

# Government Contract

COMMENTARY

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## The Reach of the False Claims Act in Iraqi Contracting: More Important Developments In The *Custer Battles* Case

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The U.S. District Court for the Eastern District of Virginia recently set aside a \$9 million jury verdict in a False Claims Act case involving the Coalition Provisional Authority, which governed Iraq immediately after the 2003 invasion.

In *United States ex rel. DRC Inc. v. Custer Battles LLC*, the plaintiffs (known as "relators" under the FCA) alleged the defendants defrauded the United States by submitting false invoices and records to justify a \$3 million advance payment Custer Battles received pursuant to a contract with the CPA for work performed in Iraq in 2003 and 2004.<sup>1</sup>

The jury returned a \$3 million verdict in favor of the relators, which was statutorily trebled to \$9 million, and the defendants moved for judgment as a matter of law on a variety of grounds. Judge T.S. Ellis III ultimately threw out the jury verdict and granted the defendants judgment as a matter of law, saying the "relators did not prove that the claims were presented to the United States."<sup>2</sup>

Judge Ellis' decision is an important precedent because *Custer Battles* is only the first of what are rumored to be hundreds of as-yet unsealed FCA lawsuits involving contracting in Iraq.

### Dinars and Dollars

The contract at issue required Custer Battles to provide support services in connection with the CPA's Iraqi Currency Exchange project, which sought to exchange new Iraqi dinars for the old Hussein-era dinars then in circulation.<sup>3</sup> The relators alleged the defendants used shell subsidiaries to submit fraudulent invoices to the CPA, including invoices

and documents used to justify a \$3 million cash advance paid by the CPA from U.S. currency seized by American forces during the invasion.

Specifically, "Count one alleged that the defendants had knowingly presented or caused 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 to support the \$3 million advance, in violation of 31 U.S.C. § 3729(a)(1)," and "Count two alleged that the defendants knowingly made, used or caused to be made or used, false records or statements and presented the false records or statements to the United States government in order to get paid, or approved a false claim in support of the \$3 million advance, in violation of 31 U.S.C. § 3729(a)(2)."<sup>4</sup>

The ICE contract was essentially a time and materials contract that was meant to reimburse Custer Battles for its direct costs plus an additional 25 percent. The relators' theory of the case was that the defendants submitted invoices to the CPA that falsely inflated Custer Battles' direct costs for work performed. "To prove this scheme, relators presented evidence that Custer Battles used these false invoices to get reimbursed for costs it never actually incurred and thereby increase the base from which Custer Battles' 25 percent profit payment was calculated."<sup>5</sup> At trial, "relators presented damaging documentary evidence that tended to support their allegations of fraud by Custer Battles, including several invoices prepared by Custer Battles and presented to the CPA that contained suspiciously rounded figures" and a spreadsheet, left behind at a meeting with CPA officials, "which detailed both the 'actual costs' of work done by Custer

Battles and the much greater 'invoiced' costs Custer Battles presented to the CPA."<sup>6</sup>

At the conclusion of the relators' case, the defendants moved for judgment as a matter of law, but the court deferred ruling on those motions and submitted the case to the jury. After several days of deliberation, the jury found that "defendants had knowingly presented both false claims and false records to justify the \$3 million advance Custer Battles received on the ICE contract" and, accordingly, "found the defendants jointly and severally liable for \$3 million in damages to the United States," which, under the terms of the FCA, was automatically trebled to \$9 million.<sup>7</sup>

### Presentment Matters

In their motion for judgment as a matter of law, the defendants principally challenged whether the relators had proven "that any false claims ... or false records ... were knowingly *presented or caused to be presented* to employees or officers of the United States acting in their official capacity."<sup>8</sup>

Judge Ellis began his analysis by noting that Section 729(a)(1) provides that "any person who knowingly presents or causes to be presented to an officer or employee of the United States government ... a false or fraudulent claim for payment of approval ... is liable to the United States government for a civil penalty."

Therefore, "to prevail under § 3729(a)(1), relators must prove by a preponderance of the evidence that: (1) there was a claim, (2) defendants knew the claim was false or fraudulent, (3) defendants presented or caused to be presented, the false claim to an officer or employee of the United States for payment or approval, and (4) the false or fraudulent aspect of the claim or claims is material."<sup>9</sup>

Judge Ellis also noted that because of his prior ruling on summary judgment regarding the nature of the funds involved in the ICE contract, "only 'claims' submitted to support the initial \$3 million advance, that is, claims requesting funds from the U.S. government fisc, were at issue during the trial."<sup>10</sup> Accordingly, it was "necessary to address defendants' challenge to relators' evidence on the FCA's third element, the 'presentment' requirement."<sup>11</sup>

The court reiterated its prior conclusion that in order to find FCA liability under Section 3729(a)(1), "the false or fraudulent 'claim' must be 'knowingly presented or caused to be presented to an officer or employee of the United States government or a member of the Armed Services of the United States.'"<sup>12</sup> As a result, "it is not enough simply to demonstrate that false claims were

presented 'to grantees of federal funds, without regard to whether claims presented to those grantees are in turn presented back to the United States for payment.'"<sup>13</sup>

Moreover, the presentment requirement is not satisfied by presentment to a United States government employee or officer who is not working in his or her official U.S. government capacity.<sup>14</sup> "In other words, presentment to U.S. government employees or officers detailed to the CPA, but acting in their CPA capacities, fails to satisfy the FCA's presentment requirement."<sup>15</sup>

The court also found this same presentment requirement implicit in Section 3729(a)(2), which "provides for FCA liability when a person '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.'"<sup>16</sup> This is the case because "by adding the phrase 'by the government' to § 3729(a)(2), Congress intended to refer back to the presentment requirement in § 3729(a)(1)."<sup>17</sup> "Thus, just as § 3729(a)(1) requires proof that false *claims* have been presented or caused to be presented to a United States government officer or employee working in his or her official capacity, § 3729(a)(2) also requires proof that any false *records or statements* were presented or caused to be presented to a United States government employee or officer working in their official capacity."<sup>18</sup>

### The CPA Is Not the U.S. Government

Since there was abundant evidence at trial "that invoices and records were presented to CPA employees, including members of the United States Armed Forces detailed to the CPA,"<sup>19</sup> Judge Ellis next turned to the issue he avoided deciding in his prior opinion: whether the CPA was or was not an instrumentality of the U.S. government. If it was, the presentment requirement would be satisfied by the submission of the claims to U.S. employees acting as such. However, "if the CPA was an international entity, rather than a U.S. entity, submission of claims to the CPA, without more, would not satisfy the presentment requirement."<sup>20</sup>

After recapping his previous analysis of the subject, Judge Ellis concluded that "the evidence clearly establishes that [the CPA] was created through and governed by multinational consent" and that "although the CPA was principally controlled and funded by the U.S., this degree of control did not rise to the level of exclusive control required to qualify as an instrumentality of the U.S. government."<sup>21</sup> "Thus, it follows that because the CPA was not a U.S. government entity and, therefore, U.S. employees of the CPA were not working in their official capacity as employees or officers of the United States government, relators have demonstrably failed to provide sufficient

evidence to enable a jury to find presentment, as required by both § 3729(a)(1) and § 3729(a)(2).<sup>22</sup>

### A Failure of Proof

Judge Ellis noted that the relators could have prevailed on their claims even though the CPA was not an instrumentality of the United States if they had introduced evidence that the false claims or records presented by Custer Battles to the CPA were subsequently presented to an officer of the United States acting as such.<sup>23</sup> This was the case because even if the CPA were not an instrumentality of the U.S. government, Custer Battles could be liable for “causing” claims to be presented to a government official or employee,<sup>24</sup> since the United States generally maintained dominion, control and possession of the funds at issue “until the Army was finally directed by CPA contracting officers to make payments directly to the contractors, whether in the form of cash, electronic funds transfer or a check drawn on the U.S. Treasury.”<sup>24</sup> “Thus, when a contractor submitted a false or fraudulent invoice for payment to a CPA contracting officer, like any subcontractor submitting a false invoice for payment to a contractor, those contractors ‘caused’ the CPA contracting officer to present a request for payment, inflated by the value of the false claim, to an officer of the United States Army.”<sup>25</sup>

However, there was no evidence at trial “that any such procedure was followed in connection with the \$3 million.”<sup>26</sup> To the contrary, the \$3 million payment to Custer Battles differed from the routine practice because it was an advance. Thus, “it follows that the CPA never submitted to the U.S. Army any certifications based on Custer Battles’ invoices for the disbursement of money,” since the money had already been disbursed.<sup>27</sup> Accordingly, because “relators failed to adduce evidence that Custer Battles ‘caused to be presented’ to the United States Army any invoices for work on the ICE project,” the defendants were entitled to judgment notwithstanding the jury’s verdict.<sup>28</sup>

### The Next Chapter

Custer Battles is not out of the woods yet. The case involves two separate contracts: the ICE contract that was at issue in the court’s most recent opinion and the “BIAP” contract, which was awarded to Custer Battles by the CPA to provide security services at Baghdad International Airport.

The relators’ claims regarding the BIAP contract have yet to be tried.<sup>29</sup> The court’s recent order setting aside the jury verdict on the ICE contract does not necessarily presage a similar result on the BIAP contract because, unlike the ICE contract, the funds at issue under the BIAP contract were paid not only as advances, but also “in monthly installments.”<sup>30</sup>

The results of the BIAP contract trial will be worth watching because if the jury and the court ultimately find that the Custer Battles defendants presented false or fraudulent claims or records to a U.S. government official, then the court may well be forced to confront other important issues, including whether the U.S. government suffered any damages under the FCA when it paid out money it had seized from the former Iraqi regime.<sup>31</sup>

### The Tip of the Iceberg

The *Custer Battles* litigation also warrants continued scrutiny since it is rumored to be only the first of hundreds of as-yet unsealed FCA cases involving Iraq. Some of those cases may also be pending in the Eastern District of Virginia, where *Custer Battles* is being litigated. Obviously, the ground rules being laid down by Judge Ellis will be critical to the outcome of future CPA cases filed in that court and will serve as an important precedent in other Iraqi fraud cases that will be litigated around the country.

For the parties to these still-secret actions, the *Custer Battles* decisions contain two critical lessons. First, money matters. The CPA paid contractors with both Iraqi and U.S. government funds, but Judge Ellis’ opinions make it clear that the FCA will only apply to the extent that U.S. government funds are involved. To the extent that the funds at issue are Iraqi monies, the FCA will not apply.

Thus, it will be critical for parties to these still-secret FCA suits to determine where the money used to pay the allegedly false claims came from. In many cases, it may be difficult to determine the source of funds and defendants may be able to secure summary judgment on the ground that relators or the United States cannot meet their burden of establishing that U.S. government funds were involved.

Second, process matters. Judge Ellis’ opinions also make it clear that even if U.S. government funds are involved, the FCA will only apply to the extent that a claim is actually presented to a U.S. government official acting as such. Presentment to U.S. employees acting on behalf of the CPA is not enough. In some cases this will be a matter of proof.

For example, if the process used to pay false claims is similar to that outlined in Judge Ellis’ original opinion — where a false claim is presented to the CPA which, in turn, presents it to a U.S. government official acting as such — there may well be FCA liability. However, if the process mimics that used in the ICE contract, where the false claim is submitted to the CPA but never in turn presented to a U.S. government official, there should be no FCA liability.

## Don't Touch That Dial

Finally, as noted above, another important lesson may be forthcoming. One of the alternative arguments advanced by the *Custer Battles* defendants in support of their motions for judgment notwithstanding the verdict was that even if there was presentment, since the monies at issue were monies the U.S. government seized from the former Iraqi government, there were therefore no damages "sustain[ed]" by the U.S. government within the meaning of Section 3729(a).

Judge Ellis did not reach this issue on the ICE contract because he found there had been no presentment and therefore no liability. However, assuming the relators can prove presentment of the claims associated with the BIAP contract, this issue may well be the subject of a future opinion following the upcoming trial concerning that contract. Stay tuned.

## Notes

<sup>1</sup> *United States ex rel. DRC Inc. v. Custer Battles LLC*, 444 F. Supp. 2d 678 (E.D. Va. 2006).

<sup>2</sup> *Id.*

<sup>3</sup> *Id.*

<sup>4</sup> *Id.* at 679-80.

<sup>5</sup> *Id.* at 680.

<sup>6</sup> *Id.* at 681.

<sup>7</sup> *Id.* at 681 & n.5.

<sup>8</sup> *Id.* at 682.

<sup>9</sup> *Id.* at 683 (citations omitted).

<sup>10</sup> *Id.*

<sup>11</sup> *Id.*

<sup>12</sup> *Id.* at 684 (quoting *United States ex rel. DRC Inc. v. Custer Battles LLC (DRC I)*, 376 F. Supp. 2d 617 (E.D. Va. 2005), (citing 31 U.S.C. § 3729(a)(1))).

<sup>13</sup> *Id.* (quoting *DRC I*, 376 F. Supp. 2d at 647 n.84 (citing *United States ex rel. Totten v. Bombardier Corp. (Totten II)*, 380 F.3d 488 (D.C. Cir. 2004))).

<sup>14</sup> *Id.*

<sup>15</sup> *Id.* at 685.

<sup>16</sup> *Id.* (quoting 31 U.S.C. § 3729(a)).

<sup>17</sup> *Id.* (quoting *DRC I*, 376 F. Supp. 2d at 650 & n 88 (citing *Totten II*, 380 F.3d at 498)).

<sup>18</sup> *Id.*

<sup>19</sup> *Id.* at 686.

<sup>20</sup> *Id.* at 685.

<sup>21</sup> *Id.* at 689.

<sup>22</sup> *Id.*

<sup>23</sup> *Id.* at 685.

<sup>24</sup> *Id.* at 686 (quoting *DRC I*, 376 F. Supp. 2d at 648).

<sup>25</sup> *Id.*

<sup>26</sup> *Id.* at 687.

<sup>27</sup> *Id.*

<sup>28</sup> *Id.*

<sup>29</sup> *Id.* at 679 n.2.

<sup>30</sup> 376 F. Supp. 2d at 630.

<sup>31</sup> See 444 F. Supp. 2d at 689.

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