

February 3, 1997

MEMORANDUM

TO: All Fraud Attorneys

FROM: Michael F. Hertz
Director
Commercial Litigation Branch
Civil Division

RE: Settlement Agreements: Standard Provisions and Policies

Over time we have disseminated a number of different memoranda outlining the different clauses that you must include in settlement agreements and policies we must follow in negotiations. This memorandum compiles those memoranda, makes a few modifications, and supersedes all of those prior memoranda.

A. Clauses and Considerations for All Agreements.

1. Make Stipulations of Dismissal Conditioned on Terms of Settlement Agreement.

If you are settling a pending case and will be stipulating to its dismissal, you should provide in the stipulation that the dismissal is "subject to" or "consistent with" the terms of the settlement agreement. Should a defendant later claim that the dismissal foreclosed a broader set of claims than we provided for in a release, this type of provision in the stipulation should give us a basis to argue that the agreement and narrow release governs.¹

¹ A word of caution is necessary here. In a declined qui tam case, where the government is asked for its consent to a settlement, you must be very careful to examine both the complaint and the proposed release to determine the effect of the government's consent to a dismissal with prejudice and the relationship of the dismissal to the terms of a settlement agreement. For example, in some cases, a relator may propose to enter into a release that is broader than a dismissal of the claims in the complaint. In that case, it would be appropriate

to **not** make the dismissal conditioned on the terms of the settlement, in order to preserve an argument that we are bound by the dismissal of only the claims in the complaint. On the other hand, where a relator has alleged very broad claims in his or her complaint and negotiated a narrower release, we should consent to dismissal only if the order clearly states that dismissal is consistent with and subject to the terms of the settlement agreement.

2. No Release of Tax Liability and Tax Neutrality - Every settlement agreement must include language stating that:

"The United States does not release John Doe or John Doe, Inc. from any claims arising under Title 26, U.S. Code (Internal Revenue Code)."

In addition, our policy is to remain neutral in any potential dispute between the settling party and the IRS regarding the tax deductibility of the amount paid to settle our claim. We **cannot** permit language such as "John Doe, Inc. is willing to compromise the United States' claim as an ordinary and necessary expense in conducting its business" or "this payment is in the nature of contract damages" or "this payment is a business expense" or "this payment is compensatory in nature" or the payment is "restitution".

Conversely, we generally will not characterize the payment as a penalty or a payment of forfeitures or double damages under the False Claims Act. The best course of action is to avoid any phrase that characterizes the payment other than a payment to settle all outstanding claims.

3. No Release of Administrative Liability - We do not release a defendant or potential defendant from administrative liability (under statute, contract or regulation, including for suspension/debarment) **unless**: (1) we have express authority from the agency to do so, **and** (2) the agency is a signatory to the agreement. We may seek to obtain that authority in our letter to the agency requesting their concurrence. Additionally, any release of suspension/debarment/exclusion liability must be strictly limited to the agency consenting. We do not release such liability on behalf of all agencies of the government.

4. No Release of Product Warranties Where Quality Not In Issue - If our allegation is **unrelated** to the quality of the goods or services delivered (and this includes allegations that the product was not tested to specification where we do not claim that product integrity was compromised), the settlement agreement must state that:

"The United States does **not** release John Doe or John Doe, Inc. from any liability under the contracts (referred to in the complaint **or** listed in the letter to John Doe dated _____ **or** listed in Exhibit A) for the delivery of any deficient or defective products/services, from liability under any

express or implied product/service liability warranties pertinent to these contracts, or liability for the failure to deliver items or services due."

5. No Release of Consequential Damages If Quality Is In Issue - If our allegation **is** related to the quality of the goods or services delivered (and assuming that we have not been made aware of and are not settling claims for such consequential damages), the settlement agreement must still state that:

"The United States does **not** release John Doe or John Doe, Inc. from any claims for personal injury or property damage or for other consequential damages arising from the products/services delivered under the contracts (referred to in the complaint **or** listed in the letter to John Doe dated _____ **or** listed in Exhibit A).

6. Unallowability of Defense Costs - In all settlement agreements, you must include a provision specifying that all costs, as defined in the FAR, incurred by a government contractor in defense of a False Claims Act investigation and any related proceedings shall be unallowable and shall not be borne by the government as a direct or indirect cost on government contracts.

Any deviation from the sample language below should not be proposed to opposing counsel without discussing the matter first with me and your reviewer.

It is agreed that all costs (as defined in the Federal Acquisition Regulations ("FAR") 31.205-47) incurred by or on behalf of _____ and its officers, directors, agents and employees in connection with (1) the matters covered by this SETTLEMENT AGREEMENT, (2) the government's audit and investigation of the matters covered by this SETTLEMENT AGREEMENT, (3) _____'s investigation, defense of the matters, and corrective actions, (4) the negotiation of this SETTLEMENT AGREEMENT, and (5) the payment made to the United States pursuant to this SETTLEMENT AGREEMENT shall be unallowable costs for government contract accounting purposes. These amounts shall be separately accounted for by _____.

In health care cases, we are to obtain a similar clause:

1. [XXX] agrees that all costs (as defined in the Federal Acquisition Regulations ("FAR") § 31.205-47 and in Titles XVIII and XIX of the Social Security Act, 42 U.S.C. §§ 1395 et. seq. and §§ 1396 et. seq., and the regulations promulgated thereunder) incurred by or on behalf of [XXX], in connection with (1) the government's investigations, and [XXX]'s investigations and defense of the matters covered by this Agreement; (2) the negotiation of this Agreement; (3) any corrective action undertaken by [XXX] for the Released Acts during the relevant period; and (4) the payments made to the United States pursuant to this Agreement, shall be unallowable costs for government contract accounting and for Medicare, Medicaid, CHAMPUS, VA and FEHBP reimbursement purposes. These amounts shall be separately estimated and accounted for by [XXX], and [XXX] will not charge such costs directly or indirectly to any contracts with the United States or any State Medicaid program, or to any cost report, cost statement, or information statement submitted by [XXX] or any of its subsidiaries to the Medicare, Medicaid, CHAMPUS, VA or FEHBP programs. [XXX] agrees further that within 60 days it will identify to applicable Medicare and CHAMPUS fiscal intermediaries, carriers and/or contractors, and Medicaid fiscal agents any unallowable costs (as defined in this paragraph) included in payments sought from the United States, or any State Medicaid Program, including, but not limited to, payments sought in any cost reports, cost statements or information reports already submitted by [XXX] or any of its subsidiaries, and will request that such cost reports, cost statements or information reports, even if already settled, be adjusted to account for the effect of the inclusion of the unallowable costs. Any payments due after the adjustments have been made shall be paid to the United States at the direction of the Department of Justice, and/or the affected agencies. The United States reserves its rights to disagree with any calculations submitted by [XXX] or any of its subsidiaries on the effect of inclusion of unallowable costs (as defined in this paragraph) on [XXX]'s, or any of its subsidiaries' cost reports, cost statements or information reports. Nothing in this Agreement shall constitute a waiver of the rights of HHS, or any Medicare or CHAMPUS fiscal intermediary or contractor, or any Medicaid fiscal agent, to examine or reexamine the unallowable costs described in this paragraph.

7. The Release Itself - The release should be as narrow as possible and must be limited to only the conduct with respect to the specific transactions that are the basis for the consideration we are being paid, and have been actually investigated by the government. The conduct should be narrowly defined both as to the nature and the time period involved. To ensure that the release is construed narrowly, **do not** use language that includes the release of "all civil monetary liability under statute or common law" or "all civil monetary liability" or similar language. Such releases could extend to statutory claims that are beyond our office's jurisdiction (for example, securities claims and environmental claims), or to claims that have not been investigated (for example, TINA claims in a product substitution case).

The release should be limited to False Claims Act and common law liability for the conduct -- defined -- at issue. Alternatively, if defendants do not agree to that limited language, we can propose a release of claims under statutes that permit recovery of damages or penalties for the specific conduct at issue (as opposed to a release of statutory liability "arising from" or "related to" the conduct). Examples of acceptable language include:

The United States releases defendants and their respective current and former directors, officers, employees, and agents from any civil or administrative monetary claim the United States has or may have under the False Claims Act, 31 U.S.C. § 3729 et seq., [in health care cases - the Civil Monetary Penalties Law, 42 U.S.C. §§ 1320a-7a]; the Program Fraud Civil Remedies Act, 31 U.S.C. §§ 3801-3812; [the Contract Disputes Act, if applicable, and the Truth in Negotiations Act, in a defective pricing case] or the common law theories of payment by mistake, unjust enrichment, breach of contract and fraud, for [specify the conduct, e.g. mischarging, inflation of contract proposals, etc.]

or

The United States releases defendants and their respective current and former directors, officers, employees, and agents, from any civil or administrative monetary claim the United States has or may have under the False Claims Act, 31 U.S.C. § 3729 et seq. [in health care cases - the Civil Monetary Penalties Law, 42 U.S.C. §§ 1320a-7a]; the Program Fraud Civil Remedies Act, 31

U.S.C. §§ 3801-3812; [the Contract Disputes Act, if applicable, and the Truth in Negotiations Act, in a defective pricing case] or the common law theories of payment by mistake, unjust enrichment, breach of contract and fraud, **or any other statute creating causes of action for civil damages or civil penalties for submitting or causing to be submitted claims to the government based on [specify the conduct, e.g. mischarging, inflations of contract proposals, etc.]**

less preferable, but another alternative to the bolded language is:

...or any other statute creating causes of action for civil damages or civil penalties which the Civil Division has actual and present authority to assert and compromise pursuant to 28 C.F.R. Part O, Subpart I, §0.45(d) (1999) for [specify the conduct, e.g. mischarging, inflations of contract proposals, etc.]

8. Identifying the Individuals/Entities Released - A release may, in appropriate cases and where authorized, extend to both the company and its divisions, subsidiaries, officers, and employees (but see, section C. 2, below, regarding reservation of claims against individuals who are or are likely to become targets of a criminal investigation for the same conduct.) On the other hand, in all other circumstances, language should be included that expressly reserves all rights against other tortfeasors, such as:

"The United States' rights against other tortfeasors are expressly reserved" **or** "The settling party is the sole intended beneficiary of this agreement and all rights not expressly released are reserved."

You should check the caselaw and statutes in your jurisdiction to ensure that we are properly reserving these claims.

9. Interest Rates - The United States is entitled to pre-judgment interest. To the extent that we are negotiating single damage claims, our negotiations should seek compensation that includes such interest from the date of our claim or at least from the date of the complaint. The rate of interest is established by the Treasury and is called the "current value of

funds." The rate remains fixed from the date of demand. See Civil Fraud Monograph § L49-50.

Similarly, the United States is entitled to post judgment interest. If a settlement agreement provides for payments over time, we should negotiate the most favorable rate possible. See Civil Fraud Monograph § L50-51 (discussion of post judgment interest rate).

10. Agency Approval - Agency approval of the settlement should be in writing from the appropriate official in the agency's headquarters prior to requesting authority to accept the settling party's offer in compromise. If that is not feasible, a verbal approval from the appropriate official should be secured with a confirming letter to follow. The appropriate agency official is typically someone in the agency's General Counsel's Office or an official in the Inspector General's office; it is almost never the local IG agent or auditor. Agencies should also approve the specific language of the proposed settlement agreement.

11. Press releases - We do not agree to refrain from issuing press releases in settled cases, nor do we negotiate the contents of press releases or agree to allow the defendant to review the press release prior to its issuance.

12. Return of documents and limitations on dissemination - Avoid any commitments to return all documents to a defendant. At a minimum, we must retain the right to keep an official file with any documents we choose to retain. Also, avoid provisions that would bar release under FOIA, to federal agencies or to Congress, or to any other entity to whom we are authorized to release documents.

B. Protecting the United States' Interests in Agreements With Payment Over Time.²

1. Security - If you agree to accept payments over time, insist that the defendant provide security. Although defendants are reluctant to purchase a letter of credit, a letter of credit provides the United States with the best security. In the alternative, the United States should insist that the outstanding amount of the debt be secured by real or personal property. Again, a financial analyst can help you determine whether the

² For a complete discussion of the legal issues involving bankruptcy, see "Medicare Fraud Cases and Bankruptcy Proceedings: When an Irresistible Force Meets an Immovable Object" (prepared by Tracy Whitaker, Sam Maizel, and Ruth Harvey, Financial Litigation Section, Commercial Litigation Branch).

defendant is able to purchase a letter of credit and what security is available.

2. Guaranties - Although it will not protect the United States in bankruptcy, you may want to demand that the defendant guaranty payment of the settlement amount by its principals or a parent corporation. Then, if the defendant defaults on the terms of the settlement agreement or files a bankruptcy case, you can pursue other, more solvent, entities.

3. Preserve the Full Amount of the United States' Claim - It is helpful to distinguish between the amount for which the United States should settle based upon litigation risk and the amount for which the United States should settle based upon the defendant's ability to pay. Settlement agreements should be drafted so that, in the event of bankruptcy, the United States can claim the full amount of the United States' claim and not the lower amount that was negotiated based upon the defendant's ability to pay.

One way to protect the United States is to demand that the settlement agreement identify the full amount of the United States' claim, less any appropriate deduction for litigation risk, as the settlement amount. The settlement agreement should then provide that the entire debt is satisfied if the defendant makes the agreed payments at the agreed times. If all payments are proffered as agreed, the remainder of the debt is forgiven and the government's claim is deemed satisfied. If the defendant defaults or files a bankruptcy case, however, the United States would be entitled to pursue recovery of the full amount of its claim less payments received.

The parties may also state in the settlement agreement that the United States' claim in a bankruptcy proceeding will be the full amount of the United States' claim. The United States can also insist that the defendant consent to judgment for the full amount of the United States' claim. A consent judgment provides better protection than an agreement between the parties if it is approved by the court and filed. In addition, if the defendant defaults but does not file a bankruptcy petition, the United States can execute on a consent judgment without further litigation.

If you do not obtain a consent judgment, the United States should not release its claims against the defendant until the United States receives the final payment due under the settlement agreement. All pending actions should be stayed and all statutes of limitations should be tolled. The settlement agreement should further provide that, in the event of default or bankruptcy, the United States is entitled to declare the settlement agreement void and pursue the full amount of its claim.

4. Dischargeability - Our settlement agreements generally contain a provision to the effect that "the United States releases its claims under the False Claims Act and common law" for the matter that is the subject of the agreement. There is a split in the Circuits as to whether such a release transforms a fraud debt that is presumptively nondischargeable under section 523(a)(2)(A) of the Bankruptcy Code, into a dischargeable one. Accordingly, in agreements that provide for a deferred payment or payments over time where the debt is not fully secured, make our receipt of all sums due a condition precedent to the operation of the release. Our release should provide that:

Conditioned only upon [defendant's name] full payment of \$ _____ as provided in paragraph _____ above, the United States shall release its claim under the False Claims Act.

5. Obtain Waiver Of The Automatic Stay For Setoff - The settlement agreement should also include a provision waiving the automatic stay. Then, if defendant files a bankruptcy case, the United States may set off funds held by government agencies against the defendant's liability to the United States. Whether a prepetition waiver of the automatic stay is enforceable is controversial. Nevertheless, you should include such a provision in settlement agreements with distressed defendants.

The waiver provision should (a) recite that the defendant knows it is waiving the right to the automatic stay and (b) give notice to the court that the waiver is in consideration for something of value, in this case the settlement of all claims against the defendant. We recommend including the following language:

In the event of a voluntary or involuntary liquidation or reorganization case by or against the defendant under bankruptcy, receivership or other insolvency law, defendant agrees not to contest or oppose any motion filed by HHS seeking relief from or modification of the automatic stay imposed by 11 U.S.C. § 362(a) nor to seek relief under 11 U.S.C. § 105 to enjoin or restrain HHS from recovering monies owed by the defendant arising out of this agreement or its underlying relationship with HHS related to Medicare Program through offset. Defendant recognizes that this express waiver is in consideration for the final settlement of _____ claims against Respondent by HHS during the period _____ to _____.

By expressly waiving the automatic stay provision, defendant agrees not to oppose or

interfere with any motion made in any federal court (including any bankruptcy courts) by HHS to exclude the defendant from participation in the Title XVIII (Medicare) and the State health care programs.

6. Obtain Waiver Of The Discharge For Fraud Claims - If the action is against an individual defendant, the settlement agreement should also include a waiver of the discharge provisions of the Bankruptcy Code.

C. Agreements Where Parallel Criminal Investigations Exist.

1. Halper clause - If there is any possibility that a subsequent criminal prosecution of the defendant in our case will follow our civil disposition, the following language, or language substantially similar, should be included in the civil settlement agreement. We should also request that the prosecutor include such language in any plea agreement where the government is not simultaneously resolving the civil consequences.

The defendant hereby waives any defenses it may have to any [criminal prosecution] [civil or administrative action] which defenses may be based in whole or in part on the Double Jeopardy Clause of the Constitution or the holding or principles set forth in United States v. Halper, 490 U.S. 435 (1989), and agrees that the amounts paid under this Agreement are not punitive in nature or effect for purposes of such [criminal prosecution] [civil or administrative action]. Nothing in this paragraph or any other provision of this Agreement constitutes an agreement by the United States concerning the characterization of the amounts paid hereunder for purposes of any proceeding under Title 26 of the Internal Revenue Code.³

³ The purpose of the last sentence is to ensure that by agreeing that the amounts are not punitive for Halper purposes, we do not imply that the amounts should be considered compensatory for tax purposes (which would allow their deductibility). This last sentence is not a substitute for, but is in addition to, the clause required in all agreements reserving the defendant's liability under Title 26, U.S. Code.

2. Reserving civil claims against individuals under criminal investigation or likely to become targets - We must reserve civil claims against those individuals who are under criminal investigation or who are likely to be investigated, by including language like the following:

"Notwithstanding the releases set forth in paragraph XX, the United States expressly reserves all civil claims against individuals, including any officers, employees, agents or employees of defendant XX corporation who receive written notification that they are the target of a criminal investigation, are indicted or charged, are convicted or who enter into a plea agreement arising from the conduct that is the subject of this agreement."

D. Agreements In Voluntary Disclosure Cases.

You may be asked by the settling party to include language acknowledging the cooperation of the company throughout the United States' investigation. While the agency may be willing to acknowledge full cooperation where it exists, our policy is to remain neutral on the fact or extent of cooperation in the settlement agreement and press release. It is appropriate, however, to state in the agreement that the settling party reported the wrongdoing to the United States. You may include language in the recitals such as:

Whereas, the XYZ Company submitted a report to the Department of Defense Inspector General; on [date] which concluded that there had been [conduct described];"

E. Agreements In Qui Tam Cases.

1. Dismissal Without Prejudice to the United States - The dismissal of the claims in the qui tam action must be **without** prejudice to the United States unless the United States receives appropriate (not nominal) consideration as part of the agreement. Review all settlement agreements in declined qui tam actions to ensure that this is the case.

2. Relator Agreement as to Adequacy of Settlement - Where the relator consents to the settlement, a provision should be included that the relator agrees that the settlement is fair, adequate and reasonable and that he will not challenge the agreement pursuant to 31 U.S.C. § 3730(c)(2)(B).

3. Relator Release of United States - If a qui tam settlement agreement determines the relator's share of any recovery, the relator must agree to language such as:

"Relator agrees to release the United States, its officers, agents and employees, from any liability arising from the filing of the complaint, including any claims to a share of the proceeds pursuant to 31 U.S.C. § 3730(d)."

4. Standard clauses - As outlined above, the agreement should have a narrow release, exceptions for title 26, product liability and consequential damages, tax neutrality and unallowability of defense costs.

5. Issuance of Forms 1099 - If a settling party agrees to pay the relator his/her share of the settlement proceeds directly, the settlement agreement must provide that the settling party will issue Forms 1099 to the IRS for those relator share payments. (Similarly, if the government agrees to pay relator's share, we will cut the 1099s, and you should so advise relator, but this does not need to be stated in the agreement.)