Part 2 of 2

Disclaimer: We once again remind readers 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 this is Part 2 of a two-part article on the Government's affirmative defense, the "special plea in fraud."

As we discussed in **Part 1** of this article, the U.S. Government uses its "special plea in fraud" defense to allege that a claim filed by a contractor against the Government is fraudulent. If the Government can show that any part of the contractor's claim is fraudulent—
i.e.
, that the contractor knowingly presented a false claim to the Court with the intention of being paid for it—then the
entire claim
(even any accurate parts) is "forfeit" and the case is tossed-out. There are no other fines or penalties—the remedy for knowingly submitting a false contract claim is the loss of the case.

We learned that the Judge has no discretion in the matter; the statute mandates that a fraudulent claim must be forfeited, regardless of any merits it may otherwise have. In Part 1, we discussed the Daewoo case, where Daewoo submitted a $64 million claim and, instead of receiving a $64 million judgment, found itself owing more than $50 million in fines and penalties.

On appeal, the Judges 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).

In Part 2, we want to discuss a very recent—and interesting—discussion of these issues in the U.S. Court of Federal Claims (which is where the original Daewoo decision was issued). Today we want to discuss the July 6, 2011, decision in the matter of
Kellogg Brown & Root Services, Inc. v. United States
. We have discussed the travails of Kellogg Brown & Root (KBR) several times on this blog; many folks consider the company to be the poster child for rapacious, war-profiteering,

contractors. In the main, their views are shaped by biased Congressional testimony and sensational allegations, rather than facts. Nonetheless, ask any average citizen what company comes to mind when thinking about government contractor fraud, waste, and abuse—and they are likely to name KBR.

In this case, KBR filed suit in the U.S. Court of Federal Claims two years ago, seeking payment of $41 million in costs it had incurred on the LOGCAP III contract supporting troops in Iraq. As part of the proceedings, the United States filed several affirmative defenses, as follows—

- Count 1: The contract was unenforceable because it was tainted by kick-backs received by KBR employees.
- Count 2: KBR's claim should be forfeit under the special plea in fraud defense, because fraud was practiced during performance of the contract.
- Count 3: KBR was liable for the kick-backs received by its employees.
- Count 4: KBR filed false claims and is liable under the False Claims Act.
- In addition, the U.S. Government filed two other motions for rescission of various portions of KBR's contract.
- For its part, KBR moved to dismiss the Government motions.

This decision would discuss whether the Government's "special plea in fraud" defense was limited to the contractor's submitted claim, or whether it could be tied to the contractor's performance on its contract.

Much of the dispute concerned kick-backs allegedly received by KBR employees. The kick-backs were paid by a KBR subcontractor, Tamimi Global Company to Terry Hall and Luther Holmes, who were responsible for "dining facility, morale and welfare, laundry, and fuel delivery services" (DFAC) at Camp Arifjan and Camp Anaconda. According to the Court (which had to assume all allegations are true for purposes of ruling on a motion for summary judgment)—

Beginning in late 2002 through the end of 2003, Messrs. Hall and Holmes received a combined $45,000.00 in cash kickbacks from Mr. Khan. 'Mr. Hall understood that the money was being provided so that Tamimi would remain in KBR's good graces and continue to get DFAC contracts from KBR.' … In 2003 Messrs. Hall and Holmes each accepted $5,000.00 in cash that Mr. Khan delivered to them at an airport in Kuwait. Mr. Khan also gave Mr. Hall an automated teller machine ('ATM') card to withdraw cash from a bank account into which Mr. Khan had deposited another $5,000.00. Mr. Hall used the ATM card to withdraw $3,500.00 in cash. Mr. Holmes withdrew the remaining $1,500.00. Mr. Holmes accepted an additional $10,000.00 in cash from Mr. Khan, which Mr. Holmes gave to his secretary. Towards the end of

2003, Mr. Hall accepted $20,000.00 from Mr. Khan, which purportedly was to be used as an investment in a 'Golden Corral' restaurant. However, Mr. Hall made no such investment, and Mr. Khan did not request that the money be paid back. …

In response to Army task orders issued upon the LOGCAP III contract, KBR issued numerous work releases to Tamimi under Master Agreement 3. These task orders include Task Order 59 issued by the Army on August 2003 … and Task Order 89…. KBR paid Tamimi approximately $466,290,328.00 for all of the work releases issued under Master Agreement 3. KBR submitted vouchers to the Army for reimbursement of payments made to Tamimi for amounts due under the work releases. In addition to reimbursement vouchers for these direct costs, KBR received a base fee of one percent of direct costs, an award fee of up to two percent of direct costs, as well as a fee for indirect costs.

The Government asserted its defenses based on the conduct of KBR's employees. KBR, for its part, did not accept the Government's assertions. Among its many arguments was this one made in response to the Government's attempt to assert the affirmative defense of special plea in fraud.

In the Court's words—

Plaintiff [KBR] attacks defendant's 'taint' theory as insufficient to state a claim for commonlaw fraud or a violation of the FCA, let alone as the predicate for an affirmative defense. These counterclaims fail because (1) they do not allege any causal link between the kickbacks and any inflated claim or scheme to defraud the Government; (2) the facts pleaded lack the requisite scienter; (3) the facts do not allege any causal nexis between the award of Master Agreement 3 or Work Release 3 and the kickbacks; and (4) the counterclaims do not support corporate vicarious liability because they do not allege that the kickbacks were accepted with any intent to benefit KBR or that they did benefit KBR. According to plaintiff, the Special Plea in Fraud does not state a claim for relief in that defendant does not allege that plaintiff possessed the specific intent to defraud the Government. Further, the forfeiture statute proscribes fraud in the prosecution of a claim, which defendant does not allege, not fraud in the performance of a contract.

Whew! That's quite a bit of lawyering in a single paragraph. As far as we can tell, KBR argued that the Government's special plea in fraud cannot prevail because there was no proof that KBR intended to defraud the Government by submission of its claim for payment; and, furthermore, KBR argued that the special plea in fraud affirmative defense addresses fraudulent claims and not fraudulent contract performance.

What did the Court think of KBR's arguments? Judge Miller wrote—

The Federal Circuit has held that to prevail on a counterclaim alleging fraud under 28 U.S.C. § 2514 defendant is required to ''establish by clear and convincing evidence that the contractor knew that its submitted claims were false, and that it intended to defraud the government by submitting those claims.'' Daewoo Eng'g & Constr. Co., v. United States, 557 F.3d 1332, 1341 (Fed. Cir. 2009) …. '[F]orfeiture under 28 U.S.C. § 2514 requires only part of the claim to be fraudulent.' Daewoo Eng'g , 557 F.3d at 1341. 'The statutory language has been construed as proscribing fraud in the prosecution of claims against the United States, not fraud in the performance of the contract.' Veridyne Corp. v. United States , 83 Fed. Cl. 575, 586 (2008) …. Therefore, to overcome plaintiff's motion to dismiss, defendant's pleadings must show KBR's knowledge that a claim submitted was false and a specific intent on the part of KBR to defraud the Government.

Pivotal to defendant's contention for Special Plea in Fraud is the scope of the prohibited conduct targeted by the statute. … The parties diverge on whether the conduct targeted by the statute includes any and all fraudulent conduct in the performance of the contract, or whether the qualifying phrase—'fraud . . . in the proof, statement, establishment, or allowance thereof'—limits the prohibited activity to the prosecution of a claim. For the instant case, the issue is decisive because plaintiff contends that defendant has failed to allege fraud in the prosecution of a claim. …

Defendant has not connected the action of accepting a kickback to the 'proof, statement, establishment, or allowance' of a claim, except insofar as the allegation that Messrs. Hall's and Holmes's acceptance of kickbacks 'tainted' the entire contract with fraud. Plaintiff asserts that this allegation alone will not implicate the forfeiture statute, which is aimed at punishing fraud in the prosecution of a claim. …

Defendant contends that the statute requires forfeiture when plaintiff engages in any fraudulent activity in the performance of a contract, regardless of its relationship to the presentation of a claim. … Under this theory any fraud 'places a stigma upon the contract at issue . . . and on all the claims arising under the contract-in-suit, sufficient to deem [a claim] unenforceable due to public policy considerations.' Supermex, Inc. v. United States, 35 Fed. Cl. 29, 42 (1996).

Defendant reads this rationale into the forfeiture statute, asserting that the statute should be implicated when 'fraud [was] practiced against the Government that was not practiced in the claim that was the basis for the lawsuit, but was practiced in the course of the performance of the contract.' … Defendant includes within the concept of 'course of performance' acceptance of a kickback, even if the acceptance had no bearing on the award of the contract or performance of the claim that plaintiff seeks to recover. Defendant relies on cases from the United States Court of Federal Claims to support his theory, capitalizing upon an overly broad articulation of the law in an effort to fashion a new cause of action under the forfeiture statute.

Several Court of Federal Claims decisions state that '[t]he words of the statute make it apparent that a claim against the United States is to be forfeited if fraud is practiced during the contract performance or in the making of a claim.' … This interpretation of the statute divorces fraud in the performance of a contract from the submission of claim and, consequently, would not require the Government to prove that the alleged fraud relates in any way to the submitted claim. However, on its face, the statute is limited to those circumstances where the Government proves fraud 'in the proof, statement, establishment, or allowance' of a claim. 28 U.S.C. § 2514. These cited Court of Federal Claims decisions thus appear to ignore the qualifying phrase altogether, an interpretation that runs contrary to a basic canon of statutory construction and that the undersigned judge will not adopt without an express direction from the Federal Circuit.

[Emphasis added.] Following that powerful declaration of judicial independence, Judge Miller devoted considerable verbiage to supporting her position, and discussing why the other Court of Federal Claims decisions were erroneous. The Court winds up with the following—

Most recently, in 2004 American Heritage cited O'Brien and Little as evidence that 'the Federal Circuit and this court [have applied] the forfeiture statute to situations outside the strict terms of the statute, as logic has dictated.'
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In relying on a hospitable line of non-binding trial court cases that beg to be distinguished, defendant's theory of the case not only misinterprets binding precedent, but ignores the explicit statutory requirement that 'the contractor knew that its submitted claims were false.' Glendale Fed. Bank
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Defendant has not cited any Federal Circuit or Court of Claims precedent to support an expansion of the plain—and limited—language of the forfeiture statute. The forfeiture statute is

aimed at proscribing fraud in the prosecution of claims against the United States, not any and all fraud in the performance of the contract. Defendant's argument that Messrs. Hall and Holmes 'tainted' Master Agreement 3 'by the fraud of the kickbacks' when they 'sat on upon the board that awarded Master Agreement 3,' … '[r]egardless of . . . whether Tamimi might have, nevertheless, still been awarded the exact same contracts even without [Messrs. Hall's and Holmes's] advocacy,' … circumvents the stated objective of the statute. The mere 'taint' of the kickback is insufficient to state a claim under the forfeiture statute when it is not alleged that the kickback is related to the 'proof, statement, establishment, or allowance' of a claim. Defendant has not alleged that the kickbacks were in any way related to the required performance under the contract or to the proof of that performance submitted with plaintiff's claim.

Well, that lengthy recap disposed of the Government's affirmative defense. But then Judge Miller turned on her own brethren, writing—

More fundamental, however, is the problem that several of the Court of Federal Claims decisions received summary affirmance or were affirmed on other grounds. Although not precedential, loose language can be adopted inadvertently on review. This is detrimental to the integrity of precedent, and plaintiff justifiably is concerned that the Court of Federal Claims could become a preferred forum for government fraud claims. … What should not occur—but be stopped in its tracks—is the exportation of judge-made law, exemplified in Ab-Tech, wherein the court proclaimed that the claim 'arises out of the very contract relationship that [the plaintiff's] deceptive dealings . . . helped falsely to maintain,' … and held broadly that Little , commands 'the forfeiture of all claims arising under a contract tainted by fraud,' …. Little stands for no such proposition, but unfortunately Ab Tech 's broad invitation to declare forfeited all claims in a contract tainted by fraud fuels defendant's new theory that the taint of fraud is sufficient to warrant forfeiture. While several of these Court of Federal Claims decisions factually conform with the binding precedent in that fraud was committed in the establishment of a claim, the adopted broader formulation of the law is of concern. If it were applied in this case, the expansion would be unwarranted. Therefore, the undersigned judge returns to the forfeiture statute's targeted language, as construed by precedential case law, and rules that the conduct pleaded by defendant is insufficient to state a claim under § 2514. Defendant has not pleaded that plaintiff's alleged fraudulent conduct related to the 'proof, statement, establishment, or allowance' of a claim.

That was not the end of the decision, by an means. There were pages and pages of further discussion and analysis of the Government's defenses. In the end, the Court found—

1. Plaintiff's [KBR's] motion to dismiss Count I of defendant's [Government's] counterclaims for forfeiture of plaintiff's breach of contract claim is granted.

2. Plaintiff's motion to dismiss Count II, defendant's AKA [Anti-Kickback Act] counterclaim for double the amount of damages of kickbacks given to Messrs. Hall and Holmes, is denied. Defendant has stated a claim based on an AKA violation of 41 U.S.C. § 53(2) due to the acceptance of the kickbacks and a claim under 41 U.S.C. § 55(a)(1). Alternatively, defendant has stated a claim under §§ 53(2) and 55(a)(2) for recovery of a civil penalty in the amount of the kickbacks.

3. Plaintiff's motion to dismiss Count III of defendant's counterclaims for a violation of the FCA is granted.

4. Plaintiff's motion to dismiss Count IV of defendant's counterclaims for rescission of the portion of the LOGCAP III contract affected by the award of Master Agreement 3 to Tamimi and for disgorgement of all moneys paid to KBR related to any work release upon Master Agreement 3 is denied.

5. Plaintiff's motion to dismiss Count V of defendant's counterclaims for disgorgement of all moneys paid to plaintiff related to Task Order 59 is denied.

6. Plaintiff's motion to strike defendant's affirmative defense is granted.

7. Plaintiff's motion to dismiss for failure to plead fraud with specificity is denied because the remedy would be to allow defendant to amend its affirmative defense and counterclaims. In ruling on the legal sufficiency of the affirmative defense and counterclaims, the court has construed these in a light that pleads the most fulsome—and, hence, adequately stated, facts.

The foregoing may appear to be a partial victory for KBR. Importantly, however, the Court firmly stopped the "exportation of judge-made law" which had held that the special plea in fraud affirmative defense could be asserted by the Government when the alleged fraud had nothing to do with the actual claim in front of the Court. Judge Miller clearly articulated the position that the special plea in fraud was reserved for contractors that knowingly submitted fraudulent claims.

And that is a very beneficial outcome for Government contractors.

Court of Federal Claims Discusses Government's "Special Plea in Fraud" Defense

Part 2 of 2

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[Emphasis added.] Following that powerful declaration of judicial independence, the Judge devoted considerable verbiage to supporting his position, and discussing why the other Court of Federal Claims decisions were erroneous. The Court winds up with the following—

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stands for no such proposition, but unfortunately
Ab Tech
's broad invitation to declare forfeited all claims in a contract tainted by fraud fuels defendant's new theory that the taint of fraud is sufficient to warrant forfeiture. While several of these Court of Federal Claims decisions factually conform with the binding precedent in that fraud was committed in the establishment of a claim, the adopted broader formulation of the law is of concern. If it were applied in this case, the expansion would be unwarranted. Therefore, the undersigned judge returns to the forfeiture statute's targeted language, as construed by precedential case law, and rules that the conduct pleaded by defendant is insufficient to state a claim under § 2514. Defendant has not pleaded that plaintiff's alleged fraudulent conduct related to the 'proof, statement, establishment, or allowance' of a claim.

That was not the end of the decision, by an means. There were pages and pages of further discussion and analysis of the Government's defenses. In the end, the Court found—

1. Plaintiff's [KBR's] motion to dismiss Count I of defendant's [Government's] counterclaims for forfeiture of plaintiff's breach of contract claim is granted.

2. Plaintiff's motion to dismiss Count II, defendant's AKA [Anti-Kickback Act] counterclaim for double the amount of damages of kickbacks given to Messrs. Hall and Holmes, is denied. Defendant has stated a claim based on an AKA violation of 41 U.S.C. § 53(2) due to the acceptance of the kickbacks and a claim under 41 U.S.C. § 55(a)(1). Alternatively, defendant has stated a claim under §§ 53(2) and 55(a)(2) for recovery of a civil penalty in the amount of the kickbacks.

3. Plaintiff's motion to dismiss Count III of defendant's counterclaims for a violation of the FCA is granted.

4. Plaintiff's motion to dismiss Count IV of defendant's counterclaims for rescission of the portion of the LOGCAP III contract affected by the award of Master Agreement 3 to Tamimi and for disgorgement of all moneys paid to KBR related to any work release upon Master Agreement 3 is denied.

5. Plaintiff's motion to dismiss Count V of defendant's counterclaims for disgorgement of all moneys paid to plaintiff related to Task Order 59 is denied.

6. Plaintiff's motion to strike defendant's affirmative defense is granted.

7. Plaintiff's motion to dismiss for failure to plead fraud with specificity is denied because the remedy would be to allow defendant to amend its affirmative defense and counterclaims. In ruling on the legal sufficiency of the affirmative defense and counterclaims, the court has construed these in a light that pleads the most fulsome—and, hence, adequately stated, facts.

The foregoing may appear to be a partial victory for KBR. Importantly, however, the Court firmly stopped the "exportation of judge-made law" which had held that the special plea in fraud affirmative defense could be asserted by the Government when the alleged fraud had nothing to do with the actual claim in front of the Court. The Judge clearly articulated the position that the special plea in fraud was reserved for contractors that knowingly submitted fraudulent claims.

And that is a very beneficial outcome for Government contractors.

MARK:

On "Part 1" link to: http://www.apogeeconsulting.biz/index.php?option=com_content&view=article&id=574:court-of-federal-claims-discusses-governments-special-plea-in-fraud-defense&catid=1:latest-news&Itemid=55

On "This decision" link to: KBR Special Plea.pdf file attached