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4th Circ. Per-Invoice Rule: Warnings For Gov't Contractors

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The contracting community is well aware of the liability risk posed by the ever-expanding False Claims Act. First enacted in 1863 to combat contractor fraud during the Civil War, the pace and scope of FCA enforcement actions has mushroomed in recent years, driven in part by the emergence of modern theories of liability, such as the "fraudulent inducement" and "false certification" theories, and in part by the rise of increasingly sophisticated and opportunistic private relators. Contractors in the defense and national security space have been among those targeted by this trend. FCA cases in the area of procurement, primarily involving defense contractors, saw record recoveries of nearly $890 million in 2013, making the defense industry the second-largest target of FCA claims after the health care industry.

For the past four years, FCA enforcement has focused most heavily on the health care industry, recovering more than $2 billion a year in cases involving health care fraud. This article discusses a recent FCA ruling by the Fourth Circuit that, if allowed to stand, could make the defense industry a more attractive target for qui tam relators by subjecting defense contractors to millions of dollars in civil penalties based solely on how often they happen to invoice the government — even if the relator never proves any damages.

A petition for certiorari in the case, United States ex rel. Bunk v. Gosselin World Wide Moving NV, 741 F.3d 390 (4th Cir. 2013), is currently pending before the U.S. Supreme Court, and is being closely watched by numerous stakeholders in the business and legal sectors. As discussed below, prompt intervention from the Supreme Court is needed: Not only is this decision wrong as a matter of statutory construction and inconsistent with the Eighth Amendment's constitutional protections, but it also subjects contractors to legal and monetary risks that are disproportionate to the benefits they gain from participation in federal procurement, without advancing legitimate enforcement objectives.

If this ruling stands, it could discourage some contractors from competing for certain contracts, which would ultimately frustrate the government's own procurement objective of achieving best value through full and open competition.

Case Overview

Gosselin involves a qui tam relator's allegations that Gosselin, a Belgian shipping company holding a government contract to transport goods to U.S. military personnel in Europe, had illegally conspired to fix shipping rates and had submitted a false certificate of independent price determination with its bid. Although the relator's original complaint alleged damages, he did not attempt to prove damages at trial. Instead, he sought only the statutory civil penalty of $5,500 to $11,000 for each false claim submitted to the government.

The parties stipulated that Gosselin had filed 9,136 invoices over the life of its large, multiyear shipping contract, and the court determined that each invoice constituted a separate false claim under the FCA. The 9,136 stipulated violations meant that the statutory penalty — at a minimum — would exceed $50 million (9,136 X $5,500 = $50,248,000), although the relator proposed to take a voluntary remittitur and seek "only" $24 million.

Given the absence of any proven damages, Gosselin challenged the $24 million penalty as an unconstitutionally excessive fine under the Eighth Amendment. The district court agreed, concluding that that the "per-invoice" penalty was grossly disproportional to Gosselin's conduct. The district court noted that "none of those invoices contained or referenced the false [certificate of independent price determination] ... and none of those 9,136 false invoices contained any factually false information. Rather, they are deemed false as a matter of law based on judicial constructions of the FCA."[1]

On appeal, the Fourth Circuit reversed and reinstated the $24 million penalty, reaffirming its mechanistic per-invoice method for calculating statutory penalties in the process. The court acknowledged that "the number of false invoices presented is hardly a perfect indicator of the relative liability that ought to attach to an FCA defendant," and it described its per-invoice rule as a "monster of our own creation."[2] Nonetheless, it justified its holding on the generic ground that a $24 million penalty "appropriately reflects the gravity of Gosselin's offenses and provides the necessary and appropriate deterrent effect going forward."[3]

Gosselin duly filed a petition for writ of certiorari to the Supreme Court. The petition has attracted significant attention from both the defense and pharmaceutical industries, and both the National Defense Industrial Association and the Pharmaceutical Research and Manufacturers of America recently submitted amicus curiae briefs supporting Gosselin's request for review.

Legal Analysis

The Fourth Circuit's mechanical per-invoice rule creates serious problems on both statutory and constitutional grounds. As a statutory matter, the FCA "imposes liability only for the commission of acts which cause false claims to be presented."[4] As Gosselin illustrates, however, modern theories of FCA liability recognize that an act of fraudulent inducement may be distinct from the subsequent submission of an invoice. In such cases, the separate act of submitting successive truthful invoices does not "cause" serial false claims; instead, the number of truthful invoices submitted is "wholly irrelevant" to the number of fraudulent "causative acts."[5] In these circumstances, a per-invoice penalty is at odds with the statutory scheme.

A strict per-invoice approach also runs afoul of the Excessive Fines Clause of the Eighth Amendment, which prohibits penalties that bear no rational relationship to a defendant's culpability. Consider, for instance, a scenario in which one contractor fraudulently induces the government to buy 50 widgets and submits one invoice for the whole order, and another contractor commits identical misconduct but invoices each widget separately. In this case, the two contractors would be equally culpable, but the

Fourth Circuit's per-invoice rule would punish the second contractor 50 times more severely than the first. Such arbitrary and inequitable punishment is inconsistent with the Eighth Amendment's guarantees.

Impact on Defense Contractors

Aside from its statutory and constitutional flaws, the per-invoice rule would have a number of adverse practical impacts on contractors. As discussed at the outset, the proliferation of FCA litigation, coupled with the uncertainties of emerging theories of liability, is of serious concern to defense contractors. Empirical studies show that the majority of qui tam actions are found to lack merit, but even meritless FCA suits can exert a strong in terrorem effect, allowing relators to extract settlements from contractors averse to high discovery costs or the risk of large losses. Unfortunately for defense contractors, the abusive potential of private FCA enforcement is magnified by the Fourth Circuit's recent ruling.

First, by tying the statutory fine to the number of bills submitted, the per-invoice rule divorces the amount of the penalty from the defendant's culpability. Under the Fourth Circuit's rule, statutory penalties are multiplied by the number of invoices submitted, even in cases like Gosselin when there is nothing false about the invoices themselves. And like Gosselin, in many cases the number of invoices bears no correlation to the defendant's culpability.

For any given contract, the number of invoices can vary depending on factors such as the type of contract, the economics underlying the transaction, and the requirements of the particular contracting officer. For example, cost-reimbursement contracts are often used for long-term research and development where it is difficult — if not impossible — to estimate the costs of performance at the outset. In recognition of the fact that contractors holding these types of contracts must rely on frequent invoicing to maintain cash flow, federal regulations allow contractors to invoice the government every two weeks.[6]

Similarly, General Services Administration Multiple Award Schedule contracts also require frequent billing. In general, contractors in the MAS program are obligated to accept orders placed by an agency, and it is not uncommon for contractors to submit thousands of invoices over the life of a single contract. Although there is no reason to believe that the number of invoices submitted under these types of contracts is indicative of greater contractor culpability, the Fourth Circuit's per-invoice rule nonetheless exposes defense contractors to exponentially increased liability.

Second, the per-invoice rule creates a divergence between the government's legitimate anti-fraud interests and the financial incentives of a relator. The 1986 FCA amendments are widely viewed as having spurred an uptick in qui tam suits by raising the relator's share of an award from 10 percent to 15–25 percent (and up to 30 percent if the U.S. Department of Justice declines to intervene). However, the per-invoice rule skews this incentive by encouraging private qui tam relators to seek out claims involving the largest numbers of invoices instead of claims involving the most serious fraud. In financial terms, a relator stands to gain more by seeking out purely technical violations of a high-invoicing contractor than uncovering serious fraudulent activity of a contractor with a less frequent billing arrangement.

At the same time, the per-invoice rule also increases the incentives of risk-averse defendants to settle FCA claims. The specter of potentially enormous liability, especially for high-invoicing contractors dedicated to government procurement, ratchets up the pressure to settle FCA actions, even those without merit. And of course, the increased likelihood of obtaining a settlement will only further

incentivize additional relators to target high-invoicing contractors with qui tam suits.

There can be little doubt that the contracting community in general — and defense contractors in particular — will bear the brunt of the Fourth Circuit's rule. But as noted above, if allowed to stand, the rule likely will hamper the government's own procurement objectives as well. The per-invoice framework effectively increases the costs of doing business with the government, and many contractors — particularly small businesses and commercial contractors with significant nongovernment business — may opt not to subject themselves to such inflated risks by pursuing public contracts.

Similarly, because the per-invoice rule acts as a disincentive to frequent billing, businesses that are less able to tolerate diminished cash flow also may be driven from the public procurement sector. The net result in both cases is less competition for government contracts, raising the possibility of an accompanying reduction in value to the government.

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Covington & Burling LLP drafted the amicus brief that was submitted on behalf of the NDIA in support of Gosselin's petition for writ of certiorari. Robert Long, who chairs Covington & Burling LLP's appellate and Supreme Court litigation group was counsel of record, and was joined on the brief by Susan Cassidy and David Zionts.

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[1] United States ex rel. Bunk v. Birkart Globistics GmbH & Co., 2012 U.S. Dist. LEXIS 18445 at *34 (E.D. Va. Feb. 14, 2012).

[2] United States ex rel. Bunk v. Gosselin World Wide Moving, N.V., 741 F.3d 390, 407-08 (4th Cir. 2013).

[3] Id. at 409.

[4] United States v. Bornstein, 423 U.S. 303, 312 (1976) (emphasis added).

[5] Id.

[6] FAR § 52.216-7. Indeed, small businesses may invoice the Government even more frequently. Id.
