Civil Liability for False Claims in Public Construction

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The current economic climate has changed the landscape of government-funded construction projects. As both the demand for experienced contractors and design professionals and the availability of new construction projects have decreased, those in the industry must do what they can to set themselves apart in order to bring in work. For some, that is relatively straightforward, as they can rely on their knowledge and reputation to earn jobs. However, others, out of fear or desperation, may consider resorting to corrupt tactics when submitting bids or performing work to obtain, or siphon money from, a project.

To combat such corruption in government construction projects, Congress enacted the Federal False Claims Act (“FFCA”). The FFCA is a body of law originally passed during the Civil War in response to overcharges and other abuses by defense contractors. Under the FFCA, both the Attorney General and private persons – known as *qui tam* “relators” or colloquially as “whistleblowers” – may institute civil actions to enforce the FFCA. Congress intended the FFCA to help the government uncover fraud and abuse by unleashing a “posse of ad hoc deputies to uncover and prosecute frauds against the government”.

The first substantial amendments to the FFCA came in 1986. In these amendments, Congress sought to broaden the reach of the FFCA to “enhance the Government’s ability to recover losses sustained as a result of fraud against the Government.” Thus, the FFCA currently enables private litigants to bring actions on behalf of the government against anyone who, among other things:

1. Knowingly presents, or causes to be presented a false or fraudulent claim for payment or approval;
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
3. Conspires to defraud the Government by getting a false or fraudulent claim allowed or paid.

The success of the FFCA has become evident in recent years. Since being revised in 1986, the Federal Government has recovered over $21 billion through actions brought under the Act. In fact, in fiscal year 2008 alone, the federal government recovered over $1 billion.

In addition to the FFCA, many states have enacted their own versions of a False Claims Act. At least 16 states, including California, Florida and Massachusetts, have adopted their own versions of the FFCA.
Federal False Claims Act: Who Can Bring an Action?

The FFCA authorizes an action to be brought by any “person”. This means that almost any current employee, former employee or even business competitor possessing evidence of fraud, can initiate a civil suit under the FFCA. Importantly, if a claim is brought under the FFCA by a current employee, contractor or agent, certain safeguards are in place to protect him or her. The FFCA specifically protects any employee, contractor or agent who is “discharged, demoted, suspended, threatened, harassed or in any other manner discriminated against in the terms and conditions of employment” when that individual brings an action under the FFCA by allowing recovery from the employer of damages that will make the individual “whole”.

There is considerable incentive for a person to institute a FFCA action. If the relator prevails, he or she receives anywhere from 15 percent to 25 percent of the government’s total recovery (if the Attorney General joins the lawsuit) and between 25 percent and 30 percent (if the Attorney General declines joining the lawsuit but allows the relator to pursue the lawsuit on his or her own). In fact, between January and September of 2008 relators were awarded approximately $198 million in successful FFCA actions. The potential to receive such a large sum of money provides tremendous incentive to commence an FFCA action.

Federal False Claims Act: Who May Be Liable?

The FFCA allows a wide range of project participants to be found liable under it. In fact, owners, design professionals, construction managers and contractors have all been found liable under the FFCA. For example, in a recent Nebraska case, the owner of an architectural and engineering firm was ordered to pay the government $460,428 for violating the FFCA. Similarly, a builder was found to have committed 76 FFCA violations when it falsely certified the costs of construction of a low-income housing project.

Basically, anyone in the construction industry who presents a false claim for payment to the government can be liable under the Act. Importantly, the FFCA requires that the defendant know of its wrongdoing, as it prohibits a contractor from “knowingly” presenting a false or fraudulent claim to the government or “knowingly” making a false record or statement to get a false claim paid. However, the Act defines “knowingly” as actual knowledge, deliberate ignorance or reckless disregard. This means that, in some instances, a contractor can be subject to liability under the FFCA even if it did not actually know of the falsity of the claim submitted.

Though it may be hard to imagine how a false claim could be unknowingly submitted, a Pennsylvania Court was recently faced with that very situation. In that case, the Court found that enough evidence existed to allow a case to go to trial where a contractor had submitted reports to the San Francisco Bay Area Transit System that overstated the amounts of money it paid to certain subcontractors. Though the contractor claimed that the report contained only “honest mistakes”, the Court found that the evidence showed that the contractor knew of these mistakes or should have caught them while reviewing the reports prior to their submission.

Federal False Claims Act: Contractors, Owners, Design Professionals and Construction Managers Beware

The Department of Justice has had remarkable success in prosecuting claims under the FFCA. In fact, of the cases that the Department of Justice has prosecuted to resolution since the enactment of the Act, it has recovered money approximately 97 percent of the time. This alone is troubling for contractors facing claims under the FFCA, however when coupled with the fact that a claim under the FFCA is so easy to allege, contractors encounter treacherous ground with the FFCA.

Though there are many ways in which a contractor may be found liable under the FFCA, there are three examples which demonstrate the most prevalent of those situations.

- **False Representations in the Bidding Process**

  Any time a party submits a bid for a government contract, it must be mindful of the representations it makes as part of its submissions. If a contractor knowingly makes a false statement in submitting a bid, it could face liability under the FFCA.

  In *Daewoo Engineering and Constructing Co., Ltd. v. United States*, Daewoo, an engineering firm and construction company, entered into a contract with the U.S. Army Corps of Engineers to build a fifty-three-mile road around a tropical island in the North Pacific. Daewoo's initial bid was $73 million, which was below the government's original estimate for the Project. Daewoo was awarded the Project and work ensued. Ultimately, the government brought a claim against Daewoo alleging, in part, violations of the FFCA. Following a thirteen-week trial, the court found the following actions by Daewoo in submitting its bid to have been fraudulent:

  - Submitting a bid identifying a specific individual, who had an excellent reputation in the construction industry and considerable experience to serve as Project Manager on the job, while knowing that the individual was unavailable to work on this project;

  - Representing to the government in its bid that it would perform its own earthwork removal, yet accepting bids from subcontractors to perform those services, and failing to disclose the potential use of these subcontractors to the government;

  - Representing to the government in its bid that it would work double shifts to perform the earthwork and failing to do so, causing an approximately seven-month delay to the project schedule.

  Thus, state and federal officials have used their resources efficiently to hold contractors accountable for their activities and to ensure that the government’s projects are completed on time and within budget.
b. **Submissions of False Certifications for Payment**

Once a party is awarded a government contract, it should check and re-check its certifications for payment. In *Lamb Engineering & Construction Co. v. United States*, the Department of Energy, the Western Area Power Administration ("WAPA") and Lamb Engineering & Construction Co. ("Lamb") entered into a contract for Lamb to construct an electrical substation in Kingman, Arizona. In the course of performing the contract, Lamb submitted five progress billings to WAPA, the last four of which were supported by attached invoices from subcontractors and suppliers.

Accompanying its submission of at least four of the progress billings were certifications by Lamb that "payments to subcontractors... have been made... and timely payments will be made." The Court found that the evidence proved that, at the time Lamb submitted its last progress billing and certification, it still owed money to at least one subcontractor and at least twelve vendors on invoices it had attached to earlier progress billings.

The Court further found that Lamb's submission of certifications averring that payments to subcontractors have been, or will timely be made, to be a false statement made with the aim of securing progress payments from the government, thus violating the FFCA.

c. **Submissions of False Certifications of Compliance**

A party must also be sure not to submit false certifications of compliance. In *Commercial Contractors, Inc. v. United States*, the U.S. Army Corps of Engineers awarded a contract to Commercial Contractors, Inc., ("CCI") to construct several segments of the Telegraph Canyon Channel in Chula Vista, California, as part of a flood control project. The contract required CCI to excavate the areas in which the channel segments were to be built, to construct the channel segments by setting up forms and pouring concrete into the forms, and to backfill the excavated areas surrounding the channel segments. The contract contained detailed specifications that governed all aspects of the work to be performed, including drawings indicating the lines to which CCI was required to excavate, quality control standards specifying the hardness that the poured concrete was required to achieve before the supporting forms could be removed, and miscellaneous other provisions specifying such factors as the proper composition and required compaction density of the backfill materials.

Ultimately, CCI asserted a claim against the government for additional costs, and the government counterclaimed against CCI, asserting violations of the FFCA and the Contract Dispute Act (CDA). The Court determined that CCI violated both the FFCA and the CDA and awarded the government $14,190,161.85 in damages. The court's judgment rested on its finding that the submissions by CCI regarding the following matters were false or fraudulent:

- Excavating less than the contract drawings required, but submitting cross-sections and quantity surveys indicating that it had excavated up to the contract lines;
- Overstating the amount of backfill it removed from the project;
- Burying debris under and alongside the channel at the project in violation of the terms of the contract, then submitting claims for properly filling the excavated areas and for clearing the excess fill and debris;
- Moving the survey stakes set forth in the contract documents to avoid construction difficulties due to wet ground caused by the tide; and
- Improperly heating concrete test cylinders to precipitate drying time where the contract set forth specific concrete placement methods.

**Federal False Claims Act: Penalties and Damages for Violating**

The FFCA authorizes the Court to impose a civil penalty of not less than $5,000 and not more than $11,000 for each violation. Though a single violation of the FFCA may impose what some would consider a modest penalty, in situations where a person is found liable for submitting fifty or sixty false claims for payments, the violator could be facing a $550,000 or $660,000 penalty.

Moreover, this penalty is in addition to any award of damages that may be granted against the violator, and the FFCA allows a person harmed by the false claim to recover triple its damages. This means that if, for example, the government incurred $50,000 in damages from a contractor's submission of falsely certified work, the contractor is required to pay the government three times its damages or $150,000. In addition, the FFCA allows for the award of reasonable attorney fees and costs to a successful claimant.
Conclusion

In view of the steep penalties and damages that may be imposed for violating the FFCA, a contractor, owner, construction manager or design professional should be petrified of (and strongly deterred from) intentionally or recklessly submitting any type of false claim. In fact, it would be prudent for every company to implement a compliance system to verify that bids and claims are vetted carefully before submission to the agency overseeing the project. In that way, project participants can steer clear of the formidable danger posed by the FFCA.

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Commentary:

by Dennis L. Allen, CPA, CFE, CCIFP, Senior Vice President for Hill International

As indicated in the attached article, the False Claims Act defines "knowingly" making a false claim as actual knowledge, deliberate ignorance, or reckless disregard. Though actual knowledge may be clear enough, the definitions of "deliberate ignorance" and "reckless disregard" must follow the U.S. Supreme Court’s threshold of "I’ll know it when I see it," as there is no clear test. What for contractors may seem to be a reasonable effort to prepare a claim can be construed by the government as deliberate ignorance or reckless disregard. The Daewoo case is an illuminating example of how a contractor can prepare a claim it believes to be reasonable, only to find itself attacked by government experts asserting the "appearance of fraud." Ultimately, the trier of fact has to make the final judgment based on its subjective judgments of the facts in evidence. The court blasted Daewoo for its estimate of future costs and, in fact, the $50 million penalty was on that future cost estimate, not the costs incurred to date. A few key points may have kept the FFCA assertions at bay and are instructive for contractors making claims (historical or projections) in the future.

- The estimated future cost was essentially a daily rate for the impacted cost to date, multiplied times a projected period for expected future efforts. The daily rate was calculated in a similar manner to the daily rate used for a large change order that had already been granted. However, the government made a point of identifying costs that may not have continued through the entire future period. One example was equipment that had been (or would be) fully depreciated for book purposes but, by using the COE Equipment Rate manual, continued to be depreciated for claim purposes. While Daewoo was technically correct, the court took offense to this situation and considered it an unfair windfall to Daewoo. The learning point for contractors is to look carefully at any claimed costs understanding clearly that using the costing method or support data accepted for a change order is not necessarily a safe harbor for the cost method or supporting data in a claim.

- The damages presented at trial were significantly less than the damages in the certified claim. One of the reasons was that the method for determining impacted direct costs was changed from the certified claim to the damages presented in trial. The court took notice of the change in methodology and concluded that the change was proof of an erroneous methodology in the initial claim. Without arguing the merits of the two different methods, the learning point is to get a testifying expert on board at some level before certifying a claim. This also would serve as further proof of necessary due diligence as discussed below.

- The Daewoo Project Manager certifying the costs in the initial claim relied greatly upon the efforts of his staff and one outsider (not the testifying expert) in the preparation of the certified claim. He trusted them to have done their best. However, that level of trust, common within a project team, gave no comfort to the court. The Project Manager apparently had no knowledge of any improprieties in the claim. While there was no indication that Daewoo had any intention of making a misleading or overstated claim, when presented with the threshold question of "how do you know it was right?" they had few good answers. It is important to show conscious effort and due diligence before certifying a claim. In fact, even without certification, a company should consider, and document, its efforts towards error prevention on any claims going to the Government. A checklist, a series of qualifying questions, and a careful "red team" review would not only decrease the chance of an arguable cost or claim, but would also mitigate an allegation of deliberate ignorance or reckless disregard.

- Finally, the implementation of, and adherence to an ethics policy (now required for many contractors) can also set a tone of compliance within the organization. One of the Government’s assertions regarding the potential for fraud was that the contractor was under great pressure to make the claim as large as possible. Frankly, what contractor with a large extra work claim against an owner is not under great pressure? An ethics policy may not change that pressure, but it will demonstrate that the contractor is committed to high standards, regardless of the pressure.
Low Bids - Beware!

Frank J. Giunta, PE, Senior Vice President And Managing Director (Americas) for Hill International

As an owner, you have just awarded a major infrastructure contract and the winning bid was 25 percent lower than your Engineer’s estimate. Finally, a benefit from this economy that will save your department money and possibly allow you to do more work. Or will it?

As a contractor, you have just been awarded a major contract. Sure the margins are low, but you can make it up on change orders, and this will allow you to keep your core staff employed and weather these tough economic times. Or will it?

These scenarios are being played out on construction projects all across the country as economic recovery money tries to tame the worst recession of our generation. Is it an oasis or merely a mirage?

In less than two years, the U.S. construction market has gone from robust to bust. Without a doubt, we are experiencing the worst economic environment in a generation. Competition for projects has increased exponentially.

Increased Competition – Lower Prices

As competition for limited opportunities increases, owners are reaping an apparent unexpected benefit in lower prices. Throughout the country owners are reporting construction prices 20 to 30 percent lower than their engineer’s estimates. As reported in a recent issue of ENR:

“Bid prices have been about 20 to 25 percent lower than North Carolina Dept. of Transportation estimates”, says Barry Jenkins, Director of the Heavy-Highway Division of the Carolinas AGC in Raleigh.17

The question to be examined is “are these cost savings real or merely a mirage?” There are a number of consequential effects or outcomes from the current economic environment. The first, as discussed above, is the realization of lower bid prices brought about by the increased competition and the natural effect of the laws of supply and demand. In many cases low bid prices are at or even below a contractor’s actual costs.

The shortage of work has made competition for contracts so intense that some companies are bidding less than what it costs to do the job. Some owners have already experienced contractor defaults and bankruptcies due to the contractor’s financial problems. 18

This obviously causes delays and disruptions that even with the benefit of a surety stepping in to complete the project, the owner can incur additional costs to complete that eliminate any perceived benefit from the lower upfront savings.

Inexperienced Contractors

Another effect of the current economic conditions is the increased competition itself. “Contractors that previously specialized in certain markets now are looking to land work wherever they can find it.”19 As many owners are realizing, contractors who previously bid primarily private commercial projects are now bidding infrastructure and other stimulus-related projects. Their unfamiliarity with this type of work is leading to quality issues and delays due to productivity deficiencies. Again, these problems can result in delays and additional costs that wipe out any upfront savings.

Increased Change Order Frequency

Third, owners are finding that projects where contractors bid low or no margins are experiencing a greater frequency of change orders, and claims. During boom times when construction margins are higher, contractors could absorb minor impacts to their work without seeking change orders or filing claims. However, even in these price-depressed times, construction “costs what it costs” with little or no margin to work with, contractors are seeking change orders and filing claims as a necessary step to staying in business. The rules of the game have changed, and owners who previously got by with contingency funds of 5 percent may find themselves scrambling for funds to pay for project overruns.

“There are concerns that the quality of work on some projects will suffer, Saliba says. “People who should not be bidding, are bidding,” he says. “It is kind of sad because the owners will see that the number of claims is going to increase down the road as these projects are completed.” 20

“...unless states performed independent estimates to find out the true costs of their projects, they risk awarding contracts to companies whose low bids did not reflect the true cost of the work. In such cases, he said, it is common for a company to try to undercut its competition with a low bid and then, once it has won the job, try to eke out a profit by putting in numerous change orders that drive up the price and delay the project.” 21

In severe cases, this increased frequency of change orders and claims can overtax an owners management team diverting it from its primary objective of managing the work, creating its own disruptive force that could impact the pace of the work.
Contractors and the False Claims Act

Thus far, we have only discussed the latent risks that low bid pricing poses to owners. As discussed above, contractors who bid work with low or no margin will be forced by economic necessity to seek change orders for any deviation from its bid assumption. There will also be those contractors that use this as a business strategy in an attempt to survive this depressed and highly competitive construction market. Note that the above indicates any deviation from a contractor’s bid assumptions as the basis for a claim, rather than a deviation from the contract documents. The latter, however, may be a moot point as economic conditions may put pressure on a contractor to become more aggressive in trying to find a cause of action to base a change order or claim for any cost not considered in its bid. So what is different you ask? Using a tight cost estimate with no contingency and smaller profit margins, contractors can no longer absorb minor deviations or oversights in its bid.

This trend toward increased frequency of change orders and claims, however, will be running headlong into an equally powerful force that is also the by product of this economy and the stimulus program – The Federal False Claims Act. Zetlin and Nardiello’s accompanying article entitled “Civil Liability for False Claims in Public Construction” explains the origin, purpose, and mechanics of the Federal False Claims Act (FFCA). Government agencies, whether they are federal, state, or local, are and will continue to be under intense pressure to monitor and control the use of stimulus funds. As explained by Zetlin and Nardiello, the FFCA is a powerful weapon that government agencies can use as a sword and a shield in their efforts to keep project overruns down. Contractors using the age old negotiating ploy of asking for $100 to get $70 may find themselves defending a false claim action by the owner.

Even a well-intended contractor, seeking what he or she believes to be a justified and supportable change order, may inadvertently trigger a false claims action. As discussed in the accompanying article by Zetlin and Nardiello, a contractor can be subject to liability under a false claims action even if it was unaware of the falsity of the claim.

"However, the Act defines "knowingly" as actual knowledge, deliberate ignorance or reckless disregard. This means that, in some instances, a contractor can be subject to liability under the FFCA even if it did not actually know of the falsity of the claim submitted." 22

In addition, many government agencies have been more aggressive than others using the statute, not just as a shield against paying inflated claims, but as a sword to aggressively prevent the filing of claims by contractors. Additionally, public owners short on funds to pay the increase of change orders and claims may look to any means, including false claim allegations, to avoid paying the increased costs. Further, the increased call for strict oversight of stimulus funds to make sure the funds are being spent prudently will, in itself, increase the number of false claims actions.

Some examples of issues which have triggered false claims actions include:

- Proposing individuals in a proposal knowing that the individual is unavailable;
- Requesting time extensions for delays that are not on the critical path or are the contractor’s responsibility;
- Overstatement of progress on payment application; and
- Methodology for charging construction equipment.

As stated by Zetlin and Nardiello in a case involving Commercial Contractors, Inc., the court found the following violated the FFCA.

- Excavating less than the contract drawings required, but submitting cross-sections and quantity surveys indicating that it had excavated up to the contract lines;
- Overstating the amount of backfill it added to the project;
- Burying debris under, and alongside, the channel at the project in violation of the terms of the contract, then submitting claims for properly filling the excavated areas and for clearing the excess fill and debris;
- Moving the survey stakes set forth in the contract documents to avoid construction difficulties due to wet ground caused by the tide; and
- Improperly heating concrete test cylinders to precipitate drying time where the contract set forth specific concrete placement methods.

Like two freight trains heading toward each other on the same track, the current trend of low bids and increased change orders in addition to the increased attention to the False Claims Act are headed for a collision.
Summary and Recommendations

How are owners and contractors going to survive these times? Common sense would seem to be the best medicine.

For Owners, if bids come in 20 to 30 percent lower than the Engineer’s estimate:

1. Additional investigation is warranted to determine if the contractor is a responsible bidder. Has the contractor performed this type of work before, of this size and complexity? What are its current obligations? This is a return to the basic questions that should be pursued on all publicly-bid projects.

2. Consider setting up a contingency fund for at least part of the difference in the Engineer’s estimate.

3. Consider establishing a detailed change management/dispute resolution protocol that incorporates progressive steps which involve senior management from both the contractor’s and owner’s organization, as well as a possible neutral third party to mediate as conditions precedent to arbitration or litigation.

For Contractors trying to avoid liability under the Federal False Claims Act:

1. Establish and educate internal ‘experts’ to educate company staff on key aspects of the Federal False Claims Act or retain competent outside guidance to train your staff.

2. Establish specific protocols for submissions to public agencies which include review and sign-off by internal ‘experts’ or outside independent experts.

3. Have all claim submissions prepared by an internal group familiar with the Federal Acquisition Regulations (FARs) or the specific public agency statutes. If using, an internal group is impractical, retain outside expertise knowledgeable in the preparation of claims for public agencies.

References

3. Id.
6. 31 U.S.C.S. § 3730
7. Id.
12. Id.
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