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Posted on August 15, 2011 by [Hal J. Perloff](#)

False Claims Act exposure for contract disputes after U.S. v. Kellogg Brown & Root

Is every routine contract dispute a potential false claim? Is it a false claim to adopt an interpretation of an ambiguous contract provision that was the subject of debate within the company? As a matter of law and common sense, the answer to these questions must be "no." But Chief Judge Royce Lamberth's August 3 decision in [United States v. Kellogg Brown & Root Services, Inc., No. 10-cv-530 \(D.D.C. Aug. 3, 2011\) \[pdf\]](#), casts sobering doubt on this answer.

The case involved KBR's LOGCAP III contract to provide logistical services for the U.S. Army in Iraq. The dispute began when the Defense Contract Audit Agency notified KBR that it was disallowing a portion of a payment KBR made to a subcontractor for costs incurred to hire a private security contractor. DCAA asserted that those costs were unallowable because the military was responsible for supplying force protection to civilian contractors in the war zone. DCAA ultimately identified more than \$100 million in payments related to private security contractors that it deemed improper.

KBR challenged the denial of payment for these costs by submitting a certified claim under the Contract Disputes Act. When the Army contracting officer failed to issue a final decision, KBR appealed the claim to the Armed Services Board of Contract Appeals. While the matter was pending at the Board, the government filed a Civil False Claims Act action against KBR. The government alleged that KBR violated the False Claims Act by seeking payment for private security costs that it knew were prohibited by the contract.

KBR moved to dismiss, arguing that there was nothing "false" about its payment requests. The court denied the motion. Relying on the D.C. Circuit's recent decision in [United States v. Science Applications International Corp., 626 F.3d 1257 \(D.C. Cir. 2010\)](#), the court rejected KBR's argument that FCA violations under the implied certification theory are limited to contractual requirements that are an express prerequisite to payment. Rather, the court held that the government need only show that KBR withheld information about its noncompliance with a material contractual requirement. According to the court, "materiality" can be shown either through express contractual

language (i.e., an express prerequisite to payment) or through testimony demonstrating that the parties understood that payment was conditional on compliance with the requirement at issue.

The court found that the government's FCA complaint demonstrated the materiality of the alleged prohibition on private security contractor costs through: (1) internal KBR email dialogue and discussion where someone stated that costs of private security contractors "could be considered unallowable;" and (2) KBR's efforts to obtain a change order to the LOGCAP III contract to allow for reimbursement of private security contractor costs. In rejecting KBR's motion to dismiss, the court noted that KBR could continue to press its positions that: (1) the LOGCAP III contract does not prohibit reimbursement of private security contractor expenses—a legal question; and (2) even if those costs are prohibited, none of the contractual provisions violated were material to payment of KBR's claims.

Background on the False Claims Act

An appreciation of the court's decision requires some basic background on the False Claims Act. In order to succeed in an FCA matter, the government must show three elements: (1) the defendant submitted a claim to the government; (2) which was false; and (3) which the defendant knew was false.

FCA cases generally fall into one of two categories—factually false or legally false. A "factually false" claim is one in which a claimant submits information that is false on its face. For example, a factually false claim occurs when a contractor knowingly bills the government for work that it did not perform, such as charging for phantom workers. Another example of a factually false claim occurs when a contractor knowingly furnishes an incorrect description of goods or services in a payment request, such as billing for an MRI when only an X-ray was performed.

The second category of false claim is a legally false claim, which commonly referred to as a "false certification." False certifications involve false representation of compliance with an applicable statute, regulation, or contract term. False certifications can be express or implied. An express certification occurs when a claimant explicitly represents that it has complied with a contractual condition but has in fact not complied.

Although it is not recognized in all judicial circuits, the "implied false certification" theory is based on an indirect certification of compliance with contractual or legal requirements. A typical instance is a fraud-in-the-inducement situation where a contractor makes a false representation in order to receive a government contract and then submits a payment request after it performs. Not every contractual requirement or law or regulation can form the basis of an implied false certification. Rather, the plaintiff must show that compliance with the requirement at issue was a material condition to payment.

The government pursued all of these theories in its response to KBR's motion to dismiss. The government argued that KBR's claims were factually false because they sought payment for private contractor security costs that were disallowed under the LOGCAP III contract. The court rejected the government's position because there was nothing factually false about KBR's payment request. The government did not allege that KBR disguised the private contractor security costs or misstated the amounts. According to the court, the issue of whether private security costs were disallowed under the contract was a question of contract interpretation, which is a legal, not a factual question. Despite its ultimate conclusion, the court went to great lengths to demonstrate that not every instance of contractual non-compliance is an FCA violation.

The government also argued the implied false certification theory. The government asserted that KBR's claims for reimbursement impliedly certified that they complied with the terms of the LOGCAP III contract and that the implied certification was false because the contract prohibited payment for private contractor security expenses. KBR argued that nothing in the LOGCAP III contract expressly conditioned government payment to KBR upon compliance with the contractual provisions that allegedly prohibited payment of private contractor security costs.

Where do we go from here?

The relaxed view of the implied certification standard reflected in the decision on KBR's motion to dismiss represents a significant expansion of potential FCA exposure for government contractors. On the one hand, the court's rejection of the government's factual false claim theory reinforces the conclusion that run-of-the-mill contract disputes are not false claims. On the other hand, turning the question of materiality into a factual question has real negative consequences for contractors. It ignores the fact that not every contract provision is clear and unambiguous, as well as the fact that there is room for disagreement and internal debate as to the interpretation of ambiguous contract provisions. The risk now, especially if the KBR decision becomes precedential, is that internal differences of opinion (even if ill-informed) will be cited as evidence of a False Claims Act violation. The negative consequences of adopting a contract interpretation later deemed incorrect have never been higher.

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