ARTICLE

CARROTS AND STICKS: PLACING REWARDS AS WELL AS PUNISHMENT IN REGULATORY AND TORT LAW

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Companies that pay bribes, defraud the government or injure private citizens with malice are subject to some of the highest penalties in the American legal system. Penalties for the first two are governed by high civil and criminal fines under the Foreign Corrupt Practices Act (FCPA) and the federal False Claims Act (FCA), respectively. Injuring with malice can give rise to unlimited punitive damages under state and federal law. These "sticks" provide harsh penalties to stop and deter companies from such actions.

This article addresses the provocative questions: should the American legal system offer companies "carrots" that remove or reduce the most significant of these penalties, even when a company cannot completely prevent corruption, fraud or personal injury? If so, under which conditions?

The article explains that such carrots must be offered to optimize corporate compliance; reduce corruption, fraud and injury; and restore needed fairness to these enforcement actions.

Specifically, under the FCPA and FCA, when a company has a compliance program to prevent, stop and remediate illegal activity by its employees, it should not share its employees' culpability. Consequently, the FCPA should have a compliance defense to criminal sanctions, and the FCA should give companies the opportunity to be notified of a potential FCA violation so that they can investigate and address the allegations before lawsuits are filed.

Similarly, when a person is injured by a product or service even though a company has fully complied with the applicable federal or state safety standards, punitive damages should be barred. When a company complies with the applicable safety standards, the law should recognize that the company cannot have the requisite malice to deserve punitive damages.

The article concludes that coupling these "carrots" and the law's existing "sticks" is the best way to incentivize the right corporate behaviors and avoid trespassing on the fundamental principle of "American Fairness" that American jurisprudence seeks to achieve.

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An essential purpose of an organized society is to encourage "good" behavior from its citizens and discourage "bad" behaviors.[1] To reach this goal, disciplinary systems involving individuals often include both carrots to reward good conduct and sticks to punish the bad. For example, schools generally have honor rolls and citizenship awards, not just probation and detentions. Individuals in prisons who demonstrate the right behavior can earn benefits, including being released before serving an entire sentence. For people in general, motivating through fear is a half-filled cup. The carrot of rewarding positive conduct is a powerful motivator and a basic ingredient for achieving optimal conduct.[2]

The American legal system fails this common sense approach when creating incentives for corporate conduct. Here, American law often relies exclusively on punishment, which takes place only after harm has occurred. It rarely gives legal "carrots" to companies that act properly so that the harms can be prevented. This Article challenges this paradigm for three high-profile, dynamic areas of law: the Foreign Corrupt Practices Act (FCPA),[3] the federal False Claims Act (FCA),[4] and punitive damages under state and federal law. Currently, each of these legal regimes relies exclusively on the powerful stick of exceedingly high penalties, which are meant solely to punish and deter improper corporate behavior.[5]

Part I of the Article focuses on the FCPA, which can subject a company to criminal punishment and fines in the United States should an employee or one of its agents engage in corruption abroad, such as by bribing a foreign official.[6] This can occur even when a corporation has invested substantial resources in state-of-the-art compliance programs that focus on internal policing to stop such actions and root them out should they occur.[7] This Article discusses the current effort to reform the FCPA to give legal carrots to companies that assist the government in both preventing and remediating corrup-

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[1] While earlier references exist, the modern use of "carrot and stick" dates from a 1946 article in *The Economist*:

> The human donkey requires either a carrot in front or a stick behind to goad it into activity. . . . However, it is not necessary for the present purpose to argue the respective potentices [sic] of the carrot and the stick; it is enough to agree that, if an active and progressive economy is to be founded on the frailties of human nature, both are needed.

The Carrot and the Stick, THE ECONOMIST, June 29, 1946, *reprinted in* 8 AM. AFF. 282, 282 (1946), *available at* http://mises.org/journals/aa/AA1946_VIII_4.pdf, *archived at* http://perma.cc/K8G8-5U9R.

[2] James Andreoni, William Harbaugh & Lise Vesterlund, *The Carrot or the Stick: Rewards, Punishments, and Cooperation*, 93 AM. ECON. R. 893, 901 (2003) ("[R]ewards and punishments act to complement one another.").

[3] Foreign Corrupt Practices Act of 1977, Pub. L. No. 95-213, 91 Stat. 1494 (1977) (codified as amended at 15 U.S.C. §§ 78dd-l to 78dd-3, 78ff, 78m(b), 78m(d)(1), 78m(g)–(h) (2006 & Supp. 2010) [hereinafter FCPA].

[4] 31 U.S.C. §§ 3729–3733 (2010).

[5] *See infra* notes 27–28, 154, 255–258.

[6] *See* FCPA *supra* note 3.

[7] *See infra* notes 27–28.

tion through anti-corruption programs. If the law treats these companies equally with those that have no programs for fighting fraud, it will discourage companies from going the extra mile to stop violations of the FCPA.

Part II analyzes the FCA's current enforcement mechanism, which largely relies on giving private individuals large financial incentives to sue companies they suspect of violating the FCA.[8] The first "insider" to file such a lawsuit can qualify for up to thirty percent of the award, which can include heightened penalties meant to punish bad actors who have defrauded the federal government.[9] As with the FCPA, the FCA also does not provide "carrots" for companies that work with the Department of Justice to police and root out FCA violations. Over the past thirty years, the FCA has been broadened to include much lesser offenses, and this article suggests that, given these developments, the law should give conscientious companies the opportunity to investigate and remediate a violation before being exposed to private, profit-motivated litigation.

Finally, Part III looks at when punitive damages should be allowed in claims over products and services regulated by state or federal law. When regulators issue safety standards, they provide guidance to companies as to how to manage risks associated with certain products and services. If a company has fully complied with these regulations, what role do punitive damages serve when someone brings a tort or contract claim alleging he or she was harmed by that product or service? Punitive damages are not needed to compensate a plaintiff for his or her injuries. They are awarded to a plaintiff only to punish a defendant whose injurious conduct was "evil" or quasi-criminal. Courts and legislatures have begun finding that, as a rule, punitive damages are not appropriate when used to punish those who comply with the law. Barring punitive damages from these claims can create a powerful incentive to get companies to abide by federal and state regulations.

The Article concludes that, in each of these corporate penal systems, balancing "carrots" and "sticks" can optimize the ability of companies to deter criminal and quasi-criminal conduct in carrying out their business affairs. All three areas of law carry significant "sticks" to punish bad actors, and the failure to adopt the right "carrots" can frustrate the purpose of these heightened penalties. With the FCPA and FCA, the lack of positive incentives could lessen a company's resolve to self-report and self-enforce the law. With the FCA and punitive damages, carrots are needed to assure that private plaintiffs and their lawyers cannot abuse the threat of heightened penalties to maximize their own gains at the expense of the proper legal outcomes. In these situations, Congress, state legislatures, and courts should tailor "carrots" to reward businesses that work with the government and follow government standards in preventing, uncovering, and enforcing violations of law.

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[8] *See, e.g.*, *infra* note 153.
[9] *See infra* at 152, 192.

I. Foreign Corrupt Practices Act: Corporate Enforcement of Employee Criminal Activity

The FCPA prohibits payment of bribes to foreign officials and establishes accounting requirements to assure that such corruption cannot be hidden in creative bookkeeping. Over the past decade, its enforcement has become one of the highest priorities for the Department of Justice ("DOJ"), ranking "second only to fighting terrorism."[10] A core element of the law is to hold a company responsible, both civilly and criminally, should an employee or one of the company's agents bribe a foreign official. Imputing an individual's criminal conduct to the entire company has led to multi-million dollar civil and criminal fines, along with disgorgement of profits.[11] It also has spurred the rise of aggressive anti-corruption compliance programs that companies have put in place to avoid such penalties. The key question this article addresses is whether a company's good faith compliance efforts to dissuade or stop the illegal act from occurring should preclude the government from charging the company criminally in addition to any civil or recuperative damages that it seeks.

Several state supreme courts have addressed the impact of compliance programs on criminal liability in other contexts. For example, several states have statutes holding an employer criminally responsible when an employee sells liquor to a minor. Here, as is often alleged in FCPA cases, the employee engages in an illegal act to sell its employer's products or services, the illegal conduct might not be authorized by the employer, and the offense can arise despite significant efforts by the employer to guard against these illegal sales.[12] Courts have ruled that criminal penalties based on vicarious liability can violate an employer's due process rights under both state constitutions and the Fourteenth Amendment to the United States Constitution when an employer has a strong program to train its employees and prevent violations.[13]

Constitutional issues aside, courts have expressed the public policy concern that criminal vicarious liability absent the company's fault violates the foundation of criminal law: culpability. The Supreme Court of Minnesota explained that, under the Model Penal Code, "[c]rime does and should mean condemnation and no court should have to pass that judgment unless it

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[10] Laurence A. Urgenson et al., *New Bumps and Tolls Along the Road to FCPA Settlements*, Bus. Crimes Bulletin, Nov. 2009, 1, *available at* http://www.kirkland.com/.cfm?contentID=223&itemId=2929 (Nov. 1, 2009), *archived at* http://perma.cc/A9Q6-RDNK.

[11] *See, e.g.,* Sasha Kalb & Marc Bohn, *An Examination of the SEC's Application of Disgorgement in FCPA Resolutions*, Corp. Compliance Insights (Apr. 12, 2010), http://www.corporatecomplianceinsights.com/disgorgement-fcpa-how-applied-calculated/, *archived at* http://perma.cc/C2GX-WXFW (discussing FCPA actions involving disgorgement and other penalties).

[12] *See, e.g.*, Davis v. City of Peachtree, 304 S.E.2d 701 (Ga. 1983).

[13] *See, e.g.*, State v. Hy-Vee, Inc., 616 N.W.2d 669 (Iowa Ct. App. 2000); State v. Guminga, 395 N.W.2d 344 (Minn. 1986).

can declare that the [employer's] act was culpable. This is too fundamental to be compromised."[14] The Court of Appeals of Iowa echoed this point, calling the requirement that the employer have "some level of culpability before being subject to criminal sanctions" the "bedrock" of criminal law.[15] When a company tries to further, not frustrate, the legislative intent of the law, creating strict criminal vicarious liability inappropriately punishes a good corporate citizen.[16]

As discussed below, FCPA compliance efforts in many companies have now matured to the point where the rationale for strict vicarious criminal liability is no longer viable. Companies with strong compliance programs are now functionally partners with DOJ and SEC in rooting out corruption. They are working to assure compliance with the law. They are not scofflaws. Giving these companies the "carrot" of a compliance defense and severing the automatic pull cord between an employee's criminal acts and a company's criminal liability is now critical for expanding these programs so that companies can further assist DOJ and SEC in advancing the FCPA's goals.

A. Purpose, History and Development of the FCPA

Congress enacted the FCPA in 1977 as part of the post-Watergate reforms to combat unethical corporate conduct. The FCPA was heralded as the world's first foreign anticorruption statute.[17] The act made it a criminal offense in the United States to provide money or gifts to a foreign official to influence that official for the purpose of gaining a competitive advantage or to obtain, retain, or direct business.[18] The Act also imposed bookkeeping and

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[14] *Guminga*, 395 N.W.2d at 347–48 (quoting the Model Penal Code § 2.05, comment 1 (1985)).

[15] *Hy-Vee, Inc.*, 616 N.W.2d at 671.

[16] *See id.* at 672.

[17] *See* Steven R. Salbu, *Bribery in the Global Market: A Critical Analysis of the Foreign Corrupt Practices Act*, 54 WASH. & LEE L. REV. 229, 231 (1997) (stating the United States is the first country to criminalize the extraterritorial payments of bribes by domestic companies); *see also* S. Rep. No. 95-114, at 4 (quoting Treasury Secretary Blumenthal that "paying bribes—apart from being morally repugnant and illegal in most countries—is simply not necessary for the successful conduct of business here or overseas"); Jimmy Carter, Foreign Corrupt Practices and Investment Disclosure Bill: Statement on Signing S. 305 into Law, 2 Pub. Papers 2157 (Dec. 20, 1977), *available at* www.presidency.ucsb.edu/ws/index.php?pid=7036, *archived at* http://perma.cc/6LRL-PPQG ("Corrupt practices between corporations and public officials overseas undermine the integrity and stability of governments and harm our relations with other countries."); Tor Krever, *Curbing Corruption? The Efficacy of the Foreign Corrupt Practices Act*, 33 N.C. J. INT'L L. & COM. REG. 83, 87 (2007).

[18] *See* 15 U.S.C. §§ 78dd-1 to 78dd-3; *see also* U.S. DEP'T OF JUSTICE AND U.S. SEC. & EXCH. COMM'N, A RESOURCE GUIDE TO THE U.S. FOREIGN CORRUPT PRACTICES ACT 12 (2012), *available at* http://www.justice.gov/criminal/fraud/fcpa/guide.pdf, *archived at* http://perma.cc/7V3E-T45N (conduct must meet "business purpose test" to fall under FCPA). The elements are:

> The actor must (1) commit an act in furtherance of (2) "an offer, payment, promise to pay, or authorization of the payment" (3) "of any money, or offer, gift" or "the giving of anything of value to" (4) "any foreign official" (5) for a listed corrupt

internal control requirements, in part, to prevent companies from covering up the illegal acts of their employees.[19] Congress charged both DOJ and SEC with enforcing the FCPA.[20] Prior to the FCPA, the SEC had uncovered millions of dollars in bribes to foreign government officials to obtain lucrative business agreements, implicating some 400 American companies.[21]

At that time, Congress decided to allow the criminal conduct of an employee to be imputed to his or her employer for criminal sanctions.[22] The philosophy behind the FCPA was that American businesses would be advantaged if they could compete on merits, not bribes, and the desire to do business with American companies would facilitate cleaning up the culture in some countries of extracting kick-backs from corporations.[23]

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purpose that aids the actor "in obtaining or retaining business for or with, or directing business to, any person."

Lauren Ann Ross, *Using Foreign Relations Law to Limit Extraterritorial Application of the Foreign Corrupt Practices Act*, 62 DUKE L.J. 445, 455 (2012) (citations omitted).

[19] *See* 15 U.S.C. § 78m(b). The accounting provisions are designed to "strengthen the accuracy of the corporate books and records and the reliability of the audit process which constitute the foundations of our system of corporate disclosure." S. REP. NO. 95-114, *supra* note 17, at 7; *see also* U.S. DEP'T OF JUSTICE AND U.S. SEC. & EXCH. COMM'N, *supra* note 18, at 38.

[20] DOJ is responsible for all criminal investigation and enforcement of the FCPA, and may initiate civil proceedings. *See* H.R. REP. NO. 95-640, at 9, 12 (1977). The SEC is responsible for civil investigations of issuers but may refer a case to DOJ for prosecution if criminal matters arise during the investigation. *See* 15 U.S.C. §§ 78d-l, 78u. The agencies may also work together in "parallel investigations." *See, e.g.,* SEC v. Dresser Indus., 628 F.2d 1368, 1379 (D.C. Cir. 1980) (stating SEC may proceed with securities investigation, even after DOJ has begun a criminal investigation for same alleged violations); United States v. KPMG-Siddharta, 4 FCPA Rep. 699.8273 (S.D. Tex. 2001) (joint injunction); *see also* James A. Barta & Julia Chapman, *Foreign Corrupt Practices Act*, 49 AM. CRIM. L. REV. 825, 844–45 (2012).

[21] *See* U.S. SEC. & EXCH. COMM'N, REP. TO THE S. COMM. ON BANKING, HOUSING AND URBAN AFFAIRS, 94TH CONG., 1ST SESS., REP. ON QUESTIONABLE AND ILLEGAL CORPORATE PAYMENTS AND PRACTICES (May 12, 1976), at 57, *reprinted in* Sec. Reg. L. Rep. (BNA) No. 353 (May 19, 1976) ("[T]he question of illegal or questionable payments is obviously a matter of international concern, and the Commission, therefore, is of the view that limited-purpose legislation in this area is desirable in order to demonstrate clear Congressional policy with respect to a thorny and controversial problem."); *see also Unlawful Corporate Payments Act of 1977: Hearings Before the Subcomm. on Consumer Prot. & Fin. of the H. Comm. on Interstate & Foreign Commerce*, 95th Cong. 1-184 (1977); S. REP. NO. 95-114, *supra* note 17, at 1–3.

[22] After discovering unreported campaign contributions in the Watergate Scandal, SEC investigated payments to domestic and foreign political officials by corporations. *See* DONALD R. CRUVER, COMPLYING WITH THE FOREIGN CORRUPT PRACTICES ACT 3–5 (2d ed. 1999) (describing bribery schemes prominent in bringing about the FCPA). *See generally* Theodore C. Sorensen, *Improper Payments Abroad: Perspectives and Proposals*, 54 FOREIGN AFF. 719 (1976) (discussing growth in support for the FCPA's enactment).

[23] *See*, *e.g.*, *Foreign and Corporate Bribes: Hearings Before the S. Comm. on Banking, Hous., and Urban Affairs*, 94th Cong. 46 (1976) (statement of Sen. William Proxmire, Chairman, S. Comm. on Banking, Hous., and Urban Affairs) (stating that countries that allow bribery "lose. They lose because what it means is that they are getting inferior products at a higher cost because of the bribery. So it's to the great interest of every country that the people who sell to them don't bribe. Now if we have a reputation of being the one country that enforces the law and everything that we sell is sold on the basis of merit and competition and not on the basis of bribery, it seems to me that's an enormous advantage. . . . It would give us a great advantage and other countries would per force be constrained to follow."); Mike Koehler, *The*

During the Act's first decade, DOJ and SEC initiated only two to three cases per year, with fines seldom exceeding $1 million.[24] There was a growing perception that U.S. corporations were disadvantaged when competing against foreign competitors not subject to the FCPA or a comparable anti-bribery statute.[25] The Act's terms also proved to be vague, which created confusion as to which conduct fell under the law. To provide more clarity, Congress amended the Act in 1988.[26] During the process of enacting those amendments, the House of Representatives included a provision that would have provided for a compliance defense, but this provision was not in the Senate version of the bill.[27] The legislative history provides no explanation as to why the compliance defense was not included in the final bill.[28]

In the 1990s, in an effort to create an even playing field for American corporations, the United States used its international influence to lead the members of the Organisation for Economic Cooperation and Development ("OECD") to adopt laws comparable to the FCPA.[29] OECD members are economically advanced and collectively have jurisdiction over many of the multi-national companies targeted by these international anti-bribery ef-

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Story of the Foreign Corrupt Practices Act, 73 OHIO ST. L. J. 929, 949 (2012) (explaining that a motivating factor for enacting the FCPA was "global leadership and the hope that other countries would soon follow the United States in enacting laws governing business conduct with foreign government officials in foreign markets").

[24] *See* Westbrook, *infra* note 38, at 495; *see also* Priya Cherian Huskins, *FCPA Prosecutions: Liability Trend to Watch*, 60 STAN. L. REV. 1447, 1449 (2008) (citing Eugene R. Erbstoesser, John H. Sture & John W. F. Chesley, *The FCPA and Analogous Foreign Liability Laws—Overview, Recent Developments and Acquisition Due Diligence*, 2 CAP. MARKETS L.J. 381, 386 (2007) (stating that between 1978 and 2000, the SEC and DOJ together averaged only three prosecutions per year).

[25] *See* David E. Sanger, *Clinton to Urge A Rights Code for Business Dealing Abroad*, N.Y. TIMES, Mar. 27, 1995, at 1 ("The act has been widely criticized by American executives in recent years, who contend that while it is well intentioned, it often places them at a competitive disadvantage when they are bidding against companies from countries without comparable laws."); *Indonesia Offers Japan Aluminum, Oil and Trouble*, BUS. MONTH, Apr. 1, 1989, at 20 (stating that one of the problems for U.S. energy companies investing in Indonesia is that the FCPA "puts U.S. companies at a competitive disadvantage").

[26] For example, it made the mens rea requirement more strict, clarified the meaning of "retaining or obtaining business," and expanded the scope of the FCPA to include foreign citizens and businesses acting within the United States. *See* Omnibus Trade and Competiveness Act of 1988, Pub. L. No. 100-418 (codified at 15 U.S.C. §§ 78m, 78dd-1 to 78dd-3, 78ff); *see also* William A. Nelson II, *Attorney Liability Under the Foreign Corrupt Practices Act: Legal and Ethical Challenges and Solutions*, 39 U. MEM. L. REV. 255, 258–59 (2009).

[27] *See* H.R. CONF. REP. on H.R. 3, 100th Cong., 2d Sess. 916 (1988), at 6, *available at* http://www.justice.gov/criminal/fraud/fcpa/history/1988/tradeact-100-418.pdf, *archived at* http://perma.cc/HC7R-U3FK ("The House bill established a new 'safe harbor' defense for civil or criminal liability of issuers and domestic concerns for FCPA violations by their employees or agents."); *see also* Jon Jordan, *The Adequate Procedures Defense Under the UK Bribery Act: A British Idea for the Foreign Corrupt Practices Act*, 17 STANFORD J. OF L. BUS. & FIN. 25, 29, 50–51 (2011).

[28] *See* H.R. CONF. REP. on H.R. 3, *supra* note 27.

[29] *See* Peter Alldridge, *The U.K. Bribery Act: "The Caffeinated Younger Sibling of the FCPA"*, 73 OHIO ST. L.J. 1181, 1187 (2012).

forts.[30] In 1997, OECD adopted the Convention on Combating Bribery of Foreign Officials in International Business Transactions, which required nations that ratified it to criminalize bribery.[31] In addition to relying on these other countries to hold their own companies accountable, Congress amended the FCPA in 1998 to expand the act's reach to include foreign individuals and companies that fall under U.S. jurisdiction.[32]

Penalties for violating the FCPA are steep. A violation of the FCPA's accounting provisions carries a criminal penalty of up to $25 million.[33] Criminal fines for violations of anti-bribery provisions can be $2 million plus a fine based on the pecuniary gain that can be multiplied based on a "culpability score."[34] SEC can also impose penalties based on the gross amount of the pecuniary gain to the defendant or the egregiousness of the conduct, ranging from $75,000 to $725,000.[35] As discussed below, this fee structure has led to significant settlements over FCPA allegations. The penalty for a company that is actually convicted of an FCPA violation can be particularly unforgiving, as any business that violates the anti-bribery provisions can be debarred from future federal contracts and grants.[36] For companies that rely on government contracts and reimbursements, such as those in

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[30] Michael P. Van Alstine, *Double Jeopardy: The OECD Anti-Bribery Convention and the FCPA*, OHIO ST. L.J. 1321, 1325-26 (2012).

[31] OECD Convention on Combating Bribery of Foreign Officials in International Business Transactions, Dec. 17, 1997, 112 Stat. 3302.

[32] *See* 15 U.S.C. § 78dd-2(h)(2); International Anti-Bribery and Fair Competition Act of 1998, Pub. L. No. 105-366, 112 Stat. 3302 (implicating foreign agents and U.S. nationals outside the United States if they furthered a corrupt payment in the United States); 15 U.S.C. § 78dd-2(h)(2); *see also* Cortney C. Thomas, *The Foreign Corrupt Practices Act: A Decade of Rapid Expansion Explained, Defended, and Justified*, 29 REV. LITIG. 439, 448 (2010) (expanding the definition of "foreign official" to include persons employed by international organizations and providing that the Act could reach certain foreign persons who commit an act in furtherance of a foreign bribe while in the United States); *see also* Carter Stewart, *The FCPA is Just as Relevant and Necessary Today as Thirty-Five Years Ago*, OHIO ST. L.J. 1039, 1043 (2012) ("The FCPA reaches foreign companies that have certain classes of securities registered in the U.S., that are required to file reports with the SEC under the 1934 Act, and that have a jurisdictional nexus to the U.S., which covers a lot of foreign companies, many of which have recently been the subject of FCPA investigations and resolutions.") (internal citations omitted).

[33] "Under the Alternative Fines Act, 18 U.S.C. § 3571(d), courts may impose significantly higher fines than those provided by the FCPA—up to twice the benefit that the defendant sought to obtain by making the corrupt payment, as long as the facts supporting the increased fines are included in the indictment and either proved to the jury beyond a reasonable doubt or admitted in a guilty plea proceeding." U.S. DEP'T OF JUSTICE AND U.S. SEC. & EXCH. COMM'N, *supra* note 21, at 68.

[34] The 1988 Amendments kept the maximum term of imprisonment at five years. *See* 15 U.S.C. §§ 78dd-1(b), 78dd-2(g); *see also* U.S. SENTENCING GUIDELINES MANUAL, § 8C2.5 (2014).

[35] *See* 15 U.S.C. § 78u(d)(3); *see also* 17 C.F.R. § 201.1004 (providing adjustments for inflation).

[36] *See* Federal Acquisition Regulation, 48 C.F.R. § 9.406-2(a) (providing agencies with the discretionary power to debar FCPA violators from contracting with the United States); *see also* Jessica Tillipman, *The Foreign Corrupt Practices Act & Government Contractors: Compliance Trends & Collateral Consequences*, 11-9 BRIEFING PAPERS 1, 9–17 (2011) (discussing consequences faced by contractors who violate the FCPA).

the defense and pharmaceutical industries, debarment is a potential corporate death sentence.[37]

By the early 2000s, DOJ had prosecuted only about twenty-five cases, totaling $35.2 million in fines, fees and penalties, but, as discussed below, that was about to change.[38]

B. The Rise of FCPA Enforcement

The second phase of FCPA enforcement began around 2004, when both DOJ and SEC significantly increased their prosecution of suspected FCPA violations.[39] Between 2007 and 2012, DOJ instituted at least sixty-four FCPA actions and SEC brought at least forty-seven actions, a total greater than all of the FCPA actions filed between 1977 and 2003.[40] In 2010, SEC also unveiled a new FCPA Unit to become "more proactive" in the Act's enforcement.[41] The FBI also dedicated a unit to solely handle FCPA investigations.[42]

The "cornerstone" of FCPA enforcement, according to Assistant Attorney General Lanny Breuer, was supposed to be "aggressive prosecution of individuals" to obtain "significant prison sentences."[43] From 2005 through 2010, DOJ pursued investigations of seventy-seven individuals for FCPA violations, but there were few prosecutions.[44] At the same time, DOJ increased its pursuit of criminal sanctions and disgorgement of profits against

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[37] *See* Irina Sivachenko, *Corporate Victims of "Victimless Crime": How the FCPA's Statutory Ambiguity, Couples with Strict Liability, Hurts Businesses and Discourages Compliance*, 54 B.C. L. REV. 393, 419 (2013) ("Even a hint of criminal involvement might lead to exclusion of U.S. companies from international opportunities or even from doing business abroad.") (internal citations omitted).

[38] *See* Michael B. Bixby, *The Lion Awakens: The Foreign Corrupt Practices Act – 1977 to 2010*, 12 SAN DIEGO INT'L L.J. 89, 103 (2010); Amy Deen Westbrook, *Enthusiastic Enforcement, Informal Legislation: The Unruly Expansion of the Foreign Corrupt Practices Act*, 45 GA. L. REV. 489, 495 (2011).

[39] *See* Bixby, *supra* note 38, at 104–06; Michael Crites, *The Foreign Corrupt Practices Act at Thirty Five: A Practitioner's Guide*, OHIO ST. L.J. 1049 (2012) ("The year 2004 served as a turning point in the enforcement of FCPA violations (or potential violations)."); Peter J. Henning, *Be Careful What You Wish for: Thoughts on a Compliance Defense under the Foreign Corrupt Practices Act,* 73 OHIO ST. L.J. 883, 884 (2012) (noting that former Attorney General John Ashcroft has said that part of the impetus for increased enforcement has been "greater international cooperation fostered by the September 11 attacks and the attention that has been paid for the role of corruption in terrorist activities").

[40] *See* Bixby, *supra* note 38, at 103.

[41] Barta & Chapman, *supra* note 19, at 827 (quoting Cheryl Scarboro, Chief of the Foreign Corrupt Practices Act Unit, U.S. Sec. & Exch. Comm'n, Remarks at News Conference Announcing New SEC Leaders in Enforcement Division (Jan. 13, 2010)).

[42] Attorney General Eric Holder in a November 2009 speech about corruption quoted President Obama as saying that "the struggle against corruption is one of the greatest struggles of our time." *See* Jon Jordan, *Recent Developments in the Foreign Corrupt Practices Act and the New UK Bribery Act: A Global Trend Towards Greater Accountability in the Prevention of Foreign Bribery*, 7 N.Y.U. J. L. & BUS. 845, 861 (2011) (internal citations omitted).

[43] *See* Lawrence J. Trautman & Kara Altenbaumer-Price, *The Foreign Corrupt Practices Act: Minefield for Directors*, 6 VA. L. & BUS. REV. 145, 160 (2011).

[44] Crites, *supra* note 39, at 1059.

companies related to those acts.[45] What DOJ found is that companies will generally settle these claims, through either a deferred prosecution agreement (DPA) or a non-prosecution agreements (NPA). Under a typical DPA or NPA, the government postpones or sets aside an indictment, and the company aids in the investigation, admits wrongdoing when appropriate, pays a penalty, and implements certain compliance measures.[46] In practice, companies have little choice but to agree to these terms; they can ill-afford to take the chance of losing a trial and being subject to debarment or other bet-the-company sanctions.[47] Indeed, there have been only two corporate FCPA trials.[48] Since 2010, DOJ and SEC have expanded their activities, pursuing companies outside the U.S. and targeting entire industries, including oil and gas, pharmaceutical, and technology.[49]

The result of the increased enforcement over the past decade has been an exponential rise in the amount of penalties collected through settlement. In 2010 alone, FCPA penalties totaled more than $1.7 billion.[50] This included settlements by the Dutch construction company Snamprogetti Netherlands B.V. for $365 million,[51] the French construction and engineering firm

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[45] In part, this is because enforcement has been broadened. "Recent cases against pharmaceutical companies, like Pfizer for payments to foreign doctors who are part of state-controlled health systems show how the law can be used in areas once thought to fall outside its purview." Peter J. Henning, *Dealing with the Foreign Corrupt Practices Act*, N.Y. Times (March 4, 2013, 2:33 PM), http://dealbook.nytimes.com/2013/03/04/dealing-with-the-foreign-corrupt-practices-act/, *archived at* http://perma.cc/5KRK-8C3H.

[46] "In contrast, a DPA defers the prosecution of an already indicted defendant." Pete J. Georgis, *Settling with Your Hands Tied: Why Judicial Intervention Is Needed to Curb an Expanding Interpretation of the Foreign Corrupt Practices Act*, 42 Golden Gate U. L. Rev. 243, 270 (2012).

[47] *See* Mike Koehler, *The Facade of FCPA Enforcement*, 41 Geo. J. Int'l L. 907, 932–33 (2010); *see also* Georgis, *supra* note 46, at 268 ("[T]he U.S. government's forceful engagement in DPAs and NPAs has created a system that encourages prosecutorial abuse and deters corporate behavior originally intended by Congress in 1977 to be permissible.").

[48] *See* Philip Urofsky et al., *How Should We Measure the Effectiveness of the Foreign Corrupt Practices Act? Don't Break What Isn't Broken—The Fallacies of Reform*, 73 Ohio St. L. J. 1145, 1169 (2012) (conceding that "the basic premise of [FCPA] criticism is valid: to date, only two corporations have taken the government to trial in the thirty-year history of the FCPA (and both of them ultimately prevailed)").

[49] Crites, *supra* note 39, at 1060–61.

[50] *See* Barta & Chapman, *supra* note 19, at 827; *see also* Westbrook, *supra* note 38, at 492–93.

[51] *See* Deferred Prosecution Agreement at 6, United States v. Snamprogetti Netherlands B.V., No. 4:10-cr-00460 (S.D. Tex. July 7, 2010); Press Release, U.S. Dep't of Justice, Snamprogetti Netherlands B.V. Resolves Foreign Corrupt Practices Act Investigation and Agrees to Pay $240 Million Criminal Penalty (July 7, 2010), http://www.justice.gov/opa/pr/2010/July/10/-crm-780.html, *archived at* http://perma.cc/V3FH-PJDJ. Snamprogetti, along with its former parent ENI S.p.A. of Italy, also agreed to pay $125 million in disgorgement of profits to the SEC. *See* Litigation Release, U.S. Sec. & Exch. Comm'n, SEC Charges Snamprogetti Netherlands, B.V. with Foreign Bribery and Related Accounting Violations and ENI, S.p.A. with Book and Records and Internal Control Violations, No. 21588 (July 7, 2010), http://www.sec.gov/litigation/litreleases/2010/lr21588.htm, *archived at* http://perma.cc/EK3V-YLFE ("Snamprogetti and ENI will jointly pay $125 million to settle the SEC's charges.").

Technip SA for $338 million,[52] U.K. defense contractor BAE Systems PLC for $400 million,[53] German automaker Daimler AG for $185 million,[54] and the global freight forwarding company Panalpina World Transport (Holding) Ltd., along with six other companies in the oil services industry, for a total of $236.5 million.[55]

C. Development of Extensive Corporate Compliance Programs

In response to this increased enforcement, companies have invested in state-of-the-art compliance programs to prevent FCPA violations.[56] The first

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[52] *See* Deferred Prosecution Agreement at 7, United States v. Technip S.A., No. 4:10-cr-439 (S.D. Tex. June 28, 2010); Press Release, U.S. Dep't of Justice, Technip S.A. Resolves Foreign Corrupt Practices Act Investigation and Agrees to Pay $240 Million Criminal Penalty (June 28, 2010), http://www.justice.gov/opa/pr/2010/June/10-crm-751.html, *archived at* http://perma.cc/5ZH7-5GHR. Technip S.A. also agreed to pay $98 million in civil penalties. *See* Litigation Release, U.S. Sec. & Exch. Comm'n, SEC Charges Technip with Foreign Bribery and Related Accounting Violations, No. 21578 (June 28, 2010), http://www.sec.gov/litigation/litreleases/2010/lr21578.htm, *archived at* http://perma.cc/C3N2-G88C.

[53] *See* Daniel Michaels & Cassel Bryan-Low, *BAE to Settle Bribery Case for More than $400 Million*, WALL ST. J., Feb. 6-7, 2010, at B1; Press Release, BAE Sys. PLC, BAE Systems PLC Announces Global Settlement with United States Department of Justice and United Kingdom Serious Fraud Office (Feb. 5, 2010), http://www.baesystems.com/article/BAES_026388/bae-systems-plc-announces-global-settlement-with-united-states-department-of-justice-and-united-kingdom-serious-fraud-office#, *archived at* http://perma.cc/M4-XZ3M. BAE Systems PLC will also pay approximately $47 million to the U.K. Serious Fraud Office. *See* Michaels & Bryan-Low, *supra*, at B1.

[54] *See* Press Release, U.S. Sec. & Exch. Comm'n, SEC Charges Daimler AG with Global Bribery & Exch. (Apr. 1, 2010), http://www.sec.gov/news/press/2010/2010-51.htm, *archived at* http://perma.cc/7AW6-DEBG ("Daimler agreed to pay $91.4 million in disgorgement to settle the SEC's charges and pay $93.6 million in fines."). Daimler also agreed to pay a penalty of $93.6 million to DOJ. Sentencing Memorandum at 11, United States v. Daimler AG, No. 1:10-cr-00063-RJL (D.D.C. Mar. 24, 2010); Press Release, U.S. Dep't of Justice, Daimler AG and Three Subsidiaries Resolve Foreign Corrupt Practices Act Investigation and Agree to Pay $93.6 Million in Criminal Penalties (Apr. 1, 2010), http://www.justice.gov/opa/pr/2010/April/10-crm-360.html, *archived at* http://perma.cc/D24S-WR7Z.

[55] *See* Press Release, U.S. Dep't of Justice, Oil Services Companies and a Freight Forwarding Company Agree to Resolve Foreign Bribery Investigations and to Pay More than $156 Million in Criminal Penalties (Nov. 4, 2010), http://www.justice.gov/opa/pr/2010/November/10-crm-1251.html, *archived at* http://perma.cc/ATW8-TXVZ; Press Release, U.S. Sec. & Exch. Comm'n, SEC Charges Seven Oil Services and Freight Forwarding Companies for Widespread Bribery of Customs Officials & Exch. (Nov. 4, 2010), http://www.sec.gov/news/press/2010/2010-214.htm, *archived at* http://perma.cc/ER6Q-Z7PV. In addition, Panalpina World Transport (Holding) Ltd., the SEC, DOJ and a Swiss company and its U.S. subsidiary, Panalpina Inc., reached settlements with Pride International, Inc., Tidewater Inc., Transocean Inc., GlobalSantaFe Corporation, Noble Corporation, and Royal Dutch Shell PLC. *See* U.S. Dep't of Justice, *supra* note 54.

[56] *See* Jon Jordan, *The Need for a Comprehensive International Foreign Bribery Compliance Program, Covering A to Z, in an Expanding Global Anti-Bribery Environment*, 117 PENN ST. L. REV. 89, 91 (2012) ("Today, it is no longer safe for companies to rely exclusively on their FCPA compliance programs as a means for staying compliant with their foreign bribery obligations. Instead, companies need to tailor their FCPA compliance programs to the international anti-bribery laws that apply to them."); Tanina Rostain, *The Emergence of "Law Consultants"*, 75 FORDHAM L. REV. 1397, 1404 (2006) ("The onus on companies to develop internal compliance structures to address various regulatory agendas has given rise to a bewildering array of compliance consulting services.").

compliance programs, while rudimentary by today's standards, were developed in the 1980s in response to a federal report of fraud and abuse in the defense industry.[57] The U.S. Sentencing Commission endorsed this development in 1991 when it released the Federal Sentencing Guidelines for Organizations to provide guidance for how such programs might be structured.[58] DOJ then detailed some of the elements that should be included in an effective compliance program in a 1999 settlement agreement.[59] Since then, FCPA "corporate compliance has evolved into a universal corporate governance activity" for companies with foreign operations.[60]

Many of the companies that have bona-fide FCPA compliance programs set a "tone at the top" that the company will not tolerate FCPA violations.[61] They often employ dedicated high-ranking FCPA compliance officers, have assigned senior executives to assure FCPA compliance, and directly involve the company's governing authority.[62] While there is no one-size-fits-all compliance program, as each company and industry faces its own challenges, there are generally three key components to an effective

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[57] Several defense contractors developed the Defense Industry Initiative on Business Ethics and Conduct. *Origins of DII*, DEF. INDUSTRY INITIATIVE OF BUS. ETHICS & CONDUCT, http://www.dii.org/about-us, *archived at* http://perma.cc/XJF3-P5XP (last visited March 10, 2014).

[58] *See generally* U.S. SENTENCING GUIDELINES MANUAL § 8 (1991).

[59] *See generally* Complaint for Permanent Injunction and Ancillary Relief, United States v. Metcalf & Eddy, Inc., No. 99-CV-12566 (D. Mass. 1999); Final Judgment of Permanent Injunction Against Metcalf & Eddy, Inc., United States v. Metcalf & Eddy, No. 99-CV-12566 (D. Mass. 1999).

[60] *See* Miriam Hechler Baer, *Governing Corporate Compliance*, 50 B.C. L. REV. 949, 952 (2009) quoting Ernst & Young, Best in Show: Cross-Industry Corporate Compliance Survey Results (2003) (surveying eighty-three companies across eleven industries). Professor Baer also stated that "[t]he sheer size of the compliance industry, which includes multiple American Lawyer 100 firms who proudly trumpet their assistance on their websites, severely undercuts the notion that corporations and compliance providers are engaged in a concerted, bad-faith attempt at intentional window-dressing." *Id.*

[61] *See* Steven Clayton, *Top Ten Basics of Foreign Corrupt Practices Act Compliance for the Small Legal Department*, ASSOC. OF CORPORATE COUNSEL (June 1, 2011), http://www.acc.com/legalresources/publications/topten/SLD-FCPA-Compliance.cfm, *archived at* http://perma.cc/DC7F-DVEL (stating that an effective compliance program "requires" a stand-alone international anti-corruption policy and executive who is accountable for the "Tone at the Top"); Melissa Epstein Mills, *Brass-Collar Crime: A Corporate Model For Command Responsibility*, 47 WILLAMETTE L. REV. 25, 61 (2010) ("The explosive growth in new FCPA cases has been successful in inducing vast changes in the corporate culture. Faced with the heightened prospect of enforcement actions, companies are now scrambling to establish effective corporate compliance programs, to instill a proper 'tone at the top,' to take the initiative in investigating potential violations, and in some cases to voluntarily self-report any corrupt activities that are discovered."); *see also* Joseph E. Murphy, *Using Incentives in Your Compliance and Ethics Program*, SOC. OF CORP. COMPLIANCE & ETHICS (Nov. 2011), http://www.corporatecompliance.org/Portals/1/PDF/Resources/complimentary/IncentivesCEProgram-Murphy.pdf, *archived at* http://perma.cc/ZD37-9GVW (discussing examples of company reward initiatives).

[62] *See* Matteson Ellis, *Three Concrete Ways in which FCPA Compliance Officers can Better Engage Operations*, FCPAMÉRICAS BLOG (June 27, 2012), http://fcpamericas.com/english/anti-corruption-compliance/three-concrete-ways-that-fcpa-compliance-officers-can-better-engage-operations, *archived at* http://perma.cc/9KKL-M845.

compliance program: preventing violations, investigating suspect activity, and taking the appropriate remedial action should an FCPA violation occur.[63]

Prevention often starts with extensive education programs that help ensure that employees understand the law and the company's intolerance for FCPA violations.[64] For example, the oil and gas service company Baker Hughes requires its employees to complete periodic electronic training modules on FCPA compliance, which are offered in twelve different languages.[65] Employees must also participate in live interactive classroom or webinar trainings.[66] The company publishes an FCPA compliance guide for all of its employees, agents, and joint venture partners, providing detailed instructions and contact numbers for reporting potential FCPA violations in countries in which the company operates.[67] The guide, which is only one part of the company's global compliance program, instructs employees on dealing with different types of foreign business entities, and how to properly make, process, and record payments, including treatment of gifts, charitable or political donations, meals, travel, or entertainment.[68]

In addition, companies increasingly monitor high-risk activity in which corrupt payments might be made and have specific due diligence requirements when retaining the services of vendors for these activities.[69] To assist with these due diligence efforts, organizations including TRACE International and TRACE Incorporated will pre-screen vendors, conduct background checks on key individuals, and look for "red flags."[70] These

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[63] *See, e.g.,* Jaclyn Jaeger, *Analysis: The Rising Cost of FCPA Compliance*, COMPLIANCE WEEK (Mar. 4, 2013), http://www.complianceweek.com/analysis-the-rising-costs-of-fcpa-investigations/article/282957/, *archived at* http://perma.cc/C2FL-EF3B.

[64] After AG Siemens was fined in 2008, the company implemented what has been described as "the gold standard of compliance programs." Thomas R. Fox, *How Do You Change Corporate Culture?*, FCPA COMPLIANCE AND ETHICS BLOG (Nov. 8, 2012), http://tfoxlaw.wordpress.com/category/Siemens/, *archived at* http://perma.cc/CR7A-NB3R; *see also* Peter Löscher, *The CEO of Siemens on Using a Scandal to Drive Change*, HARVARD BUS. REV. (Nov. 2012), http://hbr.org/2012/11/the-ceo-of-siemens-on-using-a-scandal-to-drive-change/ar/, *archived at* http://perma.cc/5P94-6QLT. This program implemented structural changes to provide more "direct and clear reporting channels" for a potential FCPA violation, and is said to have established accountability by each business unit and improved overall corporate transparency. *Id.*

[65] *See Foreign Corrupt Practices Act* at 4, BAKER HUGHES INC. (2011), *available at* http://web.archive.org/web/20130515074604/http://www.bakerhughes.com/assets/media/BAhbBlsHOgZmIlxhc3NldHMvNGRjNDAyNDhmYTdlMWM2NDAwMDAwMDAxL2ZpbGUvMDdfY29kZS1vZi1jb25kdWN0LWd1aWRlLWFuZC1mY3BhLWd1aWRlLTVfMjAxMS5wZGY, *archived at* http://perma.cc/9PVX-Z9B8.

[66] *See id.*

[67] *See id.* at 3, 5.

[68] *See id.* at 18–28.

[69] *See* Christopher Cook, *The Elements of an Effective Foreign Corrupt Practices Act Compliance Program*, JONES DAY (Mar. 2006), http://www.jonesday.com/newsknowledge/publicationdetail.aspx?publication=3208, *archived at* http://perma.cc/D78R-YUGF.

[70] *See About Trace*, TRACE INT'L, http://www.traceinternational.org/Trace/about-trace.html, *archived at* http://perma.cc/544G-7GE5 ("TRACE International is a non-profit membership organization that pools resources to provide members with anti-bribery compliance support while TRACE Incorporated offers both members and non-members customizable risk-based

organizations will also train and certify foreign vendors to assure they understand their obligations under the FCPA.[71] Companies also use third-party auditors to strengthen their internal controls.[72]

If a suspected FCPA violation is uncovered or reported, it is often aggressively investigated through outside law firms and forensic accountants.[73] For example, Ernst & Young has more than 2,000 people in its Fraud Investigation & Dispute Services group to assist in these matters.[74] These internal investigations can be costly.[75] In a case involving AG Siemens, the company reportedly spent nearly $1 billion internally investigating the violations in addition to the fines, penalties and disgorgement it paid to DOJ and SEC for the alleged violations.[76] These investigatory costs can easily exceed the costs

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due diligence, a comprehensive training package and consulting services.") (last visited March 10, 2014).

[71] *See Due Diligence Services*, TRACE INT'L, http://www.traceinternational.org/-Diligence/TRACEreview.html, *archived at* http://perma.cc/D75D-82T7 (last visited March 10, 2014); *see also* Scott Graham, *ethiXbase Launches Employee Certification System*, THE FCPA BLOG (Nov. 23, 2012, 2:20 AM), http://www.fcpablog.com/blog/2012/11/23/ethixbase-launches-employee-certification-system.html, *archived at* http://perma.cc/CQ75-VMMP (describing new FCPA compliance system based upon analysis of "every known FCPA investigation and enforcement action").

[72] *See Business Briefing: Foreign Corrupt Practices Guidance Issued*, ERNST & YOUNG 2 (Nov. 2012) [hereinafter *Ernst & Young Business Briefing*], http://www.ey.com/Publication/vwLUAssets/Fraud_Investigation_and_Dispute_Services_-_November_2012_-_Business_briefing/$FILE/FIDS_Briefing_FCPA_Guidance.pdf, *archived at* http://perma.cc/4P3K-2M4M ("More than 90% of reported FCPA cases involved the use of third-party intermediaries such as agents or consultants."). Organizations dedicated to the pursuit of compliance initiatives, such as the Society of Corporate Compliance and Ethics and Ethics Compliance Officer Association, also organize events and trainings around the world to strengthen compliance programs. *See, e.g., About SCCE*, SOC'Y OF CORPORATE COMPLIANCE AND ETHICS, http://www.corporatecompliance.org/, *archived at* http://perma.cc/47UD-83T2 (last visited March 10, 2014); *About the ECOA,* ETHICS AND COMPLIANCE OFFICER ASS'N, http://www.theecoa.org/, *archived at* http://perma.cc/7WSL-XWTQ (last visited March 10, 2014). The American Conference Institute has fashioned an FCPA "Boot Camp" to assist companies in strengthening their compliance initiatives. *See FCPA Boot Camp*, AM. CONFERENCE INST., http://www.americanconference.com/-2013/836/FCPA-boot-camp, *archived at* http://perma.cc/Q8UX-ZJ8A (last visited Feb. 22, 2014).

[73] *See, e.g., FCPA Compliance: Creating an Effective Anti-Corruption Compliance Program*, ASS'N. OF CERTIFIED FRAUD EXAM'RS, http://www.acfe.com/course_samples/FCPACompliance/player.html, *archived at* http://perma.cc/8G7W-DNT3 (offering online course stating "14 essential elements of an effective compliance program") (last visited March 10, 2014); *see also* TRACE INT'L, *supra* note 71.

[74] *See Ernst & Young Business Briefing*, *supra* note 72, at 1.

[75] *See* Jaeger, *supra* note 63 (reporting on four companies, Avon, WalMart, News Corp. and Weatherford, that each spent over $100 million related to a recent FCPA internal investigation); Mike Koehler, *Big, Bold, and Bizarre: The Foreign Corrupt Practices Act Enters a New Era*, 43 U. TOL. L. REV. 99, 106 (2011) (noting examples of companies that have spent anywhere from $3.2 million to $100 million on professional costs towards internal inquiries and investigations); *see also* Patrick J. Head, *The Development of Compliance Programs: One Company's Experience*, 18 NW. J. INT'L L. & BUS. 535 (1998).

[76] The internal audit of Siemens AG's compliance investigation reported services of over 1,500 lawyers, accountants, and support staff personnel, who billed approximately 1.5 million hours reviewing 167 million financial and accounting documents. The total bill to Siemens reached $1 billion. In comparison, the cost of its eventual settlement with United States and German authorities was $1.6 billion. *See* Nathan Vardi, *How Federal Crackdown on Bribery Hurts Business and Enriches Insiders*, FORBES, May 24, 2010, at 74, *available at* http://www

of the alleged infraction. One company, for instance, said that it spent $3.2 million to investigate $50,000 of "potentially" improper payments from a foreign division of the company.[77]

When they uncover FCPA violations, some companies respond decisively, disciplining (or terminating) offending employees, making sure the company has not improperly profited from the violation(s), and adjusting internal controls to prevent future violations. For example, in 2006, industrial manufacturer Rockwell Automation, Inc. discovered improper payments by one of its former subsidiaries to Chinese state-owned "design institutes" during a "normal internal review that was part of its corporate compliance and internal controls program."[78] According to a subsequent SEC report, "Rockwell undertook numerous remedial measures, including employee termination and disciplinary actions, enhancements to its internal controls and compliance program and conducted a broad, global review of its other operations."[79] It then reported the violation and agreed with SEC to disgorge more than $1.7 million of ill-gotten profits.[80] Such voluntary disclosure "shifts enforcement costs to the private sector by encouraging behavior and reporting that is both cheaper and more effective for the federal agencies that pursue FCPA enforcement actions."[81]

Indeed, the OECD Working Group on Bribery has called the development of corporate compliance programs "the single most important measure contributing to prevention and deterrence" of bribery.[82] In recent years, industry groups, including those in the energy and pharmaceutical sectors, have issued and continued to update codes of conduct for their members to help them implement state-of-the-art compliance programs.[83]

.forbes.com/forbes/2010/0524/business-weatherford-kbr-corruption-bribery-racket.html, *archived at* http://perma.cc/4GFB-EXKU.

[77] *See* Joseph W. Yockey, *Solicitation, Extortion, and the FCPA*, 87 NOTRE DAME L. REV. 781, 795 (2011).

[78] Claudia Westin, *Do the Right Thing: Self-Report Potential FCPA Violations*, WECOMPLY (May 10, 2011), http://www.wecomply.com/about-us/blog/post/330216-do-the-right-thing-self-report-potential-Do-the-Right-Thing-Self-Report-Potential-FCPA-Violations, *archived at* http://perma.cc/QDH4-32P8.

[79] Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities and Exchange Act of 1934, Securities Act Release NO. 64,380, 100 SEC Docket 3695, 3696 (May 3, 2011).

[80] *See id.* at 5 (reporting the company also paid a $400,000 civil penalty for the violation).

[81] Crites, *supra* note 39, at 1063.

[82] Organisation for Economic Co-operation and Development, *Report on Application of the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and the 1997 Recommendation on Combating Bribery in International Business Transactions,* ORG. FOR ECON. CO-OPERATION & DEV.17 (Oct. 2002), *available at* http://www.oecd.org/investment/anti-bribery/anti-briberyconvention/1962084.pdf, *archived at* http://perma.cc/4JSP-KSZN.

[83] *See IFPMA Code of Practice,* INT'L FED'N OF PHARM. MFRS. & ASS'NS (2012); *EITI Countries*, EXTRACTIVE INDUS. TRANSPARENCY INITIATIVE, http://eiti.org/countries, *archived at* http://perma.cc/RY2R-DRC3 (last visited March 10, 2014).

D. The Current Debate Over a Compliance Defense

When a company has an effective compliance program, much as the ones described above, the rationale for vicarious FCPA criminal liability no longer exists. The companies are, in effect, partnering with DOJ and SEC to prevent, investigate, and remediate FCPA violations. The stigma and penal structure of criminal culpability should not be applied to them. Yet, under the FCPA, such compliance efforts are generally considered in assessing the level of punishment to mete out against a company, not in determining whether the company is criminally liable.

The debate in the United States over whether an individual's criminal liability should be automatically imputed to the company began in earnest after the United Kingdom passed its Bribery Act in April 2010. The U.K. Bribery Act is considered "broader and tougher" than the FCPA.[84] Nevertheless, it contains a compliance defense for those corporations that can prove that they "had in place adequate procedures designed to prevent persons associated" with them from violating the act.[85] The decision was made in the U.K. that vicarious criminal liability ought not apply when a company takes proper steps to prevent an employee from engaging in corruption.[86] "In such a case it is appropriate that the blame fall on the individual."[87] To facilitate the implementation of the law, the U.K.'s Ministry of Justice issued a guidance setting forth principles companies must abide by to qualify for the defense.[88] The fact that this strong anti-bribery act contains a compliance exception suggests that such an exception fosters the goal of the act: to stop corporate acts of bribery and corruption as levers for business.[89]

In October 2010, a few months after the U.K. Bribery Act was enacted, the U.S. Chamber of Commerce called for adding a comparable compliance defense to the FCPA.[90] In a report titled "Restoring Balance: Proposed Amendments to the Foreign Corrupt Practices Act," the Chamber stated that a fundamental change needed in the United States is for a court to assess the company's compliance program fully and independently during the liability

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[84] Jon Jordan, *The Adequate Procedures Defense Under the UK Bribery Act: A British Idea for the Foreign Corrupt Practices Act*, 17 STANFORD J. OF L. BUS. & FIN. 25, 28 (2011).

[85] *Id.*

[86] *See* Alldridge, *supra* note 29, at 1198 (making companies "vicariously liable for the actions of their employees in bribing, unless they can establish that they had in place appropriate procedures to prevent bribery by their employees").

[87] Alldridge, *supra* note 29, at 1203.

[88] *See* MINISTRY OF JUSTICE, THE BRIBERY ACT 2010, GUIDANCE ABOUT PROCEDURES WHICH RELEVANT COMMERCIAL ORGANISATIONS CAN PUT INTO PLACE TO PREVENT PERSONS ASSOCIATED WITH THEM FROM BRIBING (SECTION 9 OF THE BRIBERY ACT 2010) (2011).

[89] *See* Jordan, *supra* note 84, at 29 (stating that the defense "would protect companies truly seeking to do the right thing in compliance with the FCPA from being held accountable for violations committed by rogue employees").

[90] ANDREW WEISSMANN & ALIXANDRA SMITH, U.S. CHAMBER INST. FOR LEGAL REFORM, RESTORING BALANCE: PROPOSED AMENDMENTS TO THE FOREIGN CORRUPT PRACTICES ACT 9 (2010) [hereinafter RESTORING BALANCE].

phase of a trial, not the sentencing.[91] Currently, a company's compliance is one of a number of factors a prosecutor is supposed to consider under his or her discretion in determining whether to pursue criminal liability.[92] The Chamber also proposed adding a "willful" element for corporate criminal liability, which would eliminate strict vicarious criminal liability.[93] The Chamber argued that these changes would increase FCPA compliance, stating that unless businesses have "an incentive to deter, identify, and self-report potential existing violations," they may be "dissuaded from instituting a rigorous FCPA compliance program for fear that the return on such an investment will be only to expose the company to increased liability and will do little to actually protect the company."[94]

The next month, the issue of whether to establish such a compliance defense took center stage during a Senate Judiciary Committee hearing. Then-Senator Arlen Specter (D-Penn.) called the hearing because, while there had been high-profile settlements with companies, he wanted to consider whether there were sufficient criminal prosecutions of individuals who violated the FCPA.[95] Senator Amy Klobuchar (D-Minn.), in particular, expressed her concern that aggressive FCPA enforcement without appropriate protections for companies was creating unease in the business community and putting American companies at a competitive disadvantage.[96] She encouraged DOJ to consider a leniency program, perhaps similar to the one it has for reporting potential antitrust violations, when the FCPA violation is caused by a "rogue employee."[97] Senator Christopher Coons (D-Del.) concurred, expressing his willingness to work on "the creation of a compliance defense."[98]

The hearing also focused on several other issues that had become magnified in the new era of FCPA greater enforcement, including uncertainties

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[91] *Id.* at 13.

[92] Department of Justice, Principles of Federal Prosecution of Business Organizations, 9-28.00 (2014) *available at* http://www.justice.gov/usao/eousa/foia_reading_room/usam/title9/28mcrm.htm#9-28.800*, archived at* http://perma.cc/B7NW-9EKM.

[93] *Id.* at 14, 20.

[94] *Id.* at 13.

[95] *See Examining Enforcement of the Foreign Corrupt Practices Act: Hearing Before the Subcomm. on Crime and Drugs of the Senate Comm. on the Judiciary*, 111th Cong. 2 (2010) [hereinafter *2010 Senate Hearings*], *available at* http://www.gpo.gov/fdsys/pkg/CHRG-111shrg66921/pdf/CHRG-111shrg66921.pdf, *archived at* http://perma.cc/UR7U-9T4U (stating his belief that "the only impact on matters of this sort is a jail sentence. Fines added to the cost of doing business end up being paid by the shareholders. Criminal conduct is individual.").

[96] *See id.* at 7.

[97] *Id.*; *See generally* ANTITRUST DIV., U.S. DEP'T OF JUSTICE, CORPORATE LENIENCY POLICY (1993), *available at* http://www.justice.gov/atr/public/guidelines/0091.pdf, *archived at* http://perma.cc/AY8E-JDKF; SCOTT D. HAMMOND & BELINDA A. BARNETT, U.S. DEP'T OF JUSTICE, FREQUENTLY ASKED QUESTIONS REGARDING THE ANTITRUST DIVISION'S LENIENCY PROGRAM AND MODEL LENIENCY LETTERS 4–6 (2008), *available at* http://www.justice.gov/atr/public/criminal/239583.pdf, *archived at* http://perma.cc/LJG4-LT24 (identifying criteria for receipt of amnesty, including whether the company is the first to report the conduct at issue).

[98] *2010 Senate Hearings*, *supra* note 95, at 22.

over how certain terms are defined.[99] A few months later, DOJ announced that it would issue an FCPA Resource Guide to provide clarity on these issues.[100] This announcement quelled the impetus for legislative action, as Congress awaited the guide.[101] DOJ, in conjunction with SEC, issued the Resource Guide in 2012. The Guide was a valuable document in providing explanations for core terms in the FCPA, such as who constitutes a "public official" and what constitutes a "gift" intended to influence that public official for a business purpose. It also set forth factors prosecutors will consider when deciding whether to investigate or bring charges against a company for an employee violation, including general hallmarks of effective corporate compliance programs.[102] The Guide did not, however, discuss instituting any type of compliance defense.

The call for a compliance defense to corporate criminal liability has grown, with several current and former DOJ and SEC officials leading the way. Former Attorney General Michael Mukasey and Andrew Weissmann, the former Director of the Enron Task Force at DOJ and Chief of the Criminal Division in the U.S. Attorney's Office for the Eastern District of New York, have argued for a complete defense for companies with a compliance program in place when the violation occurred.[103] James Doty, former SEC General Counsel and current chair of the Public Company Accounting Oversight Board, has proposed that companies be able to earn a "presumption of compliance" by having a compliance program meeting minimum standards.[104] To qualify for this presumption, the company's leadership would have to attest that the program was properly implemented and there was a reasonable basis for believing the requirements for safe harbor were met. [105]

Jon Jordan, a Senior Investigations Counsel with the Foreign Corrupt Practices Unit at the SEC, has provided "Eleven Commandments" that should be in an FCPA compliance defense.[106] As with the other proposals,

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[99] *See id.*

[100] *See* Lanny A. Breuer, Assistant Att'y Gen., Crim. Div., Dep't of Justice, Address at 26th National Conference on the Foreign Corrupt Practices Act (Nov. 8, 2011), http://www.justice.gov/criminal/pr/speeches/2011/crm-speech-111108.html, *archived at* http://perma.cc/WB6A-UN37.

[101] *See generally*, CRIM. DIV. OF THE U.S. DEP'T OF JUSTICE & ENFORCEMENT DIV. OF THE U.S. SEC. AND EXCHANGE COMM'N, A RESOURCE GUIDE TO THE U.S. FOREIGN CORRUPT PRACTICES ACT (2012) [hereinafter RESOURCE GUIDE], *available at* www.justice.gov/criminal/fraud/fcpa/guide.pdf, *archived at* http://perma.cc/SFM5-KFUL.

[102] *Id.* at 56–65.

[103] *The Foreign Corrupt Practices Act: Hearing before the Subcomm. on Crime, Terrorism, and Homeland Security of the H. Comm. on the Judiciary*, 112th Cong. 6 (2011) (statement of Michael Mukasey, former Att'y Gen. of the United States) ("It is inherently unfair to impose liability for the acts of rogue employees on a company that had in place a robust FCPA compliance program designed to prevent such acts.").

[104] James R. Doty, *Toward a Reg. FCPA: A Modest Proposal for Change in Administering the Foreign Corrupt Practices Act*, 62 BUS. LAW. 1233, 1243 (2007).

[105] *Id.* at 1245.

[106] *See* Jordan, *supra* note 84, at 60–65.

Jordan suggests the ability to establish the defense should be based on programming in place at the time the violation occurred.[107]

William Jacobson, the former assistant chief for FCPA enforcement at DOJ, has offered a limited compliance defense.[108] First, rather than seeking legislative change, he advocates that DOJ under its discretionary authority establish its own policy not to prosecute companies meeting a compliance defense that it defines.[109] Second, he would include as elements in the defense actions taken both before and after the violation occurs, including self-reporting the violation to DOJ, cooperating fully with the government investigation, and implementing appropriate remedial measures to guard against recurrence.[110] He states that if DOJ changes its policy and companies meet this test, a compliance defense can be institutionalized without statutorily revising the FCPA.[111]

Robert Tarun, a former Executive Assistant U.S. Attorney, has suggested a two-tiered defense: companies that have sufficient programs in place and take appropriate remedial action after the violation has occurred would have a robust defense against criminal liability, whereas those who cannot meet those stringent requirements, but still aid the DOJ or SEC investigation, can qualify for a pre-defined reduction in penalties.[112] As these examples show, there are numerous ways a compliance defense might be constructed with or without amending the FCPA.

Another key issue is when in the proceedings the defense could be established.[113] Some suggest that companies should be able to seek a declaratory judgment or file a pre-trial motion after DOJ files charges so that the company and DOJ would know early in the process whether the company would be able to assert the defense.[114] If, on the other hand, the defense could be established only at trial, its value to the companies would be reduced because, even with the prospect of a complete defense, few companies

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[107] *See id.* at 56 (stating that to qualify for the compliance defense, "the company should have the burden of establishing three things: (1) that it had adequate compliance procedures; (2) that it adequately implemented the relevant procedures; and (3) that the relevant potential violations involved conduct that the company did not know nor should have known about").

[108] William B. Jacobson, *No Legislation Necessary: A Five-Part Test to Negate Corporate Criminal Liability in FCPA Cases*, 91 BLOOMBERG CR. L. 77 (2012).

[109] *See id.* ("[T]here is no need to tinker with the statute. Instead, the Department of Justice could, and should, exercise its prosecutorial discretion and commit to not bringing FCPA-related criminal charges against companies that have done all they could to curb corruption . . . .").

[110] *See id.* at 77–78.

[111] *See id.* at 77.

[112] *See* Robert W. Tarun & Peter P. Tomczak, *A Proposal for a United States Department of Justice Foreign Corrupt Practices Act Leniency Policy*, 47 AM. CRIM. L. REV. 153, 214–222 (2010).

[113] Some have suggested that the defense should not be available if the offense is committed by an executive of the company. *See, e.g.*, Jacobson, *supra* note 108, at 78.

[114] *See, e.g.*, Larry D. Thompson, *The Blameless Corporation*, 47 AM. CRIM. L. REV. 1251, 1254 (2010) ("The innocence of the corporation would be established as a matter of law.").

would risk the case turning into a bet-the-company endeavor.[115] Companies would likely continue the current practice of settling, even for tens or hundreds of millions of dollars, rather than risk their livelihood.[116]

Opposition to a compliance defense has largely focused on the fear that if prosecutorial discretion were removed from individual cases, companies would implement bare minimum compliance programs that would earn the defense, but would not be vigorously implemented or enforced. Lanny Breuer, the former chief of the DOJ Criminal Division, called this approach the "race to the bottom."[117] He also has said that prosecutorial discretion facilitates other benefits. For example, he has asserted that companies are forthcoming about their own and their competitors' violations as part of trying to earn prosecutorial leniency, a leverage point that might be lost under any such reforms.[118] Amnesty International has further posited that a compliance defense would undermine the FCPA and send the message that the United States is no longer seeking to take the lead on anti-corruption efforts.[119]

The fact of the matter is that DOJ is already at times providing companies with a *de facto* compliance defense.[120] In its manual for U.S. attorneys, DOJ instructs its prosecutors that "it *may* not be appropriate to impose lia-

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[115] *See generally* Henning, *supra* note 39; *see also* Alldridge, *supra* note 29, at 1203 (stating that if prosecutors, at the very least, had to assess the availability of a defense, it might affect the decision of whether to prosecute and a company's confidence in defending itself and not being forced to settle for fear of losing at trial).

[116] Dietrich Knauth, *FCPA Guidance Offers Wake-Up Call For Contractors*, LAW360 (Nov. 16, 2012) (quoting David Nadler of Dickstein Shapiro LLP), http://www.law360.com/articles/394620/fcpa-guidance-offers-wake-up-call-for-contractors, *archived at* http://perma.cc/W6Y8-B4LX; *see also* Henning, *supra* note 39, at 899 ("[A]voiding an indictment or reaching a settlement that does not involve a guilty plea allows a company to escape many of the collateral consequences that accompany a criminal conviction.").

[117] Mike Scarcella, *After Long Wait, Do FCPA Rules Change Much? New DOJ Guidance Gets Mixed Reaction From Defense Bar*, NAT'L L.J. (Nov. 19, 2012) (quoting Lanny Breuer), *available at* http://www.nlj-digital.com/nlj-ipauth/20121119#pg1, *archived at* http://perma.cc/D3G3-ASJD ("I think that would be very dangerous and is antithetical to the way we pursue criminal justice cases. . . . I also think we run the risk of a race to the bottom. We look at compliance programs."); *see also* Erica Teichert, *DOJ Chief Says Compliance Programs Aren't An FCPA Shield*, LAW360 (Nov. 16, 2012), http://www.law360.com/articles/394929/doj-chief-says-compliance-programs-aren-t-an-fcpa-shield, *archived at* http://perma.cc/SEC8-WKDL.

[118] *See* Joe Palazzolo, *An FCPA Compliance Defense? No Way, Breuer Says*, WALL ST. J. BLOG, (Apr. 1, 2011, 2:11 PM), http://blogs.wsj.com/corruption-currents/2011/04/01/an-fcpa-compliance-defense-no-way-breuer-says/, *archived at* http://perma.cc/PX3Y-MLA5.

[119] Press Release, Transparency Int'l, Broad Coalition of 33 Civil Society and Socially Responsible Investment Leaders Call on Congress to Refrain from Introducing Legislation Amending FCPA (Jan. 12, 2012), http://www.transparency.org/files/content/pressrelease/20120112_International_FCPA_letter_EN.pdf, *archived at* http://perma.cc/93J4-EJSK.

[120] Lanny Breuer, who has opposed formalizing a compliance defense, has appreciated the value of compliance, saying "there is no doubt that a company that comes forward on its own will see a more favorable resolution than one that doesn't." Lanny A. Breuer, Assistant Att'y Gen., Crim. Div., Speech at the 24th National Conference on the Foreign Corrupt Practices Act (Nov. 16, 2010), http://www.justice.gov/criminal/pr/speeches/2010/crm-speech-101116.html, *archived at* http://perma.cc/NU8S-X2WU.

bility upon a corporation, particularly one with a robust compliance program in place, under a strict *respondeat superior* theory for the single isolated act of a rogue employee."[121] Indeed, over the past few years as compliance programs have become more commonplace, the number of DOJ and SEC "declinations" against filing an FCPA enforcement action after an investigation has increased.[122] In 2012, the agencies specifically touted Morgan Stanley's FCPA compliance program in declining to prosecute the company after a Morgan Stanley partner "used a web of deceit to thwart Morgan Stanley's efforts to maintain adequate controls designed to prevent corruption."[123] Prosecutors also are to take a company's compliance program into consideration to lower the company's "culpability score," which is used for determining the "multiplier" for the base criminal fine, though the culpability score cannot lower the base fine itself.[124]

It is understandable that DOJ does not want to surrender the power of wielding the "carrot" of a compliance defense in each individual case, but in an age when many companies have similarly robust compliance programs, it is time for an objective, neutral process that is predictable, not random in its implementation.[125] Prosecutors would never be permitted, for example, to be the ones to decide whether a person indicted on murder charges after he was attacked by an intruder could raise the issue of self-defense. The affirmative defense is available, its elements are defined, and the question of whether the defendant satisfies those elements is left to the neutral authorities of the court. When it comes to criminal conduct, personal or corporate, due process requires that the law clearly define what is considered criminal behavior and have that law applied in an objective, neutral manner so that people and businesses can take steps to assure that they will not engage in criminal activity.[126]

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[121] U.S. DEP'T OF JUSTICE, U.S. ATT'YS' MANUAL, § 9-28.500 (2008) (emphasis added).

[122] *See* Marc Alain Bohn, *Final Count for 2012 Declinations*, FCPA BLOG (Jan. 24, 2013, 6:18 AM), http://www.fcpablog.com/blog/2013/1/24/final-count-for-2012-declinations.html, *archived at* http://perma.cc/DK5D-K3D3 (reporting a total of seventeen known declinations in 2012 compared with two in 2008). To add greater perspective to these totals, at the beginning of 2013, approximately eighty-eight companies were facing FCPA investigations. *Corporate Investigations List (January 2013)*, FCPA BLOG (Jan. 3, 2013, 4:02 AM), http://www.fcpablog.com/blog/2013/1/3/the-corporate-investigations-list-january-2013.html, *archived at* http://perma.cc/TX6F-GD82.

[123] Press Release, Office of Pub. Affairs, Dept. of Justice, Former Morgan Stanley Managing Director Pleads Guilty for Role in Evading Internal Controls Required by FCPA (Apr. 25, 2012), http://www.justice.gov/opa/pr/2012/April/12-crm-534.html, *archived at* http://perma.cc/KX7L-E5L2.

[124] *See supra* note 34.

[125] The counter argument has been made that the elements of a corporate compliance defense should remain vague to increase the "likelihood that [companies] will expend too many resources because of their natural risk aversion." Henning, *supra* note 39, at 913.

[126] *See, e.g.,* International Union, United Mine Workers v. Bagwell, 512 U.S. 821, 836 (1994) ("Due process traditionally requires that criminal laws provide prior notice both of the conduct to be prohibited and of the sanction to be imposed."); Buckley v. Valeo, 424 U.S. 1, 77 (1976); Bouie v. City of Columbia, 378 U.S. 347, 350–51 (1964); *see also* BMW of North America, Inc. v. Gore, 517 U.S. 559, 574 (1996) ("Elementary notions of fairness enshrined in

This is not to exclude DOJ and SEC from the process. As the U.K. Ministry has done under the U.K. Bribery Act, DOJ and SEC can help determine the elements and steps that should be required in order to satisfy the defense. The agencies took the first steps in this direction in 2012 when issuing their joint Resource Guide. As discussed above, the Guide identified the "hallmarks" of an effective compliance program, including 1) a clear anti-corruption policy and commitment from senior management, 2) a code of conduct and compliance policies and procedures, 3) adequate oversight, 4) risk assessment protocols, 5) employee training and communication of appropriate practices, and 6) incentives and disciplinary measures.[127] These "hallmarks" can be readily converted into elements of a defense.

E. A Compliance Defense Is Needed To Further the Goals of the FCPA

In addition to the legal fairness issue, a compliance defense is needed to advance the FCPA's goals at this point. The situation today is different than when FCPA was enacted in 1977 and when a compliance defense was considered in 1988. Companies with compliance programs and other OECD countries have now fully partnered with the U.S. in fighting corruption.

Since 1997, the thirty-four OECD countries, along with six non-member countries, have adopted the OECD's anti-bribery convention.[128] The cultural change this has triggered in economically developed countries is stark. Until the 1990s, European companies could deduct from their national taxes the bribes paid in foreign countries.[129] Now, the U.K., France, and Germany are active enforcers of foreign anti-bribery statutes.[130] About a dozen of these countries, including the U.K., Germany, and Japan, which are economic competitors of the U.S., have compliance defenses; many others do not impute criminal liability to the company at all.[131] As these countries have rec-

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our constitutional jurisprudence dictate that a person receive fair notice not only of the conduct that will subject him to punishment, but also of the severity of the penalty that a State may impose.").

[127] *See* Resource Guide, *supra* note 101, at 57–60; *see also* MATTHEW J. FEELEY, KEY COMPONENTS OF THE NEWLY ISSUED FCPA GUIDE AND BEST PRACTICES FOR AN EFFECTIVE COMPLIANCE PROGRAM, ASPATORE INT'L WHITE COLLAR CRIME ENFORCEMENT (2013 ed.) ("While not providing a compliance defense—vis-à-vis the UK Bribery Act—there is little question that the DOJ and SEC will now focus on the existence and operation of an effective FCPA compliance program.").

[128] OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, Dec. 18, 1997, 37 I.L.M. 1, *available at* http://www.oecd.org/corruption/oecdantibriberyconvention.htm, *archived at* http://perma.cc/6687-VDHF.

[129] Alldridge, *supra* note 29, at 1186.

[130] *See* FRITZ HEIMANN ET AL., TRANSPARENCY INTERNATIONAL, EXPORTING CORRUPTION PROGRESS REPORT 2013: ASSESSING ENFORCEMENT OF THE OECD CONVENTION ON COMBATING FOREIGN BRIBERY 4-6 (2013), *available at* http://issuu.com/transparencyinternational/docs/2013_exportingcorruption_oecdprogre, *archived at* http://perma.cc/W7HE-PG8T.

[131] *See* Mike Koehler, *The Compliance Defense Around the World*, FCPA PROFESSOR (June 28, 2011, 5:00 AM), http://fcaprofessor.blogspot.com/2011/06/compliance-defense-around-world.html, *archived at* http://perma.cc/B4KT-4AUF (explaining that several OECD members do not need a compliance defense because they do not permit criminal prosecutions

ognized, when companies adopt the types of robust compliance programs that are now available, they are not adversaries to, but partners in, the government's effort in rooting out bribery.

Formally deputizing companies with such a compliance defense can cement these gains and facilitate a fundamental shift in the compliance culture toward social responsibility, rather than relying on fear as the sole motivating factor.[132] A compliance defense can recognize that, "[i]n the same way that combating drug use and gang violence requires a community-based approach, not just a law enforcement one, so, too, does fighting the problem of public corruption on a global scale require the support of the global community."[133] Contrary to Amnesty International's view, a compliance defense will signal to the world that the FCPA has succeeded in its mission to make fighting corruption "a positive social good."[134]

In the end, an FCPA compliance defense will help DOJ and SEC achieve the benefits of the law. The World Bank estimates there is still more than $1 trillion in bribes paid each year.[135] Companies armed with a compliance defense can continue being agents for change. They will have renewed confidence to invest in countries with known corruption problems, knowing their commitment to lawful practices will protect them from severe adverse consequences if an employee or vendor who, despite all due efforts, fails to follow the FCPA rules.[136] As the FCPA envisions, the ultimate beneficiaries will be residents in these foreign counties who will benefit, for example, when pharmaceutical companies are willing to sell medicines there and companies of all types build facilities and hire workers in their communities.

II. False Claims Act: Adding Corporate Compliance to the War Against Fraud

The False Claims Act (FCA) and FCPA provide complementary statutory regimes: whereas the FCPA focuses on foreign corruption, the FCA protects the U.S. government from being defrauded.[137] As with the FCPA, the FCA uses the powerful "stick" of heightened penalties, including treble

against companies or require corporate criminality to result from acts of those who are the "controlling minds" of the company).

[132] *See* David Hess, *Enhancing the Effectiveness of the Foreign Corrupt Practices Act Through Corporate Social Responsibility*, 73 Ohio St. L.J. 1121, 1137 (2012) ("A compliance program implemented solely to meet external, regulatory demands can lose legitimacy with employees within the corporation who grow to see the program as not 'valued, necessary, or useful' and not in their best interests. Not only does the program lose legitimacy, but so do the ethical values the program is designed to further.").

[133] Stewart, *supra* note 32, at 1046.

[134] Henning, *supra* note 39, at 893.

[135] *See The Costs of Corruption*, World Bank, (Apr. 8, 2004), http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:20190187~menuPK:34457~pagePK:34370~piPK:34424~theSitePK:4607,00.html, *archived at* http://perma.cc/V666-6VFD.

[136] Hess, *supra* note 132, at 1137–38.

[137] 31 U.S.C. § 3729(a).

damages, high per incident fines, and potential debarment, to punish those who commit fraud against the federal government.[138] Over the past thirty years, companies have developed corporate compliance programs to guard against FCA violations similar to those that have helped companies root out foreign corruption. Indeed, as alluded to above, the concept of corporate compliance began in earnest in the 1980s in response to FCA actions against defense contractors for defrauding the Department of Defense.[139] Since then, compliance programs have become essential for preventing, uncovering and stopping fraud against the U.S. government, just as they have in fighting international corruption.

A major difference between the FCPA and FCA, though, is that the FCA relies primarily on giving private individuals, largely insiders, significant financial incentives to "blow the whistle" on suspected fraud, often against their own employers. Whistleblowers, called "relators" in the statute, are given a private right of action, called a "*qui tam*" suit,[140] to sue any company he or she suspects of violating the FCA. As a reward for blowing the whistle and litigating the case, the relator keeps up to thirty percent of the overall award,[141] which can include the amount of the fraudulent transaction, plus the penalties discussed above of treble damages and per violation fines. Further, this is a competitive incentive against other "insiders" because only the first person to file a claim can qualify as the relator in a given matter. This system, therefore, spurs people to sue first and ask questions later. While this mechanism has led to exposing significant frauds, the opportunity for individuals to use this power for their own financial gain has a long history of being abused.[142]

As discussed below, the opportunities for wasteful, speculative or manufactured lawsuits have increased dramatically over the past few years.[143] Congress has significantly broadened the FCA, both with respect to the

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[138] *See* 31 U.S.C. § 3729(a)(1) (violator is liable for "a civil penalty of not less than $5,000 and not more than $10,000 . . . plus 3 times the amount of damages which the Government sustains because of the act of that person"); Federal Acquisition Regulation § 9.406, 48 C.F.R. § 9.406-2; Congressional Research Service, *Debarment and Suspension of Government Contractors: An Overview of the Law Including Recently Enacted and Proposed Amendments* 5–6 (Jan. 6, 2012) (listing "violations of the civil False Claims Act" as one cause for permissive debarment); Timothy Stoltzfus Jost & Sharon L. Davies, *The Empire Strikes Back: A Critique of the Backlash Against Fraud and Abuse Enforcement*, 51 ALA. L. REV. 239, 248 (1999) (discussing sanctions, including debarment, that the government may use to punish healthcare providers).

[139] *See supra* note 57.

[140] "Qui tam" is short for the Latin phrase "qui tam pro domino rege quam pro se ipso in hac parte sequitur," which means one "who pursues this action on our Lord the King's behalf as well as his own."

[141] *See* 31 U.S.C. § 3730(d) (2010).

[142] *See* Christopher M. Alexion, *Open The Door, Not The Floodgates: Controlling Qui Tam Litigation Under The False Claims Act*, 69 WASH. & LEE L. REV. 365, 404 (2012) ("[F]rom 1987 to 2010, the government has declined to intervene in approximately 78% of *qui tam* actions in which investigation is complete.").

[143] *See infra* notes 151 to 166.

types of conduct that can give rise to a claim (fraud is no longer required) and the types of people that can file a *qui tam* suit (insider knowledge is not needed).[144] As a result, many cases are based on manufactured or minor violations, as well as attempts to game the litigation for the relator bounty.[145] In these cases, the FCA's heightened penalties, which were designed to punish companies who commit fraudulent acts, are not the appropriate "sticks" for enforcement. Profit motivated over-punishment is not the purpose of the FCA. One way to guard against this abuse in a way that is in concert with the goals of fighting fraud is for Congress to give conscientious companies the opportunity to investigate and remediate suspected violations before facing the threat of FCA litigation. During this time, DOJ and a company can try to work out any real differences and reach resolution, allowing relator suits for heightened penalties to be reserved for when a company fails to take timely, appropriate action.

A. Purpose, History and Development of the FCA

Congress enacted the FCA in 1863 with the objective of preventing fraud by unscrupulous contractors in the sale of provisions to the Union Army during the Civil War.[146] At the height of the Civil War, fraud was an "enormous" problem that impaired Union forces.[147] Dishonest contractors and war profiteers sold decrepit horses and mules, faulty rifles and ammunition, and rancid rations to the military.[148] Some contractors who were supposed to sell sugar to the troops substituted sand in their shipments.[149] Often, these individuals acted with impunity because the scale and complexity of the war effort made identifying the responsible parties and prosecuting

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[144] *See infra* notes 168 to 185.

[145] *See infra* notes 206 to 221.

[146] *See* JOHN T. BOESE, CIVIL FALSE CLAIMS AND QUI TAM ACTIONS 1–6 (4th ed. 2011) (discussing the FCA's origin).

[147] CONG. GLOBE, 37th Cong., 3rd Sess. 956 (1863) (statement of Sen. Wilson) (stating the purpose of the FCA as "ferreting out and punishing these enormous frauds upon [the] Government").

[148] President Abraham Lincoln described such individuals as follows: "Worse than traitors in arms are the men who pretend loyalty to the flag, feast and fatten on the misfortunes of the nation while patriotic blood is crimsoning the plains of the south and their countrymen are moldering in the dust." Larry D. Lahman, *Bad Mules: A Primer on the Federal False Claims Act*, 76 OKLA. B. J. 901, 901 (2005).

[149] *See* United States ex rel. Newsham v. Lockheed Missiles & Space Co., 722 F. Supp. 607, 609 (N.D. Cal. 1989) (" 'For sugar it [the government] often got sand; for coffee, rye; for leather, something no better than brown paper; for sound horses and mules, spavined beasts and dying donkeys; and for serviceable muskets and pistols, the experimental failures of sanguine inventors, or the refuse of shops and foreign armories.'" (quoting FRED ALBERT SHANNON, THE ORGANIZATION AND ADMINISTRATION OF THE UNION ARMY, 1861–1865, at 58 (1965))); *see also* J. Randy Beck, *The False Claims Act and the English Eradication of Qui Tam Legislation*, 78 N.C. L. REV. 539, 555 (2000) (revealing that contractors provided the Union Army with "artillery shells filled with sawdust rather than explosives").

frauds too onerous.[150] Congress responded with the Informer's Act, also known as "Lincoln's Law," to target and punish these offenders.[151]

The Informer's Act, which eventually became known as the False Claims Act, included several core features of the modern statute. It applied to any fraud against the federal government.[152] It imposed statutory penalties for each false claim made and authorized damages as a multiple of the government's loss.[153] The goals of the heightened FCA penalties were two-fold: recuperate the government's loss and deter fraud by punishing anyone caught defrauding the federal government with crippling fines. The Act also exclusively relied on deputizing whistleblowers to bring these actions on behalf of the government.[154] The FCA was purely a private enforcement mechanism. The government did not intervene in cases, and relators kept fifty percent of the awards as bounties for suing on the government's behalf.

In the early 20th Century, the government's involvement in the national economy expanded through the New Deal and the pre-World War II military buildup, creating new opportunities for companies to contract with the government. This led to an increase in fraud against the federal government[155] and *qui tam* litigation.[156] At the same time, a Supreme Court ruling lowered the bar for when people could benefit from bringing an FCA enforcement action by permitting relators to receive their portion of the bounty even if they did not contribute information to the case.[157] The result was a dramatic increase in what people called "parasitic *qui tam* suits,"[158] as many individuals found ways to game the system by filing *qui tam* suits based on information that was already in the possession of the government.[159] Some relators

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[150] Senator Jacob M. Howard, the principal sponsor of the bill, called it a "crying evil[ ] of the period . . . that [the] Treasury is plundered from day to day by bands of conspirators, who are knotted together in this city and other large cities for the purpose of defrauding and plundering the Government." CONG. GLOBE, 37th Cong., 3rd Sess. 955–56 (1863).

[151] *See* False Claims Act, ch. 67, 12 Stat. 696 (1863) (current version at 31 U.S.C. §§ 3729-3730 (2010)); *see also* BOESE *supra* note 146, § 1.01[A], at 1–12.

[152] *Id.* at § 1; 12 Stat. at 696–97.

[153] *Id.* at § 3; 12 Stat. at 698.

[154] *See* BOESE, *supra* note 146 at 698; *see also* Nathan D. Sturycz, *The King and I?: An Examination of the Interest Qui Tam Relators Represent and the Implications for Future False Claims Act Litigation*, 28 ST. LOUIS U. PUB. L. REV. 459, 460 (2009).

[155] *See* Patricia Meador & Elizabeth S. Warren, *The False Claims Act: A Civil War Relic Evolves into a Modern Weapon*, 65 TENN. L. REV. 455, 459 (1998).

[156] *See* David Baker, *A Whole New World of False Claims Act Liability: The 2009 Amendments and Learning Where to Draw the Line*, 61 CATH. U. L. REV. 201, 204 (2011).

[157] This development was spurred in part by the U.S. Supreme Court's ruling in *United States ex rel. Marcus v. Hess*, 317 U.S. 537 (1943), which allowed relators to pursue a *qui tam* action without contributing any information to the case. Under *Hess*, relators could effectively copy criminal indictments into their civil actions and receive half of the government's recovery without actually assisting in uncovering fraud. *See id.* at 545.

[158] *See* Baker, *supra* note 156, at 205.

[159] *See* Meador & Warren, *supra* note 155, at 460. The amendments proved too restrictive in 1984, when a relator was unable to pursue a *qui tam* action because the government possessed the information found in the complaint before the suit was filed. Ironically, the relator was the party who provided the government with the information. *See* United States ex rel. Wisconsin v. Dean, 729 F.2d 1100, 1103 (7th Cir. 1984). As one court put it, the *Dean* deci-

even filed *qui tam* suits based on nothing more than copying a criminal indictment they played no role in helping to bring. In 1943, Congress amended the FCA to prohibit such actions.[160] The new law required relators to base claims on information the government did not possess and gave the government the opportunity to investigate and intervene in a *qui tam* suit.[161]

FCA enforcement largely remained stable until the 1980s, when fraud against the government once again became an issue of national concern. Budget deficits were rising, and federal agencies identified fraud as being pervasive in government contracts.[162] The Departments of Defense and Health and Human Services tripled their investigations into fraudulent claims. Congress has since amended the False Claims Act four times.[163] The first was in 1986 in response to these allegations.[164] After the financial crisis in 2009, Congress further reformed the FCA as part of the Fraud Enforcement and Recovery Act (FERA),[165] the Affordable Care Act (ACA),[166] and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.[167] As discussed below, these reforms have led to a new era of FCA litigation.

B. Modern False Claims Act: No Fraud or Insider Knowledge Required

Modern FCA enforcement is distinctly different from past FCA litigation in two key respects: the FCA now covers activities far beyond traditional fraud, and people can now qualify as relators even though they were never "inside" whistleblowers. This broader reach of the FCA may be helpful in rooting out fraud in certain contracting situations, but it also has wildly expanded opportunities for *qui tam* abuse, leading to a return of the "parasitic" suits.

1. The Expanded Types of Conduct Subject to the False Claims Act

Traditionally, the core elements of a false claim were that a person, acting with intent to defraud the government, "cheated" the government by

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sion showed that "Congress, in its attempt to evade Scylla, had steered precipitously close to Charybdis." United States ex rel. Springfield Terminal Ry. v. Quinn, 14 F.3d 645, 650 (D.C. Cir. 1994).

[160] *See* False Claims Act, Pub. L. No. 78-213, 57 Stat. 608, 608-09 (1943).

[161] *See* Meador & Warren, *supra* note 155, at 460.

[162] *See* BOESE, *supra* note 146.

[163] S. REP. NO. 99-345, at 2 (1986), *reprinted in* 1986 U.S.C.C.A.N. 5266, 5267 (stating that the number of fraud investigations by the Department of Defense rose thirty percent between 1982 and 1984 and that the Department of Health and Human Services "nearly tripled the number of entitlement program fraud cases referred for prosecution" from 1983 to 1986).

[164] *See* False Claims Amendments Act (FCAA) of 1986, Pub. L. No. 99-562.

[165] Pub. L. No. 111–21, 123 Stat. 1617 (2009).

[166] Pub. L. No. 111–148, 124 Stat. 119 (2010).

[167] Pub. L. No. 111–203, 124 Stat. 1376 (2010).

presenting it with a false claim and received payment for that false claim.[168] As a result of the recent changes to the statute, however, each of these elements—intent, presentment, falsity and payment—has been gutted. The FCA now covers a broad swath of conduct not typically associated with fraudulent behavior.[169]

First, Congress eliminated the long-standing requirement that the company *intended* to defraud the federal government, only requiring that it had actual knowledge of the false statement. Actual knowledge is defined in the statute as "actual knowledge of the falsity," acting in "deliberate ignorance of the truth or falsity" or "acting in reckless disregard of the truth or falsity."[170] The statute goes on to unambiguously state that these definitions "require no proof of specific intent to defraud."[171] As a result, the chief inquiry is whether the company's false statement was "material to" the government's decision to pay or approve the claim,[172] namely, did it "influence . . . the payment or receipt of money or property."[173]

While knowledge of a false claim alone may seem worthy of punishment, the reality is that because of today's detailed record-keeping, it often can be shown after-the-fact that a company had such "knowledge" in its possession. The reality is that all that needs to be shown is that the information submitted to the government was factually incorrect. A company, for example, may not have realized an overpayment and may have never intended to defraud the government, but now is subject to the same heightened penalties as if it did. FCA scholars have complained that "billing errors once viewed as mistakes in need of correction are now attacked as crimes that compel million dollar settlements."[174] By gutting the *mens rea* requirement, the FCA punishes actions that no longer resemble fraud.[175]

Second, the FCA no longer requires a company to have directed its conduct (fraud or otherwise) at the government. For example, the FCA and its heightened penal structure can now be applied to disputes between contractors and subcontractors. Such a dispute arose in *Allison Engine Co. v.*

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[168] *See* False Claims Act, ch. 67, sec. 4, 12 Stat. 698 (1863) (current version at 31 U.S.C. §§ 3729-3730 (2010)) (stating in several places that violating the act requires "false, fictitious, or fraudulent" conduct, that someone conspires to "cheat or defraud" the government, that a government official "steal, embezzle or knowingly and willfully misappropriate or apply to his own use or benefit" government property, that the violator acts "with intent to defraud the United States, or willfully to conceal such money or other property," or act "with intent to cheat, defraud, or injure the United States").

[169] *See, e.g.*, Allison Engine Co. v. United States ex rel. Sanders, 553 U.S. 662 (2008) (stating that eliminating the element of intent "would expand the FCA well beyond its intended role of combating 'fraud against the Government'").

[170] 31 U.S.C. § 3729(b)(1)(A) (2010).

[171] 31 U.S.C. § 3729(b)(1)(B) (2010).

[172] S. Rep. No. 111-10 at 12 (2009).

[173] S. Rep. No. 111-110 (2009).

[174] Meador & Warren, *supra* note 155, at 456.

[175] *See* Richard Doan, *The False Claims Act and the Eroding Scienter in Healthcare Fraud Litigation*, 20 ANNALS HEALTH L. 49, 66 (2011) ("[N]either actual knowledge nor a specific intent to defraud the government is required to establish liability.").

United States ex rel. Sanders, and Congress amended the FCA afterwards to make sure that the FCA encompassed claims made to others, not just the government.[176] In addition, the government no longer needs to be the party who ultimately pays the claim; the law requires only that the money or property at issue "is to be spent or used on the government's behalf or to advance a government program or interest."[177] Finally, there need not be any actual payment, as companies tangential to the alleged bad act can now be pursued under conspiracy theories.[178] Practitioners, scholars, and even the U.S. Supreme Court have expressed concern that, by removing these requirements, the FCA is being turned into an "all-purpose fraud statute."[179]

Third, the FCA no longer requires the company to affirmatively conceal, avoid, or decrease an obligation to the government. Unintentionally receiving funds from the government or not returning an overpayment is now sufficient.[180] Such overpayments can arise over the course of thousands of small transactions the contracting party would normally "true-up" with the government on an informal basis to even out any over or under payment. Thus, even though a company may learn about these overpayments and intend to re-pay them, it can still face an FCA claim upon receipt of the overpayment.

Some courts have relaxed these requirements even further. In a 2013 ruling, for example, a federal judge did not require any specific allegation of a false claim in order for a former employee to bring an FCA action. In this case, a billing clerk for a physician alleged that the physician did not sufficiently audit his records to detect whether there were overpayments.[181] She did "not allege that the defendant knew the specific requests for reimbursement . . . were false" and did not have documentation to show that they

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[176] 31 U.S.C. § 3729(a)(1) (Supp. III 2009).

[177] 31 U.S.C. § 3729(b)(2)(A) (2010).

[178] *See* 31 U.S.C. § 3729(a)(1)(G) (2010) ("[A]ny person who . . . knowingly conceals or knowingly and improperly avoids or decreases an obligation to pay or transmit money or property to the Government, is liable . . . .").

[179] Allison Engine Co. v. United States ex rel. Sanders, 553 U.S. 662, 672 (2008); *see also* United States ex rel. Totten v. Bombardier Corp., 380 F.3d 488, 494, 496 (D.C. Cir. 2004) (expressing concern about the reach of the FCA becoming "almost boundless"); Julie E. Kass & John S. Linham, *Fostering Healthcare Reform Through a Bifurcated Model of Fraud and Abuse Regulation*, 5 J. HEALTH & LIFE SCI. L. 75, 95 (2012) ("The government has not heeded the U.S. Supreme Court's concern that the FCA is becoming an 'all-purpose anti-fraud statute.'"); Justin P. Tschoepe, *A Fraud Against One is Apparently A Fraud Against All: The Fraud Enforcement and Recovery Act's Unprecedented Expansion of Liability Under the False Claims Act*, 47 HOUS. L. REV. 741, 745 (2010).

[180] *See* S. REP. NO. 111-10, at 15, *reprinted in* 2009 U.S.C.C.A.N. 430, 442 (2009) (stating that the FCA amendments "will be useful to prevent Government contractors and others who receive money from the Government incrementally based upon cost estimates from retaining any Government money that is overpaid during the estimate process"); *see also* Medicare Program; Reporting and Returning of Overpayments, 77 Fed. Reg. 9179 (proposed Feb. 16, 2012), *available at* http://www.gpo.gov/fdsys/pkg/FR-2012-02-16/pdf/2012-3642.pdf, *archived at* http://perma.cc/3N76-WBDA.

[181] U.S. ex rel. Elizabeth Keltner v. Lakeshore Med. Clinic Ltd., No. 2:11-cv-00892 (E.D. Wis. 2013).

were. Yet, the court permitted the case to proceed, stating that the physician's "absence of medical documentation" that the claims were not false was "sufficient to support a plausible claim of fraud."[182] Such inadvertence, to the extent it even existed in this case, was never supposed to be the province of the FCA.[183] Accordingly, regular disputes that arise among contracting parties, namely breach of contract claims and those based on a contract's enumerated damages, now qualify for the FCA's heightened enforcement.[184] Finally, courts have even relaxed the requirement that the government sustain any actual damages for an FCA claim to succeed.[185]

In addition, Congress has increased the FCA's penalties. It established civil penalties of between $5,500 and $11,000 for each false claim and allowed awards up to three times the amount of damages sustained by the government.[186] Here is how the penalty structure works, and how it can be abused in litigation. Take a modest contract in which a contractor sells 1,000 items to the government at $10 apiece for a total of $10,000. If a False Claim Act violation can be alleged against the contractor, the contractor could be sued for treble damages, which would be $30,000, and per incident violations of up to $11,000 for each of the 1,000 items. A plaintiff seeking full statutory damages, therefore, could pursue another $11 million, a steep penalty for a $10,000 contract.

As this section has shown, the FCA now places these harsh penalties on conduct that does not carry the same culpability as fraud. Further, government spending has grown to roughly forty percent of the country's Gross Domestic Product[187] and the government's use of contractors has more than doubled recently, from $203 billion in 2000 to $517 billion in 2012,[188] mean-

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[182] *Id.*; Jeff Overley, *4 Little-Noticed FCA Rulings Attys Need to Know*, Law360 (Dec. 2, 2013), http://www.law360.com/articles/482502/4-little-noticed-fca-rulings-attys-need-to-know, *archived at* http://perma.cc/B7ZC-EBL7 (stating the claim proceeded on mere "assumptions that false claims must have been submitted").

[183] *See* Overley, *supra* note 182.

[184] Contract disputes with the federal government are to be resolved under the Contract Dispute Act of 1978. *See* 41 U.S.C. §§ 7101–09 (2011).

[185] *See, e.g.,* United States ex rel. Harrison v. Westinghouse Savannah River Co., 352 F.3d 908, 913, 924 (4th Cir. 2003) (awarding $195,000 and attorney's fees totaling over $144,000 despite finding that relator failed to prove that the government sustained any loss).

[186] The FCA previously provided for the imposition of a civil penalty "of not less than $5,000 and not more than $10,000 for each false claim." 31 U.S.C. § 3729(a) (2010). This penalty range was adjusted for inflation under the Federal Civil Monetary Penalties Inflation Act of 1990, Pub. L. No. 101-410, Title III, § 31001, and the Debt Collection Improvement Act of 1996, Pub. L. No. 104-134, to between $5,500 and $11,000 for conduct occurring after September 29, 1999. 28 U.S.C.A. § 2461 note (2002); 28 C.F.R. § 85.3(9) (2000).

[187] *See* Christopher Chantrill, *U.S. Government Spending as Percent of GDP*, Government Spending in the United States of America, http://www.usgovernmentspending.com/us_20th_century_chart.html, *archived at* http://perma.cc/BXP3-V97B (last visited March 11, 2014).

[188] *See* Minority Staff of H.R. Comm. on Gov't Reform, 109th Cong., Dollars, Not Sense: Government Contracting Under the Bush Administration, House Government Reform Committee, at 3–4 (June 2006), *available at* http://oversight-archive.waxman.house.gov/documents/20061211100757-98364.pdf, *archived at* http://perma.cc/SH7A-3L75; Catherine Clifford, *Scoring Government Contracts Takes an Increasing Amount of Time and*

ing that the number of transactions potentially subject to FCA enforcement has grown substantially.

2. The New Broad Class of "Relators" Who Can Bring FCA Claims

At the same time Congress expanded the reach of the FCA, it also shifted the balance found in the 1943 amendments in favor of expanded whistleblowing. Here is how the private enforcement provisions work under current law. When a relator files a *qui tam* action, it is initially sealed, including from the defendant, so that DOJ can independently investigate the relator's allegations.[189] This review period, initially sixty days, can be extended upon showing of good cause that more time is needed for the government to learn enough about the case to make a competent decision about the claims.[190] Once the government has a sense of the case, it decides whether it is worth the government's time, resources and expertise to intervene and litigate the case directly. At that point, the seal is lifted and the action is served on the defendant, either by the relator or by the government if it chooses to enter the case.

When the government intervenes, the relator keeps 15-25% of the recovery, depending on how much information and assistance the relator provided.[191] When the government does not join the case and the relator conducts the litigation on his or her own, he or she can keep up to 30% of the recovery.[192] These awards go only to the first person to file a claim.[193] Congress established this competitive incentive to encourage presumed "insiders" to blow the whistle on suspected violations before others with knowledge of the transactions did the same. (Antitrust laws have a similar mechanism when two entities collude in violation of the nation's antitrust laws.)[194] Congress also gave employees extra protection from retaliation for blowing the whistle on their employers.[195] While these powerful incentives

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Money, ENTREPRENEUR (Aug. 1, 2013), http://www.entrepreneur.com/article/227667, *archived at* http://perma.cc/SMM5-DDB4.

[189] *See* 31 U.S.C. § 3730(b)(2) (2010); *see also* Michael Rich, *Prosecutorial Indiscretion: Encouraging the Department of Justice to Rein in Out-Of-Control Qui Tam Litigation Under the Civil False Claims Act*, 76 U. CIN. L. REV. 1233, 1241–42 (2008).

[190] *See* 31 U.S.C. § 3730(b)(3) (2010).

[191] *See* 31 U.S.C. § 3730(d)(1) (2010).

[192] *See* 31 U.S.C. § 3730(d)(2) (2010).

[193] *See* 31 U.S.C. § 3730(d)(3) (2010).

[194] *See* William E. Kovacic, *Private Monitoring and Antitrust Enforcement: Paying Informants to Reveal Cartels*, 69 GEO. WASH. L. REV. 766, 795 (2001) ("An insider who observes misconduct and delays informing runs the risk that another insider will act first and capture all or the largest share of the reward."); *see also* WILLIAM E. KOVACIC, THE ANTITRUST GOVERNMENT CONTRACTS HANDBOOK 17 (1990) (stating that conduct violating antitrust laws has increasingly become a basis for *qui tam* suits).

[195] *See* S. REP. NO. 99-345, at 4 (1986) ("The Committee's amendments contained in S. 1562 are aimed at correcting restrictive interpretations of the act's liability standard, burden of proof, *qui tam* jurisdiction and other provisions in order to make the False Claims Act a more effective weapon against Government fraud."); H. REP. NO. 99-660, at 23 (1986) (stating that *qui tam* relators should receive additional incentives since they aided the government in un-

can generate the desired behavior from real whistleblowers, they can also lead others to file *qui tam* lawsuits before knowing all the facts or to take advantage of the *qui tam* bounty.

Over the past 30 years, Congress's reforms have both expanded the types of people who can become relators and made it easier for them to bring FCA claims. Most fundamentally, the FCA no longer requires relators to be "insiders" with first-hand knowledge of the alleged violation. This change began in 1986, when Congress relaxed the requirement that a relator have completely new information upon which to base a claim. Part of this change made sense; it was a response to a case in which someone was barred from bringing a relator suit simply because that person had already provided the information to the government.[196] The law should encourage, not penalize, a person who reports allegations of fraud to the appropriate authorities. This led to an increase in *qui tam* actions, but at least the FCA still required the relator to be the "original source" of the information.

Congress, however, substantially weakened the "original source" provision in 2010 when it changed the law to allow someone to qualify as the "original source" even when he or she did not have "direct knowledge" of the information.[197] Instead of requiring a relator to have first-hand knowledge of the violation so that he or she could assist DOJ and the courts in figuring out what occurred, someone could qualify as a relator by merely obtaining information that "materially adds to the publicly disclosed allegations or transactions."[198]

Further, this "public disclosure" bar only applies to information from federal reports, hearings, audits, and investigations—not private sector, state, and local proceedings, reports, hearings, audits and investigations.[199] Thus, even when the government knows of specific allegations, is investigating the claims, and is taking appropriate action against a company, a person wholly unconnected with that process can file his or her own *qui tam* action so long as he or she knew where to find information materially different

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covering fraud); *see also* United States ex rel. Stinson v. Prudential Ins. Co., 944 F.2d 1149, 1154 (3d Cir. 1991); H. REP. NO. 99-660, at 23 (1986) (stating that *qui tam* relators should receive additional incentives since they aided the government in uncovering fraud).

[196] *See* United States ex rel. Wisconsin v. Dean, 729 F.2d 1100, 1103 (7th Cir. 1984) ("The district court properly recognized that the jurisdictional bar of section 232(C) applies whenever the government has knowledge of the 'essential information upon which the suit is predicated' before the suit is filed, even when the plaintiff is the source of that knowledge.") (quoting United States ex rel. Weinberger v. Florida, 615 F.2d 1370, 1371 (5th Cir. 1980)); *see also* 31 U.S.C. § 3730(b)(2) (2010).

[197] *See* 31 U.S.C. § 3730(e)(4)(B) (2010). The original source requirement under the 1986 version of the Act provided that a relator with direct and independent knowledge must also have "voluntarily provided the information to the Government before filing an action under this section" has been retained. *See id.*

[198] *Id.; see also* Beverly Cohen, *KABOOM! The Explosion of Qui Tam False Claims Under the Health Reform Law*, 116 PENN ST. L. REV. 77, 77 (2011) ("[T]he PPACA has enormously broadened the ability of relators to commence qui tam lawsuits under the [False Claims] Act.").

[199] 31 U.S.C. § 3730(e)(4)(A)(ii) (2010).

from what had already been publicly disclosed in the federal investigation.[200] In a particularly troubling development, the Fifth Circuit recently allowed a federal auditor to be a relator, even though his job was to investigate the alleged violation.[201] Thus, even when allegations are credible, this law can turn an erstwhile witness or information prospector into a party with a financial stake in the outcome of the case.

Finally, another recent case has put into doubt the long-held understanding that when a *qui tam* plaintiff cannot meet the public disclosure test, the court loses its jurisdiction over the claims. Without a valid plaintiff, there is no FCA action. In 2013, though, a court concluded that the public disclosure bar does not define the jurisdiction of whether the court can hear the case, but is a question of fact to be decided after discovery.[202] Thus, rather than make a determination early in the litigation as to whether the relator can bring the action, the court delayed that assessment to summary judgment, which gives relators much greater leverage to bring claims and drive settlements.

These changes have significantly shifted the careful balance Congress has historically sought between incenting the right people to come forward and blow the whistle on suspected violations on the one hand, and excluding the potential for abusive lawsuits on the other. These developments are facilitating a culture whereby individuals, namely lawyers knowledgeable in bringing *qui tam* actions, prospect for information upon which an FCA claim can be based and individuals who have that information. Unlike DOJ, private lawyers have no duty to exercise prosecutorial judgment. The government may choose not to pursue an FCA claim against a company that uncovered its own violation, reported it, and paid restitution, but a relator cannot be expected to be so restrained.[203] These changes risk the pendulum swinging considerably toward the side of "parasitic" litigation.

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[200] *See* Cohen, *supra* note 198, at 96 ("The PPACA also has the potential to increase *qui tam* litigation in other ways. For example, the PPACA subjects payments involving federal funds made through or in the healthcare insurance exchanges set up through the Act to FCA liability. The PPACA may also increase *qui tam* litigation by making a violation of the Anti-Kickback Statute a violation of the FCA.").

[201] *See* Little v. Shell Exploration & Prod. Co., 690 F.3d 282 (5th Cir. 2012).

[202] *See* Ping Chen v. EMSL Analytical, Inc., No. 10 Civ. 7504(RA), 2013 WL 4441509 (S.D.N.Y. Aug. 16, 2013); Overley, *supra* note 182.

[203] The inherent conflict between the financial incentive to maximize one's own profit and the duty to obtain justice in the courts is the reason governments cannot retain contingency-fee counsel in criminal prosecutions. *See* Baca v. Padilla, 190 P. 730, 731–32 (N.M. 1920); *see also* People ex rel. Clancy v. Super. Ct., 705 P.2d 347, 352 (Cal. 1985) ("[T]here is a class of civil actions that demands the representative of the government to be absolutely neutral."). The federal government extends the prohibition on its use of contingency-fee agreements to civil cases. *See* Exec. Order No. 13433, Protecting American Taxpayers From Payment of Contingency Fees, 72 Fed. Reg. 28,441 (May 18, 2007) (finding that hiring attorneys on an hourly or fixed fee basis, and not through a contingent fees arrangement, "help[s] ensure the integrity and effective supervision of the legal and expert witness services provided to or on behalf of the United States").

C. The Single-Focused Reliance on Whistleblowers Has Outlived Its Usefulness

True to form, there has been a dramatic increase in *qui tam* actions over the past 30 years. In the mid-1980s, relators filed only a few dozen *qui tam* actions per year.[204] Through 2009, relators filed an average of 300 to 400 *qui tam* suits per year, with DOJ initiating about 150 claims per year. Since the 2009-2010 expansions, government filings have remained the same, but the number of *qui tam* filings have doubled, with a record 647 filings in 2012.[205] There is no doubt that some of these lawsuits have led to important enforcement actions and significant recoveries, but an increasing majority have not.[206]

Experience has shown that under the new regime, the government participates in only about twenty percent of relator-initiated claims. These claims have yielded nearly $5 billion in recoveries.[207] The other eighty percent, while expensive and burdensome to defend, have accounted for less than $30 million.[208] This discrepancy has led scholars, practitioners and even courts to view DOJ's decisions not to intervene in a case as an indicator of the merits of the claim.[209] One study concluded that a vast majority of non-governmental FCA suits, some seventy percent of all *qui tam* cases filed, are of highly questionable merit.[210] The relator's conclusions about the company may not have been accurate, the alleged violation may have been *de*

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[204] *See* U.S. Dept. of Justice, Civil Division, *Fraud Statistics – Overview* (Oct. 24, 2012) [hereinafter *Fraud Statistics*], http://www.taf.org/DoJ-FCA-statistics-2012.pdf, *archived at* http://perma.cc/C7LP-V8WB.

[205] *See id.*

[206] Between 1987 and 2009, the *qui tam* plaintiff success rate has averaged approximately six percent when the government does not intervene. *See* David Kwok, *Evidence from the False Claims Act: Does Private Enforcement Attract Excessive Litigation?*, 42 PUB. CONT. L.J. 225, 237 (2013).

[207] *See, e.g.,* Juliet Macur, *Government Joins Suit Against Armstrong*, N.Y. TIMES, Feb. 22, 2013 (reporting that DOJ intervenes in approximately twenty percent of FCA cases); *Fraud Statistics*, *supra* note 204.

[208] *See Fraud Statistics*, *supra* note 204.

[209] *See, e.g.,* United States v. ex rel. Jamison v. McKesson Corp., 649 F.3d 322, 331 (5th Cir. 2011) (stating that the non-intervened claims "presumably lacked merit"); United States ex rel. Karvelas v. Melrose-Wakefield Hosp., 360 F.3d 220, 242 n. 31 (1st Cir. 2004) ("[T]he government's decision not to intervene in the action also suggested that [relator's] pleadings of fraud were inadequate."); *see also* Dayna Bowen Matthew, *The Moral Hazard Problem with Privatization of Public Enforcement: The Case of Pharmaceutical Fraud*, 40 U. MICH. J.L. REFORM 281, 337 (2007) ("Due to the sizable potential of financial gain, some *qui tam* relators will pursue cases with poor factual support or pursue flimsy legal theories that establish bad precedent and waste public resources.").

[210] *See* Christina Orsini Broderick, *Qui Tam Provision and the Public Interest: An Empirical Analysis*, 107 COLUM. L. REV. 949, 971 (2007); *see also* David Freeman Engstrom, *Public Regulation of Private Enforcement: Empirical Analysis of DOJ Oversight of Qui Tam Litigation Under the False Claims Act*, 107 Nw. U. L. REV. 1689 (2013) (concluding that merits is one of several factors affecting DOJ's decision on whether to intervene in a case); Rich, *supra* note 189, at 1264–65 (concluding "relators are permitted to proceed with [] thousands of non-meritorious qui tam suits"); Rich, *supra* note 189, at 1264 (noting statement made by senior DOJ official at a healthcare conference that the merits of non-intervened cases are "questiona-

minimis, or the action may have been generated to prospect for the *qui tam* bounty.[211] Companies facing these suits, nevertheless, must incur the costs of defending them and gauge the risk of losing. Companies may find it less expensive and legally safer to settle with the relator so that they can reduce their legal expenses and avoid any potential exposure, regardless of how remote, to the FCA's heightened penalties.

One form of FCA *qui tam* litigation generating significant attention today is the advancement of claims based solely on "false certifications."[212] Here, there is no allegation that the company defrauded the government or even that it did not adequately perform the government contract. Instead, the claim is based on statements required in some contracts that the contracting company is in compliance with certain contract terms, laws, or regulations. For example, a contractor might submit a cost report to the government certifying the account in which funds are deposited. The liability theory is that if, for any reason, a corporate defendant falls out of compliance, for instance, depositing funds in a different account in the example above, the noncompliance may be deemed a "false claim" against the government.[213] Instead of allowing the parties to resolve the dispute under regular contract law, the relator can trigger the FCA's heightened penalties and base damages on the value of the entire government contract, even when the noncompliance is unimportant and the government was satisfied with the defendant's fulfillment of that contract.[214]

In 2007, such a case reached the Fifth Circuit in which a former airport employee based an FCA claim against the airport on its use of federal aviation grants.[215] The employee did not allege that the airport misappropriated the aviation funds or breached the contract, but that it signed a certification stating that it was in compliance with certain environmental regulations when it might not have been.[216] The government investigated and did not intervene, the airport took the case to trial, won, and ultimately prevailed on

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ble at best") (quoting Robert D. McCallum Jr., Assistant Att'y Gen., Remarks to the American Health Lawyers Association Meeting (Sept. 30, 2002)).

[211] *See, e.g.,* William Y. Culbertson, *Whistleblowers and Prosecutors: Achieving the Best Interests of the Public*, 17 BUS. L. TODAY 30, 32–33 (2008) (finding that non-intervened *qui tam* cases cause "demonstrable waste of taxpayer money and palpable abuse of innocent defendants"); Joan H. Krause, *Twenty-Five Years of Health Law Through the Lens of the Civil False Claims Act*, 19 ANNALS HEALTH L. 13, 16 (2010) ("[T]o many critics the system appears ripe for abuse by self-interested relators with few, if any, real whistles to blow.").

[212] *See* JOHN T. BOESE, CIVIL FALSE CLAIMS AND QUI TAM ACTIONS 1–42 (3d ed. 2006) (characterizing false certification claims as "the most problematic and troublesome FCA cases because there are significant questions regarding whether the FCA should even apply"); Tschoepe, *supra* note 179, at 764.

[213] *See* United States *ex rel*. Augustine v. Century Health Services Inc., 289 F.3d 409, 411 (6th Cir. 2002).

[214] *See* Michael Murray, *Seeking More Scienter: The Effect of False Claims Act Interpretations*, 117 YALE L.J. 981, 982 (2008).

[215] *See* United States *ex rel*. Dallas-Fort Worth Int'l Airport Bd., No. 06-10958, 2007 WL 4561140, at 708–09 (5th Cir. 2007).

[216] *See id.*

appeal.[217] To some extent, this was a Pyrrhic victory: the airport reportedly paid $5 million to defend the claim.[218]

Similar allegations regularly arise under Medicare contracts, as health care companies must certify that they are "familiar with the laws and regulations regarding the provisions of health care services and that the services identified in [the] cost report were provided in compliance with such laws and regulations."[219] However, there are 130,000 pages of government health care rules, over 100,000 applying to Medicare.[220] Cases are filed leveraging the FCA's harsh penalties against preparers found to be unfamiliar with every such rule or, as with the airport, companies out of compliance with a rule not material to the contract. Some cases have gone further, alleging that even if the company did not sign such a certification, the certification can be implied based on the terms of the contract.[221] False certifications are just one example of the *qui tam* abuse the current system generates and are indicative of a scheme that incents litigation, regardless of the merits of a case and the willingness of a company to right a wrong.

D. Solution: Separate Wrong-Doers from Innocent Actors

Rather than focus FCA enforcement exclusively on the two-legged stool of DOJ and relator litigation, strict corporate compliance should be added as an able third leg of the stool.[222] As with the FCPA, organizations receiving government funds have developed extensive compliance programs to stop, identify, and expose fraud and other potential violations of the FCA.[223] The federal government has actively encouraged these programs.

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[217] *See id.*

[218] *See The False Claims Correction Act (S. 2041): Strengthening the Government's Most Effective Tool Against Fraud for the 21st Century*, 110th Cong. 2, at 8 (2008) (written statement of the Chamber of Commerce and the U.S. Chamber Institute for Legal Reform in Opposition to S. 2041, The False Claims Act Corrections Act of 2007) (discussing this case and estimating the cost of defense).

[219] *See* United States *ex rel*. Thompson v. Columbia/HCA Healthcare Corp., 20 F. Supp. 2d 1017, 1041 (S.D. Tex. 1998).

[220] *Rx for the Health Care System*, WALL ST. J., Oct. 8, 1998, at A18.

[221] Courts had relied on the intent requirement, which was repealed in the FERA amendments, to reject implied false certification claims. *See* Tschoepe, *supra* note 179, at 764; *see also* Susan C. Levy, Daniel J. Winters & John R. Richards, *The Implied Certification Theory: When Should the False Claims Act Reach Statements Never Spoken or Communicated, but Only Implied?*, 38 PUB. CONT. L.J. 131, 132, 139 (2008) (observing that implied certification theory has emerged in recent years to potentially widen the scope of the FCA).

[222] In recognition of this fact, if an entity identifies fraud, self-reports, and rights the wrong committed, it will receive reduced penalties. Compliance programs can reduce penalties up to ninety-five percent, so there is a strong financial incentive for companies to "do the right thing." *See* James F. Gunn, Evan R. Goldfarb & J. Stuart Showalter, *Creating a Corporate Compliance Program: Steps to a Program that Reinforces Mission and Protects the Organization*, HEALTH PROGRESS, May-June 1998, at 61.

[223] *See, e.g.,* VANGUARD HEALTH SYSTEMS, COMPLIANCE REFERENCE MATERIAL (Oct. 31, 2011), http://www.dmc.org/upload/docs/Compliance%20Manual%20112211.pdf, *archived at* http://perma.cc/PU9Y-6LF.

For example, the Department of Health and Human Services Office of the Inspector General publishes Compliance Guidance Programs for hospitals, pharmaceutical manufacturers, nursing facilities, and small physician offices that receive Medicare and Medicaid funding.[224]

Integrating DOJ investigations, whistleblowing, and responsible corporate compliance into a cohesive FCA enforcement regime can help achieve two important FCA enforcement goals. First, it can create a better dragnet for preventing and capturing some of the $72 billion in fraud that the Government Accountability Office has estimated is costing the U.S. Government, plus the $61 billion that fraud is estimated to cost Medicare on an annual basis.[225] It also can reduce wasteful spending of valuable time and resources on the "parasitic" lawsuits that have long plagued the FCA. Rather than focusing on increasing the number of *qui tam* claims, which the recent reforms have done, Congress should return to the historic goal of increasing quality FCA claims while meaningfully reducing the opportunities for *qui tam* abuse.[226]

The most fundamental change Congress should make is to require a whistleblower to report a suspected violation, either to DOJ or through their employer's compliance program, before a *qui tam* action could be filed. If the reporting is made to DOJ initially, the government would still have the opportunity to investigate the claim before alerting the company of the allegation. It could then share its findings with the company, presuming the company has a competent compliance program, and give the company the opportunity to resolve the claim administratively rather than through litigation. If the reporting is made to the responsible compliance officer within the company, he or she should be obligated to alert DOJ of the allegation, investigate the claim, report findings to DOJ, and take appropriate actions. This would include safeguarding the "whistleblower" from retaliation, correcting any problems that exist internally, and paying restitution to the appropriate agency plus any civil fines.

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[224] *See, e.g.,* OIG Compliance Program Guidance for Hospitals, 63 Fed. Reg. 8987 (Feb. 23, 1998); OIG Compliance Program Guidance for Pharmaceutical Manufacturers, 68 Fed. Reg. 23,731 (May 5, 2003); OIG Compliance Program Guidance for Nursing Facilities, 65 Fed. Reg. 14,289 (March 16, 2000).

[225] *See* U.S. GOV'T ACCOUNTABILITY OFF., GAO-09-628T, IMPROPER PAYMENTS: PROGRESS MADE BUT CHALLENGES REMAIN IN ESTIMATING AND REDUCING IMPROPER PAYMENT (Apr. 22, 2009) ("The fiscal year 2008 total improper payment estimate of $72 billion reported for fiscal year 2008 did not include any estimate for ten programs—including the Medicare Prescription Drug Benefit program—with fiscal year 2008 outlays totaling about $61 billion that were identified as susceptible to significant improper payments."); AARP, *AARP's Inside E Street: Medicare Fraud*, YOUTUBE (Oct. 29, 2010), http://www.youtube.com/watch?v=SZZrAhSgI4k, *archived at* http://perma.cc/WK8L-6EZ2.

[226] *See* Graham Cnty. Soil & Water Conservation Dist. v. United States *ex rel*. Wilson, 559 U.S. 280, 293 (2010) (acknowledging that the historic goal of the FCA is to achieve "the golden mean between adequate incentives for whistle-blowing insiders . . . and discouragement of opportunistic plaintiffs who have no significant information to contribute of their own").

With either path, a company with a qualified compliance program would be given the opportunity to effectively and efficiently resolve a claim, both internally and with the government. Studies have shown that once facts are uncovered in an investigation, the amounts in dispute are usually reduced because there is a better "understanding of the complexity of the charge" and accounting methods often associated with government contracting.[227] But, if a company does not have such a program or fails to respond appropriately or within a specific time, DOJ could give the relator the green light to file a *qui tam* action.[228] Under such a system, FCA litigation with heightened penalties would be reserved for companies who are not willing to resolve suspected FCA violations in a satisfactory manner. It would still be a powerful "stick."

Congress and DOJ would need to make several accommodations to implement such a program. First, they would need to specify the types of compliance programs companies would need to implement to earn this "carrot." As discussed in detail in the section of this article on FCPA reform, Congress and DOJ can require companies to take specific measures to prevent fraud and set a culture from the top that violating the FCA is not acceptable business practice. This may include written codes of conduct for all employees, training and educating employees to encourage compliance, and internal auditing to identify any FCA violations.[229] In addition, the responsible compliance officer in a company for receiving claims may have to be in the compliance department so that an employee can report suspicions to someone outside of his or her chain of command. The company also may need procedures for protecting the whistleblower, with respect to keeping his or her identity undisclosed when needed and assuring that there is no retribution for a reported claim.

Further, the "first to file" criteria would have to be changed so that it is satisfied when the relator reports a suspected violation, not when a lawsuit is

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[227] Letter to Senate Judiciary Chairman Patrick Leahy Regarding S. 2041, the False Claims Correction Act of 2007, Association of American Universities, Mar. 31, 2008, *available at* http://www.nacua.org/documents/FalseClaimsAct_EffectOnHigherEd.pdf, *archived at* http://perma.cc/PK4Z-WKSV (expressing "reservations of the university community about unintended consequences associated with the new authorities provided for in S. 2041, the False Claims Correction Act of 2007").

[228] The U.S. Chamber's report on False Claims Act reforms suggests that a relator must wait 180 days after reporting a claim before being vested with the private right of action to sue the company for the violation. U.S. CHAMBER INST. FOR LEGAL REFORM, FIXING THE FALSE CLAIMS ACT: THE CASE FOR COMPLIANCE-FOCUSED REFORMS (Oct. 2013), http://www.instituteforlegalreform.com/uploads/sites/1/Fixing_The_FCA_Pages_Web.pdf, *archived at* http://perma.cc/75WB-DMD9.

[229] *See, e.g.,* Memorandum from Craig S. Morford, Acting Deputy Att'y Gen., U.S. Dep't of Justice, to Heads of Dep't Components, U.S. Att'ys Regarding Selection and Use of Monitors in Deferred Prosecution Agreements with Corps., U.S. Att'ys' Manual, Title 9, Criminal Resource Manual § 163 (Mar. 7, 2008), *available at* http://www.justice.gov/usao/eousa/foia_reading_room/usam/title9/crm00163.htm, *archived at* http://perma.cc/CM49-6EPK; CIVIL PROSECUTION COMM. OF THE N.Y. STATE BAR ASS'N COMMERCIAL & FED. LITIG. SECTION, THE INDEPENDENT PRIVATE SECTOR INSPECTOR GENERAL (2005).

filed. Again, reporting can be done to the agency, DOJ, or the responsible corporate officer, which would trigger self-reporting obligations. The relator would still be entitled to a bounty for uncovering a violation that has merit. Another important change is to calibrate the penalties available with the level of violation alleged.[230] For example, for technical violations, such as false certifications, treble damages and high per incident fines are inappropriate. Lowering the stakes for lesser conduct is consistent with the FCA's purpose of punishing criminal or quasi-criminal conduct, not trapping people in record-keeping discrepancies or allowing relators to manufacture claims.

From an FCA perspective, the benefit of this "carrot and stick" approach is that it will allow the government to leverage both whistleblowers and corporate resources, not just whistleblowers, to root out fraud. It also will give parties a valuable chance to work out a regulatory or business dispute without resorting to litigation and encourage companies to promptly and appropriately address FCA allegations to an enforcement action.

III. Punitive Damages and Compliance with Government Regulations

The parallel in civil litigation to the penal structure of the FCPA and FCA is punitive damages. In federal and state litigation, economic and noneconomic compensatory damages help assure that an injured person is made whole for an injury that was wrongfully caused by the defendant. Liquidated damages serve a similar role in breach of contract disputes, and statutory damages help enforce regulations. When a defendant's wrongdoing, though, is particularly reprehensible such that he has "evil motives" or demonstrates "reckless indifference to the rights of others," punitive damages can be made available in most jurisdictions to punish the wrongdoer and deter such unlawful conduct in the future.[231] In this regard, many states treat punitive damages akin to criminal liability, requiring a heightened burden of proof, such as clear and convincing evidence, and putting limits on the awards to guard against over-punishment.[232]

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[230] The FCA already rewards effective compliance and cooperation with the government by permitting courts to reduce the amount of penalties to double the damages which the government sustained; similar reductions should be based on the severity of the allegations. *See* 31 U.S.C. §§ 3729(a)(3), 3730(d) (2012).

[231] Restatement (Second) of Torts § 908 (1979); *see* State Farm Mut. Auto. Ins. Co. v. Campbell, 538 U.S. 408, 416 (2003) (recognizing that the purpose of punitive damages is to punish specific wrongdoers, deter them from committing wrongful acts again, and deter others in similar situations from committing wrongful behavior).

[232] *See*, *e.g.*, Alaska Stat. § 09.17.020 (requiring "clear and convincing evidence" and limiting them to three times compensatory damages or $500,000 for physical injuries); Colo. Rev. Stat. § 13-21-102(1)(a) (providing that punitive damages may not exceed compensatory damages); Colo. Rev. Stat. § 13-25-127(2) (proof "beyond a reasonable doubt"); Ga. Code Ann. § 51-12-5.1 (also requiring "clear and convincing evidence" and limiting them to $250,000 unless the plaintiff demonstrated that the defendant acted with specific intent to harm).

In individual cases, though, particularly where liability is based on common law torts, punitive damages have been allowed in lesser situations, even when the product or service at issue is both governed by and compliant with federal or state regulations.[233] With these products and services, a judgment often has to be made about how safe to make the product or service, or how the product's or service's inherent risks can be managed. For example, how flame retardant should children's pajamas be, or what types of warnings are appropriate for prescription drugs to carefully and accurately describe the risk-benefit profile of that drug?[234] In these situations, all risk cannot be eliminated, meaning that some people are likely to sustain injuries from the product or service. The company's goal, therefore, is to develop designs and warnings that find the proper balance among several factors, including safety, utility, and affordability. Regardless of a company's effort to strike the right balance, though, a plaintiff can generally argue that the product or service could have been made safer in a way that would have prevented his or her injury. When trying to prove punitive damages, the plaintiff can often point to the company's internal discussions about how it made these judgments, which can come across as callous or calculated when viewed in hindsight and in the context of the injured plaintiff.

When there are government standards on point, the purpose of the standards is to establish an acceptable level of risk for the product or service at issue. In the examples above, Congress enacted the Flammable Fabrics Act to set forth a test to determine whether a fabric is dangerous when used in clothing, and the Food and Drug Administration (FDA) approves each drug's design and warnings as "safe and effective" for use.[235] Yet, when courts have allowed punitive damages in trials involving someone injured by such a product or service, juries have awarded them. Juries have found, for example, that even though the company fully complied with the applicable federal or state government standards, it still demonstrated "malicious and deceptive" or "grossly negligent" conduct in choosing the product's designs and warnings.[236]

Other courts have found that this outrage is misplaced. They have held that companies who are compliant with the law are, by definition, not involved in "flagrant" or "criminal" conduct,[237] and that the penal "stick" of

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[233] *See, e.g.*, Silkwood v. Kerr-McGee Corp., 769 F.2d 1451 (10th Cir. 1985) (presuming that Oklahoma would permit punitive damages for conduct compliant with government safety standards based on a case involving negligence); Gryc v. Dayton-Hudson Corp., 297 N.W.2d 727 (Minn. 1980) (determining that compliance with the Flammable Fabrics Act does not preclude punitive damages); Wyeth v. Rowatt, 244 P.3d 765 (Nev. 2010) (holding that compliance with FDA approval does not preclude punitive damages).

[234] *See* Gryc, 297 N.W.2d at 727 (flammability of clothing); Rowatt, 244 P.3d at 765 (prescription drugs).

[235] *See* Gryc, 297 N.W.2d at 733; Rowatt, 244 P.3d at 789–81.

[236] Rowatt, 244 P.3d at 783–84.

[237] *See*, *e.g.*, *In re* Miamisburg Train Derailment Litigation, 725 N.W.2d 738 (1999) ("No reasonable person could reconcile the appellees' compliance with the regulation in question with the notion that their behavior was somehow 'outrageous,' 'flagrant,' or 'criminal.'").

punitive damages is categorically not appropriate in these cases. As with the FCPA and FCA claims, unfair punitive liability can cause companies to settle cases and pay higher demands rather than risk losing at trial.[238] As the Supreme Court of the United States has warned, penalizing a company through punitive damages can also contradict a company's "good faith efforts" to comply with the law and "reduce the incentive" for employers to invest in programs that prevent, investigate, and remediate wrongful conduct.[239] Damages that punish serve no legitimate public policy purpose in these lawsuits.[240]

A. Impact of Regulation of Products and Services on Litigation

The liability impact of regulations has become an increasingly important issue over the past several decades because America has entered a new era of government regulation. Regulatory agencies have increased their presence in safeguarding the public, namely through issuing product safety standards, approving the design and labeling of certain products, and regulating workplace and sales practices. As discussed above, FDA approves prescription drugs and medical devices as safe and effective.[241] The National Highway Traffic Safety Administration (NHTSA) develops Federal Motor Vehicle Safety Standards that require vehicles to meet crashworthiness standards. Its regulations require seatbelts, airbags, windshields, headlights and signals, door beams, roofs, steering columns, tires, and door locks, latches and hinges to meet certain safety performance standards.[242] The Occupational Safety and Health Administration (OSHA) sets workplace safety requirements for the use of protective equipment, product labeling, and exposure of hazardous chemicals,[243] and the Consumer Product Safety Commission (CPSC) has mandatory safety standards for products such as baby bouncers, bike helmets, bunk beds, cribs, and various aspects and types of

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[238] In 2011, DOJ's Bureau of Justice Statistics found that while punitive damages were sought in 12% of all tort and contract trials, this number increased to 16% in cases where individuals were suing corporate defendants. Punitive damages were awarded in 33% of these cases. U.S. DEP'T OF JUSTICE, BUREAU OF JUSTICE STATISTICS, PUNITIVE DAMAGE AWARDS IN STATE COURTS, THOMAS COHEN AND KYLE HARBACEK, 2005 (2011).

[239] Kolstad v. Am. Dental Assoc., 527 U.S. 526, 528 (1999).

[240] Professor Dan Dobbs has explained in his well-respected hornbook that punitive damages are treated differently from compensatory damages in cases involving vicarious liability for criminal acts of employees because compensatory damages are not based on culpability: "it is just that [the company], rather than the innocent injured plaintiff," is better able to absorb the costs of the harm. DAN B. DOBBS, THE LAW OF TORTS, at 500–01 (2000).

[241] *See* U.S. FOOD AND DRUG ADMIN., DRUG SAFETY AND AVAILABILITY, http://www.fda.gov/Drugs/DrugSafety/default.htm, *archived at* http://perma.cc/QS2H-BFWH (last updated April 3, 2014); *see also* Victor E. Schwartz, Cary Silverman, Michael J. Hulka & Christopher E. Appel, *Marketing Pharmaceutical Products in the Twenty-First Century: An Analysis of the Continued Viability of Traditional Principles of Law in the Age of Direct-To-Consumer Advertising*, 32 HARV. J. L. & PUB. POL'Y 333 (2009) (discussing FDA drug evaluation process).

[242] *See* 49 C.F.R. § 571 (2013).

[243] *See* 29 C.F.R. § 1910 (2013).

toys.[244] The Environmental Protection Agency (EPA) similarly regulates corporate conduct with respect to air, water, and land pollution. States provide comparable regulations for insurance agents and brokers,[245] and public utility companies.[246]

These consumer, safety, health, and environmental standards do not eliminate all risk, but represent a careful weighing of interests. Government regulators may have to balance the needs of different types of consumers, choosing which risks are most likely to occur and how these risks can be prevented. Consequently, a suggested safety feature may make a product "safer" in one respect, but not in others, or may even cause a certain type of risk.[247] For example, when front airbags in cars were first developed, they prevented and mitigated injury from head-on collisions, but not other types of accidents; they also caused harm to children and others who sat low in the passenger seat.[248] As with front airbags, government regulators will sometimes allow manufacturers to pursue different approaches in order to encourage innovative solutions and give manufacturers the opportunity to use real-time results to adjust their safety systems in an effort to maximize the benefit for the most people.[249] When they decide it is time to issue a standard, government regulators will weigh and balance known risks through notice and comment rulemaking so they can hear from experts, evaluate data, engage in risk-benefit analyses, and gain the perspective of the consuming public as a whole.[250]

As a result of this process, regulators may not require, for example, a safety measure that, while effective, is too costly. They may conclude that

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[244] *See Regulations*, U.S. CONSUMER PROD. SAFETY COMM'N, http://www.cpsc.gov/en/Regulations-Laws--Standards/Regulations-Mandatory-Standards--Bans/Regulated-Products/, *archived at* http://perma.cc/Q4FP-GVWE (last visited Nov. 21, 2013) (providing list of mandatory standards).

[245] *See* McCarran-Ferguson Act of 1945, 15 U.S.C. §§ 1011 (providing that state law regulates the "business of insurance" unless federal law specifically provides otherwise).

[246] *See* National Ass'n of Regulatory Utility Commissioners, FEDERAL GOVERNMENT COLLABORATIVES, http://www.naruc.org/Policy/federal.cfm, *archived at* http://perma.cc/RK-M7EF (last visited Nov. 21, 2013) (noting that this non-profit organization, which represents state public service commissions that regulate the utilities, including energy, telecommunications, water, and transportation services, works in collaboration with the Federal Energy Regulatory Commission and Federal Communications Commission).

[247] *See* Geier v. American Honda Motor Co., Inc., 529 U.S. 861 (2000).

[248] *See Air Bag Deployment*, U.S. DEPT. OF TRANSP., http://www.safercar.gov/Vehicle+Shoppers/Air+Bags/Air+Bag+Deployment, *archived at* http://perma.cc/8AV3-DQCM (last visited March 22, 2014).

[249] As the latest Restatement on product design liability states: "Society does not benefit from products that are excessively safe – for example, automobiles designed with maximum speeds of 20 miles per hour – any more than it benefits from products that are too risky. Society benefits the most when the right, or optimal amount of product safety is achieved." RESTATEMENT (THIRD) OF TORTS: PRODS. LIAB. § 2 cmt. a (1998) [hereinafter RESTATEMENT (THIRD)].

[250] *See* Geier, 529 U.S. at 879 (favorably quoting the Department of Transportation's explanation in its brief to the court that "a mix of [passive restraint] devices would help develop data on comparative effectiveness" for airbags, automatic seatbelts, or other passive restraints that automakers may develop for meeting federal performance standards).

mandating its use could price the product out of the reach of many consumers or result in more consumers purchasing a less-safe alternative, both of which would reduce overall safety. Every car could be made as safe as a military tank, but automakers are "not required to supply an accident proof product," or there would be no cars available at a price most people could afford.[251] Warnings and disclosures on products and consumer contracts face similar pressures. Warnings can always be made stronger and lengthier, but regulators seek to find the right balance so that warnings are followed and not ignored.[252] It would provide little guidance to physicians and their patients if FDA required a black box around every potential side effect of a prescription medicine; these warnings are to be reserved for only the most serious and likely to occur.[253] Regulators generally seek the optimal achievable result.

B. Movement Toward Regulatory Compliance Defenses in Litigation

Over the past several decades, scholars, courts, and business advocates have suggested that regulatory compliance should play a more significant role in evaluating liability.[254] Much of this debate has centered on the role of regulatory compliance on compensatory damages, not just punitive damages. In these cases, plaintiffs allege that even though the product or service at issue was compliant with applicable regulations, the defendant breached its duty of reasonable care to the plaintiff, through negligence, product defect, or other tort.[255] Some courts have allowed such claims to proceed, reasoning that the government regulations at issue provided only the "minimum standards" that the company had to use; a jury could decide that a reasonably prudent company would have done more to protect its customers.[256] Other courts have given compliance with standards weight, even if it is not conclu-

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[251] *See, e.g.*, Featherall v. Firestone Tire & Rubber Co., 252 S.E.2d 358, 367 (Va. 1979).

[252] *See* Victor E. Schwartz & Christopher E. Appel, *Effective Communication of Warnings in the Workplace: Avoiding Injuries in Working with Industrial Materials*, 73 Mo. L. Rev. 1, 9–10 (2008) (discussing need for balanced approach to product warnings).

[253] *See* 21 C.F.R. § 201.57(c)(1) (2006) (providing that FDA may require a "black box" warning if a drug requires "certain contraindications or serious warnings, particularly those that may lead to death or serious injury"); *see also* U.S. Food & Drug Admin., FDA Consumer Health Info., A Guide to Drug Safety Terms at FDA (2012), *available at* http://www.fda.gov/ForConsumers/ConsumerUpdates/ucm107970.htm, *archived at* http://perma.cc/AW73-6ML4.

[254] *See, e.g.*, Richard C. Ausness, *The Case for a Strong Regulatory Compliance Defense*, 55 Md. L. Rev. 1210, 1253–57 (1996) (arguing "a regulatory compliance defense must fully protect manufacturers from liability when their products meet applicable federal design, testing, or labeling requirements").

[255] Victor E. Schwartz, et al., *"That's Unfair!" Says Who – The Government or Litigant?: Consumer Protection Claims Involving Regulated Conduct*, 47 Washburn L.J. 93 (2007).

[256] *See* Ausness, *supra* note 254 at 1241–47.

sive as to whether a company breached its duty of care.[257] Still others have found that government safety standards can set the standard of reasonable care for a product or service, holding that if a company meets that standard of care, it is not subject to any tort liability, even compensatory damages.[258]

The American Law Institute, a well-respected organization composed of judges, lawyers, and law professors, provides a useful common law framework for making this determination.[259] Commentary included in the ALI's Restatement Third suggests that a product should be considered non-defective as a matter of law "when the safety standard or regulation was promulgated recently, thus supplying currency to the standard therein established; when the specific standard addresses the very issue of product design or warning presented in the case before the court; and when the court is confident that the deliberative process by which the safety standard was established was full, fair, and thorough and reflected substantial expertise."[260] Conversely, there would be no liability protection "when the deliberative process that led to the safety standard . . . was tainted by the supplying of false information to, or the withholding of necessary and valid information from, the agency that promulgated the standard or certified or approved the product."[261] As the Restatement Third recognizes, courts often cite compli-

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[257] *See, e.g.*, Sims v. Washex Mach. Corp., 932 S.W.2d 559 (Tex. App. 1995) ("Compliance with government regulations is strong evidence, although not conclusive, that a machine was not defectively designed."); *see* RESTATEMENT (THIRD) § 4 cmt. d.

[258] *See, e.g.*, Lorenz v. Celotex Corp., 896 F.2d 148 (5th Cir. 1990) (compliance with safety regulation is strong and substantial evidence of lack of defect); Dentson v. Eddins & Lee Bus Sales, Inc., 491 So.2d 942, 944 (Ala. 1986) (ruling a school bus not equipped with seatbelts is not defective when the legislature has not required seatbelts); Ramirez v. Plough, Inc., 863 P.2d 167, 176 (Cal. 1993) (concluding that "the prudent course is to adopt for tort purposes the existing legislative and administrative standard of care); Beatty v. Trailmaster Prods., Inc., 625 A.2d 1005, 1014 (Md. 1993) ("[W]here no special circumstances require extra caution, a court may find that conformity to the statutory standard amounts to due care as a matter of law.").

[259] This common law analysis is separate and apart from preemption, a constitutional issue arising under the Supremacy Clause. In some circumstances, federal preemption may provide a defense to liability when the aspect of the product claimed defective in a lawsuit was approved by a federal agency or is compliant with federal standards. *See generally* Victor E. Schwartz & Cary Silverman, *Preemption of State Common Law by Federal Agency Action: Striking the Appropriate Balance that Protects Public Safety*, 84 TULANE L. REV. 1203 (2010).

[260] *See* RESTATEMENT (THIRD), *supra* note 257, at § 4 cmt. e.

[261] *Id.* In a study that preceded the RESTATEMENT (THIRD), an ALI reporter recommended that compliance with regulatory requirements preclude tort liability when (1) a legislature placed the risk under the authority of a specialized administrative agency; (2) the agency established and periodically revised safety controls; (3) the manufacturer complied with the relevant regulatory standards; and (4) the manufacturer disclosed to the agency material information in its possession or of which it has reason to be aware concerning the products' risks and means of controlling them. *See* 2 AM. LAW INST., REPORTER'S STUDY, ENTERPRISE RESPONSIBILITY FOR PERSONAL INJURY 96–97 (1991); *see also* Richard B. Stewart, *Regulatory Compliance Preclusion of Tort Liability: Limiting the Dual Track System*, 88 GEO. L.J. 2167, 2168–70 (2000).

ance with safety regulations as a factor when reaching a directed verdict for a defendant.[262]

In recent years, states' legislatures have begun providing this "carrot" by statute. Some states require courts to instruct juries, for example, that compliance with government standards are to be given special weight in evaluating compensatory liability. Several states have gone further, providing by statute that compliance with federal or state government safety regulations creates a "rebuttable presumption" that a product is not defective.[263] In Kansas, a jury may impose liability for a compliant product only if the plaintiff "proves by a preponderance of the evidence that a reasonably prudent product seller could and would have taken additional precautions."[264] Similarly, under state consumer protection acts, whether or not a company was compliant with the applicable federal or state regulations is to be considered when determining whether the conduct at issue was unfair or deceptive.[265] Together, these statutes have started a foundation for integrating government regulations, standards, and terms of approvals with liability.[266]

C. Punitive Damages and Regulatory Compliance

Notwithstanding this "big carrot" debate over the impact of government regulations on all liability, a growing number of states have enacted laws offering a "baby carrot" to companies by at least precluding punitive damage awards when the aspect of the product or service at issue in a lawsuit was approved by government regulators or complied with safety standards. These courts and legislatures have determined that it is unfair to impose quasi-criminal punishment on a business whose product or service fully complied with government regulations, but nonetheless caused injury.[267] As the Supreme Court of Georgia has explained: "To allow punitive

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[262] *See* RESTATEMENT (THIRD), *supra* note 257, at § 4 cmt. e (citing Hawkins v. Evans Cooperage Co., 766 F.2d 904, 909 (5th Cir. 1985)).

[263] COLO. REV. STAT. § 13-21-403(2) (2003); KAN. STAT. ANN. § 60-3304(a) (1981); KY. REV. STAT. ANN. § 411.310(2) (1978); MICH. COMP. LAWS § 600.2946(4) (1995); TENN. CODE ANN. § 29-28-104(a) (2011); TEX. CIV. PRAC. & REM. CODE ANN. § 82.008(a), (c) (2003); UTAH CODE ANN. § 78B-6-703(2) (2008). At least two additional states, Arkansas and Washington, specifically provide by statute that parties may introduce evidence of regulatory compliance to show that a product is not defective or that its warnings are not inadequate. *See* ARK. CODE ANN. § 16-116-105(a) (1979); WASH. REV. CODE § 7.72.050(1) (2013). These statutes do not assign any particular evidentiary weight to compliance with safety standards.

[264] KAN. STAT. ANN. § 60-3304(a).

[265] *See generally* Schwartz & Silverman, *supra* note 241, at 93.

[266] *See, e.g.,* COLO. REV. STAT. § 13-21-403(4). Most states with such laws apply the preemption to compliance with both federal and state government standards. *See, e.g.,* COLO. REV. STAT. § 13-21-403(1); KAN. STAT. ANN. § 60-3304(a); TENN. CODE ANN. § 29-28-104(a); UTAH CODE ANN. § 78B-6-703(2). *But cf.* TEX. CIV. PRAC. & REM. CODE ANN. § 82.008(a), (c) (applying the presumption only in cases involving a federal agency standard or approval).

[267] Cooper Indus. v. Leatherman Tool Group, Inc., 532 U.S. 424, 432 (2001) (quoting Pacific Mut. Life Ins. Co. v. Haslip, 499 U.S. 1, 19 (1991)) (recognizing that punitive damages are "quasi-criminal" in nature and "operate as 'private fines' intended to punish the defendant

damages in a case . . . where the offender has taken all the steps required by the supervising state authority and has expended substantial sums in doing so, would make the standard 'conscious indifference to consequences' a requirement without substance."[268]

The most common statutory regulatory compliance defenses to punitive damages apply to FDA approved products, such as prescription drugs and medical devices, when the lawsuits challenge the design or labeling of a product that received specific FDA approval.[269] New Jersey's law extends this protection to food or food additives that are approved or licensed by FDA or generally recognized as safe and effective under FDA regulations.[270] Oregon limits this protection to FDA-approved drugs.[271] Ohio recently expanded its prescription-drug-only law to include medical devices and over-the-counter drugs.[272]

These laws generally allow punitive damages when the plaintiff can show that the manufacturer "knowingly withheld or misrepresented information" required to be submitted to the FDA, and that information was "material and relevant" to the injury in the case.[273] Arizona, Oregon, and Utah require a plaintiff to show by clear and convincing evidence that the manufacturer withheld or misrepresented such information, which is the standard for punitive damages generally.[274] Ohio requires a plaintiff only to meet a preponderance-of-the-evidence standard when presenting such information.[275] Also, some states provide that punitive damages remain available

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and deter future wrongdoing"); *see* Avery v. State Farm Mut. Auto. Ins. Co., 835 N.E.2d 801 (Ill. 2005) (overturning verdict, finding the claim could not be maintained as a class action); Victor E. Schwartz & Leah Lorber, *State Farm v. Avery: State Court Regulation Through Litigation has Gone Too Far*, 33 CONN. L. REV. 1215 (2001) (discussing $1.2 billion award, including $600 million in punitive damages, against insurer that used generic parts to repair damaged vehicles, a practice permitted in all jurisdictions at issue).

[268] General Refractories Co. v. Rogers, 239 S.E.2d 795, 799–800 (Ga. 1977).

[269] ARIZ. REV. STAT. 12-701; N.J. STAT. ANN. § 2A:58C-5c; OHIO REV. CODE ANN. § 2307.80(D); OR. REV. STAT. § 30.927; TENN. CODE ANN. § 29-39-104(d); UTAH CODE ANN. § 78-18-2(1).

[270] *See* N.J. STAT. ANN. § 2A:58C-5c; McDarby v. Merck & Co., Inc., 949 A.2d 223, 271–276 (N.J. Super. Ct. App. Div. 2008) (affirming this provision and determining that, in accordance with Buckman Co. v. Plaintiffs' Legal Comm., 531 U.S. 341 (2001), there needs to be a determination by FDA that the pharmaceutical manufacturer committed fraud on the FDA in order to trigger the presumption against punitive damages under the New Jersey statute).

[271] *See* OR. REV. STAT. § 30.927.

[272] *See* Am. Sub. S.B. 80, OHIO LAWS FILE 144 (2005) (amending OHIO REV. CODE ANN. § 2307.80).

[273] N.J. STAT. ANN. § 2A:58C-5c.

[274] *See id.* § 30.927(2); ARIZ. REV. STAT. ANN. § 12-701(B); Kobar *ex rel.* Kobar v. Novartis Corp., 378 F. Supp. 2d 1166 (D.Ariz. 2005); UTAH CODE ANN. § 78B-18-202 (affirming this provision and determining that, in accordance with Buckman Co. v. Plaintiffs' Legal Comm., 531 U.S. 341 (2001), there needs to be a determination by FDA that the pharmaceutical manufacturer committed fraud on the FDA in order to trigger the presumption against punitive damages under the New Jersey statute).

[275] OHIO REV. CODE ANN. § 2307.80(C)(2).

when a manufacturer intentionally fails to conduct a recall ordered by a state or federal agency.[276]

The most recent states to enact a compliance defense for punitive damages are Tennessee and Arizona. Both of these statutes are fairly broad. The Tennessee Civil Justice Act of 2011[277] states:

> Punitive damages shall not be awarded in any civil action when a defendant demonstrates by a preponderance of the evidence that it was in substantial compliance with applicable federal and state regulations setting forth specific standards applicable to the activity in question and intended to protect a class of persons or entities that includes the plaintiff, if those regulations were in effect at the time the activity occurred.[278]

In 2012, Arizona enacted a statute explicitly applying a similar punitive damage defense to all manufacturers, service providers, or sellers.[279] Businesses are not subject to punitive damages if the product at issue was sold in accordance with the terms of approval of a government agency, the product or service was provided in accordance with government regulations or standards, or the act or transaction forming the basis of the claim involves terms of service that were authorized by, or in compliance with the rules of, a government agency.[280] These laws recognize that a company should not be punished when it follows the law.

Opponents of these laws have suggested that these laws encourage "bad behavior."[281] But, this has not occurred and, in fact, no state that has given this "carrot" has repealed it.[282] Conversely, eliminating the potential for punitive damages provides a strong incentive to companies to meticulously fulfill regulatory obligations.

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[276] *See* OHIO REV. CODE ANN. § 2307.80(C)(2).

[277] TENN. CODE ANN. § 29-39-104(d).

[278] *Id.* § 29-39-104(e). Another provision of the Tennessee Civil Justice Act of 2011 specifically precludes punitive damages with respect to products in compliance with government standards. *See also* TENN. CODE ANN. § 29-28-104(b) (providing that a manufacturer or seller, other than a manufacturer of a drug or device, is not liable for punitive damages if the product at issue was sold in accordance with the terms of approval of a government agency or complied with government standards relevant to the event or risk allegedly causing the harm unless the product was sold after a government-ordered recall or the manufacturer or seller withheld or misrepresented material information to the government during the approval process).

[279] *See* ARIZ. REV. STAT. § 12-689 (2012) (added by H.B. 2503 (Ariz. 2012)).

[280] *See id.*

[281] *See* EMILY GOTTLIEB, CTR. FOR JUSTICE & DEMOCRACY, WHAT YOU NEED TO KNOW ABOUT . . . PUNITIVE DAMAGES, at 4 (2011).

[282] Empirical research suggests that restrictions on punitive damages do not impact behavior or public safety. *See*, *e.g.*, SEARLE CIVIL JUSTICE INST., WHAT DO WE KNOW ABOUT PUNITIVE DAMAGE CAPS? A REVIEW OF THE EMPIRICAL LITERATURE (2013), *available at* http://masonlec.org/site/rte_uploads/files/Punitive%20Damage%20Caps%20(Final%20-%205.31).pdf, *archived at* http://perma.cc/53BG-5LUB (examining the results of studies considering the impact of statutory limits on punitive damages).

Indeed, exposure to punitive damage liability when the company complied with the applicable regulations can lead to unfair liability. As referenced above, in addition to inflating trial verdicts, the threat of potentially having to pay punitive damages[283] also inflates settlement values beyond amounts that might legitimately compensate a plaintiff for an injury.[284] The Bureau of Justice Statistics has found that in cases where an individual is suing a company, punitive damages are awarded thirty-three percent of the time they are requested.[285] In some judicial environments, a plaintiff's lawyer may even eschew a commonsense settlement, betting that a sympathetic plaintiff can garner a large punitive damage award against a large corporate defendant in an industry with a poor reputation or that is viewed as a "deep pocket." Further, some companies are repeatedly exposed to punitive damages when a product, such as a medicine, has inherent risks and allegedly caused harm to multiple individuals.[286] Again, these damages are above and beyond the damages required to make the plaintiff whole and meant solely to punish the defendant. When the company complied with the regulations, which again are designed to carefully balance multiple and sometimes competing factors, penalizing the company is not needed to punish or deter the conduct at issue.

The issue of regulatory compliance defense for punitive damages can arise in both federal and state courts and under either federal or state law. Courts and legislatures should consider joining the emerging effort to ban, or at least raise the bar on when, punitive damages can be available for compliant conduct in order to give companies added incentives to meet government standards.[287]

IV. Conclusion

Harsh penalties against criminal and quasi-criminal conduct play an important role in an orderly society. They punish individuals and companies

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[283] As the Supreme Court has recognized, the "real problem" with punitive damages is their "stark unpredictability"—"the spread is great, and the outlier cases subject defendants to punitive damages that dwarf the corresponding compensatories." Exxon Shipping Co. v. Baker, 554 U.S. 471, 499–500 (2008).

[284] *See* Dunn v. HOVIC, 1 F.3d 1371, 1398 (3d Cir. 1993) (Weis, J., dissenting), *modified in part*, 13 F.3d 58 (3d Cir. 1993) ("[T]he potential for punitive awards is a weighty factor in settlement negotiations and inevitability results in a larger settlement agreement than would ordinarily be obtained. To the extent that this premium exceeds what would otherwise be a fair and reasonable settlement for compensatory damages, assets that could be available for satisfaction of future compensatory claims are dissipated.").

[285] Cohen & Harbacek, *supra note* 238.

[286] *See* Victor E. Schwartz & Leah Lorber, Nat'l Legal Ctr. for the Pub. Int., Death by a Thousand Cuts: How to Stop Multiple Imposition of Punitive Damages (2003).

[287] *See* Victor E. Schwartz, Phil Goldberg, et al., Am. Legis. Exch. Council, State Legislative Action on the Impact of Federal and State Safety Regulations on Liability Has Greater Importance Following U.S. Supreme Court Ruling (2009) (listing states that have recognized some version of a regulatory compliance defense).

that cross the bounds of acceptable behavior and deter others from doing so out of fear that they may suffer the same debilitating fate. Strong penalties may also be a needed deterrent when the likelihood of catching a scofflaw is low, as was the case in Civil War times when the FCA was initially enacted and the 1970s and 1980s when the FCPA was not broadly enforced.

The rise of compliance programs as extensions of law enforcement within corporate America and the expanded enforcement of both acts have fundamentally shifted this paradigm. The same is true in civil litigation given the broad expansion of regulations for products and services in the past few decades. When a company diligently and in good faith works with the government and adheres to their standards, these punishments, as well as the threat of these punishments, are not appropriate. They can distort legal outcomes, lead to abusive litigation, and frustrate the purpose of the underlying laws themselves.

Congress, DOJ, state legislatures and courts should balance the unforgiving "sticks" in the FCPA, FCA and punitive damages with targeted "carrots." This is the best way to institutionalize and incentivize the right corporate behaviors and avoid trespassing on the fundamental principle of "American Fairness" that American jurisprudence seeks to achieve.