

Settling a False Claims Act Case: Practicalities and Pitfalls

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Overview

- Because the vast majority of FCA cases are settled, every FCA practitioner must understand the issues that surround settling an FCA case
- These issues concern more than just the settlement-related provisions of the FCA itself.
- A proper understanding of these issues should inform the settlement agreement itself, and in some cases, may inform the decision *whether* to settle at all.

When Can a Defendant Deduct a Settlement Payment?

- IRC § 162(f): prohibits deductions of “any fine or *similar penalty* paid to a government for the violation of any law”
- “Penalty” = “an amount paid in settlement of a taxpayer’s actual or potential liability for a fine or penalty,” but does not include “[c]ompensatory damages paid to a government”
- Supreme Court: FCA’s treble damages provision serves both a punitive *and* compensatory purpose
- Key inquiry for deductibility purposes: was the settlement payment punitive or compensatory?

When Can a Defendant Deduct a Settlement Payment?

- Seminal case: *Talley Industries v. Commissioner*
 - Dispute over deductibility of portion of FCA settlement
 - Taxpayer argued that because govt.'s losses exceeded total settlement amount, disputed portion was deductible
- Holding:
 - Burden on taxpayer to prove that payment was compensatory
 - Key inquiry: intent of the parties
 - Fact that payment is treble damages is not dispositive of intent
 - Taxpayer failed to offer sufficient evidence of government's actual losses sufficient to prove that entire settlement was compensatory

When Can a Defendant Deduct a Settlement Payment?

- 2008: IRS Releases Coordinated Issue Paper
- If taxpayer can demonstrate that settlement does not include treble damages, then the settlement payment is deductible
- But treble damages still may be deductible if evidence exists showing its compensatory purpose:
 - Language of settlement agreement itself
 - Offers and counter-offers showing government's actual losses
 - Damage computations submitted by government
- Portion earmarked for relator is compensatory and deductible

Best Practices for Ensuring Favorable Tax Treatment of Settlement Payments

- Best practices for defendants to ensure the deductibility of settlement payments:
 - Obtain and preserve government's damage computations showing government's actual losses
 - Include language in settlement agreement setting out purpose of payment
 - Ensure that portion of settlement earmarked for relator is spelled out in the agreement

When are Costs of an FCA Suit Allowable?

- FAR 31.205-47 governs when, and under what circumstances, costs incurred in an FCA suit are “allowable”
- “Costs incurred in connection with any proceeding” brought by the government against the contractor on any cause of action, or brought by a relator under the FCA, are unallowable if:
 - The proceeding results in a criminal conviction;
 - The proceeding results in civil liability;
 - The proceeding results in suspension/debarment or contract termination
 - The action is settled but could have lead to any of the above;
- “Costs” include legal fees
- “Proceedings” includes FCA investigations, not just lawsuits

When are Costs of an FCA Suit Allowable?

- Exceptions: Costs that are otherwise unallowable will be allowable if
 - Government and defendant agree that costs are allowable; or
 - For qui tam suits, contracting officer determines that relator would not likely have succeeded on the merits
- However, a standard provision in all DOJ settlement agreements is that costs are not allowable

When are Costs of an FCA Suit Allowable?

- Costs in connection with an FCA suit that are not rendered unallowable are presumptively allowable if:
 - Reasonable in relation to the activities required to deal with the proceedings;
 - Not otherwise recovered from the government or a third party;
 - Percentage of costs allowed does not exceed the percentage appropriate for the complexity of the litigation, but never to exceed 80%
- Thus, even if costs are allowable, a contractor may never recover more than 80% of its costs

Relator's Ability to Object to Settlements

- Relator has limited ability to object to settlements reached by the government and the defendant
- 3730(c)(2): Government may settle case over relator's objection if court determines that settlement is "fair, adequate, and reasonable under all the circumstances"
- "Fair, adequate, and reasonable" standard is deferential
- However, the relator is entitled to a hearing, and potentially to discovery

Government's Ability to Object to Settlements

- Relators can reap larger bounties by allocating the bulk of a settlement payment to his or her personal claims
- Where the Government has declined intervention, can it veto the settlement agreement between the relator and the defendant?
- 3730(b)(1): An “action may be dismissed *only if* . . . the Attorney General give[s] written consent to the dismissal”
- But, under 3730(b)(4), if the Government declines intervention, the relator has the “right to conduct the action.”
- Split of authority over how to reconcile these provisions

Government's Ability to Object to Settlements

- *U.S. ex rel. Killingsworth v. Northrop Corp.* (9th Cir.)
 - Government declined to intervene in case
 - Bulk of relator's settlement with Government goes to retaliation claim
 - Despite Government's objection to settlement and lack of consent to dismissal, district court dismissed case.
- Holding
 - Requirement that Government must consent to dismissal applies only if the Government intervenes
 - 3730(b)(1) does not give the Government absolute veto power
 - Relator's right to "conduct the action" includes right to settle

Government's Ability to Object to Settlements

- Fifth and Sixth Circuits: Government has absolute ability to block settlement.
 - *Searcy v. Philips Electronics Corp.*, 117 F.3d 154 (5th Cir. 1997)
 - *U.S. v. Health Possibilities P.S.C.*, 207 F.3d 335 (6th Cir. 2000)
- 3730(b)(1)'s requirement that Government consent to dismissal applies even when the Government declines to intervene
- Rationale is that Government approval is necessary to prevent relators from manipulating settlement agreements

Court's Ability to Reject Settlements

- *Sharma v. University of Southern California* (9th Cir.)
 - In settlement agreement, the “proceeds” used to calculate relator’s share included attorneys’ fees.
 - District court modified settlement by subtracting attorneys fees from proceeds.
- Holding
 - Because FCA requires court to approve settlements, court has power to bring settlements into compliance with FCA
 - Attorneys’ fees cannot be included in the calculation of “proceeds” to which relator is entitled

Determining the Relator's Share of the Proceeds

- Relator entitled to 15-25% of proceeds in intervened cases; 25-30% of proceeds in non-intervened cases
- Factors:
 - Extent of relator's contribution to suit;
 - Extent of government's prior knowledge of fraud;
 - Whether relator participated in the fraud;
 - Lengthiness of case;
 - Size of FCA recovery (if small, increases relator's share)

Determining the Relator's Share of the Proceeds

- In intervened cases, when the action is based primarily on public disclosures, relator may not get more than 10%
- But under the FCA's public disclosure bar, "no court shall have jurisdiction over an action based upon the public disclosure of allegations"
- How to reconcile these provisions?
- Fifth Circuit: 10% limit applies only to relators who were the original source of the publicly disclosed information, and where the action is based primarily on publicly disclosed information

Determining the Relator's Share of the Proceeds

- 3730(d): Relator is entitled to percentage of “proceeds of the action or settlement of the claim”
- What is meant by “proceeds”?
- Fifth Circuit: Value of a defendant's release of its claims against the government can be factored into calculation of “proceeds”
- Ninth Circuit: “In-kind” services can be factored into calculation of “proceeds”

When is the Relator Entitled to Attorney's Fees?

- The FCA makes clear that a successful qui tam relator, regardless of whether the government intervenes, is entitled to attorney's fees, expenses, and costs
- Attorney's fees are separate from, and in addition to, the percentage of the "proceeds" to which the relator is entitled.
- The relator is entitled to attorney's fees even where the case is settled
- However, attorney's fees need not be included in a settlement agreement and may become the subject of separate litigation

When is the Defendant Entitled to Attorney's Fees from the Government?

- There is no provision of the FCA that entitles a successful defendant to attorney's fees against the Government
- Right to attorney's fees against the Government is governed by the Equal Access to Justice Act, which permits a fee award only where:
 - The party is a "prevailing party"
 - The Government's position was not "substantially justified"
 - Corporate defendant has a net worth of \$7 million or less and 500 or fewer employees;
 - Individual defendant has a net worth of \$2 million or less
- A "prevailing party" includes a party who reaches a favorable settlement with the government

When is the Defendant Entitled to Attorney's Fees from the Relator?

- If the Government declines intervention, court may order the relator to pay defendant's attorney fees if:
 - Defendant "prevails in the action;" and
 - Relator's claim is "clearly frivolous, clearly vexatious, or brought primarily for purposes of harrassment."
- Given this difficult standard, it is unlikely that a relator would agree to pay a defendant's attorney's fees without a court order

Questions?

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