking retaliation with no foundation, with no basis in fact, I do not think many lawyers would be willing to take that risk because the authority of the judges today under existing precedent by the U.S. Supreme Court, the Federal rules, and others to impose sanctions against counsel personally for filing unsubstantiated charges like this is a strong deterrent—and it is happening more and more. I simply do not believe that filing such unsubstantiated meritless suits would he a problem. If it turns out to be a case without any substance, it will be treated in a very summary fashion and go no further. It is not much harassment, frankly, to a big company like General Electric to have a lawsuit with no basis filed against it. It can be handled quite quickly.

Mr. GLICKMAN. You can also require, as I think the Grassley bill does, that the judge would award legal fees if the suit were filed frivolously.

Mr. PHILLIPS. If it is for the purpose of harassment, the Grassley bill does contain such langauge.

Mr. GLICKMAN. There is some way to statutorily contain it. One of the objections to the qui tam amendment has to do with the fact at the time the law was passed and amended there were no statutory inspector general as there are now, and the point seems to be the that Government has greatly increased investigatory resources and, therefore, these amendments are unnecessary. I wonder if you might respond to this as an option to the qui tam provisions.

Mr. PHILLIPS. Admittedly the Government today is different than it was in 1863 when the bill was first enacted. However, based on my own experience with Federal prosecutors, Government investigators, to do the job that needs to be done here they simply do not have the resources if the fraud that is going on today came to the surface. It is not a way of really challenging their authority. It is a way of assisting them. They ought to view it as a partnership and an opportunity to encourage people who are on the front lines, people like Mr. Gravitt, to step forward with their information and

to give them some incentive to do so. That is really what the purpose of this act is. They are not going to step forward today given the risks that they face professionally and personally unless they feel that there are some safeguards built into the bill that these amendments would provide.

I do know why the Justice Department would have some reservations about this bill, because they like to control their own dockets. They do not like a great deal of pressure being brought to bear on them. They do not like somebody, as in the case of Mr. Gravitt, saying you are not doing your job. They have got many cases to handle. They are always complaining about inadequate resources. They are the first to say we need larger budgets, but Gramm-Rudman is going to confront their staffs as well.

This is an opportunity without adding one more person to the Federal payroll of enlisting support of thousands of people in ferreting out fraud against the Government.

Mr. GLICKMAN. One of the things we would probably like to have for the record is the number of qui tam actions filed and the number of successful ones, you know, all the statistics on these. Do you have that information?

Mr. PHILLIPS. All I have is based on our own research which was based on reading the cases and interpreting the law over the past 123 years, and I can tell you there are relatively few. The Justice Department admitted, apparently in previous testimony and in talking to Mr. Gravitt's counsel, that there are very, very few of these actions filed. When Mr. Gravitt's suit was filed, the Justice Department people were quoted even in the press, I recall at the time, this is one of the first they had ever heard of. There are a few cases, one filed I think in Mississippi, much smaller in scale, but I do not have the specific numbers except the knowledge there are so few as to be totally insignificant, and that has been probably because the barriers and hurdles are so substantial to overcome.

Mr. GLICKMAN. There is the qui tam person at the Justice Department. We may be in a position to ask him.

Mr. PHILLIPS. He would probably know, but Mr. Gravitt's counsel said how many have been to trial since he has been there, 5 years, and he said zero.

Mr. GLICKMAN. The final question concerns the issue of the substantial award, substantial monetary award. I do not want to get into a situation where it looks as if for people doing their patriotic duty they are getting a substantial monetary award, but in the sense that I think with respect to the public they need to know both motives are there. They are both doing their patriotic duty as well as getting a substantial monetary award, but that second one does not far exceed the first one.

I wonder when you talk about the substantial monetary award how would you characterize that? As an incentive fee, a finder's fee, informant's fee?

Mr. PHILLIPS. You could characterize it in different ways. If the Government takes over the case, successfully prosecutes it with very minimum participation once having filed the case by the qui tam plaintiff, then I think you call it a finder's fee because they are the persons responsible for bringing the information to the attention of the Government and the Government then takes it from

there. If the person plays a very active role in continuing the litigation, which is necessary frequently to keep the pressure on the Justice Department—and certainly in the case of Mr. Gravitt would have been very helpful, 2 years hence we would have found a lot more discovery having been completed and a lot more information disclosed—then I think that person should receive substantially more compensation and there is a discretionary amount, in a range, that a court has the authority to impose based on that amount of participation. But I believe it is very important there be a minimum a percentage that the person can realize as opposed to it being totally discretionary. And if you are completely subject to the discretion of a particular court, it is not inconceivable the person could have done all this with a successful outcome and then have very little or nothing to show for it.

It is important from the beginning to know that going into this, if they are successful, if their facts are well justified, they are going to be entitled to some compensation, that they may not find themselves at the end of that process with absolutely nothing. That could happen under the existing law and this bill will amend that.

Mr. GLICKMAN. Thank you for your testimony. I appreciate it very much.

[Information referred to above follows:]

U.S. Department of Justice

Civil Division

Office of the Assistant Attorney General

Washington, D.C. 20530

FEB 20 1986

Honorable Daniel Glickman
Chairman
Subcommittee on Administrative Law
and Governmental Relations
Committee on the Judiciary
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

Following my testimony before the Subcommittee on March 5, 1985, the Subcommittee heard testimony from Mr. John Michael Gravitt and his attorney, Mr. James Helmer, as to the Justice Department's handling of the qui tam action which Mr. Gravitt brought against General Electric on behalf of the United States. Because Mr. Helmer's testimony contained serious misstatements as to the government's handling of this action, I would like to take this opportunity to set the record straight.

The instant action was brought under the citizens suit or "qui tam" provisions of the False Claims Act, 31 U.S.C. § 3730, by Mr. Gravitt against his former employer, General Electric. Let me state at the outset that Mr. Gravitt is to be commended for his actions in this case. By coming forward when he did, he helped to expose a conspiracy to falsify time cards and vouchers in the DMO machine shop at G.E.'s Evendale plant, which prevented the government from gaining a true picture of labor costs in that shop.

Notwithstanding Mr. Gravitt's help in exposing mischarging in the DMO machine shop, Mr. Gravitt and his attorney evidently remain under a severe misapprehension as to the true facts of this case despite the extensive briefings they have received by Justice Department and FBI personnel.

First and foremost, after an estimated 5,000 hours of investigation, the government has concluded that it has suffered no measurable monetary damage due to the mischarging in the DMO

shop. While there was undoubtedly a conspiracy to mischarge hours systematically in the DMO shop, our investigation led us to conclude that the mischarging was done in an effort to meet internal G.E. production guidelines, and not to defraud the government. In fact, it appears that the United States was actually undercharged due to this conspiracy. In effect, the conspiracy Mr. Gravitt uncovered was designed to defraud General Electric and to protect the jobs of employees in the DMO shop, not to defraud the government.

More seriously, upon reviewing the transcript, I see that Mr. Helmer left the Subcommittee with the impression that in our handling of the civil suit, the Department failed to conduct an adequate investigation of this matter, and that in reaching a settlement with G.E., we simply accepted their view of the facts and entered into a "sweetheart" deal. Nothing could be further from the truth.

Almost a year before Mr. Gravitt filed suit in October 1984, his allegations had been brought to the attention of the Defense Contract Audit Agency (DCAA) by General Electric after it had conducted its own internal investigation prompted by Mr. Gravitt's letter to them of June 30, 1983. DCAA reviewed G.E.'s internal investigation and the work papers underlying that study. They determined that the government had suffered no loss as a result of the scheme, and were satisfied that G.E. was taking adequate steps to correct the problem. In light of those findings, DCAA determined not to refer the matter for prosecution.

After Mr. Gravitt's suit was filed, the United States Attorney in Cincinnati took over the action. Due to the seriousness of the allegations in Mr. Gravitt's complaint and the accompanying disclosure statement, and the fact that we had what then appeared to be a similar action pending against G.E. in Philadelphia, the investigation was reopened for both criminal and civil purposes by the United States Attorney. As is our practice in such cases, we sought a stay of the civil proceedings so that General Electric would not have the opportunity to use the liberal civil discovery rules to discover aspects of the government's criminal investigation.

Over the course of that investigaton, which lasted from approximately December of 1984 to August of 1985, the FBI, the Air Force Office of Special Investigations and the DCAA interviewed approximately 35 witnesses and, with the cooperation of G.E., conducted an extensive audit of the activities of the DMO shop from 1981 through 1983. Of the approximately 60,000 time cards generated during that period, we selected for careful review by government auditors a sample of approximately 12,500, representing all the timecards from six non-consecutive

months. Where necessary, special infra-red analysis was used to determine how timecards had been altered. In summary, we determined that for every five hours mischarged on the altered cards, one was mischarged to the detriment of the government, two were mischarged to the detriment of G.E. and two had a neutral impact. It was on the basis of this investigation that the Department, and all of the investigating agencies, concluded that the government had not been defrauded by the scheme.

Further, because this investigation was conducted before any grand jury testimony was taken (that did not occur until August or September, 1985), the fruits of the investigation could be and were, in fact, shared by both criminal and civil attorneys in the Department. In short, the strictures of Rule 6(e) of the Federal Rules of Criminal Procedure, as interpreted by the Supreme Court in United States v. Sells Engineering, Inc., 103 S. Ct. 3133 (1983), did not impede the Civil Division's evaluation of this case. We did not move for a court order for access to the grand jury testimony for the simple reason that it was not necessary; the prior investigation was more than adequate. Our conclusions in this regard are buttressed by the fact that the prosecutors in the Department declined to bring criminal charges against G.E. or the individuals involved.

Thus, by September of 1985, we realized that Mr. Gravitt's charges related to a serious situation involving mischarging in the DMO shop, but one in which the United States had suffered no measurable damage. Moreover, in both the criminal and the civil cases, we would have been required to prove that G.E. intended to defraud the government by the scheme. Obviously, this was not a case which we believed we could prove. Nevertheless, because some of the Evendale plant's monthly claims on government contracts could technically be considered false because they did not present a true picture of the work being done in the DMO shop, even though their falsity resulted in a net undercharge, we were able to use the False Claims Act's civil penalty provision aggressively in settlement negotiations, which ultimately yielded the $234,000 settlement currently at issue.

Under the False Claims Act, the government is entitled to double its actual damages, plus a $2,000 civil penalty for each false claim or false statement submitted to get a claim paid. In this case, we determined that there were 303 monthly billings by the Evendale plant which included DMO work for the relevant period. Using the ratio of overcharges to undercharges developed through the audit of the six-month sample, DCAA was able to estimate that 117 of the 303 claims were likely to have resulted in falsely inflated charges to the government. The settlement amount reflects a $2,000 forfeiture for each of these claims.

Mr. Helmer's apparent confusion arises from his erroneous belief that because the government received a $2,000 civil penalty for each false timecard in an apparently similar case against G.E. in Philadelphia, it should have received a similar award in this action. (He calculates that the government should get a $2,000 forfeiture for each incorrect time card, or a total of $36 to $48 million.) However, in the Philadelphia case the criminal action was based upon G.E.'s actual submission of the false timecards in connection with a post payment audit of claims. G.E. pleaded guilty to submitting four false claims and making 100 false statements to the government by presenting 100 false timecards in connection with the audit. In their effort to resolve their civil liability under the False Claims Act, G.E. offered to pay the government $1.9 million. Their calculation apparently included doubling of the actual damages which the government suffered as a result of the scheme, plus a $2,000 civil penalty for each of the false statements and claims.

Unlike the Philadelphia case, in the present case, G.E. never presented the false timecards to the government representing them to be true. When G.E. management learned of the falsity of the timecards by way of Gravitt's letter, they informed DCAA. Therefore, there was no basis for asserting that each of the timecards was a false statement submitted to the government in order to get a false claim paid. Moreover, even if we were able to demonstrate that thousands of false timecards had been presented to get the claims paid, courts have often held, over the government's objection, that they have discretion to reduce the number of forfeitures if the amount is grossly out of line with the government's actual loss. See, e.g., Peterson v. Weinberger, 508 F.2d 45 (5th Cir. 1975).

Finally, Mr. Helmer alleged that the Department threatened his client with the loss of the 10% of the recovery to which he might have been entitled as a qui tam relator if he objected to the government's "sweetheart settlement." In fact, during the course of settlement discussions, our attorney informed Mr. Helmer of our intention to settle with G.E. for $234,000 and pointed out, in connection with Mr. Helmer's objections to the settlement amount, that the government believed that it knew of Mr. Gravitt's allegations before he brought the suit, and therefore, a court could find that he was not a proper plaintiff or "relator" under the Act. Our attorney explained further that if he found it necessary to formally object to the settlement in court, we would defend the settlement on the ground, among others, that Mr. Gravitt was not a proper relator under the Act because of the government's prior knowledge, and thus Mr. Gravitt had no standing to object to the settlement. As a matter of courtesy, our attorney also informed Mr. Helmer that if that argument was accepted, Mr. Gravitt would, as a matter of

law, not be entitled to a court award of up to 10% of the recovery. Because we faced some litigation risk that a court might deem the government's knowledge insufficient in light of the extent of Mr. Gravitt's disclosure statement and the fact that the government did not initially proceed with the case, we were prepared to give up our right to object to Mr. Gravitt's status as a proper relator in exchange for Mr. Gravitt foregoing any objection to the settlement with G.E.

The statements made to Mr. Helmer should be preceived in this light and not as threats in an effort to prevent public disclosure. As I noted above, we believe that we reached a good settlement, which we are prepared to defend before the District Court.

I trust that this answers any questions which might have arisen about the Department's handling of this case. If necessary, we would be prepared to provide a more detailed briefing for members of the Subcommittee or staff. While we do not ordinarily like to discuss pending litigation in such detail, I felt that it was essential to set the record straight in this matter.

Sincerely,

Richard K. Willard

RICHARD K. WILLARD
Assistant Attorney General

Mr. GLICKMAN. Our next witness is Mr. Marshall J. Breger, chairman of the legislative liaison committee of the Administrative Conference of the United States. We apologize to you for the delays, but we are glad to have you. You might introduce for the record the people who are accompanying you as well.

TESTIMONY OF MABSHALL J. HREGER, CHAIRMAN, ADMINISTRATIVE CONFERENCE OF THE UNITED STATES, ACCOMPANIED BY RICHARD K. BERG, GENERAL COUNSEL, AND JEFFREY S. LUBBERS, RESEARCH DIRECTOR

Mr. BREGER. Certainly, Mr. Chairman. I am delighted to be here and to introduce my general counsel, Richard K. Berg, and my research director, Jeffrey Lubbers. We are grateful for the opportunity to testify on H.R. 3335, the proposed Program Fraud Civil Penalties Act of 1985.

Our interest is in H.R. 3335 in a more esoteric but perhaps a no less important matter than those raised thus far today, the administrative procedures used in the act's enforcement provision. In discussing these procedural issues, however, I would like to make a number of preliminary comments and disclaimers.

First, the committee is doubtless aware the bill covers a broad variety of programs and activities. It would reach not only very large enterprises but also very small ones and, indeed, even encompass individuals who are asserting claims or seeking benefits from the Government. We are not prepared to advise the committee on the optimum scope of coverage. Practical considerations, however, both in terms of the seriousness of the violation and the financial situation of the respondent, will undoubtedly limit resort to the penalty process, notwithstanding the breadth of coverage. Nevertheless, the committee should certainly give consideration as to whether the coverage of the bill should be narrowed.

Second, we understand that there has been some question as to the standard of liability to impose, whether it should be only for intentional misstatements of fact or for some broader standard. We do not claim expertise in this area of the law and take no position on what standard of scienter should be applied; but, obviously, the standard you select depends to some extent on the situations you intend to cover. One can reasonably hold large, sophisticated enterprises to a higher standard of candor in dealings with the government than perhaps an individual applicant for unemployment benefits. I offer these simply as preliminary observations.

I would like to turn to aspects of the bill about which we do claim some expertise—administrative procedures. I want to make some recommendations about civil money penalty procedures based on recommendations that the Administrative Conference adopted in 1972 and in 1979, and these recommendations are attached to our written testimony which I hope will be included in the record of today's hearing.

Mr. GLICKMAN. Without objection.

Mr. BREGER. First of all, it is black letter law that before any civil money penalty can be collected the alleged violator must have an opportunity for some kind of hearing on the record to defend himself and to cross-examine his accusers. There are two places

such a hearing may be held: in a Federal court as a trial de novo or in an agency adjudication prior to the imposition of any penalty. The traditional statutory model requires the enforcing agency to make a preliminary finding that there has been a violation and then to forward the case to the Justice Department for prosecution in a Federal district court—a trial de novo.

There are still many statutes on the books that operate in that manner. Our studies, however, have shown that this model often does not work very well for a number of reasons: (1) district court litigation is expensive; (2) U.S. attorneys often assign a low priority to these occasional cases and often settle them, we feel, too readily; (3) U.S. attorneys and Federal judges are often unfamiliar with the subject matters involved; and (4) as a result of the above the enforcement agency loses control of its own agenda and of its own priorities.

Therefore, in our recommendations we ha ve urged that Congress consider giving agencies specific authority to impose civil penalties after an agency hearing with judicial review under the substantial evidence that on the record of the agency proceeding. We recommend that the full hearing provisions of the Administrative Procedure Act, the APA, be employed in these cases, and normally that includes an initial decision by an administrative law judge

We have been very pleased with the way this recommendation has been received. The Supreme Court in 1977 in the *Atlas Roofing* case ruled that the OSHA administrative imposition model employed in the Occupational Safety and Health Act was constitutional; and since our 1972 recommendation, many major regulatory statutes use that model, including those governing mine safety, strip mining, toxic substances, fishery management, migrant worker protection, banking regulations and, of course, the Medicare fraud legislation of 1981, a direct precursor to H.R. 3335, also follows this model.

So we think that in H.R. 3335 you have wisely chosen the option of providing the constitutionally-required hearing in the agency, not in the district court, and we applaud that. Our concern, however, is that the bill, as presently drafted, deviates from APA hearing procedures and raises unnecessary questions as to the objectivity and independence of the hearing officer.

I have to become technical at this juncture so please excuse me. Section 801(8) of the bill provides that agency hearings are to be presided over by a hearing examiner, defined as and I quote, "an administrative law judge or another official designated by the authority agency." That definition goes on to provide that the hearing examiner must either be at grade GS–15 and above or, if in the military, in grade O–7 or above and be independent of the other agency officers involved in the case.

We realize that some of the agencies and departments meeting the bill's definition of on "authority" do not have enough ALJ's to hold the additional hearings that will be required under this bill. We believe that agencies should either hire new ALJ's, as HHS did in beginning its Medicare Fraud Program, or borrow them, which is specifically permitted by the APA and is often done between agencies. That is not something new or strange. In addition, a 1984 law allows agencies to reappoint retired ALJ's for a specific period

or for specified cases. So the lack of ALJ's in a particular agency when this bill becomes law should not preclude the use of ALJ's.

Further, if a particular agency or department can adequately explain why it does not wish to use ALJ's in its hearing process, then the bill could specifically provide for this by designating other employees to hold hearings in that case and for that agency. Indeed, the APA contemplates such a situation in section 556(b). But in view of the penalties involved and the concerns of many expressed about this matter, we believe it would be better to amend the bill to require ALJ hearings as a general rule. As the bill now stands, there is no guarantee that "another official designated by the authority head," to quote the language of the bill, will be independent enough to satisfy the need for an adjudicative process which is fair and is perceived to be fair.

As an aside, Mr. Chairman, I know you and others have been interested in proposals to make ALJ's completely independent of enforcement agencies by separating them into a central ALJ corps. This is, of course, a suhject for another day, but I would point out that by permitting agencies to use officials who lack even the independence that ALJ's currently have, this bill goes in the opposite direction.

Moreover, the dichotomy between the ALJ hearings and the non-ALJ hearings contemplated by the bill introduces unnecessary confusion into those provisions which deal with hearing procedures; and we submit that this confusion, this mish-mash, is unnecessary. The APA already provides a tried and true set of procedures that courts have validated as meeting due process requirements.

In sum, we believe the hill's starting point should he to require the civil penalty proceedings to follow the adjudication procedures of the Administrative Procedure Act in all cases, and that includes use of ALJ's as presiding officers, except where justification is shown for deviation. That is to say, the APA allows for service as presiding officers by "employees specially provided for by or designated under statute," 5 USC 556(b). There is no reason to have this bill give the agencies a blank check to depart from the APA model. To obtain the benefits of agency imposition of civil money penalties the agency adjudications must be fair and must be perceived to be fair. The APA, we suggest, provides the ready-made solution.

If I might speak for a moment as a citizen and not as the chairman of a Federal agency, I support fully the substantive goals of this bill. Every dollar saved or recouped by cracking down on fraud will mean one more dollar that is saved taxpayers. The Administrative Conference stands ready to assist the committee and your staff in making any modifications to the bill that will accommodate our procedural concerns. I should warn you that we, indeed, have some specific minor drafting points which we would be happy to share with your staff.

Thank you for affording us an opportunity to present our views today, and we sincerely hope that the Program Fraud Civil Penalties Act will soon become a public law.

[The statement of Marshall J. Breger follows:]

(REVISED)

HEARING BEFORE THE

SUBCOMMITTEE ON ADMINISTRATIVE LAW
AND GOVERNMENTAL RELATIONS

OF THE HOUSE JUDICIARY COMMITTEE

ON

H.R. 3335

THE PROGRAM FRAUD CIVIL PENALTIES ACT OF 1985

TESTIMONY OF
MARSHALL J. BREGER, CHAIRMAN

ADMINISTRATIVE CONFERENCE OF THE UNITED STATES

Accompanied by:

Richard K. Berg
General Counsel

Jeffrey S. Lubbers
Research Director

February 6, 1986

Mr. Chairman and Members of the Committee

I am Marshall J. Breger, Chairman of the Administrative Conference of the United States. With me today are Richard K. Berg, my General Counsel and Jeffrey S. Lubbers, my Research Director.

I am grateful for the opportunity to testify on H.R. 3335, the proposed Program Fraud Civil Penalties Act of 1985. This important bill would provide an administrative procedure for imposing civil penalties for false claims and statements made to the United States in connection with agency programs. It would cover a broad range of agencies and programs and be administered by the respective agencies affected by such frauds. We are interested in this legislation, not only because it is an integral part of the President's Anti-Fraud Enforcement Initiative, but also because of the Administrative Conference's long-standing support for the use of civil money penalties as an enforcement technique. We have also been a leading proponent of administrative agency imposition of civil money penalties based on our belief that administrative agencies, through the use of formal hearings held under the Administrative Procedure Act, can ordinarily provide a fair hearing faster, more efficiently, and more inexpensively than the equivalent trial by a federal district court.

For these reasons, we applaud the Committee's consideration of this bill and approve of the bill's general approach, but we would like to make a number of preliminary comments and disclaimers. First, as the Committee is doubtless aware, the bill covers a broad variety of programs and activities. It would reach very large enterprises, but also very small ones, and, indeed, even individuals asserting claims or seeking benefits from the Government. We are not prepared to advise the Committee on the optimum scope of coverage. Practical considerations, both in terms of the

seriousness of the violation and the financial situation of the respondent, will undoubtedly limit resort to the penalty process, notwithstanding the breadth of coverage. Nevertheless, the Committee will certainly give consideration to whether the coverage of the bill should be narrowed. Second, we understand there has been some question as to the standard of liability to impose—whether it should be only for intentional misstatements of fact or some broader standard. We are not familiar with this area of the law and take no position on what standard of scienter should be applied, but obviously the standard you select depends to some extent on the situations you intend to cover. One can reasonably hold large sophisticated enterprises to a higher standard of candor in dealings with the Government than, perhaps, an individual applicant for unemployment benefits. I offer these simply as preliminary observations.

As you know, Mr. Chairman, the Administrative Conference of the United States is a federal agency whose mission is to study problems and recommend improvements in the administrative procedures used by federal departments and agencies. The Conference's unique structure, with its membership of designated representatives of federal agencies and volunteer public members who include distinguished private practitioners and law professors, enables it to bring a valuable perspective to procedural matters.

We have addressed civil money penalty procedures twice. Beginning in 1972 (See Recommendation 72-6, attached), we have supported the use of civil penalties based on their several advantages. Unlike criminal sanctions, license revocations or debarments, they can be used against less serious offenses, and are feasible where the offender provides services which cannot be disrupted without public harm. Moreover, civil penalties do not stigmatize as much as criminal penalties, and are therefore less likely to discourage prosecutorial decisions. Finally, unlike most courts imposing fines, agencies

assessing penalties can develop expertise and relatively precise formulas and can also use informal processes for assessing and mitigating penalties without the need for a hearing.

Civil money penalty statutes are no longer rare; even without this bill, there are already over 350 statutory civil penalty provisions, enforced by dozens of agencies. However, under most of these statutes, the penalty cannot be imposed until the agency (normally through a U.S. Attorney) has succeeded in a de novo adjudication in federal district court. Our study found that this scheme often did not work well because of the expense of district court litigation, the tendency of U.S. Attorneys to assign a relatively low priority to these occasional regulatory cases and to often settle them too readily, the unfamiliarity of U.S. Attorneys and judges with the subject matters involved, inconsistent results in the many district courts, and the inability of the enforcement agency to control its own agenda.

In part B of our 1972 recommendation, we therefore urged agencies and Congress to consider the desirability of administrative imposition of civil penalties after an agency hearing, and concluded that such a scheme is preferable to court adjudication where there is a large volume of cases, where speedy adjudication is important, where issues of law (e.g. statutory interpretation) requiring judicial resolution are rare, where consistency of outcome and size of penalties imposed is important, and where the penalties are likely to be relatively small.

At the time the recommendation was adopted, few statutes provided for administrative, as opposed to judicial, imposition of civil penalties. However, in recent years, in response perhaps to our urgings, and, certainly to the increasingly urgent need to alleviate the burden on the federal courts, Congress has frequently provided for administrative imposition under procedures similar to those set forth in H.R. 3335. One example, of course, that is closely analogous to the Program Fraud bill is the medicare

fraud civil penalty program administered by the Department of Health and Human Services under the Medicare and Medicaid Amendments of 1981, 42 U.S.C. §1320a-7a.* Moreover, in 1977, constitutional questions raised by administrative imposition of civil money penalties were largely put to rest by the Supreme Court in Atlas Roofing Co. v. OSHRC, 420 U.S. 442 (1977). Finally, in 1979, the Administrative Conference in Recommendation 79-3 (attached), reaffirmed its support of administrative imposition and welcomed the increased use of such procedures since our 1972 recommendation.

Given this history, it should be no surprise that we strongly support the principal thrust of H.R. 3335 and its general approach of assigning the adjudication of civil penalties for program fraud to the administering agencies. However, we also believe that for such a system to work, the fairness of the administrative proceeding and the impartiality of the forum must be unquestioned. It is in this area where we believe the bill needs some modification.

Under our own recommendations and in the administrative imposition statutes discussed earlier (including the OSHA program at issue in the Atlas Roofing case), the agency is required to offer the alleged violator notice and opportunity for a hearing on the record pursuant to the Administrative Procedure Act, 5 U.S.C. §554-57. This ordinarily means that the hearing is conducted by an administrative law judge (ALJ), appointed under 5 U.S.C. §3105, whose tenure and decisional independence is protected by other provisions in title 5. After the hearing and initial decision, the violator may, of

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* Other important recent regulatory statutes prescribing this model include laws governing: worker safety (OSHA), 29 U.S.C. §§659, 666; mine safety, 30 U.S.C. §815; strip mining, 30 U.S.C. §1268; toxic substances, 15 U.S.C. §2615, fishery management, 16 U.S.C. §1858; migrant worker protections, 29 U.S.C. §1853; commodities trading, 7 U.S.C. §9; communications regulation, 47 U.S.C. §503(b); banking regulation, 12 U.S.C. (various provisions), and agricultural violations, 7 U.S.C. (various provisions).

course, seek review by the agency head and then judicial review in the court of appeals under the APA's substantial evidence test, 5 U.S.C. §706(2)(E).

In this regard, it would be appropriate to remind ourselves that when the Administrative Procedure Act was being debated in the early 1940's, one of the key issues was the independence of the presiding agency hearing officers. Prior to the APA there were no reliable safeguards to ensure the objectivity and judicial capability of presiding officers in formal administrative proceedings. Ordinarily these officers were subordinate employees chosen by the agencies, and the power of the agencies to control and influence such personnel made questionable the contention of any agency that its proceedings assured fundamental fairness. The APA was designed to correct these conditions, and we have now reached the point where the Supreme Court can confidently say:

> "There can be little doubt that the role of the modern federal hearing examiner or administrative law judge is 'functionally comparable' to that of a judge. . . . More importantly, the process of agency adjudication is currently structured so as to assure that the hearing examiner exercises his independent judgment on the evidence, free from pressures by the parties or other officials of the agency."
> Butz v. Economou, 438 U.S. 478, 513 (1978)

In view of this settled consensus on the role of the administrative law judge, and the need for decisional independence, we question the wisdom of H.R. 3335's partial deviation from the APA hearing procedures. The bill [see §801(8)] provides that agency hearings are to be conducted by a "hearing examiner" (a better alternative term would be "presiding officer"), defined as "an administrative law judge or another official designated by the authority head. . . ." (emphasis added). The definition goes on to provide that the hearing examiner must either be at grade GS-15 and above or, if in the military, in grade O-7 or above, and be independent of the other agency offices involved

in the case. We realize that some of the agencies and departments meeting the bill's definition of "authority" do not have enough ALJs to hold the additional hearings to be required under this bill. This is not a reason to exempt them from the APA's hearing provisions. We believe that agencies should either hire new ALJs (as HHS did in beginning its medicare fraud program) or borrow them under the terms of 5 U.S.C. §3344. In addition, under Public Law 98-224 (1984), agencies may reappoint retired ALJs for a specified period or for specified cases, 5 U.S.C. §3323(b)(2).

If a particular agency or department can adequately explain why it does not wish to use ALJs for these hearings, then the bill could provide for this by specifically designating other employees to hold the hearing. Such designations are contemplated by the APA, §556(b), and have been occasionally used, as in the Atomic Energy Act, which parmits hearings before Atomic Safety Licensing Boards. However, in view of the size of the penalties involved and the concerns of the bar associations already expressed about this bill, we question whether any deviation from the APA pattern is desirable. As the bill now stands there is no guarantee that "another official designated by the authority head" will be independent enough to satisfy the need for an adjudicative process which is fair and is perceived to be fair.

Furthermore, the bill introduces unnecessary confusion by distinguishing in its procedural requirements between the ALJ hearings and the "non-ALJ" hearings. In section 803(f)(1), the bill provides that if the hearing is conducted by an ALJ, the procedures should follow the APA, but that otherwise the hearing is to follow either the APA or procedures promulgated by the authority head which must include a set of provisions enumerated in §803(f)(2), most, but not all of which, track the APA. We submit that this confusion and complication is unnecessary when the APA already provides a tried-and-true, set of procedures that courts have validated as meeting due

process requirements. In this connection, let me quote from one of my esteemed predecessors, now-Judge Antonin Scalia, who in a 1974 letter to Chairman Dingell on another bill, made the following complaint, which unfortunately too often remains valid twelve years later:

> " In recent years, there has been a visible and steady erosion of standardized administrative practice, through individualized provisions contained in new pieces of regulatory legislation where no real reason for individualized treatment exists. While absolute standardization, of course, is not desirable, the basic principle of a uniform administrative practice, with only such variations as operational differences justify, serves several important values. It is indispensible to the retention of an administrative system that can be fathomed by the general public and penetrated by lawyers who are not specialists in narrow fields of Federal practice. It is helpful to the courts in their review of agency action, facilitating the development of overall principles of judicial review and enabling the creation of a body of case law that can serve as precedent in more than one limited field. Finally, and perhaps most important, an allegiance to a standard body of procedural principles such as that contained within the APA has great advantages in the legislative process. The procedural provisions of major substantive legislation are understandably not the portions to which the Congress devotes its closest attention; and the comments it receives from both the agencies and the private sector are inclined to dwell upon the extent, rather than the manner, of the regulation that is to be imposed. It is generally desirable, then, for the Congress to adhere to the judgments it made when procedure itself was the center of its attention rather than merely the incidental accompaniment of a substantive program under examination. Those judgments are likely to be significantly more sound than the random procedural innovations which may slip by with each new piece of substantive legislation.
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> "[Letter from Antonin Scalia, Chairman of the Administrative Conference, to Hon. John D. Dingell, on H.R. 7917, May 23, 1974, at page 4.]

In sum, we believe the bill's starting point should be to require the civil penalty proceedings to follow the adjudication procedures of the Administrative Procedure Act, unless some agency can establish a need for special treatment in all cases. This includes use of ALJs as presiding officers. To obtain the benefits of agency imposition of civil money penalties, the agency adjudications must be fair and perceived to be fair. The

APA provides the ready-made solution.

As a citizen, not an expert, Mr. Chairman, I support the aims of the substantive provisions of this bill. We of course, stand ready to assist the Committee and your staff in making any modifications to the bill that will accomodate our procedural concerns. We also have some other more minor drafting points which we will be glad to share with your staff.

We appreciate the chance to participate today, and we sincerely hope the Program Fraud Civil Penalty Act will soon become a public law.

§ 305.72-6 Civil Money Penalties as a Sanction (Recommendation No. 72-6).

(a) Federal administrative agencies enforce many statutory provisions and administrative regulations for violation of which fixed or variable civil money penalties may be imposed.[1] During Fiscal 1971, seven executive departments and thirteen independent agencies collected well in excess of $10 million, in over 15,000 cases; all evidence points to a doubling or tripling dollar magnitude and substantially increasing caseload within the next few years.

(b) Increased use of civil money penalties is an important and salutary trend. When civil money penalties are not available, agency administrators often voice frustration at having to render harsh "all-or-nothing decisions" (e.g., in license revocation proceedings), sometimes adversely affecting innocent third parties, in cases in which enforcement purposes could better be served by a more precise measurement of culpability and a more flexible response. In many areas of increased concern (e.g., health and safety, the environment, consumer protection) availability of civil money penalties might significantly enhance an agency's ability to achieve its statutory goals.

(c) In developing a range of sanctions adequate to meet enforcement needs, Congress and agencies must often determine whether a "criminal fine" or a "civil money penalty," or both, should be applied to a given regulatory offense. The choice they make has large consequences. Criminal penalties expose an offender to the disgrace and disabilities associated with "convictions"; they require special procedural and other protections; and they can not be imposed administratively. These factors make it appropriate to consider whether criminal sanctions should not be supplemented or replaced by civil money penalties.

(d) Under most money penalty statutes, the penalty cannot be imposed until the agency has succeeded in a de novo adjudication in federal district court, whether or not an administrative proceeding has been held previously. The already serious overburdening of the courts argues against flooding them with controversies of this type, which generally have small precedential significance.

(e) Because of such factors as considerations of equity, mitigating circumstances, and the substantial time, effort and expertise such litigation often requires in cases usually involving relatively small sums (an average of less than $1,000 per case), agencies settle well over 90 percent of their cases by means of compromise, remission, or mitigation. Settlements are not wrong *per se*, but the quality of the settlements under the present system is a matter of concern. Regulatory needs are sometimes sacrificed for what is collectible. On the other hand, those accused sometimes charge that they are being denied procedural protections and an impartial forum and that they are often forced to acquiesce in unfair settlements because of the lack of a prompt and economical procedure for judicial resolution. Moreover, several agency administrators warn that some of the worst offenders, who will not settle and cannot feasibly be brought to trial, are escaping penalties altogether.

This recommendation is intended to meet the problems posed above.

RECOMMENDATION

A. *Desirability of Civil Money Penalties as a Sanction.* 1. Federal administrative agencies should evaluate the benefits which may be derived from the use (or increased use) of civil money penalties as a sanction. Such penalties should not be adopted as a means of supplanting or curtailing other private or public civil remedies.

2. Civil money penalties are often particularly valuable, and generally should be sought, to supplement those more potent sanctions already available to an agency—such as license suspension or revocation—whose use may prove: (a) Unduly harsh for relatively minor offenses, or (b) infeasible because, for example, the offender provides services which cannot be disrupted without serious harm to the public.

3. Each federal agency which administers laws that provide for criminal sanctions should review its experience with such sanctions to determine whether authorizing civil money penalties as another or substitute sanction would be in the public interest. Such authority for civil money penalties would be particularly appropriate, and generally should be sought, where offending behavior is not of a type readily recognizable as likely to warrant imprisonment.

B. *Adjudication of Civil Money Penalty Cases in an Administrative Imposition System.* 1. In some circumstances it is desirable to commit the imposition of civil money penalties to agencies themselves, without subjecting agency determinations to *de novo* judicial review. Agencies should consider asking Congress to grant them such authority.[2]

Factors whose presence tends to commend such a course with respect to a particular penalty provision include the following:

(a) A large volume of cases likely to be processed annually;

(b) The availability to the agency of more potent sanctions with the resulting likelihood that civil money penalties will be used to moderate an otherwise too harsh response;

(c) The importance to the enforcement scheme of speedy adjudications;

(d) The need for specialized knowledge and agency expertise in the resolution of disputed issues;

(e) The relative rarity of issues of law (*e.g.*, statutory interpretation) which require judicial resolution;

(f) The importance of greater consistency of outcome (particularly as to the penalties imposed) which could result from agency, as opposed to district court, adjudications; and

(g) The likelihood that an agency (or a group of agencies in combination) will establish an impartial forum in which cases can be efficiently and fairly decided.

Considerations such as those set forth above should be weighed heavily in favor of administrative imposition when the usual monetary penalty for an offense or a related series of offenses would be relatively small, and should normally be decisive when the penalty would be unlikely to exceed $5,000. However, the benefits to be derived from civil money penalties, and

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[1] For purposes of this recommendation, no distinction has been drawn between sanctions denominated "money penalties" and sanctions denominated "forfeitures" (e.g., in FCC legislation) and "fines" (e.g., in Postal Service legislation) so long as: (i) The sanction is classified as civil and (ii) money is, in fact, subject to collection by an agency or a court. Excluded are situations involving penalties or liquidated damages assessed pursuant to the terms of a government contract or terms withheld or recovered for failure to comply with the terms of a government grant.

[2] Due to the special procedures and status of the United States Tax Court, the rationale for administrative imposition may have only limited applicability to civil money penalties administered by the Internal Revenue Service.

§ 305.79-3 Agency Assessment and Mitigation of Civil Money Penalties (Recommendation No. 79-3).

(a) The civil money penalty has become one of the most widely used techniques in the enforcement programs of federal administrative agencies. Most regulatory offenses punishable by civil penalties involve adverse social consequences of private business activity. The motivational impact of these penalties depends in large part on the certainty of imposition and uniformity of amount, although some cases may require individualized tailoring to the circumstance of the offender so as to remove the economic benefit of the illegal conduct. Other civil penalties may also serve a secondary function of compensating society for the harm caused by unlawful conduct.

(b) Recommendation 72-6 urged that the advantages of civil money penalties would be best achieved through an "administrative imposition system" in which the agency would be empowered to adjudicate the violation and impose the penalty after a trial-type hearing, subject to "substantial evidence" judicial review. Such a system, it was stated, would avoid the delays, high costs, and jurisdictional fictions inherent in the traditional and most common system of imposing civil money penalties by a court in a civil action initiated on behalf of the agency by the Department of Justice.

(c) Since adoption of that Recommendation in 1972, the use of civil money penalties in general and of administratively imposed civil money penalties in particular has increased significantly, and the constitutionality and desirability of administratively imposed penalties has been widely recognized.

(d) Experience has shown that agencies play a crucial role and exercise broad discretion in the administration of civil penalty programs, whether or not the statute in question authorizes an administrative imposition system. Agencies possessing such authority have found it efficient to try to resolve cases before the formal hearing stage, through settlement and negotiation. Those agencies not possessing administrative imposition authority operate under a wide variety of statutes: some make no express reference to an agency role in the penalty process, while others confer on the agency only a power to "assess" or to "mitigate" penalties, thereby expressly or implicitly reserving to the respondent the right to seek a subsequent de novo fact-finding hearing by the court in a collection proceeding. Agencies typically exercise their statutory authority to "mitigate" in resolving contested penalty assessments prior to the institution of formal enforcement action. In these recommendations the term "mitigation" refers to any informal process of resolving a contested initial penalty assessment.

(e) Whatever the statutory framework, the enforcing agency typically makes the initial assessment, and provides a process for mitigation of the penalty. Thus, both where there exists administrative imposition authority and where such authority does not exist, agencies and respondents customarily utilize these initial assessment and mitigation processes to resolve the great majority of civil money penalty cases without reaching the stage of formal administrative adjudication or court collection proceeding.

(f) These informal processes for the initiation and termination of civil penalty proceedings represent an area of previously unstudied and largely discretionary agency action. Appropriate standards and structures for the exercise of such discretion are needed to improve the consistency, efficiency and openness of agency assessment and mitigation processes.

(g) The recommendations that follow focus on: (1) The need for agencies to develop standards for determining penalty amounts, (2) agency procedures for initially assessing penalties, (3) agency mitigation procedures, and (4) the use by agencies of evidentiary hearings to impose civil penalties where such a procedure, though not required by statute, might result in a limited scope of judicial review.

Recommendation

A. Standards for Determination of Penalty Amount

1. Agencies enforcing regulatory statutes, violation of which is punishable by a civil money penalty, should establish standards for determining appropriate penalty amounts for individual cases. In establishing standards, agencies should specify the factors to be considered in determining the appropriate penalty amount in a particular case. To the extent practicable, agencies should specify the relative weights to be attached to individual factors in the penalty calculation, and incorporate such factors into formulas for determining penalty amounts or into fixed schedules of prima facie penalty amounts for the most common types or categories of violation. A penalty intended to deter or influence economic behavior should, at a minimum, be designed to remove the economic benefit of the illegal activity, taking into account the documented benefit and the likelihood of escaping detection. Penalty standards should, in ad-

dition, specify whether and to what extent the agency will consider other factors such as compensation for harm caused by the violation or the impact of the penalty on the violator's financial condition. In order to reduce the cost of the penalty calculation process and increase the predictability of the sanction, simplifying assumptions about the benefit realized from or the harm caused by illegal activity should be utilized.

2. Agencies should periodically evaluate the continuing effectiveness of their penalty standards. Such evaluations should be based upon the results of compliance surveys and internal audits of agency assessment and mitigation decisions as well as data on the nature and frequency of violations routinely generated by the agency's enforcement program.

3. Agencies should make such standards known to the public to the greatest extent feasible through rulemaking or publication of policy statements. Such an approach is especially desirable where adjudications that produce written decisions are rare.

4. Agencies should collect and index those written decisions made in response to mitigation requests or after agency assessment hearings, and make such decisions available to the public except to the extent that their disclosure is prohibited by law. Whenever a respondent cites a previous written decision as a precedent for the agency to follow in the respondent's case, the agency should either do so, distinguish the two cases, or explain its reasons for not following the prior decision.

B. INITIAL ASSESSMENT OF PENALTIES

1. Agencies should give adequate written notice to the respondent of the factual and legal basis for, and amount of, the penalty assessment.

2. Agencies should not mechanically assess variable civil money penalties at the statutory maximum if reliable evidence in their possession indicates the presence of mitigating factors. Nor, if they possess such evidence, should agencies assess at the statutory level fixed penalties which are subject to an express administrative "mitigation" authority.

3. The greater the degree to which an agency decentralizes its penalty assessment authority, the more it should structure the exercise of that authority by the use of highly specific standards. Agencies should not ordinarily delegate discretionary authority to assess civil money penalties to investigative personnel unless the delay inherent in review by an independent assessment official would materially impair the effectiveness of the enforcement process.

C. MITIGATION OF PENALTIES

Respondents in civil money penalty cases have a right to a trial-type hearing at either the administrative or judicial level. It is nevertheless desirable that agencies establish fair and economical procedures whereby respondents may informally contest the initial assessment of civil penalties without the necessity of going forward to trial-type hearings. These procedures should be governed by the following principles:

1. Agencies should provide the respondent with a right to reply in writing to a penalty claim.

2. Agency staff should not refuse a reasonable request to discuss a penalty claim orally. But an informal conference need not be built into the process except in those categories of cases where the use of written communications is likely to prove inadequate because of such factors as the unsophistication of violators or the prevalence of factual disputes.

3. Agencies should consider providing an opportunity for administrative review of a decision denying a request for mitigation.

4. Agency decisions on mitigation requests should be in writing and should be accompanied by a brief indication of the grounds for the decision.

5. In regulatory programs typically involving the imposition of small penalties, agencies may appropriately rely most heavily on readily ascertainable standards of liability, fixed schedules of prima facie penalty amounts for the most common types of categories of violations, and highly objective inspection procedures. Opportunity for mitigation should be narrowly confined and mitigation requests entertained only if in written form.

6. In regulatory programs typically involving the imposition of large penalties, agencies may appropriately provide an opportunity to a respondent to present a request for mitigation, orally or in writing, request an oral conference thereon, receive a written decision, and submit a written petition for review of such decision or for compromise of such claim at a higher agency level.

D. EVIDENTIARY HEARINGS

As expressed in Recommendation 72-6, it is desirable that agencies be given express authority to employ the procedures of adjudication on the record pursuant to the APA, 5 U.S.C. 554-557, for the imposition of civil money penalties. Where its statute does not provide for such procedure but confers upon the agency authority to "assess" or to "mitigate" a penalty, particularly if the agency is required to conduct a "hearing," the agency should consider establishing such procedures by regulation, especially where by doing so a de novo proceeding upon judicial review could be avoided. Where such a hearing procedure has in fact been observed by the agency, and the statute does not provide for de novo judicial proceedings, the court should ordinarily utilize a limited scope of review of such agency action imposing civil money penalties.

[44 FR 36824, July 3, 1979]

the administrative imposition thereof, should also be considered when the penalties may be relatively large.

2. An administrative imposition system should provide:

(a) For and adjudication on the record pursuant to the Administrative Procedure Act, 5 U.S.C. 554-57 (1970), at the option of the alleged offender or the agency;

(b) For finality of an agency's decision unless appealed within a specified period of time;

(c) That, if the person on whom the penalty is imposed appeals, an agency's decision will be reviewed in United States Courts of Appeals under the substantial evidence rule in accordance with the Administrative Procedure Act, 5 U.S.C. 706(e);

(d) That issues made final by reason of (b) above and issues which were raised, or might have been raised, in a proceeding for review under (c) above may not be raised as a defense to a suit by the United States for collection of the penalty.

Agencies should adopt rules of practice which will enable just, inexpensive and speedy determinations. They should provide procedures for settlement by means of remission, mitigation or compromise.

Mr. GLICKMAN. Thank very much, Mr. Breger.

I want to ask you a question that relates to the applicability of this law to the Defense Department and how the APA is brought into it. I was about ready to introduce a bill yesterday which incorporated not only some of the provisions that we have talked about before, increasing civil penalties, but also program fraud provisions. It suddenly hit me that the Defense Department having hearing examiners to hear cases and render penalties against civilian contractors might present some very serious statutory and perhaps constitutional problems in that the Defense Department, I believe, takes the position that they are not subject to the Administrative Procedures Act in many of their dealings. It concerned me that we could have a serious due process problem if we passed a bill giving perhaps a military tribunal authority to impose fines, civil penalties on civilian contractors. That was a whole different ballgame under debarment or suspension. I wonder if you might comment to that.

Mr. BREGER. I would be happy to do so. Let me first say that you are correct, Mr. Chairman, or rather the Defense Department is correct in saying that the Administrative Procedure Act has exceptions from certain requirements for military and foreign affairs activities. However, we believe that the case law will show that these exceptions do not go by agency but rather by function; that is to say, military function or foreign affairs function. It would be, of course, a question of specific statutory interpretation whether matters of procurement fraud which you are attempting to consider here, would fall into that military—function—exception.

As to the more general question, whether civil penalities can be given by military personnel, I am going to ask my general counsel here, Mr. Berg, to address that more specifically; but the point of having ALJ's as opposed to the present situation in H.R. 3335 which, in fact, military officers who are over O-7 in grade, to make those decisions is to ensure the kind of autonomy and independence you are talking about, and I believe that ALJ civilian employees of the DOD would be able to do that.

Mr. BERG. Well, I hesitate to state the conclusion very firmly. I do not think there would be any constitutional problem if the bill made it clear that that was what was contemplated, but it would certainly be an unusual result. I cannot think of any analog in our present practice. I believe military officers do deal with debarment and, as a practical matter, debarment can be more painful, more costly than civil penalties, but still the law has traditionally recognized a distinction between those two kinds of procedures.

Mr. GLICKMAN. But clearly designating those people within the Defense Department who would hear these cases as ALJ's and using ALJ's as defined under the law would at least negate a lot of the problem you see in terms of having an other designees, people who are in the right GS classification, but who knows what they do for a living, handle these cases. You see, we are talking about 80 percent of procurement in government is Defense Department related, so it is more than an academic problem. This is the heart of the civil program section, and in my mind raises the question as to what the Pentagon would do to implement this bill or what the Defense Department would do with such provisions. I think that your

suggestions are very good ones and I think that we should try to draft this in such a way that it brings the APA in as much as possible. Otherwise, I fear that we are going to have serious challenges by everybody who is going to be hit by one of these penalties, a claim that due process has been violated, and they may be right as far as I know.

Let me ask you this, going back to the ALJ issue. Do you think it is necessary to designate an employee as the equivalent of an ALJ even if the agency explains why it does not want to use ALJ's? For example, NASA does not have ALJ's, I do not think.

Mr. LUBBERS. That is correct, Mr. Chairman. There are about 28 agencies in the Government that do employ their own administrative law judges. Other agencies, as Chairman Breger pointed out, borrow them regularly from other agencies, and there is no reason why NASA or the Department of Defense could not receive authority from the Office of Personnel Management to hire some ALJ's. But if you wanted to set up a scheme where the Department of Defense did use officers that were equivalent to administrative law judges, you could do that as the APA permits.

Another alternative might be to use the Armed Services Board of Contract Appeals which already has judges who are for all practical purposes equivalent to administrative law judges in their independence and so forth. But I think——

Mr. GLICKMAN. Are they all civilian?

Mr. LUBBERS. I do not know.

Mr. GLICKMAN. Does that matter?

Mr. LUBBERS. I do not think it should matter on a constitutional level whether or not they are civilians. However, it might be hard to provide military officers the same protection of tenure as the APA provides for ALJ's. The way somebody becomes an administrative law judge, is he or she has to pass an examination, administered by OPM and it is a fairly rigorous merit selection process.

Mr. GLICKMAN. OK. I think that the suggestions you make in your statement, Mr. Breger, are ones we are going to try to incorporate in the bill I introduce. I am going to withhold the introduction of the bill until such time I can clarify the provisions because these are the ones that are causing me some concern.

Mr. BREGER. Mr. Chairman, we would be happy to work with you and your staff in any way you think would help make a better product in this area.

Mr. GLICKMAN. You see, I think to some extent, you know, I am going to draft a bill to prevent program fraud wherever it exists, but we do have some basic need to adhere to due process principles in this Government. So I want to make sure that we can conform this to what the case law and statutes have said we have to do; otherwise, I think the fears of some contractors that they can be subject to Star Chamber procedures could be well founded.

Mr. BREGER. I might just add, Mr. Chairman, that a bill which tracks the Administrative Procedure Act would still allow for full and vigorous prosecution of program fraud.

Mr. GLICKMAN. OK. Thank you for your testimony.

Mr. BREGER. Thank you.

Mr. GLICKMAN. The last witness, and I hate to do this to you, but we have two bells and we will be back in 15 minutes and we will

try to finish it up fairly quickly. The alternative is for you to try to do it in 5 minutes, the American Bar Association, or about 3½ minutes, and I do not want to do that to you.

[Recess.]

Mr. GLICKMAN. The last witness, not the least——

Ms. WILLIAMS. Thank you.

Mr. GLICKMAN [continuing]. Is Karen Hastie Williams, chairman of the Legislative Liaison Committee of the Public Contract Law Section of the American Bar Association.

TESTIMONY OF KAREN HASTIE WILLIAMS, CHAIRMAN, LEGISLATIVE LIAISON COMMITTEE OF THE PUBLIC CONTRACT LAW SECTION OF THE AMERICAN BAR ASSOCIATION, ACCOMPANIED BY ALAN C. BROWN, CHAIRMAN OF THE SECTION'S PROCUREMENT FRAUD COMMITTEE

Ms. WILLIAMS. Thank you very much, Mr. Chairman. It is a pleasure to be with you this afternoon.

I have a prepared statement and I would ask that it be incorporated in its entirety into the hearing record. In light of the late hour I will try to summarize the highlights of our testimony for the benefit of the committee.

As the committee is aware, the Public Contract Law Section has taken an active role in the consideration of procurement reform legislation, both in this Congress and in previous Congresses. We were pleased to testify on S. 1134, the Program Fraud Civil Penalties Act on the Senate side, and are pleased to be here today to testify on its companion legislation as well as amendments to the False Claims Act in the House.

Our testimony before the Senate focused on several are as of concern with respect to protecting due process rights of individuals who were charged with violation of the program fraud civil penalties legislation. We would hope that the concerns we expressed there would be considered by this committee. For that reason we have appended to our testimony today comments made before the Senate Governmental Affairs Committee and a letter to Senator Cohen. The letter expresses our concern about the bill that was finally reported in four areas: (1) the standard of knowledge; (2) the continued existence of testimonial subpoena power; (3) the lack of independent prosecutorial review; and (4) the excessive and duplicative penalties. We hope those issues may yet be ironed out before that bill is finally passed the other body.

Our testimony here today, Mr. Chairman, is going to focus on the appropriate knowledge standard, an issue which is equally applicable to the program fraud bill and to the proposed amendments to the False Claims Act. I think it is fair to say that the program fraud bill is conceived as a mini-False Claims Act. Logically, the two measures should incorporate the same standard of intent. Let me summarize for you the five principles that the section feels should guide the standard of intent.

First, the proceedings contemplated by these bills are fundamentally actions for fraud. Like the existing civil False Claims Act, the legislation authorizes imposition of substantial penalties, including double damages, on persons who submit false, fraudulent, or ficti-

cious claims. Both the nature of the charge and the severity of the penalties dictate that these proceedings should not be lightly initiated or liability unfairly assessed. Accordingly, our first principle is that it is important that whether or not a person is liable for fraud should hinge on the person's actual state of knowledge at the time of the alleged offense, and liability should require proof of culpability.

The second principle we would articulate is that we do not believe a specific intent to defraud the United States should be a necessary element of liability under these bills. We agree with the overwhelming majority of the courts that have looked at this issue and have ruled that proof of actual knowledge of a falsity is sufficient prerequisite for liability under the False Claims Act.

The third principle we would suggest is that in certain circumstances reckless conduct that evinces disregard for the truth of a statement or deliberate efforts to shield one's self from the knowledge of falsity may reflect sufficient culpability that actual knowledge can he inferred. Thus adoption of a reckless disregard for the truth standard would comport with the most liberal interpretations of the False Claims Act and would, in our view, adequately protect the United States from persons who attempt to avoid liability for their deceit by deliberate efforts to keep from learning the truth.

The fourth principle we would suggest to the committee is that efforts to adjudicate charges of fraud by comparison of a person's conduct to undefined subjective standards or duties without regard to the person's actual culpahility or state of mind are inappropriate and patently unfair.

Lastly, we would hope that any legislation that this committee supports would assure that mistakes, inadvertence, negligence, and sloppiness are not fraud and are not treated as fraud in the legislation.

Mr. Chairman, the program fraud civil penalties legislation, both S. 1134 and the bills pending before this committee, should be viewed as alternative administrative remedies to the False Claims Act. It is important to remember that these pieces of legislation are intended to be remedial and they are not supposed to be penalty legislation. I think that some of the testimony that has been presented to this committee painfully suggests there are those who view this as penalty legislation and not remedial legislation.

We believe that the starting point for considering the appropriate standard of knowledge under the false claims legislation and program fraud legislation is to look at the case law that has been developed under the False Claims Act. Our written testimony goes into the law in detail, and I would commend it to the committee.

Let me say that the standard adopted by the eighth circuit and also by the Federal circuit here in the District of Columbia, which probably hears most of the Federal payment cases in the context of contract cases, tax cases and personnel cases, has adopted a constructive knowledge test and has held that recklessness or carelessness in the extreme is sufficient knowledge to give rise to liability under the False Claims Act. Other courts have moved along the spectrum in terms of the standard of intent. Those are detailed in our written testimony.

Let me just say for the record that we do believe that clarity in defining the standard of intent is most important. When we have situations in which administrative law judges in a number of different agencies are the decisionmakers for civil false claims, it is important that they have some clear guidance in terms of the applicable standard of intent.

In looking at the position that the Justice Department has taken recently, there is clearly some inconsistency with the position that they took before the Senate when it was conducting hearings on the program fraud civil penalties bill. We are very concerned that their apparent endorsement of a substantially reduced negligence standard, that is, a gross negligence standard, would ignore the individual's culpability or state of mind by inventing a subjective duty to inquire. This standard, if adopted, would significantly decrease the standard of intent necessary to impose penalties on persons for false claims or false statements. I would commend to the committee the discussion of the distinction between negligence and knowledge in a recent Massachusetts case, Computer Systems, which is detailed in our written testimony.

There is a substantial body of case law with respect to reckless disregard of the truth, and it occurs in various instances, not only in the case of contracts but mail fraud, debt and bankruptcy, challenges to search warrants, libel, and slander. Again, we think that it is important that this committee consider what the jurisprudence is in this area before going forward with some new, untested standard.

At least seven different standards by our count have been proposed by members for the program fraud civil penalties bill. They can generally be grouped into two categories. One category would impose a duty to inquire on persons submitting statements or claims to the United States. This duty of inquiry, we believe, would impose substantial liability on persons who breach, grossly neglect, or recklessly disregard that duty of inquiry. We believe this would be a test that would be next to impossible to invoke.

The duty to investigate, which has been supported by your colleagues on the Senate side, is unrealistic and unfair, particularly when substantial penalties will be meted out for neglect violations. Examples of situations which may realistically give rise to liability would include the small businessman, the farmer or the student who applies for Federal assistance in the same manner as in previous years. But the individual could well be unaware of the change in rules or regulations, announcements in the Federal Register with respect to eligibility and the filing of that claim which would give rise to liability under the legislation as it has been proposed on the Senate side and has been endorsed by the Justice Department.

The program fraud bill goes far beyond the Government contractors about whom members were talking earlier and would apply to any individual or any company that would have a claim against the Government. I would hope the committee might consider narrowing down the scope of this bill signficantly in terms of its reach so that the problems that the committee identifies are addressed and there is not an indiscriminate attack on individuals who may

make legitimate claims, all be them inadvertently false, to the Federal Government.

The second category rests on the question of the knowledge of the defendant's actual state of mind. By adopting a definition of knowledge which includes actual knowledge, deliberate ignorance, and reckless disregard for the truth. We think the proposed legislation would reach those individuals who intentionally make false claims as well as persons who evidence personal culpability by trying to avoid the truth.

In sum, Mr. Chairman, we believe that the subcommittee has a serious task before it in trying to fully understand and review the impact of amendments to false claims of legislation on individuals as well as on corporations. In pursuing your public policy, which the section supports, of finding fraud and focusing on liability of individuals or corporations who have acted in reckless disregard of the truth, a clear signal on liability must be presented to the public and to those enforcing the laws.

I am accompanied today by Mr. Alan Brown who is the chairman of our Program Fraud Committee, and I think he would like to add just a few comments.

Mr. ALAN BROWN. Mr. Chairman, the one distinction in the proposed standard by the Senate committee, the one main distinction on this duty of inquiry, is that in imposing such a duty of inquiry it would abolish the defense that the individual actually believed his claim to be true. We strongly believe with any charge of fraud against a person it should be a defense to that charge if a person acted in good faith and actually believed that his claim was accurate. This would be a valid defense even if a different person in the same circumstances might have done additional checking. This duty of inquiry or gross negligence of a duty of inquiry which a reasonable and prudent man would have under the circumstances, ignores that defense. As a result, even though a person acted totally in good faith, he could be penalized under these bills if later, maybe several years later, an administrative law judge determines that if he had been in that person's circumstances he would have checked further, would have examined the rules further and so forth. We think this result is inappropriate.

We think it is also important to point out that the Government is not without a remedy in these other circumstances. The Government has common law rights to recover money any time it is paid out inappropriately, by mistake or if a person in the Government authorizing the payment were without authority. The Government has many remedies to get back actual overpayments or to avoid payment to the individual.

But what we are talking about under these statutes is penalties, double damages, forfeitures, increased damages being levied against an individual, such penalties should be based on the individual's culpability, state of mind at the time; and, therefore, we have proposed in our statement that the appropriate standard would be if that individual actually knows that the claim is false, acts in reckless disregard of whether the claim is false, for example, if a person has intentionally avoided keeping records so that when he is called upon to account for the amount he has no paperwork that he could check to see whether his claim is accurate or if

he acts in reckless disregard of whether it is true or not, for example, by supplying information that he has no basis whatsoever for knowing whether it is accurate, if he just makes up numbers out of the air.

But it should not include the individual who truly believes that his statement is true. He should not be charged with fraud just because someone else thinks he should have checked further.

Ms. WILLIAMS. Thank you, Mr. Chairman. We will be happy to respond to your questions.

[The statement of Karen Hastie Williams follows:]

STATEMENT OF

KAREN HASTIE WILLIAMS

CHAIRMAN

LEGISLATIVE LIAISON COMMITTEE

SECTION OF PUBLIC CONTRACT LAW

AMERICAN BAR ASSOCIATION

Mr. Chairman and members of the Subcommittee, my name is Karen Hastie Williams. I am chairman of the Legislative Liaison Committee of the Section of Public Contract Law of the American Bar Association (ABA). With me today is Alan C. Brown, Chairman of the Section's Procurement Fraud Committee.

We are pleased.to testify today on False Claims legislation pending before the Congress, including the Program Fraud Civil Penalties Act of 1985, S.1134. This statement represents the views of the Section but has not been approved by the House of Delegates or Board of Governors of the ABA. As such, it represents only the position of the Section of Public Contract Law and should not be construed as representing the position of the American Bar Association.

As the Committee is well aware, members of the Section of Public Contract Law include a cross-section of lawyers from the private bar, government, corporations and academia. However, the positions of the Section are developed independently as a group of public contract professionals after much study and constructive debate.

Our section has consistently taken the position that legislation to correct abuses of the procurement system and fraudulent actions by contractors is an appropriate objective.

Our concerns have always been addressed to the lack of due process protections to which every citizen of this country is entitled.

I regret that past statements have interpreted our earlier expressions of concern as "resistance" to anti-fraud legislation. I want to assure this Committee that the motivation of our membership is to ensure due process for all concerned. We share the concerns of the Congress for the reduction and prevention of false claims and of program fraud. We seek to resolve fraud problems through appropriate legislation that will correct contractual abuses. We have always supported creative effort to improve government procurement laws and regulations. Our concerns with respect to past legislative solutions were not reflective of any single interest group, but were aimed at protecting the constitutional rights of persons accused of fraud.

As false claims and program fraud legislation is considered, however, it is important to recognize that the potential defendants in proceedings under this bill include individuals, small businesses, and non-profit organizations, as well as major corporations and contractors. The standard of knowledge required for these actions must be carefully considered. The assignment of fraud cases to administrative agencies for adjudication means that these persons will lose ths right to a jury trial and other significant protections

which have heretofore always been available. We remain concerned that, in this procees, certain minimum standards of fairness and due process are maintained.

As the Committee is aware, more than 400 atatutea and regulations already provide the Government with criminal, civil and administrative remedies to deal with contractor fraud. Numerous bills have been introduced in the 99th Congress to address these issues.

The Public Contract Law Section has been active in the consideration of S.1134 -- The Program Fraud Civil Remedies Act of 1985. Representatives of the Section testified before the Senate Committee on Government Affairs in connection with that bill. While S.1134 is clearly an improvement over earlier bills, the Section continues to have concerns about the knowledge standard and has voiced concerns regarding that and other aspects of the bill in a November 18, 1985, letter to Senator Roth (Attachments 1 and 2).

Our testimony today will focus on the appropriate knowledge standard, an issue equally applicable to the Program Fraud Bill, as reported from the Senate Committee on Governmental Affairs and to the proposed amendments to the False Claims Act, S.1562 and 1673, H.R.3334. The Program Fraud Bill is conceived as a "mini" False Claims Act, and logically the two measures should incorporate the same standard of intent. Any other result will only generate inequities and encourage forum shopping. Our Section Council will consider the

Administration's proposed False Claims Act amendments at our Midwinter Meeting. We are in the process of preparing comments, and I would request permission to furnish a detailed analysis of the Section's position on those bills to your shortly.

Let me begin by summarizing our Section's views regarding the appropriate standard of knowledge and intent which should be applicable to proceedings under Program Fraud legislation.

First, the proceeding contemplated by bills such as S.1134, is, fundamentally, an action for fraud. Like the existing False Claims Act, the bill authorizes imposition of substantial penalties and double damages on persons who submit false, fraudulent and fictitious claims to the United States. Both the nature of the charge and severity of the penalties dictate that proceedings should not lightly be initiated nor liability unfairly assessed. Whether a person is liable for fraud should hinge on that person's actual state of mind at the time of the alleged offense, and liability should require proof of culpability.

Second, we do not believe that a "specific intent to defraud" the United States should be a necessary element of liability under these bills. Instead, we agree with the overwhelming majority of courts which have ruled that proof of actual knowledge of the falsity is a sufficient prerequisite to liability under the False Claims Act.

Third, in certain circumstances, reckless conduct evincing a disregard for the truth of a statement, or deliberate efforts to shield oneself from knowledge of the falsity of a statement, may reflect sufficient culpability that actual knowledge can be inferred. Adoption of a "reckless disregard for the truth" standard of knowledge would comport with the most liberal interpretation of the False Claims Act, and would adequately protect the United States from persons who attempt to avoid liability for their deceit by deliberate efforts to keep from learning the truth.

Fourth, we strongly believe that efforts to adjudicate charges of fraud by comparison of a person's conduct to undefined and subjective standards or duties, without regard to the person's actual culpability or state of mind, are inappropriate and unfair.

Lastly, mistakes, inadvertence, negligence, and sloppiness are not fraud and should not be treated as fraud or included in the proposed legislation.

These principles are discussed more fully below.

THE PROGRAM FRAUD CIVIL REMEDIES ACT OF 1985 (S.1134)

The proposed Program Fraud Civil Remedies Act of 1985 (S.1134) is intended to create an administrative counterpart to the False Claims Act, 31 U.S.C. §3729, and would authorize administrative penalties and assessments in small fraud cases where the amount involved does not warrant liti-

gation in the District Courts. Sections 802(a)(1) and (2) of S.1134 authorize the assessment of civil penalties of up to $10,000, plus double damages, on any person who makes, presents, submits or causes to be made, presented or submitted to a Federal agency a claim or statement which he knows or has reason to know is false, fictitious or fraudulent. Section 801(a)(6) defines "knows or has reason to know" to mean that the person has actual knowledge of the falsity, or "acts in gross negligence of the duty to make such inquiry as would be reasonable and prudent to conduct under the circumstances to ascertain the true and accurate basis of the claim or statement."

Standard of Knowledge Under The False Claims Act

A starting point for considering the appropriate standard of knowledge under the S.1134 is the substantial body of case law which has developed under the False Claims Act, 31 U.S.C. §3729. The courts today are split among three different views of the appropriate standard of knowledge or intent under that statute.

The most liberal standard of knowledge was adopted by the Eighth Circuit in United States v. Cooperative Grain & Supply Co., 476 F.2d 47 (8th Cir. 1973). In Cooperative Grain, the Court adopted a "constructive knowledge" test and

held that recklessness or "carelessness in the extreme" can be deemed to reflect sufficient knowledge or intent to give rise to liability under the False Claims Act.

At the opposite end of the spectrum, both the Fifth and Ninth Circuits continue to require not only actual, rather than constructive, knowledge of the falsity, but also a specific intent to defraud the United States. See United States v. Mead, 426 F.2d 118 (9th Cir. 1970); United States v. National Wholesalers, 236 F.2d 944 (9th Cir. 1956), cert. denied 353 U.S. 930 (1957). This is by no means an outdated or obsolete view. Only four months ago, the Court in Thevenot v. National Flood Insurance Program, ___ F.Supp. ___ (W.D. La. October 10, 1985) reaffirmed the Fifth Circuit rule, stating:

> The requisite intent needed to establish a violation of the False Claims Act is well established in the Fifth Circuit. "To establish a violation of the False Claims Act, the United States must demonstrate, by a preponderance of the evidence, that the defendant possessed guilty knowledge or guilty intent to cheat the government". United States v. Thomas, 709 F.2d 968 (5th Cir. 1983); Peterson v. Weinberger, 508 F.2d 45 (5th Cir. 1975); United States v. Aerodex, 469 F.2d 1003 (5th Cir. 1972). [Emphasis added.]

An overwhelming majority of courts have rejected both of these positions and have continued to follow the middle view that proof of actual knowledge is required under the Act, but specific intent to defraud is not. See, e.g., United States v. Hughes, 585 F.2d 284 (7th Cir. 1978); United States v. Ekelman & Assoc., 532 F.2d 545 (6th Cir. 1976);

United States v. Children's Shelter, Inc., 604 F.Supp. 865 (W.D. Okla. 1985) [stating Tenth Circuit rule]; United States v. Dibona, 614 F.Supp. 4D (E.D. Pa. 1984) [stating Third Circuit rule]; United States v. Alaska, 591 F.Supp. 794 (N.D. Ill. 1984); Alsco-Harvard Fraud Litigation, 523 F.Supp. 790 (D.D.C. 1981). In Ekelman, 532 F.2d at 548, for example, the Sixth Circuit refused to adopt a "recklessness" or "should have known" standard, stating:

> Thus, the law of this Circuit requires a showing of actual knowledge to establish liability under the False Claims Act. This appears to be the preponderant view.

The distinctions between these different views are best explained in Alsco-Harvard, 523 F.Supp. at 806. After identifying the various interpretations, the Court stated:

> The preponderant, and better view, however, is that the Act only requires that the defendant knowingly present a false claim to the Government.
>
> * * *
>
> Despite the fact that plaintiff need only prove that defendants had knowledge of the submission of false claims and not a specific intent to deceive the Government, the United States must prove that defendants had "actual knowledge". It is not enough to allege that defendants knew "or should have known" that certain claims presented to the Government were false, fictitious or fraudulent. [Emphasis added.][1]

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[1] The predominance of the "actual knowledge" standard under the False Claims Act is recognized in the memorandum submitted for the Hearing record on S.1134 by HHS Inspector General Richard P. Kusserow. See Hearing before the Subcommittee on Oversight of Government Management on S.1134, 99th Cong., 1st Sess. (1985), at 202 [hereafter "Hearing"]. The Kusserow Memorandum identifies the vsrious interpre-

THE COOPERATIVE GRAIN DECISION

Although it remains a minority interpretation of only one circuit of the False Claims Act, the Cooperative Grain decision has become the principal legal foundation for the various constructive knowledge standards proposed for S.1134. It has been suggested that Cooperative Grain both imposes an independent duty to investigate questions of eligibility for Federal programs, and creates liability for double damages and statutory forfeitures for negligent failures to fulfill this duty. This argument substantially overstates the Cooperative Grain decision.

In Cooperative Grain, a grain storage cooperative, its managing officer, and several grain producers, obtained Federal price support payments for grain which they had purchased rather than grown. The program regulations required that to be eligible, the grain was required to have been grown by the claimant. The issue was whether the defendants "knew" that they were ineligible for price supports at the time they submitted their claims.

> The question here then would be whether the defendants' "clumsiness" or "carelessness and foolishness in the extreme" constitute conduct that the court can deem to create sufficient knowledge or awareness under the False Claims Act to

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tations, and concludes "The predominant view in most circuits requires actual 'knowledge'." The Memorandum continues by discussing the Cooperstive Grain decision, concluding, "This minority view has not been widely followed."

be civilly actionable. 476 F.2d at 56.

The evidence did not indicate that the defendants had merely been mistaken about their eligibility or that they had acted in good faith. Several of the defendant producers admitted that they knew that only produced grain was eligible. Id. at 60. Several of the producers had also been officers of the Cooperative and were well familiar with the program. None of the producers had so much as asked the local Commodity Credit Corporation office whether the purchased grain was eligible. Id. The number of farmers who had tried to substitute purchased for produced grain was small. Id. at 61. In the end, the Court of Appeals simply did not believe the defendants' claims of innocence, stating:

> [I]t is incredible that the producers did not know that purchased grain was not eligible for price support. Id. at 60 [emphasis added].

The Court did not hold that the defendants were liable under the False Claims Act because they had been negligent, but, to the contrary, held that the defendants were "a full step beyond negligent misrepresentation". The Court explained:

> The defendants' conduct, as the District Court held, was extremely careless and foolish. That conduct is not only negligent but approaches fraud, an intentional misrepresentation. The intent to deceive of a fraudulent misrepresentation may include a reckless disregard for the truth or falsity of a belief. Id. at 60. [emphasis added.]

Thus, the Cooperative Grain decision stands for the proposition that an "extremely careless" or "reckless" disregard for the truth of a statement is equivalent to actual knowledge of its falsity. The decision does not adopt a "negligence" standard of liability, nor sanction liability for fraud based upon comparison with a subjective "reasonable and prudent" duty of inquiry. Most importantly, the decision does not purport to penalize an individual who fails to read all of the pertinent regulations prior to seeking a benefit from the Government in the absence of proof of some personal culpability or bad faith. The decision does not support the definition of "knows or has reason to know" presently contained in S.1134.

Reckless Disregard For The Truth Is The Appropriate Standard Of Intent Under S.1134

Until the Department of Justice letter to Senator Cohen dated August 2, 1985 (Hearing at 158), the minimum appropriate standard of intent under both the False Claims Act and Program Fraud Civil Penalties Act had been viewed by most parties--including the Justice Department--to be "reckless disregard for the truth". For example, in 1980, the Senata Judiciary Committee approved amendments to the False Claims Act proposed by the Department of Justice which defined knowledge to mean that the person had actual knowledge, or "had constructive knowledge in that the defendant acted in reckless disregard for the truth." S.1981, 96th Cong., 2d

Sess. The Judiciary Committee report on that bill recognized that this standard is sufficient to encompass those "ostriches" who attempt to shield themselves from knowledge of or involvement in a fraud, stating:

> Section 2 of the bill, which is intended to embody all of the requisite elements for liability under the Act, excludes elements of common law fraud such as intent and reliance from this statutory cause of action. The Committee intends that knowledge of falsity shall constitute the basic element giving rise to liability. Section 2 accordingly embraces situations in which the evidence establishes that the defendant had actual knowledge of the falsity, as well as cases in which the defendant had constructive knowledge of the falsity in that he acted in reckless disregard of the truth. With regard to this constructive knowledge standard, the language of the bill is sufficiently broad in scope so as to encompass the person who seeks payment from the government without regard to his eligibility and with indifference for the requirements of eligibility, or who certifies information to the government in support of his claim with neither personal knowledge of its accuracy nor reasonable investigative efforts. It also encompasses the individual who would hide behind a shield of self-imposed ignorance.
> S.Rep. No. 96-615, 96th Cong., 2d Sess. (1980) at 5-6 [emphasis added.]

Again in 1982, Assistant Attorney General J. Paul McGrath, testifying in support of S.1780--the proposed Program Fraud Civil Penalties Act--explained the "knowledge" requirement as follows:

> This element of scienter--in this context knowledge of the falsity of the claim or statement--encompasses both actual knowledge of the falsity and conduct evincing a reckless disregard of whether or not a given representation is false. In this respect, the scienter provisions of the bill

> parallel those of the False Claims Act.... S.1780 thus in our view wisely includes reckless disregard of the truth as part of the scienter requirement of the bill. [emphasis added.]

Most recently, in the section-by-section analysis submitted by the Attorney General to the Vice President on September 16, 1985, with the Administration's proposed False Claims Act Amendments, the view was again expressed that "knows or had reason to know" means "reckless disregard" for the truth. The analysis states:

> Under the amendment, a contractor who knew that a claim was false, or who acted in reckless disregard of the truth in submitting the false claim, would be equally liable. The amendment repudiates a requirement that the government prove specific intent to defraud, as is required at common law. We believe this is the better view of the drafters of the original act and is the majority view in the courts today.

Indeed, the negligence or "reasonable and prudent" standard currently contained in S.1134 is inconsistent with Assistant Attorney General Willard's testimony on this bill. Mr. Willard, in defining the "knows or has reason to know" standard, testified:

> We don't regard that as being a specific intent requirement at all. We think it does require something more than an innocent mistake. It does require a showing of some kind of deliberate act or fault on the part of the individual. Hearing at 9 [emphasis added].

In providing examples of "reason to know," Mr. Willard continued:

> I think it would include a situation, for

> example, where a responsible person deliberately insulated himself from knowledge by structuring the corporate affairs in a way that he was deliberately shielded from knowledge of the falsity of a claim or statement submitted by his subordinates.
>
> * * *
>
> But another situation would be where the responsible person was reckless in submitting a claim without taking the appropriate steps to determine whether or not it was false. Hearing at 15. [emphasis added.]

Mr. Willard's testimony supports the conclusion that "reason to know" should require some deliberate or conscious act, and properly encompasses reckless disregard of truth or falsity and deliberate ignorance.

The Justice Department in its August 2 letter, advocated for the first time a substantially reduced negligence standard. The Department would not only apply a "gross negligence standard but would ignore the individual's culpability or state of mind by inventing a subjective "duty of inquiry." (Hearing at 160). This standard, if adopted, would significantly decrease the standard of intent necessary to impose penalties on persons for false claims or statements over that existing at common law or under the False Claims Act.

An excellent discussion of the distinction between "negligence" and "knowledge" is contained in Computer Systems Eng., Inc. v. Quantel Corp., 571 F.Supp. 1365, 1374-77 (D. Mass. 1983), aff'd 740 F.2d 59, 67-68 (1st Cir. 1984).

> Negligence--even gross negligence--is determined by an objective standard. In determining negligence, we use the hypo-

> thetical conduct of a creature of the law--an ordinary prudent person--as a standard for comparison of the person being judged. By that standard, one who should have known a fact but did not is negligent. In contrast, the standard prescribed by "willful" as well as the standard prescribed by "knowing", is a state-of-mind standard that requires the fact finder to determine not whether a defendant should have had that state of mind, but whether in fact the defendant did have that state of mind. Even though evidence that an ordinarily prudent person would have known, and that defendant should have known, may be received as circumstantial evidence that the defendant did know, the question the fact finder must answer is whether in fact the defendant did know.
>
> * * *
>
> To prove that the defendant committed a knowing violation by fraud, the plaintiff may show that agents of the defendant knew that the fact they represented to be true was not true. Similarly, to prove that the defendant committed a willful violation by fraud, the plaintiff may prove that agents of the defendant knew that they did not know whether the fact represented was true or false--that they made the representation without knowing whether it was true or false and with reckless disregard for whether it was true or false. Though not the equivalent of proving the state of mind of knowing the falsity of the fact represented, this is nevertheless proof of a culpable state of mind--the state of mind of willful disregard for truth or falsity of the fact represented. [Citations and parentheticals omitted, emphasis added.]

The necessity of focusing on the defendant's actual state of mind, rather than on a "reasonable and prudent man" standard, is plain from the definitions of "culpability",

"recklessly" and "knowledge" in the Model Penal Code, §202. The Model Penal Code defines four decreasing stages of culpability: (a) "Purposely", (b) "Knowingly", (c) "Recklessly", and (4) "Negligently." "Recklessly" is defined as follows:

> A person acts recklessly with respect to a material element of an offense when he consciously disregards a substantial and unjustifiable risk that the material element exists or will result from his conduct. The risk must be of such a nature and degree that, considering the nature and purpose of the actor's conduct and the circumstances known to him, its disregard involves a gross deviation from a standard of conduct that a law-abiding person would observe in the actor's situation. [emphasis added.]

There is a substantial body of case law equating "reckless disregard" with knowledge in a variety of contexts. Among other things, reckless disregard of the truth is sufficient to impose liability for False Statements under 18 U.S.C. §1001 and False Claims under 18 U.S.C. §287 (see United States v. White, 765 F.2d 1469 (11th Cir. 1985)) and mail fraud under 18 U.S.C. §1341 (see United States v. Dick, 744 F.2d 546 (7th Cir. 1984)); to prevent discharge of a debt in bankruptcy (see Birmingham Trust National Bank v. Case, 755 F.2d 1474 (11th Cir. 1985 ["reckless disregard" equals "false representation"]); to challenge the validity of an affidavit supporting a search warrant (see Franks v. Delaware, 438 U.S. 154 (1978) and United States v. Helmel, 769 F.2d 1306 (8th Cir. 1985)); and to establish liability for libel or slander (see McDonald

v. Smith, 105 S.Ct. 2787 (1985) and New York Times v. Sullivan, 376 U.S. 254 (1965) [reckless disregard equals actual malice]).

Similarly, "knowledge" is defined in Model Penal Code §2.02(7) as follows:

> When knowledge of the existence of a particular fact is an element of an offense, such knowledge is established if a person is aware of a high probability of its existence, unless he actually believes that it does not exist. [emphasis added.]

This standard has been applied by the Supreme Court and other courts in a variety of contexts. See, e.g., Turner v. United States, 396 U.S. 398, 416 n. 20 (1970); Leary v. United States, 395 U.S. 6, 45 n. 93 (1969); United States v. Restrepo-Granda, 575 F.2d 524, 528 (5th Cir.), cert. denied, 439 U.S. 935 (1978). S.1134, on the other hand, would permit liability to be premised on constructive knowledge, even if the person actually believed that his statements were true.

In Restrepo-Granda, the Fifth Circuit also held that "deliberate ignorance" was encompassed within the broader requirement of knowledge, and defined it as follows:

> The term as used denotes a conscious effort to avoid positive knowledge of a fact which is an element of an offense charged, the defendant choosing to remain ignorant so that he can plead lack of positive knowledge in the event he should be caught.

Many other decisions have adopted and explained the "deliberate ignorance" test. For example, in United States v. Jewell, 532 F.2d 697 (9th Cir.) (en banc), cert. denied, 426 U.S. 951 (1976) [on which the so-called "Jewell instruction" on deliberate ignorance is based], defendant was charged with "knowing" possession of a controlled substance after he was arrested driving an automobile containing 110 pounds of marijuana in a secret compartment. Defendant testified that he did not know the drugs were in the car. Evidence indicated, though, that he was aware of the secret compartment and of facts suggesting drugs were present, but had "deliberately avoided positive knowledge of the presence of the contraband to avoid responsibility in the event of discovery." Relying in part on the Model Penal Code, the Court did not hesitate to find that the "knowledge" element of the statute had been satisfied. The Court explained the "deliberate ignorance" rule as follows:

> The substantive justification for the rule is that deliberate ignorance and positive knowledge are equally culpable. The textual justification is that in common understanding one "knows" facts of which he is less than absolutely certain. To act "knowingly" therefore, is not necessarily to act only with positive knowledge, but also to act with an awareness of a high probability of the existence of the fact in question. When such awareness is present, "positive" knowledge is not required. 532 F.2d at 700.

See also, United States v. MacKenzie, 777 F.2d 811, 818-19 (2d Cir. 1985); United States v. Henderson, 721 F.2d 276, 277-279 (9th Cir. 1983).

The Model Penal Code's definition of "negligently", on the other hand, eliminates the requirement that the person "consciously disregard" the risk, and substitutes instead the mere requirement that he "should be aware" of the risk. "Negligence" also eliminates the defense that the person actually believes that his statement is truthful. Thus negligence requires no examination of the person's actual state of mind, and penalties may be imposed on a person who, while acting in good faith, fails to live up to a "reasonable man" standard of conduct. This is the standard adopted by S.1134.

THE PROPOSED STANDARDS

At least seven different standards of knowledge have been proposed for S.1134. These proposals can generally be separated into two groupings. Several of the proposals are similar in that they would impose a "duty of inquiry" on persons submitting statements or claims to the United States, and would impose substantial liability on persons who breach, "grossly neglect" or "recklessly disregard" that duty of inquiry. We believe this test is inappropriate in legislation such as S.1134.

Application of a subjective "duty of inquiry" circumvents any examination of the defendant's actual state of mind or culpability, and penalties could be imposed if a person is found to have violated this undefined duty, even though the person actually believed his statements to be true and acted in good faith. In effect, each of these standards would eliminate from the Model Penal Code definition of "knowledge" the caveat that, regardless of the circumstances, a person should not be deemed to "know" a fact which he honestly and actually believes does not exist.

The "duty to investigate" sought to be imposed by S.1134 is unrealistic and unfair, particularly when substantial penalties will be meted out for negligent violations of the duty. As Justice Jackson stated long ago:

> To my mind, it is an absurdity to hold that every farmer who insures his crops knows what the Federal Register contains or even knows that there is such a publication. If he were to peruse this voluminous and dull publication as it is issued from time to time in order to make sure whether anything has been promulgated that affects his rights, he would never get time to plant any crops. Federal Crop Ins. Corp. v. Merrill, 332 U.S. 380, 387 (1947) [dissenting opinion].

Examples of situations which may realistically give rise to liability under S.1134 include the small businessman, farmer, or student, who applies for Federal assistance in the same manner as in previous years, but is unaware of a change in rules which render him ineligible. The person does not

know that his claim is false, and has no reason to doubt the validity and accuracy of his claim, yet he could easily have verified his eligibility by checking publicly available regulations. While this person could be characterized as "grossly negligent," he has no intent or culpability and has not in any sense defrauded or attempted to defraud the United States. Nonetheless, this person could be subjected to substantial penalties under S.1134.

Similarly, a corporate officer who, relying in good faith on his subordinates, signs a claim which he truly believes is accurate, could later be severely penalized for "fraud" under S.1134 if a hearing examiner, months or years later, determines that a "reasonable and prudent" person would have checked further. This result is unfair and unwarranted.

The appropriate standard must properly rest the question of knowledge on the defendant's actual state of mind. By adopting a definition of knowledge which includes (1) actual knowledge, (2) deliberate ignorance, and (3) reckless disregard for the truth, the proposed legislation would reach those individuals who intentionally make false claims, as well as persons who evidence personal culpability by a reckless disregard for the truth of their statements, or by deliberate efforts to avoid learning the truth. For example, an individual who purposely provides information on an application with no basis whatsoever for knowing whether it is accurate or not, or a businessman who deliberately avoids maintaining

records and is thereby unable to verify his claim, have committed an intentional act which is more than sufficient to reflect a culpable state of mind. We agree that these persons should appropriately be encompassed within the proposed legislation. At the same time, basing liability on the defendant's state of mind rather than a subjective "duty" test will protect individuals who, while inattentive, actually believe in good faith that their statements are true.

A more appropriate standard under S.1134 and any false claims proposal would be the following definition of knowledge:

> "knows or has reason to know" means that a person, with respect to a fact --
>
> (A) has actual knowledge of the fact; or
>
> (B) acts in deliberate ignorance of the truth or falsity of the fact; or
>
> (C) acts with reckless disregard of the truth or falsity of the fact.

This definition provides both the greatest clarity and sufficient breadth to include all persons who attempt to wrongfully obtain money or property from the United States.

As this Subcommittee continues its deliberations on false claims and fraud legislation, the American Bar Association encourages you to examine closely the question of scienter. As lawyers we are deeply concerned that wrongdoers be brought to justice but wish fervently to protect the rights of innocent parties.

Prior to the adoption of any new legislation, we urge you first to consider the plethora of existing statutory restraints applicable to taxpayers, federal and military employees, grantees, contractors, and all who receive some form of government assistance. We are preparing a detailed analysis of H.R.3334, the Administration's False Claims Act and would request that we be permitted to submit it for the Record within the next few weeks.

The ABA looks forward to working with the members of the Subcommittee and your colleagues in the House to explore these important issues.

We appreciate the opportunity to appear here today and would be pleased to respond to any questions you may have.

* * *

59-415 O - 86 - 16

Mr. GLICKMAN. Do you have any thoughts with reference to my previous comments with Mr. Breger in reference to the administrative law issues?

Ms. WILLIAMS. We strongly support the position that the Administrative Conference has taken on the need for independent judges and in previous testimony we have supported the use of ALJ's in agencies that do not currently use them. We agree with your analysis that it would be important that agencies who use ALJ's use them so that the independence that currently attaches to an ALJ as a decisionmaker would carry over to the program fraud area. Specifically, with respect to the Department of Defense, the issue has arisen in a number of instances in identifying hearing examiners to be the equivalent of an ALJ. The indicia of the designee as spelled out, for example, in the Cohen bill, would be one way of addressing these concerns. Using the due process protections of the Administrative Procedure Act would also be another way of doing it.

Mr. GLICKMAN. The basic requirements of the Administrative Procedure Act and whatever format was used by the Department of Defense.

Ms. WILLIAMS. Exactly. The legislation would specify, if someone was designated, that an ALJ designee would be cloaked in the procedural protections—the due process protections—of the APA.

Mr. BROWN. With regard to the questions you raised earlier regarding military officers, I think our concern has been directed at making sure the hearing examiners are truly a body of independent, preferably full-time hearing examiners who have no other function serving as part-time procurement officials so they should not serve as hearing examiners on program fraud hearings on contracts; and I suppose there is a question whether military officers, because of the line of command and so forth, could ever have a sufficient independence to be acting as hearing examiners in that context.

Mr. GLICKMAN. I think that is an important question.

The other one is the qui tam provisions. Do you support the qui tam provisions that we talked about earlier, the expanded provisions that Mr. Berman and others talked about and as discussed by Mr. Gravitt's attorney?

Ms. WILLIAMS. Mr. Chairman, the American Bar Association and the section have not taken a formal position on the qui tam provisions. I will be happy to submit the position for the record for you after the Public Contract Law Council has had a chance to look at the provisions in pending bills.

Mr. GLICKMAN. My thinking is that something along those lines is going to make it into whatever bill we produce over here, so you ought to give us your thoughts on that.

Ms. WILLIAMS. We will be happy to.

Mr. GLICKMAN. Thank you very much.

That concludes the hearing today. We will no doubt be pursuing this subject further, however.

The hearing today is adjourned.

[Whereupon, at 2:20 p.m., the subcommittee was adjourned.]

[The following statements were submitted to the Subcommittee on Administrative Law and Governmental for inclusion in the

record of the hearings held on February 5 and 6, 1982, relating to false claims:]

STATEMENT

NATIONAL ASSOCIATION OF MANUFACTURERS

SUBMITTED TO
THE SUBCOMMITTEE ON ADMINISTRATIVE LAW
AND GOVERNMENTAL RELATIONS

COMMITTEE ON THE JUDICIARY
U.S. HOUSE OF REPRESENTATIVES

FEBRUARY 20, 1986

Thank you for agreeing to hold open the record for your recent hearings regarding the problems of fraud in government programs, and various legislative proposals offered as remedies. Since you have before you several legislative proposals and since Chairman Glickman indicated during the hearing that he would be offering a new proposal, this statement will serve more to deal with the issues, concerns and alternative suggestions.

The National Association of Manufacturers is a voluntary business association of over 13,000 corporations, large and small, located in every state. Members range in size from the very large to over 9,000 smaller manufacturing firms, each with an employee base of less than 500. NAM member companies employ 85 percent of all workers in manufacturing and produce 80 percent of the nation's manufactured goods. NAM is affiliated with an additional 158,000 businesses through its Associations Council and National Industrial Council.

Because the membership of the NAM is representative of all types of manufacturers, we believe we can offer a unique perspective on this issue. Certainly, fraud of any sort against the government, or any consumer, is deplorable and cannot be condoned. In the case of defrauding the government, which is the present concern of the Subcommittee, it is all taxpayers, corporate and individual, who are the ultimate losers.

All acts of substantiated and provable fraud should and must be prosecuted to the extent feasible. The NAM recognizes that much too often the amount of money involved which would be recoverable is not sufficient for a local U.S. Attorney to pursue a court action and agrees in principle with the thrust of a majority of the bills proposed so far that administrative remedies may be the best means for prevention of fraud involving relatively small sums of money.

We take strong exception, however, to proposals which threaten basic civil liberties and the right to due process for individuals as well as corporations or which would otherwise hamper the efficient operation of normal business procedures.

One of the most serious threats to legitimate businessmen, in many of the proposed legislative solutions, is the definition of the standard of knowledge. At a minimum, the standard of knowledge for a successful finding of fraud should be "reckless disregard for the truth." As detailed in the statement by the Section of Public Contract Law of the American Bar Association, the case law defining "reckless disregard" contains the act of "deliberate ignorance." Within its scope, "knows or has reason to know" language would be a

reasonable standard for legislation such as H.R.3317, and H.R.3334, and would seem to comply with the reckless disregard criteria. However, the definition is refined to lower the standard to one of "gross negligence," which would not necessitate a finding of intent to be held liable; further, "gross negligence" includes a failure to pursue a line of inquiry regarding the complete accuracy of a statement made to the government. You can certainly appreciate the fact that most businessmen, like most Members of Congress, rely on subordinates or other sources of information believed to be trustworthy. This is how it should be. Neither a manager or corporate officer in a large corporation nor the head of a small business has the time personally to oversee and review the derivation of every fact or figure for a document, yet the standard proposed in these bills would hold him personally liable for fines.

Other major difficulties with the proposals are in the areas of due process and civil liberties, which would be abridged by the granting of subpoena power. At the hearing, the Inspector General of the Department of Health and Human Services testified to the benefits of the Civil Monetary Penalties Law (CMPL) applicable to Medicare and Medicaid. Please note that CMPL does not grant any testimonial subpoena power. The granting of testimonial subpoena power to Inspectors General should not be undertaken without careful and considerate deliberation, particularly since the experience under CMPL shows it is not necessary. Since the solution to fraud contained in the proposed bills relies on administrative proceedings, the accused no longer would have the protections of a court or a grand jury to ensure that his civil liberties are not violated during the investigation or the proceedings.

It is in the best interest of justice that the right to a full hearing should attach as a matter of right and would have to be waived instead of requested since it is conceivable that someone with insufficient knowledge of the process could be reluctant to exercise this right. In addition, full discovery rights must be available to the accused and not limited, as stated in Section 803(f)(3)(B)(ii) of S.1134, "to the extent that the hearing examiner determines that such discovery is necessary for the expeditious, fair, and reasonable consideration of the issues." In light of the fact that the government's burden of proof would be lowered from the present "clear and convincing evidence" standard to one of "a preponderance of the evidence," discovery rights take on added importance.

While all of the current bills offered claim to be civil, and not criminal, in nature, S.1562 allows for the arrest and posting of bail for a person accused of fraud. By implication, this provides for imprisonment of the accused if he cannot post bail. This is especially threatening given the fact that intent to defraud is not a necessary element for a finding of fraud.

Additionally, appeals of agency findings must be made more accessible than to the U.S. Court of Appeals. While it is true that a common intent of the current proliferation of fraud legislation is to relieve the District Court caseload and to secure some sort of action since many local U.S. Attorneys do not consider allegations of fraud of less than $100,000 worth the time and effort of prosecution, perhaps the Administrative Law and Governmental Relations Subcommittee could arrive at a compromise whereby appeals could be made to the District Court.

Regarding revision of the current qui tam provisions of the False Claims Act, the NAM would caution the Subcommittee against a full-scale reimplementation. Although in certain cases this course of action may be the only recourse to initiate fraud proceedings, care must be taken to ensure that harassment or frivolous lawsuits do not proliferate. A key ingredient would include a prohibition against qui tam suits based on information currently under review or resolved by governmental entities and/or has become public information. The impact of qui tam has not been adequately reviewed to determine its effectiveness and until that is done the existing provisions should not be broadened.

Since the full Judiciary Committee will soon begin consideration of reforming the Racketeer Influenced Corrupt Organizations Act (RICO), it is in a good position to understand the importance of resisting the temptation to rush into the hasty implementation of ill-conceived legislative solutions to such a complex issue. RICO was enacted in 1970 with the uncontroversial goal of weeding out organized crime from American businesses. However, legitimate businessmen with absolutely no ties to organized crime recently have become subject to the harsh civil provisions of the RICO statute due to broad language which was intended to make prosecutions easier. The courts have stated that their "hands are tied," and it is up to Congress to correct the original statute to prevent continued misuse of the law. Let us not make the same mistake with anti-fraud legislation.

In summary, the National Association of Manufacturers, on behalf of its membership, supports the elimination of waste and fraud from all government programs as a means of ensuring the wise and efficient use of tax monies paid into the national treasury. However, care must be exercised during the legislative process so that normal business procedures are not jeopardized and civil liberties and due process rights are not violated. We appreciate the careful approach which the Subcommittee indicated it will take during the recent hearings and the opportunity to submit this statement for the record. We are certainly willing and available to work with you and your staff to develop a well-reasoned and balanced approach to the problem of government program fraud.

NATIONAL CONFERENCE
OF
BOARDS OF CONTRACT APPEALS MEMBERS
P.O. BOX 23330 • WASHINGTON, DC 20026-3330

February 14, 1986

Honorable Dan Glickman
Chairman, Subcommittee on Administrative Law
and Government Relations
House Judiciary Committee
Room B351 A Rayburn House Office Building
Washington, DC 20515

Dear Congressman Glickman:

On behalf of the National Conference of Boards of Contract Appeals Members, thank you for the opportunity to comment on H.R. 3335, the Program Fraud Civil Penalties Act of 1985. We would like our comments to become part of the permanent record, if you deem it appropriate.

The Conference is an organization comprised of administrative judges serving on boards of contract appeals. As program fraud cases will arise in areas related to the jurisdiction conferred on boards of contract appeals by the Contract Disputes Act of 1978 (the Act), 41 U.S.C. § 601-613, we believe that the boards could be of service in providing administrative due process in program fraud cases.

In passing the Act, Congress was mindful of contract claims as a potential source of fraud, as section 5 of the Act, 41 U.S.C. § 604, "Fraudulent Claims," is expressly addressed to that subject. Under current procedures, boards do not finally adjudicate alleged infractions arising under section 5. However, judges on boards have routinely dealt with issues involving fraud in contract performance under the standard "Inspections" clause. That clause, which has been substantially unchanged for decades, provides that final contract acceptance will not be conclusive where fraud is involved. Boards have also routinely dealt with contract cost principles, which we believe to be an area of concern under H.R. 3335. Thus, we believe contract disputes should be a subject of significant consideration in creating a legislative plan for program fraud, and that judges on the boards of contract appeals should play a role in that plan.

Specifically, we believe the administrative judges serving on the boards should be expressly included in section 801(a)(8) of H.R. 3335 under the definition of "hearing examiner." The boards presently adjudicate contract appeals involving billions of dollars annually and have extensive experience conducting hearings and providing fair and impartial administrative due process. We note that a parallel bill, S. 1134, the Program Civil Remedies Act of 1985, contains a more detailed definition of hearing examiner, including specific reference to protection from removal. A recent GAO report* raised the issue of removal protection for board members under the Act. Under the GAO interpretation, the administrative judges serving on boards of contract appeals would not meet the criteria of S. 1134. We not believe the Act was properly interpreted in the GAO report. See the memorandum enclosed as Exhibit A supporting the Conference's position that board members have retention rights under the Act. However, it has been reported that the Senate Governmental Affairs Committee is submitting legislation to clarify the Act so that board members would unquestionably have the same retention rights as administrative law judges. See Exhibit B enclosed. Thus, even under the GAO interpretation of the Act and the Senate's definition of hearing examiner, board members would be qualified to adjudicate program fraud cases if the clarifying amendment is enacted before or concurrent with H.R. 3335.

We also believe that the boards of contract appeals are appropriate forums to resolve program fraud cases for reasons of administrative efficiency as well as expertise. Initially, at least, we would expect the caseload to be relatively small and capable of being absorbed by the existing boards without increasing the number of administrative judges, with the possible exception of the Armed Services Board of Contract Appeals. Thus, there would be no need to create a new forum to provide administrative due process, and no corresponding need to dismantle an elaborate administrative mechanism if experience later proved the need for a different approach. Additionally, agencies with boards of contract appeals but no administrative law judges could use their boards for program fraud cases.

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*Report to the Chairman, Committee on Governmental Affairs, United States Senate, The Armed Services Board of Contract Appeals Has Operated Independently, GAO/NSIAD-85-102, September 23, 1985.

Accordingly, the Conference respectfully suggests that the first sentence of the definition of hearing examiner in Section 801(a)(8) of H.R. 3335 be amended to read as follows:

> 'hearing examiner' means an administrative law judge, a member of a board of contract appeals appointed pursuant to 41 U.S.C. 607, or ...

We believe this amendment will serve to implement the objectives of H.R. 3335. If the Conference can provide additional information or if a meeting with you or your staff is deemed advisable, please call me at 453-2890.

Sincerely,

Carroll C. Dicus, Jr.
President

Enclosures

cc: Janet Sue Potts, Esq., w/encls.

Memorandum on Removal Of BCA Members Under the Contract Disputes Act of 1978

The specific statutory language upon which this memorandum is focussed appears in Sec. 8 (b) (1) of the Contract Disputes Act of 1978 (the Act), 41 U.S.C. 607 (b) (1):

> "...members of agency boards shall be selected and appointed to serve in the same manner as hearing examiners appointed pursuant to section 3105 of title 5 of the United States Code..."

A recent GAO report [1] ponders the Congressional intention behind this language, while noting that use of "to serve" may indicate "...a Congressional reliance more upon the manner of service, e.g., the rendering of quasi-judicial opinions without threat of the member being summarily removed..." [2] Thus, while specifically questioning the position espoused by the Conference elsewhere in the report, [3] the GAO echoes that position in the above quote. [4]

The GAO report also notes the legislative intent to ensure independence so that board members "...would not be subject to direction or control by procurement agency authorities." [5]

1/ Report to the Chairman, Committee on Governmental Affairs, United States Senate. The Armed Services Board of Contract Appeals Has Operated Independently, GAO/NSIAD-85-102, September 23, 1985.

2/ Id. at 14.

3/ Id. at 16.

4/ Id. at 18.

5/ S. Rep No. 95-118, 95 Cong., 2nd Sess. 23, reprinted in 1978 U.S. CODE CONG. & AD.NEWS 5257.

The GAO report concludes, however, that it was "not implausible" Congress intended independence to come about solely through the appointment of candidates who show promise of acting independently.[6/] We submit that it is implausible Congress relied solely upon appointment of independent-minded people to be board members as a dependable means of ensuring independence in the decision-making process. A matter as crucial to the objectives of the Contract Disputes Act as the independence of boards - it is the "principal purpose" behind emulating the administrative law judge system[7/] - could not logically be implied to rest upon anything as elusive as the ability to predict future independence of candidates during the selection and appointment process.

The Conference also finds support for its position in the Congressional intention that the administrative law judge system, for which removal protection is a keystone, was "...perceived as a model for assuring [the] requisite independence. The intent [of the Act] is to establish a corps of contract appeals board memebers comparable to that system."[8/] Moreover, the Office of Personnel Management originally supported our reading of the Act and specifically proposed removal procedures before the Merit Systems Protection Board in 1979 (see Exhibit 1).

6/ GAO Report, supra at 15.

7/ S. Rep., supra at 24, 5238.

8/ Id.

The House Report also places emphasis on independence and refers to new standards for "selection [and] tenure" in the bill to increase independence. It goes on to state "...[t]hese boards will function with the independence of trial courts..." 9/ The House Report also incorporates a comment from HUD that a manifestation of Board independence "...is that there has been no political interference in their operations..." 10/

The intention to make boards independent is antithetical to continuation of their agencies right to remove individual judges without a hearing or a showing of good cause. Removal protection of the type afforded to administrative law judges is essential to ensuring independence. Without it, an agency has an imposing weapon with which it can easily reverse the independence attained through the most successful of selection procedures - by simply firing judges whose decisions they disagree with until the agency gets the desired mindset on its board. We believe the many statements about independence in the committee reports can reasonably be read in context only as embracing removal protection for administrative judges serving on boards of contract appeals.

While the reports constitute the most persuasive portion of the legislative history, other sections reinforce the emphasis on independence. In the Senate hearings, Senator Chiles discussed

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9/ H.R. 1556, 95th Cong., 2d Sess. 12.

10/ Id. at 71.

the role of the Office of Federal Procurement Policy, and the discontinuance of boards based solely on workload and not displeasure with the way cases are decided.[11/] See also Senator Metzenbaum's opening statement relative to the board's increased independence from their agencies.[12/] The hearings also contain statements from represenatives of the American Bar Association[13/] and the Associated General Contractors[14/] to the effect that board independence is necessary. The House hearings contain testimony on behalf of the Justice Department supporting the need for independence.[15/]

Finally, in the Senate debates, Senator Byrd "[a] major thrust of [the Act] is to make agency boards more prestigious and independent."[16/]

On balance , we believe the foregoing amply demonstrates

11/ Contract Disputes Act of 1978: Joint Hearings Before the Subcommittee on Federal Spending Practices and Open Government of the Committee on Governmental Affairs and the Subcommittee on Citizens and Shareholders Rights and Remedies of the Committee on the Judiciary, United States Senate, on S. 2787, S. 3178, 95th Cong. 2d Sess. (June 14 and 20, 1978) at 79-80.

12/ Id. at 4.

13/ Id. at 125.

14/ Id. at 144.

15/ Hearings Before the Subcommitte on Administrative Law and Governmental Relations of the Committee on the Judiciary, House of Representatives, 95th Cong., 1st Sess. on H.R. 6e4 and Related Bills (November 10 and 11, 1977) at 97.

16/ 43 CONG. REC. S 18e41 (daily ed. Oct.12, 1977).

Congressional concern about board independence, and the legislative intent that board independence be ensured. It is n possible to ensure independence unless the administrative judges serving on those boards know that a decision causing agency ire will not result in summary dismissal. Thus, we believe the original intent of the Act should be clearly implemented oy an amendment specifically providing the same removal protection to board members as administrative law judges now enjoy, for unless Congress acts, the Office of Personnel Management has left no doubt that it will continue to treat board memebers as subject to summary dismissal.

United States of America
Office of Personnel Management Washington, D.C. 20415

JUL 11 1979

Honorable James T. McIntyre, Jr.
Director, Office of Management
and Budget
Old Executive Office Building
17th and Pennsylvania Avenue, N.W.
Washington, D.C. 20500

Subject: Selection, Performance Appraisal, and Personnel Action Procedures for Boards of Contract Appeals

Dear Jim:

This letter discusses the approach recommended to implement the requirement in section 8(b)(1) of the Contract Disputes Act that members of boards of contract appeals be selected and appointed to serve in the same manner as administrative law judges. Its purpose is to provide background information and to support my recommendation that the accompanying letter be sent to all affected agencies.

I. The Statutory Requirements

The Contract Disputes Act of 1978, P.L. 95-563, 92 Stat. 2383, was enacted to provide a fair, balanced and comprehensive statutory system of legal and administrative remedies in resolving Government contract claims.1/ Section 8(b)(1) of that Act provides that the members of agency boards shall be selected and appointed to serve in the same manner as administrative law judges. The purpose of this section is to ensure the independence of contract appeals board members as quasi-judicial officers.2/ Congress' intent was not to require that every detail of the administrative law judge system be adopted but, rather, that a comparable system be established.3/

In implementing this statutory requirement, we have been guided by two principal concerns: (1) protecting the independence of board members; and

1/ S. Rep. 95-1118, 95 Cong. 2d Sess. 1 (1978).

2/ S. Rep. supra, 24.

3/ Id.

(2) providing the regulatory flexibility needed to prevent the reenactment of problems with the current ALJ system. As a result, we strongly believe that board members should remain in the excepted service. Placing them in the competitive service would decrease their independence because agencies would be required to appraise the performance of individual board members.4/ This appraisal would have to be taken into account in any personnel action involving members.5/

Placement of board members in the excepted service provides the regulatory flexibility required to meet the needs of the boards. For example, it allows the use of category rankings described in the interim selection procedures designed by OPM's Personnel Research and Development Center6/; the modification of performance appraisal requirements; and the modification of adverse action and unacceptable performance procedures. This freedom will permit us to set up a system for board of contract appeals members which tracks the system proposed by the Administration for ALJs under the Regulatory Reform Act.

I. Recommended Approach

A. Introduction

The approach that we are recommending results from close collaboration between the Office of Management and Budget (OMB), the Office of Personnel Management (OPM) and the major agencies that are affected by the legislation. After the bill was enacted, the Office of Federal Procurement Policy (OFPP) formed a task force comprised of representatives from the agencies involved and from groups outside Government that had an interest in the legislation. As a result of a series of meetings and of events within OFPP, this task force evolved into a smaller operating group that included representatives of OPM, DOD, Navy, GSA, and OFPP. The approach detailed below and the recommended letter to affected agencies has been reviewed and cleared by these agencies represented in the operating group.

We recommend that a larger work group be appointed to assist in the implementation process. This group, co-chaired by OPM and OFPP, would consist of representatives of all agencies with contract appeals boards. It would serve in an advisory capacity to OPM and OFPP in evaluating options and proposed regulations.

4/ If placed in the competitive service, board members would meet the definition of employee in 5 U.S.C. 4301(2) and would be subject to agency performance appraisals under 5 U.S.C. 4302. It would not be possible to fashion an administrative exemption.

5/ 5 U.S.C. 4302.

6/ A copy is attached.

B. Selection Procedures

1. Interim Procedures

OPM's Personnel Research and Development Center, in cooperation with DOD, GS and the Army Corps of Engineers, has developed interim selection procedures that meet the requirements of section 6(b)(2) of the Contract Disputes Act a the Uniform Guidelines on Employee Selection Procedures. The procedures were developed because DOD, GSA, and the Corps of Engineers needed to fill existing vacancies as quickly as possible. The procedures, which are based on a job analysis, rely on four measures; (1) an evaluation of the candidate's experience; (2) inquiries as to candidate's qualification based on structured questionnaires sent to ten references; (3) an evaluation of the candidate's writing samples; and (4) an interview. Based on these measures, candidates will be placed in one of three categories: adequate, above average, and outstanding by a panel consisting of two board members an an outside expert in contract law (preferably a member of an academic institution). Selection will be made by the head of the agency. A copy of the interim procedures are attached.

It must be stressed that these procedures may only be used for a limited period of time. Although they meet the Uniform Guidelines requirements for interim procedures, they do not meet the requirements for permanent procedures. Thus, unless permanent procedures are developed and are adequately validated, agencies risk a finding that the procedures are in violation of the law.

2. Permanent Criteria Procedures

To establish permanent selection criteria and procedures, it is necessary to secure the services of a contractor. OPM does not have staff with the requisite experience to complete the required work expeditiously. Additionally, if OPM were to conduct the study, it would have to be reimbursed b the agencies for its expenditures because of the prohibiton in its appropriation against spending funds for examining attorneys. Moreover, if the criteria and procedures are challenged, it would be better to have the testimony of an independent contractor.

The funds for the contract will be provided by the DOD. DOD has the largest board and, thus, the greatest stake in the outcome. It is recommended, however, that DOD be reimbursed by these agencies using the selection procedures based on the relative size of their contract appeals boards. It believed that the maximum cost of the contract would be $50,000. OPM will assist in preparing a draft request for proposals and will assist in the selection and the monitoring of the contract.7/

7/ The work group also will be consulted concerning the selection of the contractor.

Once the contractor has completed work, OPM will draft the required regulations with the advice and assistance of OFPP and the task force. These regulations probably will provide that the interagency work group, or a group similar to it, should be used to evaluate the candidates. Administrative support to the work group will probably be provided by DOD. We anticipate that any regulations will be issued jointly by OPM and OFPP.

We believe that the interagency work group or a group similar to it should be used to evaluate the candidates.

C. Performance Appraisals

The performance appraisal issue is the most difficult. On one hand, the boards adamantly oppose any performance appraisal system that places the appraisal responsibility with the agency head. This opposition is grounded on the appearance of effecting the board's independence. On the other hand, some sort of appraisal system is necessary. The importance of appraisals was discussed at length in GAO's report on ALJs. Moreover, the Administration's regulatory reform bill requires that the Administrative Conference conduct appraisals of ALJs. Thus, it would be incongruous and counterproductive to exclude board members from appraisals. A large number of alternatives have been considered by the operating group. It appears that the most feasible approach is to require annual appraisals of board members by the board chairman and to provide for review of these appraisals by a panel of board chairmen. Board chairmen would be evaluated annually by a panel of board chairmen with review by a third party, probably the Director of OFPP. Although this proposal is similar to that for ALJs proposed by the Administration bill, it is opposed by some board chairmen because of their concern about the impartiality of other board chairmen. This is an issue that the interagency task force will have to resolve.

The recommended letter to agencies merely states the concern for board members' independence and the need for designing a system that will safeguard their independence. It also solicits suggestions from the agencies concerned.

D. Unacceptable Performance Actions and Adverse Actions

To protect the independence of board members, we believe that OPM and OMB should, by regulation, extend the procedural protections provided by Chapters 43 and 75 of title 5 to all board members. If this action is not taken, non-preference eligible board members would not receive any of the Chapter 75 protections and would be unable to appeal either a Chapter 75 or Chapter 43 action to the MSPB.

Additionally, we recommend providing, by regulation, that a stay of any proposed action against a board member, pending MSPB's final decision, may be granted by a single member of the MSPB. A stay would be available in any

instance where the request was not frivolous. It should be noted, however, that our authority to provide a stay may be questionable. This issue is being researched.

II. Recommended Action

The enclosed letter will alert those agencies who have not been directly involved in the operating group, as well as provide formal communication to the agencies which have been working with OPM and OFPP, of our interest in developing procedures for the selection and appointment of Board of Contract Appeals members. It will set in place the mechanism for resolving the concerns expressed above and for issuing implementing regulations as required by the Contract Disputes Act of 1978. If you would sign the letters and return them to my office, my staff will take care of the ministerial work. If you have any questions, please call me directly or Margery Waxman, General Counsel, OPM, at 632-4632.

Sincerely yours,

Alan K. Campbell
Director

Enclosures

seek a court order to use the materials in their own administrative proceedings.

HR 1407, which is sponsored by Rep. John Conyers (D-Mich), would permit attorneys to come into the grand jury room for purposes of advising their clients. Under current law, a grand jury witness must ask to leave the room to consult with his attorney. HR 1407 emphasizes that allowing attorneys into the grand jury room would be only for purposes of giving advice; counsel would not be permitted to engage in advocacy or raise objections to questions made to the witness.

The Senate counterpart to HR 3340 is S 1676, which was introduced at the Administration's request by Senate Judiciary Chairman Thurmond. The committee held a hearing on the bill last year, and heard Associate Deputy Attorney General Jay B. Stephens argue that continued restrictions on federal attorneys' ability to obtain grand jury information frustrates the government's efforts to combat fraud. S 1676 has since been referred from the full committee to Sen. Paul Laxalt's (R-Nev) subcommittee on Criminal Law.

Bribes and Gratuities

Senate Judiciary also plans a hearing on the Administration's "bribes and gratuities" bill (S 1675 in the Senate, HR 3336 in the House). The bills, also part of the Administration's package of antifraud proposals, would allow the government to rescind a contract tainted by a bribe or gratuity, retain any benefits received, and assess damages against the contractor.

The hearing will focus on due process issues, a Judiciary staffer said. Citing recent allegations of bribery in connection with submarine contracts, he pointed out that, under S 1675, the government could keep the submarine, refuse to pay the contractor, and then levy a penalty ten times the amount of the bribes. "This may be an unconstitutional taking," he observed. Nevertheless, the committee consensus is that there must be a remedy, if not this one than another, for the government in such cases.

On the House side, the Government Operations Committee is expected to hold further hearings on the Paradyne Corporation's performance of major ADP contracts for the Social Security Administration. Paradyne Chairman Robert Wiggins and eight current and former executives have been indicted on charges of conspiracy to defraud the government. The company and a former vice president were also charged with bribing a Social Security Administration official in return for related software contracts.

Contract Disputes Act

The Administration has proposed amending the Contract Disputes Act to make the Claims Court the exclusive forum for bid protest suits. The Administration's bills (S 1674 in the Senate, HR 3337 in the House) would oust the federal district courts of their *Scanwell* jurisdiction. The Senate Judiciary Subcommittee on Courts is planning to hold a hearing on this subject this Spring; no action is planned on the House side at this time.

Meanwhile, the Senate Governmental Affairs is drafting legislation that would give members of the boards of contract appeals added protection against removal, according to a staff member. The measure would amend the Disputes Act to provide that board members would be equivalent to administrative law judges and would enjoy the same protection against removal. GAO, in a study requested by the committee last year reported that the Armed Services Board of Contract Appeals was operating independently, although its members were not completely insulated from agency pressures.

On the House side, Rep. Thomas Kindness (R-OH) will likely try one more time o amend the Contract Disputes Act's certification requirement. "We want to work out something acceptable to the Justice Department," an aide said. "We don't want a veto." In 1983, both the House and Senate passed legislation to do away with the certification requirement, only to see President Reagan veto the bill.

The Justice Department and DOD continue to oppose a complete elimination of certification, the staffer noted. Consequently, Kindness is working with industry groups and the ABA Public Contract Law Section on a "veto-proof" bill that would be acceptable to the Administration. Kindness wants to avoid a lengthy amendment process at the subcommittee level that would sabotage the bill's chances in a short congressional session.

Product Liability

The House Judiciary Subcommittee on Administrative Law last year held a hearing on proposals to expand product liability indemnification for government contractors. HR 1623, which is sponsored by Kindness, would set up a system to indemnify contractors for product liability losses that exceed reasonably available insurance. The bill also would provide for an "equitable reduction" of contractor liability, based on the proportion of fault attributable to the government. Grassley is sponsoring a similar measure (S 1254) in the Senate.

During last year's hearing, Rep. Glickman challenged contractors to come up with "compelling reasons" to pass HR 1623. House Judiciary Committee staffers say they have received no response from industry providing those reasons.

It will be even more difficult to move HR 1623 this year, a staffer commented. One concern is how indemnification authority would be provided, in light of Gramm-Rudman, he said. In addition, there is still a general anti-contractor climate on Capitol Hill, he noted. "That is the greatest hurdle, notwithstanding the merits of the [bill]."

Moreover, the subcommittee has a full agenda, including authorization bills for the Justice Department, the Administrative Conference of the U.S., and the Foreign Claims Settlement Commission. Consequently, further work on HR 1623 is unlikely in this short legislative session.

Prospects for passage of an indemnification bill are likely to further diminish after this year, which will be Kindness' last in the House. The Ohio Republican will relinquish his House seat to challenge incumbent Sen. Glenn, a Judiciary Committee staffer noted.

Contracting Out

An issue which continues to be a point of contention between federal employee unions, agencies, and contractors, i.e., turning so-called "commercial activities" performed by government workers over to performance by private companies under procedures

Statement of

The Associated General Contractors of America

To The

Subcommittee on Administrative Law and Governmental Relations

Of The

Committee on the Judiciary

United States House of Representatives

On The Subject Of

The Proposed Program Fraud Civil Penalties Act, H.R.3335

February 6, 1986

AGC is:

* More than 30,000 firms including 8,400 of America's leading general contracting firms responsible for the employment of 3,500,000-plus employees;

* 110 chapters nationwide;

AGC members complete:

* More than 80% of America's contract construction of commercial buildings, highways, industrial and municipal-utility facilities;

* Approximately 50% of the contract construction by American firms in more than 100 countries abroad.

The Associated General Contractors of America appreciates the opportunity to submit its views on the proposed "Program Fraud Civil Penalties Act of 1985," H.R.3335.

The proposed Program Fraud Civil Penalties Act would establish, for the first time, a government-wide administrative mechanism to resolve small civil fraud cases outside the courts. These claims initially would be decided by hearing examiners. The Inspectors General of the various departments and agencies would initiate such claims when the Department of Justice makes a determination that the federal government has a valid claim but that it has neither the time nor the available resources to litigate. Any finding of liability in the administrative proceeding could be appealed to a federal circuit court.

AGC has great concern, however, that the mechanisms which would be established in H.R.3335 to discover cases of fraud overreach the government's authority over its citizens.

The bill's provisions relating to standards of proof and the implied limitation on judicial review appear to violate due process requirements.

In general, due process guarantees apply to the conduct of administrative agencies and officials. A person is entitled to procedural due process at any adjudicatory proceeding before an administrative agency. If liberty or property rights of an individual are involved in an adjudicatory proceeding, the following is required:

1. Notice and hearing, unless there is provision for appeal to a judicial tribunal.

2. Procedures consistent with the elements of a fair trial. These include:

a. the right to conduct discovery;

b. the right to cross-examine witnesses;

c. the right to offer evidence;

d. the right to meet claims of the opposing party and to present a defense; and

e. the right to counsel.

3. The determination by the administrative agency must be on sufficient evidence. Hearsay alone is not enough. In addition, the tribunal or hearing officer must make findings of fact and law and give reasons for the decision made.

4. The administrative proceedings must be impartial and unbiased. It is not necessary, however, for investigative and adjudicative functions to be undertaken by separate agencies or officials.

AGC has great concern that the above points are not recognized in H.R.3335.

In particular, AGC questions the need to apply the provisions of H.R.3335 to construction procurement. Procurement of construction is different from procurement of military hardware and office supplies. While payment for these latter goods is based on cost, payment for construction is based on a firm fixed price which was arrived at through intense competition. Virtually all of the public work purchased in the United States is procured using the competitively bid firm fixed price method of construction.

Contract modifications which are based on the contractor's costs are audited by the awarding agency. Contract modifications which exceed $100,000 are required by law to be audited; contract modifications in an amount less than that are audited at the discretion of the contracting officer.

Contract claims, like contract modifications, are required to be audited if they exceed $100,000 and are audited below that amount

at the discretion of the contracting officer. Penalties for submitting false and fraudulent claims are already established by the False Claims Act.

There is no need for application of the provisions of H.R.3335 to the construction industry in light of the method of procurement used in the industry and the safeguards and controls which are already in place.

Therefore, AGC urges that if the subcommittee decides to advance the proposed "Program Fraud Civil Penalties Act of 1985," that it be amended to exclude the construction industry from its provisions.

American Farm Bureau Federation

WASHINGTON OFFICE
600 MARYLAND AVE., S.W.
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February 6, 1986

The Honorable Dan Glickman
Chariman
Administrative Law and
Governmental Relations Subcommittee
House Judiciary Committee
Room B-351-A Rayburn House Office Building
Washington, D.C. 20515

Dear Chairman Glickman:

We are submitting the attached statement regarding program fraud civil penalties legislation on behalf of the American Farm Bureau Federation.

We ask that our statement be made a part of the hearing record.

Respectfully,

John Datt

John C. Datt
Executive Director
Washington Office

JCD/lh
Attachment
cc: Subcommittee Members

STATEMENT OF THE AMERICAN FARM BUREAU FEDERATION
TO THE SUBCOMMITTEE ON ADMINISTRATIVE LAW AND GOVERNMENT RELATIONS
OF THE HOUSE JUDICIARY COMMITTEE
REGARDING PROGRAM FRAUD CIVIL PENALTIES LEGISLATION

February 6, 1986

The American Farm Bureau is the largest general farm organization in the country, with a current voluntary membership of nearly 3.4 million families in 49 states and Puerto Rico. At least 75 percent of the nation's farmers and ranchers are members of Farm Bureau in nearly 2,800 counties.

A great many farmers and ranchers are participants in a wide range of federal programs, particularly those administered by the Department of Agriculture, that require applications for services and benefits, thus involving contractural arrangements with the federal government. "Crop subsidy programs" have been mentioned by one of the chief sponsors of this legislation as one example of the serious areas of fraud that needs to be addressed.

We are in agreement with the purpose and thrust of the various bills concerning program fraud civil penalties that have been introduced in the House and Senate. However, we have some concerns regarding specific language in the bills that we ask the Subcommittee to seriously consider during this hearing and during markup of the legislation.

Rather than address the specific provisions of the various bills under consideration, we will state our concerns and recommendations in a general way.

First, we are concerned about the "knowledge" standard that is to be included in this legislation. Unless such a standard is clearly stated in the legislation, farmers and others doing business with the government will be subject to administrative citations of fraud that may be committed through inadvertent errors in filling out forms. Even the term "knows or has reason to know" is vague and subject to wide interpretation. At the very least, the Committee report should lay out the intent of the Congress in the use of that terminology. It should be made clear that agencies are not expected to proceed to bring actions based on inadvertent errors, oversights or misunderstandings. The preponderance of the evidence should show that the claimant committed fraud with full knowledge and intent.

Second, we are concerned about safeguards in the administrative proceedings. Language in some or all of the bills concerning subpoena authority indicates that broad authority is granted to the investigating official of the administrative agency, with no independent prosecutional review and unlimited subpoena power.

Congress must be exceedingly careful that basic constitutional rights are not weakened through this effort to alleviate fraud in dealings with the government. We suggest this language be carefully reviewed with the thought of reducing somewhat the power of the investigating official. It appears to us that the powers already available to administrative law judges in the Administrative Procedures Act are sufficient in this regard.

Third, we believe the monetary threshold of $100,000 contained in some of the bills is too high. Without doubt, the Justice Department would have an incentive to ignore cases under that threshold, even though it would have 90 days to take action before the administrative remedy proceeds. We believe this would have the effect of shifting far too many cases away from the regular judicial processes.

We realize that every decision reached by an administrative agency would be subject to appeal to the court of appeals, but that would be a most expensive undertaking for most farmers and the case would be tried on the record created by the administrative procedure. We believe the objective of the bills could be achieved without causing a major shift away from the responsibility of the Attorney General.

While we go along with reasonable legislation that would reduce the extent of fraud in dealings with the government, we want to point out that an administrative judgment of fraud can have a devastating effect on a farmer or other small businessman. If such a judgment is reached through due process, utilizing the normal safeguards our judicial system normally affords to any citizen, no farmer or other businessman can complain. However, if such a judgment is reached lightly, without ensuring independent prosecutorial review or without providing adequate judicial review, there can be no justification under our system of law.

We ask that this statement be made a part of the record.