# SUPREME COURT UNANIMOUSLY AGREES: FALSE CLAIMS ACT REACHES GOVERNMENT SUBCONTRACTORS

On June 9, 2008, the United States Supreme Court unanimously confirmed that Federal Government subcontractors can be liable under the False Claims Act for committing indirect fraud against the Federal Government fisc. In *Allison Engine Co. v. United States ex rel. Sanders*, 2008 U.S. LEXIS 4704 (2008), the Supreme Court rejected the notion that Government subcontractors could avoid False Claims Act liability merely because they never "presented" their false claims for payment directly to the Federal Government. For the Supreme Court, the important inquiry regarding the reach of the False Claims Act is whether fraud has occurred against the Federal Government, not whether a fraudfeasor's false claims ever reach a Federal Government employee.

The Supreme Court granted *certiorari* in the *Allison Engine* case to resolve a conflict between the Sixth Circuit's decision and a 2004 decision by the Court of Appeals for the District of Columbia Circuit, *United States ex rel. Totten v. Bombardier Corp*., 380 F.3d 488 (D.C. Cir. 2004), *cert. denied*, 544 U.S. 1032 (2005). A divided panel in *Totten* held that a false claim to a Federal Government grantee could never support liability under the False Claims Act unless that false claim was re-presented by the grantee to the Government. The *Totten* majority recognized that the text of the False Claims Act identifies "presentment" of a false claim to the Government as an element of liability only in Section (a)(1), yet the Court decided that there must be a blanket "presentment" requirement in all provisions of the False Claims Act in order to ensure that the Federal Government is truly the defrauded party. This construction of the Act seemed at odds with its plain text—which has a definition of actionable "claims" that includes those that are not "presented" directly to the Government—and also with the 1986 False Claims Act legislative history, in which both the House and Senate stated unequivocally that false claims to a non-Government party are actionable if the ultimate loss is suffered by the Government.

After *Totten*, many lower courts began rigidly applying the so-called "presentment" requirement to dismiss cases involving much different circumstances. The holding in *Totten* was driven by two fact-specific concerns: First, the grantee in that case (Amtrak) was funded by both Federal and private dollars, so it was not clear whether Government funds were used by Amtrak to pay the false claims of the subcontractors. Second, there was no identification of Government requirements that had been violated by the subcontractors, so it was not clear whether the claims were false in a way that ultimately defrauded the Government rather than Amtrak. Courts that

began using *Totten* to dismiss cases against subcontractors (and other entities that did not have direct contact with the Government) did not account for these factual circumstances. Thus, even where Government requirements were clearly violated by subcontractors, and even where Government funds were indisputably used to pay the false claims, the False Claims Act was being held inapplicable solely because the subcontractor invoices never actually reached a Government employee. That is what happened in *Allison Engine*.

*Allison Engine* involved Navy subcontractors hired to build generator sets for the Navy's new fleet of *Arleigh Burke* class destroyers. Over the course of a five-week trial, Relators introduced evidence that the defendant subcontractors were each specifically required by their contracts to make the generator sets in accord with identified Navy standards, and those Navy standards were systematically violated for many years. Relators showed that all the money paid to the defendants came from the Navy and, moreover, these defendants were actually required to certify in writing to the Navy that the generator sets had been made to the Navy's specifications in order to be paid with Navy funds. Both the contract provisions calling for the defendants to certify compliance with the Navy standards as a condition of payment, as well as the actual Certificates of Conformance themselves, were very clear:

6. CERTIFICATE OF COMPLIANCE

6.1 When specified by the purchase order, Bath Iron Works Certificate of Compliance (Exhibit A) will be signed and attached to the Seller's packing slip. U.S. Navy Inspectors at the Shipbuilder's facilities cannot release material for use until the Certificate of Compliance is available. Payment of your invoice will be withheld pending receipt of the Certificate.

6.2 Certificates of Compliance (Exhibit A or similar) shall indicate that all supplies furnished under the purchase order have been inspected and tested and meet all quality assurance requirements invoked by the purchase order. When specified by the purchase order, the Seller shall furnish verifiable test data, including the names of witnessing inspectors and present any other verifiable quality data required by the purchase order or at any time up to and after final payment of the order.

Allison

PRLE 05-93-53

CERTIFICATE OF CONFORMANCE

Allison Gas Turbine certifies that the AG9130 Generator Set, P/N 23036001, shipped herewith was manufactured in accordance with all applicable specifications, drawings, and procedures. Materials contained within the assembly conform with Parts List Number 3398. The unit met functional requirements per Production Test Specification 861D. Exceptions are listed below.

Generator Set Serial No. AGS0041

Purchase Order No. M2-03019-011

T. F. Gee

T. F. Gee, Director
Product Reliability
ALLISON GAS TURBINE DIVISION
General Motors Corporation

Date May 28, 1993

In deciding a directed verdict motion, the district court accepting as true that the defendants made defective generator sets, submitted thousands of false invoices to the shipyards, and were paid with Navy funds after they falsely certified to the Navy that the generator sets met the Navy's standards. Yet, based solely on *Totten*, the district court found that the defendants did not violate the False Claims Act because their false invoices were not "presented" to the Navy.

The Sixth Circuit reversed. In *United States ex rel. Sanders v. Allison Engine Co.*, 471 F.3d 610 (6th Cir. 2006), the majority rejected the holding in *Totten* that "presentment" is always required for False Claims Act liability. Adhering to the False Claims Act plain text and legislative history, the Court held that "presentment" was clearly not an element of liability under Sections (a)(2) or (a)(3)—only Section (a)(1) mentions "presentment," and the Court found no reason to add such an atextual requirement when Congress had not done so. For the Sixth Circuit, the False Claims Act clearly reached the subcontractor fraud at issue because the defendants violated Navy requirements, repeatedly made false statements to the Navy to receive payment, and were indisputably paid all with Navy funds. This was an unexceptional application of the False Claims Act to reach clear fraud against the Navy, so the defendants sought *certiorari* by ignoring the facts of the case and taking statements by the Sixth Circuit out of context. For the *Allison Engine* defendants, the Sixth Circuit had extended the False Claims Act to reach any claim made to anyone that might have received "Government funds." Though this obviously was not the Sixth Circuit's holding, nor was it the facts of this case, the Supreme Court nonetheless granted *certiorari* to resolve the conflict with *Totten*.

In *Allison Engine*, the Supreme Court unanimously followed the Sixth Circuit and rejected the *Totten* "presentment" rationale. The Supreme Court found that subcontractors can be liable under Sections (a)(2) and (a)(3) even if their false invoices never reach a Government employee, since fraud against the Government can certainly occur without such direct contact. Despite the vigorous efforts by the defendant subcontractors and their *amici*, the Supreme Court would not let Government subcontractors escape False Claims Act liability. At the same time, however, the Court was clearly concerned that the Sixth Circuit's decision might be misconstrued (as the defendants had done) to extend the False Claims Act to any claim for "Government funds." Thus, the Court decided that liability cannot be premised merely on claims that seek "Government funds," but must instead involve proof that the Government is truly the defrauded party. This can be done with evidence that a subcontractor made false statements to a prime contractor "intending" that the statements be "material" to the Government's decision to pay the claim—which would be enough of a "direct link" to show that the Government is the defrauded party. On the facts of *Allison Engine*, of course, such a "direct link" was clear, so the Supreme Court remanded the case for further proceedings.

*Allison Engine* is an important victory for the False Claims Act, since it will remain a viable tool to redress indirect fraud against the Government. Yet there are certain to be efforts to use the *Allison Engine* decision to narrow the application of the False Claims Act to dismiss cases involving clear fraud against the Government by inviting lower courts to focus myopically on undefined terms such as "intent" or "materiality" or "direct link." This would be against the holding and spirit of *Allison Engine*—where the Supreme Court said quite clearly that the False Claims Act must always be construed so that it reaches fraud against the Government.