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Paper Title: Federal Fraud Investigations Update: Some Construction and Surety Industry Hotspots

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I. Introduction

Increasingly, companies engaged in federal contracting find themselves in the precarious position of dealing with investigators appearing at the company's office

particular contract. Typically, investigators not only insist on taking computers and files but also seek to question management or employees about the government contract, often without any explanation of the purpose of the visit. In the last few years, the government has added sureties, brokers, and bond producers to the ever-growing list of targets of fraud investigations. How would your company respond to a government fraud investigation that may be in high gear?

Despite the pandemic, the Department of Justice (DOJ) announced that the government recover

the failures.

Several corporate settlements required defendant individuals, particularly senior executives and owners, to pay a portion of the settlement amount. For instance, as part of a $4.25 million settlement, five individual shareholders of an asphalt contractor agreed to pay a total of nearly $2 million to resolve the allegations that the company violated the False Claims Act by misrepresenting to the government the asphalt mix that it was using to pave federally funded roads.

DOJ enforcement efforts have also encompassed foreign military sales (FMS) as these sales have increased in recent years. In November 2019, a company agreed to pay $2.8 million and give up $16 million in potential administrative claims to settle allegations that it violated the FCA by fraudulently obtaining a foreign military sales contract reserved for American companies. The settlement resolved allegations that the company presented false claims to the government certifying that it was performing work as the prime contractor when, in fact, the work was performed by its parent company, which was a foreign company.

III. Fraud Involving Small Business Administration Programs

A. The Federal Paycheck Protection Program

In March 2020, Congress passed a $2.2 trillion economic relief bill known as the Coronavirus Aid, Relief, and Economic Security (CARES) Act designed to provide emergency financial assistance to the millions of Americans who are suffering the economic effects caused by the COVID-19 pandemic. Administered by the SBA, the CARES Act created a Paycheck Protection Program (PPP) to enable businesses to apply for low-

As the case reflects, both businesses and the individuals that prepare and submit loan documentation can be held liable for false claims. Businesses who have received PPP loans and/or are considering seeking forgiveness of these loans should fully understand their obligations under the program and take appropriate steps to ensure that all documentation fully substantiates compliance with PPP rules. Although the SBA requires only loans above $2 million to be audited, this case demonstrates that the DOJ will pursue allegations of fraud regardless of the dollar amount loaned.

B. -Disabled Veteran-Owned, and Women-Owned Small Business Programs

Regulations dealing with government contracting programs for small businesses are outlined in the Title 13 Part 125 of the Code of Federal Regulations (CFR). The government works to make sure small businesses get at least 23 percent of all federal contracting dollars. Additionally, the government aims to award a certain percentage

with knowledge that the contractors were not eligible for the set-aside contracts. The surety defendants moved to dismiss the claims against them, arguing the complaint failed to allege sufficient facts that, even if true, would state a plausible claim for relief. The U.S. District Court for the District of Columbia agreed, finding that the complaint failed to allege sufficient facts to support any of the FCA claims against the sureties.

The relator subsequently amended his complaint asserting the same four causes of action against the surety defendants but provided some additional factual allegations in support of each count. More specifically, the amended complaint alleged that through the underwriting process and an on-site inspection of the

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Regulation and SBA rules is likely to either deter certain sureties from bonding set-aside contracts and/or result in a dramatic increase of cost for Miller Act bonds.

women-owned small businesses (WOSB), service-disabled veteran-owned small businesses (SDVOSB), and Historically Under-Utilized Business Zone (HUBZone) small businesses. Like the 8(a) Program, the ASMPP also provides an exception to affiliation for assistance that a protégé firm receives from a mentor and allows the protégé and mentor to joint venture as a small business provided the protégé qualifies as small for the size standard corresponding to the NAICS code assigned to the procurement. The affiliation exceptions under the mentor-protégé programs are significant because SBA's regulations require a small business to count its own annual receipts or employees, plus the annual receipts or employees of each affiliate, when determining its size status. The ASMPP has been enormously popular because it gives all small protégé businesses more capability to compete for larger and more sophisticated work while simultaneously giving large mentor businesses the opportunity to conduct up to 60% of work on a

was the difference between the amount paid to the new contractor to complete the work and the unpaid balance of the contract with Lodge. Both Lodge and its surety challenged the default termination before the COFC.

In 2017, the government sought and was granted leave to assert several fraud counterclaims against Lodge and its surety. See *Hanover Ins. Co. v. United States*, 134 Fed. Cl. 51 (2017). The government asserted three specific fraud counterclaims against Lodge under three separate statutes: (1) a False Claims Act claim under 31 U.S.C. § 3729 et seq.; (2) a claim under the anti-fraud provision, 41 U.S.C. § 604; and (3) a Special Plea in Fraud claim under 28 U.S.C. 2514. For jurisdictional reasons, the COFC FCA claims against the surety to the District of Massachusetts. Now, approaching eight years of litigation, the remaining parties recently presented cross motions for summary judgment.

On April 14, 2021, the COFC found that issues of material fact preclude summary judgment on both the liability and fraud issues. *Lodge Construction, Inc. v. United States*, No. 13-499, 2021 WL 1418847 (Fed. Cl. Apr. 14, 2021). However, in its cross motion, Lodge successfully a

-fraud provision is time-barred. Lodge successfully argued that the -year limitations period began running when the claims were submitted to the Contracting Officer in 2012 and elapsed six years later because no court

authorize an agency head to settle, compromise, pay, or otherwise adjust any claim involving frau As a result, the United States Court of Appeals for the Federal Circuit has held that CDA jurisdiction at the BCA requires *M.*

Maropakis Carpentry,

finding contrary would allow the government, whenever it expected to lose on

A D&O insurer that receives an FCA claim is, ironically considering the discussion abo
professional services. While that would seem to suggest that either a D&O or professional liability policy will respond to a claim, in the great majority of cases the policy will only provide a defense because any settlement or judgment would be considered an uninsurable loss. If a company has D&O and professional liability policies issued by different insurers, the insurers may take different views of whether the conduct alleged constitutes professional services. That would, at least temporarily, lead to no insurer defending the claim.

3. Employment Practices Liability Policies

It may seem odd that a policy designed to cover losses resulting from claims by employees for wrongful termination, retaliation, harassment, and other conduct would respond to an FCA claim. Such claims are often brought by whistleblowers who are employees or former employees. Those employees may allege that they were retaliated against for questioning the practices that underlie the FCA claim, or that they have otherwise been treated inappropriately. Those allegations may be

practices liability (EPL) policy. The EPL insurer will be forced to defend the claim

claim.

VI. Conclusion

In 1986, Congress strengthened the FCA by increasing incentives for whistleblowers to file lawsuits alleging false claims on behalf of the government. Whistleblowers filed 672 *qui tam* suits in fiscal year 2020, and this past year the department recovered over $1.6 billion in these and earlier-filed suits. Sureties are now facing false claims regarding both underwriting and claims handling. Although the courts have not yet imposed a duty on sureties in this respect, the industry is closely watching how it may need to respond and adjust to a changing risk landscape.

As for government contractors, there are steps that companies can take to avoid that fateful knock on the door by a fraud investigator. Although all contractor employees should be aware of compliance issues and potential for fraud, there are certain groups within a company that are more directly involved with closely scrutinized activities. Personnel in these departments are susceptible to creating a defective pricing, mischarging or fraud situation by their actions or inaction. One cost effective method of educating your employees in dealing with government auditors and establishing or enhancing an appropriate response strategy to a fraud investigation is a company compliance program seminar. Besides familiarizing employees with the fraud indicators, such a seminar is useful in keeping abreast

with the latest changes and amendments to statutes and regulations related to compliance matters.

Finally, while companies cannot rely on their insurers to cover all loss arising from an FCA claim, it is essential for companies facing a claim to notify the relevant insurers as soon as they become aware of the matter. Doing so will ensure that companies receive all the coverage that is available.