How Sureties Can Avoid False Claims Act Violations

Sponsored By the Fidelity and Surety Law Committee

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False Claims
Act Elements

Presentment Claims
• The defendant submitted a claim to the government.
• The claim was false.
• The defendant knew the claim was false.

False Statement Claims
• Requires evidence that the defendant made a false statement to the government, as opposed to the submission of a false claim for payment.

Knowingly
• Actual Knowledge
• Deliberate Ignorance
• Reckless Disregard
Reverse False Claims Act Elements

Knowingly makes, uses, or causes to be made or used, a false record or statement material to an obligation to pay or transmit money or property to the Government, or knowingly conceals or knowingly and improperly avoids or decreases an obligation to pay or transmit money or property to the Government.

- A reverse false claim is any fraudulent conduct that results in no payment to the government when a payment is obligated.

- Whereas a traditional false claim action involves a false or fraudulent statement made to the government to support a claim for money from the government, a typical reverse false claim action involves a defendant knowingly making a false statement in order to avoid having to pay the government when payment is otherwise due.
An agreement existed to have false or fraudulent claims allowed or paid to the government.

Each alleged member of the conspiracy joined that agreement.

One or more conspirators knowingly committed one or more overt acts in furtherance of the object of the conspiracy.

An action for conspiracy cannot exist absent underlying tortious conduct, and therefore there can be no liability for conspiracy where there is no underlying violation of the FCA.
Indirect Presentment/Making of False Statements

- The degree to which that party was involved in the scheme that results in the actual submission.

- Was the defendant's conduct at least a substantial factor in causing, if not the but-for cause of, submission of false claims?
  - When the non-submitting party takes advantage of an unwitting intermediary.
  - When the non-submitter was the driving force behind an allegedly fraudulent scheme.
  - When they had agreed to take certain critical actions in furtherance of the fraud.
  - When the non-submitter continued to do business with an entity upon becoming aware that that entity was submitting false claims.

- Failure to act is insufficient.

“The Amended Complaint does not allege that the insurance defendants directly presented false claims or made false statements to the government. Rather, plaintiff-relator relies on a theory of indirect presentment. He argues that the actions of the insurance defendants were critical actions that directly led to the submission of false claims and that they continued to do business with the other defendants upon becoming aware that the other defendants were submitting false claims. The Court finds that the Amended Complaint sufficiently alleges such theories of indirect presentment.”
The Dunbar/COE Contract

Corps of Engineers issues set-aside contract for Ditch 27 project in October 2013.

Dunbar bids on Ditch 27 contract and is awarded the job for $2,047,455.74 on December 18, 2013.

Contract is set-aside for Service-Disabled Veteran Owned Businesses (SDVOBs) only.
On the same day as the Prime Contract was awarded to Dunbar, December 18, 2013, Dunbar enters into a subcontract with Harding Enterprises, LLC. The Dunbar/Harding subcontract was for $1,794,136.00.

Subcontract Scope of Work: “Provide all work that was provided in the proposal Contract Documents: The contract documents shall consist of the Plans & Specifications; Safety Attachment; the invitation to Bid dated 10/7/2013 and this Agreement…”

January 14, 2014, Dunbar hires Gregg Harding to be a "project manager" for Ditch 27 for $62,000.00.

Hanover bonds the subcontract on February 5, 2014.
Participant Verification Code (PVC)

PLEASE WRITE THIS CODE DOWN For CLE Compliance & Attendance Verification

IL1912
Veterans Benefits Act

- Congress passed the VBA in 2003
- VBA allows contracting officers to conduct competitive contract set-asides and sole-source procurements among service-disabled veteran-owned small businesses (SDVOSBs).
- Like other set-aside contracts, there are limits on subcontracting.
Subcontracting Limits

- The SDVOSB must agree that “it will not pay more than 85% of the amount paid by the government to firms that are not similarly situated.” 13 C.F.R. § 125.6(a)(3)

- “At least 15 percent of the cost of the contract performance incurred for personnel will be spent on the concern’s employees or other employees of other service-disabled veteran-owned small business concerns…” 48 C.F.R. § 52.219-27.

- “The Contractor shall perform on the site, work equivalent to at least [15%] of the total amount of work to be performed under the contract.” 48 C.F.R. § 52.236-1.

- The Prime Contract itself incorporates F.A.R. 52.236-1 into the language of the contract stating: “The Contractor shall perform on the site...work equivalent to at least 15 percent of the total amount of work to be performed under the contract.”
April 20, 2017

Dunbar gives notice to Harding that it intends to terminate Harding’s subcontract for default.

Dunbar calls on Hanover to perform under its bond.

Hanover begins its investigation.
Hired technical reps

Asked for project status, pay apps, etc.

Dunbar stated in an email: “The Contracting Officer on this project said he would give us detailed drawings and figures [showing] where we are…”

Dunbar then stated: “Preliminary figures show Harding complete around 70%...Harding has been trying to get billed to 87%. Big discrepancy.”

Dunbar had no project drawings and few if any documents. Did not know status of project.
Investigation continues…

- Counsel for Dunbar took over all communications in June 2017.
- Only partial document production.
- By August, counsel for Dunbar stated, “Dunbar was providing General Supervision...Administration and Accounting for the Contract.”
- Hanover asked for cost reports, general supervision reports, administration reports; accounting reports; and certified payroll reports.
- Non-responsive document production.
Email from Dunbar’s counsel: “Harding was to perform 100% of the work required by the prime contract less the 15% that Dunbar was planning to perform”

“Dunbar’s 15% was to be performed by Gregg Harding as Project Manager for Dunbar…”

“Harding Enterprises was to perform all of the work described in the subcontract which included all of the labor, materials, and equipment for completion of the project.”

“Under the terms of the subcontract, Dunbar was not providing any of the labor, equipment or material to perform the project work.”

“Other than Greg Harding acting under the terms of his personal services contract, the only other employee which Dunbar had at the job site was Brett Blanks who was assigned to the project after Greg Harding repeatedly failed to be present at the job site…”
Potential Liability

- Dunbar threatened; violation of subcontracting limits carries potential penalties:
  - Penalties provided at 13 C.F.R. 125.6(h) [applying penalties at 15 U.S.C. 645(g)].
  - Greater of $500,000 or the dollar amount expended on subcontractors in excess of cap
  - Potential imprisonment for not more than 10 years
Confirming SDVOSB Status

- Evidentiary problem – Harding not a party, unresponsive to other subpoenas
- Had admission under oath, but hearsay
- Searching DUNS numbers and SAM.gov
- Phone calls to Washington
- Phone calls and emails to veteran organizations
- Phone calls and emails to SBA
- Fedmine.us
Did the subcontract facially violate the limits on subcontracting?
The 15% pay requirement

$1,794,136.00 (Subcontract Amount)

$2,047,455.74 (Fixed-Price Prime Contract)

= 87.6%
The 15% work requirement

How much work was Dunbar performing?

Subcontract Scope of Work: “Provide all work that was provided in the proposal Contract Documents: The contract documents shall consist of the Plans & Specifications; Safety Attachment; the invitation to Bid dated 10/7/2013 and this Agreement...”

Counsel for Dunbar: “Under the terms of the subcontract, Dunbar was not providing any of the labor, equipment or material to perform the project work.”
Potential FCA Liability

- United States ex rel. Scollick v. Narula
  - Potential FCA liability for surety?

Are You Covered?
False Claims Act
31 U.S.C. § 3729(a)

Illegal to present false claims to the government

<table>
<thead>
<tr>
<th>False statement or engaging in a fraudulent course of conduct</th>
<th>Requisite scienter (knowledge)</th>
<th>Materiality</th>
<th>Government paid out money due to the false statement.</th>
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Elements:
Scienter: Knowledge

- Claimant does not have to intend specifically to defraud the government
- More than negligence or mistake
- Actual knowledge
- Acting in deliberate ignorance
- Acting in reckless disregard
Materiality

- Does the false statement have the natural tendency to influence an agency action?
- What is the potential effect of the false statement?
- Objective test
- Is the statement capable of influencing payment or receipt of money from the government?
What were the false statements?

The Prime Contract incorporated F.A.R. 52.236-1 into the language of the contract stating: “The Contractor shall perform on the site...work equivalent to at least 15 percent of the total amount of work to be performed under the contract.”

F.A.R. 52.219-27 – Upon submission of the offer, execution of the Prime Contract Dunbar agreed that it would perform the contract requirements.
Expressly False Claim

- Where a claim falsely certifies compliance with a contract, and compliance is a prerequisite to payment.
- Called "certification theory" of liability; "legally false certification"
- Pay apps.
Participant Verification Code (PVC)

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IL1912
Fraudulent Inducement

- 1986 Amendment to FCA
- Arguably, each pay app submitted could be a new false statement
Conspiracy Liability under the FCA

Hanover’s main concern:


- Liability may even exist where a non-submitter of a false claim continues to do business with an entity upon becoming aware that the entity was submitting false claims were sufficient.
If a party knows of the false claim, but does not cease doing business with the claimant or disclose the false claim to the US, this is "ostrich-like behavior...a course of conduct that allow[s] fraudulent claims to be presented to the government." United States v. President & Fellows of Harvard Coll., 323 F.Supp 2d 151 (D. Mass. 2004).

Hanover has two options:

- Cease doing business
- Tell the government
Contract Rescission

- Fraud is a ground of rescission
- Inability to perform a contract is a ground of rescission
- Illegal contracts are unable to be performed or enforced

- Suretyship contracts induced by fraud are subject to rescission. (Rst. (Third) of Suretyship and Guaranty § 12
- Usually, if the obligee doesn't know, the surety can't rescind
- Here the obligee was the bad actor.
After Rescission

- Refund the premium
- Dunbar threatens suit
- Hanover sues for declaratory judgment
- Dunbar counter sues.
- Hanover asserts one, sole affirmative defense: illegality.
Black letter law: illegal contracts are impossible to perform.

"The illegality of a contract is in general a perfect defense...It may indeed be regarded as impossibility by act of law; and it is put upon the same footing as an impossibility by act of God, because it would be absurd for the law to punish a man for not doing, or in other words, to require him to do that which it forbids his doing." Heart v. E. Tenn. Brewing Co., 121 Tenn. 69, 71 (1908).

Mound v. Barker, 44 A. 346 (Vt. 1899): Bond in suit was given by defendant as surety for lessees of a hotel, where lessor and lessees understood and expected to sell alcohol illegally on the premises. Court held that neither the suit on the lease, nor the suit on the bond could be maintained. "[W]hen the foundation fails, all goes to the ground."
Hanover wins summary judgment.

Court writes: "Because the Subcontract is illegal, Hanover is not obligated to fulfill its obligations under the Bond which ensured performance of the Subcontract. Illegality is a ground for rescinding a contract."

Cites case from 1912. "Any act which is forbidden, either by the common or statutory law, whether it is malum in se, or merely malum prohibitum, indictable or only subject to a penalty or forfeiture, or however otherwise prohibited by statute or the common law, cannot be the foundation of a valid contract; nor can anything auxiliary to or promotive of such act."

Red Flags to Look for During a Claim Investigation
Don’t inadvertently strengthen *Scollick v. Narula*.

- As in *Dunbar*, focus on the bonded contract being illegal.
What's Next?
Fidelity & Surety Law Mid-Winter Conference
Grand Hyatt New York, NY
January 29 - 31, 2020
Book Your Stay Today!