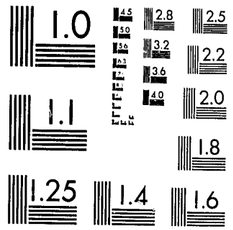

PROGRAM FRAUD CIVIL PENALTIES ACT

HEARING

BEFORE THE

COMMITTEE ON GOVERNMENTAL AFFAIRS UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

SECOND SESSION

ON

S. 1780

TO PROVIDE CIVIL PENALTIES FOR FALSE CLAIMS AND STATEMENTS MADE TO THE UNITED STATES, TO RECIPIENTS OF PROPERTY, SERVICES, OR MONEY FROM THE UNITED STATES, OR TO PARTIES TO CONTRACTS WITH THE UNITED STATES, AND FOR OTHER PURPOSES

APRIL 1, 1982

Printed for the use of the Committee on Governmental Affairs

U.S. GOVERNMENT PRINTING OFFICE
WASHINGTON: 1982

CONTENTS

PROGRAM FRAUD CIVIL PENALTIES ACT

THURSDAY, APRIL 1, 1982

U.S. SENATE,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, D.C.

The committee met at 10 a.m., in room 3302, Dirksen Senate Office Building, Hon. William V. Roth, Jr. (chairman of the committee) presiding.

Present: Senators Roth and Rudman.

Staff present: S. Cass Weiland, chief counsel, Permanent Subcommittee on Investigations; Michael C. Eberhardt, deputy chief counsel, Permanent Subcommittee on Investigations; and Howard W. Cox, staff counsel, Permanent Subcommittee on Investigations.

OPENING STATEMENT OF SENATOR ROTH

Chairman ROTH. Today's hearing of the Committee on Governmental Affairs will focus on the need for legislation to provide Federal agencies with the ability to recover money lost as a result of fraud by Government contractors, grantees, and employees, along with the imposition of penalties where such fraud has been accomplished by the submission of false claims or false statements.

To provide this ability, I introduced the Program Fraud Civil Penalties Act in October 1981.

Much of my interest in offering legislation dealing with this troublesome area of fraud in the Federal Government has been derived from several recent efforts by this committee, the Permanent Subcommittee on Investigations, and the General Accounting Office to identify the extent of fraud in major Federal programs.

For example, within the past year, the Permanent Subcommittee on Investigations has identified significant vulnerabilities in the home health program administered by the Department of Health and Human Services and the Federal employees' compensation program administered by the Department of Labor.

Similarly, during the last year, the General Accounting Office released a report entitled "Fraud in Government Programs—How Extensive Is it—How Can it Be Controlled". The report observed that during the period October 1976 to September 1979, the Government lost hundreds of millions of dollars as a result of fraud directly related to Government programs.

Among its conclusions, the report recommended the enactment of an administrative penalty statute which would allow Federal agencies to impose appropriate monetary sanctions against persons, corporations, and other entities who engage in fraud upon the Government.

GAO observed that current Federal efforts to control fraud were primarily directed toward the filing of criminal and civil actions by the Department of Justice. GAO concluded that these efforts were insufficient to address the magnitude of the problem and that a new statutory penalty must be enacted which would allow affected agencies to directly impose administrative monetary penalties for fraud.

GAO estimated that during the reporting period, approximately 77,000 cases of fraud were detected. Of this number, only 12,900 cases were referred to the Department of Justice for criminal prosecution.

The Department of Justice subsequently declined to prosecute 61 percent of these cases.

Furthermore, GAO estimates that, under Department of Justice guidelines for white collar crime prosecutions, an even greater percentage of such cases will be declined.

GAO further noted that the Department of Justice, in pursuing criminal fraud cases, did not adequately consider appropriate remedies which would make the Government whole for the loss suffered from an incident of fraud.

A previous GAO report noted that the Department of Justice did not coordinate criminal and civil remedies in most fraud cases. Even when a civil case was proposed by an agency to the Department of Justice, a civil suit was rarely ever filed. Of the 393 cases referred to the Department of Justice during the reporting period for the commencement of a civil fraud suit, only 28 cases were filed.

Even if criminal or civil action is commenced, the Government rarely recovers an amount equal to the loss sustained. The GAO estimated that in approximately 1,500 criminal and civil cases, defendants were ordered to reimburse $14 million to the Federal Government.

However, in many instances the Government achieved only a judgment against the individual and was not able to recover the full amount due.

Furthermore, GAO concluded that even if the criminal or civil penalty resulted in a monetary judgment for the Government, neither the Department of Justice nor the affected agencies have aggressively sought to enforce these judgments and to make the Government whole.

Administrative civil penalties would give the Government an additional tool to serve as a deterrent against fraud and to recover Federal funds lost due to fraud.

Ideally, this administrative mechanism would be used in appropriate circumstances when the Department of Justice declines to prosecute.

According to GAO estimates, 62 percent of all Department of Justice declinations are based upon the following factors: (a) Lack of prosecutive merit/jury appeal—16 percent. (b) Small monetary loss to the Government—14 percent. (c) Administrative action is more appropriate—8 percent. (d) Insufficient evidence for criminal prosecution—24 percent.

Are the cases which comprise the majority of these declinations within the scope of an administrative proceeding? I think they probably are.

The Program Fraud Civil Penalties Act is designed to create an administrative mechanism that will allow the affected agency to impose a monetary penalty for fraud. This penalty is cumulative with existing criminal, civil and administrative penalties, and is ideally suited for those who have defrauded Federal programs. The bill will also assist agencies in the collection of such penalties by allowing an offset of such penalties against any other outstanding Federal obligation owed to the liable party, including Federal tax refunds.

As I stated earlier, S. 1780 was introduced by me and several cosponsors in October 1981. Both the Department of Justice and Office of Management and Budget were asked for their comments months ago. To date, we have received only an interim response from the Office of Management and Budget, with a recommendation for further staff discussion to explore certain issues in more detail.

On at least three occasions in the last several weeks, my staff has scheduled meetings with the Office of Management and Budget to determine its concerns and those of key agencies. All of these meetings were canceled by the Office of Management and Budget at the last minute due to the inability of the Departments of Justice and Defense to agree on certain points in the legislation. Rather than sustain further delays, I believe it is necessary to go forward with these hearings today.

We have invited both the Departments of Justice and Defense to testify, so that we might provide the executive branch with an opportunity to comment on a piece of legislation which has had substantial endorsement by virtually every Inspector General, the General Accounting Office, and even the Office of Management and Budget, as evidenced by its letter of December 1981, which I ask be included in the record.

[The letter referred to follows:]

EXECUTIVE OFFICE OF THE PRESIDENT,
OFFICE OF MANAGEMENT AND BUDGET,
Washington D.C., December 10, 1981.

Hon. WILLIAM V. ROTH, Jr.,
Chairman, Committee on Governmental Affairs,
U.S. Senate, Washington, D.C.

DEAR BILL: We appreciate the opportunity to work with you on S. 1780, the proposed "Program Fraud Civil Penalties Act of 1981." We believe that the basic concepts embodied in S. 1780 are both timely and necessary to support our common efforts to reduce fraud, waste, and abuse in federal programs. We look forward to the hearings that you plan to hold within the near future.

As you requested in your letter of November 10, 1981, we asked the affected departments and agencies, including the Inspectors General, for their views and recommendations. While we have received some of these advisories, many of the requested views are still outstanding and our review of S. 1780 is not yet complete.

However, I would like to share with you some preliminary observations about issues raised in the comments we have received. Some of these concerns were being considered as part of the Administration's ongoing review of a similar proposal developed by the Department of Justice, of which I understand you are aware.

The Administration strongly supports S. 1780's basic proposal to enable departments and agencies to impose administratively civil penalties upon those who file false claims intending to defraud the Government. We believe that an important

criterion by which any proposed legislation should be judged is whether it deals effectively with the problem of numerous small dollar amount frauds against the Government that "appear" to be condoned because the Government does not prosecute. In general, experience has demonstrated that it is not cost effective to prosecute when the property or services for which claim is made are $50,000 or less and the damages suffered by the Government are $25,000 or less—essentially the juridical limits of the Department of Justice proposal.

The absence of any dollar "threshold" in S. 1780 is one area we would want the Committee to consider. Other issues raised in the comments we received include concern that including negotiation of contracts and adjustments in the coverage of the bill would undermine the procurement process; and whether a $10,000 penalty for each false claim is not excessive if the basis for the administrative sanction is to provide an inexpensive remedy for a small fraud; 31 U.S.C. 231 currently provides a penalty of $2,000 and the Justice proposal calls for $5,000.

I believe that a constructive next step would be to have our staffs pursue these issues and other areas of concern to determine if we can develop a consensus before the hearings. I feel quite sanguine about the prospects for success.

I look forward to hearing from you.

Sincerely,

EDWIN L. HARPER,
Deputy Director.

Chairman ROTH. Senator Rudman.

Senator RUDMAN. Thank you, Mr. Chairman. I don't have an opening statement.

Chairman ROTH. Our first witness—we are very pleased to have with us—is Milton J. Socolar, Special Assistant to the Comptroller General, General Accounting Office.

It is our practice, as you know, to permit you to summarize your statement and the whole statement will be included in the record as read.

TESTIMONY OF MILTON J. SOCOLAR, SPECIAL ASSISTANT TO THE COMPTROLLER GENERAL, GENERAL ACCOUNTING OFFICE

Mr. SOCOLAR. Thank you, Mr. Chairman.

Fraud in Government operations and programs undermines the integrity of the Federal Government. Unfortunately, many now believe that individuals can commit fraud against the Government with little or no fear of Federal reprisal. The sad truth is that they are often right. Crime against the Federal Government often does pay.

Recently, concern about fraud in the Government has increased, and a number of actions have been taken. The actions include the establishment of the Offices of Inspector General, and the establishment of the President's Council on Integrity and Efficiency, which the President established by Executive order.

S. 1780 would provide the Government with the mechanism to impose civil penalties against those who knowingly make false claims or statements for money, property, or services provided by the Federal Government. Basically, it would improve the Government's fraud fighting arsenal.

In 1982, we issued a report pointing out that a relatively small number of fraud cases found within Federal agencies were actually prosecuted by the Department of Justice. There are a number of reasons why the Department did not prosecute those cases. Foremost among them were the relatively minor dollar amounts involved and the lack of sufficient evidence to support a criminal determination.

The Department of Justice essentially is forced to concentrate on cases that involve significant amounts of money or have significant deterrent effects.

I have a few specific comments on the proposed legislation. In section 801(a), the proposed act would apply specifically to the Postal Service, to all agencies with statutory Inspectors General authorized by the Inspector General Act of 1978 and to the executive departments designated in section 101 of title 5 of the United States Code.

This might be read to exclude the military departments since the military departments are not specifically designated as executive departments they are characterized separately in section 102 of title 5.

Section 802(b) discusses the liability for false claims and statements. It provides for civil penalties of not more than $10,000 for each false claim or statement and an assessment of not more than double either one, the amount of money paid or the value of the property or services received as a result of the false claim, or two, the amount of damages sustained by the United States, including consequential damages and the cost of investigating the false claim or statement. We think the bill might be clarified to show more precisely that the term "consequential damages" is intended to cover all costs incurred by the Government, including such items as administrative expenses incurred in documenting a false claim or statement.

Third, section 806 calls for a waiting period of 120 days before the administrative agency may take action to institute proceedings on a false claim. We think that 120 days is too long given the need for prompt action in these cases. We think that 60 days would be reasonable.

We support the proposed legislation. As I said earlier, we think it would serve a needed purpose within the agencies by allowing them to undertake proceedings against fraud.

The Department of Justice cannot handle all the cases that are referred to it. The administrative agencies have a great interest in the integrity of their programs. While we support the proposed legislation, we think it is important for agencies to vigorously pursue the establishment of good internal controls. Agencies should place primary emphasis on fraud prevention rather than detection.

Internal controls will not guarantee that fraud will not occur. But sound controls make fraud difficult to perpetrate and we are pleased to acknowledge the increasing emphasis directed toward this important aspect of fiscal integrity. Legislation, which GAO supports, has been passed in the House (the Federal Managers Accountability Act (H.R. 1526)) and a bill that has been reported out of this committee (Financial Integrity Act (S. 864)) to strengthen systems of internal controls in the Federal Government are important measures in this regard.

There is no question but that funds lost through fraud should be recovered. Because it is impossible, as a practical matter, for Justice to handle all cases, we think that Federal agencies need the independent authority introduced in this bill.

I will be pleased to answer any questions that you might have.

Chairman ROTH. Thank you for your statement, Mr. Socolar. I strongly agree with you that punitive action is no substitute for internal control. What we are trying to address in this legislation is a problem that I think became obviously paramount, namely your recent study and report on how widespread fraud is in Government.

As I recall, one of the things you learned in the study is that in the case of Federal employees, many of our employees felt the Government would never take corrective action so that there was no point in disclosing acts of fraud or abuse that came to their attention, and that as a result, your study probably vastly underestimated the number of incidents in that period of time.

Would this kind of approach, do you think, have a beneficial impact on Federal employees in feeling that if they were to disclose fraud and abuse that maybe something would be done about it?

Mr. SOCOLAR. I think it would. I think that there is a need for Federal agencies to have the means available to deal with cases that arise and to allow them to pursue cases. It should be made very clear to the public that these mechanisms will be used. In the event fraudulent statements or claims are made in connection with Government programs, the public should know that there will be more at stake than simply being declared ineligible. For example, future benefits will be affected and penalties will be assessed.

Chairman ROTH. In your May study, the one I just made reference to, the GAO stated that the Department of Justice declined prosecution in a majority of cases based on such facts as lack of jury appeal, no dollar loss to the Government, insufficient evidence for criminal case, and the belief that administrative action is more appropriate. Would these kinds of cases be potential cases for the administrative fraud penalty?

Mr. SOCOLAR. Yes, they would. As I said earlier, the agencies themselves would probably have a greater interest in the integrity of their own programs and in terms of the application of civil penalties. While the bill affords all of the due process rights that parties charged are entitled to, the standard of proof with regard to a civil penalty is somewhat less than the standard of proof required in a criminal prosecution. The availability of the authority to assess these civil penalties should help a great deal.

Chairman ROTH. In your study, you identified false statements as the second largest category comprising almost 25 percent of all fraud committed on the Government. Do you support the inclusion of false statements in addition to false claims within the provisions of the administrative penalty bill or do you think there might be a chilling effect by including false statements?

For example, we had a small businessman recently harassed by the Pentagon primarily because he did not seem to fit the mold. Would you see this kind of legislation including false statements as conceivably being a basis for harassing or putting inhibition on the private sector? Let's assume, for example, you have a small businessman who is trying to do business with the Pentagon. Business is known to use a certain amount of what is called puff. Would this open the door to his being accused of false claims and harassed as a means of getting back at people that the establishment does not favor?

Mr. SOCOLAR. I couldn't answer that question categorically. I don't see that there would be any reason to believe that would happen.

While, as I said before, the standard of proof in a civil proceeding is somewhat less than in a criminal proceeding, it would seem to me that the puffery, as we described it, could readily and easily be distinguished from the outright false statements that many do provide in connection with their seeking Federal benefits.

There is a significant number of false statement cases which would clearly not fall in the category you described. They must be addressed, and I think that the due process provisions, the assurance that persons who are accused have the right to properly defend themselves, should ameliorate any tendency to go in the direction that the question suggests.

Chairman ROTH. Mr. Socolar, are you an attorney?

Mr. SOCOLAR. Yes, sir; I am.

Chairman ROTH. I want to ask you a legal question. That is the reason I raised the question.

So I take it that you support the inclusion of false statements even though it does not harm the Government. Do you think that is desirable?

Mr. SOCOLAR. I really don't see that one can say that false statements do not harm the Government. They may not result in any dollar outlay by the Government, but it seems to me that the Government ought to be able to rely on the validity of the information received from applicants for Federal assistance and benefits.

Chairman ROTH. You don't think the buyer should beware?

Mr. SOCOLAR. You have to recognize that in many of these situations benefits might well be going to a portion of the population that is ineligible for participation. As a result of the false statements made by ineligible applicants, benefits may be denied to those deserving the benefits.

Chairman ROTH. In your statement you made some reference to consequential damages. Would you limit that provision to where it could be shown there was financial loss to the Government?

For example, let's say a claim, a false claim, resulted where a business got a contract that was not indeed small business or a minority contractor. How would you evaluate damages in those cases?

Mr. SOCOLAR. The bill provides for penalties up to $10,000. It would seem to me that agencies would not be able to simply assess penalties by formula. Individual cases would have to be dealt with in terms of the particular issues involved, and the penalty provisions would have to be judiciously applied. The important thing is to have the tool available. As the situation now exists, agencies are simply not in the position to even address these situations.

Chairman ROTH. We are concerned with avoiding the creation of additional expenses in the administrative system to implement this legislation. Do you think that the procedural requirements can be implemented by the existing apparatus within most Federal agencies, such as the administrative law judge or the Board of Contract Appeals or do you think it would require additional personnel? You are talking about 77,000 cases in your study, most of which were not prosecuted. Do you see this as a major administrative problem?

Mr. SOCOLAR. I think that the safeguards are extremely important, but I do think that, in general, the agencies have the apparatus needed to handle these cases. The fact that there are 77,000 cases or any number of cases wouldn't mean that the apparatus would have to be overloaded to the point of causing the costs involved to be greater than the benefits derived. The apparatus is there and I think readily available in most cases.

Chairman ROTH. Senator Rudman?

Senator RUDMAN. Thank you, Mr. Chairman.

Mr. Socolar, looking at section 802 of the act, following through the discussion you just had with the chairman, I want to ask each of you this question.

There, of course, is a very legitimate concern that in the wrong hands a bill that was too tightly drawn could lead to abuse and persecution in some cases.

I think we had that in mind when section 802 was drafted. Section A defines false statements and claims, but then section B states that any person who on or after the effective date of the act knowingly makes, presents, or submits or causes to be made to be presented or submitted false claims or statements is liable to the United States for penalties.

Then section 2 states for purposes of this section knowingly means with wreckless disregard for whether a claim or statement is false.

My question is simply this: Although we admittedly are adopting, or will adopt should this be passed, a level of proof that is in accord with civil proof as opposed to criminal proof, which, of course, is beyond a reasonable doubt, civil being a preponderance of the evidence in almost any jurisdiction, even with that lowered level of proof, don't you think that section 2, which sets up knowingly as meaning a wreckless disregard kind of protects those who might be the subject of unfair persecution under this act?

Mr. SOCOLAR. Yes, I do. I think that the due process provision that the bill contains, would safeguard against any serious harassment problem that might otherwise take place.

I think the safeguards here are pretty well established.

Senator RUDMAN. Of course, if somewhere in the legislative process, and there has been discussion about this, we were to leave the bill intact but remove that section about wreckless disregard, leaving "knowingly" to be defined in a more general way as it is used in civil and in some criminal cases, then we would have a situation, with the definitions as they are set forth in section 802A and then in 802(a)(1)(A)(B) which are on pages 6 and 7, we would truly have only a civil level of burden of proof, preponderance of the evidence and in that case it is my view, and I don't know whether you agree with me, that without having that elevated definition of knowingly we would have a situation where, in the hands of the wrong people, who for purposes of retribution or otherwise wanted to get somebody that they probably could if that was missing.

Mr. SOCOLAR. Actually that might work the other way. If all you had left was "knowingly" and you remove paragraph 2, you might actually require a higher standard of proof rather than a lesser.

For example, assume a small businessman is asked to certify that he is a small business, and that he doesn't really know whether he is or is not a small business but simply ignores the issue and certifies, yes. He might be dealt with under paragraph 2 for having wrecklessly disregarded it. The omission of paragraph 2 would make it more difficult to prove that he knowingly made a false statement.

Senator RUDMAN. I think that is possible.

Mr. SOCOLAR. In other words, I am not sure of exactly, having focused on that, how that would work without paragraph 2.

Senator RUDMAN. I believe if you look at the various definitions of knowingly that the various courts have set forth over the last dozen or so years, you could be correct or you could be incorrect.

At any rate, I think you and I both agree that elevating the level of conduct to wreckless disregard tied in with the definition of knowingly is a safer way for this committee to go.

Mr. SOCOLAR. Let me say that I think it is a safe way. I think that those definitions and the due-process safeguards should adequately protect against undue harrassment of charged individuals.

Senator RUDMAN. Thank you very much.

Chairman ROTH. One final question: If a penalty is assessed against an individual, the enforcement of that penalty still requires referral to the Justice Department unless you are able to offset it against some claim of funds that the Government has.

Do you see that we are talking about thousands of cases, that this alternative method of collecting will help avoid the necessity of going to the Justice Department which, as we know, has not prosecuted these cases because of the manpower shortages or do you think we will be leading ourselves into another alley where we get the penalties but find it very difficult to get them paid?

Mr. SOCOLAR. The offset provisions in the bill do help. The reference to the Department of Justice for the collection would result, as far as the Department is concerned, in a much less extensive suit, in terms of time and effort to prosecute, than having to establish the claim in the first instance.

Chairman ROTH. But conceivably, we are talking about thousands of cases?

Mr. SOCOLAR. That is correct.

Chairman ROTH. If this statute if going to be successful—or do you think it will have an effect such that that won't be necessary?

Mr. SOCOLAR. There are any number of ways that might play out. One might expect, for example, that with the statute on the books, and with the availability of these kinds of remedies, not all of those cases would have to go to a full proceeding. There might well be settlements that would be readily obtainable that are not obtainable under the current structure. Again, I have to say that the fact that there may be thousands upon thousands of fraud cases in the process does not mean that there would be thousands and thousands of proceedings under this statute. There would be an opportunity to fit the number of prosecutions within an agency to some estimate of benefit versus cost. The important thing is to have this remedy available.

Chairman ROTH. Thank you very much for coming here today, Mr. Socolar. Your testimony is most helpful.

Mr. SOCOLAR. Thank you very much.

[The prepared statement of Mr. Socolar follows:]

PREPARED STATEMENT OF MILTON J. SOCOLAR

Mr. Chairman and members of the committee, we are here at your request to comment on S. 1780, entitled the "Program Fraud Civil Penalties Act."

Fraud in Government operations and programs undermines the integrity of the Federal Government. Unfortunately, many now believe that individuals can commit fraud against the Government with little or no fear of Federal reprisal. The sad truth is that often they are right; crime against the Federal Government often does pay.

Recently, there has been increased concern in Government about its susceptibility to fraud, and consequently, an increased desire for greater accountability. This is evidenced by a number of actions the Government has already taken such as the establishment of fraud hotlines in several agencies, and the Office of Management and Budget's recent issuance of its circular on internal control systems.

S. 1780 would provide agencies with a mechanism to impose civil penalties against those who knowingly make false claims or statements for money, property, or services provided by the Federal Government. The proposed bill would strengthen the Government's ability to recover funds lost due to fraud and if aggressively implemented, its penalty provisions should serve as a deterrent to the commission of fraud. Enactment of this legislation would be a positive step toward providing the tolls necessary for effectively combatting fraud against the American taxpayer. The use of civil money penalties has been increasingly recognized as an effective mechanism to enforce a wide variety of Government program requirements.

GAO'S 1981 FRAUD REPORT

In May 1981 we issued Volume I of a three-volume report to the Congress entitled, "Fraud In Government Programs:—How Extensive Is It?—How Can It Be Controlled?". The report disclosed the results of a statistical analysis of over 77,000 cases of fraud and other illegal activities identified by 21 Federal agencies over a 2½ year period. We pointed out that the Department of Justice, for a number of reasons, often declined criminal or civil prosecution. We also pointed out that Federal agencies in some cases took administrative action focusing on recovery of the moneys lost as a result of fraud without assessment of any penalties. We recommended that Congress consider the enactment of legislation to authorize agency assessment of civil monetary penalties against persons and organizations who commit fraud against Federal programs.

Every year about 200,000 cases of all types of Federal crime, including fraud, are referred to the Justice Department for prosecution. With limited resources, the Justice Department is forced to concentrate on those cases which it perceives to be of greatest importance and likely to attract public attention. Over the 2½ year period covered by our review we projected that Justice declined to prosecute about 7,800 cases or 61 percent of the nearly 13,000 fraud cases agencies referred for prosecution. Lack of prosecutive merit or jury appeal and insignificance of the Government's financial loss were the reasons most frequently cited by Justice for declining prosecution.

We recognize that the Justice Department cannot prosecute every fraud case Federal agencies refer. For this very reason we consider it important that Federal agencies be authorized to levy civil money penalties and assessments in those fraud cases which Justice elects not to prosecute. The proposed act would be a useful tool for discouraging attempts to defraud the Government.

Mr. Chairman, at this point I would like to note that at your request we are currently conducting at selected agencies a detailed review of the effectiveness of administrative actions taken to: (1) Recover funds lost due to fraud; and (2) penalize those who committed the fraud. We believe the results of this current review should further support the need for this legislation.

SPECIFIC COMMENTS ON PROPOSED ACT

I would like now to address several specific features of the bill.

First, section 801(a) indicates that the proposed act would apply specifically to the Postal Service, to all agencies with statutory inspectors general authorized by the Inspector General Act of 1978 and to the executive departments designated in section 101 of Title 5 of the United States Code. This might be read to exclude the military departments as they are specifically designated as such in section 102 of Title 5. The Committee should consider clarifying this aspect of the bill.

Second, section 802(b) discusses the liability for false claims and statements. It provides for civil penalties of not more than $10,000 for each false claim or statement and assessment of not more than double either (1) The amount of money paid or the value of the property or services received as a result of the false claim; or (2) the amount of damage sustained by the United States including consequential damages and the cost of investigating the false claim or statement. We think the bill should be clarified to show that the term "consequential damages" is intended to cover all costs incurred by the Government, including such items as the cost of any administrative expenses incurred in documenting a false claim or statement.

Third, section 806 provides that the authority head may initiate proceedings upon approval by the Attorney General, or may initiate proceedings if the Attorney General takes no action within 120 days after receipt of the written notice of intent to initiate a proceeding. We think a waiting period of 120 days is too long given the need for prompt action in these cases. Something on the order of 60 days would, in our view, be reasonable.

BETTER INTERNAL CONTROLS NEEDED

While we support the proposed legislation as a useful measure toward changing perceptions regarding our tolerance of fraud, it is important to recognize that other approaches should be vigorously pursued as well. In our May 1981 report on fraud and in congressional hearings we have emphasized that a major element in the fight against fraud lies in strengthening systems of agency internal controls. Fraud and related illegal acts are better dealt with through prevention than through after the fact actions seeking recoveries and the assessment of penalties criminal or civil.

Internal controls will not guarantee that fraud will not occur. But sound controls make fraud difficult to perpetrate and we are pleased to acknowledge the increasing emphasis directed toward this important aspect of fiscal integrity. Legislation, which GAO supports, has been passed in the House (The Federal Managers Accountability Act (H.R. 1526)) and a bill has been reported out of this Committee (Financial Integrity Act (S. 864)) to strengthen systems of internal controls in the Federal Government.

Though in the long run the best way to prevent fraud and related acts is through effective internal control systems, there is no question but that fraud funds lost through fraud should be recovered, and that perpetrators of fraud should be penalized. Because it is impossible as a practical matter for every fraud case to be prosecuted by the Justice Department, Federal agencies need independent authority to take meaningful administrative action. S. 1780 would provide that authority.

Mr. Chairman, this concludes my prepared statement. I would be pleased to respond to any questions you or other members of the Committee may have.

Chairman ROTH. We next will call on J. Paul McGrath, Assistant Attorney General, Civil Division, Department of Justice.

Welcome to the committee.

Would you please introduce your colleague?

TESTIMONY OF J. PAUL McGRATH, ASSISTANT ATTORNEY GENERAL, CIVIL DIVISION, DEPARTMENT OF JUSTICE

Mr McGRATH. Thank you, sir.

I am here this morning with Mr. Alexander Younger, who is a supervising attorney in the part of our Commercial Branch which is responsible for civil fraud litigation.

Chairman ROTH. Your statement may be summarized if you choose. It will be included in the record as read.

Mr. McGRATH. Thank you, Mr. Chairman.

I would like just to summarize it and to point out what seems to us to be the principal points in the testimony.

First of all, I would like to say it is a pleasure to appear here today to state the views of the Department of Justice and the administration generally on S. 1780, which would provide for the imposition of civil penalties for false claims made to the United States in administrative proceedings.

I think it should be clear that the administration and Congress share a vital concern about program fraud. In many cases in the

past, such false claims—as has already been clear from what has been said this morning—have escaped prosecution.

We think it is vital that anything that can be done to alleviate gaps in the current enforcement system be closed up. And the reason for that is obviously that the victims of such fraud are the taxpayers in general and especially those citizens for whose benefit particular programs have been established by Congress.

As I am sure the committee is aware, the principal responsibilities in the Department of Justice for handling the Government's commercial and contractual litigation, including claims of fraud are handled by the Civil Division. Although a number of remedies are applied and a number of statutes are used, the principal enforcement mechanism is the False Claims Act, which provides for double damages and $2,000 forfeitures where false claims have been submitted to the Government or where people have conspired to defraud the Government with respect to contracts or other programs.

I want to make it clear, Mr. Chairman, that the administration strongly supports consideration by Congress of alternative remedies to supplement those remedies already in existence, because the ability to impose effective monetary sanctions on those who defraud the Government is both a useful deterrent and an efficacious means of recovering damages which the Government has suffered.

My written testimony summarizes the act, and I don't want to repeat that, but I would like to emphasize several elements of the proposed legislation which we regard as very important.

One is the definition of scienter or knowing in the act. In the bill as now drafted the language specifically states that a knowing false statement includes a statement that is made in wreckless disregard of the truth.

In our view, it is important to have that in this legislation. That codifies what we regard as the most appropriate holdings by courts of appeals and the Court of Claims under the False Claims Act.

We believe those holdings are the best statement of the law and that it makes a good deal of sense to incorporate them into the language of this statute, the language which Senator Rudman referred to earlier.

Second, and we think equally important, section 802 also makes it clear that the Government can recover consequential damages in proceedings under this bill. Again, we think that is very important because, otherwise, the Government cannot recover losses which are directly attributable to false claims.

One reason for this is that unless consequential damages are permitted there are many situations in which the Government cannot recover damages because the only person left with funds may be an individual with whom the Government is not in privity of contract. So people who defraud the Government in a very real way have been able to escape liability.

The principal reason why we strongly support the basic concept of S. 1780, which would permit fraud claims to be handled by administrative agencies, is that many fraud claims simply cannot be litigated in the courts in anything like an economically feasible fashion. The cost of litigation in the Federal courts is simply too great in many cases for it to make good economic sense to bring a civil fraud case in the Federal courts.

The administrative resolution of such claims would address this problem because that resolution would be a more expeditious and inexpensive method of resolving these claims and would also permit a more efficient allocation of the administration's resources, the resources of the Department of Justice and those of the courts.

One question that has been raised about this legislation is whether the administrative proceeding mechanism would improperly deprive persons who were brought in under fraud claims of their 7th amendment jury trial rights.

We want to make it clear that in our view the Supreme Court's holding in the *Atlas Roofing* case, which is cited in our testimony, indicates that there would not be a 7th amendment problem here because this statute would create new administrative rights which did not exist at common law; and that any other interpretation of the 7th amendment would, in our view, put an overly mechanical straitjacket on this area of the law.

Mr. Chairman, having said all of that, as the testimony indicates, there are a number of respects in which we would suggest modification of the bill as now drafted. One is that the bill as now drafted does not limit in dollar amount the claims that could be made before administrative tribunals.

We believe that it would be more appropriate to have a dollar limit. We have suggested a $50,000 amount for the amount claimed or $25,000 amount for the amount of damages. There is no magic in those amounts, but we do believe it would be more appropriate to have a dollar limit and the main reason for that is we feel the larger and more complex cases should be litigated in court where there is a broader variety of remedies available to the parties. The administrative mechanism which is provided for in this bill, we believe, is essentially necessary for smaller claims.

Second, the definitional section of the bill, which defines what investigating officials would be able to investigate false claims under this act, does not include the Federal Bureau of Investigation. We believe the Federal Bureau of Investigation should be included. It has a significant role in investigating fraud generally, and we believe that should be reflected in the bill. We are also concerned that if it is not reflected, one might later claim that there was something improper about the FBI being involved in such a proceeding.

We also believe that the requirement that a finding of possible criminal violation be reported to the Inspectors General and then to the Attorney General should be changed. We believe that, rather, any finding of possible criminal violation by agencies ought to be able to be reported directly to the Attorney General, and that there need not be any intermediary position in the chain of that message. Obviously, it would be equally appropriate if the report were made simultaneously to the Attorney General and the Inspector General of the agency.

Third, the bill as now drafted includes both false claims and false claims statements within its purview.

We believe that false statements should not be included. The reason for that is that under current law, including several Su-

96-086 O - 82 - 2

preme Court cases, only false claims and not false statements are actionable under the False Claims Act.

We believe that in starting out this new program it would make a lot of sense to go with the body of law that now exists, under the False Claims Act, to make for a much simpler transition to this new procedure.

If, over time, it seems to make sense to broaden it to add new areas of law, then I think that should be done. But in order to get it off to a running start it would be a lot more efficient to take the body of law that exists under the False Claims Act and move ahead with that in this area.

Fourth, the act now provides for a set 120-day limit on the time in which the Department of Justice would have to indicate either that it agreed that a proceeding under this legislation could be brought or to indicate that it should not be brought.

We oppose such a set time period. We think it makes much more sense to have a statutory direction to the Attorney General to enter into a memorandum of understanding with agencies to govern this part of the procedure.

Fifth, there is one point of clarification that we think is very important in the bill. Section 802(d)(2)(A) now seems to indicate that an agency is vested with litigation authority in court to enforce civil penalty assessments. We suspect that that was not intended because it seems to be inconsistent with other provisions of the bill. We believe it is inconsistent with 28 U.S.C. 516 to 519 also.

Sixth, the bill now provides for a $10,000 civil penalty. We believe that it would be a little more appropriate to adjust that downward to $5,000. The reason for that is that the False Claims Act now provides for a $2,000 penalty, and although in the past we have favored an upward adjustment of that amount, in any event we think that $5,000 would be more appropriate to avoid what otherwise would be quite a widely disparate result in cases, depending on whether you went the administrative route or whether you went to court.

There are several other items mentioned in my testimony. I don't believe I need to refer them right now. But I would like to reiterate that the administration strongly endorses the overall concept of S. 1780.

We believe that a procedure such as that set forth in this legislation would significantly enhance the Government's ability to deal with the ever-increasing problem of fraudulent abuse of Federal programs and the ever-increasing concern among the citizens of this country with such fraud.

I would be happy to answer any questions that the committee has, Mr. Chairman.

Chairman ROTH. Thank you, Mr. McGrath. Let me make two or three comments on your testimony.

My initial reaction is that your proposal that we include the FBI can be done. In the case of the 120 days I am sure you heard the testimony of the previous witness that it ought to be a shorter period. I will be candid with you. I am inclined to agree. I think the need in these cases is to expedite action and not delay it. But that is something we can look further into.

I was also very much interested in your comments on false statements, as a matter which I still have an open mind on. As you point out it is not covered in the False Claims Act. Let me give you an illustration. Let's go back to your case, where a large company falsely states that it is a small business and is awarded a contract and fully performs so that there is no financial impact or recovery.

What action do you think the Government should be able to take against that kind of a false statement?

Mr. MCGRATH. Whether or not there ought to be debarment or suspension proceedings or some such thing I think perhaps is beyond the scope of what we are talking about this morning. Our view is that the main purpose of this legislation is to remedy situations where the Government has lost money, where the taxpayers in some way have been economically deprived of money, where there has been a loss. In the situation that you have referred to, Mr. Chairman, there is no loss to the Government. It may be that someone has done wrong, that they have not followed procedures correctly, that they are subject to criminal prosecution under 18 U.S.C. 1001. But if the Government has not been injured, it is a big step to go and penalize someone civilly for that.

On the other hand, false claims have been defined quite broadly by the courts to include any false payment demand. So that under the Supreme Court case just a few years ago, *United States* v. *Bornstein,* I think you can have a situation where if indeed the false claim that is made results directly in the payment to the individual even if there isn't a loss to the United States, there could be a recovery.

So I guess what I am really saying is that if there is a mere statement out there that is false, just as false as you can imagine but it hasn't led to the payment of money directly, then it should not be actionable. However, any false statement which leads directly to a false payment demand which leads directly to a false payment should be.

I can give you one example that I think is a pretty good one, that has been in some cases.

If one makes a false statement in a loan guarantee application and the loan is given, and there has not been a default, that may be a false statement that would be actionable under the criminal law but under the False Claims Act it probably would not be unless there is some default, unless there is some damage to the Government.

Chairman ROTH. As you know, this legislation at least seeks to address the question of false statements, and I suppose what we are saying here is that, while there is not a direct financial impact, these statements do help to defeat a legislative policy of giving opportunities to small businesses, minority groups, and so forth.

Mr. MCGRATH. Yes.

Chairman ROTH. So, I guess it depends on how you define injury and, of course, under the False Claims Act there is no protection. I think this is something that we are going to have to carefully consider because it does raise some problems in my own mind. I think there is a very serious problem here.

I would like to go back to the point that I raised earlier. Do you think there are adequate checks to prevent this procedure from

being used to harass small businessmen or someone in the private sector? What would be your comment on that?

Mr. McGRATH. My comment is that there are adequate checks in that regard. I believe one of the provisions that was discussed in that earlier discussion with Mr. Socolar was the definition of when one knowingly submits a false claim. And the language in this bill about submitting something with reckless disregard of the truth seems to us very appropriate because without that language it is much easier for the defendant to come in and say, well, yes, it turned out what I stated was false but I didn't know that. I just didn't check it.

If it is a situation where the information is right there, it is the kind of thing he would always check, he would know about it, it seems to us that it is not appropriate to apply an overly strict definition of scienter. The courts that have held that reckless disregard of the truth is the standard in this area would not have any problems with protecting the rights of defendants. One reason that they have held, however, is that under the False Claims Act the burden of proof generally has been clear and convincing evidence and not a preponderance of the evidence.

That has been one of the safeguards. I would think that if this particular statute did not address the burden-of-proof question that probably the courts would incorporate into it a finding that it was clear and convincing standard as it generally is in the Federal courts in fraud cases. That would be another protection that individuals would have.

In general, they have the whole protection of the body of law that has grown up around civil fraud in the Federal courts, which body of law makes it more difficult to prove a fraud claim but at the same time protects those against whom the claim was brought.

Chairman ROTH. Senator Rudman?

Senator RUDMAN. I will pick up that point because I am aware of the "clear and convincing" test in the Federal jurisdictions. Of course, that is quite contrary to the level of proof in most State jurisdictions in this kind of case.

Mr. McGRATH. Yes; I believe it is.

Senator RUDMAN. As a matter of fact, it is, and one of the things that I think we are seriously concerned with here is to make sure that the chairman's concerns as expressed, and I think very well expressed, are met. This should not be a vehicle for abuse. On the other hand, one of the clear reasons for this legislation is to give the administrative agencies a better opportunity to in fact get at some of these fraud claims which historically have been quite difficult to prove, and I know that the American people don't understand some of these cases when they read of them in the popular press especially the more flagrant ones.

One of the things I want to consider here is as this works its way through the committee and the Senate is whether we may want to have a definition in here of what the standards will be. I am not sure that I would go with clear and convincing. I am sure you didn't advocate that. You simply suggested that as what they might do. I am not sure that is what they would do in this case. I think it is possible. Maybe we would want to go to the kind of level

of proof that many of the States use, that is, preponderance of the evidence. That is the first point.

You don't really have to answer that. That is just a comment.

I take it from what you said regarding the definition section at the bottom of page 7, in fact in your testimony you used the words "knowingly includes reckless disregard" that it might be better draftsmanship if the word "means" were stricken and the word "includes" were inserted there.

Mr. McGRATH. Yes; I agree.

Senator RUDMAN. I want to establish a major point here, that it is your belief and the feeling of the Department of Justice that we ought to have a dollar limit. That troubles me, Mr. McGrath. It troubles me for two reasons. First, of course, is the record of the Department of Justice, and I do not say this critically, having been in a similar role myself as a State attorney general. Your statistics don't look all that good but when you get into the parameters of each case I am sure there was a reason. Obviously you don't want to go ahead and start prosecution in any of these cases under various acts unless you have some likelihood of success. Sometimes I think you are a bit too conservative but that, of course, is a matter of one's judgment. You may get a situation here where you choose not to prosecute even though it is above your statutory limit. Let's say for a hypothesis here that we put in preponderance as a burden in this legislation which eventually passes in that form. Don't you think that by doing that you are denying the agencies a possible crack at success at some fraud which under your levels of proof and your act may be difficult which they might be able to enforce with all of the procedural due process that anyone is entitled to but maybe with a different standard?

That is my problem.

Mr. McGRATH. I understand. First of all I think you understand that fraud cases are frequently not brought for a whole variety of reasons and particularly when you start talking about the kind we are talking about here, collectibility more often than not is the main reason. The person who has committed the fraud has done it because he was broke and he is still just as broke when we go to bring the lawsuit.

Senator RUDMAN. Unfortunately we often reward those people with more money later. We have found such examples in this committee.

Mr. McGRATH. Yes. A problem that we have with making the remedies or procedures under this particular act totally different from the False Claims Act is that basically we are going after people for the same thing, for penalties where a fraud has been committed. And although this is not a criminal statute, where you are looking for double damages and forfeitures, it is still an extreme remedy. And it does seem to us that it is appropriate to have at least generally the same kind of procedural safeguards in terms of what constitutes a fraud and so on applied in this area as it would if we were in court.

It doesn't have to be exactly the same. Consistency doesn't have to be carried out that far. But it does seem to us that because this is an extreme remedy that we ought to be careful, because otherwise all kinds of due process quasi-constitutional claims can be

raised. I think that the area of burden of proof is probably a good one. It isn't to say that you couldn't have a burden of proof in fraud cases that was preponderance of the evidence, that that would be unconstitutional, but nevertheless the Federal courts have grafted a somewhat stricter burden of proof on fraud cases and I think that we ought to be kind of careful before we go the other route in this legislation.

I think the other question you were raising, however, if I understand you, is essentially if the Department of Justice has signed off on a case, has decided it is not an appropriate case for criminal sanctions and they declined to bring a civil suit, should the agency have another crack at it? In our view that would not be appropriate for several reasons.

One, it strikes us as beginning to bring an element of unfairness into the situation. A company or an individual comes in, there is a whole review as to whether there would be a lawsuit for a particular kind of penalty, it is decided that it would not be brought for whatever reasons, not enough evidence, unfairness, noncollectibility, whatever. Then to have an administrative agency take a second crack at that strikes us at least as bordering on unfair.

Second, the reason why we have central litigating authority in the Department of Justice is a feeling that there should be some consistency in handling, in at least major litigative endeavors, major enforcement endeavors. And this area we are talking about now, program fraud civil penalties, ought to be handled uniformly. We shouldn't have wildly disparate handling in the Department of Defense and in HUD and in HHS. There ought to be some kind of consistency of approach.

The only way you are going to be sure of having it under this kind of statute which would permit administrative claims to be brought in a number of different agencies is if you have this kind of check and balance in the Department of Justice. For that reason, we feel that if the Department of Justice has declined and feels a suit should not be brought that it should not be brought.

Senator RUDMAN. I understand that argument. I agree with parts of it and disagree with parts. Let me ask you this: How many people do you have in the section that are dealing right now with Federal?

Mr. MCGRATH. We have 125 in our commercial branch but they handle all kinds of things. There are probably about 2 dozen people who work most of the time on fraud cases. There are other lawyers who handle fraud cases but of course a large percentage of fraud cases are handled by the U.S. attorney's offices which we supervise in this area. So I can't give you an exact number of lawyers who are involved in fraud cases but we do have a large number of attorneys who are involved.

Senator RUDMAN. Do you feel it is inaccurate to state that in fact as you go through all of the criteria relating to whether or not you will go forward in a case that there are instances where there is probably collectibility, it may be a difficult case, but something you think you be able to go ahead with, but for reasons of just sheer numbers like any other office you choose those cases that have the greatest amount of money in them, and the greatest chance of success, that there are cases in fact that do not go forward out of these

thousands of cases that were declined that in fact might have collectibility and a reasonable chance for success but the question of priorities, questions of the mass numbers you are dealing with that you just make decisions that exclude some of those? Is that inaccurate?

Mr. MCGRATH. I hope it is inaccurate but I can't swear to you that it doesn't happen. If it happens in an area, the area it happens in is the area of the small cases. That is the real problem—the case that comes in involving $5,000, $10,000, or $20,000. It would cost that much or more than that to prosecute it civilly. We do not have a great excess of resources in our litigating groups. And that kind of case, I am concerned, especially in the future as things get tighter, is going to be much more difficult to bring.

That is the area that we have been focusing on and are concerned about.

Senator RUDMAN. Finally, Mr. Chairman, I want to state to you, Mr. McGrath, that I believe that there is a certain deterrent value to prosecuting those claims. I can think of an instance that is taking place now in your Criminal Division in San Diego that has to do with the Defense Department, some shipyard operations out there that is of a serious nature. And there are others around the country I have been aware of, some of which have not been prosecuted either criminally or civilly. I think the deterrent value of going after some of these even small claims has something, you can say something about it in terms of really helping to put the word out that the Federal Government does not intend to be defrauded and will move vigorously even though the claim might be small.

So I think your points are very well taken. I think your testimony has been very helpful. Obvously we have some choices to make here. I have found your comments very helpful. I agree with most of them. I disagree with several.

Mr. MCGRATH. I would just like to say that that deterrent point you mentioned is the one that is critical to us. You can never find all the frauds that are committed. You have to hope that your system is strong enough that it deters people who you will never know about from committing fraud. I think that is the essence of it, Senator. I agree.

Senator RUDMAN. Thank you, Mr. Chairman.

Chairman ROTH. Thank you Senator Rudman and you, Mr. McGrath. We appreciate your being here.

[Mr. McGrath's prepared statement follows:]

PREPARED STATEMENT OF J. PAUL McGRATH

Mr. Chairman and Members of the Committee:

It is a pleasure to appear before you today to furnish to the Committee the views of the Department of Justice on S.1780, a bill to provide for the imposition of civil penalties for false claims and statements made to the United States, or to those receiving property or having contractual relations with the United States.

Among our principal responsibilities in the Department of Justice is the handling of the Government's commercial and contractual litigation, including litigation to recover losses resulting from frauds upon the Government, and from the corruption of federal employees. In the fraud area, this litigation typically involves suits brought under the False Claims Act (31 U.S.C. §§231-235) to recover double damages and $2,000 forfeitures from those who submit false claims to the Government, from those who cause such false claims to be submitted, or who conspire to defraud the Government with respect to its contracts and other programs. In this respect, the False Claims Act is somewhat analogous to the objectives which the principal provisions of S.1780 seek to achieve through administrative action.

The Department of Justice supports consideration by Congress of alternative remedies to supplement the Government's principal rights to seek redress against the perpetrators of fraud through the imposition of criminal sanctions or judicially imposed civil

liability. We believe that the imposition of effective monetary sanctions by the agencies which have themselves been victimized may serve both as a useful deterrent and as an efficacious means of recovering damages in those cases which would be inappropriate for resolution through the judicial system. We have examined S.1780 with these views in mind.

S.1780 would establish a civil penalty mechanism for the disposition of cases involving false claims and false statements to the United States, or to those with whom it has commercial relations in the form of grants or contracts. The bill contemplates that various Federal agencies, as well as the Postal Service, will be authorized to impose the prescribed civil penalties.

At the heart of this civil penalty mechanism are the definitional provisions in proposed sections 801 and 802.

In section 801, a claim is defined to mean either a request or demand to the Government for property, services or money. A "claim" under section 802 also includes requests or demands which are made to recipients of Federal funds, or to parties to contracts with the United States in circumstances in which the Government provided a portion of the money or property claimed. Section 801 also defines a statement to mean, in substance, written representations or certifications made to the Government, its grantees or contractors. A "statement" differs from a "claim" in that it does not necessarily contemplate the transfer of Federal money, property or services to the maker.

Section 802 sets forth the circumstances under which a claim or a statement will give rise to liability for civil penalties. The section requires that the Government show that the claim or statement was false. This element of falsity looks generally to whether or not the claim or statement contains information which is substantially inaccurate, or -- in the case of a claim -- is for money, property or services which were not provided in accordance with law.

Section 802 does not, however, require the imposition of civil penalties simply because a claim or statement is false. As subsection (b) provides, a false claim or statement must be knowingly made before liability attaches. This element of scienter -- in this context, knowledge of the falsity of the claim or statement -- encompasses both actual knowledge of 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. As many courts have recognized, since concealment is the very essence of fraudulent conduct, and since fraudulent conduct itself is involved in matters relating to false claims and false statements, the use of this traditional tort concept of recklessness is fully warranted. S.1780 thus in our view wisely includes reckless disregard of the truth as part of the scienter requirement of the bill.

Section 802 also insures that the Government can recover its consequential damages in any proceeding under the bill. In our experience, in many matters involving program fraud, the Government is unable to seek redress against those with whom it had privity of contract. A disturbing number of cases involves corporate entities that have become defunct before proceedings can be initiated, while the principals of such entities -- with whom the Government had no privity of contract -- have sufficient assets to recompense the Government for the fraud which they perpetrated through their former corporation. To insure against any interpretation which would deny full recovery to the Government where proceedings are initiated against those with whom the Government had no privity, S.1780 properly includes consequential damages in Section 802.

We at the Department of Justice strongly support many of the other concepts in S.1780. As I indicated previously, we believe that a mechanism for resolution of many fraud matters through administrative proceedings is long overdue. The Government's present remedies for attempted or successful fraudulent conduct are confined to the judicial system. Many of the Government's false claims and false statement cases involve relatively small amounts of money. In these cases, litigation in the Federal courts may be economically unfeasible because both the actual dollar loss to the Government and the potential recovery in a

civil suit may be exceeded by the Government's cost of litigation. Moreover, the large volume of such small fraud cases which could be brought -- such as matters including fraudulently-obtained FHA-insured home improvement loans, or CHAMPUS or Social Security benefits -- would impose an unnecessary burden on the docket of the Federal courts. Administrative resolution of such small cases will, in our view, address this problem by establishing an expeditious and inexpensive method of resolving them. At the same time, administrative resolution of smaller cases would permit a more efficient allocation of the resources of the Department of Justice, thus enhancing the Administration's efforts to control program fraud.

We believe that the administrative proceedings outlined in section 803(b) will achieve this result, and will withstand constitutional challenge. In light of the Supreme Court's holding in Atlas Roofing Co. v. Occupational Safety and Health Administration, 430 U.S. 442 (1977), we do not believe that these proceedings would violate the Seventh Amendment's guarantee to trial by jury. In Atlas Roofing, the Court rejected a Seventh Amendment challenge to the administrative penalty provisions of the Occupational Safety and Health Act of 1970 because it concluded that Congress had created new rights which did not exist at common law when the Amendment was adopted. The Court held that:

> when Congress creates new statutory "public rights," it may assign their adjudication to an administrative agency with which a jury trial would be incompatible, without violating the Seventh Amendment's injunction that jury trial is to be "preserved" in "suits at common law."
> 430 U.S. at 455.

The rights created here are not co-extensive with any common law cause of action known when the Seventh Amendment was adopted. In addition, we believe that the statute may, like the False Claims Act, be characterized as a "remedial" statute imposing a "civil sanction." See United States ex rel. Marcus v. Hess, 317 U.S. 537 (1943). Given these considerations, the administrative proceedings do not deny trial by jury.

While we thus endorse many of the essential provisions of S.1780, we believe that the bill could be improved along a number of lines. First, we believe that the coverage of the bill should be limited to claims below certain dollar amounts. In our view, the contemplated administrative proceedings should be confined to cases in which either the amount claimed does not exceed $50,000, or the Government's damages do not exceed $25,000. Such limitations are appropriate because, in larger and more complex cases, the resort to administrative proceedings may deprive both the Government and the defendant of remedies which would be available to it in a judicial proceeding. Moreover, the administrative civil penalty mechanism is most efficacious for pursuing smaller fraud matters, where the amounts of the claims make civil and

criminal litigation impracticable. At the same time, larger fraud cases often involve a myriad of inter-related claims and counterclaims for which the Federal courts alone can provide full relief to all the parties.

Secondly, we believe that the scope of investigatory jurisdiction, as defined in section 803(a)(1), should be broadened. Section 803(a)(1) mandates that the "investigating official" be either the Inspector General for an agency covered by the Inspector General Act of 1978, or, for an agency not so covered, an official within the agency designated by the agency head to investigate cases to be brought under the administrative mechanism. Given the provisions of 28 U.S.C. §535, we do not believe that the Federal Bureau of Investigation should be excluded from cases falling within the coverage of the bill. In addition, we believe that the reporting requirement set forth in section 806(d)(1) should not be structured to require agencies that do have Inspectors General to report evidence of official corruption to the Attorney General through the Inspector General. Given the provisions of 28 U.S.C. §535, we believe that any such reports should be made directly to the Attorney General, or to both the Attorney General and the Inspector General simultaneously.

Third, we question the desirability of the inclusion of false statements within the scope of the bill. Under existing law under the False Claims Act, a false statement alone is not actionable.

United States v. McNinch, 356 U.S. 595 (1958). Accordingly, false statements are presently actionable through criminal remedies provided in 18 U.S.C. §1001 and similar statutes. The deletion of false statements from the coverage of the bill will make the bill consonant with the False Claims Act, and will permit agencies to draw upon a body of established case law in interpreting the statute.

Fourth, we believe that the 120-day time limit specified in section 806(a)(2) is inappropriate. We believe that a far more desirable approach to the preceived problem of the processing of referrals is a statutory direction to the Attorney General to enter into memoranda of understanding at the request of any agency head. These agreements will provide for a limited review period for the Department to determine whether to initiate criminal or civil proceedings.

Fifth, we believe that section 802(d)(2)(A) is in need of clarification. This section, which has been inserted in that portion of the bill establishing the elements for liability, appears to contemplate that an agency head will be vested with litigation authority to enforce civil penalty assessments. We believe that the action is undesirable because section 805 deals with collection and

enforcement of civil penalty assessments. Those provisions look to a civil action brought by the Attorney General. To the extent that section 802(a)(2)(A) contemplates otherwise, it is discordant with other provisions of the bill and with 28 U.S.C. §§516 and 519. See I.C.C. v. Southern Railway Co., 543 F.2d 534 (5th Cir. 1976).

Sixth, we believe that the $10,000 civil penalty amount may require downward adjustment. The existing forfeiture provisions of the False Claims Act -- which Congress enacted in 1863 -- impose a $2,000 forfeiture for each false claim. A person making a false claim, or causing a false claim to be made, could conceivably be liable under either statute, and to avoid widely disparate results in potential forfeiture liability, we recommend that the forfeiture amount be set at $5,000.

We also suggest we suggest that the Subcommittee consider whether the administrative proceedings contemplated in section 803 should be sufficiently flexible so as to permit agencies which are not covered by the Administrative Procedure Act to employ alternative procedures. We are reviewing within the Administration what standards should govern the conduct of such proceedings.

Finally, we also urge the Subcommittee to weigh the desirabilty of section 803(d), which permits Inspectors General and other investigatory officials to use compulsory process to obtain testimonial evidence as part of an investigation. Under the existing provisions of the Inspector General Act of 1978, Inspectors General are authorized to compel production of documentary evidence alone. Neither the Inspectors General, nor the Federal Bureau of Investigation --- the Government's principal law enforcement investigatory agency -- presently issue investigative subpoenas to compel testimony. Section 803(d) would permit such a departure, and we urge that the Subcommittee keep this legislation consistent with present law.

In conclusion, let me reiterate that the Department of Justice strongly endorses the overall concept of S. 1780. We believe that, if enacted with the recommendations which we have set forth above, the bill would significantly enhance the Government's ability to deal with the ever-increasing problem of fraudulent abuse of Federal programs. We stand ready to work with the Subcommittee and its staff to provide whatever assistance it desires to arrive at agreement upon a bill which reconciles all of our concerns.

96-086 O - 82 - 3

Chairman ROTH. We will now call forward a panel including Richard P. Kusserow, Inspector General, Health and Human Services, and Sherman M. Funk, Inspector General, Department of Commerce.

We welcome both of you.

We appreciate the fact you are here today.

You have heard me say before that your full statement will be included in the record as if read, so that you will, hopefully, summarize.

TESTIMONY OF RICHARD P. KUSSEROW, INSPECTOR GENERAL, HEALTH AND HUMAN SERVICES, AND SHERMAN M. FUNK, INSPECTOR GENERAL, DEPARTMENT OF COMMERCE

Mr. KUSSEROW. Thank you, Mr. Chairman.

I am Richard Kusserow, Inspector General of the Department of Health and Human Services and I am pleased to appear before you today to discuss the utility of providing Federal agencies with the authority to recover damages and impose civil penalties administratively for filing of false claims or statements.

I also want to take this opportunity to thank the committee for its continuing efforts to combat fraud, waste, and abuse in Federal programs. The committee should be congratulated for its fine work. As you know, many Inspectors General have been advocating the need for legislation along the lines of that under consideration today. It will give us a vital additional weapon to control fraud.

I consider myself fortunate to be the Inspector General of a Department which already has legislation covering its health financing programs similar to the bill you have under consideration. As you know, the Omnibus Budget Reconciliation Act of 1981, Public Law 97-35, gave our Department the first civil monetary penalties law of its kind.

Under that law, section 1128A of the Social Security Act, persons participating in medicaid, medicare, or maternal and child health programs who submit false or prohibited claims to the Government for reimbursement under those programs are subject to civil penalties.

The penalty cannot exceed $2,000 for each item or service falsely or wrongfully claimed, and is in addition to any other penalties that may be prescribed by law.

In addition, the person can be assessed an amount of up to twice the amount wrongfully claimed.

We in the Department have begun to take the steps necessary to implement this program. I am happy to report substantial progress on many fronts. First, the organizational arrangements have been worked out. Investigations will be conducted by the Office of Inspector General; General Counsel of HHS will provide the legal support, including the administrative prosecution of the case if a hearing is requested; and the administrative law judges who will hear the cases will be assigned to the Health Care Financing Administration.

During the past few months, I have been developing plans for a significant reorganization of the OIG. As part of this reorganization, I am establishing a Civil Fraud Division which will include a

unit to be responsible for overseeing the operation of the civil penalties process.

The Division will be a major component of the Office of Investigations. It will work closely with all our investigators, both in Washington, D.C., and in the field, to assure aggressive use of this new antifraud mechanism. It will also work closely with the Civil Division of the Justice Department to assure that they follow through on cases appropriate for prosecution under the False Claims Act.

We hope to have the new Division and the Civil Fraud Unit fully operational shortly.

We have already begun reviewing ongoing Federal and State investigations to uncover instances where a civil penalty would be the appropriate remedy.

The OIG has also begun to provide guidance to representatives of State medicaid fraud control units on the development and investigation of cases for funneling into this system, and we are developing training programs for both State and Federal investigators.

We are in the process of drafting a comprehensive legal and investigative manual on the civil money penalty law, which should be completed shortly. We will be pleased to provide copies to the committee when it is complete.

Finally, we have been meeting with respresentatives of the Justice Department to work out procedures for coordinating our handling of these cases with them.

In 1979, the Inspector General of our Department signed a memorandum of understanding covering these procedures with the Assistant Attorneys General for the Civil and Criminal Divisions. I am providing a copy of the memorandum of understanding for the record. The main objective of our recent conversations with Justice is the further refinement of the memorandum of understanding in order to assure that we will have the most effective program possible. I am extremely hopeful that we can develop the kind of approach that will prove so successful that our procedures will be able to serve as a model for other agencies to follow should legislation along the lines of S. 1780 become law.

[The memorandum of understanding referred to follows:]

MEMORANDUM OF UNDERSTANDING BETWEEN THE DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE AND THE DEPARTMENT OF JUSTICE ON PROCEDURES FOR THE IMPOSITION OF CIVIL MONEY PENALTIES

I. INTRODUCTION

The purpose of this Memorandum is to delineate procedures which the Department of Justice (DOJ) and the Department of Health, Education, and Welfare (HEW) to impose civil money penalties for certain fraudulent activities in the Medicare and Medicaid programs.

II. GUIDELINES

A. All matters will be referred to DOJ (used herein to denote both the Department and the FBI and the United States Attorneys) before HEW may initiate any action to impose civil money penalties except where DOJ has authorized HEW to proceed without prior authority.

B. Where a matter referred to DOJ for criminal prosecution is pending prosecutive decision, or completion of criminal process, HEW will not initiate any action to impose civil money penalties unless the DOJ so authorizes.

C. Where a matter has been referred to the DOJ for criminal prosecution, and prosecution has been declined, or where a matter has been referred only for civil consideration, HEW will initiate action to impose civil money penalties only if:

1. The DOJ declines to take civil action; or
2. The DOJ fails to notify HEW, within sixty days from the date on which the matter is referred for civil action, of its decision whether or not to proceed with litigation; or
3. The DOJ otherwise authorized HEW to proceed.

D. Where a provider of services under the Medicaid program is convicted in State court of an offense arising out of his participation in that program, and where the Federal share of the claims involved is in excess of $30,000 or where the total of the Federal share of the claims, plus forfeitures and other damages recoverable in a civil fraud action, is in excess of $75,000, HEW will initiate action to impose civil money penalties only after the matter has been referred to the Civil Division, and

1. The Civil Division has declined to bring a civil action; or
2. The Civil Division has failed to notify HEW, within sixty days from the date on which the matter was referred, of its decision whether or not to proceed with litigation; or
3. The Civil Division has otherwise authorized HEW to proceed.

III. REPORTS

A. HEW will notify the Civil Division when any civil money penalty action is initiated and report on the results of that action.

B. HEW will provide the DOJ with an annual report setting out the number of civil money penalty actions begun, the amounts claimed, and the status of disposition of each action.

PHILIP B. HEYMANN,
Assistant Attorney General, Criminal Division, Department of Justice.
BARBARA ALLEN BABCOCK,
Assistant Attorney General, Civil Division, Department of Justice.
THOMAS D. MORRIS,
Inspector General, Department of Health, Education, and Welfare.

Mr. KUSSEROW. Turning to S. 1780, let me first state my conviction that this administration will support in concept a legislative proposal which promises to save the taxpayers money by reducing fraud and abuse in Federal programs and by permitting us to recoup for the Government any money that has been wrongfully paid.

In general, I support the concepts and principles embodied in S. 1780. I believe that for many agencies it will serve as a significant additional tool to control fraud and abuse.

The authority to impose penalties administratively would provide a means of pursuing those who defraud the Government in circumstances where criminal prosecution is not pursued or the cost of civil litigation is more than the fraud itself.

For instance, there are cases of providers of medical services who have submitted scores of false claims to medicare, but who, because the total dollar amount of their fraud was not substantial, have not been prosecuted either criminally or civilly by the Department of Justice. If the provisions of S. 1780 had applied, these providers could have assessed penalties administratively.

We endorse many features of S. 1780, including:

The bill makes clear that organizations, as well as individuals, would be liable for the filing of false claims.

The maximum penalty for each false claim—$10,000—is considerably higher than our statute provides.

Also, under S. 1780, the statute of limitations is 6 years from the date of submission of the claim.

I do have a suggestion for your consideration. I do not believe it is necessary to specify a time limit in the statute for Justice to respond to our case referrals. Under section 1128A, the Justice Department has agreed to respond to HHS case referrals in 60 days. However, not every agency has the same kind of caseload. We therefore believe it would be better not to specify a deadline in the statute, but instead permit each agency to work out a suitable arrangement with Justice.

My staff is preparing a paper which addresses some of our less significant or technical concerns. We would like to provide those additional suggestions to your committee staff after they are prepared. I also will provide them with a chart which compares the most significant features of section 1128A, S. 1780, and the False Claims Act.

I want to thank you again for affording me this opportunity to present my views on S. 1780.

After Mr. Funk has had an opportunity to make a statement, we will be prepared to answer any questions.

Chairman ROTH. I think we will hear first from Mr. Funk.

Mr. FUNK. Thank you, Mr. Chairman, Senator Rudman.

It is my pleasure to appear before this committee today to testify about S. 1780, the Program Fraud Civil Penalties Act.

I especially appreciate the committee's interest in hearing from the Inspectors General.

My interest is not academic because, under the bill, the Inspectors General would be responsible for investigating allegations of false claims and false statements.

I should like to note that my statement and comments today reflect my personal opinions as an Inspector General and do not necessarily represent the position of the administration.

Before I give some examples of the kinds of cases we have in commerce that would benefit from the availability of administrative penalties, I should like to make some general comments about this area.

Admittedly, criminal prosecution resulting from our investigations represents the more glamorous side of Inspector General activity. Many of us are "graded," in effect, by the number of convictions to which we contribute. This emphasis on criminal proceedings raises a few troublesome questions:

For one thing, it places administrative action on a back burner until a decision is reached about criminal action. The practical impact of this is very likely to be inordinate delays in seeking recovery of fraudulent expenditures or in dismissing or otherwise punishing employees guilty of misconduct. Such an impact is exacerbated by the light penalties which courts tend to award white collar criminals; employees perceive the end product of fraud to be a slap on the wrist. Swift and equitable administrative penalties would be more meaningful in many cases, and would hit the wrongdoer where it hurts most, in his checkbook.

Another problem is that once Justice has declined criminal prosecution or civil action, the Department may be left without an adequate or appropriate remedy against those who have corrupted its programs. The wrongdoer, if he or she is faced with an adverse personnel action, can always point to the Department of Justice declination as exculpatory material.

An even more difficult problem arises from the "parallel proceedings" which are inevitable when we seek criminal, and civil and/or administrative sanctions concurrently. If S. 1780 is enacted, we can anticipate that a number of false submission cases will start our as criminal investigations involving grand jury presentations.

Given the case law interpreting rule 6(e) of the Federal Rules of Criminal Procedure, which governs access to grand jury materials, it is unlikely that our investigators could get a court order for access to any grand jury records of testimony for use in an agency administrative hearing even after the criminal case had been concluded.

Actually, the system is even worse than that: If any of our investigators worked with the grand jury, we would have to disqualify them from working on the administrative case.

Indeed, we have this precise situation in one of our major current investigations. To avoid any possible contamination of grand jury material, we are fielding a complete double team: One is composed of auditors and investigators assigned to the criminal prosecution side. The second, which scrupulously avoids contact with the first, consists of auditors and investigators assigned to the noncriminal side.

They all are handling the same case. I consider this a wasteful duplication of effort. I respectfully suggest that, at some future time, the committee may wish to explore the effects of rule 6(e) on Federal administrative investigations.

S. 1780 may not solve all of these problems, but it clearly will plug some of the larger administrative loopholes. Not least, it will give us a powerful self-help remedy which also will serve as an effective deterrent.

Specific aspects of the bill merit discussion. I am pleased that S. 1780 explicitly covers false statements as well as false claims. Often, a false statement with no monetary loss can damage the Government—in terms of decreased public integrity—as severely as monetary losses caused by false claims.

I also applaud the bill's coverage of false submissions to Government recipients and other intermediaries. The same reasons for penalizing false submissions to the Federal Government apply when those submissions are made to a federally funded entity or agent; indeed, this is where big ticket fraud is most likely to occur.

I am delighted with the provision for collecting civil penalties and assessments through setoff. Such a provision should substantially decrease the burdens on the Department of Justice associated with court-ordered recoveries.

The bill also permits monetary sanctions to be imposed in addition to any criminal penalty provided by law. This would create a greater likelihood that the Government will be made whole for losses occasioned by false submissions. Of course, in many criminal

cases restitution has been ordered by the court. Far too often, however, the Government has not recouped its losses, S. 1780 would provide this opportunity.

Finally, as I have mentioned, under the proposal it would be the responsibility of the Inspectors General to establish probable cause, building the Government's complete case for an administrative hearing. In furtherance of their investigations, the bill would give the Inspectors General the authority to issue testimonial subpenas. Although we always hope for cooperative witnesses, experience teaches us that in many investigations there is no way to insure the cooperation of witnesses short of compulsory process. Testimonial subpenas are therefore essential if we are to accomplish the goals of S. 1780.

I would like to offer a few illustrations of how the Department of Commerce can use administrative penalites to the advantage of the Government, or could have used them earlier if they had been available.

We have spent considerable resources in reviewing the $6 billion of local public works grants awarded by the Economic Development Administration. The authorizing statute for round II of this program required that at least 10 percent of the amount of each grant be set aside for bona fide minority business enterprises [MBE]. Too often, this requirement was discharged fraudulently either by the use of "front" firms, that is, phoney MBE's, or by using legitimate MBE's to conduct only token work. In either case, such fraud not only made a mockery of the law, but performed a profound disservice to the minority business community. Here is a case in point.

One of our investigations revealed that a local public works contractor submitted false statements to EDA regarding employment of a minority subcontractor on several local public works projects. Specifically, the contractor entered into three subcontracts with a minority firm for a total of $280,000 in construction work.

When the projects were completed, however, the MBE had received only $17,000. All of the other costs attributed to the minority firm were incurred by the prime contractor through employees fictitiously assigned to the MBE's labor force, or through supplier accounts set up and paid for by the prime with no participation, control, or benefits by the minority firm. In fact, the MBE's only actual employee on the three projects was one carpenter.

The Department of Justice declined criminal prosecution in favor of administrative action. We recommended to EDA that the MBE costs for the three projects be disallowed to EDA, and EDA has agreed to seek recovery. I believe that the chances for such recovery are slim. Frankly, I am not even convinced that it is fair to proceed against the grantee, because we have no evidence that it acted in bad faith.

I understand why Justice declined to go criminally. After all, the Department suffered no monetary loss in this case. We awarded money to build three projects, and they were built.

Nevertheless, the public policy of minority set-asides enunciated by the Congress was sorely abused. If we had a procedure then in effect for the assesment of an administrative penalty, the Department could have moved swiftly against the prime contractor, assur-

ing a direct sanction for the company's false submissions, instead of seeking an indirect sanction from the grantee who did no wrong.

The dollars involved here are not large, but the principle is. The potential deterrent effect is larger still. I recently visited all of our OIG offices around the country and, without exception, each of them had a number of local public works MBE cases remarkably similar to this; none appeared likely to obtain criminal prosecution.

This is very disheartening to our people, who take very seriously the fight against fraud, waste, and abuse, only to see the results of their effort collect dust in the file.

Let us look at another area, where we not only have a dollar loss but a very significant one. About half a billion dollars of EDA's portfolio of direct and guaranteed loans are now in liguidation, default or special handling which is likely to precede default.

The taxpayers will have to pick up most of the resulting tab. When we dig into some of these losses, we often find that the loans were predicated upon false or misleading statements made in the loan applications. Of course, we proceed criminally and/or civilly where we can, but we would be in a better position to take effective action if we were armed with the tools of S. 1780.

Civil penalty legislation would help us also in deterring fraud by Federal employees.

After a recent investigation, a Commerce employee pleaded guilty to submission of false claims and statements. On 33 separate occasions, she had falsely claimed overtime totalling almost $6,000. The judge ordered restitution as part of her sentence, provided that she remains employed. There is no provision for restitution should be become unemployed. Under Department rules, however, her conduct required dismissal. The assessment of a civil penalty would restore the Government's loss in this circumstance.

Let me mention a case that came to my attention just yesterday. A former employee of the Department has apparently had free use of a GSA car since he was terminated as an employee on October 31, 1980. A GSA car was first assigned to the employee under questionable circumstances back in mid-1977. Over the last year the Department has paid approximately $3,000 in vehicle rental and mileage charges. We do not yet know how much was paid for gasoline used, parts installed, or repairs performed on the vehicle. The local U.S. attorney's office has declined prosecution in favor of civil action because the case lacks jury appeal. This would be a perfect case to pursue under S. 1780.

Another recent investigation revealed that, on two occasions in 1979, an employee in a position of considerable responsibility knowingly submitted false and fictitious documents, thereby obtaining money which he converted to his personal use. He also submitted a false statement to obtain other money he used for unauthorized purposes.

The U.S. attorney's office declined prosecution in favor of administrative action by the Department. The employee resigned last April, before the Department could take disciplinary action.

This case cried out for the assessment of a civil penalty. Although the dollars involved were quite small, it is clear that the employee's misconduct warranted additional sanctions. Having occupied a position of trust which he abused, the employee sought to rationalize his behavior rather than admit culpability.

Imposition of a civil penalty would have created a public record of the transactions, and assured other employees that comparable examples of fraud would result in a monetary penalty. That is what deterrence is all about.

Finally, I wish to suggest a number of changes in S. 1780 and comment briefly on other proposed modifications.

My suggested changes in no way represent objections to the bill, because I feel strongly enough about it that I would support the legislation as is. However, I believe that certain modifications would make the bill more workable, and, hence, more effective. Others might undermine its usefulness.

First, as presently drafted section 801(a)(6) defines investigating official as a statutory Inspector General or, in an agency without a statutory Insepctor General, an official designated by the head of the agency. I think that this definition should be broadened to include the FBI because their investigations might frequently lead to administrative hearings.

Second, it has been suggested that the contemplated administrative proceedings should be confined to cases in which either the amount claimed does not exceed $50,000, or the Government's damages do not exceed $25,000. I think it would be a mistake to tie agency jurisdiction to the amount of the claim or the Government's damages.

Picture a situation in which a defendant escapes an administrative penalty because he proves that the Government actually suffered a loss of $25,100 or that his claim was actually in excess of $50,000 by some small sum. Imagine the anomalous situation of the Government trying to downplay its loss.

I agree completely that defendants should be protected from unlimited liabilty in administrative proceedings. I suggest, however, that a better way to achieve this is to place a reasonable cap on the penalties and assessments to be imposed on any one person, rather than establishing an arbitrary threshold for administrative proceedings.

Third, section 805(g) provides that penalties and assessments collected shall be deposited as miscellaneous receipts in the Treasury.

Perhaps it is my Inspectors General cynicism showing, but I believe that the agencies would pursue administrative cases more agressively if they could recoup the money themselves. In other words, receipts should be credited to the agency affected by the false claim or statements.

There is sound precedent for this because the Supreme Court, in *Marshall* v. *Jerrico, Inc.*, 446 U.S. 238(1980), rejected the argument that agencies are biased if they are the beneficiaries of their own determinations.

Fourth, section 806(b)(1) establishes a 6-year statute of limitations for the initiation of civil penalty hearings. Because of the length of time it takes to discover, investigate, refer and prosecute false claim and false statement cases, I urge that this section be amended to toll the statute of limitations from indictment to final appeal or acquittal.

Fifth, I recommend that section 806(a)(2)(b) be revised so that the time during which the Department of Justice is allowed to consider administrative remedy be reduced from 120 to 60 days.

I recognize that this imposes a tight constraint upon Justice, but it is not an unrealistic one. Generally, we are not dealing here with the kind of case which requires exhaustive review by Justice before disposition can be determined. More important, our experience has been that fraud cases are highly perishable: The longer the delay in initiating administrative action, the less likely it is that such action will be successful.

Thank you for giving me the chance to comment on the very important and badly needed legislation encompassed in S. 1780. I shall be pleased to answer any questions you may have.

Chairman ROTH. Just to have the record clear, I would ask both of you gentlemen to state your position on the number of days that the Department of Justice has had to authorize administrative action. I take it you said 60 days?

Mr. FUNK. Sixty days.

Mr. KUSSEROW. In our discussions with the Department of Justice we concluded with them that 60 days would be appropriate. They agree that that will be adequate time for them to take action; 60 days.

Chairman ROTH. Is there any reason not to write that into the law?

Mr. KUSSEROW. From our discussions with them, we are aware that the departments programs vary widely. In the context in which we were discussing it, in looking at our progams, how it applied to us, we thought 60 days was more than adequate and I think they agreed with us on that. But as far as other departments are concerned, how much more time they might need, I wouldn't be competent to respond.

Chairman ROTH. It is my reaction to write it into a law to avoid lengthy bureaucratic delays in negotiations.

Let me ask you both this question again for purposes of the record. I take it both of you would have S. 1780 apply to the false statements. Is that correct?

Mr. KUSSEROW. Yes, sir.

Mr. FUNK. Yes, sir.

Chairman ROTH. What assurance do we have that this authority will not be abused by some aggressive Federal employee?

Mr. FUNK. Senator, there are all kinds of legally stringent safeguards build into the system. The investigating official first has to complete a report and determine that there is probable cause for the violation. Then it will be submited to a reviewing official who will also make a similar determination based on the report and his own review of the case. And only after that can the reviewing official refer it to the authority head for initiation of the formal hearing.

Even before that, the Department of Justice can step into a proceeding if they feel there is inequity involved.

Mr. KUSSEROW. In underscoring that, I would add that we probably have more safeguards with S. 1780 against abuse than you would under the False Claims Act because you built in some extra controls.

The first control you have, of course, is you have a proper investigation system that is within the Inspector's General Office to assure that only those matters that are being brought forward meet the criteria necessary, but second, you have to go through a clearance process where the Department of Justice, both Criminal and Civil Division to begin with, which in turn, if it is referred to the departments for administrative action, goes through another attorney review process, administratively, before going ahead and then of course you go through all of the other procedures that Mr. Funk outlined.

So we think that we probably have more safeguards here against abuse than you have even under existing criminal statutes.

Chairman ROTH. As you gentlemen know, there is a great deal of discussion about the new federalism, trying to allocate different levels of our responsibilities to different levels of government. Under this act, as it is now written, the Federal Government would have authority, as I understand it, I assume I am correct, to take administrative action against State and local authorities, including Governors, county officials, public works groups; is that correct? Nevertheless, it does give very broad authority to take administrative action against State and local authorities. I wonder if you think that is desirable, for example, or is that too broad?

Mr. KUSSEROW. So long as it meets the criterion of deceit which is built into the statute. As far as the State employees really not having any higher burden on them than we have with our own Federal employees with regard to fraudulent conduct, providing false claims or generating false claims.

Chairman ROTH. It raises some very interesting questions, I think, that we are going to have to explore. For example, if you have a very broad block grant, with broad authority to the States, to what extent can the Federal Government pursue this remedy? I am not sure what the answer to that is. But I think it is a matter that we will have to investigate.

Mr. KUSSEROW. The only analogous thing, Mr. Chairman, that I can think of for the purposes of our discussion at this point would be looking at the medicaid program which is funded by us, but State administered, wherein there is concurrent jurisdiction with the State authorities. And therein we have a situation where under the False Claims Act we can proceed under their own law.

Chairman ROTH. Would it make any sense to have authoriity to be able to use this remedy as well where Federal funds are involved?

Mr. KUSSEROW. States will have enacted legislation that has met their needs in this area and it varies greatly from State to State. But many States, for example, have a false claims statute very much analogous to our own Federal False Claims Act. Some States do not. It varies throughout the country. I would assume that with regard to some sort of an administrative penalty provision again that would probably be up to the States.

Chairman ROTH. In other words, you are saying to leave it to the State's discretion.

Mr. KUSSEROW. As to whether they would care to enact legislation parallel with yours.

Chairman ROTH. That is not really my question. My question is, does this legislation permit State authority to use this authority.

Mr. FUNK. I would not want to exempt any State, county, or local official, because we have a number of cases we are working right now which involve——

Chairman ROTH. That is a different question. What I am suggesting here is concurrent jurisdiction in administrative proceedings.

Mr. FUNK. I have no objection to that.

Mr. KUSSEROW. I would think it would warrant some further consideration as to whether or not we would be causing a potential avalanche of cases to come, being generated in the State system and hitting the Department of Justice for clearance. I think it would warrant some close scrutiny as to what the possible effects of having State entities join in on this.

Chairman ROTH. Senator Rudman?

Senator RUDMAN. Thank you, Mr. Chairman.

Mr. Kusserow, under the statute you are currently operating under there is a dollar limit?

Mr. KUSSEROW. No, our legislation has no limit, although the Justice Department would prefer that cases over a certain amount not be handled administratively.

Senator RUDMAN. Do you share Mr. Funk's concerns about the limit proposed in this legislation?

Mr. KUSSEROW. Yes, I think if we have a limit, it should at least be much higher.

Senator RUDMAN. For your agency?

Mr. KUSSEROW. For our agency.

Senator RUDMAN. In some of the other agencies that also would hardly be enough.

Mr. KUSSEROW. I can't speak for factors to be considered in cases of other agencies.

Senator RUDMAN. Mr. Funk, I find that it is entirely appropriate, considering you are Inspector General of the Department of Commerce that you believe so much in the free enterprise system that you want these funds to return to your own agency. I can understand that. But do you share any of my concerns or do you think they are concerns I shouldn't be worred about that in this time of restricted budgets that such a device might result in very vigorous enforcement of claims?

Mr. FUNK. I would hope so, sir. I certainly would hope so.

Senator RUDMAN. That is what I thought your answer would be.

Mr. FUNK. I am a pragmatist. I believe if I were an agency manager faced with a thousand calls on my people every day in every way, I would be reluctant to commit the resources to handle administrative penalties and the proceedings that go with it, unless I had some assurance that I could recoup the losses which I had incurred previously.

Senator RUDMAN. I guess it comes down to a definition of efficiency versus zealousness. I am just not sure about having those funds go back into the agency. It is an interesting concept.

Mr. Chairman, I want to apologize to Mr. Sherick of the Department of Defense whom I met and with whom I have worked. I will have to leave the hearing at this time. I will read his testimony.

Chairman ROTH. I appreciate your being here, Senator Rudman. I might say on this last point we had some hearings and I think part of the problem in the administration of that program is a lack of national interest in which is going on. I don't have any fixed position on the matter.

Mr. KUSSEROW. If I could add to that point one other piece of perspective here, if you will, and that is the fact that there is always going to be a check if you are looking at this from a zealous, very aggressive cost-effective program because there would be revenue flowing back to the agency, rather than to the General Treasury. I would submit also that the cost-effectiveness would suggest that there would not be a misuse of investigative and legal time on small spurious matters because that would not be cost effective, that it would not be cost effective if you spend a lot of money doing an investigation that really has small dollar amounts.

So I think it works the other way around, it is a check upon having too many unnecessary or improper investigations. I think it is a natural check.

Mr. FUNK. Sir, in the *Marshall* v. *Jerricho* case in 1980, the Supreme Court did go along with agencies recouping money.

Chairman ROTH. Gentlemen, we appreciate very much your being here today. We are strong supporters of the IG concept. We are encouraged by what we heard today. Thank you very much.

[The prepared statements of Messrs. Kusserow and Funk follow:]

PREPARED STATEMENT OF RICHARD P. KUSSEROW

Good morning. I am Richard Kusserow, Inspector General of the Department of Health and Human Services. I am pleased to appear before you today to discuss the utility of providing federal agencies the authority to recover damages and impose civil penalties administratively for the filing of false claims or statements.

I also want to take this opportunity to thank the Committee for its continuing efforts to combat fraud, waste, and abuse in federal programs. The Committee should be congratulated for its fine work. As you know, many Inspectors General have been advocating the need for legislation along the lines of that under consideration today. It will give us a vital additional weapon to control fraud.

I consider myself fortunate to be the Inspector General of a Department which already has legislation covering its health financing programs similar to the bill you have under consideration. As you know, the Omnibus Budget Reconciliation Act of 1981, P.L. 97-35, gave our Department the first civil monetary penalties law of its kind.

Under that law, section 1128A of the Social Security Act, persons participating in the Medicaid, Medicare or Maternal and Child Health programs who submit false or prohibited claims to the government for reimbursement under those programs are subject

to civil penalties. The penalty cannot exceed $2,000 for each item or service falsely or wrongfully claimed, and is in addition to any other penalties that may be prescribed by law. In addition, the person can be assessed an amount of up to twice the amount wrongfully claimed.

We in the Department have begun to take the steps necessary to implement this program. I am happy to report substantial progress on many fronts. First, the organizational arrangements have been worked out. Investigations will be conducted by the OIG; General Counsel will provide the legal support, including the administrative prosecution of the case if a hearing is requested; and the ALJ's who will hear the cases will be assigned to the Health Care Financing Administration.

During the past few months, I have been developing plans for a significant reorganization of the OIG. As part of this reorganization, I am establishing a Civil Fraud Division which will include a unit to be responsible for overseeing the operation of the civil penalties process. The Division will be major component of the Office of Investigations. It will work closely with all our investigators, both in Washington, D.C. and in the field, to assure aggressive use of this new anti-fraud mechanism. It will also work closely with the Civil Division of the Justice Department to assure that they follow through on cases appropriate for prosecution under the False Claims Act. We hope to have the new Division and the Civil Fraud Unit fully operational shortly.

We have already begun reviewing ongoing federal and state investigations to uncover instances where a civil penalty would be the appropriate remedy. The OIG has also begun to provide guidance to representatives of State Medicaid Fraud Control Units on the development and investigation of cases for funneling into this system, and we are developing training programs for both state and federal investigators. We are in the process of drafting a comprehensive legal and investigative manual on the civil money penalty law, which should be completed shortly. We will be pleased to provide copies to the Committee when it is complete.

Finally, we have been meeting with representatives of the Justice Department to work out procedures for coordinating our handling of these cases with them. In 1979, the IG of our Department signed a Memorandum of Understanding (MOU) covering these procedures with the Assistant Attorneys General for the Civil and Criminal Divisions. I am providing a copy of the MOU for the record. The main objective of our recent conversations with Justice is the further refinement of the MOU in order to assure that we will have the most effective program possible. I am extremely hopeful that we can develop the kind of approach that will prove so successful that our procedures will be able to serve as a model for other agencies to follow should legislation along the lines of S. 1780 become law.

Turning to S. 1780, let me first state my conviction that this Administration will support in concept a legislative proposal which promises to save the taxpayers' money by reducing fraud

and abuse in federal programs and by permitting us to recoup for the government any money that has been wrongfully paid. In general, I support the concepts and principles embodied in S. 1780. I believe that for many agencies it will serve as a significant additional tool to control fraud and abuse. The authority to impose penalties administratively would provide a means of pursuing those who defraud the government in circumstances where criminal prosecution is not pursued or the cost of civil litigation is more than the fraud itself.

For instance, there are cases of providers of medical services who have submitted scores of false claims to Medicare, but who, because the total dollar amount of their fraud was not substantial, have not been prosecuted either criminally or civilly by the Department of Justice. If the provisions of S. 1780 had applied, these providers could have been assessed penalties administratively.

We endorse many features of S. 1780, including:

- The bill makes clear that organizations, as well as individuals, would be liable for the filing of false claims.
- The maximum penalty for each false claim ($10,000) is considerably higher than our statute provides.
- Also, under S. 1780, the statute of limitations is six years from the date of submission of the claim.

96-086 O - 82 - 4

I do have a suggestion for your consideration. I do not believe it is necessary to specify a time limit in the statute for Justice to respond to our case referrals. Under section 1128A, the Justice Department has agreed to respond to HHS case referrals in 60 days. However, not every agency has the same kind of caseload. We therefore believe it would be better not to specify a deadline in the statute, but instead permit each agency to work out a suitable arrangement with Justice.

My staff is preparing a paper which addresses some of our less significant or technical concerns. We would like to provide those additional suggestions to your Committee staff after they are prepared. I also will provide them with a chart which compares the most significant features of section 1128A, S. 1780, and the False Claims Act.

I want to thank you again for affording me this opportunity to present my views on S. 1780.

STATEMENT OF

SHERMAN M. FUNK
INSPECTOR GENERAL
U.S. DEPARTMENT OF COMMERCE

BEFORE THE SENATE COMMITTEE ON
GOVERNMENTAL AFFAIRS
APRIL 1, 1982

Mr. Chairman and Members of the Committee:

It is my pleasure to appear before this Committee today to testify about S. 1780, the "Program Fraud Civil Penalties Act." I especially appreciate the Committee's interest in hearing from the Inspectors General. As you know, under provisions of this bill, the Inspectors General would have the responsibility for investigating allegations of false claims and false statements. The Inspector General Act of 1978 already requires us to conduct audits and investigations to prevent and detect fraud against the Government.

S. 1780, if enacted, would help us accomplish this formidable task in two vital ways. First, it would establish an administrative mechanism by which stiff monetary sanctions could be imposed for false submissions. In so doing, the bill would help ensure that culpable parties, who might otherwise profit from their wrongdoing, are penalized regardless of criminal or civil prosecution by the Department of Justice. Second, S. 1780 would give the Inspectors General a new investigative tool, the testimonial subpoena. Without this authority, it would be extremely difficult, if not impossible, to develop the type of

evidence necessary to prove the Government's case at an administrative hearing.

Briefly, S. 1780 would provide that a person who knowingly submits or causes to be submitted a false claim or false statement would be liable for a civil penalty up to $10,000. In addition, the culpable party could be required to pay an assessment of not more than double the money received (or value of property or services delivered) as a result of the fraud, or, in the alternative, the damages to the Government, including the amount of consequential damages.

The process for determining liability would work as follows. Allegations of false submissions would be referred to an Inspector General or other designated official for investigation. At the completion of the investigation, findings would be presented to an agency reviewing official. If the reviewing official decided there was probable cause to believe there was a a false submission, he would refer the case to the agency head for a hearing.

Before initiating a hearing, the agency head would be required to send written notice to the Attorney General. As presently drafted, a hearing to establish liability would be held if the Attorney General gave his approval or took no action after 120 days.

The Attorney General would be authorized to enter into a memorandum of understanding with the agency head to provide expeditious procedures for approving or disapproving the initiation of a hearing. This memo could provide advanced authorization to proceed with respect to any particular class of alleged false claim or false statement.

The hearing would determine the party's liability, the amount of damages to the Government, and the amount of the penalty and assessment. There would be a right to judicial review of the results of a hearing.

Before I give some examples of the kinds of cases we have in Commerce that would benefit from the availability of administrative penalties, I should like to make some general comments about this area.

Admittedly, criminal prosecution resulting from our investigations represents the more glamorous side of IG activity. Many of us are "graded," in effect, by the number of convictions to which we contribute. This emphasis on criminal proceedings raises a few troublesome questions:

o For one thing, it places administrative action on a back burner until a decision is reached about criminal action. The practical impact of this is very likely to be inordinate delays in seeking recovery of fraudulent expenditures or in dismissing

or otherwise punishing employees guilty of misconduct. Such an impact is exacerbated by the light penalties which courts tend to award white collar criminals; employees perceive the end product of fraud to be a slap on the wrist. Swift and equitable administrative penalties would be more meaningful in many cases, and would hit the wrongdoer where it hurts most, in his checkbook.

o Another problem is that once Justice has declined criminal prosecution or civil action, the Department may be left without an adequate or appropriate remedy against those who have corrupted its programs. The wrongdoer, if he or she is faced with an adverse Personnel Action, can always point to the DOJ declination as exculpatory material.

o An even more difficult problem arises from the "parallel proceedings" which are inevitable when we seek criminal, and civil and/or administrative sanctions concurrently. If S. 1780 is enacted, we can anticipate that a number of false submission cases will start out as criminal investigations involving Grand Jury presentations. Given the case law interpreting Rule 6(e) of the Federal Rules of Criminal Procedure, which governs access to Grand Jury materials, it is unlikely that our investigators could get a court order for access to any Grand Jury records or testimony for use in an agency administrative hearing even after the criminal case had been concluded. Actually, the system is even worse than that: if any of our investigators worked with

the Grand Jury, we would have to disqualify them from working on the administrative case.

Indeed, we have this precise situation in one of our major current investigations. To avoid any possible "contamination" of Grand Jury material, we are fielding a complete double team: one is composed of auditors and investigators assigned to the criminal prosecution side. The second, which scrupulously avoids contact with the first, consists of auditors and investigators assigned to the non-criminal side. They all are handling the same case. I consider this a wasteful duplication of effort. I respectfully suggest that, at some future time, the Committee may wish to consider exploring the adverse effects of Rule 6(e) on Federal administrative investigations.

S. 1780 may not solve all of these problems, but it clearly will plug some of the larger administrative loopholes. Not least, it will give us a powerful self-help remedy which also will serve as an effective deterrent.

Specific aspects of the bill merit discussion. I am pleased that S. 1780 explicitly covers false statements as well as false claims. Often, a false statement with no monetary loss can damage the Government (in terms of decreased public integrity) as severely as monetary losses caused by false claims.

I also applaud the bill's coverage of false submissions to Government recipients and other intermediaries. The same reasons for penalizing false submissions to the Federal Government apply when those submissions are made to a federally funded entity or agent; indeed, this is where big ticket fraud is most likely to occur.

I am delighted with the provision for collecting civil penalties and assessments through setoff. Such a provision should substantially decrease the burdens on the Department of Justice associated with court ordered recoveries.

The bill also permits monetary sanctions to be imposed in addition to any criminal penalty provided by law. This would create a greater likelihood that the Government will be made whole for losses occasioned by false submissions. Of course, in many criminal cases restitution has been ordered by the court. Far too often, however, the Government has not recouped its losses. S. 1780 would provide this opportunity.

Finally, as I've mentioned, under the proposal it would be the responsibility of the Inspectors General to establish probable cause, building the Government's complete case for an administrative hearing. In furtherance of their investigations, the bill would give the Inspectors General the authority to issue testimonial subpoenas. Although we always hope for cooperative witnesses, experience teaches us that in many investigations

there is no way to ensure the cooperation of witnesses short of compulsory process. Testimonial subpoenas are therefore essential if we are to accomplish the goals of S. 1780.

I would like to offer a few illustrations of how the Department of Commerce can use administrative penalties to the advantage of the Government, or could have used them earlier if they had been available.

We have spent considerable resources in reviewing the six billion dollars of Local Public Works (LPW) grants awarded by the Economic Development Administration. The authorizing statute for Round II of this program required that at least 10 percent of the amount of each grant be set aside for *bona fide* minority business enterprises (MBE). Too often, this requirement was discharged fraudulently either by the use of "front" firms, that is, phoney MBEs, or by using legitimate MBEs to conduct only token work. In either case, such fraud not only made a mockery of the law, but performed a profound disservice to the minority business community. Here is a case in point.

One of our investigations revealed that an LPW contractor submitted false statements to EDA regarding employment of a minority subcontractor on several LPW projects. Specifically, the contractor entered into three subcontracts with a minority firm for a total of $280,000 in construction work. When the projects were completed, however, the MBE had received only

$17,000. All of the other costs attributed to the minority firm were incurred by the prime contractor through employees fictiously assigned to the MBE's labor force, or through supplier accounts set up and paid for by the prime with no participation, control or benefits by the minority firm. In fact, the MBE's only actual employee on the three projects was one carpenter.

The Department of Justice declined criminal prosecution in favor of administrative action. We recommended to EDA that the MBE costs for the three projects be disallowed, and EDA has agreed to seek recovery. I believe that the chances for such recovery are slim. Frankly, I am not even convinced that it is fair to proceed against the grantee, because we have no evidence that it acted in bad faith.

I can understand why Justice declined to go criminally. After all, the Department suffered no monetary loss in this case. We awarded money to build three projects, and they were built. Nevertheless, the public policy of minority set-asides enunciated by the Congress was sorely abused. If we had a procedure then in effect for the assessment of an administrative penalty, the Department could have moved swiftly against the prime contractor, assuring a direct sanction for the company's false submissions, instead of seeking an indirect sanction from the grantee who did no wrong.

The dollars involved here are not large, but the principle is.

The potential deterrent effect is larger still. I recently visited all of our OIG offices around the country and, without exception, each of them had a number of Local Public Works MBE cases remarkably similar to this; none appeared likely to obtain criminal prosecution. This is very disheartening to our people, who take very seriously the fight against fraud, waste and abuse, only to see the results of their effort collect dust in the file.

Another relevant example is an investigation now winding up, which we hope will result in prosecution of a grantee for false statements. To meet its performance goals and to assure further Commerce funding, the grantee claimed that it had assisted minority firms to obtain about $16 million worth of sales. Our audit revealed that more than $11 million worth of these sales, nearly 70 percent, were either fictitious or had been obtained with no help from the grantee. Our investigation also showed that grantee personnel had requested clients to provide false letters and certifications to support claims that the grantee had helped them to obtain business.

We have a strong fraud case here, but no evidence of any dollar loss to the Government. The assessment of a monetary penalty would be an appropriate response to the egregious damage done to the minority business assistance program, whether or not there is criminal prosecution.

Let us look at another area, where we not only have a dollar loss

but a very significant one. About half a billion dollars of EDA's portfolio of direct and guaranteed loans are now in liquidation, default, or special handling. The taxpayers will have to pick up most of the resulting tab. When we dig into some of these losses, we often find that the loans were predicated upon false or misleading statements made in the loan applications. Of course, we proceed criminally and/or civilly where we can, but we would be in a better position to take effective action if we were armed with the tools of S. 1780.

Civil penalty legislation would help us also in deterring fraud by Federal employees.

After a recent investigation, a Commerce employee pleaded guilty to submission of false claims and statements. On 33 separate occasions, she had falsely claimed overtime totalling almost $6,000. The judge ordered restitution as part of her sentence, provided that she remains employed. There is no provision for restitution should she become unemployed. Under Department rules, however, her conduct required dismissal. The assessment of a civil penalty would restore the Government's loss in this circumstance.

Another recent investigation revealed that, on two occasions in 1979, an employee in a position of considerable responsibility knowingly submitted false and fictitious documents, thereby obtaining money which he converted to his personal use. He also

submitted a false statement to obtain other money he used for unauthorized purposes. The U.S. Attorney's office declined prosecution in favor of administrative action by the Department. The employee resigned last April, before the Department could take disciplinary action.

This case cried out for the assessment of a civil penalty. Although the dollars involved were quite small, it is clear that the employee's misconduct warranted additional sanctions. Having occupied a position of trust which he abused, the employee sought to rationalize his behavior rather than admit culpability. Imposition of a civil penalty would have created a public record of the transactions, and assured other employees that comparable examples of fraud would result in a monetary penalty. That is what deterrence is all about.

Finally, I wish to suggest a number of changes in S. 1780. These in no way represent objections to the bill, because I feel strongly enough about it that I would support the legisation as is. However, I believe that the following modifications would make the bill more workable and, hence, more effective.

o First, Section 805(g) provides that penalties and assessments collected shall be deposited as miscellaneous receipts in the Treasury. Perhaps it is my Inspector General's cynicism showing, but I believe that the agencies would pursue administrative cases more aggressively if they could recoup the

money themselves. In other words, receipts should be credited to the agency affected by the false claim or statements. There is sound precedent for this because the Supreme Court, in Marshall v. Jerrico, Inc., 446 U.S. 238 (1980), rejected the argument that agencies are biased if they are the beneficiaries of their own determinations.

o Second, Section 806(b)(1) establishes a six-year statute of limitations for the initiation of civil penalty hearings. Because of the length of time it takes to discover, investigate, refer and prosecute false claim and false statement cases, I urge that this section be amended to toll the statute of limitations from indictment to final appeal or acquittal.

o Third, I recommend that Section 806(a)(2)(B) be revised so that the time during which the Department of Justice is allowed to consider administrative remedy be reduced from 120 to 60 days. I recognize that this imposes a tight constraint upon Justice, but it is not an unrealistic one. Generally, we are not dealing here with the kind of case which requires exhaustive review by Justice before disposition can be determined. More important, our experience has been that fraud cases are highly perishable: the longer the delay in initiating administrative prosecution, the less likely it is that such prosecution will be successful.

o Fourth, Section 802(b)(1) establishes liability if a

person "knowingly" makes a false claim or statement. I have no problem with that. I do have a problem with Section 802(b)(2), which defines "knowingly" in one sense only, to mean "with reckless disregard for whether a claim or statement is false." I am not certain that the bill needs any definition of this term. However, at a minimum, any definition should include the traditional concept of an intentional act.

There is one change in the bill that I would strongly urge not be made. It has been suggested that language should be inserted in S. 1780 that would establish specific dollar threshholds. I can understand the desire of many agencies to avoid being "nickeled and dimed" by a flood of small dollar cases. I can understand the concern of those who fear that our courts will be inundated with the disposition of cases decided earlier administratively. Given the resource constraints faced by the IGs, Justice and the Courts, this could be a real problem. However, establishing a triggering threshhold of, say, $25,000 would create an even worse problem. What this would do, in effect, is serve public notice that it is OK to defraud the Government, as long as you keep it below $25,000. I do not believe that this is the message Congress wants to get across. Better to let the bill, as it does now, stand mute on dollar specifics, and permit the IGs, Justice and the U.S. Attorneys around the country to work out our own informal arrangements on acceptable levels for referral, based on local circumstances.

Thank you for giving me the chance to comment on the very important and badly-needed legislation encompassed in S. 1780. I shall be pleased to answer any questions you may have.

Chairman ROTH. At this time I would like to call Joseph H. Sherick, Assistant to the Secretary of Defense for Review and Oversight.

Mr. Sherick, it is a pleasure to welcome you here again.

We will proceed as we did in the past. You may summarize your testimony. We will include it in the record.

TESTIMONY OF JOSEPH H. SHERICK, ASSISTANT TO THE SECRETARY OF DEFENSE (REVIEW AND OVERSIGHT), ACCOMPANIED BY KATHLEEN BUCK, ASSISTANT GENERAL COUNSEL (LEGAL COUNSEL), DEPARTMENT OF DEFENSE

Mr. SHERICK. Thank you.

I have with me today Kathleen Buck, Assistant General Counsel for the Department of Defense. She will be joining me in our testimony.

I have a short statement to make. And I would like to read that if you would permit me and then move to questions.

I am pleased to appear today to discuss S. 1780, the Program Fraud Civil Penalties Act, introduced by Chairman Roth with several cosponsors. As the members of this committee know, I am the Assistant to the Secretary of Defense for Review and Oversight and, in that capacity, serve as his principal adviser on matters relating to fraud, waste, and abuse.

My responsibilities include conducting audits and investigations through the Defense Audit Service and Defense Criminal Investigative Service, and reviewing and overseeing the activities of the military service audit, inspection, and investigative activities that relate to fraud, waste, and abuse. Therefore, I am quite interested in this legislation and strongly support its purpose. Other witnesses have previously outlined the problems and the administration's position on this legislation. I would like to give my personal view as an Inspector General-type official, if you will, in the Department of Defense on the need of this legislation from my perspective as the Assistant to the Secretary for Review and Oversight.

First I would like to say that I feel, and I am sure the Secretary of Defense agrees, that the Department of Defense is a major target for thieves and cheats. Second I support any legislation that would add the antifraud arsenal of program managers, auditors, inspectors, and investigators in the Federal Government.

This legislation, with the changes discussed by the Department of Justice representatives, should speed up the processing of fraud cases, and thus make our efforts in combating fraud more effective. I would also provide a clear-cut mechanism for imposing civil penalties after a case has been declined for criminal prosecution by the Department of Justice.

The Department of Defense is very sensitive to the time it takes for the processing of cases. Justice administered to military personnel who are under the Uniform Code of Military Justice is usually quite speedy and generally requires only a few months, while successful court litigation involving fraud often takes years. We in Defense may encounter a situation where there is speedy punishment for military personnel who commit crimes, but it takes much longer to act on civilian personnel perpetrating fraud against the

Government. Clearly, this creates the appearance of a double standard to our people and impacts on the morale of our own criminal investigators. It can have the effect of encourageing thieves to prey on our activities.

The Department of Defense supports the concept of according the Department of Justice a review period after which agencies can act on their own under this legislation. However, we feel this can be accomplished in a more orderly manner through the execution of a memorandum of understanding outlining specific categories and procedures and time periods which would be agreed to between the Department of Defense and the Justice Department.

Mr. Chairman, I would like to state that since my appointment I have worked closely with Justice representatives to set out our priorities and improve procedures for both referral and prosecution. They have been most cooperative and supportive and we have already seen improvements in our relationships and in our joint actions.

Notwithstanding this improved relationship and support, the enactment of a Program Fraud Civil Penalties Act is still important because it would allow the Department of Defense to take action on the large number of fraud cases. This can help deter the commission of such frauds by installing the fear of ultimate prosecution without regard to the dollar value of the fraud.

Mr. Chairman, I appreciate the opportunity to appear before this committee and I am now prepared to answer any questions.

Chairman ROTH. Thank you, Mr. Sherick.

One of my questions goes back to the observation I made with the previous witnesses, the fact of concern about what some of us thought was harassment of the small businessman. Do you see this legislation opening the door to additional harassment by overeager or improper Federal servants?

Mr. SHERICK. Yes. As you mentioned earlier, the cases that were mentioned before this committee on harassment certainly make me believe that there is an opportunity for harassment. We feel that the safeguards proposed for this bill are adequate to protect against such harassment. I have no personal objection to including false statements within the scope of the bill, and I agree that the safeguards you have included add to the level of protection. However, I still think some possibility for harassment does exist. We have to be very careful in the way we apply this bill, to see that it doesn't happen.

Chairman ROTH. If you later have any specific thoughts in that direction, I would appreciate it.

Mr. SHERICK. We have discussed that matter with Justice and OMB and the administration bill will probably address it.

Chairman ROTH. Do you have any position on whether S. 1780 should apply to both false claims and false statements?

Mr. SHERICK. Again, I have no objection to including false statements. But we recognize that in the area of "puffing," as you brought out, there is a concern. We feel that there has to be some protection, especially in the area of contract proposals. The legislation could be misapplied and the wording of the bill should take that into consideration. Maybe Ms. Buck would like to add something.

96-086 O - 82 - 5

Ms. BUCK. I think that Mr. Sherick has addressed the matter very well and it is indeed of great concern to us that this provision not be used to abuse or harass our defense contractors.

Chairman ROTH. Again, I would say to you what I said to Mr. Sherick. I would be personally very much interested in any further comments you might have in this area, particularly any specific language that might be added or an approach taken.

Do you think that because of the size of the Defense Department—of course we don't yet have an Inspector General, we hope before long we will—that there ought to be similar authority—should similar authority, for example, be given to the Army, Navy, Air Force in addition to the Secretary of Defense in the IG?

Mr. SHERICK. I was assuming that this would apply to each of the military services but the GAO brought up that point. I think that ought to be clarified.

Kathleen, would you like to comment?

Ms. BUCK. I agree with that completely. I think GAO made a very good point which we would want to address and I think that we did contemplate that the proposed legislation would apply to the military departments.

Chairman ROTH. As well?

Ms. BUCK. Yes. Internally I think we would also want to be careful that within the Office of the Secretary of Defense we would not duplicate the efforts of the military departments.

Chairman ROTH. Mr. Sherick, as it is currently drafted, do you have concerns over the due process provision of S. 1780?

Mr. SHERICK. No. I think other than the areas I have discussed, I personally have no concerns.

Chairman ROTH. I would ask the young lady?

Ms. BUCK. Yes. We would hope, Senator, that sufficient flexibility would be incorporated into the bill, to make sure that there would be alternative procedures to the Administrative Procedures Act, because the Departmnet of Defense is not generally subject to the Administrative Procedures Act. Of course, we do have any number of adjudicative procedures within the Department with respect to other programs which could serve as a model for establishing some sort of adjudicative procedure in order to implement this legislation, something similar to say the Board of Contract Appeals.

Chairman ROTH. That is all the questions I have at this time. I appreciate both you being here and look forward to working further with you on this matter.

Mr. SHERICK. Thank you.

[Mr. Sherick's prepared statement follows:]

STATEMENT BY JOSEPH H. SHERICK, ASSISTANT TO THE SECRETARY OF DEFENSE (REVIEW AND OVERSIGHT) BEFORE THE COMMITTEE ON GOVERNMENTAL AFFAIRS, U.S. SENATE, ON S. 1780, PROGRAM FRAUD CIVIL PENALTIES ACT, APRIL 1, 1982

Mr. Chairman and Members of the Committee:

I am pleased to appear today to discuss S. 1780, the Program Fraud Civil Penalties Act, introduced by Chairman Roth with several co-sponsors. As the members of this Committee know, I am the Assistant to the Secretary of Defense for Review and Oversight and, in that capacity, serve as his principal advisor on matters relating to fraud, waste and abuse. My responsibilities include conducting audits and investigations through the Defense Audit Service and Defense Criminal Investigative Service, and reviewing and overseeing the activities of the Military Service audit, inspection and investigative activities that relate to fraud. Therefore, I am quite interested in this legislation.

S. 1780 would create an administrative mechanism for imposing civil monetary assessments and penalties against those who knowingly submit specified categories of false claims or statements in connection with federal programs involving grants, loans, contracts, insurance and other forms of assistance. We cannot make a good estimate of the amount of fraud in DoD programs alone, however, the Department of Justice has estimated that, in the aggregate, program fraud may be resulting in significant annual losses.

I understand the Committee is interested in knowing the usefulness of this type of administrative penalty as well as examples where an administrative mechanism might be helpful.

At the outset, I should say that the Administration is currently in the process of formulating its own proposal, and it clearly supports the underlying concept. I also support the concept, and will give you my personal views on the need for this legislation from my perspective as Assistant to the Secretary for Review and Oversight.

As a general matter, I support legislation of this nature that would add to the antifraud arsenal of program managers, auditors, inspectors and investigators in the Federal Government. The legislation should enable the processing of smaller fraud cases more rapidly than under existing procedures to initiate civil or criminal proceedings. It would allow the Department to minimize a long process involving referrals of matters to the Department of Justice for prosecution, many of which are eventually declined, but often only after a fairly long period of time has elapsed. The realities make us realize that there are a substantial number of fraud cases where criminal prosecutions are not undertaken. Additionally, the actual dollar loss to the Government and potential recovery in a civil suit may be exceeded by the cost of litigation. The legislation would at the same time preserve the due process rights of the individual.

The Department of Defense is sensitive to the time it takes for the processing of cases. Justice administered to military personnel who are under the Uniform Code of Military Justice (UCMJ) is usually quite speedy and generally requires only a few months. Successful court litigation

involving fraud often takes years. We in Defense may encounter a situation where there is speedy punishment for military personnel who commit crimes, but it takes much longer to act on the civilian personnel involved. Certainly, this is not a good situation for DoD to be in. Also, there is no question that delay or dismissal of prosecution can have a negative impact on the morale and effectiveness of our criminal investigators.

The Department of Defense supports the concept of according the Department of Justice a review period after which agencies can act on their own under this act. However, we feel this can be accomplished more rapidly through the execution of a memorandum of understanding outlining specific procedures between the Defense and Justice Departments.

The application of civil penalties, through a mechanism such as a Program Fraud Civil Penalties Act, could be quite helpful in obtaining speedier justice and in recovering funds where prosecution is not feasible. It could also help in deterring fraud. Let me give you some examples of how such legislation might be used.

Under existing laws and regulations, all cases of suspected fraud or false claims in connection with the Civilian Health and Medical Program of the Uniform Services (CHAMPUS) must be referred to the Department of Justice for consideration of criminal action. Only after the Justice Department has declined to initiate criminal action may an agency implement administrative procedures to recover lost funds. Historically, despite the best efforts of the Justice Department, their limited resources permit them to prosecute less than 1% of the CHAMPUS cases

of suspected fraud or false claims which are referred. Procedural delays significantly increase the difficulty in accomplishing subsequent recoupment efforts. As a result of administrative frustration, every effort is made to resolve any suspicion of fraud or false claim in order to avoid referring the case to Justice and expedite administrative recoupment efforts. This legislation would provide a mechanism for the Department of Defense and other agencies to institute their own enforcement actions, thereby permitting a more rapid recovery of funds lost through fraud.

Here are some examples of CHAMPUS cases where an act of this nature might have proven helpful.

Case Example No. 1: A clinical psychologist submitted claims for $2,000 to CHAMPUS for services not rendered the patient. This was accomplished by billing for twice the number of therapy sessions actually rendered and billing for a longer period of treatment than actually occurred. The psychologist explained that his billing was to cover the CHAMPUS annual $100 deductible and 20% cost sharing on outpatient service and because the CHAMPUS level of reimbursement for psychotherapy was less than the psychologist charged. In late 1981, the Department of Justice declined the case for prosecution. Under a Program Fraud Civil Penalties Act, we could attempt to collect twice the false claim and assess a penalty.

Case Example No 2: An individual filed CHAMPUS claims for reimbursement of $20,000 for drugs and some other minor medical expenses. The individual obtained blank statements from providers, primarily drug stores, and filled them out himself for drugs and services he never received. Prosecution was declined because it was felt that obtaining a

conviction was unlikely. Under a Program Fraud Civil Penalties Act, we could attempt to collect twice the false claim and assess a penalty.

Besides CHAMPUS, there are several other cases involving DoD contracting where this act might be quite helpful, for example:

Case Example No. 3: An automotive dealer provided rebuilt truck transmissions to various Department of Defense customers. The firm was to provide 100 percent testing of the product. The truck transmissions were received at various Department of Defense depots for distribution as needed. Due to numerous customer complaints, a decision was made to retest a sampling of the transmissions in storage at the depots. The sample consisted of 26 transmissions, all of which the retesting established required replacement parts and/or fluids. Repair costs for these transmissions were approximately $10,000. The Department of Justice declined civil or criminal proceedings. Under a Program Fraud Civil Penalties Act, we could attempt to recover twice our damages and assess a penalty.

Case Example No. 4: A dealer in various diesel engine components submitted bids on replacement locomotive parts. The parts were specifically identified by the contractor as new/unused in the contract. The items that were received by the various Department of Defense entities were actually used, rebuilt parts which were not serviceable for the specific requirements. The firm owner admits substitution. The Department of Justice declined criminal prosecution but is pursuing a civil remedy. Since the warranty options had expired under the six contracts involved, the Department of Defense stands to sustain losses of

$43,000.00 if this action is not successful. Under a Program Fraud Civil Penalties Act, the Department of Defense could immediately initiate proceedings to recover twice our damages and assess a penalty.

Case Example No. 5: The contractor operating the enlisted dining hall at an Air Force base allegedly padded the records showing meals served in order to increase income received under the contract. Air Force investigation and audit established a $5,972.00 false claim by the contractor due to falsification of records by a management employee. The matter was originally referred to the FBI who recommend further investigation and, upon subsequent referral to the Department of Justice, criminal prosecution was declined. Under a Program Fraud Civil Penalties Act, we could attempt to recover twice the amount of the false claim and assess a penalty.

Mr. Chairman, I have provided these cases as specific examples of where we might be able to employ a mechanism such as that available under a Program Fraud Civil Penalties Act. I would like to emphasize that since my appointment I have worked closely with Justice representatives to set out priorities and improve procedures for referral and prosecution. They have been most cooperative and supportive, and we have already seen improvements in our relationships and joint actions. Notwithstanding this improved relationship and support, the enactment of a Program Fraud Civil Penalties Act is still important because it will allow the Department of Defense to take action on a large number of small frauds. This will help deter the commission of such frauds by instilling the fear of ultimate prosecution without regard to the small dollar value.

Mr. Chairman, I appreciate the opportunity to appear before this Committee today, and I am now prepared to answer your questions.

Chairman ROTH. The committee is in recess.

[Whereupon, at 12 noon the hearing adjourned, subject to the call of the Chair.]

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

97TH CONGRESS
1ST SESSION

S. 1780

To provide civil penalties for false claims and statements made to the United States, to recipients of property, services, or money from the United States, or to parties to contracts with the United States, and for other purposes.

IN THE SENATE OF THE UNITED STATES

OCTOBER 27 (legislative day, OCTOBER 14), 1981

Mr. ROTH (for himself, Mr. RUDMAN, Mr. COHEN, and Mr. NUNN) introduced the following bill; which was read twice and referred to the Committee on Governmental Affairs

A BILL

To provide civil penalties for false claims and statements made to the United States, to recipients of property, services, or money from the United States, or to parties to contracts with the United States, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Program Fraud Civil Penalties Act of 1981".

SEC. 2. (a) Title 5 of the United States Code is amended by inserting after chapter 7 the following new chapter:

"CHAPTER 8—ADMINISTRATIVE PENALTIES AND ASSESSMENTS FOR FALSE CLAIMS AND STATEMENTS

"§ 801. Definitions

"(a) As used in this chapter—

"(1) 'authority' means any establishment as defined in section 11(2) of the Inspector General Act of 1978 (92 Stat. 1109), any department designated as an Executive department in section 101 of this title, and the United States Postal Service;

"(2) 'authority head' means—

"(A) the head of an authority, or

"(B) an official or employee of the authority designated in regulations promulgated by the head of the authority, to make findings and determinations under this chapter on behalf of the head of the authority;

"(3) 'claim' means any request or demand, whether under a contract or otherwise—

"(A) to an authority for property, services, or money (including money representing grants, loans, insurance, or benefits); or

"(B) to a recipient of property, services, or money from an authority or to a party to a contract with an authority—

"(i) for property or services if the United States provided such property or services or any portion of the funds for purchase of such property or services or will reimburse such recipient or party for the purchase of such property or services; or

"(ii) for the payment of money (including money representing grants, loans, insurance, or benefits) if the United States provided any portion of the money requested or demanded or will reimburse such recipient for any portion of the money paid on such request or demand;

"(4) 'statement' means any written representation or certification—

"(A) with respect to a claim; or

"(B) with respect to—

"(i) a contract with, or a bid or proposal for a contract with;

"(ii) a grant, loan, or benefit from;

"(iii) an application for insurance from; or

"(iv) an application for employment with;

an authority, or any State, political subdivision of a State, or other party acting in behalf of, or based upon the credit or guarantee of, an authority;

"(5) 'person' means any individual, partnership, corporation, association, or private organization;

"(6) 'investigating official' means—

"(A) the Inspector General of the authority as authorized by the Inspector General Act of 1978 (92 Stat. 1101) or any other Federal law; or

"(B) in an authority which is not authorized an Inspector General by the Inspector General Act of 1978 (91 Stat. 1101) or other Federal law, any official or employee of an authority designated by the head of the authority to conduct investigation under the provisions of section 803(a)(1) of this chapter; and

"(7) 'reviewing official' means any official or employee of an authority—

"(A) whose rate of basic pay is equal to or greater than the minimum rate of basic pay for grade GS–18 under section 5332 of this title; and

"(B) designated by the head of the authority to make the determination provided in section 803(a)(2) of this chapter.

"(b) For purposes of clause (3) of subsection (a) of this section—

"(1) each voucher, invoice, claim form, or other separate request or demand for property, services, or money constitutes a separate claim whether submitted singly or together with other claims;

"(2) each request or demand for property, services, or money constitutes a claim regardless of whether such property, services, or money is actually delivered or paid; and

"(3) a claim shall be considered made to an authority, recipient, or party when such claim is made to an agent, fiscal intermediary, or other entity, including any State or political subdivision thereof, acting for or on behalf of such authority, recipient, or party.

"(c) For purposes of clause (4) of subsection (a) of this section—

"(1) each written representation or certification constitutes a separate statement whether submitted singly or together with other statements; and

"(2) a statement shall be considered made to an authority although such statement is actually made to an agent, fiscal intermediary, or other entity, including any State or political subdivision thereof, acting for or in behalf of such authority.

"§ 802. Liability for false claims and statements

"(a) For purposes of this chapter—

"(1) a claim is false when the claim—

"(A) includes or is supported by any false statement, document, record, or accounting or bookkeeping entry; or

"(B) is for payment for the provision of property or services which the claimant has not provided, or has not provided in accordance with the terms of the contract on which such claim is based, or has provided in violation of any applicable Federal or State statute or regulation; and

"(2) a statement is false when any material fact—

"(A) asserted in such statement is false, fictitious, or fraudulent; or

"(B) is omitted from such statement and—

"(i) as a result of such omission, such statement is substantially false, fictitious, or fraudulent; or

"(ii) the person making such statement has a duty to include such material fact in the statement.

"(b)(1) Any person who, on or after the effective date of this Act, knowingly makes, presents, or submits, or causes to be made, presented, or submitted, a false claim or statement, is liable to the United States for—

"(A) a civil penalty of not more than $10,000 for each false claim or statement; and

"(B) an assessment of not more than double—

"(i) the full amount of money paid and the value of property or services delivered to a person as a result of the false claim or statement of such person; or

"(ii) the amount of damages, including the amount of consequential damages and the cost of investigating such false claim or statement, sustained by the United States as a result of the false claim or statement.

"(2) For purposes of this section, 'knowingly' means with reckless disregard for whether a claim or statement is false.

"(c) Except as provided in section 803(b)(4) or 805(e)(1) of this chapter, the total amount of the penalty and assessment determined under this section shall not be less than the amount of damages sustained by the United States as a result of the false claim or statement.

"(d)(1) The penalties and assessments provided in this section shall be in addition to all criminal penalties provided by law.

"(2)(A) Except as provided in subparagraph (B) of this paragraph, the authority head may use all civil remedies and enforce any civil penalty and assessment for false claims and statements authorized by any other applicable provision of Federal law in addition to the provisions of this chapter.

"(B) No civil penalty or assessment may be imposed in any case subject to this chapter except in an amount provided in subsection (b) of this section.

"§ 803. Hearing and determination by authority head; subpena authority

"(a)(1) The investigating official of an authority shall investigate allegations that a person is liable under section 802(b) of this chapter and report the findings and conclusions to the reviewing official of the authority.

"(2) If the reviewing official determines, based upon the report of the investigating official, that there is probable cause to believe that a person is liable under section 802(b) of

this chapter, the reviewing official shall refer the allegations contained in such report to the authority head for a hearing.

"(b)(1) The authority head shall conduct a hearing on the record regarding any allegation referred to him pursuant to this section to determine—

"(A) whether a person is liable under section 802(b) of this chapter;

"(B) the amount of damages suffered by the United States as a result of the false claim or statement creating such liability; and

"(C) the amount of any penalty and assessment to be imposed upon such person.

"(2) The person alleged to be liable under section 802(b) of this chapter shall be entitled—

"(A) to written notice of the hearing specifically setting forth all allegations and the date, time, and place for such hearing;

"(B) to be present at such hearing;

"(C) to be represented by counsel;

"(D) to present evidence; and

"(E) to cross-examine any witnesses.

"(3)(A) Except as provided in subparagraph (B) of this paragraph and section 804 of this chapter, the findings and determinations of the authority head under paragraph (1) of this subsection are final.

"(B) If the authority head conducting the hearing under this subparagraph is an individual described in section 801(a)(2)(B) of this chapter, the amount of penalty and assessment imposed on a person may be reduced by the authority head described in section 801(a)(2)(A) of this chapter to any amount not less than the amount provided in section 802(c) of this chapter.

"(4) The total amount of the penalty and assessment determined under this section may be less than the amount provided in section 802(c) of this chapter if the authority head determines that a lower amount is in the best interest of the United States and enters in the written record and makes available for public inspection such determination and the reasons for such determination.

"(c) After a hearing pursuant to subsection (b) of this section, the authority head shall promptly send to any person determined to be liable under section 802(b) of this chapter written notice of the findings and determinations of the authority head and the right to judicial review under section 804 of this chapter.

"(d) For the purposes of an investigation under subsection (a) of this section the investigating official is authorized—

"(1) to administer oaths or affirmations; and

"(2) to require by subpena the attendance and testimony of witnesses and the production of all information, documents, reports, answers, records, accounts, papers, and other data and documentary evidence necessary to conduct such investigation.

"(e) For the purposes of conducting a hearing under subsection (b) of this section, the authority head is authorized—

"(1) to administer oaths or affirmations; and

"(2) to require by subpena the attendance and testimony of witnesses and the production of all information, documents, reports, answers, records, accounts, papers, and other data and documentary evidence which the authority head considers relevant and material to the hearing.

"(f) In the case of contumacy or refusal to obey a subpena issued pursuant to subsection (d) or (e) of this section, the investigating official or authority head, as the case may be, may invoke the aid of any United States district court where such investigation or hearing is being conducted, or where such subpenaed person resides or conducts business, and such court shall have jurisdiction to issue any appropriate order for the enforcement of such subpena. Any failure to obey such order of the court is punishable by such court as contempt.

"(g) Unless a petition is filed as provided in section 804 of this chapter, the determination of liability pursuant to this section shall be final and shall not be subject to judicial review.

"§ 804. Judicial review

"(a) Any person who has been determined pursuant to section 803 of this chapter to be liable under section 802(b) of this chapter may obtain review of such determination in the United States Court of Appeals for the circuit in which such person resides or in which the claim or statement upon which the determination of liability is based was made, presented, or submitted, or for the District of Columbia Circuit by filing in such court within sixty days following the sending of the notice required by section 803(c) of this chapter a written petition that such determination be modified or set aside. The clerk of the court shall transmit a copy of such petition to the authority head and to the Attorney General. Upon receipt of the copy of such petition the authority head shall transmit to the Attorney General the record in the proceeding. Except as otherwise provided in this section, the courts of appeals described in this subsection shall have jurisdiction to review the findings and determinations in issue and to affirm, modify, remand for further consideration, or set aside, in whole or in part, the findings and determinations of the authority head, and to enforce such findings and determina-

tions to the extent that such findings and determinations are affirmed or modified.

"(b) The findings of the authority head with respect to questions of fact, if supported by substantial evidence on the record considered as a whole, shall be conclusive.

"(c) The determination of the authority head as to the amount of any penalty and assessment shall be conclusive and shall not be subject to review except to the extent that such amount may exceed the maximum amount provided in section 802 of this chapter.

"(d) Any court of appeals reviewing under this section the findings and determinations of the authority head shall not consider any objection that was not raised in the hearing conducted pursuant to section 803(b) of this chapter absent a showing of extraordinary circumstances causing such failure. If any party shows to the satisfaction of the court that additional evidence not presented at such hearing is material and that there were reasonable grounds for the failure to present such evidence at such hearing, the court shall remand the findings and determinations of the authority head for consideration of such additional evidence.

"(e) Upon a final determination by the court of appeals that a person is liable under section 802(b) of this chapter, the court shall enter a final judgment for the appropriate amount in favor of the United States, and such judgment may

14

be recorded and enforced by the Attorney General to the same extent and in the same manner as a judgment entered by any United States district court.

"§ 805. Collection of civil penalties and assessments

"(a) Any penalty or assessment imposed in a determination which has become final pursuant to section 803(g) of this chapter may be recovered in a civil action brought by the Attorney General. In any such action, no matters that were raised or that could have been raised in a hearing conducted under section 803(b) of this chapter or in a review pursuant to section 804 of this chapter may be raised as a defense, and the determination of liability and the determination of amounts of penalties and assessments shall not be subject to review.

"(b) The district courts of the United States and of any territory or possession of the United States shall have jurisdiction of any action commenced by the United States under subsection (a) of this section.

"(c) Any action under subsection (a) of this section may, without regard to venue requirements, be joined and consolidated with or asserted as a counterclaim, cross-claim, or setoff by the United States in any other civil action which includes as parties the United States and the person against whom such action may be brought.

15

"(d)(1) The Court of Claims shall have jurisdiction of any action under subsection (a) of this section to recover any penalty and assessment if the cause of action is asserted in a counterclaim by the United States. The United States may join as additional parties in such counterclaim all persons who may be jointly and severally liable with the person against whom such counterclaim is asserted.

"(2) No cross-claims or third-party claims not otherwise within the jurisdiction of the Court of Claims shall be asserted among additional parties joined under paragraph (1) of this subsection.

"(e)(1) Except as provided in paragraph (2), the authority head may compromise or settle any penalty and assessment determined pursuant to section 803 of this chapter. No compromise or settlement under this subsection shall provide for a recovery of an amount less than the amount described in section 802(c) of this chapter unless the authority head makes the determination and takes the action provided in section 803(b)(4) of this chapter.

"(2) The Attorney General shall have exclusive authority to compromise or settle any penalty and assessment the determination of which is the subject of a pending petition pursuant to section 804 of this chapter or a pending action to recover such penalty or assessment pursuant to this section.

16

"(f) Whenever a penalty and assessment is imposed and collected pursuant to this chapter and part of any money paid or property or services delivered as a result of the false claim or statement on which such penalty and assessment is based was provided by a State or political subdivision thereof which has not previously been reimbursed for such money or property, the United States shall reimburse such State or political subdivision the lesser of—

"(1) an amount bearing the same ratio to the penalty and assessment recovered as the amount paid, or the cost to the State or political subdivision of property or services delivered, by the State or political subdivision on the basis of such false claim or statement bears to the total amount paid, or total cost of property or services delivered, based on such false claim or statement; or

"(2) the total amount actually paid, or the total actual cost to the State or political subdivision of property or services delivered, by the State or political subdivision on the basis of such false claim or statement.

"(g) Except as provided in subsection (f) of this section, any amount of penalty and assessment collected under this chapter shall be deposited as miscellaneous receipts in the Treasury of the United States.

17

"§ 806. Limitations

"(a)(1) Prior to initiating a proceeding under section 803(b) of this chapter the authority head shall transmit to the Attorney General written notice of the intention to initiate such proceeding together with the reasons for such intention.

"(2) The authority head may initiate a proceeding under section 803(b) of this chapter if—

"(A) the Attorney General approves the initiation of such proceeding; or

"(B) the Attorney General takes no action within one hundred and twenty days after receipt of the notice required by paragraph (1) of this subsection to disapprove the initiation of such proceeding.

"(b)(1) No proceeding under section 803(b) of this chapter shall be commenced more than six years after the making, presentation, or submission of the claim or statement which is alleged to be a false claim or statement.

"(2) A proceeding under such section is commenced by mailing by registered or certified mail the notice required in section 803(b)(2)(A) of this chapter.

"(c) Every civil action to recover any penalty and assessment under section 805 of this chapter shall be commenced within three years of the date on which the determination of liability for such penalty and assessment becomes final.

96-086 O - 82 - 6

"(d) If at any time during the course of proceedings brought pursuant to this chapter the authority head receives or discovers any specific information regarding bribery, gratuities, conflict of interest, or other corruption or similar activity in relation to a false claim or statement, the authority head shall immediately report such information to—

"(1) the Inspector General of the authority for transmission to the Attorney General if an Inspector General is authorized for the authority by the Inspector General Act of 1978 (92 Stat. 1101) or any other Federal law; or

"(2) the Attorney General if the authority is not authorized an Inspector General by the Inspector General Act of 1978 (92 Stat. 1101) or any other Federal law.

"(e) Upon transmission of a written finding by the Attorney General to an authority head that continuation of any proceeding under section 803 of this chapter may adversely affect any pending or potential criminal or civil action related to an alleged false claim or statement under consideration in such proceeding, such proceeding shall be immediately stayed and may be resumed only upon written authorization of the Attorney General.

"§ 807. Right to setoff

"(a)(1) The amount of any penalty and assessment which has become final under section 803(g) of this chapter, or for which a judgment has been entered under section 804(e) or 805 of this chapter, and any amount agreed upon in a settlement or compromise under section 805(e) of this chapter, may be deducted from any sum, including refund of overpayment of Federal taxes, then or later owing by the United States to the person liable for such penalty and assessment.

"(2) The authority head shall transmit written notice of the deduction made under this paragraph to the person liable for such penalty and assessment.

"(3) All amounts retained pursuant to this paragraph shall be remitted to the Secretary of the Treasury for disposition in accordance with section 805(g) of this chapter.

"(b) An authority head may forward a certified copy of any determination as to liability for any penalty and assessment which has become final under section 803(g) of this chapter, or a certified copy of any judgment which has been entered under section 804(e) or 805 of this chapter to the Secretary of the Treasury for action in accordance with subsection (a) of this section.

"§ 808. Regulations

"(a) The head of each authority shall make such rules and regulations as may be necessary to carry out the provi-

20

sions of this chapter. Such rules and regulations shall insure that investigating officials are not responsible for making the determinations or conducting the hearing required in section 803(b) of this chapter or making the collections under section 805 of this chapter.

"(b) The Attorney General may enter into a memorandum of understanding with the head of any authority to provide expeditious procedures for approving or disapproving the initiation of proceedings under section 803(b) of this chapter, and referral of matters for action under sections 804, 805, and 806(e) of this chapter. Such memorandum of understanding may provide advanced authorization to initiate proceedings under section 803(b) of this chapter with respect to any particular type or class of alleged false claim or statement if not otherwise barred by section 806 of this chapter.".

(b) The table of chapters of part I of title 5 of the United States Code is amended by adding after the item relating to chapter 7 the following new item:

"8. **Administrative Penalties and Assessments for False Claims and Statements** ..... 801.".

SEC. 3. The regulations required by section 808 of title 5, United States Code, as provided by this Act, shall be promulgated not later than one hundred and eighty days after the effective date of this Act.

SEC. 4. This Act shall take effect December 31, 1981.

AMERICAN BAR ASSOCIATION

WRITER'S ADDRESS AND TELEPHONE

One Golden Shore
Long Beach, CA 90802
(213) 435-6676
April 20, 1982

The Honorable William V. Roth, Jr.
Chairman, Committee on Government Affairs
United States Senate
Washington, D.C. 20510

Re: Program Fraud Civil Penalty Act of 1981 (S. 1780).

Dear Senator Roth:

You will find attached a Report to the United States Congress reflecting the comments of the Section of Public Contract Law of the American Bar Association on S. 1780, "Program Fraud Civil Penalty Act of 1981," which is currently pending before the Committee on Government Affairs. The views expressed in the Report represent only those of the Section and should not be construed as representing the position of the Association.

The proposed legislation would make very fundamental changes in the law applicable to Government procurement, changes which we believe would have an extremely negative effect on orderly procurement procedures. The proposed legislation would change substantially the definition of "false claims" against the Government, including the reduction of the scienter requirement to a standard of "recklessness." The proposed legislation would authorize individual agencies to assess large financial penalties against contractors found "guilty" of false claims in administrative hearings before the agencies. The fundamental changes which would result from the proposed legislation raise complex legal issues about matters of great public importance.

The proposed legislation is extremely broad in scope. It would affect the rights of virtually every individual or organization making a monetary claim against the Government.

The provisions of the proposed statute would cover not only contract claims, but also claims under grants and entitlement programs. In fact, abuses in grant and entitlement programs appear to be a major motivation for the legislation. We do not believe that such disparate activities can or should be treated under one set of procedural rules. There simply is no justification for encumbering the procurement system with the additional burdens which this statute would create.

The legislation would transform many contractual disagreements with the Government which have traditionally been resolved in existing disputes processes into "false claims" actions outside the disputes process. The existing disputes process has generally worked very well, and the Government already has available to it adequate remedies to guard against fraudulent claims. We do not believe that there is any justification for expanding those remedies to permit individual agencies to act as prosecutor, judge, and jury.

When coupled with other pending proposals which would have the almost automatic effect of disqualifying contractors administratively "convicted" of "false claims" from working on Government contracts, the effect of the proposed legislation would probably be to destroy the business of many contractors. We believe that a decision which places such awesome powers in the control of individual agencies whose competence varies widely is unconscionable.

If you or the Committee on Government Affairs have any questions about the views set forth in the attached Report, please feel free to call me at (213) 435-6676.

Sincerely yours,

David L. Hirsch

David L. Hirsch
Chairman
Section of Public Contract Law

Enclosure

cc: All members of the Senate Committee on Government Affairs

cc: The Honorable Fred F. Fielding
Counsel to the President
Room 113
Old Executive Office Building
17th & Pennsylvania Avenue, N.W.
Washington, D.C. 20500

The Honorable J. Paul McGrath
Assistant Attorney General
Civil Division
Department of Justice
Washington, D.C. 20530

The Honorable Joseph H. Sherrick
Assistant to Secretary of Defense
for Review & Oversight
The Pentagon
Room 3E1081
Washington, D.C. 20301

Milton J. Socolar, Esq.
General Counsel
General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

The Honorable Donald E. Sowle
Administrator
Office of Federal Procurement Policy
New Executive Office Bldg.
726 Jackson Place, N.W.
Washington, D.C. 20503

CONTINUED

1 OF 2

REPORT ON PROPOSED

"PROGRAM FRAUD CIVIL PENALTY ACT OF 1981"

S. 1780

American Bar Association
Public Contract Law Section
April 20, 1982

TABLE OF CONTENTS

REPORT ON PROPOSED "PROGRAM FRAUD CIVIL PENALTY ACT OF 1981," S. 1780

I. INTRODUCTION

On October 27, 1981, the proposed "Program Fraud Civil Penalties Act of 1981" was introduced in the Senate as S. 1780 by Mr. Roth and co-sponsored by Messrs. Cohen, Rudman and Nunn. This bill would authorize each major executive agency to assess penalties for so-called "false claims" with regard to federal programs.

S. 1780 presents several serious concerns:

- The bill would impose punitive penalties while reducing the "intent" standard for liability. The possibility of suspension and debarment makes even a minor "false claims" finding a potential threat to a contractor's continued viability.
- The bill's administrative mechanism is unclear, and its breadth might subsume Disputes Act procedures for resolving government contract claims.
- The notion of a "claim" under the bill might reach every transaction with federal, state or local governments and private, federal contractors.

If adopted, S. 1780 could reach everyone providing goods and services to the government. Congressmen considering this measure should be aware that the government already has extensive remedies to recover amounts lost through fraud or misconduct. Accordingly, S. 1780 requires close scrutiny before any action is taken.

The comments in this memorandum are from the perspective of attorneys -- representing both the government and contractors -- who practice in the federal procurement area. We recognize that S. 1780 is designed to apply not only to government contracts, but also to grants and entitlement programs. Nonetheless, S. 1780's broad scope will have a direct and substantial effect on the procurement process.

The Justice Department has indicated on several occasions that it seeks a broad statute covering all types of false claims, regardless of the context in which the claim originated. While this has the benefit of simplicity, it bears the vice of imposing liability where it might be inappropriate. For example, assessing damages that did not relate to a false statement would, in most instances, be unconscionable. Thus, we urge that anti-fraud legislation should not be drafted to deal with every conceivable aberrant situation. Instead, such legislation should provide a strong, fair remedy for a wide range of situations, supplemented with special legislation to deal with particular areas, such as grant or entitlement programs.

In evaluating the specific provisions of S. 1780, its dual purpose -- deterrence and providing the government a fair remedy -- must be considered. We believe that the following specific proposed changes do not serve either objective:

1. S. 1780 would allow the government to assess penalties of twice the full amount of either the tainted claim (even if only a small portion was "false") or consequential damages from the claim (even if the damages were only remotely related to the false statement). Neither fine, necessarily, is directly related to the amount of a false claim or the government's damages. These penalties could be imposed in addition to government's existing civil remedies, including suspension and debarment.
2. S. 1780 would impose liability where the defendant did not intend to defraud the government or otherwise act in a willful manner.
3. S. 1780's definition of "claim" might well encompass, every type of dealing with federal, state and local governments and dealings with private entities that contract with the federal government.
4. The bill is silent on the details of the administrative proceeding that would impose these penalties. S. 1780 does not require that fact finding be by an administrative law judge in

compliance with the Administrative Procedure Act.

5. S. 1780 would extend the current statute of limitations to six or nine years, even though, by their nature, small "false" claims require witness testimony as opposed to documentary evidence.
6. S. 1780 could impose the burden of collecting fraud assessments on the Internal Revenue Service. If so, this would compromise the special status of the IRS and, potentially, shift the burden of proof in enforcement actions by forcing the defendant to challenge the government's action by suing for a tax refund.

We note with interest that S. 1780 does not speak in any way to false claims by the government against contractors and other entities dealing with the government. While we do not seek to broaden S. 1780, we do wish to note that claims by the government in "reckless disregard of the truth" do occur. Yet a contractor has no remedy for false statements in favor of the government, nor can a contractor recover for added expense in proving that an asserted liability to the government is based upon false claims asserted by government officials.

The remainder of this report describes the proposed statutory changes and outlines issues which, we believe, should be considered in evaluating S. 1780.

II. THE BILL'S REMEDIES ARE PUNITIVE

The bill could impose sizeable penalties without regard to the nature or seriousness of the alleged violation. Moreover, even a minor "false statement" finding under this measure could lead to a contractor's suspension or debarment, thereby possibly forcing the company out of business.

A. Penalties Remotely Related to the Violation

S. 1780 provides for two penalties. The first is a maximum civil penalty of $10,000 for each false claim or statement. (Section 802(b)(1)(A)). In addition, the agency can assess a penalty as high as twice the full value of the tainted claim or twice the amount of damages, including "consequential damages," to the government from the false claim or statement. (Section 802(b)(1)(B)).1/

1/ Even though the bill provides only for administrative proceedings, the penalties imposed on the defendant are significantly more severe than might be awarded after a jury trial under the Civil False Claims Act, 31 U.S.C. § 231, R.S. §§ 3490, 5438. The Civil False Claims Act provides only a $2,000 forfeiture per claim and does not provide a penalty of twice the amount of the tainted claim or twice the "consequential" (as opposed to direct) damages.

Because of arbitrariness in defining a "claim," the bill could lead to a $100,000 fine in a case involving ten tainted claims of $10.00 each.

In addition, recovery of twice the amount of a tainted claim can result in a penalty only remotely related to the offense. Suppose contractor X submits an invoice for $20,000 for painting a government building when, in fact, he did not paint one room in the building. Even if the contractor returns and paints the room at no cost to the government, the contractor could be assessed a $40,000 penalty under S. 1780.

The other remedy, a penalty equal to twice the government's consequential damages, can also result in damages disproportionate to the seriousness of the "false" aspects of the claim. Moreover, "consequential damages" liability significantly broadens the scope of the government's recovery, as compared to the Civil False Claims Act which does not permit recovery of "consequential damages." United States v. Aerodex, 469 F.2d 1003 (5th Cir. 1972).

This result is illustrated by applying S. 1780 to the facts in United States v. Hibbs, 568 F.2d 347 (3d Cir. 1978). The defendant in Hibbs falsely certified to the Federal Housing Administration (FHA) that certain HUD standards had been met in six houses. In fact, deficiencies existed which would have cost about $3,500 to repair. Subsequently, FHA insured mortgages on the houses (which had become worthless for other reasons) and all six

mortgagors defaulted. The Court held there was no direct causal connection between the false certificates and the defaults; the government's False Claim Act damages were limited to the difference between the real value of the houses and the value represented in the defendant's certificates. Had S. 1780 been in effect, the government might have been able to collect twice the value of the houses as consequential damages, even though the loss was only remotely related to acts of the defendant. Providing the government such windfalls because of relatively minor and remotely connected false claims cannot be justified.

Similarly, on the facts considered in Aerodex, supra, the government could recover significantly greater damages under S. 1780 than it could under the Civil False Claim Act. Aerodex dealt with a $27,000 contract for aircraft engine bearings. The contractor substituted different bearings for those specified in the contract. The government removed all the improper bearings at a cost of $161,000. The Court allowed the government to recover False Claims Act penalties of $60,000 (twice the $27,000 contract price plus the $2,000 statutory penalty for each of three invoices). In addition, the Court stated that the costs of removing the deficient bearings were consequential damages and could not be recovered as damages under the Civil False Claims Act, but would be recoverable under the contract's express warranty. Accordingly, the government could recover a total of $221,000 (i.e., the cost of replacing the bearings plus the Civil False

Claims Act penalties). In contrast, under the principles of S. 1780 the government could have recovered $352,000 (twice the "consequential damages" of $161,000 plus a maximum of $10,000 per invoice), in addition to a possible contract recovery of $161,000 for breach of warranty. This would have been a total recovery of $513,000 on a $27,000 contract. As is apparent, the government can receive full and complete relief without imposing the penalties provided in this bill.

Government and contractor personnel have considerable difficulty determining liability for consequential damages, which can be unlimited in the context of government procurement. In light of this uncertainty, we believe consequential damages should not be part of with the government's recovery under S. 1780, and it would be particularly inappropriate to double the consequential damages.

The consequential damages provision is made particularly harsh by the limited flexibility given the administrators applying the statute. The bill can be read to prevent an administrator from reducing the assessment below the consequential damages figure unless the administrator affirmatively finds that a lower assessment is "in the best interest of the United States" and states his reasons in writing as part of the administrative record. (Sections 802(c) and 803(b)(4)).

Another remedy provision deserving comment is Section 802(d)(2)(A), which makes the bill's remedies cumulative with "all

civil remedies and . . . any civil penalty and assessment for false claims and statements authorized by any other applicable provisions of a Federal law. . . ." Thus, a $10,000 fine per "false statement" can be imposed on a contractor who would then be subject to full contract liability the Civil False Claims Act penalties. The Civil False Claims Act provides for a $2,000 forfeiture for each false claim plus twice the government's actual damages.2/

These cumulative remedies highlight the government's existing tools to defend itself from the unscrupulous. That more than one of these penalties might be imposed on the same person for the same transaction underscores the punitive character of S. 1780.

B. Suspension and Debarment

During the past few years contracting agencies repeatedly have moved to suspend companies upon indictment or suspicion of so-called "fraud." Furthermore, the Office of Federal Procurement Policy has proposed regulations which would require all executive agencies to suspend or debar a contractor who has been suspended or debarred by any other executive agency. Policy

---

2/ The Supreme Court has recognized that these penalties are, in essence, criminal. United States v. McNinch, 356 U.S. 595, 598 (1958), citing Rainwater v. United States, 356 U.S. 590, 592 n. 8 (1958). One federal appellate court has noted that the trial by jury or the court available under the Civil False Claims Act is the check on abusive impositions of penalties under the law. Toepelman v. United States, 263 F.2d 697 (4th Cir. 1958), cert. denied, 359 U.S. 989 (1959).

Letter 81-3, 46 Fed Reg. § 37832 (1981), §§ 6.1(c) and 7.1(c), 46 Fed. Reg. 37833 (July 22, 1981) (daily ed.). Thus, a "fraud" finding by one agency could lead to the contractor's debarment by the entire government.

The effects of debarment or suspension are severe; the contractor may not be awarded any future contracts, nor may the contractor bid or submit proposals on new contracts (D.A.R. § 1-601.1; F.P.R. § 1-1.603; Proposed § 5). Debarment precludes such procurement activity for a specified period of time up to three years (D.A.R. § 1-604.2(a); F.P.R. § 1-1.604(c); Proposed § 6.4.), while suspension, generally imposed as a preliminary step to debarment, results in such exclusion for a temporary period pending completion of investigations or legal proceedings. (D.A.R. § 1-605.1; F.P.R. § 1-1.605-2; Proposed § 7.4.)

Suspension and debarment may result from "serious and compelling" causes affecting the "responsibility" of the contractor, as well as from conduct constituting fraud or fraudulent activities. This standard is vague and leaves broad discretion in the hands of government officials.3/

3/ Under Defense Department regulations the government may suspend the firm or individual "upon adequate evidence of (A) commission of fraud . . . as an incident to obtaining, attempting to obtain, or in the performance of a public contract," or "for other cause of such serious and compelling nature, affecting the responsibility as a Government Contractor, ... as may be determined by the Secretary of the Department concerned to justify suspension." (D.A.R. § 1-605.1; See

[Footnote continued on next page.]

Considering both the strong pressure to suspend or debar contractors and the lack of clear standards for agencies to follow, it is certainly possible, if not likely, that an administrative "fraud" determination under this bill will lead to contractor suspension or debarment. If so, that single suspension or debarment could, under the proposed regulations, exclude the contractor from all future procurement activity for a period which might extend for years. Moreover, nothing in the current or proposed regulations would preclude an agency from instituting suspension or debarment proceedings against a contractor who submitted a "false claim" to another agency but who was not debarred by that agency. Thus, a contractor may face an endless series of such proceedings if it contracts with numerous agencies.

The full impact of S. 1780 becomes clear when one considers that suspension or debarment may result from an individual's misconduct imputed to the entire business with which he is connected, and to any "affiliates" of the business. (D.A.R. § 1-604.2(b); F.P.R. § 1-1.604-1(c); Proposed §§ 6.1(b) and 7.1(c)). Under the proposed regulations, that individual may be someone as remotely connected to management as a shareholder or an employee. (Proposed §§ 6.5 and 7.5). Thus, one false invoice submitted by an

---

[Footnote continued from previous page.]

also F.P.R. § 1-1.605-1; Proposed § 7.2). A contractor also may be debarred for a "cause of such serious and compelling nature, affecting responsibility as a Government Contractor, ... as may be determined by the Secretary of the Department." (D.A.R. § 1-604.1; See also F.P.R. § 1-1.604(a)(5); Proposed § 6.2).

employee to an agency could result in that agency's institution of false statment proceedings under S. 1780, imposition of punitive damages and complete debarment or suspension from all immediate, and perhaps long-term, procurement activity. The fact that the "false claim" may have involved only a relatively small dollar amount is irrelevant. It is not hard to imagine how such a determination by an administrative agency could seriously affect any government contractor, regardless of its size.

III. S. 1780 COULD SUPERSEDE THE CURRENT DISPUTES PROCESS

The S. 1780 definition of "false claim" could include nearly every contract dispute now resolved by administrative contract appeals boards or the Court of Claims pursuant to the "Disputes Clause" in government contracts.4/

This contract disputes procedure has developed over nearly thirty years, and is an important component of this country's procurement process. Congress recently reaffirmed the continuing vitality of the disputes process by adopting Contract Disputes Act of 1978, P.L. 95-563 ("Disputes Act").

S. 1780 might affect the disputes process because the definitions of "claim" and "false claim" could apply to nearly every

---

4/ The "Disputes Clause" in government contracts (e.g., F.P.R. § 1-314, D.A.R. § 7-103.12) requires that contractor claims be presented to the appropriate government contracting officer for his final decision. If the contracting officer determines that the contract does not permit the claim, the contractor may appeal that decision to the appropriate administrative contract appeals board or the Court of Claims.

contract appeal. Under the bill a false claim includes a claim for "payment for the provision of property or services which the claimant has not provided, or has not provided in accordance with the terms of the contract on which such claim is based." (Section 802(a)(1)(B)) The term "claim" is defined to include "any request or demand . . . to an authority . . . for the payment or [reimbursement] . . . of money." (Section 801(a)(3)(A) and (B))

Every contract appeal involves a claim which the authorized contracting officer has determined is in excess of that properly due, or for products or services "not provided in accordance" with the contract. Thus, by definition, every contract appeal might be a "false claim." Moreover, each such appeal is made by the contractor knowingly and intentionally, with the full understanding that the responsible government official believes that the "claim" is wrong.

From the government's perspective every contract appeal could be a "false claim" to be resolved through an administrative fraud proceeding. Thus, S. 1780 would enable the government to adjudicate the merits of each contract dispute in the context of a fraud proceeding, rather than before a contract appeals board or the Court of Claims. There would be no way for agencies to prevent Inspectors General, who are protected by statute from agency interference in their investigations, from bringing a "false claim" charge when a contractor makes a "claim" under its contract.

This would be significant. At a minimum, it would interfere with the contract appeals process, which has developed a comprehensive body of contract interpretation precedents over the past thirty years. At worst, S. 1780 could be used to intimidate contractors from filing legitimate claims because of the threat of punitive fraud proceedings.

Having only recently affirmed the continued legitimacy and viability of the contract disputes process, Congress should not question that process by adopting S. 1780.

IV. S. 1780'S SCOPE AND APPLICATION IS UNCLEAR

The bill does not address issues central to its administration, such as who will preside over the hearing and the burden of proof to be sustained. Moreover, the bill's definition of a "claim" could extend to requests for payment or services from not only the federal government, but also from state, county, and local governments and private federal contractors.

A. The Bill Does Not Specify the Administrative Procedure And Burden to Be Sustained In Imposing These Penalties

The bill's penalties are triggered by a "false claim or statement" finding, yet the bill would permit each agency to decide who will make that finding. This could bypass the Administrative Procedure Act and deprive an accused person of the traditional procedural safeguards in administrative proceedings.

One such safeguard is the use of Administrative Law Judges to make initial determinations of fact. These judges are trained to act with independence and professionalism, and to foster an impartial proceeding. S. 1780 does not require that factual determinations be made by Administrative Law Judges. Instead, the agency head can appoint another person to make these findings, even if the designee is not independent from the authority bringing the "false claims" charge. This is a serious shortcoming in the bill which could permit significant unfairness in its administration.

Likewise, by not addressing the issue of "burden of proof" S. 1780 might reduce the government's burden from the standard and character of evidence required in similar proceedings. At the present time the government must have "clear and convincing evidence" to prove a Civil False Claims Act violation. United States v. Ekelman & Associates, Inc., 532 F.2d 545, 548 (6th Cir. 1976); United States v. Mead, 426 F.2d 118, 129 (9th Cir. 1970) ("clear, explicit and unequivocal").

The bill is silent on the quality and burden of evidence to be applied in the new administrative proceeding. Although "preponderance of the evidence" is the burden of proof standard generally applied in administrative cases, it is not required by this bill. Likewise, the measure is silent on whether the prosecution must show "clear and convincing evidence" of a violation. Indeed, Section 804(b) of the bill provides that on judicial review the administrative finding will be upheld "if supported by

substantial evidence on the record considered as a whole." (Emphasis added).

In light of S. 1780's provisions reducing the requirement of intent and substantially increasing potential penalties, it seems particularly inappropriate not to specify a burden of proof and to require "clear and convincing" evidence. The "clear and convincing" standard generally is applied in civil cases involving fraud, as well as in certain other civil actions, such as tax fraud cases. See, e.g., Loftin & Woodward, Inc., v. United States, 577 F.2d 1206, 1236 (5th Cir. 1978) (requiring clear and convincing evidence to prove income tax fraud); See also, McCormick on Evidence, Section 340; IX Wigmore on Evidence, Section 2498. Such a standard is appropriate since the fraud action, though administrative in form, has clear criminal attributes.

The "clear and convincing" standard makes sense as a matter of policy. Where there is an asserted improper claim, the government has a number of alternative remedies. When conduct is sufficiently egregious, the government may bring criminal proceedings, requiring proof "beyond a reasonable doubt." At the other extreme, the government may simply recover its losses under the contract. This would require a preponderance of the evidence and would permit recovery of full compensatory damages.

S. 1780 may fall somewhere between the criminal penalty and compensatory recovery under the contract or at common law. Under the bill the government would recover double damages, plus penal-

ties. As such, an intermediate standard of proof -- clear and convincing evidence -- makes sense. It would seem unfair to permit the government to obtain punitive damages without a higher level of proof than required for compensatory damages.

B. S. 1780 Might Reach Every Transaction With Federal, State, County or Local Governments And Transactions With Private, Federal Contractors

S. 1780 defines the term "claim" to include more than a claim for money or services under federal programs. In addition to those claims, the bill would cover requests or demands made to anyone who is a "recipient of property, services or money . . ." if that person received property or services or "any portion of the funds" or "any portion of the money" from the United States.5/ (Section 801(a)(3)(B).)

This definition extends the bill's application beyond federal programs. The bill would apply to any demand for payment of money, "including money representing grants, loans, insurance, or benefits" from any entity "if the United States provided any portion of the money . . . or [would] reimburse such recipient for

---

5/ In addition, Section 801(b)(3) of S. 1780 provides:

> [A] claim shall be considered made to an authority, recipient, or party when such claim is made to an agent, fiscal intermediary, or other entity, including any State or political subdivision thereof, acting for or on behalf of such authority, recipient or party.

any portion of the money paid." (Section 801(a)(3)) (emphasis added).

There appears to be no limit on how far a federal government payment can be traced for the purpose of applying the bill. Where state and local governments receive federal revenue sharing and block grant funds, every dollar they spend might conceivably be covered by S. 1780. Likewise, private companies that do business with the federal government might be said to receive federal money, so any transaction by a third party with those companies might be subject to this bill.

This broad application might have significant consequences. People with no reason to believe they were dealing with the federal government, directly or indirectly, will find themselves subject to fraud charges before federal administrators in Washington. Moreover, state and local governments and private companies might be surprised to find themselves subject to federal investigation because of activities that had little or nothing to do with Washington. The possibility of confusion and disruption in the federal system is apparent.

C. Reducing the "Intent" Requirement

This legislation would change the mental element -- specific intent to defraud -- required to prove common law fraud by permitting recovery for imputed knowledge. S. 1780 would impose

liability if a defendant has acted with "a reckless disregard for whether [the] claim or statement is false." (Section 802(b)(2)).

S. 1780 would permit a lower standard of proof than is now required by some circuit courts of appeal under the Civil False Claims Act. These courts have interpreted the Act to require proof of specific intent to defraud.6/ See, e.g., United States v. Ehrlich, 643 F.2d 634 (9th Cir. 1981); United States v. Ekelman & Associates, Inc., 532 F.2d 545 (5th Cir. 1976); Peterson v. Weinberger, 508 F.2d 45 (5th Cir.), cert. denied, 423 U.S. 830 (1975); United States v. Aerodex, 469 F.2d 1003 (5th Cir. 1972); United States v. Mead, 426 F.2d 118 (9th Cir. 1970); United States v. Ridglea State Bank, 357 F.2d 495 (5th Cir. 1966); United States v. Ueber, 299 F.2d 310 (6th Cir. 1962); United States v. Priola, 272 F.2d589 (5th Cir. 1959); United States v. National Wholesalers, 236 F.2d 944 (9th Cir. 1956), cert. denied, 353 U.S. 930 (1957).

6/ The scope of intent required by the Civil False Claims Act is unclear since other courts have stated that the government need only show a knowing submission of a false claim without explaining whether specific intent is required. E.g., Eastern School v. United States, 381 F.2d 421 (Ct. Cl. 1967); Acme Process Equipment Co. v. United States, 347 F.2d 509 (Ct. Cl. 1965), rev'd on other grounds, 385 U.S. 138 (1966). Still other courts have specifically stated that intent to defraud need not be shown. United States v. Hughes, 585 F.2d 284 (7th Cir. 1978); United States v. Cooperative Grain and Supply Co., 476 F.2d 47 (8th Cir. 1973); United States v. Foster Wheeler Corp., 316 F. Supp. 963 (S.D.N.Y. 1970), aff'd, 447 F.2d 100 (2d Cir. 1971); Fleming v. United States, 336 F.2d 475 (10th Cir. 1964), cert. denied, 380 U.S. 907 (1965).

In light of the severity of the penalties that can be imposed under S. 1780, we believe that such a loose standard of proof for intent is inappropriate. The threat of complete debarment or suspension also warrants the requirement that the government prove specific intent to defraud, as many courts appear to have done under the Civil False Claims Act.

V. THE GOVERNMENT ALREADY HAS ADMINISTRATIVE AND JUDICIAL REMEDIES TO RECOVER LOSSES FROM "FALSE CLAIMS" BY CONTRACTORS

We support government efforts to recover fully and completely any losses sustained through fraud. However, S. 1780 apparently would impose penalty assessments even where the government has recovered its full and complete losses under the contract. Accordingly, before acting on this bill Congress should consider the other tools currently available to achieve these objectives.

The government has a wide range of remedies under its contracts. For example, the inspection clause, standard in most supply contracts, provides that the government's acceptance of goods may be overturned where such acceptance was induced by fraud or "gross mistakes as to the amount of fraud." Catalytic Engineering and Manufacturing Corp., ASBCA No. 15,257, 72-1 BCA ¶ 9342.

Further administrative protection is afforded in Public Law 87-653, the Truth in Negotiations Act, which requires contractors to disclose all relevant cost or pricing data while negotiating large noncompetitive contracts and any major change to a competi-

tive contract. To the extent such data are not accurate, current and complete, the government is entitled to a reduction of the contract price pursuant to the contract.

Administrative boards of contracts appeals have not shied away from addressing contractual disputes even though the government alleges fraud by a contractor. E.g., Nashua Corporation, GSBCA No. 5892, 81-2 BCA ¶ _____ (slip. op. September 30, 1981) (Inspector General's allegations of fraud do not mean there is fraud; the Disputes Act does not appear to eliminate board jurisdiction over contract issues where fraud has been alleged).

We are not suggesting that the government's sole remedy for false statements should be through administrative proceedings under the contract. Rather, we point out that the government already may recover compensatory damages through administrative proceedings. S. 1780 may not be necessary to protect the government's interests, at least with respect to procurement.

In addition, under the Disputes Act of 1978, P.L. 95-563, the government is entitled to recover from the contractor the amount of any claim which the contractor is unable to support because of intentional misrepresentation or fraud. Thus, if a contractor submitted a claim for $500,000, and he was unable to support that claim because of fraud or intentional misrepresentation, the contractor would owe the government $500,000, plus the government's costs for reviewing the claim.

The government may also recover cumulative penalties under both civil and criminal statutes. The Civil False Claims Act, 31 U.S.C. § 231, R.S. §§ 3490, 5438, entitles the government to recover $2,000 for each false claim and twice the amount of any damages it sustains as a result of the wrongdoing. S. 1780 completely overlaps the Civil False Claims Act and therefore, is unnecessary.

Another judicial remedy available to the government is the Forfeiture of Claims provision, 28 U.S.C. § 2514. This statute provides that a contractor's claim is forfeited if it involves fraud against the United States in relation to a claim brought in the Court of Claims. Under this statute, which is enforceable in the Court of Claims, a contractor forfeits his entire claim even if only a small portion has been misrepresented.

The government also has traditional criminal statutes to deal with such conduct. Under 18 U.S.C. § 1001, a person who makes false, fictitious or fraudulent statements concerning a matter within the jurisdiction of a government agency can be fined up to $10,000 and imprisoned for up to five years. Similarly, one who makes false, fictitious or fraudulent claims can be fined up to $10,000 and imprisoned up to five years under 18 U.S.C. § 287. Analogous criminal remedies can be imposed for conspiracy to defraud the government (18 U.S.C. §§ 286 and 371) or even for mail fraud (18 U.S.C. § 1341).

The broad range of administrative as well as judicial remedies available to the government suggests that, particularly in the context of government contracts, the protection afforded by S. 1780 may already be available. At a minimum, Congress should consider whether it is necessary to apply the broad authority of this bill to the procurement process, which has been subject to administrative enforcement for the last thirty years.

VI. CONCLUSION

In summary, we oppose S. 1780. We particularly object to the punitive nature of S. 1780's penalties (including potential debarment and suspension), the absence of traditional Administrative Procedure Act protection, the lower standard of "intent," the ambiguous burden of proof, and the measure's potential application to "claims" made on many state, local and even private authorities. The bill interjects into the disputes process an unnecessary, overlapping administrative proceeding that could cause confusion and uncertainty. The government already has significant administrative, civil and criminal penalties to impose on the unscrupulous, and enactment of this measure appears inappropriate.

Therefore, we urge that S. 1780 not be adopted.

○

END