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Prospective Damages and CDA Certification: The Real *Daewoo* Issue

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Two recent decisions by the U.S. Court of Federal Claims caused alarm in the government-contracting community, spurring countless symposia, lectures, legal advisories and other presentations about the "new danger" to contractors who appeal denied claims to the court under the Contract Disputes Act.[1]

The supposed danger is a renewed focus on fraud counterclaims in the Department of Justice.[2] Yet, the timing of the two decisions is merely coincidental, and any attention to the DOJ's apparent motives distracts from the cases' true significance: both fraud decisions arose from a contractor's misguided effort to obtain recovery of amounts where the loss or expense claimed had not yet occurred.

In *Daewoo Engineering & Construction Co. Ltd. v. United States*, 73 Fed. Cl. 547 (Fed. Cl. Oct. 13, 2006), the contractor allegedly included in a certified claim losses that had not occurred at the time of certification under the CDA.

In the other case, *Morse Diesel International Inc. v. United States*, 74 Fed. Cl. 601 (Fed. Cl. Jan. 26, 2007), the contractor sought government reimbursement of surety bond costs it had not yet incurred and then caused false invoices to be prepared that purported to represent prior payment.

For different reasons, the government denied both contractors' claims. The Federal Claims Court ultimately held that the contractors committed fraud, thereby forfeiting their claims. They also were subject to statutory fraud damages.

Rather than any new DOJ approach to defending claims in the claims court, the real issue in the cases concern the contractors' efforts regarding not-yet-incurred costs or damages.

While both cases are instructive, contractors have substantial room to obtain full recovery on claims without risking fraud counterclaims brought by the government. Yet, *Daewoo* does hold the potential for bringing significant change in the requirements for proving fraud. It may turn out that to constitute fraud, a misrepresentation no longer must relate to an existing, provable fact at the time the allegedly false statement was made.

Judge Robert H. Hodges Jr. issued his decision in *Daewoo* in October 2006.[3] In his 85-page opinion, he concluded that the contractor's certified claim, which included about $50 million in damages the company had not yet incurred at the time of certification, represented "an attempt to defraud the United States."[4]

The court then entered judgment in favor of the government for $50.6 million, resulting from the contractor's iolation of the CDA's fraud provision.[5]

About three months later Judge Susan G. Braden issued her decision in *Morse Diesel*.[6] In that case the court entered summary judgment on the government's counterclaims under the Anti-Kickback Act[7] and the False Claims Act,[8] concluding that the contractor violated the Forfeiture of Fraudulent Claims Act,[9] and thus forfeited its various claims totaling $53.5 million.[10]

Morse Diesel

Morse Diesel should not be viewed as groundbreaking. The case is simply a timely reminder of both the care that contractors must exercise in the administration and performance of their public contracts[11] and the government's vigilance in monitoring its contractors' compliance with procurement laws and regulations.[12]

While the contractor's initial effort to obtain the surety-bond cost did not satisfy the terms of the contract because the cost had not yet been incurred at the time the request was presented,[13] that effort did not rise to the level of fraud until the contractor created false invoices that misrepresented prior payment of that amount.[14]

Thus, the misrepresentation that led to the forfeiture of the contractor's claim was the claim that the costs had been incurred. *Morse Diesel*, therefore, should neither be surprising nor alarming to government contractors who act with reasonable judgment and in good faith.

Daewoo

Daewoo, in contrast, presents a more complicated problem. In fact, the resolution of its underlying fraud issue may yet affect contractors seeking to ensure they receive full and complete compensation arising from government-contract changes or breaches.

The dispute in *Daewoo* arose under a contract between the U.S. Corps of Engineers and Daewoo for the construction of a 53-three mile, two-lane road on Babeldaob Island in the Republic of Palau.

During construction, Daewoo experienced what it considered to be excess weather delays and adverse subsurface site conditions exceeding what it reasonably could have anticipated from the information in the corps' request for proposals.[15] The company alleged that these conditions adversely affected its ability to complete the project on time and within budget.

After considerable delay, extensive testing, additional engineering and non-compensable time extensions, Daewoo submitted a certified claim alleging that the corps' method for determining the number of adverse weather days to be expected during construction was improper and that the embankment-construction specifications were defective.[16]

Daewoo alleged that together these facts made performance of the contract within the established time impossible. Daewoo's certified claim sought a 928-day extension and $64 million in additional costs.

The key fact issues here are the exact nature of the certification by Daewoo and the ensuing incorporation of that certified claim into the claims court complaint. According to Judge Hodges' decision, Daewoo "demanded $13.4 million in 'incurred damages' as of Dec. 31, 2001, and projected additional costs of $50 million not yet incurred. Plaintiff's complaint incorporated the certified claim and also included a total of nearly $64 million in the prayer for relief."[17]

The court further noted that:

> As discussed elsewhere, the total amount of the claim has been a moving target. Page 9, [paragraph] 32 of the complaint recites the damages included in its March 29, 2002, claim to the contracting officer "wherein it requested damages for the added costs incurred from Oct. 13, 2000, through Dec. 31, 2001, in the amount of [$13.3 million] and for the added costs incurred *and* to be incurred after Dec. 31, 2001, in the amount of [$50.6 million] for a *total monetary damage claim* of [$63.7 million].[18]

Thus, the decision quite clearly identifies the distinction drawn by Daewoo at the time of the certification between incurred and projected costs.

The contracting officer ultimately denied Daewoo's claim. Daewoo thereafter continued performing under its contract and contemporaneously appealed the contracting officer's denial to the claims court under the CDA.[19]

Daewoo's complaint in the claims court recited its claims of defective specifications, superior knowledge and impossibility of performance, as well as its demand for $64 million.

During the course of its appeal to the claims court, Daewoo retained an expert to evaluate its claims. The expert altered the method of calculation used to determine Daewoo's claim, reducing its value by $22 million.[20] Daewoo did not, however, amend its complaint.

After conducting an extensive trial, the court affirmed the corps' final decision denying Daewoo's claim and entered judgment on the government's counterclaim, concluding that the company's claim must be forfeited. The court also awarded the government an amount equal to the portion of the certified claim that was determined to have been presented fraudulently, in this instance, the entire $50 million-value of prospective, estimated damages.[21]

Interestingly, the fact that caused the most alarm in the contractor community was not the nature of the allegedly false misrepresentation, but the fact that the counterclaim was first asserted at the conclusion at trial of Daewoo's case in chief.[22]

Section 604 of the CDA, upon which the government's affirmative $50 million recovery in *Daewoo* was based, states in part the following:

> 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.[23]

Daewoo held that the contractor violated this CDA provision because it "made the claim for purposes other than a good-faith belief that the government" owed that amount.[24]

The court's decision was based on the testimony of Daewoo's project manager (who had certified the original claim) that "some part of the claim" was included "to indicate 'the seriousness of the situation' and to get the government to 'pay attention' so it would agree to a cheaper method of constructing" portions of the project affected by the government's alleged defective specifications.[25]

The court concluded as follows:

> The "part of [the] claim" that is fraudulent without question is[$50.6 million]. Plaintiff's authorized official certified this claim and presented it to the contracting officer as costs "to be incurred after Dec. 31, 2001." The certifying official, Mr. Kim, testified that he submitted the claim to get the government's attention. He wanted the corps to know how much it would cost the government if Mr. Morrison did not approve the new compaction method that plaintiff preferred. Plaintiff's counsel acknowledged that Daewoo's purpose was to ensure that the corps would approve the new method sooner rather than later. "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." Daewoo used a certified claim to "suggest" that the government change the method of compaction required by the contract that plaintiff bid on and won, to save plaintiff money. [26]

As a consequence, the court entered summary judgment in favor of the government for the 'falsely-certified' amount.

Left largely unaddressed in the *Daewoo* decision is the impact of the certification of *prospective* costs on the fraud analysis. As properly recognized by the court, the CDA's fraud provision imposes liability where all or a portion of a contractor's claim is unsupportable because of a "misrepresentation of fact or fraud."[27]

The CDA defines a "misrepresentation of fact" as "a false statement of substantive fact or any conduct which leads to a belief of a substantive fact material to proper understanding of the matter in hand, made with intent to deceive or mislead."[28]

Other than the phrase "substantive fact," this statutory language provides little guidance as to whether a false statement must be about an existing, provable fact at the time of the statement.

Daewoo does not precisely articulate the "substantive fact" falsely asserted by the Daewoo company in prosecuting its claim. Instead, we are left to assume that this fraud or misrepresentation of a "substantive fact" occurred when Daewoo submitted a certified claim that included $50 million in prospective damages for the purpose of obtaining a change in the contract specifications. If so, more analysis of the facts and applicable law is required to ensure fraud liability is appropriate.

The Requirement of a Misrepresented Existing Fact in Fraud Claims

Hornbook common law fraud typically requires the falsity to relate to a current, existing fact at the time of its utterance: "As a general rule, actionable fraud cannot consist of unfulfilled predictions or erroneous conjectures as to future events."[29]

Exceptions to this general rule are few and generally are limited to situations where the occurrence or nonoccurrence of the future event is already known to or within the control of the person making the false representation.[30]

The False Claims Act is no different, with courts utilizing the common law for gap-filling purposes.[31] Even though the FCA requires a lower intent standard than common-law fraud, courts still require that the fraudulent statement be one of current fact: "Fraud may only be found in expressions of fact which '(1) admit … of being adjudged true or false in a way that (2) admit … of empirical verification.'"[32]

The same requirement is true of the plea-in-fraud (forfeiture) statute.[33] Further, while the authors found no case on point for the CDA fraud provision at issue in *Daewoo*, there appears to be no statutory language that would suggest a different analysis.

Thus, predictions of future events or statements of belief made with a belief that there is at least some possibility, however remote, that the events could unfold as predicted, would not and should not normally be the subject of a government-fraud claim, whether under the common law, the FCA, the plea-in-fraud statute or the CDA.

Daewoo does not directly address the split nature of Daewoo's certification in the context of these fraud principles. For example, while the court places heavy

reliance on the certifying official's testimony that he was trying to get the "attention" of the corps with the claim, and while the judge does address evidence regarding the temporal nature of the certification,[34] the court does not clearly conclude that at the time of the certification that Daewoo knew for a certainty that the costs it was claiming could never be incurred.

The closest the court came to an analysis of the prospective assertion principle and its exception was during its discussion of whether the certified claim needed to be "updated" during the litigation.

The court said:

> Plaintiff argued that it is appropriate to "update" a claim with better numbers. This may be true. *See*, *e.g.*, *UMC Elecs. Co. v. United States, 43 Fed. Cl. 776 (1999)* (finding that a contractor was guilty of fraud on all counts where he certified updated claims submitted to the government). No one certified Daewoo's "updated claims." Plaintiff's experts testified that the $29 million claim was not an update in any event, but a "re-priced claim." That is, the experts started over with a re-priced claim; they developed new numbers using a new method of calculation, the measured mile. *UMC* noted that "when a contractor claims future costs, the contractor must explain its 'estimating process,' including any 'judgmental factors' applied and 'contingencies.'" *Id*. at 803. That court emphasized that "a contractor may claim future expenses; however, when a contractor submits a claim that includes future expenses, projected costs should be in good faith and in compliance with the FAR, and identified as not yet incurred." *Id*. (citing 48 C.F.R. § 15.804-6). *See also* 48 C.F.R. § 31.001 (defining "actual costs" and "costs incurred, as distinguished from 'forecasted costs' ").[35]

Following further discussion, the court writes, "Plaintiff did not honestly believe that the government owed it the various amounts stated *when it certified the claim*."[36] Yet, even this factual finding fails to draw a distinction between a belief that the claimed amounts were owed at the time and a belief that the claimed amounts would and could never be owed.

In order to qualify for the exception to the requirement that prospective assertions are not actionable in fraud, the court needed to have found as a fact that the certifying official did not believe, at the time of the certification, that the predicted events have any possibility of occurrence, whether remote or otherwise. In the absence of that finding of fact, the rule prohibiting a finding of fraud should have applied.

The absence of such an analysis begs the question whether a statement, believed to have a probability of occurring of 1-in-1000, 1-in-100 or 1-in-10, satisfies the intent standard under the CDA fraud statute.

It is also arguable that even if the contractor had no *belief* that the prediction could come true, if in fact there were some possibility that it could have, then the prediction fails to be demonstrably "false." Stated another way, while a finding that the contractor did not *believe* the prediction satisfies the intent standard, a separate analysis must show that the statement is false *in fact*, meaning it could never come true.

The course of events following the certification in *Daewoo* arguably rendered the prediction of costs impossible to actually gauge as true or false. Some of the assumptions underlying the "certified" prediction did not occur (changes apparently were actually made to the specifications).[37] It is therefore arguably *impossible* to determine whether the prediction at the time it was made was indeed false.

Thus, it seems problematic, to say the least, to rest a fraud determination and a $50 million-award to the government on a prediction of events that could never be accurately tested as true or false.

Even in the absence of such a finding of fact, liability might still have attached, but under more traditional fraud principles. The misrepresentation upon which the fraud determination was based might not have been Daewoo's false prediction of a future event made with no belief into its likelihood. Instead, the determination might have been that there was a false assertion of existing fact. While the discussion in the opinion is unclear, the court repeatedly refers to the contents of the complaint and the contractor's failure to amend it. Thus, the court might have grounded its decision on an implicit or explicit reaffirmation of Daewoo's certification at the time it submitted its pleading.

Recall that the CDA fraud statute need not require an affirmative statement, but may be based on "any conduct which leads to a belief of a substantive fact material to proper understanding of the matter in hand, made with intent to deceive or mislead."[38]

Only after Daewoo's claim was on appeal to the claims court did Daewoo retain an expert, who reviewed the facts, changed the claim-calculation methodology, and concluded that increased costs from the company were approximately $22 million less than originally projected.

However, Daewoo failed to amend its complaint to remove from its appeal the portion of the initial prediction that, in

retrospect, turned out not to have occurred based on the expert's analysis. When it did not and instead continued to press its appeal of the denied certified claim, the court might have concluded that such was an implied reaffirmation of the "substantive fact," converting the flawed prediction into a false statement of past fact.

In any event, the U.S. Court of Appeals for the Federal Circuit will be faced with the question whether a CDA (or other government contract) fraud counterclaim can rest entirely on a prediction of future events that may or may not come true. Further factual findings might be required in *Daewoo* to address these issues.

The implications of that decision are worthy of focus, and contractors should not be distracted by suggestions that the DOJ has become more aggressive in the pursuit of fraud counterclaims.

Given the lack of complete clarity on the prospective assertion issue in *Daewoo*, it is worth repeating that contractors may always certify incurred costs and then still adjust that certification upward as new costs arising from the existing claim are incurred or include later incurred costs as part of the claims court (or board) appeal of the denied initial claim.[39]

It was unnecessary for Daewoo to attempt to quantify (and allegedly certify) amounts that had yet to occur. And it was Morse Diesel's error to create invoices that falsely represented that costs subject to reimbursement had been incurred. Nevertheless, while the latter is clearly fraud, it is still a far closer question concerning whether the former should be, justifying a $50 million penalty, in the absence of necessary factual findings on the belief at the time of the certification and the probability of the predicted outcome at that time.

Notes

[1] 41 U.S.C. § 601 *et seq*.

[2] *See, e.g*., Adrian L. Bastianelli III and Patrick J. Greene Jr., *New Stakes in Doing Business With the Federal Government* (February 2007), available at http://www.pecklaw.com/PDF_files/Client_Alert-Fed_Gov.pdf (last visited Nov. 13, 2007); L. James D'agostino and Sean M. Connolly, *Ethics Corner: Contractors See Rise in Counterclaims National Defense,* Sept. 1, 2007, available at http://www.thefreelibrary.com/Contractors+see+rise+in+fraud+counterclaims.-a0168736974 (last visited Nov. 13, 2007).

[3] 73 Fed. Cl. 547 (2006).

[4] *Id.* at 585.

[5] *Id.* at 597.

[6] 74 Fed. Cl. 601 (2007).

[7] 41 U.S.C. § 51 *et seq*.

[8] 31 U.S.C. § 3729 *et seq*.

[9] 28 U.S.C. § 2514.

[10] The contractor brought some of its claims before the General Services Board of Contract Appeals, and others in the claims court. Pursuant to 41 U.S.C. § 609(d), the government consolidated all of the appeals at the Court of Federal Claims. 74 Fed. Cl. at 618.

[11] The contractor's liability under the False Claims Act stemmed from its submission of a routine application for payment, wherein it sought reimbursement for surety bonds premiums it had not yet paid, a contractually required condition for reimbursement. 74 Fed. Cl. at 624. Further, the contractor negotiated with its bonding agent for what the court concluded was a rebate (in favor of the contractor's parent company), but credit for which was never passed along to the government, *id*. at and was found to have trumped up invoices to provide the necessary "backup" for reimbursement, knowing that payment to the bonding agent had not occurred. *Id*. at 608-09. After the court's decision and a hearing on damages, judgment in favor of the government was entered for about $7.3 million. At press time, the contractor had not filed a notice of appeal.

[12] Indeed, much of the factual development in the claims court arose from admitted facts arising out of the criminal prosecution of the company, which led to a plea agreement. 74 Fed. Cl. at 626-34.

[13] *Id*. at 624, 625 n.18.

[14] *Id*. at 610.

[15] 73 Fed. Cl. at 560.

[16] *Id*.

[17] 73 Fed. Cl. at 560 (footnote omitted).

[18] *Id*. n.19 (quoting the complaint). *See also id*. at 569-71, 585 & n.39.

[19] At the time of the claims court's decision, the road still had not been completed. *Id*. at 550 n.1.

[20] *Id*. at 573.

[21] *Id*. at 584-85.

[22] The government moved for permission to add various fraud-related counterclaims, including under the fraud provision of the CDA, after the close of Daewoo's case in chief. *Id*. at 550. The government's other claims were brought under the special plea in fraud statute and the civil False Claims Act.

[23] 41 U.S.C. § 604 (emphasis added).

[24] 73 Fed. Cl. at 585.

[25] *Id*. at 570.

[26] *Id*. at 595. Daewoo appealed Judge Hodges' decision to the U.S. Circuit Court of Appeals for the Federal Circuit. Daewoo's brief on appeal contends, among other things, that amounts exceeding the $13 million incurred costs at the time of the certification were not certified by Daewoo at the time the claim was submitted, but were referenced only on an advisory basis. Brief of Plaintiff-Appellant

Daewoo Engineering & Construction Co. at 17-19, 21, *Daewoo Engineering & Const. Co. Ltd. v. United States*, No. 07-5129 (Fed. Cir. Nov. 13, 2007). Daewoo further has contended that the court improperly relied upon an
inartfully drafted complaint, and not upon the claim itself. Id. at 20.

[27] 41 U.S.C. § 604.

[28] *Id*. § 601(7).

[29] *Bennett v. Coors Brewing Co*., 189 F.3d 1221, 1230 (10th Cir. 1999); *see also Doe v. Howe Military Sch*., 227 F.3d 981, 990 (7th Cir. 2000) ("Actual fraud may not be based on representations regarding future conduct or on broken promises, unfulfilled predictions or statements of existing intent which are not executed."); *Presidio Enters. Inc. v. Warner Bros. Distrib. Corp.*, 784 F.2d 674, 678-79 (5th Cir. 1986) ("The first obstacle in Presidio's path is the rule that expressions of opinion are not actionable [for fraud]. This is a wise and sound principle that is deeply embedded in the common law."); and 37 Am. Jur. 2d Fraud and Deceit § 80 n. 2 (2001) (and cases cited therein).

[30] *See* 37 Am. Jur. 2d § 81 (and cases cited therein).

[31] Concerns about the government's prosecution of fraud claims predicated on estimates or good-faith predictions is not new, and cases impliedly sanctioning such claims have been critically scrutinized. *See* David Z. Bodenheimer, *The Strange Notion of Estimates as Fraud: Will Weather Predictions Be Next Under the False Claims Act?*, 40 Procurement Law. 1 (Summer 2005).

[32] Harrison v. Westinghouse Savannah River Co., 176 F.3d 776, 792 (4th Cir. 1999) (quoting Presidio Enters. Inc. v. Warner Bros. Distrib. Corp., 784 F.2d 674, 679 (5th Cir. 1986)). See also United States ex rel. Bettis v. Odebrecht Contractors of Cal. Inc., 297 F. Supp. 2d 272, 297 n.38 (D.D.C. 2004); and Boisjoly v. Morton Thoikol Inc., 706 F.Supp. 795, 810 (D. Utah 1988).

[33] *See Am. Heritage Bancorp v. United States*, 61 Fed. Cl. 376, 386 (2004) ("For the purposes of Section 2514, the government must show: 1) that the plaintiff made a false statement to the government knowing that it was false and 2) that this statement was intended to deceive the government.") (citing *Glendale v. United States*, 239 F.3d 1374, 1379 (Fed. Cir. 2001) (emphasis added)). Prior to the Federal Circuit's *Glendale* decision, for purposes of Section 2514, the claims court required the government to prove the common law elements of fraud. *See Id*. at 386 n.8.

[34] *See, e.g.,* 73 Fed. Cl. at 574, 574 n. 46, 583, 583 n. 60.

[35] 73 Fed. Cl. at 589-90. Notably, *UMC Electronics* did not involve a fraud claim founded on a prediction of amounts owed, but instead involved a recertification of an updated amount alleged to have already been incurred and owing. The court expressly addressed the evidence demonstrating that the certifying official knew that the costs that the contractor was claiming were "actual costs" within the meaning of FAR Part 31, meaning they had already been incurred at the time of the claim. 43 Fed. Cl. at 797-99.

[36] 73 Fed. Cl. at 590 (emphasis added).

[37] *Id*. at 557-58. According to Daewoo's appellate brief, it suffered more than $100 million in damages to ultimately complete the contract, an amount greater than the predicted future costs upon which the finding of fraud was based. *See* appellant's brief, supra, note 27, at 12.

[38] 41 U.S.C. § 601(9).

[39] See, e.g., Tecum Inc. v. United States, 732 F.2d 935, 937 (Fed. Cir. 1984); *Youngdale & Sons Const. Co. Inc. v. United States,* 27 Fed. Cl. 516, 540 (1993).

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