

Narrowing the Reach of the False Claims Act

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By Vernon Howerton

Any contractor working on a project funded, in whole or in part, by the federal government needs to be aware of the potential liability imposed by the False Claims Act (FCA). First enacted in 1863 to address fraud against the federal government committed by defense contractors during the Civil War, the potential reach of FCA liability was examined and narrowed last year by the U.S. Supreme Court in *Allison Engine Co. v. United States*.

Basic Rules

Today, the FCA applies to any project using federal funds, whether via a direct government contract or a federal grant to a state or local government or other recipient. Potential FCA liability flows with any payments made from federal funds—from the initial recipient down to the last supplier. Under the law, 3729(a), a person or company violates the FCA if it:

- (a)(1) knowingly presents, or causes to be presented, [to the U.S. government] a false or fraudulent claim for payment or approval;
- (a)(2) knowingly makes, uses, or causes to be made or used, a false record or statement to get a false or fraudulent claim paid or approved by the government; or
- (a)(3) conspires to defraud the government by getting a false or fraudulent claim allowed or paid.

The FCA's definition of "claim" is extremely important. It includes not only claims presented directly to the government, but also claims presented to recipients of government funds. A claim is defined as any request or demand, whether under a contract or otherwise, for money or property that is made to a contractor (such as government prime contractors), a grantee (such as state or local government recipients of federal funds) or other recipients if the government provides or reimburses any portion of the money or property that is requested or demanded.

"Knowingly" includes actions taken in reckless disregard for the truth, in addition to actions taken in deliberate disregard for the truth. Absent mitigating factors, FCA violators are

liable to the government “for a civil penalty of not less than \$5,000 and not more than \$10,000, plus three times the amount of damages which the government sustains” because of the violation. Prior to Allison Engine, some courts found a 3729(a)(2) violation occurred any time a false application for payment was made and paid from funds derived from government funds.

Allison Engine

Allison Engine, a former division of General Motors (GM), subcontracted to furnish generator sets for ArleighBurke class-guided missile destroyers being built by two shipyards for the Navy. Allison further subcontracted parts of its work to General Tool Company (GTC) and Southern Ohio Fabricators (SOFCO). After the U.S. Treasury spent billions of dollars on the destroyers, two former employees of GTC brought suit against Allison, GM, GTC and SOFCO under the whistleblower provisions of the FCA.

The plaintiffs alleged in the suit that invoices submitted to the shipyards fraudulently sought payment for work not done by GTC and SOFCO to meet Navy plans and specifications. In a jury trial, the plaintiffs presented evidence of false certifications of workmanship that had been presented to the shipyards with applications for payment. However, no evidence was ever presented to the Navy proving the false certifications. The trial court entered judgment for the defendants, finding no FCA liability can exist without evidence that the false claims actually were presented to the government.

In *United States v. Allison Engine Co.*, the 6th Circuit Court of Appeals reversed and found actual presentment of a false claim was only required under Section (a)(1). It did not believe presentment was a requirement for proof of an (a)(2) violation for use of a false statement to induce government payment or an (a)(3) violation for conspiracy to defraud the government. In other words, the court took the position that if a false record or statement was used to obtain a payment traceable to government funds, an FCA violation occurred.

The persons making or transmitting such a statement were liable, even if the false statement was never actually presented to or relied on by the government in making payment.

In reaching this conclusion, the court relied on the legislative history behind certain 1986 amendments to the FCA wherein Congress expanded the reach of the act to cover false claims submitted by subcontractors that ultimately result in a loss to the government, even if the claim was actually made to a grant recipient or prime contractor. Additionally, the 1986 amendments were intended to correct prior restrictive interpretations of the FCA by the courts.

Supreme Court

The defendants appealed to the U.S. Supreme Court, which agreed to review whether a person asserting a FCA violation under 3729(a)(2) or (3) must show a relationship between the false statement and the government payment in order for FCA liability to exist. In reversing the court of appeals, the Supreme Court held "a plaintiff asserting a 3729(a)(2) claim must prove that the defendant intended that the false record or statement be material to the government's decision to pay or approve the false claim. Similarly, a plaintiff asserting a claim under 3729(a)(3) must show that the conspirators agreed to make use of the false record or statement to achieve this end."

Although the court did not find a presentment requirement in 3729(a)(2), it declared the use of the words "to get" show intent to defraud the government by the person making the false statement. Thus, for a subcontractor to be liable, it must make a false statement to the prime contractor that is used to obtain payment.

Similarly, to impose liability under 3729(a)(3), the plaintiff must show the conspirators intended on "getting" payment from the government based on the false statement and knew it would have a material effect on the government's decision to pay.

Legal Ramifications

Allison Engine limits potential FCA liability of persons who include false information in connection with a request for payment on a contract remotely funded by the federal government, whether a routine pay application or a change order claim. As the Supreme Court observed, every attempt to defraud a federally funded entity is not viewed as an attempt to defraud the United States.

Practically, Allison Engine may curtail the use of FCA counterclaims as a defense to routine suits to recover on denied change order requests involving federal funds. This is a good thing. However, contractors that knowingly make or pass false statements supporting a request for payment that ultimately will be presented to the government do so at their own peril. This is as it should be, and is as it has been for more than a century.

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