Behind the Curtain: Ethics and Compliance – What Every Contractor, Subcontractor, Design Professional, and Their Counsel Need to Know About Business Ethics and Compliance and Why Owners Should Care

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Introduction

It would be impossible to ignore the recent, highly publicized examples of global companies going through ethics nightmares. The recent Wells Fargo and Volkswagen scandals may be the two most recognizable examples. The damaging repercussions experienced by those global corporations, stemming from decisions made by their employees, management and executives, continue in the form of negative publicity, lost business and share values, sanctions, penalties, and in some cases, criminal prosecution of executives and counsel.

In the construction industry in particular, ethical behavior is essential to a company’s ability to obtain, perform and get paid for work. Failure to comply with the many ethical and legal compliance obligations applicable to the participants in most construction projects can expose them to severe peril, including: debarment from future work, contract invalidation, forfeiture of the right to payment for work performed, and personal as well as corporate liability for tort claims, attorneys’ fees, punitive damages, and criminal penalties. Additionally, in the case of public projects, much can go wrong when governmental owners fail to enforce the complicated statutes and regulations designed to protect the integrity of the public procurement process, safeguard public funds and reinforce the public’s trust in the honesty of its elected officials. Such statutes are “directed at an evil which endangers the very fabric of a democratic society, for a democracy is effective only if the people have faith in those who govern and that faith is bound to be shattered when high officials engage in malfeasance and corruption.”

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This paper discusses the most common ethical compliance obligations and risks applicable to the actors in public and private construction projects, before and during the lifecycle of a construction project, including the need for codes of compliance and ethics programs.

I. A Crucial Question: Is the Project Subject to Public Contracting Laws?

The scope of ethical and legal responsibilities of the participants in a given construction project depends in part on whether the project is “public” or “private”. While there are numerous statutory and contractual ethical constraints applicable to private projects, public work is governed by federal, state or local laws that impose additional ethical duties that must be followed to the letter. As Justice Holmes opined in 1920, “Men must turn square corners when they deal with the Government.” More recently, federal construction attorney James F. Nagle explained, “Contracting with the federal government is like dancing with a gorilla. With very few exceptions, you dance the way the gorilla wants you to dance [or] … things can get ugly very quickly.” Mr. Nagle’s description also applies to contracting with state and local government.

Strict vigilance in the observance and enforcement of such laws is justified as insuring the integrity of government contracting. It also serves to prevent the costs of unethical behavior such as kickbacks, bribes and anticompetitive behavior being passed on to the taxpaying public in the form of increased contracts and avoids saddling the government with contractors who, having obtained the job other than on merit, are perhaps entirely unreliable in other ways.

However, it is not always clear when a project or contract is subject to public contracting laws. Often the result depends on the interpretation of legislation that does not appear to exactly address the precise circumstances of a given project. One thing is clear: case law attests to the fact that courts in multiple jurisdictions can reach opposite conclusions on this issue based on similar facts. Indeed, a project may be considered public even though it is constructed by a
privately-owned developer. Public-private partnerships, turnkey or sale/lease-back transactions, and other innovative delivery methods blending public and private funding, construction and ultimate project usage also may blur the private-public distinction.6

Nevertheless, certain red flags signal the possibility that a project that appears to be privately built will be considered to be public for purposes of compliance with certain public contracting laws.

First, a project may be considered public, even though “privately” developed, if it is ultimately intended for public use, ownership, control, or if it is part of a larger publicly-planned project. For example, in Cinema West, LLC v. Baker,7 a California court ruled that a movie theatre constructed by a private company on private land, with private financing, was nevertheless a “public work” subject to the prevailing wage laws governing public projects, because the cinema was part of an overall, integrated downtown revitalization project. Similarly, the private renovation of a privately-owned building to lease a portion of that building to a county was deemed to be a public project in Plumbers and Steamfitters Local 290 v. Duncan.8 By contrast, despite the apparent factual similarity, a privately built hospital, intended to be leased to a public agency, was held to be a private project in Willman v. Children’s Hospital of Pittsburg.9

The second characteristic of a possibly public project is the involvement of public funding, a financial incentive or tax credit. Thus, in Fox v. Mayor and Town Council of Borough of Chambersbury,10 a project built “privately” on formerly public land was held to be public because of a relatively small amount of public funding provided for infrastructure. On the other hand, public contracting laws were ruled inapplicable to a project partially financed by a federal grant in Mechanical Contractors Association of Northwest Pennsylvania v. Senior Citizens
Similarly, conflicting decisions have reached opposite conclusions on the question of whether use of tax credits to fund a project requires compliance with public contracting laws.

Confusing the public/private project issue even more is the fact that not all participants in a public project may be subject to the same public contracting statutes. Some statutes apply only to contractors, while others also apply to some but not all subcontractor trades. It is also possible that the laws of multiple governmental entities may apply to some or all aspects of a project. Unfortunately, it is beyond the scope and purpose of this paper to do more than highlight the importance of determining whether a project is public or private and alert the reader to some of the factors that courts have found relevant to the issue. Also, where we discuss the requirements of public contracting laws, most of our analysis concerns the requirements of federal codes and regulations to project participants, because state and local laws often are patterned after or embody ethical obligations similar to those imposed by federal law.

II. A Reputation for Integrity and Ethical Business Practices is Necessary to Prove that a Contractor or Professional is “Responsible” Enough to be Trusted to Perform its Contract in a Timely Manner.

In a government project, the issue of a contractor’s or design professional’s integrity usually arises at the initial stage of contract procurement bidding or negotiation. This is when a public owner evaluates whether the bidder or contracting professional is “a responsible party”; that is, whether it has the skills, financial and technical capability, and the integrity to be trusted to perform the work if awarded the contract. The Federal Acquisition Regulation (“FAR”) makes clear that in order to be determined “responsible” and thus eligible to bid on a contract, a prospective contractor must have, inter alia, “a satisfactory record of integrity and business ethics”. State and local laws similarly require proof of contractor integrity. Essentially, the question of a company’s integrity, honesty, trustworthiness and business ethics requires an
analysis of whether it has a satisfactory history of compliance with all laws applicable to its industry, including contracting, tax, labor and employment, environmental, antitrust, and consumer protection.  

Thus, companies seeking to contract with the government have been disqualified as “non-responsible” due to a history of unlawful activity, such as:

- The use of “sham” minority business enterprise (“MBE”) subcontractors;
- Bid collusion, bid rigging, fraud, and payment of gratuities to public officials;
- Failure to have the requisite licenses; and
- Submission of false information as part of the bid package.

These and other examples of unethical and illegal practices are discussed below.

### III. Ethical Obligations Inherent in Protecting the Integrity of the Competitive Bidding Process

Many large prime or general construction contracts for public projects are awarded as a result of competitive bidding. There are numerous federal, state and local procurement statutes and implementing regulations that define the mechanics of competitive, sealed bidding for such projects. When applicable to a particular project, they have the force of law, even if not referenced in the contract or known to the bidders. Because competitive bidding is required only when mandated by law, the relevant statutes and regulations should be reviewed carefully to determine whether the specific contracting governmental entity or agency and the particular project both fall within the scope of competitive bidding laws. Then, the statute must be examined to determine the parties in a given project to which it applies. Alternatively, depending on the jurisdiction, certain types of contracts or projects may be exempted from a competitive process, such as contracts for professional services, emergency work, small projects, when there is no effective competition in the marketplace for the type of work involved, or other situations
in which, in the discretion of the contracting public entity, a waiver of competitive bidding better serves the public interest.\textsuperscript{22}

The expense, delay and complexity of competitive bidding commonly is justified by the belief that “the bright lights of open scrutiny” will protect the public and potential bidders against the unfair awarding or pricing of public construction projects.\textsuperscript{23} The integrity of this process is so important that contracts that result from violations of the requirements of bidding laws usually are considered illegal and void as a matter of longstanding common and statutory law.\textsuperscript{24}

Additionally, numerous statutes and other legal remedies have been developed to ensure that mandated competitive procedures are protected from secret schemes, corruption, or various other efforts to circumvent the integrity of the competitive bidding process.\textsuperscript{25} Failure to comply with all lawful bidding requirements and the commission of acts that impair the fairness of the bidding process are considered to be illegal, as well as unethical, acts showing a lack of integrity and responsiveness.

A. Antitrust Violations and Other Types of Bidder Collusion

Since at least 1890, it has been illegal to collude to sell goods or services to the government “in restraint of trade”.\textsuperscript{26} Since then, the large number of construction cases accumulated in the annotations to the federal Sherman Anti-Trust Act,\textsuperscript{27} prove that government procurement of construction contracts is especially fertile ground for illegal, anticompetitive conduct. Antitrust violations in the construction industry is an enormous topic, but essentially, federal and state antitrust laws are intended to protect competition on public and private projects by precluding schemes whereby collusion among bidders, owners and subcontractors may control the price of services or commodities to the injury of the public or otherwise deprive the
public of the benefits of competitive markets. The schemes that violate these statutes can be “suave and insidiously evasive arrangements, operating in secret understandings”. 28

For example, numerous cases stand for the proposition that “bid rigging” agreements that “eliminate, reduce or interfere” with competition for a contract awarded based on public bidding are per se illegal. 29 Bid rigging is any agreement between competitors pursuant to which contract offers are to be submitted to or withheld from a third party. 30 In United States v. Reicher, 31 the court found that Reicher committed a per se restraint of trade when it persuaded another contractor, who had no interest in or ability to perform a particular contract, to submit a bid on that contract that was higher than Reicher’s to ensure that there were at least two bidders and that Reicher would be the successful bidder. The court found, “This is exactly the sort of threat to the central nervous system of the economy [internal cites omitted] that the antitrust laws were meant to address.”

Bid rigging agreements may involve schemes between “competitors” or between prime and subcontractors or suppliers. They may involve agreements by one contractor not to compete with another, to withdraw a bid in exchange for a share in the profits of the resulting contract or for a corresponding promise not to compete on another project, or for a supplier to promise not to sell sole source materials to any competitors. Thus, in Uvalde Construction Co., v. Shannon, 33 the court voided a contract to sell materials only to one prime contractor as being invalid under common law and state antitrust statutes. Another type of illegal bid rigging scheme was identified in United States v. Inryco, Inc., 34 in which one contractor, Western, agreed to submit three “complementary” or intentionally higher bids than those submitted by its co-conspirator, Inryco on the same projects. In turn, Inryco agreed to subcontract with Western if awarded contracts on those projects. 35 The anticompetitive result was to eliminate Western as a
competitor for the prime contracts and give Western a competitive advantage in the “subcontract … market”. 36

1.  *Kickbacks and Bribes*

It is antithetical to the idea of a fair and competitive process of public procurement for bidders or others contracting with the government to trade on favoritism, exercise undue influence on the decision makers, or even worse, bribe or provide other value to public officials in exchange for a contract award. Consequently, federal and state anti-kickback and bribery laws are intended to protect the public from the evil consequences of the corruption of public servants. As the Court of Claims explained in *Continental Management, Inc. v. United States*, 37 such statutes are “directed at an evil which endangers the very fabric of a democratic society, for a democracy is effective only if the people have faith in those who govern and that faith is bound to be shattered when high officials engage in malfeasance and corruption.” Such activity is just as abhorrent on private projects, where it can lead to termination of contracts, firing of employees, and jeopardize reputations and opportunities for future work. Additionally, as discussed below, it is a violation of the Foreign Corrupt Practices Act (“FCPA”) for any contractor to ask for or give bribes or accept kickbacks from any foreign government official in connection with any project located outside the United States.

The federal Public Contracts Anti-Kickback Act, 38 prohibits the offering, giving, or accepting of any money, gift, gratuity, credit or thing of value by a “prime contractor”, or subcontractor or their employees, 39 in order to obtain or reward favorable treatment directly or indirectly in connection with a prime contract with the government. “In the idiom of economic crime, a ‘kickback’ is a kind of commercial bribe”. 40 It also has been referred to as an illegal gratuity. 41 The Anti-Kickback Act applies to negotiated and competitively bid contracts and subcontracts on public projects, even if the offeror of the kickback was unaware that the
government was involved in the project.\textsuperscript{42} For example, in \textit{United States v. Purdy},\textsuperscript{43} a materials fabricator and subcontractor named Purdy sold materials to a company that contracted with private businesses as well as the federal government. Because Purdy paid kickbacks to his customer’s purchasing agents, he was convicted of violating the Anti-Kickback Act, even though he argued he did not intend or necessarily know that his materials would be used in the performance of government contracts.\textsuperscript{44} The court explained that the statute is intended to cover kickbacks or bribery occurring anywhere within the federal procurement system, regardless of the wrongdoer’s knowledge of the government’s involvement.\textsuperscript{45}

Illegal kickbacks can occur in a variety of other ways, including:

\begin{itemize}
  \item Interest free loans by a subcontractor to a prime contractor, even if the loan was intended to be repaid.\textsuperscript{46}
  \item An agreement between an insurance broker and a government contractor to split the commission fees earned on surety bonds required for the contractor’s federal projects, in return for the contractor’s agreement to cease doing business with another insurance broker.\textsuperscript{47} In this case, the court found it was irrelevant that the parties to this arrangement may not have known they were violating the law.\textsuperscript{48}
  \item Gifts of candy, cigars, beer, liquor and shares of stock, from a subcontractor to a prime contractor’s employee.\textsuperscript{49}
\end{itemize}

The federal arsenal against bribery includes 18 U.S.C. § 201, which makes illegal the “corrupt” offering or giving of anything of value to public officials or employees with an intent to influence their actions in their official capacity. The classic bribery construction scenario involves some variation on the facts in \textit{United States v. Griffin},\textsuperscript{50} in which a government employee demanded and was paid 10\% of the revenue received by prime contractors upon the
award to them of public contracts. Indeed, the dishonest official helped the contractors fix their bid amounts, so they would be assured of being the low bidder.51

However, the point at which gifts or contributions to public officials become bribes is not always as easy to identify as in the Griffin case. To be illegal, the bribe must be given in pursuit of or in reward for favorable treatment or a benefit more specific than better customer relations or congenial feelings.52 Thus, the court in United States v. Arthur,53 stated that not every gift, favor or contribution to government officials constitutes bribery. “Bribery imports the notion of some more or less specific quid pro quo for which the gift is offered or accepted.54 Nevertheless, for some time, courts struggled with the issue of whether evidence of quid pro quo was necessary to prove bribery or receipt of illegal gratuities.55

Recently, the Supreme Court, in the high-profile case of McDonnell v. United States,56 clarified the quid pro quo element of this crime. In that decision, the Court overturned the criminal conviction of Virginia Governor Robert F. McDonnell, because the prosecution had failed to prove that the governor had agreed, as “his end of the bargain”, to perform any illegal official acts in exchange for the lavish gifts admittedly given to him and his wife.57 That is, the Court found no proof of any agreed-upon official conduct committed by McDonnell that would constitute the type of illegal quid pro quo necessary for violation of the bribery statute. The Court explained that merely acting on constituents’ requests for meetings, requests to be included in public events or to speak to other public officials about matters of public interest to one’s constituents is the ordinary business of a public official, which could not be made illegal without “significant constitutional concerns.”58

The question of when gratuities or gifts to officials become illegal bribery also is of crucial importance to U.S. companies doing business in foreign countries. The widespread
prevalence of bribery and similar acts of corruption in international construction has been criticized and proscribed legislatively for decades. In 1977, Congress passed the FCPA, which criminalized certain behaviors defined by the Act as constituting corrupt practices, required full disclosure of certain types of behavior involved in foreign contracting, and mandated the creation of financial controls within companies doing business internationally. The level of FCPA enforcement has increased significantly in recent years. Given such heightened scrutiny, it is important to be able to distinguish between illegal bribes and legal compliance with the type of “grease” payments that are customary in certain countries in order to “expedite” such normal activities as permitting and routine requests for information. Such payments may be considered legal if they are reasonable in amount, meet the “bona fide expenditure” provisions of the FCPA, and if they are accounted for as required by that statute.

2. Unethical Conflicts of Interest in Contract Procurement

It is a truism that “no man can serve two masters”. It is equally true that conflicts of interest in government contracting can be found in infinite forms, causing serious havoc with the procurement process. It has been observed that integrity is considered (along with competition and transparency) to be one of the three pillars of our procurement systems. Of the three, integrity, or honest and fair dealing by the actors in the procurement system, is the lynchpin of a successful and fair procurement system. For example, a government employee hoping for future employment with a contractor undermines any chance of competition and transparency, when he provides information to that contractor regarding a competitor’s proposal for a government project.

There are two general scenarios in which unethical conflicts of interest would preclude government employees or officers from participating in decisions to award contracts to particular bidders on a public project. The first scenario involves offers of future employment to such
public officers or employees, while the second involves other types of financial arrangements by which the public officers or employees, or their family members or close business associates know they will benefit by the contract. The risk presented by both scenarios is that the government employee may provide a bidding or contracting party with a substantial and unfair advantage during the procurement process by giving that party crucial information not available to other bidders.65

Consequently, both scenarios are the subject of detailed federal, state, and local statutory regulation for the purposes of insuring honesty in governmental business dealings and preventing public agents from advancing their own interests at the expense of public welfare. In general, such statutes limit or bar persons, and those close to them, who are involved with the development of a project’s specifications or plans or evaluating bidders on that project, from submitting or bidding on that project or benefiting from later employment arranged by such bidders.66

Specifically, 18 U.S.C. §§ 201, et seq., the federal conflict of interest statutes, and their implementing regulations, 48 CFR §§ 9.500, et seq., preclude government employees or officers from participating “in their governmental capacity” in matters in which they, their spouses or minor children, business associates or entities with whom they are negotiating for employment have a financial interest. Sections 207 and 208 restrict certain federal officers and employees from working for private entities on government projects in which that person was once involved.

So, for example, a former government employee would be barred from acting on behalf of a successful bidder in formulating and presenting a response to a proposal for the same project in which he substantially had been involved while working for the government.67 Similarly, in
Express One International, Inc. v. United States Postal Service, the court enjoined the award of a contract to a bidder whose subcontractor had offered future employment to an agency employee charged with evaluating the bids. The statutes also apply to government consultants. In United States v. Mississippi Valley Generating Co., a consultant that represented the government concerning the early negotiation of a project with its sponsors was prohibited from later serving as an officer of the successful bidder, even though he apparently had nothing to do with the awarding of the contract.

3. Violation of Statutory Bidder Preferences

It is common for politicians to try to insure distribution of work to particular members of the public previously considered to have been historically disadvantaged in the free marketplace. Thus, governments at all levels promulgate contractor “preferences” that favor the awarding of contracts to benefit variously described categories or classes of business based on their status as being, for example, minority owned, “disadvantaged” (commonly referred to as “MBE” or “DBE” contractors), or employing local labor.

However, such preferential programs are fraught with ethical peril, causing public contracting entities to scrutinize carefully the way in which such preferences are enforced, in order to protect the integrity of the process. Common violators include owners of large businesses who pretend to be small businesses, such as a large contractor owned by a father that created a sham small company supposedly run by his son or a majority owned and managed company may falsely purport to be owned and managed by a woman, minority or member of some other favored status. Another area of frequent abuse is the sham use of DBE joint ventures or DBE subcontractors to pretend to satisfy the preferential requirements of the prime contractor’s bid, where the DBE entity does little or no actual work. Consequently, prime
contractors often are required to show that the DBE entities are performing “commercially useful functions”.  

4. **Bid Shopping, Peddling, or Chiseling**

Variations of the practice known as “bid shopping” raise several ethical issues for prime contractors on private as well as public projects. Bid shopping arises when a prime contractor bases its bid on the estimates of a particular specialty subcontractor and then, once awarded the prime contract, the prime contractor auctions or “shops” the subcontract work to the lowest bidder, often pressuring the original subcontractor to do the work for less than its bid or suffer a loss of the subcontract. As part of this process, the prime contractor discloses the bid price of the original subcontractor to the sub’s competitors. In a variation on this practice known as “bid peddling,” a subcontractor whose bid was not used in the prime’s original bid offers post-award to perform the subcontract work for less in order to replace the original sub. In the case of “bid chiseling,” the prime contractor pressures the subcontractor that assisted in assembling its winning bid to lower its subcontract price or the prime will do the work itself.

Not surprisingly, subcontractors strongly object to these behaviors, which The American Subcontractor’s Association describes as “abhorrent”, “unethical”, and “anticompetitive”. Such post-award “negotiating” is considered unethical and harmful to the integrity of the competitive bidding system, in part because the subcontractor who assists the prime contractor in preparing its bid expends considerable time and expense in reviewing the plans and specifications, creating internal estimates and drafting the subcontract bid, the cost of which is lost if the sub is not awarded the related subcontract at its bid price. Such misconduct also promotes lower quality work and incentivizes cost cutting by the ultimate subcontractor, which presumably would be performing the work below fair market value.
For these reasons, a handful of states and other governmental entities require a prime bidder to list its major subcontractors by name in its bid submission and then compel the prime to contract with the listed subcontractors. Also, disappointed subcontractors who have been harmed by bid shopping may have remedies against faithless prime contractors under the theories of promissory estoppel, breach of contract, or violation of unfair trade practices acts.

B. Penalties, Liabilities, and Other Consequences of Unethical Conduct

1. Consequences of Circumventing the Integrity of the Public Bidding Process

Bids that violate the law or contain misrepresentations as to the bidder’s compliance with the law are deemed to deviate from the requirements of the invitation to bid and to be non-responsive. Such bids also violate the public policy objectives of the competitive bidding process by allowing dishonest bidders an advantage over others. Thus, for example, a bidder was found to be a non-responsive bidder, because it represented it would use an MBE joint-venturer that in fact was unable to perform the work.

It is a fundamental rule of government procurement at every level that contracts earned by any such unethical and illegal behavior are illegal and void as a matter of law. Once a contract is declared void, the contractor will have no right to complete that contract and may forfeit its right to payment for work performed. For example, a contractor discovered to have submitted false information to a public entity in support of its bid, lost its right to further payment, even for work performed. Alternatively, the public owner may elect to declare the contract to be in material breach, justifying termination for cause. Additionally, by statute, and depending on the severity and intentionality of the violations, contractors may be debarred – that is suspended or lose bidding privileges – and even be subject to criminal sanctions.
Moreover, a dishonest or non-responsible bidder may be held liable in administrative or judicial proceedings to an unsuccessful bidder, for its damages, including lost profits, based on various types of statutory claims such as claims for antitrust, deceptive business practices or under other, specific public contracting statutes, or common law misrepresentation. Recently, a successful bidder, whose bid contained misrepresentations, was held liable for an unsuccessful bidder’s lost profits, based on the common law theory of “tortious interference with a prospective business advantage.” Judicial or administrative challenges to an illegally awarded contract may be brought by any “aggrieved” party who has suffered a “non-trivial competitive injury which can be addressed by judicial relief.” Other bidders, design professionals or government consultants may find themselves sued for defamation in the event they make unprivileged, unethical, or other damaging comments about a bidder that deprives the bidder of fair consideration in the bidding process.

Contracting parties found guilty of providing kickbacks or bribes may also find themselves subject to civil liability for multiples of the amounts of the illegal favors, as well as criminally liable for statutory fines and imprisonment. Thus, the president of a company convicted of bribery was sentenced to 37 months in jail and a $250,000 fine. Additionally, the government may be able to offset the amount of the kickbacks against any amounts owed the contractor. Also, the contracting agency may void the contract, even though there is no specific statutory authority to do so.

Conflict of interest violations also may result in avoidance or rescission of the tainted contract. Additionally, the dishonest contractor may be required to repay all funds received under the contract. Disappointed bidders may seek injunctive relief awarding themselves the
contract. Similarly, those committing conflict of interest violations may be subject to civil and criminal penalties and fines.

Finally, criminal punishment and civil liability may result from conduct unlawfully restraining trade in violation of the federal or state antitrust statutes. For example, in United States v. Anderson, a U.S. citizen was found guilty of conspiracy to violate federal antitrust laws for bid-rigging on a project in Egypt, financed by a U.S. government agency. Alleged collusion among an owner, its consultant, and a low bidder may state a claim for civil liability to a disappointed bidder.

2. Consequences of Contracting Without Proper Licensing

When licensing of a contractor or design professional is required in order to perform a specific contract, it is unethical as well as illegal not to have the requisite license at the time the contract is negotiated or bids are submitted. An unlicensed contractor or design professional will be deemed to be non-responsible and ineligible to do the work. The consequences of failure to be properly licensed at the requisite time “are varied and almost always unpleasant.” Punishment for unlicensed contractors or design professionals may include: forfeiture of the right to payment, in whole or in part; administrative sanctions, including fines and denial of the right to do business; and less commonly, criminal penalties or imprisonment. Additionally, a licensing misrepresentation could constitute fraudulent inducement to enter into a construction contract, barring discharge in bankruptcy of any debt owned by the unlicensed contractor arising out of that contract.

IV. Consideration of Claims of Illegal or Unethical Conduct When Drafting ADR Provisions in Construction Contracts

The risk of claims based on allegations of unethical conduct should be considered when drafting arbitration or other alternative dispute resolution provisions in construction contracts.
Unless the arbitration agreement is properly drafted, it may be ambiguous as to its scope or otherwise fail to provide for arbitration of claims of contract avoidance, or allegations of tortious, unethical or illegal conduct. For example, in *United States and State of Nevada ex rel. Mary Kay Welch v. My Left Foot Children's Therapy*, after litigation in the federal district and circuit courts, the Ninth Circuit ruled that an arbitration agreement failed to authorize the arbitrator to determine whether the scope of the arbitration agreement included a false claim act qui tam action. As a result, the parties may find themselves embroiled in the very type of time consuming and expensive litigation that they hoped to avoid by including ADR provisions in their contracts.

To avoid this result, arbitration agreements should clearly and broadly state that they apply to and include claims based in tort, fraud, fraud in the inducement, statutory violations, and all other claims related to the avoidance, validity, formation or performance of the contract. The agreement also should provide for the additional authority of the arbitrator to rule on such claims and to award sanctions, punitive damages, injunctive relief and other statutory penalties or equitable remedies. Finally, the arbitration agreement should make clear that it applies to conduct occurring prior to the effective date of the underlying contract and to claims accruing after that contract is declared to be terminated or void.

**V. Ethical Obligations During Contract Performance**

Contractor ethical obligations, of course, do not end at contract award. Knowingly false or inaccurate submissions that contractors, subcontractors, and design professionals make to public owners – especially the federal government – during contract performance can trigger liability under a myriad of federal statutes. While most contractors, subcontractors, and design professionals are aware that submitting false change order proposals or requests for equitable adjustment can subject them to liability, the scope of these federal statutes is actually much broader than change order proposals and requests for equitable adjustment. Contractors,
subcontractors, and design professionals can find themselves facing allegations of false claims and false statements based on the submission of a variety of inaccurate contract documents, including certified payrolls, progress payment applications, certifications of country of origin of supplies and construction materials, certification of small or disadvantaged business status, and other submittals such as test reports. In today’s highly charged government contracting atmosphere, where contractors sometimes are viewed as no better than crooks and thieves, contractors, subcontractors, and design professionals are well advised to carefully review all submissions to public owners for accuracy before they are submitted.

Below is a summary of three of the key federal statutes that most often can trigger liability for contractors, subcontractors, and design professionals: the Federal False Claims Act, the False Statements Act, and the Truthful Cost or Pricing Data statute.

A. The Federal False Claims Act

The federal government has various statutes and regulations designed to ferret out fraud, waste, and abuse and to punish offenders. Perhaps the strongest and most broad-reaching of those statutes is the False Claims Act (“FCA”) also known as the Lincoln Law.109

Historically, federal ethics laws were enacted in response to cases of fraud, waste, and abuse in government contracting, and the FCA is no different. In the 1850s, Congress began investigating fraud and mismanagement in the War Department. At the beginning of the Civil War, Congress’s attention began to focus on government contractors themselves. An 1861 congressional report found that government contractors fraudulently reaped enormous profits from arms sales “through a system of brokerage as unprincipled and dishonest, as unfriendly to the success and welfare of the nation, as the plottings of actual treason.”110 In response to the congressional report, President Lincoln declared that unscrupulous contractors “ought to have their devilish heads shot off.”111
The FCA was enacted in 1863 in response to reports of massive frauds perpetrated by government contractors during the Civil War, including selling defective munitions and rifles and diseased horses and mules. As initially enacted, the FCA provided for penalties of double damages and a $2,000 civil fine for each false claim.

Over time, the FCA fell into disuse. By the end of World War II, relatively few actions were being brought against government contractors under the FCA. Government contract scandals in the 1980s such as the $435 hammer, $640 toilet seat, and $7,600 coffee maker, however, once again focused Congress’s attention of false claims.

In 1986, Congress made significant revisions to the FCA designed to make it easier to bring FCA actions. Specifically, the 1986 amendments lowered the standard of proof required to prevail on FCA actions, increased the government’s damage recovery from double damages to treble damages, raised the civil penalties from $2,000 to a range of $5,000 to $10,000, and added protections against retaliation for whistleblowers. Many of these revisions were designed to encourage whistleblowers to come forward with fraud allegations.

The mortgage scandals of the late 2000s resulted in even more changes to the FCA. In response to perceived weaknesses in the enforcement of federal ethics laws, Congress enacted the Fraud Enforcement Recovery Act of 2009 (“FERA”). FERA contained amendments to the FCA to “correct and clarify” the FCA and “reflect the original intent of the law.” The amendments were not limited to financial institutions, but applied to anyone who does business with the federal government or receives federal assistance such as a grant or loan. The effect of FERA was to expand the circumstances under which contractors, subcontractors, and design professionals could be liable for false claims.
FERA was enacted in part in response to the U.S. Supreme Court’s decision in Allison Engine Co. v. United States ex rel. Sanders.\textsuperscript{117} In Allison Engine, the Supreme Court held that subcontractors, who allegedly supplied engine generators that they knew did not comply with Navy specifications, were not liable under the FCA because the alleged false claims were not presented to the federal government. The impact of the decision was to require proof that the person who submitted the false claim intended that the federal government itself pay the claim as opposed to payment by an intermediary such as a federal grantee.\textsuperscript{118}

The 2009 FCA amendments had the practical effect of overruling the Allison Engine decision and making the FCA applicable to all federally funded contracts and grants, thereby significantly broadening the reach of the FCA. Now, the FCA applies not just to contracts directly with the federal government but also contracts with state and local governmental entities as well as private owners when the federal government is providing assistance to the project. Thus, even seemingly private commercial projects may be subject to the FCA if a federal agency such as the Department of Housing and Urban Development is providing assistance. Therefore, contractors, subcontractors, and design professionals are well advised to learn their owners’ funding sources.

Since 2009, actions under the FCA have increased dramatically. The Department of Justice reported that the federal government recovered $4.7 billion in settlements and judgments under the FCA in Fiscal Year 2016 – the third highest annual recovery in FCA history.\textsuperscript{119}

Further, many states and local jurisdictions have enacted false claims acts. Currently, twenty-nine states plus the District of Columbia have false claims acts, although eleven of these acts only apply to Medicaid fraud. Many of these false claims acts are modeled after the Federal FCA.
1. **Prohibited Acts under the FCA**

The FCA prohibits seven acts. Specifically 31 U.S.C. § 3729(a) prohibits:

1. Knowingly presenting, or causing to be presented, a false or fraudulent claim for payment or approval;

2. Knowingly making, using, or causing to be made or used, a false record or statement material to a false or fraudulent claim;

3. Conspiring to commit a violation of the FCA;

4. Having possession, custody, or control of property or money used, or to be used, by the government and knowingly delivering, or causing to be delivered, less than all of that money or property;

5. Making or delivering a document certifying receipt of property used, or to be used, by the government and, intending to defraud the government, making or delivering the receipt without completely knowing that the information on the receipt is true;

6. Knowingly buying, or receiving as a pledge of an obligation or debt, public property from an officer or employee of the government, or a member of the Armed Forces, who lawfully may not sell or pledge property; and

7. Knowingly making, using, or causing 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 concealing or knowingly and improperly avoiding or decreasing an obligation to pay or transmit money or property to the government.

The first three prohibited acts are the commonly-alleged FCA violations, although many FCA complaints include allegations relating to more than one of the prohibited acts.
2. Elements of an FCA Action

Generally speaking, there are four elements to an FCA violation: (1) the contractor submitted a claim; (2) the claim was false or fraudulent; (3) the contractor knew that the claim was false or fraudulent; and (4) the falsity was material to the government’s decision on whether to pay the claim. Each of these elements is discussed below.

a. Submission of a Claim

The FCA defines a claim as any request or demand, whether under a contract or otherwise, for money or property and whether or not the United States has title to the money or property, that:

1. Is presented to an officer, employee, or agent of the United States; or

2. Is made to a contractor, grantee, or other recipient, if the money or property is to be spent or used on the Government’s behalf or to advance a Government program or interest, and if the United States Government—

   a. Provides or has provided any portion of the money or property requested or demanded; or

   b. Will reimburse such contractor, grantee, or other recipient for any portion of the money or property which is requested or demanded.

The term “claim” under the FCA is much broader than the term is typically defined in contracts for disputes purposes. Claim encompasses among other things invoices, payment applications, requests for equitable adjustment, change order proposals, and other requests for payment. Thus, contractors, subcontractors, and design professionals need to be cognizant that even routine payment requests may be considered “claims” for purposes of the FCA. Indeed, progress payment applications provide a very common basis for false claims.

Further, contractors, subcontractors, and design professionals must be mindful that claims do not have to be submitted directly to the federal government to trigger liability. The FCA encompasses any claim made to a contractor, grantee, or other recipient if the money is spent on
the federal government’s behalf and if the federal government provides any of the money
 demanded or will reimburse the contractor or grantee. In other words, the FCA is not just
 applicable to federal government contracts. Projects with state or local governments or even
 private owners may be subject to the FCA, if the federal government is providing financial or
 other assistance to the owner.

b. Requirement that the Claim be False or Fraudulent

A claim must be false or fraudulent in order for there to be a violation of the FCA. The
 FCA, however, does not define the terms “false” or “fraudulent.” This lack of definition has
 contributed to the disputes over whether specific claims are false or fraudulent in FCA actions. In
 general, the courts have held the claim must be objectively false (i.e., a lie) in order to be
 considered false or fraudulent under the FCA.124

Whether a claim contains an objective falsehood often depends upon the terms and
 conditions of the contract since the validity of a claim depends upon the contract provision that
 supposedly justifies the claim.125 In other words, to determine whether the claim is false or
 fraudulent, the basis for the claim must be examined in the context of the contractor’s rights and
 obligations under the contract.

The courts have held that the FCA was not intended to create liability for simple errors in
 judgment, the misreading of drawings or specifications, or the misinterpretation of contract
 requirements.126 The courts have recognized that disputes arise between the government and its
 contractors every day and the fact that the contractor misunderstands its legal entitlement does
 not trigger FCA liability.127 However, if the contractor’s contract interpretation is objectively
 unreasonable, it may be considered an objective falsehood sufficient to subject the contractor to
 FCA liability.
As the Court of Appeals for the Federal Circuit stated in *Commercial Contractors, Inc. v. United States*:

If a contractor submits a claim based on a plausible but erroneous contract interpretation, the contractor will not be liable, absent some specific evidence of knowledge that the claim is false or of intent to deceive. Yet when a contractor adopts a contract interpretation that is implausible in light of the unambiguous terms of the contract and other evidence (such as repeated warnings from a subcontractor or the fact that the interpretation is contrary to well-established industry practice), the contractor may be liable under the FCA or the [Contract Disputes Act] even in the absence of any deliberate concealment or misstatement of facts.

Thus, while most performance disputes between a contractor or design professional and the government will never rise to the level of a false claim, a contractor whose claim is based on an implausible and unreasonable contract interpretation may find itself subject to liability. Therefore, it is vital that the contractor or design professional have a factual and legal argument for any claim that it submits.

c. Knowledge Requirement

The FCA is a knowledge based statute. It requires that the contractor have some knowledge of the falsity of its claim as a condition to liability. The FCA does not penalize all factually inaccurate statements, only those statements made with knowledge of their falsity. As is commonly stated, the FCA was not intended to punish innocent mistakes or negligence. The FCA defines the terms “knowing” and “knowingly” as follows:

(1) the terms “knowing” and “knowingly”—

(A) mean that a person, with respect to information—

(i) has actual knowledge of the information;

(ii) acts in deliberate ignorance of the truth or falsity of the information; or

(iii) acts in reckless disregard of the truth or falsity of the information; and
(B) require no proof of specific intent to defraud.\textsuperscript{130}

Thus, while actual knowledge is one basis for triggering liability, it is not the only basis. A form of knowledge short of actual knowledge can form the basis of liability. As the Court of Appeals for the Ninth Circuit stated in \textit{United States v. Bourseau}\textsuperscript{131}:

\begin{quote}
In defining knowingly, Congress attempted “to reach what has become known as the ‘ostrich’ type situation where an individual has ‘buried his head in the sand’ and failed to make simple inquiries which would alert him that false claims are being submitted.” S. Rep. No. 99–345, at 21 (1986), as reprinted in 1986 U.S.C.C.A.N. 5266, 5286. Congress adopted “the concept that individuals and contractors receiving public funds have some duty to make a limited inquiry so as to be reasonably certain they are entitled to the money they seek.” \textit{Id.} at 20; see also \textit{id.} at 7 (discussing the importance of individual responsibility because the government has limited resources to police fraud). “While the Committee intends that at least some inquiry be made, the inquiry need only be ‘reasonable and prudent under the circumstances.’” \textit{Id.} at 21.
\end{quote}

Actual knowledge goes to subjective knowledge while deliberate ignorance and reckless disregard are the kind of willful blindness from which subjective intent can be inferred.\textsuperscript{132} Negligence – even gross negligence – is not sufficient to establish deliberate ignorance or reckless disregard.\textsuperscript{133} However, this does not mean that contractors, subcontractors, and design professionals should disregard their obligation to review claims to ensure there is a factual and legal basis for the claim before submitting them.

Contractors may be able to negate the FCA’s scienter requirement in instances where the government had knowledge of the facts that allegedly made the contractor’s claim false before the contractor’s claim was submitted and decided to pay the claim anyway. This is commonly referred to as the “government knowledge defense” or the “government knowledge inference.” Various courts have held that this government knowledge can negate the FCA’s knowledge requirement when the government’s knowledge of or cooperation with the contractor’s actions is so extensive that the contractor as a matter of law could not possess the requisition state of mind
to be liable under the FCA.\textsuperscript{134} Government knowledge, however, it is not an automatic defense to FCA liability as the question of liability is based on the contractor’s knowledge of whether its claim was false.\textsuperscript{135} Therefore, the fact that the government knows that the contractor’s claim is false does not exculpate the contractor.

d. \textit{Implied Certification & Materiality}

Under the implied certification theory, a contractor’s claim is considered to contain an implied certification that the contractor complied with the contract requirements as well as all applicable laws and regulations. If that implied certification is false, the contractor can be held to have violated the FCA. Prior to June 2016, the federal courts of appeals were split over the question of whether a contractor could be held liable under the implied certification theory. This split was resolved in June 2016 when the Supreme Court in a unanimous opinion held that, under certain circumstances, a contractor can be liable for FCA violations under the implied certification theory.\textsuperscript{136}

In \textit{Universal Health Services, Inc. v. United States ex rel. Escobar}, the Supreme Court held that the implied certification theory can be a basis for liability when: (1) the contractor submits a claim for payment that does not merely request payment but also makes specific representations about the goods or services provided; and (2) the contractor’s failure to disclose its noncompliance with material statutory, regulatory, or contractual requirements makes those representation misleading half-truths.\textsuperscript{137} The Supreme Court further explained that the violation need not be of an expressly designated condition for payment; instead, the proper inquiry is whether the misrepresentation was material to the government’s payment decision.\textsuperscript{138}

Not all misrepresentations in claims will trigger liability under the FCA. Rather, the misrepresentation must be material. The FCA defines the term “material” as having a natural tendency to influence, or be capable of influencing, the payment or receipt of money or
property. In *Universal Health Services, Inc.*, the Supreme Court characterized this materiality standard as “rigorous” and “demanding” and stated that a material misrepresentation is one that goes “to the very essence of the bargain.” Materiality is not found where the contractor’s noncompliance is “minor or insubstantial.”

To determine whether a misrepresentation is material, the Supreme Court directed the courts to look to see whether the government paid or rejected a claim based on noncompliance with the particular statutory, regulatory, or contractual requirements and whether the contractor knew of the government’s position regarding payment. A misrepresentation is not material merely because the government designates compliance with a particular statutory, regulatory, or contractual requirement as a condition of payment or because the government would have the option to decline to pay if it knew of the contractor’s noncompliance. Proof of materiality can include, but is not necessarily limited to, evidence that the contractor knows that the government consistently refuses to pay claims based on noncompliance with the particular statutory, regulatory, or contractual requirement. The fact that the government pays a particular claim in full despite its actual knowledge that certain requirements were violated, on the other hand, is very strong evidence that the requirements are not material.

3. *Penalties for Violations*

Contractors who violate the FCA can be subject to significant penalties.

First, the FCA provides for treble the government’s actual damages. For example, if the government’s actual damages are $1 million, the contractor may be liable for $3 million. However, even if the government suffers no actual damages (e.g., the government does not pay the false claim), the contractor still may be found liable under the FCA for submitting a false claim.

The court may reduce the treble damages to double damages if the court finds that:
1. The person committing the violation furnished officials of the United States responsible for investigating false claims violations with all information known to such person about the violation within 30 days after the date on which the defendant first obtained the information;

2. The person fully cooperated with any government investigation of such violation; and

3. At the time such person furnished the United States with the information about the violation, no criminal prosecution, civil action, or administrative action had commenced under the FCA with respect to such violation, and the person did not have actual knowledge of the existence of an investigation into such violation.144

Second, the FCA permits the court to assess a civil penalty. The civil penalty is not less than $5,000 and not more than $10,000, as adjusted by the Federal Civil Inflation Adjustment Act145, for each false claim.146 In 2016, the FCA civil penalties were adjusted to $10,781 to $21,563 per violation. For 2017, the penalties as adjusted for inflation are $10,957 to $21,916.147

Third, a contractor who violates the FCA may be suspended or debarred from doing business with the federal government.148 This potentially may be the most significant penalty for some government contractors. While a contractor is suspended or debarred, it is precluded from bidding on any new federal government contracts and from receiving contracts funded by the federal government.149 It also generally is precluded from acting as a subcontractor on government contracts.150 Also, some state and local governments follow the federal government and will not contract with a contractor who has been suspended or debarred by the federal government. Thus, a contractor who has been suspended or debarred may find itself precluded from receiving any public contracts and may go out of business.

Finally, contractors should not disregard the damage to their business reputations resulting from allegations of false claims. Allegations of false claims often become public news.
Indeed, there are websites devoted to reporting on contractor misconduct. These public reports can have a serious impact on the contractor’s business.

4. **Types of FCA Actions**

FCA claims are initiated in one of two ways. First, the federal government can file a civil action under the FCA against a contractor in a federal district court.¹⁵¹ The federal government also can pursue an FCA claim against the contractor as counterclaim in an action initiated by the contractor in the Court of Federal Claims. In Fiscal Year 2016 alone, the government brought 143 new FCA matters.¹⁵²

Second, private parties – known as qui tam plaintiffs or qui tam relators – can bring an FCA action in the name of the federal government.¹⁵³ The FCA complaint is filed under seal and a copy of the complaint is provided to the Department of Justice. The defendant will not be served with the complaint while the Department of Justice decides whether or not to intervene and take over the action. If the Department of Justice decides to intervene, it will take over the action. If the Department of Justice declines to intervene, the qui tam relator still may proceed with the action.

Qui tam relators are incentivized to bring FCA actions by receiving a portion of any recovery. The FCA provides that the qui tam relator can receive 15% to 25% of the proceeds or settlement depending upon whether the relator substantially contributed to the prosecution of the action when the federal government intervenes.¹⁵⁴ If the federal government does not intervene, the qui tam relator can receive 25% to 30% of the proceeds of the action or settlement as well as his/her reasonable expenses, attorneys’ fees, and costs.¹⁵⁵

In Fiscal Year 2016 alone, 702 new qui tam actions were filed.¹⁵⁶ That same year, qui tam relators received more than $519 million from FCA actions. Indeed, from Fiscal Year 1988
through Fiscal Year 2016, relators have received over $6 billion. Thus, there is a significant
monetary incentive for qui tam relators to bring FCA actions.

**B. The False Statements Act**

Actions for violations of the False Statements Act ("FSA")\(^{157}\) often go hand in hand with
FCA criminal actions brought against contractors. Essentially, the FSA makes it a crime to
knowingly make a materially false statement to the federal government. The FSA states in
pertinent part:

(a) Except as otherwise provided in this section, whoever, in any matter within the
jurisdiction of the executive, legislative, or judicial branch of the Government of
the United States, knowingly and willfully--

(1) falsifies, conceals, or covers up by any trick, scheme, or device a
material fact;

(2) makes any materially false, fictitious, or fraudulent statement or
representation; or

(3) makes or uses any false writing or document knowing the same to
contain any materially false, fictitious, or fraudulent statement or entry;

shall be fined under this title, imprisoned not more than 5 years or, if the offense
involves international or domestic terrorism (as defined in section 2331),
imprisoned not more than 8 years, or both. If the matter relates to an offense
under chapter 109A, 109B, 110, or 117, or section 1591, then the term of
imprisonment imposed under this section shall be not more than 8 years.\(^{158}\)

There are five elements of a violation of the FSA: (1) the defendant made a statement; (2)
the statement was false; (3) the statement was material, (4) the statement was knowingly and
willingly made; and (5) the statement concerned a matter within the jurisdiction of a federal
department or agency.\(^{159}\) Under the FSA, the statement can be oral or written, signed or
unsigned, and sworn or unsworn.\(^{160}\)

Further, the false statement need not be made directly to a federal agency as long as
federal funds are involved.\(^{161}\) As the court stated in *United States v. Baker*\(^{162}\):
18 U.S.C. § 1001 is designed to protect federal funds and functions from fraudulent interference. In furthering these purposes, it is irrelevant whether defendant knew that his intentionally false statements might eventually influence a federal agency. Moreover, the requirement that defendant intend to deceive by making a statement which he knows is false serves to insure against punishing one who has committed no culpable act. While we reassert this strict requirement of specific intent, we decline to extend it to require proof of defendant’s knowledge of federal involvement. In other words, we hold that proof of defendant’s knowledge that a federal agency was involved in the matter is not an essential element of a § 1001 conviction. See United States v. Lewis, 587 F.2d 854, 857 (6th Cir. 1978) (per curiam).

Nor does the government have to prove that the defendant knew that his/her statements eventually would be transmitted to a federal agency or that the statements in fact were transmitted to the federal government. For example, a contractor was convicted of violating the FSA when he submitted false invoices for snow removal work to the City of Chicago, which was using commingled federal, state, and local funds to pay for the snow removal, even though the City discovered the false invoices and did not pass them through to the federal government.

1. **Materiality Requirement**

The FSA imposes liability only when the false statement is material. The FSA, however, does not define “materially false.” In determining whether a false statement is material, the courts generally look to see whether the statement had a natural tendency to influence, or was capable of influencing, the agency decision. It is not necessary that the government actually be influenced by the false statement.

In United States v. Abraham, the Court of Appeals for the Fifth Circuit explained:

The Defendant challenges only whether the Government proved that the Defendant’s false statement was “material.” The parties agree that the first step in the analysis is to ask two “questions of purely historical fact” (1) what statement was made, and (2) what decision the agency was trying to make. [United States v. Najera Jimenez, 593 F.3d 391, 399 (5th Cir. 2010)] (citing United States v. Gaudin, 515 U.S. 506, 509, 115 S. Ct. 2310, 132 L.Ed.2d 444 (1995)). The third question is whether, under the appropriate legal standard, the statement was
material to the decision the agency is trying to make. To meet the standard of materiality under § 1001, “[t]he statement must have a natural tendency to influence or be capable of influencing the decision of the decisionmaking body to which it was addressed.” Id. (internal citations omitted). Actual influence is not required—a statement can be ignored or never read and still be material—and the statement need not be believed. Id.

In United States v. Clark, the Court of Appeals for the Seventh Circuit affirmed criminal convictions against the owner of a trucking business for submitting false certified payrolls. The defendant’s trucking company was hired to perform hauling services on a state-and federally funded highway project, which required the payment of Davis-Bacon Act prevailing wages. The defendant submitted weekly payroll certifications in which he falsely attested to paying his workers prevailing wages.

The defendant was convicted of violating the FSA. On appeal, the defendant argued that the government presented insufficient evidence for the jury to conclude that his false statements were material. The defendant argued that, since he was not required to pay prevailing wages, the payroll certifications were not material. The court disagreed, finding that the defendant was convicted for lying about the wages he paid and not necessarily for violating the Davis-Bacon Act itself. The court noted that false statements on the certified payrolls would have a natural tendency to influence the federal government in some way.

2. **Knowledge Requirement**

A violation of the FSA requires proof that the defendant made the false statement knowingly and willfully or at least with reckless disregard of the truth and with a conscious purpose to avoid learning the truth.\(^{171}\) The knowingly and willfully requirement relates to the defendant’s knowledge that the statements made to the government were false or were made with the conscious purpose of evading the truth.\(^ {172}\) In other words, knowingly only requires proof that the defendant acted with knowledge, and willfully only requires proof that the defendant acted
deliberately and with knowledge that his/her statements were false when made or consciously disregarded the statement’s likely falsity.\(^{173}\)

In *United States v. White*\(^{174}\), several government contractors and subcontractors were convicted of submitting false statements and false claims to NASA on four construction contracts at the Kennedy Space Center. The defendants submitted requests for equitable adjustment that were characterized as cost proposals. The defendants represented during the change order negotiations that the itemized expenses in the costs proposals were not estimates but rather hard dollar hours and actual costs. They also misrepresented who actually was performing the work.

In actuality, the cost proposals were based on estimates. These estimates were significantly inflated when compared to actual hours and actual costs. The defendants argued that the cost proposals were merely estimates presented to the government as an opening position in the process of negotiating the amount to be paid and could not constitute a false statement as a matter of law.

The court disagreed, noting that the evidence was uncontradicted that the cost proposals deleted the formulas and factors used to derive the pricing and that the defendants knew this information had been deleted. Further, various defendants had reviewed the timecards and were aware that the hours submitted in no way reflected the actual hours shown on the timecards. The court stated that a contractor may not invoke the terms estimates and negotiation to justify a “willful attempt to fleece the system.” The court also held that, even if the estimates truly were based on mathematical formula, the defendants had a duty to make sure that they reflected reasonably incurred costs, and the failure to do so demonstrated a reckless disregard of the truth.
with a conscious purpose to avoid learning the truth. According to the court, such action is sufficient to show that a false statement was made knowingly or willfully.

C. Truthful Cost or Pricing Data

The federal government is required to purchase supplies, services, and construction at fair and reasonable prices. The Truthful Cost or Pricing Data statute (formerly known as the Truth in Negotiations Act or TINA) is designed to put the federal government on equal footing with government contractors when negotiating contracts and change orders to ensure that the price is fair and reasonable. The statute requires contractors and subcontractors to submit cost or pricing data under certain circumstances and to certify that such data are current, accurate and complete as of the date of final agreement on price. The contractor must disclose all facts at the time of price agreement that “prudent buyers and sellers would reasonably expect to affect price negotiations.” This duty is continual, and the contractor must update its data submission, until the parties reach an agreement on the price to be paid.

The Truthful Cost or Pricing Data statute is applicable to government contracts. In addition, some state and local government require their contractors to submit cost or pricing data when negotiating change orders.

The contractor’s unintentional failure to submit accurate, current and complete cost or pricing data (hereinafter referred to as “defective cost or pricing data”) can result in a contract price reduction under the various Price Reduction for Defective Certified Cost or Pricing Data clauses. The contract price will be reduced to exclude any significant amount by which the price was increased because the contractor submitted defective cost or pricing data. Intentional submission of defective cost or pricing data can result in civil and criminal penalties under other federal statutes such as the FCA and the FSA.
1. What Are Cost or Pricing Data

The FAR defines cost or pricing data in pertinent part as:

[A]ll facts that, as of the date of price agreement, or, if applicable, an earlier date agreed upon between the parties that is as close as practicable to the date of agreement on price, prudent buyers and sellers would reasonably expect to affect price negotiations significantly. Cost or pricing data are factual, not judgmental; and are verifiable. While they do not indicate the accuracy of the prospective contractor’s judgment about estimated future costs or projections, they do include the data forming the basis for that judgment. Cost or pricing data are more than historical accounting data; they are all the facts that can be reasonably expected to contribute to the soundness of estimates of future costs and to the validity of determinations of costs already incurred.\textsuperscript{179}

Examples of cost or pricing data include:

1. Vendor quotations;
2. Nonrecurring costs;
3. Information on changes in production methods and in production or purchasing volume;
4. Data supporting projections of business prospects and objectives and related operations costs;
5. Unit-cost trends such as those associated with labor efficiency;
6. Make-or-buy decisions;
7. Estimated resources to attain business goals; and
8. Information on management decisions that could have a significant bearing on costs.\textsuperscript{180}

It is important to note that cost or pricing data are factual information and are not subjective judgments. While subjective judgments themselves are not cost or pricing data, the factual information on which that judgment is based is cost or pricing data that has to be disclosed.
2. **When Cost or Pricing Data Are Required**

Unless one of the statutory exemptions applies, the federal government is required to obtain certified cost or pricing data before accomplishing any of the following actions if the action will be in excess of $750,000:

1. The award of any negotiated (as opposed to sealed bid) contract;
2. The award of a subcontract at any tier, if the contractor and each higher-tier subcontractor were required to furnish certified cost or pricing data;
3. The modification of any sealed bid or negotiated contract (whether or not certified cost or pricing data were initially required) or any subcontract.\(^{181}\)

In determining the amount of a modification, both price increases and decreases are considered. For example, if a modification will increase some of the contractor’s costs by $600,000 but decrease other costs by $200,000, the modification exceeds the cost or pricing data submission threshold ($600,000 + $200,000 = $800,000).

The Truthful Cost or Pricing Data statute has exceptions to the requirement to submit certified cost or pricing data.\(^{182}\) Except for modifications, these exceptions often are broader than the rule. As a result, the award of contracts and subcontracts usually does not require the submission of certified cost or pricing data. The exceptions are:

1. Price based on adequate competition. In general, price is based on adequate price competition if two or more responsible offerors, competing independently submit offers that satisfy the government’s requirements or the government had a reasonable expectation that it would receive two or more offers even if only one offer is received.\(^{183}\)
2. Prices are set by law or regulation.\(^{184}\)
3. The government is acquiring a commercial item.\(^{185}\)
4. The head of the contracting activity waives the requirement.\(^{186}\)

Application of these exceptions is within the sound discretion of the contracting officer.\(^{187}\)
When an exception is applied, the federal government may not require the submission of certified cost or pricing data. The government, however, still may require the submission of other data if necessary to allow the government to determine that the proposed price is fair and reasonable. Such data can include uncertified cost or pricing data, sales data, and any other information reasonably required to explain the offeror’s estimating process such as the judgmental factors applied, mathematical or other methods used in the estimate, and the nature and amount of any contingencies included in the proposed price.

3. **Certification of Cost or Pricing Data**

When required to be submitted under the Truthful Cost or Pricing Data statute, the cost or pricing must be certified by the contractor or subcontractor. The contractor or subcontractor must execute the government’s Certificate of Current Cost or Pricing Data. The Certificate states:

**CERTIFICATE OF CURRENT COST OR PRICING DATA**

This is to certify that, to the best of my knowledge and belief, the cost or pricing data (as defined in section 2.101 of the Federal Acquisition Regulation (FAR) and required under FAR subsection 15.403-4) submitted, either actually or by specific identification in writing, to the Contracting Officer or to the Contracting Officer’s representative in support of _____ * are accurate, complete, and current as of ______**. This certification includes the cost or pricing data supporting any advance agreements and forward pricing rate agreements between the offeror and the Government that are part of the proposal.

Firm __________________________________________________________

Signature ______________________________________________________

Name _________________________________________________________

Title __________________________________________________________

Date of execution*** ____________________________________________

* Identify the proposal, request for price adjustment, or other submission involved, giving the appropriate identifying number (e.g., RFP No.).
Since this is a certificate, if the contractor, subcontractor, or design professional knowingly submits a false certification, it may be subject to liability under the FCA or FSA.

4. **Price Reduction for Defective Cost or Pricing Data**

If the contractor submits defective cost or pricing data, the federal government can seek a price reduction under the contract’s Price Reduction for Defective Certified Cost or Pricing Data clause. The contract price will be reduced to exclude any significant amount by which the price was increased because the contractor submitted defective cost or pricing data. In other words, the government is entitled to a contract price adjustment if the government proves that the contractor furnished defective cost or pricing data and that the government relied on the defective cost or pricing data to its detriment.

The government has the burden of proving by a preponderance of the evidence that:

1. The contractor submitted cost or pricing data within the meaning of the Truthful Cost or Pricing Data statute.
2. Cost or pricing data was defective.
3. The government detrimentally relied on the defective data.
4. The final negotiated price was overstated as a result.

There is a rebuttable presumption that the natural and probable consequence of the contractor’s nondisclosure or the use of noncurrent or inaccurate cost or pricing data is an increase in the contract price. The contractor can rebut this presumption by showing that the defective data
was not relied upon or that the undisclosed data would not have been relied upon even if there had been complete disclosure.  

If the contractor rebuts the presumption, the government then must prove that it relied upon the defective data to its detriment in agreeing to the contract price. The government bears the ultimate burden of proving a causal connection between the defective data and the overstated contract price.  

5. Limited Defenses

The Truthful Cost or Pricing Data statute limits the defenses that a contractor can raise in defending against a government action for defective cost or pricing data. Specifically, the statute provides that it is not a defense that:

1. The contract price would not have been modified even if accurate, complete, and current cost or pricing data had been submitted by the contractor or subcontractor because the contractor or subcontractor was the sole source of the property or services procured or otherwise was in a superior bargaining position with respect to the property or services procured.

2. The contracting officer should have known that the cost and pricing data in issue were defective even though the contractor or subcontractor took no affirmative action to bring the character of the data to the attention of the contracting officer.

3. The contract was based on an agreement between the contractor and the United States about the total cost of the contract and there was no agreement about the cost of each item procured under such contract.

4. The prime contractor or subcontractor did not submit a certification of cost and pricing data.

VI. Codes of Conduct and Ethics and Compliance Programs

A. The Backdrop for Codes of Conduct and Compliance Programs

Having a well-crafted, written code of conduct and ethics compliance program might not be a magic bullet to avoiding PR disasters like the recent Wells Fargo and Volkswagen scandals referenced at the outset of this paper, but it is pretty close. To use a construction term, a good
code of conduct and accompanying compliance program is the load-bearing beam that prevents
the structure from collapsing in the seismic event of an ethics scandal. Better yet, it may actually
prevent one. As many contractors have learned the hard way, not having a well-crafted
compliance program can become a serious legal issue, as opposed to simply being a “best
practices” goal based in ethics.

B. Why Have a Written Code of Conduct?

There are many reasons having a written code of conduct is important to virtually any business. As stated by the organization, Ethics and Compliance Initiative, which assists
companies in preparing codes of conduct and ethics compliance programs, “[a] well-written code
of conduct clarifies an organization's mission, values and principles, linking them with standards
of professional conduct. The code articulates the values the organization wishes to foster in
leaders and employees and, in doing so, defines desired behavior. As a result, written codes of
conduct or ethics can become benchmarks against which individual and organizational
performance can be measured.”

Beyond the impact on the business and its employees, a code also serves numerous
outward-facing goals, such as compliance (e.g., the Sarbanes-Oxley Act requires public
companies to implement codes or explain why they do not have one). Moreover, a well-crafted
code can be an effective marketing device. And perhaps most critical for many organizations,
having a written code and complying with it in good faith can offer risk mitigation in the form of
reduced exposure to fines and other liabilities. A recent example that came up in this author’s
experience was the case of a California employee who started a competing business prior to
termination of his employment. Although California employment laws are notoriously
employee-friendly, and the enforcement of non-compete agreements is difficult or impossible, it
was an outright violation of the company’s code of conduct, which expressly prohibited
competing with the employer. This helped the company establish cause to terminate the employee and avoid a potential wrongful termination case.

C. Government Contracting and Codes of Conduct

For government contractors, there are exponentially more reasons for adopting a well-crafted code of conduct. As the largest consumer of goods and services in the United States, the federal government presents an opportunity for many contractors to bid work that is attractive and fairly steady. However, contracting with the federal government is very different from contracting in the private sector. Failure to abide by public contracting’s stringent and numerous requirements could lead to suspension or debarment from future public contracting (which debarment would also flow down to the state and municipal level and impact public contracting as a whole), civil actions resulting in the payment of treble damages, and, in extreme cases, criminal prosecutions of the parties involved, including their principals.

By law, federal government contractors are required to be honest and have integrity. According to the government, “[t]he public demands honesty and integrity in corporations with which the Government does business.” This mandate is further supported by the countless codifications of laws, prohibiting bribes, kickbacks, gifts in exchange for favors, conflicts of interest and other conduct that would undercut the integrity of public procurements.

Since 2008, the federal government has required its contractors to have written codes of conduct, compliance programs and internal controls designed to curb unethical behavior. When such internal controls come into play, a contractor’s ability to respond quickly and undertake effective corrective actions could easily be the difference between continuing to be a federal government contractor, versus suspension or debarment of the company.
D. **Looking Inward When Planning a Compliance Program**

Whether by virtue of complying with contractual obligations or avoiding bad press, it is in the interest of all contractors (especially government contractors), prior to creating a compliance program, to look long and hard in the mirror, with specific attention to accomplishing the following goals:

1. Identify business activities that are especially prone to misconduct, and craft the code of conduct specifically to address those vulnerabilities;
2. Continuously train employees on the company’s code of conduct;
3. Foster a workplace environment in which employees can discuss and raise any ethical concerns which they might have;
4. Create and communicate a process for employees to report perceived misconduct to management in an anonymous fashion;
5. Create and communicate “whistleblower” protections for employees who report potential or perceived misconduct;
6. Establish and communicate to employees the sanctions for violating the company’s code — and follow through with appropriate repercussions in the event misconduct is found;
7. Track employee compliance with the company’s code;
8. Create and maintain procedures for investigating and disclosing misconduct to the appropriate government officials when credible evidence exists; and
9. Maintain and update the code as appropriate.

When this program is planned and created, the written code of conduct will summarize it comprehensively.

E. **The Written Code of Conduct – Simplicity is Paramount**

If a company’s code of conduct is not a document that is easily digestible by a typical employee, or worse yet, an executive running the business, it is a good indicator that it is too long, too complicated, or poorly worded. In simple terms, a code of conduct should:
• Express and represent the business’s corporate culture.

• Clearly and concisely communicate behavior in which employees are expected to engage.

• Reference additional resources that employees may turn to in complicated situations.

• Identify and address the company’s unique critical ethics and compliance risks.

• Communicate the enterprise’s commitment to integrity, both internally and externally.

A written code of conduct must be easy to comprehend for it to be effective. Employees who reference it will be discouraged from pursuing a positive solution if they cannot understand something in the document. It is critical to explain how employees can raise concerns or seek answers. Simplicity is key.

Beyond being easy to follow, a code should take into account the industry in which the company practices, with its unique risks and exposures. It is important that the various units and departments within the organization work together in preparing the code, to make certain that the code of conduct addresses the most critical issues company-wide.

The code needs to be able to evolve with technological, cultural and societal advancement. Before social media became the hot topic, surfing the internet was the new phenomenon distracting employees. Before that, it was email. We do not as we sit here have any clue what the new concerns will be even five or ten years from now. The code needs to be able to change with the times. Emerging issues may be somewhat identifiable, and if so, the code should reflect them as they emerge. And the code will need to be updated as society evolves.

The code – and accompanying company policies and processes – must also provide protections for whistleblowers. It is critical that it provide employees with resources they can contact, including but not limited to an ethics hotline, a hierarchy of reporting, a human
resources department, and so on. The code should make it clear that reporting misconduct is protected, and that retaliation by the company or management will not be tolerated.

In addition to the above, a business should consider including all or some of the following content within its written code of conduct:

- Description of Company Vision
- A Brand Promise
- Listing of Employee & Employer Responsibilities
- Duties of Management
- Discussion of Workplace Environment
- Equal Opportunity Employer Statement
- Diversity Statement
- Alcohol and Drugs Policy
- Health & Safety Discussion
- Conflicts of Interest Prohibition
- Gifts & Entertainment Policy
- Fair Competition Policy
- Anti-Bribery & Corruption Policy
- Insider Trading Prohibition
- Policies Concerning Company Assets, Intellectual Property, Books & Records, Confidential Business Information, Privacy, Electronic Communications
- Policy Concerning Political Involvement, Contributions
- Policy Concerning Charitable Contributions
- Guidelines for Making Good Decisions
If the code is simple, and lays out the principles described above, it will be more effective and therefore more valuable to the business and its workforce.

**F. Internal Compliance Policies, and Monitoring and Reporting Mechanisms**

Once a code has been drafted and adopted by the contractor, the next step, for federal contracts in particular and any company that strives to be FAR-compliant, is to create and implement the procedures outlined in the code through a series of policies, referred to in the FAR as the “Internal Control System.”\(^{206}\) Companies must create standards and procedures to facilitate timely discovery of misconduct, and make sure that they timely activate corrective actions. FAR 52.203-13(c)(2)(ii) specifies the requirements for an acceptable Internal Control System, setting forth that it should: (1) assign the duty to oversee the ethics compliance program to a high-level management employee within the company; (2) assure that the program receive adequate funding and other resources; (3) detect and implement measures to avoid conflicts of interest for high-level employees; (4) make sure there are periodic audits, evaluations, and updates to the code, the Internal Control System, and the training programs; (5) provide a program to train employees in how to carry out their duties in an ethical way, and in the detection and reporting of potentially improper conduct; (6) create and implement an internal reporting system that allows employees to report improper conduct in confidence; (7) discipline employees who have violated ethics rules; (8) disclose in writing to the contracting agency evidence of ethics violations in connection with a contract; and (9) engage in full cooperation with government agencies.\(^{207}\)

FAR-compliant programs will include common processes such as anonymous reporting procedures, often in the form of ethics hotlines. What happens following a report can and will vary within the parameters of FAR, but should certainly include having a designated executive-level manager investigate the concern, report high level concerns to the company’s board of
directors if credible evidence is discovered, and take appropriate action thereafter. Procedures relating to lower level concerns can be distinguished within the program, and provide for lower-level reporting and executive processes.

G. Conclusion

Companies with more than a few employees would be doing themselves a disservice by not adopting a code of conduct and ethics compliance program, applying the principles described above. What’s more, if a company is a government contractor, it is required that they do so. In an era of viral publicity, having an effective program can be a necessary survival tool.

VII. Appendix

In the pages that follow, we have provided a sample Code of Conduct – published and implemented by BrightView Landscapes, LLC.

1 Continental Mgmt., Inc. v. United States, 527 F.2d 613, 617 n. 3 (Ct. Cl. 1975).
3 JAMES F. NAGLE, FEDERAL GOVERNMENT CONSTRUCTION CONTRACTS 1 (Am. Bar Ass’n 2003).
6 Id.
8 69 Cal. Rptr.3d 184, 192 (Cal. Ct. App. 2007).
13 See e.g., St. Louis Hous. Auth. ex rel. Jamison Elec., LLC v. Hankins Constr. Co., Case No. 4:12CV1746, 2013 WL 6592754 (E.D. Mo. Dec. 16, 2013) (holding that subcontractors were not subject to the public contracting laws that applied to the general contractor); cf. Mechanical Contractors Ass’n of E. Pa, Inc. v. Commwealth Dept. of Educ., 860 A.2d 1145 (Pa. Commw. Ct. 2000), order aff’d in part, rev’d in part, 934 A.2d 1262, 1267 (Pa. 2007) (competitive bidding statute applicable only to certain specialty trades, such as electrical, plumbing, heating and air conditioning); see also BRUNER & O’CONNOR, supra note 5, § 2:20.
14 See e.g., BRUNER & O’CONNOR, supra note 5, § 2.20 and the authorities cited therein.
The determination of whether a bidder is responsible and whether its bid is responsive to the terms and conditions of the solicitation for bid are two separate tests that must be passed to be awarded a competitively bid government contract. *S.A. Healy Co. v. Washington Metro Area Transp. Auth.*, 615 F. Supp. 1132, 1134, n.3 (D.D.C. 1985).

*See e.g., Prote Contracting Co. v. New York City Sch. Constr. Auth.*, 670 N.Y.S.2d 562, 564 (N.Y. App. Div. 1998) (In determining the lowest responsible bidder, the agency should be concerned with the bidders’ skill, judgment and integrity.).

FAR 9.104-1.

*See BRUNER & O’CONNOR, supra* note 5, § 2.110.

*See* FAR 9.104-3(c).

*See e.g.,* FAR 6.00, 14.000.

*See BRUNER & O’CONNOR, supra* note 5, § 2:32.


*See BRUNER & O’CONNOR, supra* note 5, § 2:32.

*See e.g., Richmond Co. v. Rock-a-way, Inc.*, 404 So.2d 121, 122-23 (Fla. App. 1981) (citing case law from 1932, for the proposition that “The rule is well settled that all agreements, whether principal or subsidiary in character which, in their necessary operation upon the actions of contractors engaged in bidding for public work, tend to restrain the natural rivalry and competition of the parties, and thus produce a result disadvantageous to the public, are against public policy and void.”).

A further discussion of the consequences of statutory violations follows *infra* at part III.B.1.

*See e.g., Addyston Pipe & Steel Co. v. United States*, 175 U.S. 211, 212 (1899). A “restraint of trade” is any contract, combination or conspiracy that affects a restraint of competition. 58 C.J.S. Monopolies §§ 68, 102 (2009).


*Richmond Co.*, 404 So. 2d at 122-23.


*Reicher*, 983 F.2d. at 170.

*Id.* at 170.

*Id.*

165 S.W.2d 512, 513-14 (Tex. App. 1942).

642 F.2d 290 (9th Cir. 1981).

*Id.* at 292.

*Id.* at 295.

527 F.2d 613, 617 n. 3 (Ct. Cl. 1975).


A corporation will be found liable for its employees’ illegal kickbacks if the acts were made knowingly by employees whose authority or managerial roles were such that their knowledge is imputable to the corporation. *Vavra v. Kellogg Brown & Root, Inc.*, 848 F.3d 366, 375 (5th Cir. 2017).


*Vavra*, 848 F.3d at 379.
42 Purdy, 144 F.3d at 243.
43 Id. at 242.
44 Id. at 243, 245.
45 Id. at 244.
48 Id. at 800-801.
50 Id. at 1222 (S.D. Ind. 1975).
51 Id. at 1228.
52 Vavra, 848 F.3d at 792-93 (2005).
53 Id. at 800-801.
54 See e.g., United States v. Evans, 572 F.2d 455, 479 (5th Cir. 1978) (“It is not necessary that the official actually engage in identifiable … misconduct nor that any specific quid pro quo be contemplated by the parties.”)
56 BRUNER & O’CONNOR, supra note 5, § 2:12; Kathuria, 38 PUB. CONT. L. J. at 803. 
59 See BRUNER & O’CONNOR, supra note 5, § 2:59; Kathuria, 38 PUB. CONT. L. J. at 803.
60 CACI, Inc.-Federal v. United States, 719 F.2d 1567, 1576 (Fed. Cir. 1983).
63 Turner Constr. Co. v. United States, 645 F.3d 1377, 1387 (Fed. Cir. 2011).
64 Id.
65 Texas-Capital Contractors, Inc. v. Abdnor, 933 F.2d 261, 267-68 (5th Cir. 1990).
However, this criticism may not apply, if all of the bidding subcontractors for a project have invested time and expense in preparation of their respective bids, whether or not their bid was the one used by the prime to obtain the general contract.

On the other hand, some have concerns that such statutes give the listed subcontractors extraordinary bargaining leverage with the prime contractor. For example, the court in Jay Dee/Mole Jr. Venture v. Mayor and City Council of Baltimore, Md., 725 F. Supp. 2d 513, 527 (D. Md. 2010) observed, “I must note my concern about the City's M/WBE requirements and compliance process. By demanding that prime contractors hire M/WBE subcontractors—who are likely to be repeat players familiar with City officials—and generally refusing to allow post-contract award substitution, the City gives M/WBEs extraordinary bargaining power in negotiating their subcontracts. Prime contractors unable to finalize these subcontracts may find themselves at the whim of unelected bureaucrats—who may have preexisting relationships with the M/WBE(s) involved, yet possess the de facto power to scuttle contracts often worth millions of dollars.”

Such subcontractor listing requirements also have the beneficial purpose of allowing the government to verify the responsibility of each subcontractor. See Joel Rubinstein and Lawrence Rosen, Subcontracting, FEDERAL GOVERNMENT CONSTRUCTION CONTRACTS, p. 558 (Am. Bar Ass’n 2003).

Gregory and Tavers, 30 CONSTR. LAW at 33.


BRUNER & O’CONNOR, supra note 5, § 2:176.

BRUNER & O’CONNOR, supra note 5, § 2:182.

BRUNER & O’CONNOR, supra note 5, § 2:176.


Purdy, 144 F.3d at 243. See also Grossman, 400 F.2d at 953; Morse Diesel Int’l., Inc., 66 Fed. Cl. at 801.


JAMES F. NAGLE, A HISTORY OF GOVERNMENT CONTRACTING 191-92 (2D ED. 1999).


The decline in FCA actions was caused in significant part by amendments to the FCA in 1943 that reduced the amount that qui tam plaintiffs could recover under FCA actions and prohibited FCA actions when the Federal Government already had information in its possession regarding the alleged false claim.


Id. at 669.


One basis for liability is false certifications in progress payments. Often in progress payments, the contractor will certify that the work was performed in accordance with the contract requirements and that subcontractors have been paid in full. If these certifications are false, the contractor may be held liable under the FCA. See The Liquidating Trustee Ester Duval of KI Liquidation, Inc. v. United States, 116 Fed. Cl. 338 (2014); Lamb Eng’g & Constr. Co. v. United States, 58 Fed. Cl. 16 (2003).


See generally, United States ex rel. Yannacopoulos v. General Dynamics, 652 F.3d 818, 833 (7th Cir. 2011) (providing that faulty calculations are not actionable under the FCA); United States ex rel. Owens v. First Kuwaiti Gen. Trading & Contracting Co., 612 F.3d 724, 732-33 (4th Cir. 2010) (holding that, for estimates to qualify as knowingly false claims for FCA purposes, the estimate must be made by one who either knows of no facts that would support the estimate or has knowledge of facts that preclude the estimate); United States v. Basin Elec. Power Co-op., 248 F.3d 781, 794 (8th Cir. 2001) (holding that the mere misinterpretation of a contract cannot be the basis of an FCA violation); Hindo v. Univ. of Health Sciences/The Chicago Med. Sch., 65 F.3d 608, 613–14 (7th Cir. 1995) (providing that innocent mistakes, negligence, and the common failings of scientists or engineers are insufficient to establish false claim); United States v. Kernan Hospital, 880 F. Supp.2d 676 (D. Md. 2012) (holding that mere allegations of poor and inefficient contract performance are not a false claim).


128 154 F.3d. 1357, 1366 (Fed. Cir. 1998).

129 Hindo, 65 F.3d at 613.


131 531 F.3d 1159, 1168 (9th Cir. 2008).


133 United States ex rel. Burlbaw v. Orenduff, 548 F.3d 931, 949 (10th Cir. 2008) (stating that numerous courts have observed that simple negligence does not violate the FCA); United States ex rel. Farmer v. City of Houston, 523 F.3d 333, 338 (5th Cir. 2008) (holding that the FCA’s mens rea requirement is not met by mere negligence or even gross negligence); United States ex rel. Aakhus v. Dyncorp, Inc., 136 F.3d 676, 682 (10th Cir. 1998) (holding that reckless disregard is an aggravated form of gross negligence); United States v. Krizek, 111 F.3d 934, 942 (D.C. Cir. 1997) (holding that reckless disregard lies on a continuum between gross negligence and intentional harm).


135 United Tech. Corp., 985 F.2d at 1156 (clarifying that the defendant’s knowledge of the falsity of its claim is not automatically exonerated by any overlapping knowledge by government officials); United States v. Newport News Shipbuilding, Inc., 276 F. Supp.2d 539, 564 (E.D. Va. 2003) (explaining that a contractor’s disclosure to the Government is relevant, not because government knowledge of a misrepresentation shields a contractor from liability but because evidence of disclosure may point persuasively away from the conclusion that the contractor made a knowing misrepresentation).

137 Id. at 2001.
138 Id. at 2002.
141 Id. at 2003-2004.
147 82 FR 9131.
149 FAR 52.209-5 requires the contractor to certify whether the offeror and/or any of its principals are presently debarred, suspended, proposed for debarment, or declared ineligible for the award of contracts by any Federal agency.
150 FAR 52.209-6 requires prime contractors to have their proposed subcontractors whose subcontracts will exceed $35,000, other than a subcontractor providing a commercially available off-the-shelf item, to disclose to the contractor, in writing, whether as of the time of award of the subcontract, the subcontractor, or its principals, is debarred, suspended, or proposed for debarment by the Federal Government. The prime contractor must notify the contracting officer if the subcontractor is ineligible and provide a compelling reason for doing business with the subcontractor.
156 Department of Justice Fraud Statistics Overview, note 44.
159 United States v. Ringer, 300 F.3d 788, 791 (7th Cir. 2002); United States v. Johnson, 937 F.2d 392, 396 (8th Cir. 1991); United States v. Lawson, 809 F.2d 1514, 1517 (11th Cir. 1987); United States v. Montemayor, 712 F.2d 104, 107 (5th Cir. 1983).
160 United States v. Massey, 550 F.2d 300, 305 (5th Cir. 1977).
161 United States v. Clark, 787 F.3d 451, 459 (7th Cir. 2015); United States v. Baker, 626 F.2d 512, 514 (5th Cir. 1980).
162 626 F.2d at 516.
164 United States v. Petullo, 709 F.2d 1178, 1180 (7th Cir. 1983) (citing United States v. Diaz, 690 F.2d 1352, 1357 (11th Cir. 1982)).
165 Id.
167 Id.; United States v. Moore, 612 F.3d 698, 701 (D.C. Cir. 2010); United States v. Moore, 446 F.3d 671, 681 (7th Cir. 2006); Christopher Village, L.P. v. United States, 360 F.3d 1319, 1336 (Fed. Cir. 2004); United States v. White, 270 F.3d 356, 365 (6th Cir. 2001); United States v. Calhoon, 97 F.3d 518, 530 (11th Cir. 1996); United States v. Lawson, 809 F.2d 1514, 1520 (11th Cir. 1987); United States v. Deep, 497 F.2d 1316, 1321 (9th Cir. 1974).
169 678 F.3d 370, 373-74 (5th Cir. 2012).
170 787 F.3d 451 (7th Cir. 2015).
171 United States v. Lupton, 620 F.3d 790, 806 (7th Cir. 2010); United States v. Lange, 528 F.2d 1280, 1288 (5th Cir. 1976).
172 Lupton, 620 F.3d at 806.
173 United States v. Gonsalves, 435 F.3d 64, 70 (1st Cir. 2006).
174 765 F.2d 1469 (11th Cir. 1985).
175 See generally, FAR 15.402(a).
177 Aerojet Solid Propulsion Co. v. White, 291 F.3d 1328, 1330 (Fed. Cir. 2002).
178 See FAR 52.214-27; FAR 52.215-10; FAR 52.215-11.
179 FAR 2.101.
180 Id.; Aerojet Solid Propulsion Co. v. White, 291 F.3d 1328 (explaining that additional sealed bids from suppliers were cost or pricing data required to be disclosed); Singer Co., Librascope Div. v. United States, 576 F.2d 905 (Ct. Cl. 1978) (asserting that downward trending labor costs were cost or pricing data); United States ex rel. Campbell v. Lockheed Martin Corp., 282 F. Supp.2d 1324 (M.D. Fla. 2003) (holding that labor performance data on efficiency of manufacturing operation was cost or pricing data); United States ex rel. Sanders v. Allison Engine Co., 364 F. Supp.2d 699 (S.D. Ohio 2003) (observing that redesign of generator set was not cost or pricing data when there was no factual data regarding potential cost savings from the redesign); United Technologies Corp., ASBCA No. 51410, 04-1 BCA ¶ 32,556 (2004) (holding that the best and final offer was cost or pricing data; In re Grumman Aerospace Corp., ASBCA No. 27,476, 86-3 BCA ¶ 19,091 (1986) (providing that cost analysis report consisting of narrative analysis and statistical data was cost and pricing data).
181 10 U.S.C. § 2306a(a); 41 U.S.C. § 3502; FAR 15.403-4(a)(1).
182 10 U.S.C. § 2306a(b); 41 U.S.C. § 3503(a); FAR 15.403-1.
185 10 U.S.C. § 2306a(b)(1)(B); 41 U.S.C. § 3503(a)(2); FAR 15.403-1(c)(3). FAR 2.101 contains a detailed definition of commercial item. Basically, a commercial item is an item of the
type customarily used by the general public for other than governmental purposes that has been sold, leased, or licensed to the general public or has been offered for sale, lease or license to the general public. Construction is not considered to be a commercial item.

186 10 U.S.C. § 2306a(b)(1)(C); 41 U.S.C. § 3503(a)(3); FAR 15.403-1(c)(4). Waivers only are supposed to be granted in exceptional cases.


188 FAR 15.403-1(b).

189 10 U.S.C. § 2306a(d); 41 U.S.C. § 3505; FAR 15.403-3(a)(1).

190 FAR 2.101.

191 FAR 15.403-4(b)(2); FAR 15.406-2.

192 FAR 15.406-2.

193 See FAR 52.214-27; FAR 52.215-10; FAR 52.215-11.


197 41 U.S.C. § 3506(b).

198 In re Aerojet Solid Propulsion Co., ASBCA No. 46057, 00-1 BCA ¶ 30,855 (2000); General Dynamics Corp., ASBCA No. 39866, 94-1 BCA ¶ 26,339 (1993).

199 10 U.S.C. § 2306a(e)(3); 41 U.S.C. § 2306a(c).


202 FAR Subpart 9.406, Debarment.

FAR 9.406-1, General

(a) It is the debarring official’s responsibility to determine whether debarment is in the Government’s interest. The debarring official may, in the public interest, debar a contractor for any of the causes in 9.406-2, using the procedures in 9.406-3. The existence of a cause for debarment, however, does not necessarily require that the contractor be debarred; the seriousness of the contractor’s acts or omissions and any remedial measures or mitigating factors should be considered in making any debarment decision. Before arriving at any debarment decision, the debarring official should consider factors such as the following:

(1) Whether the contractor had effective standards of conduct and internal control systems in place at the time of the activity which constitutes cause for debarment or had adopted such procedures prior to any Government investigation of the activity cited as a cause for debarment.

(2) Whether the contractor brought the activity cited as a cause for debarment to the attention of the appropriate Government agency in a timely manner.
(3) Whether the contractor has fully investigated the circumstances surrounding the cause for debarment and, if so, made the result of the investigation available to the debarring official.

(4) Whether the contractor cooperated fully with Government agencies during the investigation and any court or administrative action.

(5) Whether the contractor has paid or has agreed to pay all criminal, civil, and administrative liability for the improper activity, including any investigative or administrative costs incurred by the Government, and has made or agreed to make full restitution.

(6) Whether the contractor has taken appropriate disciplinary action against the individuals responsible for the activity which constitutes cause for debarment.

(7) Whether the contractor has implemented or agreed to implement remedial measures, including any identified by the Government.

(8) Whether the contractor has instituted or agreed to institute new or revised review and control procedures and ethics training programs.

(9) Whether the contractor has had adequate time to eliminate the circumstances within the contractor’s organization that led to the cause for debarment.

(10) Whether the contractor’s management recognizes and understands the seriousness of the misconduct giving rise to the cause for debarment and has implemented programs to prevent recurrence.

The existence or nonexistence of any mitigating factors or remedial measures such as set forth in this paragraph (a) is not necessarily determinative of a contractor’s present responsibility. Accordingly, if a cause for debarment exists, the contractor has the burden of demonstrating, to the satisfaction of the debarring official, its present responsibility and that debarment is not necessary.

(b) Debarment constitutes debarment of all divisions or other organizational elements of the contractor, unless the debarment decision is limited by its terms to specific divisions, organizational elements, or commodities. The debarring official may extend the debarment decision to include any affiliates of the contractor if they are—

(1) Specifically named; and

(2) Given written notice of the proposed debarment and an opportunity to respond (see 9.406-3(c)).

(c) A contractor’s debarment, or proposed debarment, shall be effective throughout the executive branch of the Government, unless the agency head or a designee (except see 23.506(e)) states in writing the compelling reasons justifying continued business dealings between that agency and the contractor.

(d)(1) When the debarring official has authority to debar contractors from both acquisition contracts pursuant to this regulation and contracts for the purchase of Federal personal property pursuant to the Federal Property Management Regulations (FPMR) 101-45.6, that official shall consider simultaneously debarring the contractor from the award of acquisition contracts and from the purchase of Federal personal property.
(2) When debarring a contractor from the award of acquisition contracts and from
the purchase of Federal personal property, the debarment notice shall so indicate
and the appropriate FAR and FPMR citations shall be included.


The debarring official may debar—
(a) A contractor for a conviction of or civil judgment for—
(1) Commission of fraud or a criminal offense in connection with—
(i) Obtaining;
(ii) Attempting to obtain; or
(iii) Performing a public contract or subcontract.
(2) Violation of Federal or State antitrust statutes relating to the submission of
offers;
(3) Commission of embezzlement, theft, forgery, bribery, falsification or
destruction of records, making false statements, tax evasion, violating Federal
criminal tax laws, or receiving stolen property;
(4) Intentionally affixing a label bearing a “Made in America” inscription (or any
inscription having the same meaning) to a product sold in or shipped to the United
States or its outlying areas, when the product was not made in the United States or
its outlying areas (see Section 202 of the Defense Production Act (Public Law
102-558)); or
(5) Commission of any other offense indicating a lack of business integrity or
business honesty that seriously and directly affects the present responsibility of a
Government contractor or subcontractor.
(b)(1) A contractor, based upon a preponderance of the evidence, for any of the
following—
(i) Violation of the terms of a Government contract or subcontract so serious as to
justify debarment, such as—
(A) Willful failure to perform in accordance with the terms of one or more
contracts; or
(B) A history of failure to perform, or of unsatisfactory performance of, one or
more contracts.
(ii) Violations of 41 U.S.C. chapter 81, Drug-Free Workplace, as indicated by—
(A) Failure to comply with the requirements of the clause at 52.223-6, Drug-Free
Workplace; or
(B) Such a number of contractor employees convicted of violations of criminal
drug statutes occurring in the workplace as to indicate that the contractor has
failed to make a good faith effort to provide a drug-free workplace (see 23.504).
(iii) Intentionally affixing a label bearing a “Made in America” inscription (or any
inscription having the same meaning) to a product sold in or shipped to the United
States or its outlying areas, when the product was not made in the United States or
its outlying areas (see Section 202 of the Defense Production Act (Public Law
102-558)).
(iv) Commission of an unfair trade practice as defined in 9.403 (see Section 201
of the Defense Production Act (Pub. L. 102-558)).
(v) Delinquent Federal taxes in an amount that exceeds $3,500.
(A) Federal taxes are considered delinquent for purposes of this provision if both of the following criteria apply:

(1) The tax liability is finally determined. The liability is finally determined if it has been assessed. A liability is not finally determined if there is a pending administrative or judicial challenge. In the case of a judicial challenge to the liability, the liability is not finally determined until all judicial appeal rights have been exhausted.

(2) The taxpayer is delinquent in making payment. A taxpayer is delinquent if the taxpayer has failed to pay the tax liability when full payment was due and required. A taxpayer is not delinquent in cases where enforced collection action is precluded.

(B) Examples.

(1) The taxpayer has received a statutory notice of deficiency, under I.R.C. §6212, which entitles the taxpayer to seek Tax Court review of a proposed tax deficiency. This is not a delinquent tax because it is not a final tax liability. Should the taxpayer seek Tax Court review, this will not be a final tax liability until the taxpayer has exercised all judicial appeal rights.

(2) The IRS has filed a notice of Federal tax lien with respect to an assessed tax liability, and the taxpayer has been issued a notice under I.R.C. §6320 entitling the taxpayer to request a hearing with the IRS Office of Appeals contesting the lien filing, and to further appeal to the Tax Court if the IRS determines to sustain the lien filing. In the course of the hearing, the taxpayer is entitled to contest the underlying tax liability because the taxpayer has had no prior opportunity to contest the liability. This is not a delinquent tax because it is not a final tax liability. Should the taxpayer seek tax court review, this will not be a final tax liability until the taxpayer has exercised all judicial appeal rights.

(3) The taxpayer has entered into an installment agreement pursuant to I.R.C. §6159. The taxpayer is making timely payments and is in full compliance with the agreement terms. The taxpayer is not delinquent because the taxpayer is not currently required to make full payment.

(4) The taxpayer has filed for bankruptcy protection. The taxpayer is not delinquent because enforced collection action is stayed under 11 U.S.C. 362 (the Bankruptcy Code).

(vi) Knowing failure by a principal, until 3 years after final payment on any Government contract awarded to the contractor, to timely disclose to the Government, in connection with the award, performance, or closeout of the contract or a subcontract thereunder, credible evidence of—

(A) Violation of Federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations found in Title 18 of the United States Code;

(B) Violation of the civil False Claims Act (31 U.S.C. 3729-3733); or

(C) Significant overpayment(s) on the contract, other than overpayments resulting from contract financing payments as defined in 32.001.

(2) A contractor, based on a determination by the Secretary of Homeland Security or the Attorney General of the United States, that the contractor is not in compliance with Immigration and Nationality Act employment provisions (see
Executive Order 12989, as amended by Executive Order 13286). Such determination is not reviewable in the debarment proceedings.

(c) A contractor or subcontractor based on any other cause of so serious or compelling a nature that it affects the present responsibility of the contractor or subcontractor.


205 FAR 3.10, Contractor Code of Business Ethics and Conduct.

206 FAR 52.203-13(c)(2)(i).

207 FAR 52.203-13(c)(2)(ii).