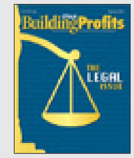

BY DAVID R. COOK & MARK V. HANRAHAN

The False Claims Act: What CFMs Need to Know

Recent amendments to the *False Claims Act* (FCA)[1] have eased requirements for recovery against contractors by the government and whistleblowers.

By eliminating previously existing "intent" and "presentment" requirements, these amendments have substantially increased contractors' exposure to liability under the FCA – which permits the government to recover three times the resulting loss (i.e., treble damages). While this article refers to "contractors," the FCA equally applies to subcontractors and sub-subcontractors of any tier.

The FCA was enacted during the Civil War to combat fraud associated with government contracts. The FCA has since been amended several times, including through the *Fraud Enforcement and Recovery Act of 2009* (FERA). This amendment brought about sweeping changes that broadened the statute's reach and increased the government's power to bring and prosecute claims.

The Department of Justice reports that FY 2012 was a record-breaking year for FCA claims.[2] It recovered approximately $5 billion – the most it has recovered in a single year. Interestingly, since 2009 (when FERA was enacted) the government has recovered $13.3 billion, which is more than a third of total recoveries since the FCA was last amended in 1986.

The FCA's reach can extend to contractors that do business with the federal government in various forms: 1) by contracting directly with the government, 2) by performing work on federal projects, or 3) by performing work on state or local projects that receive federal funds. In addition, claims can be pursued by the government or by private citizens, known as whistleblowers or *qui tam* relators. (For more information, see next page.)

Liability under the FCA is tied to "claims," which typically involve representations about cost or related financial information made in connection with a request for payment of money under a governmental contract. Thus, CFMs should evaluate and pay close attention to the requirements of the FCA so that they can avoid potential liability.

Basics of the False Claims Act

The FCA authorizes enhanced recovery by the government or private individuals against a person who:

- Knowingly presents, or causes to be presented, a false or fraudulent claim for payment or approval;
- Knowingly makes, uses, or causes to be made or used, a false record or statement material to a false or fraudulent claim;
- Has possession, custody, or control of property or money used, or to be used, by the government and knowingly delivers, or causes to be delivered, less than all of that money or property;
- Is authorized to make or deliver a document certifying receipt of property used, or to be used, by the government and, intending to defraud the government, makes or delivers the receipt without completely knowing that the information on the receipt is true;
- Knowingly buys, or receives 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;
- Knowingly makes, uses, or causes to be made or used, a false record or statement material to an obligation to pay or transmit money or property to the government, or knowingly conceals or knowingly and improperly avoids or decreases an obligation to pay or transmit money or property to the government; or
- Conspires to do any of these.

The FCA's scope is broad and its penalties are severe. If one of these acts is committed, civil penalties of $5,500 and not more than $11,000 per claim, plus three times the amount of the loss, are imposed.

Important Definitions

The FCA introduces three fundamental concepts that are critical to understanding its scope. First, to establish a violation of the FCA, a plaintiff (either the government or a *qui tam* relator) must show that a contractor or subcontractor *knowingly* committed the violation. The FCA defines the terms "knowing" and "knowingly" to mean 1) actual knowledge of information, 2) deliberate ignorance of the truth or falsity of information, or 3) reckless disregard of the truth or falsity of information.[3] Importantly, to impose liability, the FCA does not require the plaintiff to show a specific intent to defraud. A simple "knowing" violation is sufficient.

Second, several of the listed violations require the plaintiff to show a contractor or subcontractor made a claim. Under the FCA, a "claim" is any request or demand for money or property, whether or not the government has title to the money or property.[4]

Before FERA, the FCA applied solely to claims presented to the government, known as the "presentment" requirement. FERA expanded the FCA to include claims made to others 1) if the demand is for money or property to be spent or used on the government's behalf or to advance a government program or interest and 2) if the government provides or has provided any portion of the money or property or will provide reimbursement. The amendment by FERA was designed to expand the FCA to include claims made by subcontractors and others that have no direct contract with the government.

Third, for some violations, a plaintiff must show the false statement was material to the claim. The term "material" means having a natural tendency to influence, or be capable of influencing, the payment or receipt of money or property.[5]

With an understanding of the FCA itself, along with these three concepts, contractors can begin to assess their risk of FCA liability.

Risk Assessment Under the FCA by Contractors & Subcontractors

To identify and mitigate risk under the FCA, contractors on federal projects should review any process in which information is presented to the government or any other entity in connection with any request for payment of money on a governmental project. In this regard, there are certain key scenarios that pose the most potential risk to contractors under the FCA.

Risk Arising from the Payment & Invoicing Process

The most common example of a claim is a document requesting payment, such as an application for payment or invoice. Here, for example, a knowing misrepresentation of actual labor, material, or equipment costs under a cost-based contract could result in an overpayment and give rise to liability under the FCA. Additionally, on a lump-sum contract, inflated representations of progress or completion could support an FCA claim. For example, the contents of progress reports and schedule updates that report on the status of work, if false, could give rise to FCA liability. Likewise, any document, record, or certification that is material to the evaluation of a request for payment falls within the ambit of a claim.

One case, ***Veridyne Corp. v. United States***, 105 Fed. Cl. 769 (2012), provides particularly instructive examples. The contractor submitted invoices to the government that

Private Suits Under the FCA: **Qui Tam Actions**

In addition to the federal government bringing an action directly, private citizens may sue on behalf of the government to recover funds obtained from the government by fraud. The suits brought by private citizens are known as ***qui tam*** actions.

The FCA provides substantial incentive to private citizens to commence ***qui tam*** actions, as the FCA allows such private citizens to receive between 15-25% of the government's recovery and attorneys' fees. Typical relators are company insiders who discover that their employer has provided false information and overcharged the government on a claim. Other relators include labor unions and disappointed bidders.

Other Federal **Statutes Based on the FCA**

In addition to the FCA, other federal statutes and state laws based on the FCA may impose civil and criminal liability or other remedies for false claims. Important federal statutes include:

- Criminal violation for false claims: 18 USC §287 and §1001
- *Contract Disputes Act:* 41 USC §7101 *et seq.*
- *Program Fraud Civil Remedies Act of 1986:* 31 USC §3801 *et seq.*
- *Truth in Negotiations Act:* 10 USC §2306a
- *Anti-Kickback Act:* 41 USC §8701 *et seq.*
- *False Statements Accountability Act of 1996:* 18 USC §1001
- *Forfeiture of Fraudulent Claims Act:* 28 USC §2514

1) exceeded funding limits known to the contractor, 2) requested reimbursement of indirect costs that related to tasks not covered by the invoice or arose from periods not covered by the invoice, and 3) rebilled certain costs in a way that "camouflaged" the billing of such costs in earlier invoices.

Among other things, the contractor argued that the government had knowledge of some of the misrepresentations. Notwithstanding the government's potential knowledge, because the contractor knowingly inflated its costs invoiced to the government, the court ruled the contractor violated the FCA and imposed the maximum penalty.

There are countless other cases involving inflated costs or false representations about cost. Before the enactment of FERA, however, many courts refused to impose liability under the FCA unless the plaintiff demonstrated an intent to fraudulently obtain funds. Obviously the changes brought about by FERA will almost certainly increase the frequency of FCA claims and their probability of success.

Certifications fall into the same risk category as invoices. Many agreements require contractors to make certain certifications in conjunction with their applications for payment or invoices in order to induce payments. Examples include certification that:

- The work meets the requirements of the contract documents;
- Subcontractors and suppliers that have provided labor, material, or equipment have been timely paid;
- Material and performance testing required under the contract documents has been properly performed and that materials or work meet the testing requirements;
- Minority/Disadvantaged/Women-Owned Business Enterprise program goals have been met; and
- The requirements of the *Buy American Act* have been met.

A knowing presentment of a certification that is false or contains false information can give rise to liability under the FCA.

Risk Arising from Requests for Equitable Adjustment

Another common example of a claim is a request for equitable adjustment (REA). Contractors expose themselves to liability under the FCA when they certify an REA that contains falsehoods or misrepresents material facts. Such misrepresentations may relate to the government's responsibility for payment of the claim or relate to quantification of the claim in the form of false or inaccurate pricing or cost information.

Because REAs typically involve representations about cost, they are an important risk component for contractors under the FCA. For example, in ***Railway Logistics International v. The United States of America,*** 103 Fed. Cl. 252 (2012), a contractor submitted REAs for additional costs related to alleged delays, changes, and subcontractor costs.

In support of its REAs, the contractor submitted a spreadsheet that, as the court eventually found, grossly overstated its costs. Among other things, the spreadsheet identified manufacturer costs that were never billed to the contractor, more than tripled the actual delivery and transportation costs, and requested reimbursement for unexplained amounts owed to another company owned by the contractor's owner.

In its defense, the contractor argued that the REAs' overstated and inflated costs did not rise to the level of fraud. At most, it argued, these errors showed poor recordkeeping and accounting. The court, however, did not agree. Instead of awarding the contractor more than $6.5 million requested by its REAs, the court found that the contractor had violated the FCA and awarded the government more than $1 million.

In another case, ***Larry D. Barnes, Inc. v. United States,*** 45 Fed. Appx. 907 (Fed. Cir. 2002), a contractor's poor job cost accounting contributed to its FCA liability arising from REAs. In that case, a contractor submitted REAs for additional costs incurred because it was required to perform excavation work in a less efficient manner than it anticipated. The REAs sought recovery of lost profits on deleted work. Even though the contractor's Vice President testified that he knew such profits were not recoverable, he nevertheless decided to "let it ride . . . in hopes that [the government would] pay some of it."

Additionally, the contractor's REAs requested work-stoppage costs during periods when the contractor actually performed work and sought "added costs" without any reasonable explanation. In fact, the added costs represented "hypothetical revenue [the contractor] could have made" if it had used a more efficient machine to perform the work.

Significantly, in support of the court's finding of a "knowing" FCA violation, it noted that the contractor "refused to document the added costs, stating that 'job cost accounting is not warranted.'" Such refusal to follow proper job cost accounting and maintain documentation demonstrated the contractor's reckless disregard of the truth and resulted in liability under the FCA.

Risk Arising from Proposals

False claims can occur even before construction begins. A number of cases involve misrepresentations in contractors' or subcontractors' proposals for contracts or modifications. These cases state that all invoices submitted in connection with a contract or modification obtained by a fraudulent proposal are tainted by fraud.

In the *Veridyne* case previously discussed, the court held that all invoices submitted pursuant to a modification obtained by a fraudulent proposal violated the FCA. In that case, the contractor submitted a proposal to modify its governmental contract that contained several false representations.

In order to limit the contract to less than the $3 million threshold for competitive bidding, the contractor's proposal vastly understated the known value of services that the government would ultimately require. Its proposal was dramatically out of line with its actual historical cost for the quoted work. In addition, despite the contractor's certification to the contrary, the proposal was not prepared in accordance with established estimating practices. Based on these false statements, the court denied the contractor's payment requests and ruled in favor of the government on its FCA claim.

Risk Related to Cost Accounting Principles

In the post-FERA era of the FCA, CFMs must ensure representations about cost – whether invoices, pay requests, REAs, or work proposals – are accurate and properly supported. False claims can arise from the failure to follow and apply proper cost accounting principles.

Contractors working under governmental contracts may be subject to specific cost accounting rules. For instance, the Federal Acquisition Regulation (FAR) contains two primary sets of cost accounting rules: Contract Cost Principles and Procedures (FAR Cost Principles) and Cost Accounting Standards (CAS Rules). When a contractor's cost accounting deviates from applicable rules, the resulting excess is generally not recoverable, and the risk of FCA liability increases.

For instance, under FAR Cost Principles, cost is allowable only when it satisfies the following principles:

- Reasonableness,
- Allocability,
- Contract terms,
- CAS Rules (when applicable), and
- Other limits imposed by FAR Cost Principles.

First, a cost is reasonable if, in nature and amount, it does not exceed the amount that would be incurred by a prudent person in the conduct of a competitive business. The FAR sets forth specific factors for a determination of reasonableness. Second, a cost is allocable to a project if it is specifically incurred for the project, allocated to the project in reasonable proportion to benefits received, or necessary to the overall operation of the business but not directly related to the project.

Third, contract terms may specify the rates or basis for recovery of particular costs. Or, the contract may refer to rates published by agencies or industry averages. As the FAR explains, "[b]ecause of widely varying factors such as the nature, size, duration, and location of the construction project, advance agreements . . . for such items as home office overhead, partners' compensation, employment of consultants, and equipment usage costs, are particularly important."[6]

Within FAR Cost Principles, specific rules apply to construction and architect/engineer contracts. These rules address equipment ownership, operating, and rental costs; jobsite costs, such as superintendence, timekeeping and clerical work, engineering, utility costs, supplies, material handling, restoration, and cleanup; and rent related to land and facilities.

As an example, under FAR Cost Principles, in calculating equipment ownership and operation costs, contractors must use actual cost data from their accounting records.[7] When such data is unavailable, the government may specify a schedule of predetermined rates, such as the *Construction Equipment Ownership and Operating Expense Schedule* (the "Manual") published by the U.S. Army Corps of Engineers.

In one case, a contractor violated the FCA by using equipment ownership rates in the Manual instead of its actual costs, which resulted in an inflated REA.[8] Under the FAR Cost Principles, "[u]sing the Manual is improper, . . . where its purpose is to inflate the amount of a claim." The contractor "purposely avoided looking at its own acquisition costs in favor of the higher Manual numbers. This intentional inflation of the claim is fraud."

The court noted other instances in which the contractor's REA violated the FCA:

- Overstating costs and rates for equipment and indirect overhead;

- Depreciating equipment beyond its original acquisition costs;
- Claiming costs for scrapped and duplicated equipment; and
- Claiming unallowable costs, including interest and entertainment costs.

Based on the contractor's false REAs, the court ruled in favor of the government for more than $50 million in losses. But, it also noted that it could have imposed a statutory penalty of $10,000 (now $11,000) for each claim, which would have resulted in an additional $7 million.[9] Obviously, the FCA is not a matter of light concern for CFMs.

Recommendations

In light of the risks arising from the FCA, how can contractors mitigate these risks? Because these risks are so ubiquitous, they can't be completely eliminated; however, there are some key actions that will lessen some of them:

- Involve the accounting department early and throughout any project involving government funds. These professionals have a keen eye for accuracy and are perhaps the only people who understand cost accounting principles.
- Emphasize the importance of cost accounting and recordkeeping to job superintendents and key project personnel. Consider holding training sessions to demonstrate the substantial risks involved with submitting false information or misstatements on projects involving government funds.
- Review all submissions and correspondence for risk of FCA liability.
- Review all cost-related submissions – whether cost proposals, invoices, pay applications, REAs, requests for modifications, and termination proposals – for accuracy and compliance with applicable cost accounting principles.
- Establish company-wide procedures for reviewing and approving proposals, pay applications, REAs, and other important documents, especially those with certifications by the contractor or subcontractor.
- Maintain documents in a system that ensures their storage and recovery, and allows for quick location and retrieval. Electronic recordkeeping may prove to be invaluable in this effort. Note further that unsupported costs may be denied by the government on that basis alone.
- Consider engaging legal counsel and consultants to review any cost-based submission. ■

Endnotes:

1. 31 USC §3729 *et seq.*
2. "Justice Department Recovers Nearly $5 Billion in False Claims Act Cases in Fiscal Year 2012," Dept. of Justice Office of Public Affairs News Release (Dec. 4, 2012).
3. 31 USC §3729(b)(1).
4. 31 USC §3729(b)(2).
5. 31 USC §3729(b)(4).
6. FAR §31.105(d)(1).
7. FAR §31.105(d)(2)(i)(A).
8. *Daewoo Engineering and Constr. Co. v. United States*, 73 Fed.Cl. 547 (2006).
9. Since the parties did not fully brief the issue, the court declined to rule on whether each claim was a separate "claim" under the FCA.

DAVID R. COOK is a Construction Law Attorney and Partner at Autry, Horton & Cole, LLP in Atlanta, GA. He represents construction industry clients in a wide variety of construction matters, including contract development, avoidance of claims and disputes, alternative dispute resolution, and litigation.

A previous author for *CFMA Building Profits,* David is a member of CFMA's Georgia Chapter. He also belongs to the AICPA, American Association of Attorney-CPAs, and Construction Owners Association of America.

Phone: 770-818-4442
E-Mail: cook@ahclaw.com
Website: www.ahclaw.com

MARK V. HANRAHAN is a Partner at Autry, Horton & Cole, LLP in Atlanta, GA, where he focuses on construction industry clients. He represents owners and contractors from pre-construction planning through project closeout. He represents construction industry clients in a wide variety of construction matters, including contract development, avoidance of claims and disputes, alternative dispute resolution, and litigation.

Mark regularly writes about and presents on construction-related topics. He earned a BS in Building Science from Auburn University in Auburn, AL and a JD from Georgia State University College of Law.

Phone: 770-818-4443
E-Mail: hanrahan@ahclaw.com
Website: www.ahclaw.com

Many Forms of **False Claims**

- Billing costs in excess of amounts allowable under the contract
- Billing for costs that are not recoverable under FAR Cost Principles, CAS Rules, or other applicable cost accounting rules
- Applying rates or multipliers that exceed the amount allowable under the contract or for which there is no factual support
- Applying rates from schedules when actual cost-based rates are available
- Billing for costs that are not properly documented
- Failing to pass through credits, rebates, and reimbursements to the government
- Charging costs to allocation pools that are not allocable, or allocating such pools on an unreasonable basis
- Billing for work or materials that are not installed, or that are not authorized under the contract
- Inflating percentage of completion or other basis for billings
- Underbidding a project, or providing a lower estimate, with the goal of profiting through inflated modifications and REAs (e.g., bait-and-switch scheme)
- Billing for work that is not compliant with the contract
- Certifying noncompliant work as compliant
- Using affiliated entities, such as corporate subsidiaries, to artificially inflate billings
- Requesting costs based on overstated delay, suspension, or work-stop periods
- Misstating project conditions to support modifications and REAs