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Client Alert

NEW STAKES IN DOING BUSINESS WITH THE FEDERAL GOVERNMENT

In two recent decisions issued by the Court of Federal Claims,[1] contractors working for the Federal Government were handed devastating decisions based upon the court's finding that the contractor had filed false claims or defrauded the Government.

In Daewoo, the contractor lost a $64 million claim. More importantly, it was assessed $50 million in damages for submitting a false claim because it failed to adjust its claim downward as new information became available and because of other actions that the judge found crossed the line. Contractors may view some of the practices sanctioned by the court to be common in the construction industry.

In AMEC, the contractor forfeited its rights to all its contract balances and claims on three contracts involving two major courthouse projects (stated by the court to be $53 million) because employees submitted requests for payment for bond premium costs that had not been incurred or paid and in some cases supported their requests with certifications and documentary "proof" that AMEC had already paid the surety. Although the case does not indicate that AMEC or its employees derived significant benefit from theses actions, AMEC paid dearly for its employees' actions. It pled guilty to corporate fraud in two Federal jurisdictions, it paid large fines, it was barred from contracting with the Government for a prolonged period of time, and it spent millions dealing with this issue. The final blow was the forfeiture of all Amec's claims.

Both cases surely will be appealed, and it remains to be seen whether or not the lower courts' rulings will be upheld.

You can read about the specific facts that led Daewoo and AMEC to disastrous decisions in the case abstracts that are attached. While there are lessons to be learned from the particular facts of these cases, we address this Alert to a more basic issue: **is your company equipped to work for the Federal Government?**

Contractors doing business with the Federal Government have always understood that they needed to comply with Federal rules and regulations. However, these two decisions and other recent decisions[2] raise the stakes of non-compliance and will surely embolden other government agencies to pursue false claims allegations with more vigor. At the same time, the pervasiveness of government funding for everything from roads, to local government projects, to housing and educational institutions brings government regulations and compliance issues into more and more construction projects. In addition, local governments are enacting their own versions of "Little False Claims Acts".

If you have any questions, please contact Adrian L. Bastianelli, III at abastianelli@pecklaw.com or Patrick J. Greene, Jr. at pgreene@pecklaw.com

1 Daewoo Engineering and Construction Co., LTD v. United States, 73 Fed. Cl. 547 (2006); Morse Diesel Int'l d/b/a AMEC Construction Mgmt., Inc. v. United States, 2007 U.S. Claims LEXIS 10 (January 26, 2007).

2 Long Island Savings Bank, FSB v. United States, 2007 U.S. App. LEXIS 2135 (Fed. Cir. 2007) (Plaintiff forfeits $435 million judgment as a result of fraud committed by one of plaintiff's officers, even though plaintiff did not benefit from the fraud); Morse Diesel Int'l d/b/a AMEC Construction Mgmt., Inc. v. United States, 66 Fed. Cl. 788 (July 15, 2005) (As a matter of law, a fee commission splitting arrangement was for the purpose of improperly obtaining or rewarding favorable treatment and therefore constituted an illegal kickback).

So, what do we suggest is the solution?

We do not suggest that contractors walk away from Federal Government work, or even local government work. The Federal Government is the largest procurer of construction services in the world, and in most cases, is a fair and reasonable owner if the contractor understands the rules and is careful to comply with those rules. However, at the same time, we do suggest that contractors exposed in any way to public funding of their projects should make a conscious commitment to take the necessary steps to assure compliance and avoid ending up on the wrong end of another of these dramatic court decisions. In that regard, we recommend that all contractors, but especially those directly contracting with the Government, take the following actions:

- Designate a trained and experienced team to handle all written submissions to the Owner and Government-a team that either knows the regulations and the law or at least knows when to ask a question from qualified advisors.

- Institute an in-house training program on Federal contract regulations and practices to be sure your teams are aware of the requirements and are trained in how to adhere to them.

- Establish a "Compliance Program" that includes third-party audits of performance to find mistakes and misunderstandings of the law and correct them before they become the source of serious problems.

Finally, we urge those of you who are working for the Federal Government and who have not been the subject of an investigation or allegations of false claims or fraud **not to assume that you have been spared this misery because you must be doing things correctly**. Often false claims actions result, not from the intent to defraud, but from a lack of knowledge or understanding of the law, untrained employees, a lack of checks and balances, or carelessness-in other words, they have been the result of things that could possibly even happen in your company. Only a program of education and oversight can avoid the consequences of such circumstances.

DAEWOO ENGINEERING AND CONSTRUCTION CO. V. UNITED STATES

COURT OF FEDERAL CLAIMS, OCTOBER 13, 2006

This case involved the construction of a 53 mile road on the North Pacific island of Palau for the Army Corps of Engineers ("COE"). The RFP set forth a two step process whereby offerors would be judged on technical merit and price. The RFP included express warnings regarding the difficulty of the project, including the tropical weather to be encountered (over 150 inches of rainfall per year) and the difficulties that could be anticipated in compacting the native soils.

As required by the RFP, in its proposal, Daewoo identified the project manager and construction manager that would be assigned to the project. Daewoo also indicated that it would self-perform the major portions of the work and planned to use double shifts throughout the course of the work. Daewoo received high technical scores from the COE because of its experience with these types of projects and the management team identified in its proposal.

Daewoo's initial bid price was roughly $73 million, which was significantly below the COE's estimate and the next low bid of $100 million. During discussions, the COE alerted Daewoo to a possible bid mistake, and in response, Daewoo increased its bid to $88 million.

Daewoo immediately encountered problems at the outset of the project. The problems revolved primarily around meeting the compaction requirements in the contract. The moisture content of the soils, which was substantially affected by the large amounts of rainfall experienced, was the primary source of the problems.

During construction, Daewoo submitted a certified claim in the amount of $64 million. Importantly, the claim was comprised of $13 million in alleged actual costs, and $50 million in future costs that allegedly would be incurred if the COE did not approve a revised method of construction proposed by Daewoo.

Subsequent to the submission of its certified claim, Daewoo hired an expert to price its claim. The expert did not use the certified claim as the basis of its pricing; rather, the expert utilized the measured mile methodology. Based on the use of this methodology, the expert priced Daewoo's claim at $43 million, some $23 million lower than Daewoo's certified claim. However, Daewoo did not recertify its claim.

At trial, Daewoo's primary legal arguments were that the specifications were defective, both with respect to the amount of rainfall to be encountered and the achievement of the compaction requirements. At the conclusion of Daewoo's direct case, the court permitted the Government to file several fraud related counterclaims, including counts under: the fraud provisions of the Contract Disputes Act (41 U.S.C. § 604); the False Claims Act (31 U.S.C. § 3729); the Forfeiture Statute (28 U.S.C. § 2514); and common law fraud in the inducement.

Based on the express warnings in the RFP regarding both the weather conditions to be anticipated and the difficulty in compacting the native soils, the court found that Daewoo's claims had no merit and were fraudulent. Accordingly, Daewoo recovered nothing on its claim. Moreover, the court found in favor of the Government on its counterclaims. The court found generally that Daewoo's witnesses, including its experts, were not credible. The court also found that the specific intent of Daewoo's certified claim was to serve as a negotiating ploy to get the COE to approve Daewoo's proposed method of performing the work. The court held that this type of "horse trading" was made illegal by the CDA's fraud provisions.

In making its findings on the Government's fraud counterclaims, the court noted in part as follows:

(1) Daewoo retained a pricing expert for trial who computed an amount that was two-thirds of the certified claim and the amount contained in the complaint, but neither the claim nor complaint was ever decreased.

(2) Daewoo listed personnel for the job in its technical proposal that it knew it would not use on the project, indicated in its proposal that it would self perform the major portions of the work when it knew it would not, and stated in its proposal that it would use double shifts when it knew that it would not. Based on these findings, the court held that Daewoo fraudulently induced the Government into the contract and that such fraud would support forfeiture of Daewoo's claims under the Forfeiture Statute if Daewoo's claims otherwise had any merit.

(3) Daewoo used equipment rates from the COE rate manual even though the acquisition rates in its books and records were less than the rates in the manual.

(4) Daewoo's experts did not verify or question inconsistent information and only changed calculations in its report after the problems were pointed out by the Government.

(5) Daewoo included fully depreciated equipment in its claim.

(6) Daewoo inflated the number of hours a piece of equipment was used per day, e.g., the contractor claimed eight hours a day of use for all pickups.

(7) All errors in the contractor's claim increased the amount of the claim.

(8) Daewoo reclaimed costs that were rejected by DCAA as unsupported in a previous claim audit.

(9) The court found that the testimony of the fact and expert witnesses from the contractor was not credible.

Because the COE never paid any part of Daewoo's claim that the court ruled to be fraudulent, the COE did not incur any actual damages. However, the court relied upon the CDA's fraud provisions in calculating the Government's damages. Section 604 the CDA provides in part that, where a contractor cannot support any part of its claim due to misrepresentation or fraud, the contractor "shall be liable to the Government for an amount equal to such unsupported part of the claim in addition to all costs to the Government attributable to the cost of reviewing said part of his claim." The court concluded that the $50 million of future costs included in Daewoo's certified claim were unsupported due to fraud and entered judgment against Daewoo in this amount.

In sum, in a case where at the start of trial the contractor was prosecuting a $64 million claim and the Government had no counterclaim, at the end of the trial the contractor recovered nothing on its claim and instead had a judgment entered against it in excess of $50 million.

MORSE DIESEL INTERNATIONAL, INC., D/B/A, AMEC CONSTRUCTION MANAGEMENT, INC. V. UNITED STATES

COURT OF FEDERAL CLAIMS, JANUARY, 26, 2007

The United States Court of Federal Claims rendered a decision on Friday, January 26, 2007 forfeiting more than $53 million in claims pending in that court and related jurisdictions arising out of several government projects and asserted by AMEC Construction Management, Inc. (formerly Morse Diesel, Inc.) (hereafter "AMEC") and related companies. The forfeiture was triggered by violations of the Anti-Kickback Act and the False Claims Act not directly related to the claims themselves. The court relied upon a provision it called the "Forfeiture of False Claims Act", 28 USC § 2514. This provision has been held to allow the Court of Federal Claims to forfeit any and all claims pending in that court when the contractor has practiced any fraud in obtaining or performing that contract.

The AMEC case involved three construction projects and four contracts. The projects were the San Francisco Customs House, the Sacramento Courthouse and the St. Louis Courthouse (which included Phase I and Phase II contracts). All were lump-sum competitively bid contracts. During a routine audit of a change order on St. Louis Phase I, a GSA auditor discovered that AMEC had not paid its bond premium when it had requested reimbursement for the premium as part of progress payments under the standard FAR progress payment provision. Indeed, he discovered that the premium had not been paid at the time AMEC submitted an invoice marked "paid". Eventually, the Government learned that a Morse Diesel employee, after being told that the government needed proof of payment of the bond premium had asked for and received a falsely stamped invoice form its bond broker.

An investigation revealed other bond related practices that the Government questioned. AMEC relied upon the financial strength of its parent company in obtaining bonds. In compensation for the exposure of its parent company's books in this manner, AMEC had decided that it would increase the amount charged to its customers by what was referred to as an indemnity "surcharge". As a result of this surcharge, the amount charged to its customers by AMEC for bonds was in line with the amount charged by its competition but not directly reflective of its actual costs. The court found that the record contained no evidence that this surcharge, when received by AMEC was remitted to the parent company. In addition, for some period of time, AMEC entered into what is referred to as a "commercial partnership" with its bond broker. Under the commercial partnership, the broker remitted a portion of the commissions it received on the AMEC bonds to the parent company as a form of discount or rebate. The reduced cost of the bonds resulting from the commercial arrangement was not directly reflected on the books of AMEC. In a prior reported decision in the same case, the court had found that the commercial partnership violated the Anti-Kickback Act.

Civil False Claims Act proceedings were commenced against AMEC in the United States District Court for the Eastern District of Missouri. This case was later dropped in favor of fraud counterclaims filed by the Government in the Court of Federal Claims. Eventually, AMEC's claims pending in the GSBCA were removed by the Government to the Court of Federal Claims to be subject to the court's counterclaim and forfeiture jurisdiction. In addition, criminal investigations resulted in guilty pleas filed in the Eastern District of Missouri and Eastern District of California.

According to the court's findings, each of the contracts on which claims were pending, Sacramento and St Louis Phase I and II were tainted by one or more of the allegedly fraudulent scenarios and each was subject to being forfeited.

The court determined that requiring the forfeiture of the more than $53 million in claims would not violate the “excessive fines” clause of the 8th Amendment of the US Constitution. In doing so, the court asserted that AMEC did not have any right to sue the Government, which as a sovereign can only be sued to the extent it consents and that Congress must be afforded significant deference in deciding punitive remedies. For the latter proposition the court cited the Supreme Court's decision in Bajakajian which actually held that the amount of forfeiture must be balanced against the wrong in order to pass muster under the 8th Amendment. An earlier Court of Federal Claims case, Barren Island, had held that such a balancing approach applied to forfeiture under the statute in question. The court did not mention Barren Island or explain its apparent disagreement with it. The court also did not address Due Process arguments raised by AMEC deferring that analysis until after determination of whether the government suffered any False Claims Act damages.

Of interest, all of the contracts in question were lump-sum agreements. In each case, the price had been arrived at through competition. The alleged frauds all affected the amount and timing of progress payments to be made against those contracts. In other words, the price paid by the Government in each instance was apparently not affected. The harm to the Government, if any, was in making some progress payments earlier than they otherwise would have been made. The court did not explore the extent to which the improper conduct damaged the Government, if at all.