

A CHECKLIST TO AVOID FALSE CLAIMS

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Introduction

Since its last amendment in 1986, the Federal False Claims Act (FCA) has led to the recovery of more than \$12 billion from various government contractors.¹ Following the Federal civil FCA, many states have adopted similar false claims statutes. These Federal and state FCAs are increasingly potential threats to government contractors, including construction contractors. It has become an especially serious topic in California, where some contractors believe that some public agencies are utilizing the Act as a sword, rather than a shield.

False claims liability has raised various questions for construction contractors involved in publicly-funded projects. This article focuses on one of those questions, namely how can contractors ensure that any claims for extra money are properly prepared and submitted? Though there is no guarantee that such a request will never meet a FCA response, we have developed the checklist presented in this article, to help contractors minimize the potential for FCA liability. The authors welcome input from readers.

FCA Basics

The Federal FCA, nicknamed the “Lincoln Law”, was first enacted in 1863 to combat fraud by contractors selling military goods to the U.S. government. Its use did not increase substantially until a major amendment in 1986 provided financial incentives to whistleblowers to bring what are called “qui tam” lawsuits. Contractors “knowingly” submitting false claims are liable to civil penalties between \$5,000 and \$10,000 per claim, plus treble damages. They may also be debarred from further contracting with the government.

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Claims under the Federal FCA involve requests or demands for the payment of money and property. The California FCA extends this to include requests or demands for services. The term “knowingly” (or “knowing”) means that a person has “actual knowledge” or acts in “deliberate ignorance” or “reckless disregard” of the truth or falsity of the information submitted.²

A growing number of states have enacted civil FCAs modeled after the Federal FCA. California was the first state to pass a FCA in 1987. Currently, nine other states including Delaware, Florida, Hawaii, Illinois, Massachusetts, New Mexico, Nevada, Texas, and Virginia, and the District of Columbia have passed their own FCAs to deal with contractor fraud in state- and locally-funded projects. Louisiana and Tennessee have Medical-only FCA.

Courts have generally held that “materiality” is required, which involves the (i) size and essence of the claim, (ii) timing of the claim, and (iii) how much the public owner relied on the claim. For example, the California FCA does not apply to claims involving less than \$500 in value.³ A civil action under the Federal FCA may not be brought “more than 6 years after the date on which the violation is committed” or “more than 3 years after the date when facts material to the right of action are known or reasonably should have been known.”⁴ A statement is considered “material” if it has “a natural tendency to influence” or is “capable of influencing” the agency.⁵

Any person, including a current or former employee of the contractor, or a member of a labor union, an unsuccessful bidder, or a government employee can initiate a qui tam lawsuit. This “whistleblower” is then entitled to a share of any funds recovered. Whether or not the whistleblower or the agency prevails against the contractor, contractors can spend very large sums of money and effort to defend or appeal FCA cases. In one instance, a prominent California case has taken nearly ten years without a final resolution.

Many people mistakenly think of false claims as pertaining only to change order requests, but FCA actions have also been applied to: (i) false bid documents and certifications; (ii) incorrect or inflated invoices, cost pricing data, wage rates and overhead; (iii) representations that work that meets specifications, terms and conditions of the contract when it does not; (iv) failure to meet specified self-performance or

disadvantaged business requirements; and (v) other types of false representations to government bodies. Certifications that can be “false” include certifications of payment, product quality, and compliance with laws and regulations such as environmental regulations, the Davis-Bacon Act, and the Buy America Act.

Nuances of the FCA

The FCA statute is increasingly being applied in a broader variety of situations. The City and County of San Francisco recently sued a contractor for a violation of city minority contracting rules and over-billing. In another well-known case, a labor union filed suit under the FCA statute alleging that a contractor had circumvented prevailing wage provisions on a project when he awarded work usually done by one labor craft to a different craft.

Ambiguities in the law also offer opportunities to expand its coverage. In California, one contractor was threatened with multiple FCA actions when an early change order request was found to be faulty and 37 later change requests had been based on it. Even if the later change order requests were accurate in and of themselves, the public agency took the position that treble damages could be assessed against all 38 requests. This theory was never tested in a court of law but it was sufficient to make the contractor relent in its request.

The FCA is not just a threat to construction contractors. It has been applied to other parties including a construction management firm that was recently prosecuted for filing false project planning applications to the Federal Government.⁶ The California Statute specially applies to people who assist in the preparation of a False Claim.

A Checklist to Minimize the Potential for A False Claims Suit

As previously explained, the term a “false claim” is very broad under the FCA. A contractor may be in violation even at the earliest stages of a public project. As such, in order to prevent false claims, contractors have to be aware of potential false claims at every stage of the project: bid preparation, contract negotiations, and contract administration. Due to limitations in the length of this article, we are presenting our checklist for the contract administration stage (Table 1).

The key points of this table are that precautions should be taken for managing contract performance, documenting claims, dealing with pass-through claims, and following up the already-submitted claims.

Table 1. Checklist for false claims avoidance

<p>1. General</p> <ul style="list-style-type: none"> 1.1 Be honest. 1.2 Institute written policies against false claims. 1.3 Implement a documented compliance program to prevent the knowing submission of false claims. 1.4 Alert/inform/train in-house personnel about False Claim issues and liability. 1.5 Take a careful look at all your business practices for securing and administering work as well as claims submission and administration practices. 1.6 Appoint as key claims personnel those who understand false claims liability. 1.7 Do not hesitate to consult lawyers and experts.
<p>2. Contract Performance</p> <ul style="list-style-type: none"> 2.1 Maintain complete project records: daily logs, change order logs, cost accounting... 2.2 Document the occurrence of claims-related events, their impact upon the project and the resultant costs incurred in project records. (Best Practice calls for tracking claims costs separately from other job costs.) 2.3 Verify compliance with as-bid statements; obtain approvals, if anything changes. 2.4 Carefully screen pass-through costs.
<p>3. Claims Documentation</p> <ul style="list-style-type: none"> 3.1 Be careful in calculations. 3.2 Verify factual assertions by reference to project records. 3.3 Avoid inflated claims and overstated/duplicated billings or damages. 3.4 Do not use information in claims that you know, or should have reason to know, is false, exaggerated or groundless. 3.5 Do not conceal information that you know bears on the validity or accuracy of your claim. 3.6 Do not present a total or modified total cost and/or total time claim that fails to properly account for known factors that exonerate the owner's liability. 3.7 Require key claims personnel to certify that they carefully reviewed entitlement and quantum and in their opinion the claim is well-founded as to both entitlement and quantum.
<p>4. Pass-through Claims</p> <ul style="list-style-type: none"> 4.1 Carefully screen pass-through claims from subcontractors and vendors. 4.2 Require each pass-through claim certified by the claimant in writing as to entitlement and quantum. 4.3 Do not present pass-through claims from vendors or subcontractors that you know or suspect are false or inflated or otherwise unjustified. 4.4 Communicate directly with subcontractor in writing the reasons why you are not

<p>passing the claim along and what information needs to be provided before the claim will be passed along.</p>
<p>4.5 Be sure the person reviewing the pass-through claim has first hand knowledge of project details so that they can spot suspect factual information. Have the claim reviewed by persons with accounting knowledge and project knowledge so they can spot suspect data.</p>
<p>5. Claims Follow-up</p> <p>5.1 Be prepared to present valid, auditable backup to the public owner to support both entitlement and quantum.</p> <p>5.2 Inform the public owner if any false claim is discovered. The California statute actually has provisions that allow penalties to be reduced if voluntary disclosure is promptly made.</p>

Conclusions

False Claims Act allegations will almost certainly continue to grow in the construction industry. Honesty, care, good documentation, and an effective document compliance program are the keys to prevent false claims and defend FCA lawsuits. More than ever, contractors need a Standard of Practice to help them avoid False Claims allegations from public agencies. The checklist presented in this article hopefully will be seen as a good start.

References

¹ U.S. Department of Justice, *Immediate Release*, November 10, 2003.

² 31 U.S.C. § 3729 (b).

³ Calif. Gov't Code § 12651 (d).

⁴ 31 U.S.C § 3731 (b).

⁵ *Kungys v. United States*, 485 U.S. 759, 770 (1988)

⁶ *United States ex rel. Ali v. Daniel, Mann, Johnson & Mendenhall*, 355 F.3d 1140 (9th Cir. 2004)

Endnotes

¹ U.S. Department of Justice, *Immediate Release*, November 10, 2003.

² 31 U.S.C. § 3729 (b).

³ Calif. Gov't Code § 12651 (d).

⁴ 31 U.S.C § 3731 (b).

⁵ *Kungys v. United States*, 485 U.S. 759, 770 (1988)