HOW SURETIES CAN AVOID FALSE CLAIMS ACT VIOLATIONS
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- **FCA Claims Act Elements**
  - Different ways FCA Violations Can Arise
    - Presentment
    - False Statement Claims
    - Acting Knowingly

- **Reverse False Claims Act Elements**
  - Traditional FCA actions involve false statements to the government to support a claim for money from the government. Reverse FCAs involve a defendant knowingly making a false statement in order to avoid having to pay the government.

  - Problematic holding for surety industry.

- **The Dunbar/COE Contract**
  - Corps of Engineers issues set-aside contract for Ditch 27 project in October 2013.
  - Contract is set-aside for Service-Disabled Veteran Owned Businesses (SDVOBs) only.
  - Dunbar bids on Ditch 27 contract and is awarded the job for $2,047,455.74 on December 18, 2013.
  - 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.

- **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.”

### Harding Default
- 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.

### Hanover’s 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.
- 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.

### Admissions?
- 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**

\[
\frac{\$1,794,136.00 \text{ (Subcontract Amount)}}{\$2,047,455.74 \text{ (Fixed-Price Prime Contract)}} = 87.6\%
\]

**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?
• False Claims Act
31 U.S.C. § 3729(a)
  o Illegal to present false claims to the government
  o Elements:
    ▪ False statement or engaging in a fraudulent course of conduct
    ▪ Requisite scienter (knowledge)
    ▪ Materiality
    ▪ Government paid out money due to the false statement.

• Scienter: Knowledge
  o Claimant does not have to intend specifically to defraud the government
  o More than negligence or mistake
  o Actual knowledge
  o Acting in deliberate ignorance
  o Acting in reckless disregard

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

• What were the false statements?
  o 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.”
  o 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
  o Where a claim falsely certifies compliance with a contract, and compliance is a prerequisite to payment.
  o Called "certification theory" of liability; "legally false certification"
  o Pay apps.

• 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 to show that the non-submitter had 'caused' the claims' submission.

Conspiracy...
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."

• **Summary judgment**
  - Hanover wins summary judgment.
  - Court says: "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.”