



PROCUREMENT FRAUD

PANEL DISCUSSION

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PANELISTS

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Issue 1: The Vague Contract

What Can Go Wrong

- Ambiguous commercial contracts are typically addressed by informal negotiation or, at worst, breach of contract suits.
- Ambiguous government contracts ideally follow the same path. But the FCA changes the calculus for the parties.
 - There is a risk of a disconnect between how relators and DOJ interpret a contract versus how the contractor interprets it.
 - Relators and DOJ have brought several cases based on contract language that the contractor understood differently than the agency.
 - *Qui tam* cases can remain under seal for years, meaning that government and contractor witnesses to the original agreement can become unavailable.
 - Starting a fraud investigation changes the tone between the contractor and the agency, leading both sides to become reluctant to negotiate.
 - FCA allegations can also foreclose the possibility of obtaining a definitive contract interpretation from a Board of Contract Appeals.

Issue 1: The Vague Contract

Legal Issues

Objective Falsehood

- FCA liability requires an “objective falsehood,” not just a difference of opinion or “a disputed legal question involving the terms of a contract.” *E.g., U.S. ex rel. Danielides v. Northrop Grumman Sys. Corp.*, 2015 WL 5916871 (N.D. Ill. Oct. 8, 2015)

Scienter / Knowledge

- Many courts have ruled that FCA liability cannot arise where a defendant had a “facially reasonable interpretation of [an] undefined and ambiguous term” and the agency did not “officially warn[] ... away” the defendant from that interpretation. These decisions follow the Supreme Court’s decision in *Safeco Insurance Co. of America v. Burr*, 551 U.S. 47 (2007). *E.g., U.S. ex rel. Purcell v. MWI Corp.*, 807 F.3d 281, 284 (D.C. Cir. 2015).
- Other courts have ruled that regardless of whether a contract term is ambiguous and the defendant has an reasonable interpretation, evidence that the defendant had subjective knowledge of the government’s interpretation can establish knowledge. These cases follow *Halo Electronics, Inc. v. Pulse Electronics, Inc.*, 136 S. Ct. 1923 (2016). *E.g., U.S. ex rel. Gerry Phalp et al. v. Lincare Holdings, Inc.*, 857 F.3d 1148 (11th Cir. 2017).
- Relators in *Purcell* petitioned for certiorari on this issue in 2016, and after the government recommended against the grant of certiorari, the Supreme Court denied cert. in 2017.

Issue 1: The Vague Contract

Legal Issues

Materiality

- “[I]f the Government pays a particular claim in full despite its actual knowledge that certain requirements were violated, that is very strong evidence that those requirements are not material.” *Universal Health Services, Inc. v. U.S. ex rel. Escobar*, 139 S. Ct. 1989 (2016)
 - This suggests that if the government knew the contractor was not acting in accordance with the government’s interpretation of the contract, but took no action, then the violation could not be material under *Escobar*.
- “What matters is not the label the Government attaches to a requirement, but whether the defendant knowingly violated a requirement that the defendant knows is material to the Government’s payment decision.” *Id.*
 - This language confirms that defendants have to know the violation of the contract term was material to the government. It also suggests that not only would the government or relator need to surmount the *Safeco* test, but rather they would *also* need to establish the defendant had subjective knowledge of the government’s understanding of the contract.

Issue 1: The Vague Contract

Case Study: *U.S. ex rel. Danielides v. Northrop Grumman Sys.*

No. 09-cv-7306, 2015 WL 5916871 (N.D. Ill. Oct. 8, 2015)

Issue: Objective Falsehood

Dispute

- Contract to develop civilian aircraft missile defense system styled as a “**fixed price best efforts**” contract. This term was not defined in the contract.
- Defendant understood the term to mean that if it could not complete the deliverables for the fixed price, it could still be paid for its best efforts after providing evidence of its best efforts to the government.
- Former employee brought *qui tam* alleging, among other things, that “best efforts” meant defendant had to spend the entire budgeted funds, less a guaranteed profit, in furtherance of the contract’s objectives.

Issue 1: The Vague Contract

U.S. ex rel. Danielides v. Northrop Grumman Sys., cont'd

Result

- Defendant moved to dismiss, arguing that “fixed price best efforts” was ambiguous, and so its claims for payment based on its reasonable interpretation of the contract were not “**objectively false.**”
 - Court denied motion to dismiss because relator had alleged the defendant and the government had a shared understanding of the contract, and allowed limited, staged discovery on the interpretation of “fixed price best efforts.”
- After discovery, Defendant moved for summary judgment arguing that relator had not established that the defendant and the government had a shared understanding of the term “fixed price best efforts.”
 - Court granted summary judgment because record failed to establish that either the defendant or the government interpreted the contract in the same way as the relator. It also held that the government and defendant did not share a common interpretation of the contract.

Issue 1: The Vague Contract

Case Study: *U.S. ex rel. Purcell v. MWI Corp.*,
807 F.3d 281, 284 (D.C. Cir. 2015)

Issue: **Scienter/Knowledge**

Dispute

- Defendant contracted to sell irrigation equipment to Nigeria financed by the federal Export-Import Bank. As part of approval for loan, the Bank required the defendant to certify it had not paid any discounts, rebates, etc., in connection with the sale except for “regular commissions.”
- Former MWI employee filed a *qui tam action* claiming that \$28 million in commissions to a Nigerian sales agent were “non-regular commissions” that should have been reported. The United States intervened.
- After years of litigation, the parties on appeal to the D.C. Circuit agreed that there could be three possible interpretations of the ambiguous term:
 - Government’s “industry-wide” interpretation: “Regular” means the commissions align with industry benchmarks.
 - Intra-firm interpretation: “Regular” means the customary commission paid by the defendant.
 - MWI’s “individual-agent” interpretation: “Regular” means the commission customarily paid to the specific agent.

Issue 1: The Vague Contract

Scienter / Knowledge: *U.S. ex rel. Purcell v. MWI Corp.*, cont'd.

Result

- At trial, the jury found MWI liable for \$7.5 million. The court trebled the amount to \$22.5 million.
- On appeal, the D.C. Circuit ruled that the contract term “regular commissions” was ambiguous, that MWI’s “individual-agent” interpretation was objectively reasonable, and that the record lacked evidence that the government published written guidance on the meaning of the term or otherwise warned MWI away from its interpretation.
- The D.C. Circuit overturned the jury verdict finding and remanded with instructions to enter judgment in favor of MWI. Relators petitioned for certiorari on the scienter issue, and that petition was denied in 2017.

Issue 1: The Vague Contract

Case Study: *U.S. ex rel. Shemesh v. CA, Inc.*,
89 F. Supp. 3d 67(D.D.C. 2015)

Issue: **Scienter/Knowledge**

Dispute

- Defendant contracted with the General Services Administration (“GSA”) to provide software licenses and maintenance to various other agencies under a Multiple Award Schedule contract.
- During negotiations to renew the contract and during performance, CA was required to make disclosures about the prices it charged to commercial customers, and to continue to gather data about its commercial prices.
- A former employee brought a *qui tam* action and the government intervened. The government alleged that CA excluded certain commercial discounts from the information it gathered and disclosed to the government, in violation of the contract. The government claimed those incorrect disclosures fraudulently induced GSA to award and continue paying for the contract at an inflated price, and thus CA’s claims for payment were false.

Issue 1: The Vague Contract

Scienter / Knowledge: *U.S. ex rel. Shemesh v. CA, Inc.*, cont'd.

Result

- CA moved to dismiss. CA argued that its disclosures complied with the terms of the contract and so were not factually false. CA also argued that it could not have scienter because it complied with its own objectively reasonable understanding the contract and disclosure requirements.
- The district court disagreed that the contract language clearly favored CA's preferred interpretation, or clearly established that CA's interpretation was at least objectively reasonable. Thus, the Court concluded it could not resolve these issues on the pleadings and denied CA's motion to dismiss.
- CA eventually settled with the government for \$45 million, of which \$10.2 million went to the relator.