

MANAGING RISKS OF POTENTIAL GOVERNMENT CONTRACT AND CONSTRUCTION FALSE CLAIMS

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I. INTRODUCTION

Any discussion about false claims tends to provoke strong emotions. Many contractors and owners accept the idea that false claims statutes are necessary and appropriate. The strong emotions tend to center on the nature of the statutes and how the statutes are applied in practice.

As they say with politics, emotions on false claims tends to run along party lines. Contractors often feel that the false claims statutes are being used as a club to deny or reduce legitimate claims for changed work or “Requests for Equitable Adjustment.” Contractors also feel that the “reckless disregard” aspects of false claims statutes allow government agencies to allege false claims for minor infractions, minor breaches of a contract or regulation and inadvertent errors. Government agencies, on the other hand, feel they have a duty to protect the public. They believe pursuing false claims is wholly appropriate to help assure integrity and ethical behavior by contractors and to penalize contractors that behave improperly.

The unique nature of false claims situations adds to the strong emotions. Damages are often trebled. Penalties can be levied in addition to treble damages. Penalties sometimes significantly exceed the underlying damage amounts. Qui Tam Relators or whistleblowers can sue on behalf of government agencies (in some cases where the agency has decided not to pursue the claim). Current and prior employees, inspectors, auditors and others may be whistleblowers. Whistleblowers can receive a percentage of the false claims recovery. Individuals that participated in or perpetrated the alleged false

claims may also become whistleblowers. False claims proceedings addressing complex contract accounting issues often occur before a jury. In some instances penalties are applied even in the absence of any damage to the government agency.

Generally, a False Claim finding requires: 1) the knowing submission to a Government agency of a false claim or a false statement in order to get a claim paid (i.e. a finding of liability); 2) that the false claim caused damage to the Government (i.e., causation); and 3) a showing of the amount of the economic damage to the Government agency from the false claim.

This paper provides ideas to consider in managing risks of potential Government Contracts and Construction project false claims allegations, investigations and trials. This paper discusses 1) the nature of false claims allegations (section II); 2) issues that arise in analyzing causation and damages aspects of false claims cases (section III); and 3) some ideas to help avoid and to reduce the risk of potential false claims.

This article does not address legal issues on false claims cases or issues involving liability for, or the intent to, submit false claims. The ideas outlined in this paper are based on experience with false claims allegations and investigations; however, each claim must be considered in the context of the facts and circumstances of the case and the applicable Federal or State legal requirements.

II. THE NATURE OF FALSE CLAIMS ALLEGATIONS

The variety of false claims allegations mirrors the complexity and variety of Government contract manufacturing, construction, supply and other agreements between entities and various Federal and State government agencies. False claims allegations typically involve claims of over-billing or providing less value than required by the contractual terms. In some instances Government agencies contend that an entity took actions to reduce the amount owed to the government agency. These circumstances are referred to

as reverse false claims. False claims have been alleged in virtually all areas of agreements with the government agencies, including military procurement, health care, transportation, energy, materials management and construction.

The following list shows examples of false claims that have been alleged on government, construction and supply agreements.

- Mischarging Labor
- Defective Pricing and Providing False Estimates
- Charging Commercial Costs to Government Contracts
- Overstating Claims and Requests for Equitable Adjustment
- Billing for Expressly Unallowable Costs
- Failing to Perform in Accordance with Contract Requirements
- Premature Progress Billings or Advance Billings
- Misstating Progress Reporting (e.g., Estimates at Completion)
- Failure to Follow Disclosed Accounting Practices
- Performing and Charging for Unauthorized Work
- Performing Deficient Work
- Use of Residual Inventory without Providing Credit to the Agency
- Understating Credits for Deleted Work
- Overstating Equipment Charges and Rental Rates
- Double Billing for the Same Work
- Submitting Invoices for Work not Performed
- Falsifying of Timecard Hours
- Overstating of Labor Hours
- Overstating of Labor Wage Rates
- Mischarging Fixed Price Work to Cost-Type Contracts
- Substitution of Cheaper/Substandard Materials or Equipment
- Overstating Overhead Rates
- Forging or Altering Third Party Invoices
- Advance Billing of Travel Expenses

- Environmental Non-Compliance
- Falsifying Original Bid Information
- Intentional Underbidding
- Falsely Representing Planned Performance of Work or Planned Rates
- Claiming Crews and Equipment that were not Delayed
- Front Loading of Bids or Schedule of Values
- Improperly Claiming Feasibility of Design and Construction
- Falsely Disclosing Accounting Practices
- Charging Sale Leaseback Rental Costs
- Falsely Classifying Workers
- Prevailing Wage Rate Violations
- Building Uninhabitable Military Housing
- Falsifying Quality Control or Inspection Reports
- Misrepresenting Small Business Status
- Advance Billing of Subcontractor Costs
- Violating Minority Business Enterprise (MBE) and Disadvantaged Business Enterprise (DBE) Participation Requirements
- Inflating Disadvantaged Business Participation Figures
- Violating Subcontractor Listing or Licensing Requirements
- Improperly Substituting Subcontractors
- Passing Through Fraudulent Costs of Subcontractors
- Violating Buy America Requirements
- Falsifying Safety Reports
- Proposing “A” Team, but Using “B” Team

The Purpose of this list is not to conclude that these items are or are not false claims, rather the list is intended to demonstrate the broad nature of false claims allegations. As can be seen in the list above, many allegations that might otherwise be considered breach of contract claims can become allegations of false claims. The implications of this difference include trebling of damages, penalties and the reputational impact of being accused and potentially being found liable for fraud against the Government.

III. ISSUES THAT ARISE IN ANALYZING CAUSATION AND DAMAGES ASPECTS OF FALSE CLAIMS

If a false claim has been submitted to a government agency, the issue arises as to whether the government agency has been damaged. In general, damages are measured as the economic difference between the circumstances that actually occurred and the circumstances that would have happened without the alleged improper conduct. The objective is to make the plaintiff whole from an economic perspective. To calculate economic damages one must determine whether, and if so to what extent, a plaintiff was affected by the liability issues in a particular case.

Depending on the circumstances, damages may be measured as increased costs, lost profits, diminution in asset or business value or in some instances lost royalties. Damages cannot include amounts that are highly remote or the result of speculation or guesswork.

In the context of false claims cases, damages are typically measured as either: 1) the difference between what the Government agency paid and what it would have paid without the false claim or; 2) the difference between the value received and the value contracted for.

In determining whether a false claim has damaged a government agency there are a number of issues that may require consideration. The initial question is relatively straight forward – did the government agency pay the false claim? The remaining issues that may arise in determining whether a government agency has been damaged are more complicated and revolve around causation and reliance issues including the following:

1. What was the basis for the payment made by the Government?
2. Did the government agency rely on false information from the contractor?
3. Was a contractual remedy previously agreed upon between the contractor and the government agency?
4. Did the government agency contemporaneously concur with the contractor's actions?
5. Did the government agency have knowledge of the contractor's actions?
6. Did the contractor's action comply with contract requirements?
7. Did the contractor's action comply with regulatory requirements?
8. Did the government agency inspect and accept the product during performance?
9. Did the government agency audit or review the contractor's practices?
10. Were the government agencies' actions during performance consistent with its false claims allegations?

The answers to these questions are often found in the contractor's and government agency's project records and documents. Due to the broad nature of the false claims allegations and the issues that arise, potentially relevant documents go beyond cost accounting and billing information.

Relevant information may be contained in the following government agency, contractor and Architect/Engineer documents, including: Audit Reports, Government Correspondence, Cost Accounting Standards Disclosure Statements, Audited and Unaudited Financial Statements, Price Negotiation Memoranda, Progress Reports, Cost and Schedule System Reports, Quotations, Bid Estimates, Budgets, Job Cost Reports, Change Order files, Material Reports, Equipment Reports, Labor Distribution Reports,

Labor Productivity Analyses, Maintenance Records, Correspondence, E-mails, Planning and Pre-bid Information, Operational and Construction Phase Documents and Accounting Documents.

IV. RECOMMENDATIONS

Managing risks of potential government contract and construction false claims is best handled by employing good management on a day-to-day basis. This topic will be discussed in more detail at the conference. Good management includes: 1) Fostering an environment of integrity and ethics, 2) Documenting rationale for decisions and actions, 3) Providing appropriate training, 4) Discussing with employees the current legal environment relating to the potential for false claims allegations, 5) Communicating timely and appropriately with government agencies, 6) Documenting responses to employee concerns, 7) Assuring that employees understand the requirements of the contract and of relevant regulations and 8) Performing independent reviews of claims and substantial change orders.