Written by Nick Sanders
Thursday, 21 July 2011 05:17

Part 1 of 2

This is an article about legal stuff—namely, the Government's "affirmative defense" called the "special plea in fraud". (28 U.S.C. § 2514.) Let us remind readers right off the bat that we are not attorneys and we are not giving legal advice and we are not qualified to have any opinions whatsoever on such tricky topics as common-law fraud or affirmative defenses or special pleas in anything.

Yet here we are.

An "affirmative defense," Black's Law Dictionary (6th Edition) tells us, is "in pleading, a matter asserted by defendant which, assuming the complaint to be true, constitutes a defense to it. A response to a plaintiff's claim which attacks the plaintiff's
legal
right to bring an action, as opposed to attacking the truth of claim."

The Government's "special plea in fraud" defense has a long and, as we shall learn in Part 2 of this article, a mixed history in Federal jurisprudence. Our favorite example of its use was in the 2006 decision by the U.S. Court of Federal Claims in the matter of Daewoo Engineering and Construction Co., Ltd. v. USA
. Here's
a link
to that decision. The Judge summed up his decision thusly—

Daewoo's case against the United States is wholly without merit; its claims are fraudulent. The Corps of Engineers has been as conscientious, patient, and fair in its administration of this contract as Daewoo has been demanding, unreasonable, and inept.

(The good stuff in the decision starts about page 34, for those interested in such things. Fair warning: we are going to be quoting extensively from the decision.)

The Judge wrote—

Plaintiff did not present a clear legal theory to support its large claim against the Government. It appeared that Daewoo did not expect to find itself in court trying to justify its case; perhaps it thought defendant would pay a negotiated amount. The purpose of the Contract Disputes Act is to prevent this sort of gamesmanship. …

[Daewoo's witnesses] did not seem capable of providing testimony that would support a coherent legal theory, if one could have been identified. This was true despite the court's conviction that Daewoo prepared its witnesses with unusual care. We did not have an effective understanding of plaintiff's legal position other than its insistence on having been misled by the Weather Clause [in the contract]. …

Kim [Daewoo's Project Manager] certified the claim for $64 million, and he testified that he expected the Government to pay the entire amount. Later the same day, he recanted that testimony, stating that the claim was for only $13 million. Plaintiff's counsel made the remarkable argument that Kim's testimony concerning the amount of the claim, and in fact the complaint itself, are 'irrelevant.' We understood him to mean that Kim's testimony should be viewed as irrelevant because it was 'inconclusive.' The testimony was inconclusive because it was 'inconsistent.' Kim was the project manager. He was the person whom Daewoo authorized to certify claims to the United States on plaintiff's behalf. His 'conflicting testimony' on an issue of paramount importance to this case does not go to relevance; it goes to credibility.

Okay, readers. Somewhere about this time you ought to be getting the sense that Daewoo was in trouble with this Judge, that its case wasn't going as well as it initially may have hoped. This was confirmed later in the decision, as follows—

Mr. Kim's testimony also provided examples of Daewoo's lack of good faith. He testified that some part of the claim was intended to indicate 'the seriousness of the situation' and to get the Government to 'pay attention' so defendant would agree to Daewoo's preferred method of compaction. This is the source of the dispute regarding plaintiff's 'negotiating ploy.' Using a claim to gain leverage against the United States violates the principle on which Congress enacted the Contract Disputes Act, including its effort to prevent contractors from using the claims process to obtain higher profits. Congress called it 'horse trading.'

Daewoo's project manager testified that plaintiff filed at least $50 million of its certified claim as a negotiating ploy; Daewoo's counsel essentially confirmed it: 'Daewoo's suggestion that the Government expedite a previously approved and validated alternative embankment placement method is a reasonable request that served the projects best interests and, therefore, is grossly mischaracterized as a 'ploy.'' Unfortunately, Daewoo's 'reasonable request' or 'suggestion' that the Government 'expedite' approval of the cheaper compaction method took the form of a certified claim.

As some-time expert witnesses we were interested in how Daewoo's experts fared in the Judge's scathing decision. Answer: they did not fare well. Here's a longish snippet—

The testimony of plaintiff's expert witnesses was obtuse. It was not always clear what they were attempting to accomplish or avoid by their use of such careful semantics, however. They jostled with government counsel about whether the firm was hired to 'update' plaintiff's certified claim or to 'reprice' it. … Presumably, they preferred the word 'reprice' because [the experts] wanted it known that they had nothing to do with the certified claim, which they reduced by more than $20 million from $64 million (or increased by approximately $30 million from $13 million). 'Update' would suggest that they started with numbers used in the certified claim and refined them, accounted for passage of time for example, but that was not the case. Each expert deferred to the other for responses to questions that both should have known but could not or would not address.

The experts emphasized that they had not read the certified claim they were to update or reprice. They wished to distance themselves from any numbers or supporting data that had been a part of that claim. The issue became more cloudy later in their testimony. Mr. Allen reported that he may have 'looked it over. That's all.' Mr. Freas 'did not go in and look at Daewoo's bid in its entirety, check every single number, every single quantity. That I did not do.' So either they merely scanned the certified claim or they did not read it at all.

There are literally pages and pages of the Judge's review of Daewoo's witnesses and scathing dismissal of their arguments. (You may be gleaning the reason why this is one of our favorite cases….) But now we'll skip to the Government's counterarguments—which included counterclaims for fraud.

The evidence of fraud arose from and during the testimony of plaintiff's own witnesses, during its case-in-chief. … The Government showed primarily through cross-examination that it was

not liable on plaintiff's claims, and that Daewoo's claims were fraudulent. Defendant used its own case to establish additional evidence supporting findings of fraud and quantifying them. Defendant did not hire new experts to pursue its fraud counterclaims or call new witnesses. Its accountants expanded their testimony somewhat to include additional examples of plaintiff's efforts to inflate its claims. We offered plaintiff's counsel the opportunity to depose defendant's expert witnesses on the expanded testimony, but they declined.

Despite the magnitude and importance of this case, plaintiff did not present a coherent legal theory for recovery other than its insistence on having been misled by the Weather Clause. Every witness seemingly was instructed to emphasize that the Weather Clause was misleading. …

The Government is entitled to judgment on all its counterclaims for reasons discussed throughout this Opinion. Plaintiff made obvious mistakes and overly-optimistic assumptions in its bid proposal, but its claims against the Government go well beyond mere error or oversight.

The Judge went into some detail regarding the Contracts Disputes Act (CDA) and the role of claim certification in the disputes process. He wrote—

The Contract Disputes Act requires that an authorized corporate official certify that the contractor's claims are 'made in good faith.' See 41 U.S.C. § 605(c)(1). 'The supporting data must be accurate and complete to the best of [the official's] knowledge and belief, [and] the amount requested [must] accurately reflect[] the contract adjustment for which the contractor believes the government is liable. . . .' Id.

Congress provided that claims against the United States must be certified by an authorized corporate official, to 'discourag[e] the submission of unwarranted contractor claims.' … Plaintiff's Project Manager, Mr. Kim, certified Daewoo's claim. He testified repeatedly that the claim totaled $64 million. He expected the Government to pay the entire amount. …

Daewoo's experts could have performed an important service by checking plaintiff's books and records concerning operating costs and acquisition costs of equipment. They could have found the duplicated and scrapped equipment in the claim …. See United States v. TDC Mgmt Corp., 24 F.3d at 292, 298 (D.C. Cir. 1994) ('[E]very party filing a claim before the contracting officer

and this court has a duty to examine its records to determine what amounts the Government already has paid or whether payments are actually owed to subcontractors or vendors. . . . [A] failure to make a minimal examination of records constitutes deliberate ignorance or reckless disregard, and a contractor that deliberately ignored false information submitted as part of a claim is liable under the False Claims Act.').

The Government filed counterclaims pursuant to the False Claims Act, the Special Plea in Fraud, and the Contract Disputes Act. Defendant also claimed fraud in the inducement, or 'bait and switch,' an unusual counterclaim in this context.

According to the Judge in the Daewoo case, the Government's "special plea in fraud" defense is summarized by this quote from the United States Code:

A claim against the United States shall be forfeited to the United States by any person who corruptly practices or attempts to practice any fraud against the United States in the proof, statement, establishment, or allowance thereof.

As the Judge found—

The forfeiture counterclaim carries no monetary penalties other than the forfeiture itself. We found no liability against the Government on plaintiff's claim, so Daewoo has nothing to forfeit. Defendant made the necessary showings of intent and otherwise met the elements and the burden called for by this section, however. For example, defendant showed by clear and convincing evidence that the contractor knowingly presented a false claim with the intention of being paid for it. Once these standards and burdens are established, this court must forfeit plaintiff's entire claim. 'In such cases, the United States Court of Federal Claims shall specifically find such fraud or attempt and render judgment of forfeiture.' 28 U.S.C. § 2514 (emphasis added).

Thus, regardless of the merits of Daewoo's claim against the Government, its claim was forfeit and it received nothing as a matter of law.

If the foregoing wasn't a sufficient penalty, the Judge also invoked the fraud provisions of the Contract Disputes Act. (41 U.S.C. § 604.) He quoted the statute as follows—

If a contractor is unable to support any part of his claim and it is determined that such inability is attributable to misrepresentation of fact or fraud on the part of the contractor, he shall be liable to the Government for an amount equal to such unsupported part of the claim in addition to all costs to the Government attributable to the cost of reviewing said part of his claim.

As you may well suspect by this point in the story, the Judge found that Daewoo had violated the fraud provisions of the CDA. He wrote—

The Government proved by any standard that Daewoo's $64 million claim was fraudulent. Plaintiff made the claim for purposes other than a good faith belief that the Government owed Daewoo that amount. Plaintiff in fact did not believe that the Government owed it $64 million as a matter of right. … Daewoo submitted a certified claim as a negotiating ploy; that is, for a reason other than an attempt to recover money for which Daewoo believed the Government is liable. … Daewoo's entire $64 million claim was an attempt to defraud the United States.

So let's recap Daewoo's situation at this point. It had filed a $64 million claim against the U.S. Government which had been forfeited by the special plea in fraud. In addition, the company was looking at roughly $50 million in civil penalties related to its filing of a fraudulent claim under the CDA. But that's not all. There was still more to come for this inept contractor.

In addition to its other arguments, the Government alleged that Daewoo also violated the False Claims Act by submitting its fraudulent claim. As the Judge explained—

Daewoo presented a false claim for payment and knowingly used false records or statements to support the claim. The penalty is $10,000 plus three times the amount of damages. 31 U.S.C. § 3729(a)(3). 'Claim' is defined broadly by the statute to include 'any request or demand . . . for money or property' from the Government. See § 3729(c). …

The certified claim itself was false or fraudulent and plaintiff knew that it was false or fraudulent.

Whether the United States suffered damages as a result, however, is a matter that we could not establish.

Because the Court couldn't determine any damages actually suffered by the Government, it could only assess a simple $10,000 penalty. Had damages been able to have been assessed, the Judge opined that Daewoo might have been liable for an additional $7.6 million. He concluded his decision as follows—

Daewoo violated the False Claims Act by knowingly submitting false or fraudulent claims; it violated the Contract Disputes Act through its submission of false or fraudulent claims with an intent to deceive or mislead the government; and it attempted to practice fraud against the United States 'in the proof, statement, establishment, or allowance' of its claims. … These findings are supported by testimony of plaintiff's witnesses and other evidence produced by plaintiff and defendant. Plaintiff's claim to the contracting officer and its complaint in this court sought a 'total monetary damage claim' of $64 million, an amount that Daewoo's own witnesses, experts, and attorneys abandoned before the trial was over. …

Daewoo obtained this contract under false pretenses, though we have not attempted to assign damages to the Government's claim of fraud in the inducement. It submitted false records and made false statements in preparing, certifying, and pursuing its claim and subsequent "updates." Defendant lists a number of instances in which plaintiff made false statements to the Government to further its ambitions or to obtain money or property ultimately. …

We enter judgment for defendant on its counterclaims pursuant to the Contract Disputes Act, the Special Plea in Fraud, and the False Claims Act as follows:

Contract Disputes Act – $50,629,855.88.
False Claims Act – $10,000.
Special Plea in Fraud – No monetary judgement.

Daewoo appealed the decision. It did not fare well in the **appellate decision** either. We quote some of the interesting bits below.

The Court of Federal Claims did not find that Daewoo's theories of the government's breach of the contract—based on alleged defective specifications, failure to disclose superior knowledge, and impossibility—were fraudulent (though it ultimately found these theories to be without merit). Rather, the Court of Federal Claims found that Daewoo's $50.6 million projected cost calculation was fraudulent. That calculation assumed that the government was responsible for each day of additional performance beyond the original 1080-day contract period, without even considering whether there was any contractor-caused delay or delay for which the government was not responsible. The calculation then simply assumed that Daewoo's current daily expenditures represented costs for which the government was responsible.6 Daewoo apparently used no outside experts to make its certified claim calculation, and at trial made no real effort to justify the accuracy of the claim for future costs or even to explain how it was prepared. … Indeed, Daewoo's damages experts at trial treated the certified claim computation as essentially worthless, did not utilize it, and did not even bother to understand it. … The Court of Federal Claims pointed out that Daewoo's claim preparation witnesses inconsistently referred to and interchanged actual, future, estimated, calculated and planned costs. … The court found that J.W. Kim, who certified the claim, gave false testimony. … The court also found that the testimony of Daewoo's witness Mr. Richardson regarding the calculation of Daewoo's certified claim 'left no doubt that [Daewoo's] case was unsupportable and was pursued by Daewoo with fraudulent intent.' …

Daewoo appears to argue that a claim can be fraudulent only if it rests upon false facts rather than on a baseless calculation. We disagree. Here Daewoo certified, as required by 41 U.S.C. § 605(c)(1), that 'the claim is made in good faith; that the supporting data are accurate and complete to the best of my knowledge and belief; that the amount requested accurately reflects the contract adjustment for which the Contractor believes the Government is liable.' … By certifying a claim for damages in the amount of $64 million, Daewoo represented that the claim was made 'in good faith.' It is well established that a baseless certified claim is a fraudulent claim.

Going a bit into the Government's special plea in fraud defense, the Appellate Court wrote—

Unlike the antifraud provision of the Contract Disputes Act, 41 U.S.C. § 604, under which a contractor may incur liability only for the unsupported part of a claim, forfeiture under 28 U.S.C. § 2514 requires only part of the claim to be fraudulent. For instance, in Young-Montenay, Inc. v. United States , we held that because a contractor had submitted a claim to the government for $153,000 when the contractor knew the government was liable only for $104,000, such a knowingly false claim forfeited the contractor's later damages claim against the government under the contract. 15 F.3d 1040, 1042-43 (Fed. Cir. 1994).

Needless to say, the original Court of Federal Claims decision was affirmed.

Think this was a long article? It was just prelude. In the next installment, we will discuss a recent Court of Federal Claims decision in which the Government's special plea in fraud defense was rebuffed by the Judge.