

## Examining fraud and public contracting

Common practice in private sector can result in false claim liability on public projects

Front-end-loaded progress payments and overinflated change order requests are common – if not accepted – practices on private construction projects, but they are also imprudent and can lead to significant liability on public projects.



### CONSTRUCTIVE ADVICE

Sean Gay

Although fraud and public contracting have long been associated with one another, the number of fraud-related public contracting lawsuits is on the rise. While much of this increase may be attributed to the problems related to war-time contracting, public-private partnerships and increased construction spending at all levels of government have provided more opportunities for corruption. And those opportunities have not always been passed over. Both public agencies and the contractors with whom they do business need to better understand the types of conduct that give rise to fraud liability and how to prevent it.

### What is a false claim?

Generally, a false claim is any misrepresentation made to a public agency for the purpose of obtaining compensation. In addition, the misrepresentation must be knowing and material. That is, the person making the representation must know that it is false, and the statement must in some way influence the agency's decision to pay.

### When do false claims arise?

False claims can arise at any point in the public contracting process, from bidding to post-project disputes. Examples of the types of situations that can lead to false claim liability include:

- Bid certifications and representations, such as false representations about good-faith attempts to obtain minority, women, and emerging small business enterprise participation
- Fraudulently “buying” contracts by submitting below-cost bids and seeking to make up the difference through change order requests
- Bid rigging, collusive bidding, bump agreements, complementary bidding, bid shopping, and kickback schemes
- False representations on payment applications, such as prevailing wage certifications or certifications about subcontractor payment
- Billing for work not performed or defective work
- Product substitution requests
- Change order requests, particularly when the contract

requires actual cost information

- Submitting false schedule updates, such as showing progress ahead or behind its actual position
- Insurance and surety “rebate” programs, especially under cost-reimbursable contracts if the rebate or some portion of it is not passed on to the public agency
- Sponsoring dubious subcontractor claims against a public agency, such as asserting a false subcontractor claim on a pass-through basis
- Contract disputes, requests for equitable adjustments, and claims

### Who can be liable?

Any person or entity that submits a false claim to the government can be liable. This means that a contractor and its individual employees face potential liability. However, design professionals, construction managers, and private owners involved in public-private partnerships have also been implicated in false claims suits. In addition, local public agencies that receive state or federal funding may also be liable for making false statements or certifications on grant or loan applications. As a result, any person or entity making representations to the government may fall within the broad reach of anti-fraud laws.

### What are the penalties?

Although damages and penalties vary, courts generally seek to make the aggrieved agency whole and, when appropriate, assess civil penalties. Additionally, an adverse decision often leads to debarment, which means that the guilty party is prohibited from bidding on future public contracts. Of course, the accused may also be subject to criminal action under criminal fraud, conspiracy, mail fraud, or wire fraud statutes.

### How is false claim liability avoided?

Obviously, honesty and ethical business practices are the first line of defense against false claim liability. However, the line between fair-but-aggressive and fraudulent business practices is often blurred. To address this, contractors and public agencies can develop strategies such as employee training, and creation of internal controls and disciplinary procedures; that will make it easier to steer clear of problems and maintain good reputations necessary for future success.

*Sean Gay is a member of the construction and design practice group at Stoel Rives LLP. Contact him at 503-294-9239 or [scgay@stoel.com](mailto:scgay@stoel.com).*