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Client Alert

Subcontracting Status Reports, Even if False, Are Not Claims Under the FCA

June 22, 2021

In *U.S. ex rel. Howard v. Caddell Construction Company, Inc.*, 2021 WL 1206584 (E.D.N.C. Mar. 30, 2021), the District Court for the Eastern District of North Carolina held that status reports certifying compliance with subcontracting rules do not constitute false claims under the False Claims Act ("FCA") because the claims were not relevant to the contract payments.

At issue in this case was a Navy contract awarded in 2008 to a joint venture of Caddell Construction Company and W.G. Yates & Sons Construction Company ("the JV"). This contract incorporated FAR 52.219-8, requiring that small businesses have the "maximum possible practicable opportunity to participate in performing contracts," as well as FAR 52.219-9, requiring the JV to have a small business subcontracting plan setting forth targets for subcontracting to different types of small businesses ("Subcontracting Plan"). Of the total subcontracting dollars, the JV's plan included a 77% small business goal and 14% women-owned small business ("WOSB") goal. The subcontracting plan was incorporated into the contract and the JV was required to biannually submit Individual Subcontracting Reports (Standard Form 294) ("ISRs").

In 2011, a relator filed an FCA qui tam suit alleging that the defendants evaded small business subcontracting rules by making false statements in the ISRs submitted to the Navy. Specifically, the relator claimed the defendants made express and/or implied certifications that they were complying in good faith with the Subcontracting Plan and FAR 52.219-8. The relator alleged that defendants falsified the ISRs and monthly progress payment requests in two principle ways: (1) the JV reported its subcontract with Breslow Construction as WOSB spend when the defendants should have known that this entity did not qualify as a small business; and (2) the JV reported as small business spend subcontracts with five small businesses that the JV knew did not perform actual labor but rather subcontracted the work to large businesses via a "pass-through" scheme. The relator in this case was the former estimator and president of operations of Pompano Masonry, a large company that had submitted a bid to perform masonry on this project and was subsequently sold to Breslow Trust. Breslow then went on to form Breslow Construction as a WOSB.

The Eastern District of North Carolina granted defendants' motion for summary judgment, holding that the ISRs, even if they included a false statement, were not actionable under the FCA because they were not part of a claim for payment. In contrast, the monthly progress payment requests—which would qualify as claims—did not specifically certify compliance with the terms and conditions of the Subcontracting Plan or FAR 52.219-8, and therefore were not false under an express certification theory. The Court similarly rejected relator's implied certification theory; citing the Supreme Court's decision in *Universal Health Services, Inc. v. U.S. ex rel. Escobar*, 136 S.Ct. 1989 (2016), the Court found that small business certifications in ISRs were neither "core" nor "basic" requirements for the work provided under the contract. Thus, the defendant did not fail to disclose

noncompliance with material requirements that would render its representations "misleading half-truths" as required by the Supreme Court's decision in *Escobar*.

The court also found that the relator failed to satisfy the required element of materiality because the Subcontracting Plan was not an express condition of payment and the consequence for a contractor that could not verify the accuracy of the ISR was merely the rejection of the report as a deliverable, and not a stoppage of work or payments to the contractor. The court also found significant that, even after the relator commenced the FCA action and criminal charges were filed against Breslow, the Navy continued to pay the JV and assessed no liquidated damages in 2015 when scrutinizing the JV's good faith efforts to comply with the Subcontracting Plan. Finally, the court ruled that the defendants did not know that the certification of compliance with the subcontracting plan was material to the Government's decision to make monthly payments, nor did any Government agents tell the defendants otherwise. All of these factors precluded a finding of materiality under *Escobar*.

Finally, the court also granted summary judgment on scienter. The Court found that the JV had acted in good faith when it obtained and relied on Breslow Construction's self-certification as a WOSB. Second, the Court found that the JV had also made a good-faith mistake in its interpretation of FAR 52.236-1, Performance of Work by the Contractor, to allow pass-through subcontracts. Defendants had actually disclosed to the Government both the concept of and specific pass-through subcontracts, but were not "warned away" by the Government from their otherwise reasonable interpretation that such subcontracts were permissible.

This case highlights the important distinction between requests for payment and status reports that simply certify compliance with a subcontracting plan. If the latter is not a direct part of a claim for payment, this case suggests that this may not be sufficient for FCA liability—even if the contractor's statements on the report are inaccurate.

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