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A Lawyer's View of Procurement Fraud - I

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Assistant General Counsel for Finance & Litigation

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The False Claims Act

by Fred Kopatich

Over the last decade, numerous instances of procurement fraud, many of them spectacular, have come to light. The perpetrators have ranged from the smallest contractors to the largest. For instance, a 1992 GAO fact sheet reported that from October 1991 through June 1992, the Justice Department obtained 38 criminal convictions and settled 92 civil fraud cases, all of which involved just the top 100 defense contractors or their subsidiaries.[1] While the most notorious cases have involved defense contracts, any agency can be victimized by the fraudulent acts of its contractors. "Procurement fraud," in fact, is a very general concept, which can arise at any stage of the procurement process, and which can involve either contractor or government personnel. For instance, procurement fraud can occur during the pre-contract stage (*eg.*, collusion among bidders, promulgation of "wired specifications" by dishonest procurement officers), at the formation of the contract (false small business or Walsh-Healey certifications), or during contract performance (submission of falsified cost data; substitution of inferior products).

Once fraud is suspected or identified, a whole range of remedies are available to the Government. In terms of contract administration, there are limits on what actions a contracting officer may take as well as a range of remedies available to mitigate the impact of fraud.[2] The Government also has available numerous legal avenues available to pursue procurement fraud. Penalties can be assessed administratively, through civil actions in federal courts, or in criminal prosecutions. The Government's response can thus be fine-tuned to address such factors as the amount of money involved in the fraud, the extent of the contractor's cooperation with law enforcement, and how strong an example the Government wishes to make of the case.

Primary among the tools available to the Government are civil suits brought under the False Claims Act ("FCA"), 31 U.S.C. §§ 3729-3733. This Lawyer's View article focuses on the FCA, its history, scope and interpretation in the courts. A subsequent article will address issues of contract administration and other civil and criminal remedies available to the Government when procurement fraud is detected.

History of the False Claims Act

From the inception of the federal government in 1788 through the 1850s, fraud in the procurement process was not much of an issue for a simple reason–there wasn't really much federal procurement in those times of limited central government. Among the consequences of the beginning of the Civil War, however, was the vast expansion of the federal government and an immediate need to procure massive amounts of materials to fight the war. Not surprisingly, as the Government's procurement needs increased, so did the proliferation of fraudulent claims by contractors. To address this situation, the False Claims Act was passed by Congress in 1863. As originally written, the FCA was primarily a criminal statute, although it did allow the Government to seek monetary penalties against contractors through civil suits.

Until the 1980s, in virtually all cases brought under the FCA, the Justice Department chose to handle them as criminal, not civil, cases. Studies in the early 1980s showed that this emphasis on criminal prosecution was doing little to stop procurement fraud. Due to the high cost of prosecuting fraud cases in the federal courts, the Justice Department could only pursue a few of the largest cases, leaving unpunished the majority of contractors guilty of procurement fraud. Thus, for many contractors, the risk in submitting false claims for payment may

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not have been a significant one.

In response to this problem, Congress virtually rewrote the civil penalty provisions of the FCA in 1986 to make it easier to bring a civil case under the Act and to strengthen the remedies available to the Government in such cases. At the same time, Congress also passed the Program Fraud Civil Remedies Act ("PFCRA"), providing federal agencies with the means to pursue fraud cases administratively without the need to go through the federal court system. A subsequent article will discuss the PFCRA.

Scope of the FCA

The False Claims Act, as amended in 1986, has a broad scope. In general, anyone may be liable for civil penalties and damages if they submit a false claim or statement to the Government in an attempt to obtain federal funds. A contractor is liable for a civil penalty even if the Government made no payment on the false claim. *U.S. ex rel. Hagood v. Sonoma County Water Agency*, 929 F.2d 1416 (9th Cir. 1991); *United States v. Ridglea State Bank*, 357 F.2d 495 (5th Cir. 1966). In the procurement area, the FCA can apply to any statement made in relation to the award and administration of federal contracts, such as false certifications in contracts, false statements in proposals related to such evaluation factors as capacity to perform, technical approach and projected costs, or submission of falsified invoices. The statement or claim does not have to be certified, although a false certification certainly would be actionable under the FCA. The 1986 Amendments to the FCA also expanded the application of the FCA to include a "reverse false claim"– a false statement made in an attempt to defeat a Government claim for money. 31 U.S.C. § 3729(a)(7).

Under the FCA, the Government must prove that the person making the false claim acted with something more than mere negligence. That is, the false statement or claim had to have been made (i) with the specific intent to defraud the U.S., or (ii) with deliberate ignorance or reckless disregard for the truth or falsity of the information submitted. 31 U.S.C. § 3729(b). As a House Conference Report stated, the "reckless disregard" language in the statute was intended to ensure that contractors do not deliberately ignore "red flags" alerting them that information they are providing the Government may be false.[3] A contractor, however, may avoid liability if it can show that it made a false statement in reliance upon its interpretation of an ambiguous contract provision, and its interpretation was reasonable. See, *eg. U.S. v. Anderson*, 579 F.2d 455 (8th Cir. 1978).

Once the requisite intent is shown, the Government must show a violation of the FCA only by "a preponderance of the evidence." 31 U.S.C. § 3731(c). This is a substantially lesser showing than is required for a criminal conviction—"beyond a reasonable doubt" or what was required prior to the 1986 Amendments–proof of an FCA violation "by clear and convincing evidence." Because the showing required under the FCA is less than that required in a criminal case, a contractor's prior acquittal in a criminal prosecution does not bar a subsequent FCA action. See, *e.g., U.S. v. JT Const. Co., Inc.*, 668 F.Supp. 592 (W.D. Tex. 1987)(a contractor's acquittal on criminal charges relating to fraudulently inflating subcontractor price quotes does not limit a subsequent FCA civil suit because the Government's burden of proof is lower in an FCA civil action). Moreover, a criminal conviction based upon submission of a false claim is conclusive of a violation of the civil provisions of the FCA, and civil penalties may be assessed in addition to any criminal sanctions already imposed. *U.S. v. Killough*, 848 F.2d 1523 (11th Cir. 1988)(a criminal conviction under the criminal provisions of the False Claims Act and for conspiracy to defraud the Government is conclusive of a violation of the FCA's civil provisions); *United States v. Uzzell*, 648 F.Supp. 1362 (D.D.C. 1986)(involving prior conviction for criminal conspiracy to submit false claims).[4]

The penalties which can be imposed for submission of a false claim can be substantial. At a minimum, a penalty from $5,000 to $10,000 must be imposed for each false claim, regardless of the actual monetary loss suffered by the Government. 31 U.S.C. § 3729 (a). The penalty is applied separately to each submission of a false

claim, such as each of a series of invoices containing fraudulent cost data. In addition, if the Government has actually suffered a monetary loss due to submission of a false claim, then damages are to be assessed in an amount equal to three times Government's loss. *Id.*

The 1986 Amendments to the FCA also gave new powers to the Attorney General to issue "civil investigative demands," a significant new investigative tool for the Government. 31 U.S.C. § 3733. Again, this amendment to the FCA arose from problems associated with the Justice Department's pursuit of procurement fraud in the criminal courts. Investigations of criminal fraud are the province of grand juries. Grand juries have sweeping powers, which include compelling testimony by witnesses; however, all evidence obtained by a grand jury is secret. As a result, if a grand jury does not wish to prosecute a government contractor, any testimony or evidence it obtained could not be revealed to the Department of Justice to enable it to pursue a civil action.

The 1986 Amendments to the FCA rectified this situation by furnishing the Attorney General with many of the investigative tools used by grand juries. In investigating whether a violation of the FCA has occurred, the Attorney General now has the power to subpoena documents, compel testimony under oath, or require that witnesses answer written interrogatories. These are significant investigative powers, as they compel companies and individuals to respond prior to the filing of any civil suit. Without these powers, contractors could refuse to cooperate in an investigation, and decisions whether to pursue an FCA case would, in many instances, have to be made upon little solid evidence.

Conclusion

While the vast majority of government contractors maintain the highest standards of business integrity in their dealings with the federal government, procurement fraud is a major problem, costing the taxpayers millions of dollars each year. Practice has demonstrated that criminal prosecutions are, at best, a limited tool to combat such fraud. Emphasis has now shifted to the civil arena, where pursuit of fraud is easier and much more cost effective. As amended in 1986, the False Claims Act is now one of the primary statutes invoked to both penalize contractors for submission of false claims and to reimburse the government for its losses. While a contractor may avoid the stigma of a criminal conviction when a civil action is pursued under the FCA, the severe penalties which are imposed can act as an effective deterrent to procurement fraud.

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1. "Defense Procurement Fraud: Information on Plea Agreements and Settlements"

2. Under the Contract Disputes Act, a contracting officer has no authority to "settle, compromise, pay or otherwise adjust any claim involving fraud." 41 U.S.C. § 605.

3. H.R. Rep. No. 99-660, 99th Cong., 2d Sess 17 (1986).

4. If a contractor has been previously convicted on the basis of the submission of a false claim, then any civil penalty imposed upon him may not be grossly disproportionate to the actual harm to the Government. In U.S. v. Halper, ___ U.S. ___, 109 S.Ct. 1892 (1989), Halper was convicted of submitting 65 separate claims for Medicare reimbursement, each of which had been inflated by $9, causing a total loss to the Government of $585. In a subsequent FCA action, Halper was assessed $130,000 in penalties–$2,000 for each false submission. The Supreme Court found that such a disproportionate penalty amounted to a second criminal sanction for the same offenses, thus violating the Constitutional ban against double jeopardy.