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United States General Accounting Office
Washington, DC 20548

November 26, 2003

The Honorable Edward J. Markey
House of Representatives

Subject: *Department of Energy: Reimbursement of Contractor Litigation Costs*

Dear Mr. Markey:

The Department of Energy (DOE) contracts with not-for-profit universities and private companies to operate its facilities. As part of the cost of operating these facilities, DOE can reimburse its contractors for the litigation costs associated with cases brought against them. Each year the department spends millions of dollars in such reimbursements. For the most part, litigation expenses involve the costs of outside counsel and resulting judgments and settlements for a variety of types of cases, such as equal employment opportunity, radiation and/or toxic exposure, personal injury, wrongful termination of employment, and whistleblower protections.

You asked us to study the extent to which DOE reimburses its contractors' litigation costs and the process for doing so. As agreed with your staff, we obtained information on (1) how much DOE spends to reimburse litigation costs for its contractors, (2) what major criteria DOE uses to reimburse its contractors for litigation costs and how it implements these criteria, (3) what major criteria the Department of Defense and the National Aeronautics and Space Administration use to reimburse their contractors for litigation costs, (4) the extent to which a state university that is a DOE contractor has a valid immunity defense to a lawsuit, and (5) the extent to which state universities that are DOE contractors have invoked immunity as a defense. We provided your staff with a formal briefing on our findings on October 16, 2003. (See encl. I.) This report presents the results of that briefing.

In summary, we found the following:

- DOE reimbursed contractors for \$330.5 million in litigation costs associated with 1,895 cases from fiscal year 1998 through March 2003, including \$249.4 million for litigation costs and \$81.1 million for judgments and settlements. During the same period, DOE estimates that contractors spent about \$12 million without being reimbursed.

- The major criteria DOE uses to reimburse contractors depend on the nature of a case.¹ DOE pays all reasonable litigation costs in most cases. DOE does not pay litigation costs when the contractor's actions involved either willful misconduct; lack of good faith; or failure to exercise prudent business judgment by the contractor's managerial personnel; nor does DOE pay in certain other circumstances, such as when the contractor is liable under the False Claims Act.² When a contractor prevails in a False Claims Act case or prevails in other cases where a government entity has sued the contractor, DOE pays a maximum of 80 percent of reasonable litigation costs.
- The major criteria the Department of Defense and the National Aeronautics and Space Administration use to reimburse contractors for litigation costs are similar to DOE's. The only important difference we identified was that the Department of Defense and the National Aeronautics and Space Administration do not have specific criteria prohibiting payment to a contractor involving the contractor's managerial personnel's willful misconduct, lack of good faith, or failure to exercise prudent business judgment.
- A state university that is sued in the course of its operation of a DOE facility may be entitled to assert immunity under the Eleventh Amendment and other immunity-related defenses, such as being exempt from punitive damages under state law.³ Whether a particular state university is entitled to assert such defenses depends on whether it qualifies as a state entity, which in turn depends on a variety of factors, such as whether the state is liable for judgments against the university, the nature of the functions the university is performing, and whether the university is a separate incorporated entity.
- The University of California is the only DOE contractor to use immunity as a defense. Officials at the university, which operates three DOE facilities—Los Alamos National Laboratory, Lawrence Livermore National Laboratory, and Lawrence Berkely National Laboratory—estimated that the university used Eleventh Amendment immunity in 8 of about 35 federal cases in 5-1/2 years. Also, officials at the University of California estimated that the university, in its role as a DOE contractor, has asserted other immunity-related defenses in at least 62 of about 137 cases, predominantly to defend against punitive damages.

We met with DOE's Deputy General Counsel for Litigation and other DOE attorneys in the General Counsel's Office to discuss the facts in this report. They generally agreed with the information in our report and provided some clarifying comments that we incorporated as appropriate. Our methodology is discussed in enclosure II. We performed our work from March through October 2003 in accordance with generally accepted government auditing standards.

¹See 48 C.F.R. §§ 31.205-47 and 970.5228-1 for the criteria.

²The False Claims Act, 31 U.S.C. §§ 3729 to 3733, provides for civil monetary penalties and damages for anyone who knowingly submits false claims to the United States.

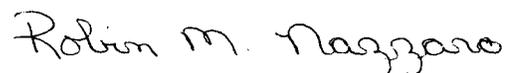
³The Eleventh Amendment to the Constitution provides the states with immunity from lawsuit by a private party in federal court.

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As arranged with your office, unless you release its contents earlier, we plan no further distribution of this report until 30 days after its issuance date. At that time, we will send copies to interested parties. In addition, this report will be available at no charge on the GAO Web site at <http://www.gao.gov>.

If you have any questions about this report or need additional information, please contact me at (202) 512-3841. Key contributors to this report were Robert G. Crystal, William F. Fenzel, and Daniel J. Semick.

Sincerely yours,

Handwritten signature of Robin M. Nazzaro in cursive script.

Robin M. Nazzaro
Director, Natural Resources
and Environment

Enclosures - 2



DOE Reimbursement of Contractor Litigation Costs

**Briefing for
Representative Edward J. Markey**

October 16, 2003



Objectives

- How much does DOE spend to reimburse litigation costs for its contractors?
 - What major criteria does DOE use to reimburse its contractors for litigation costs and how does it implement these criteria?
 - What major criteria do DOD and NASA use to reimburse their contractors for litigation costs?
 - To what extent does a state university that is a DOE contractor have a valid immunity defense to a lawsuit?
 - To what extent have DOE contractors invoked Eleventh Amendment immunity or other immunity-related defenses?
-



Objective 1: Litigation Costs

DOE reimbursed contractors for about \$330.5 million from FY 1998 through March 2003¹

- \$196.5 million in litigation costs for ongoing cases
- \$52.9 million for litigation costs on closed cases
- \$81.1 million for judgment and settlement costs

For the same period, DOE estimates that unreimbursed contractor costs were about \$12 million, or about

- \$7 million in litigation costs for ongoing cases²
- \$1 million for litigation costs on closed cases
- \$4 million for judgment and settlement costs

¹In general, DOE contractors retain outside counsel for handling their litigation cases. The \$330.5 million reflects those costs.

²DOE officials said there might be several million dollars in additional litigation costs for ongoing cases that contractors have not reported to DOE. Contractors may eventually seek reimbursement for some of these costs.



Objective 2: Major DOE Criteria and Implementation

Major Criteria

- DOE pays reasonable litigation costs unless the contractor's actions involved
 - willful misconduct, lack of good faith, or failure to exercise prudent business judgment by the contractor's managerial personnel in M&O contracts;
 - certain other circumstances, such as when the contractor is liable under the Major Fraud Act or False Claims Act.

 - DOE pays a maximum of 80 percent for a case where the contractor prevails in a case that was
 - brought by a government entity alleging a contractor's violation or failure to comply with law or regulation or
 - brought by a third party under the False Claims Act
-



Objective 2: Major DOE Criteria and Implementation (continued)

Implementation

- When a contractor is sued, the contractor alerts DOE's lawyers in the appropriate field office.
- If DOE attorneys initially determine the contractor's actions appear proper, DOE conditionally pays litigation costs.
- DOE attorneys continually reevaluate whether the case meets the payment criteria as they get more information. They base their judgment on the facts and contract case law.
- If at any time DOE attorneys determine the contractor should not be reimbursed they can recommend that DOE stop reimbursements and seek the return of funds paid to the contractor.



Objective 2: Major DOE Criteria and Implementation (continued)

- We identified only one case where a contractor paid all costs because of managerial personnel's willful misconduct, lack of good faith, or failure to use prudent business judgment.
 - Managerial personnel were defined and limited from 10 to 41 individuals in the contracts we reviewed.
 - DOE lawyers can help shape the legal defense strategies in individual cases (*e.g.*, by encouraging early settlements or deciding whether to appeal).
 - DOE lawyers also review the contractor's litigation costs against established allowable cost guidelines.
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Objective 3: Major DOD and NASA Criteria

- DOD and NASA pay reasonable litigation costs, but do not have written overall criteria similar to DOE's in which they specify that they will not pay a contractor's litigation costs resulting from willful misconduct, lack of good faith, or failure to exercise prudent business judgment by the contractor's managerial personnel in M&O contracts.
- DOD and NASA pay a maximum of 80 percent for a case where the contractor prevails in a case that was
 - brought by a government entity alleging a contractor's violation or failure to comply with law or regulation or
 - brought by a third party under the False Claims Act.



Objective 4: Potential State University Immunity

Eleventh Amendment immunity

- Eleventh Amendment provides for state immunity from lawsuit by a private party in federal court.
- In some areas, such as employment discrimination, Congress has abolished states' immunity.
- States may waive immunity (state waiver would preclude state university from invoking immunity). Congress may be able to preclude states from invoking immunity by requiring them to waive immunity as a condition of receiving federal benefits or protections —*e.g.*, H.R. 2344; S. 1191.



Objective 4: Potential State University Immunity (continued)

Other immunity-related defenses

- Sovereign immunity in state court—depends on nature of action and varies from state to state (conditions and waivers are set by states).
- Statutes that apply to “persons” or specific types of entities may not apply to states—*e.g.*, the False Claims Act.
- Punitive damages generally do not apply to states—*e.g.*, California.
- State employees in some states have limited rights in suing states—*e.g.*, California employees may not sue for breach of contract.



Objective 4: Potential State University Immunity (continued)

Whether a state university is an arm of the state and thus may have a valid immunity claim depends on a variety of factors

- Liability of state for judgments against the university [DOE reimbursement for judgments does not divest university of Eleventh Amendment immunity—*Regents of the University of California v. John Doe*, 519 U.S. 425 (1997)]
- Nature of the functions the university is performing
- Ability of the university to sue and be sued
- Right of the university to hold property in its own name
- Corporate status of the university—*e.g.*, University of California (UC) is a corporation



Objective 4: Potential State University Immunity (continued)

Past and current litigation regarding the issue of UC as a state entity

- The U.S. Court of Appeals for the Ninth Circuit relied on the state's potential liability for judgment against UC in holding that UC is a state entity in its operation of a DOE facility and may assert Eleventh Amendment immunity—*John Doe v. Lawrence Livermore National Laboratory*, 131 F.3d 836,839 (9th Cir. 1997).
- The issue of whether UC is a state entity when acting as a DOE contractor is in litigation again in *United States ex rel. Adrian v. Regents of the University of California* in the U.S. Court of Appeals for the Fifth Circuit. The plaintiff is relying on factors such as UC's corporate status and its authority to sue and be sued to show that UC is not a state entity, but is a "person" subject to *qui tam* liability under the False Claims Act. Under the California Constitution, Art. IX, §9, UC is a "corporation" with the "power to sue and to be sued."



Objective 4: Potential State University Immunity (continued)

The plaintiff's arguments in the *Adrian* case include:

- The Supreme Court has held that a municipal corporation is a "person" under the False Claims Act—*Cook County v. United States ex rel. Chandler*, 538 US 119 (2003).
- The Supreme Court has said that when Congress gives an agency authority to sue and be sued, unless it is clear that such language is to be narrowly construed, that agency should be treated like a private enterprise when sued—*Federal Housing Administration v. Burr*, 309 U.S. 242, 245 (1940).



Objective 5: Use of Immunity as a Defense

Only two of DOE's current major contractors, UC and Iowa State, are state universities that may be able to claim Eleventh Amendment immunity or other immunity-related defenses. UC operates three DOE facilities (Los Alamos National Laboratory, Lawrence Livermore National Laboratory, and Lawrence Berkeley National Laboratory) and Iowa State operates one facility (Ames Research Laboratory).

Eleventh Amendment immunity

UC identified 8 out of about 35 federal cases where it invoked immunity under the Eleventh Amendment in 5-1/2 years; 2 were dismissed without further litigation because of this argument; 2 were resolved in federal or state court on other grounds; 2 were settled; and 2 are pending. DOE said Iowa State has not used the argument.



Objective 5: Use of Immunity as a Defense (continued)

Other immunity-related defenses

- UC officials estimated that the university used immunity-related defenses in at least 62 of about 137 cases from October 1998 through March 2003.
 - Often these defenses are successful in obtaining a dismissal for at least part of the cases. UC officials estimated that in at least 42 cases where an immunity-related defense was used at least that part of the case was dismissed.
 - The predominant immunity-related argument used by UC at Los Alamos and Lawrence Livermore was to defend against punitive damages; at Lawrence Berkeley it was to defend against employee breach of contract arguments.
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Appendix 1: Number and Types of Cases

Number and Type of Closed and Ongoing Cases (FY 1998 through March 2003)

Closed cases							Ongoing	Total
Type	1998	1999	2000	2001	2002	1 ST half fy 2003		
EEO	57	62	42	31	14	6	56	268
Radiation and/or toxic	1	4	2	2	7	0	24	40
Personal injury	21	15	18	14	7	1	23	99
Wrongful termination of employment	10	10	8	10	0	2	10	50
Whistle blower	18	16	23	17	9	3	14	100
Worker compensation	99	86	101	68	99	71	290	814
Other*	78	93	67	69	63	8	146	524
Total	284	286	261	211	199	91	563	1,895

Source: DOE.

*This includes various types of cases such as contract, labor relations, and tax cases.



Appendix 2: Disposition of Cases

Disposition of Cases (FY 1998 through March 2003)

FY closed	Number of cases				Total
	Dismissed	Settlement reached	Judgment ^a	Other	
1998	2	146	136	0	284
1999	0	147	139	0	286
2000	4	147	107	3	261
2001	12	119	74	6	211
2002	22	129	39	9	199
First half 2003	9	73	7	2	91
Total	49	761	502	20	1,332

Source: DOE.

^aThis includes judgments for and against DOE's contractors.

Scope and Methodology

To determine how much DOE spent to reimburse its contractors for litigation costs from fiscal year 1998 through March 2003, we obtained data from DOE's Legal Management Tracking System (LMTS)—a Web-based database established to track such costs. It relies on entries from the relevant DOE field offices. To address the reliability of the LMTS data used in our review, we discussed the development of LMTS with agency officials. In addition, we received detailed responses to a list of questions about LMTS, including a description of the database, its development, limitations of the data it contains, its format, descriptions of how data are entered into the database, and quality control checks on its content. Also, we performed limited data reliability testing. Responses to these questions were prepared by agency officials who are responsible for overseeing the LMTS. In addition, we summarized some of the LMTS data for the 5-1/2 year period and compared these data with the information in DOE's summary. After taking these steps, we determined that the LMTS data were sufficiently reliable for the purposes of this report.

To obtain information on the amount that contractors have spent without reimbursement from DOE, we surveyed DOE's 18 field offices. Since the information is not in a DOE database, DOE field office personnel obtained the information by analyzing their records of cases or asking the relevant contractors to assist them in providing the information. After we received the data, we discussed the responses with attorneys at several DOE field offices to obtain further explanations. Respondents in most DOE field offices said they were highly confident the information they received was accurate and complete for those cases in which contractors responded. However, contractors did not provide their unreimbursed costs for all cases, according to DOE's Deputy General Counsel for Litigation. He estimated that contractors might have several million dollars in additional unreimbursed costs for ongoing cases that they did not report to DOE. We determined the data were sufficiently reliable for the purposes of this report, and we added a note to our briefing slides indicating that several million dollars may not be included in the estimate.

To determine DOE's major criteria for reimbursing its contractors' legal costs and how DOE implements the criteria, we examined federal regulations, including DOE's own regulations, on reimbursement of contractor legal costs, and we interviewed attorneys at DOE's headquarters and field offices about the guidance and their implementation. Similarly, to determine the major criteria the Department of Defense and the National Aeronautics and Space Administration use to reimburse contractor litigation costs, we examined federal laws and regulations, such as the Federal Acquisition Regulations, and we interviewed officials at the Department of Defense and the National Aeronautics and Space Administration responsible for developing those regulations as they pertain to reimbursing contractor litigation costs. To determine the extent to which a state university that is a DOE contractor may have a valid immunity defense, we examined relevant laws and court cases. To determine the extent to which DOE contractors have invoked immunity or immunity-

Enclosure II

related defenses, we obtained estimates from the University of California. University of California attorneys at DOE facilities said that in some cases they relied on examining files, but in other cases they relied on summaries of files and institutional memory.

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