Allison Engine, Subcontractor Liability and Politics of False Claims

On June 9, 2008, the US Supreme Court issued a unanimous opinion in Allison Engine Co., Inc. v. United States ex rel. Sanders, No. 07-214, 128 S. Ct. 2123, 2008 WL 2329722. While most commentators view the Court's decision as tilting the interpretive balance of the False Claims Act in favor of subcontractors, the decision is unlikely to alter materially the scope of liability for entities contracting indirectly with the federal government. Indeed, the comments of several Justices during oral argument suggest that the plaintiffs in the case could well succeed in having the jury consider their claim on remand. In its decision, the Supreme Court explained that establishing subcontractor liability under the False Claims Act requires evidence of specific intent: liability depends on whether a defendant made a false statement for the purpose of inducing payment from the federal government on a false claim. Allison Engine, 2008 WL at *6. Evidence that a subcontractor defendant knew that a prime contractor would submit the defendant's false claim to the government for payment is likely sufficient to withstand a defendant's motion for judgment as a matter of law.

Allison Engine is hardly the last word on subcontractor liability and False Claims conspiracy. Legislative efforts to expand the scope of the False Claims Act are likely to take on new life as trial courts implement the Court's interpretive guidance on cases involving indirect government contractors. While scrutiny of the Court's decision in Allison Engine is vital for any person contracting—directly or indirectly—with the federal government, careful attention to legislative developments on this issue is also of critical importance.

"While the Court's articulation of a specific intent standard necessary to trigger subcontractor liability is hardly a radical interpretive shift, Allison Engine does represent a significant jurisprudential development involving false claims conspiracy actions."
Overview of the False Claims Act

The False Claims Act, 31 U.S.C. §§ 3729-3733 (West 2008) (the FCA), is the government's principal weapon to combat fraud in federal contracting. The statute prohibits anyone from knowingly submitting—or knowingly causing to be submitted—a false or fraudulent claim for payment to the United States. See 31 U.S.C. §§ 3729 et seq. The statute authorizes private whistleblowers or “relators” to act as private attorney generals and file “qui tam” suits on behalf of the government. See 31 U.S.C. § 3730(b). The FCA imposes treble damages and civil penalties of $5,500 to $11,000 per false claim.

The FCA was enacted in 1863, in response to wide-spread fraud and profiteering associated with private contractors who furnished shoddy supplies and materials to the Union Army during the Civil War. Prior to 1982, the statute consisted of a single unwieldy sentence which generally prohibited any person from making or presenting—or causing to be made or presented—any false or fictitious claim for payment or approval to the government. See United States ex rel. Totten v. Bombardier, 380 F.3d 488, 489-500 (D.C. Cir. 2004) (detailing the evolution of the false claims act). As part of a comprehensive grammatical and non-substantive revision of the FCA in 1982, Congress divided portions of the single sentence statute into separate subsections. See id. In 1986, the FCA was substantively amended, motivated by a congressional desire to broaden the scope of the statute and “to enhance the Government’s ability to recover losses sustained as a result of fraud.” S. Rep. No. 99-435, at 1, reprinted in 1986 U.S.C.C.A.N. 5266.

Today, the prohibition on false claims consists of seven subsections, three of which formed the basis of the relators’ allegations in Allison Engine:

Any person who—
1) knowingly presents, or causes to be presented, to an officer or employee of the United States Government or a member of the Armed Forces of the United States a false or fraudulent claim for payment or approval;
2) knowingly makes, uses, or causes to be made or used, a false record or statement to get a false or fraudulent claim paid or approved by the Government;
3) Conspires to defraud the Government by getting a false or fraudulent claim allowed or paid;

...is liable to the United States Government for a civil penalty of not less than $5,000 and not more than $10,000, plus 3 times the amount of damages which the Government sustains because of the act of that person.


The Facts Underlying the Litigation

Allison Engine involved allegations that a group of military subcontractors delivered defective components to the United States Navy in connection with a 1985 contract between the Navy and two shipyards involving the construction of a new fleet of Ashleigh Burke class destroyers. The shipyards subcontracted with the Allison Engine Company, Inc. (AEC) to build generator sets to furnish electrical power for the class of destroyers. AEC, in turn, subcontracted with another entity to build particular components of the generator sets, and that entity further subcontracted a portion of the work on the generator sets. The Navy’s contracts with the shipyards required them to build the destroyers in accordance with detailed standards and to demonstrate adherence to this requirement by submitting a certificate of conformance (COC) when
they delivered each component. This COC requirement was incorporated into each one of the subcontracts for the generator sets.

In 1995, two former employees (the relators) of one of the subcontractors filed suits under the FCA, alleging that invoices submitted by the various subcontractors, including AEC, were false because they sought payment for defective work. In addition, the relators alleged that the COCs falsely certified that the work on the generator sets was in compliance with military standards. Based on these allegations, the relators contended that AEC and the other subcontractors violated 31 U.S.C. §§3729(a)(1)-(3).

**Allison Engine Prevails at the District Court**

During a five-week jury trial, the relators introduced evidence of the false COCs submitted by AEC and the other subcontractors. The relators also introduced evidence of the invoices the subcontractors submitted to the shipyards. However, the relators never introduced into evidence any of the invoices submitted by the shipyards to the Navy, characterizing these invoices as “totally irrelevant,” and arguing that “they [did] not have to show that there was a false claim submitted to the Government.” Case No. 1-:95-cv-970, 2005 WL 713569, at *1 (S.D. Ohio March 11, 2005). The Southern District of Ohio disagreed and granted the defendants’ motion for judgment as a matter of law.

The District Court explained that, absent proof of false claims presented to the Navy, the plaintiffs’ evidence was legally insufficient to establish liability under subsections 3729(a)(1) and (a)(2). Id., at *10. In reaching this conclusion, the District Court noted that it was unaware of any precedent predating FCA liability under subsection 3729(a)(2) without requiring evidence of presentment—the submission of the false claim to the government. Id., at 2 (surveying decisions from nine federal circuits). Relying on the D.C. Circuit’s decision in Totten, the District Court reasoned that “a false claim that is not presented to an officer or employee of the United States Government is not actionable simply because payment will come out of funds received from the federal government.” Id., at 4 (citing Totten, 380 F.3d at 492-93). Absence of any evidence of presentment was fatal to the relators’ claim under subsections 3729(a)(1) and (a)(2).

The District Court cursorily rejected the relators’ conspiracy claim under subsection (a)(3), explaining that without a false claim under subsections (a)(1) and (a)(2), the claim of a false claim conspiracy failed. 2005 WL 713569, at *11.

**Allison Engine Loses at the Sixth Circuit**

A divided panel of the Sixth Circuit Court of Appeals reversed in relevant part, holding that FCA claims under 31 U.S.C. §3729(a)(2) and (a)(3) did not require evidence of presentment. 471 F.3d 610 (6th Cir. 2006). Relying on the plain language of subsections (a)(2) and (a)(3)—and guided by the policy rationales underlying the 1986 amendments to the FCA—the Sixth Circuit rejected Totten’s presentment requirement for subsection (a)(2):

We disagree with the Totten court’s interpretation of the FCA for several reasons. One, the plain language of subsections (a)(2) and (a)(3) simply does not require that a claim must be presented to the government to be actionable. Congress could have chosen to include the presentment language of subsection (a)(1) in other parts of the FCA and did not . . . . The FCA cannot be read so as to make the meanings of subsections (a)(1) and (a)(2) indistinguishable.

471 F. 3d at 616-617.
The appellate court reasoned that the phrase "to get" in subsection (a)(2) required a causal connection between a "false record or statement" and "government payment or approval." \textit{Id.} at 621. Evidence sufficient to satisfy this causal connection depended not on presentment, but rather on proof that government money was used to pay a false claim. \textit{Id.} at 622. Based on this legal framework, the Sixth Circuit determined that relators had, in fact, offered sufficient evidence at trial to withstand a motion for judgment as a matter of law. The particular evidence recited by the Sixth Circuit included all the invoices submitted by AEC (and the other subcontractors) to the shipyards, as well as testimony by an AEC program manager who acknowledged that these invoices were paid with funds the shipyard received from the government. \textit{Id.}

\textbf{Allison Engine "Wins" at the Supreme Court}

On February 26, 2008, the Supreme Court heard oral argument in \textit{Allison Engine}. The argument highlighted that the allegedly false statements prepared by the subcontractors were actually presented to the Navy through the shipyard. During an exchange with Justice Scalia, relators' counsel revealed that AEC had, in fact, presented the shipyards with COCs, and that the shipyard had then presented those COCs to the Navy in order to obtain payment under the contract:

\textbf{Relators' Counsel:}

The contract with [the shipyard] required the Navy to receive [the COC] for Allison to be paid. There was evidence in this case that Allison was, in fact, paid for delivering these [generators]. That's circumstantial evidence that [the shipyards] did submit [the subcontractors'] certificates of conformance.

\textbf{Justice Scalia:}

Well, then there's less to this case than we had thought. My goodness, even under the Petitioners' theory, you win. If indeed a fraudulent document was given to [the shipyard] and [the shipyard] passed that on, I think the Petitioners would have conceded—I wish you had said that in your brief because we could have saved ourselves a lot of reading.

\textit{Tr. of Oral Argument, at 43-45 (February 26, 2008); see also Tr. at 49-53 (colloquy between the Court and relators' counsel in which counsel explains that, pursuant to section 6.1 of its contract with AEC, the shipyard was \textit{required} to submit AEC's COC to the Navy).}

Less than four months later, a unanimous Supreme Court reversed the Sixth Circuit's decision in favor of AEC. 128 S. Ct. 2123, 2008 WL 2329722. But the Court's reasoning suggested that the standard of specific intent required under subsection (a)(2) may not be difficult for the relators to meet. In particular, the Court interpreted the phrase "to get" in subsection (a)(2) as denoting purpose: "a person must have the purpose of getting a false or fraudulent claim 'paid or approved by the Government' in order to be liable under § 3729(a)(2)." 2008 WL at *5.

Based on this language, the Court reasoned that under subsection (a)(2), "a defendant must intend that the Government itself pay the claim." \textit{Id.} And in a case in which the subcontractor defendant knew that the prime contractor shipyard would present the subcontractor's allegedly false statement to the government, evidence of the requisite intent is likely satisfied.

While the Supreme Court rejected \textit{Totten}'s presentment requirement, it never expressly addressed the reasoning underlying that decision (authored by Chief Justice Roberts when he sat on the D.C. Circuit). The Court similarly never addressed the remedial purposes of the FCA's 1986 amendments—
purposes that played a significant role in the Sixth Circuit's decision. Nor did the Court address the subcontractor liability/indirect payment cases the 1986 amendments to the FCA were designed to overrule. See, e.g., United States v. Azzarelli Construction Co., 647 F.2d 757 (7th Cir. 1981) (holding that FCA liability only exists where a claim is presented upon or against the government); S. Rep. No. 99-345 at 21-22 (Senate Judiciary Committee Report accompanying 1986 FCA amendments). These arguments were raised before the Court not only by the United States, but also by amicus curiae Senator Charles E. Grassley (R-IA), one of the principal Senate sponsors of the 1986 amendments to the FCA. See generally Br. of Amicus Curiae Senator Grassley 14-20 (January 22, 2008).

While avoiding any discussion of Congressional intent, remedial purposes or legislative history, the Court announced a rule which, when understood in light of the facts of the underlying proceeding, suggests that the Allison Engine relators would likely withstand a motion for judgment as a matter of law under subsection 3729(a)(2):

[A] subcontractor violates § 3729(a)(2) if the subcontractor submits a false statement to the prime contractor intending for the statement to be used by the prime contractor to get the Government to pay its claim.


The Court Announces a Specific Intent Requirement for False Claims Conspiracy Liability

After devoting substantially all of its opinion discussing liability under subsection (a)(2), the Court devoted two paragraphs of Allison Engine to subsection (a)(3). The Court rejected relators’ argument that AEC and the other subcontractors were subject to conspiratorial liability simply because they "agreed upon a fraud scheme that had the effect of causing a private entity to make payments using money obtained from the Government." 2008 WL at *7. Instead, the Court explained that the relators were required to prove that AEC and the other subcontractors conspired to defraud the government—and not just the shipyards—by making a false record or statement that “had the purpose of ‘getting’ the false record or statement to bring about the Government’s payment of a false or fraudulent claim.” Id. at *7. Relying on a decision interpreting a federal criminal statute, United States v. Tanner, 483 U.S. 107 (1987), the Court reasoned that simply conspiring to obtain funds from a federally funded private entity would dramatically increase the scope of liability under subsection (a)(3) and the plain language of the statute precluded such an interpretation: “Had Congress intended subsection (a)(3) to apply to anyone who conspired to defraud a recipient of Government funds, it would have so provided.” Id.

Lower courts interpreting subsection (a)(3) of the FCA have relied on general conspiracy principles to evaluate liability. See, e.g., United States ex rel. Durcholz v. FKW Inc., 189 F.3d 542, 545-46 (7th Cir. 1999); United States v. Murphy, 937 F.2d 1032, 1039 (6th Cir. 1991). These general principles require the plaintiff to demonstrate (i) an agreement with one or more persons to get a false or fraudulent claim allowed or paid by the United States, and (ii) performance of an overt act in furtherance of the agreement. See, e.g., United States ex rel. Reagan v. East Texas Medical Center Regional Healthcare System, 274 F. Supp. 2d 824, 857 (S.D. Tex. 2003); United States v. Hill, 676 F. Supp. 1158, 1173 (N.D. Fla. 1987). While some district courts have suggested that liability under subsection (a)(3) also requires demonstrating that the defendant possessed a specific intent to “defraud the government,” see
Reagan, 274 F. Supp. 2d at 857, they have not provided extensive guidance on this element.

Given this paucity of case law on false claims conspiracy (and the absence of any circuit split on the issue), Allison Engine’s analysis of the specific intent required to establish liability under subsection (a)(3) is particularly noteworthy. The Court held that the agreement element of a subsection (a)(3) conspiracy must reflect specific intent to induce the government’s payment or approval of a false claim: “[i]t must be established that they [the alleged conspirators] agreed that the false record or statement would have a material effect on the Government’s decision to pay the false or fraudulent claim.” 2008 WL at *7. Thus, if AEC and the other subcontractors engineered a scheme to defraud only the shipyards by submitting false COCs, liability under subsection (a)(3) would not exist. However, if AEC and the subcontractors knew that the shipyards would, in turn, rely on the subcontractors’ COCs to receive payment from the Navy (as suggested in oral argument before the Supreme Court), intent sufficient to establish liability for conspiracy likely exists.

Implications of the Decision and the Politics of False Claims Liability

On remand, the Allison Engine relators could well withstand the defendants’ request for judgment as a matter of law. Indeed, as suggested by the Justices’ colloquy during oral argument, evidence that the contract between AEC and the shipyards required the shipyards to present the fraudulent AEC COCs to the Navy will likely demonstrate sufficient intent to withstand judgment as a matter of law under both subsections (a)(2) and (a)(3) and satisfy the Court’s presentment by proxy standard of liability. See 2008 WL 2329722, at *6. But the Court’s decision is hardly the end of the matter. Relators and their advocates will likely push for a looser intent requirement, claiming that Allison Engine ignores Congress’ intent in promulgating the 1986 amendments to the FCA. The decision will likely breathe new life into the legislation introduced by Senator Grassley and Senator Richard Durbin (D-IL) in 2007—the False Claims Correction Act (the FCCA). Among its other proposed changes, the FCCA (as initially introduced) proposed to overrule Totten’s presentment requirement by expanding the definition of a “claim” under the FCA. While Allison Engine has effectively overruled Totten, supporters of the legislation have already signaled that they are evaluating options to reverse legislatively the Court’s decision:

Today’s decision by the Supreme Court is further proof that we need legislation to clarify the true intent of the False Claims Act. As the author of the 1986 amendments, I can attest to the fact that this result was not what Congress envisioned when we updated Lincoln’s law. To say that knowingly submitting fraudulent invoices to a prime contractor is not enough to establish a ‘direct link’ between the fraudulent submission and the Government’s decision to pay, makes it more difficult to prosecute fraud and poses a threat to the federal treasury.


Senator Grassley’s insistence that a subcontractor’s submission of a false claim to a prime contractor should be sufficient to trigger FCA liability ignores the Court’s warning against a limitless expansion of the statute. The Allison Engine Court admonished against “[r]ecognizing a cause of action under the FCA for fraud directed at private entities” because such an interpretation “would threaten to transform the FCA
into an all-purpose fraud statute.” 2008 WL 2329722, at *6. By adopting a logical and textual interpretation of subsection (a)(2), the Court crafted a workable limit to liability—liability attaches to only those subcontractors who make a false statement for the purpose of getting the government to pay or approve a false claim.

Despite Senator Grassley’s protestations to the contrary, Allison Engine does not—as a practical matter—significantly restrict the scope of FCA liability for subcontractors. The contractual relationships between most prime and subcontractors are characterized by “flow-down” requirements: statutory, regulatory or contractual obligations between the government and the prime contractor which “flow-down” to the subcontractor. (In Allison Engine, for example, the COC requirements were flow-downs from the Navy’s contracts with the shipyards.) These flow-down requirements will likely provide sufficient evidence on subcontractor intent, capable of demonstrating that a subcontractor defendant knew that its deliverables were necessary to trigger the government’s payment obligation to the prime contractor.

Endnote

1 On April 3, 2008, the Senate Judiciary Committee approved S. 2041, the FCCA. Since that date, the Senate legislation has stalled. The companion House legislation, H.R. 4854, was approved by the US House of Representatives’ Committee on Judiciary on July 16, 2008—and the full House is expected to consider the bill shortly.
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