3 exhibits (ctm file)

Connecticut Construction Industries Association, Inc.

912 SILAS DEANE HIGHWAY, WETHERSFIELD, CT 06109 Phone (860) 529-6855 / FAX (860) 563-0616
Web: http://www.ctconstruction.org

House Bill 5923, An Act Concerning Fraud Against the State
Judiciary Committee
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CCIA Position: OPPOSED

Connecticut Construction Industries Association, Inc. (CCIA) represents the commercial construction industry in Connecticut and is committed to working together to advance and promote a better quality of life for all citizens in the state. CCIA is comprised of more than 350 members, including contractors, subcontractors, suppliers and affiliated organizations representing all aspects of the construction industry. CCIA has been actively engaged in state contracting reform and supports efforts to reform state contracting. CCIA seeks to ensure that the integrity of the contracting reform effort is preserved.

CCIA is **opposed** to House Bill 5923, An Act Concerning Fraud Against the State, and respectfully requests that the Judiciary Committee not act on the bill. House Bill 5923 is a state false claims act, which most would agree is an imperfect statute. If enacted, HB 5923 will impose the specter of treble damages and high penalties on transactions in the government marketplace, and will virtually guarantee a dramatic increase in lawsuits asserted against innocent persons, *even if* a false claim is not committed.

Under House Bill 5923, any person who has been found to have submitted a false or fraudulent claim for payment or approval to the state – or even an incorrect claim – is subject to a civil penalty of up to $10,000, plus three times the amount of the state's damages, and all costs for investigation and prosecution of any civil action brought by the state. The bill permits *qui tam* actions, that is, lawsuits brought by private informants in the name of the government charging false claims on the part of persons who are alleged to have improperly received or used public funds.

House Bill 5923 should be rejected by the committee because it can easily be used in unintended ways for improper purposes. Under the bill, every company and organization that works under a state-funded contract or seeks state reimbursement is potentially subject to lawsuits comprised of aggressively asserted positions under a growing number of legal theories that stretch the boundaries of the Act. House Bill 5923 is not in the interest of the State or its citizens. Nor is it in the interest of the businesses that are partners with the State, or organizations that operate under state grants.

Significant points that identify the many negative aspects of a false claims act (FCA) that are in House Bill 5923 that are of grave concern to the construction industry include:

- The definition of "claim" is so broad that almost any action by a contractor could be a claim. Some interpret a claim to be a single document; others interpret it to be separate phrases or items within a single document. A claim need not be in writing at all. Likewise, there is no distinction where negotiations over a difference of opinion end and a claim begins. (Section 1 (2))

- The definition of "knowing" and "knowingly" is expanded by two broad provisions that have no boundaries. Acting in deliberate ignorance or reckless disregard of the truth or falsity leaves the provision open to interpretation. (Section 1 (1))

- The term "false" is not defined. In many cases falsity is not clear. For example, questions of scientific or engineering judgment are neither strictly true nor strictly false. Questions of interpretation of specifications, drawings or other technical requirements may be matters of opinion on which reasonable minds may disagree without making a "false" statement. Here, any contractor that shares his true thinking with the government can be liable for a false claim.

- A FCA does not require a showing of specific intent to defraud. The standard for this "scienter" requirement for civil liability is much easier to meet than for common law fraud or the criminal FCA. Here, a corporation may be held liable under the civil FCA for acts of its employees and subcontractors as long as they acted within the scope of authority, even if no management personnel knew about the false claims. (Section 1(1)(C)).

- A FCA does not require a showing of materiality. Materiality means that the claim's falsity must have had a natural tendency to influence the government's decision to pay. Without it, the Act allows misconstruing trivial violations of the letter of the contract documents as false claims.

- The "preponderance of the evidence" standard of proof is lower than the "clear and convincing evidence" standard of proof that applies to actions in fraud. The low standard of proof combines with the broad elements of a claim to make actions relatively easy to allege and prove, especially considering the gray area of construction judgment. The low standard of proof encourages abuse, because it compounds the problems with the broad definitions. (Section 13)

- The high penalties and damages often far exceed any harm to the government. Penalties of $5,000 to $10,000 per claim, three times the government's damages, all costs of investigation and prosecution, and suspension and debarment combine with the easy legal standards to create a tremendous threat. (Section 2 (b))

- The attorney fees and costs provisions are unbalanced. A successful plaintiff automatically collects reasonable attorney fees and costs; on the other hand, a successful defendant only has a remedy against the plaintiff for abuse of a false claims act in rare and unusual circumstances. Even then, it is only permissive by the court. (Section 2(b) and Section 6 (c))

CCIA is **opposed** to House Bill 5923 because:

- **Potential misuse**.
  - A FCA is a powerful tool that could be easily misused to intimidate lawful state contractors who are genuinely owed money by the state. There are often differing positions between contractors and state agencies as to the interpretation of documents, changes in the work, differing site conditions, and delays on projects. Under HB 5923, because there is no distinction between a difference of opinion and a "false claim", there would be a tremendous incentive for a state agency and the Attorney General to use the threat of turning a contract dispute into a false claims action to raise the stakes in a negotiation or litigation to the point that the contractor has little choice but to relinquish its claim and settle. The threat of a FCA action forces the contractor to settle even where the contractor knows it has done nothing wrong, and despite any personal feelings of disgust and angst for what such a settlement may suggest to those unfamiliar with modern day litigation.
  - Private individuals and some plaintiffs lawyers could misuse a FCA in a variety of ways to pursue frivolous claims in order to collect unjustified sums under the bill's generous provisions. Some plaintiffs have over the past decade aggressively asserted positions seeking financial gain and to intimidate not only contractors but public officials.

- **Damage to a contractor's reputation, bankruptcy and impact on jobs and state revenue**.
  - The bill does not offer enough protection to contractors defending frivolous actions, putting honest and reputable contractors—as well as jobs—at risk. Information disclosed by the news media is enough to provide a plaintiff attorney the opportunity to make an allegation against a contractor. It costs hundreds of thousands, if not millions, of dollars to defend such a suit. Lawful defendants are often forced to spend a great deal of money and waste resources before settling lawsuits to avoid the nuisance of litigation, even though the contractor knows it has done nothing wrong.
  - Moreover, under Connecticut's contracting reform legislation the collateral consequences are of grave concern. The mere allegation of "false claims" can:
    - tarnish a contractor's reputation and cause the contractor to lose his or her prequalification certificate - eliminating him from performing public work; or

- cause state agencies, or the Contracting Standards Board to suspend or debar the contractor.

- **Loose legal standards and significant penalties**. A contractor can easily be accused of submitting a false claim to the government. Key elements of a cause of action, such as the term "false", are not defined in the bill. A FCA does not require a defendant to have intended to deceive the government. The term "claim" is defined broadly. The term "knowledge" is expanded. These broad and vague legal elements combine with the low standard of proof and high penalty and damages provisions to create a tremendous threat that imposes a significant burden on contractors.

- **Unnecessary**. State law already provides sufficient remedies, including actions for fraud or misrepresentation, prequalification laws, and many legal and contractual contracting reform measures, all of which can be used effectively by state agencies, the Attorney General, and the Office of State Ethics to address issues related to the administration and performance of contracts.

Responding to the tremendous amount of investigatory demands and the costs associated with mounting a defense to a FCA action can drain limited resources from production and easily put a business at risk. Exposure to this type of risk could even deter contractors from presenting meritorious claims. Likewise, fewer quality contractors will bid for state contracts, raising costs for the state. All of these risks can put the contractor out of business and willing workers out of jobs, creating a domino effect where the state suffers a revenue loss and taxpayers lose double, when projects cost more due to a lack of bidders.

While a FCA inherently creates exposure for members of the construction industry, it creates similar risk for all other businesses and organizations that operate under state contracts or receive reimbursements under state grant programs. A false claims action could be the death knell for any participant in an endeavor that is wholly or partially funded by the state.

Background

Almost every year since 1999, a bill to adopt a FCA in Connecticut has been introduced in—and rejected by—the General Assembly.

The federal Deficit Reduction Act of 2005 provides a financial incentive to states to enact FCAs comparable to the federal act. Effective January 1, 2007, the federal government will give 10% of the federal government's share of a recovery under a Medicaid enforcement action brought under such state's law that would otherwise have gone to the federal government.

Other problems

Some examples of abuse of a FCA include:

1. In *Valley Engineers, Inc. v. City of Vernon*, Los Angeles County Superior Court Case No. BC 227815, the government entity filed a counterclaim based on the FCA against the contractor's claim for payment alleging that the contractor *underbilled* for an item of work and submitted a "false" claim. Even though the under-billing allegation runs contrary to the purpose of the FCA, the potential threat of FCA allegations raised the stakes in litigation to a point that the contractor, after laying off workers and selling equipment to raise the money necessary to defend against the counterclaim under the FCA, had no choice but to settle its claim with the city for a fraction of what the city actually owed the contractor. Without surprise, the abusive FCA allegations in the counterclaim were dropped after the contractor agreed to relinquish part of its claim. (Information is attached)

2. In *US ex rel. Bettis v. Odebrecht Contractors*, 393 F.3d 1321 (D.C.Cir. 2005) a whistleblower filed a FCA action against a contractor who had received a "Contractor of the Year" award for exceptional performance on the project, alleging that the contractor purposely "deflated" his bid to induce the government to award the contract. The whistleblower and the plaintiff's attorney representing him were seeking their share of millions of dollars of alleged "false claims". The contractor had the resources to defend against the FCA action in the U.S. District and Appellate Courts where the courts held that none of the evidence offered by the plaintiff proved the contractor's bid was fraudulent and dismissed the case. After years of expensive investigations and litigation, public humiliation, and risk of suspension or debarment, the contractor was left without a remedy to recover any of the costs to defend against the abusive lawsuit.

3. In *U.S. ex rel. Durcholz v. FKW Inc.*, 189 F.3d 542 (7th Cir. 1999) a government official was one of the victims of an abusive lawsuit. In this action, a whistleblower alleged a government contracting officer was part of a conspiracy because he had instructed the contractor to prepare its invoices in a way that was allegedly "false". Here, the whistleblower was a disappointed bidder who utilized the FCA to further its challenges to the award of the contract to a competitor. However, the courts recognized that frequently in the real world, for purposes of convenience, efficiency, common sense, and just getting the work done, the government customer and contractor agree to depart from the strict terms of a contract or procedure without committing false claims. Like above, after years of expensive investigations and litigation, the case was dismissed.

4. Even public officials have experienced misuse of a FCA against the government itself. In *U.S. ex rel. Stierli v. Shasta Services, Inc.*, 2006 WL 1897109 (July 11, 2006), a case decided under both the federal and California state FCAs, the federal district court for the Eastern District of California dismissed a disappointed bidder's *qui tam* complaint alleging that the awardee

> of a federally-funded state construction contract had violated both Acts by submitting incomplete information in its proposal regarding its efforts to enlist disadvantaged subcontractors. Remarkably and atypically, the successful motions to dismiss were filed by both the federal and state governments that were the alleged victims of the fraud.
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> In the case, the court was persuaded not only by the fact that the state government customer had full knowledge of the alleged noncompliance prior to awarding the contract, but also by the California Attorney General's contention that the state government has a ***"legitimate interest in ensuring that the [FCA] is not 'misused by unsuccessful, disgruntled public contract bidders as a device to intimidate competitors' [and that otherwise] 'every award process could potentially be converted into a[n FCA] action with the winning bidder facing the specter of civil penalties and treble damages even when the state—the real party in interest—contends no false claim was committed.'"*** (emphasis added)

FCA abuse is growing and expanding. The incentive for abuse is encouraging some whistleblowers and federal agencies to push the curious proposition that estimates of future costs can be fraudulent, thus triggering liability under a FCA. *See: The Strange Notion of Estimates as Fraud: Will Weather Predictions Be Next Under the False Claims Act?,* 40 Proc. Law. 1 (Summer 2005)*; "False" or "Inaccurate" Estimates,* West Publications: Briefing Papers, Second Series No. 05-13 (December 2005). Here, FCA plaintiffs are in quest of virtually unlimited opportunities to abuse the FCA by using 20/20 hindsight to second guess good-faith judgments made by contractors and accepted by government contracting agencies during negotiations.

Another authority has commented: "State prosecutions are more directly influenced by political changes than the federal system, so there is greater potential for inconsistency in a new proliferation of state enforcement actions....One can only imagine what politically – motivated state attorneys general (e.g., Elliot Spitzer), not to mention city attorneys hoping for higher office, will do with a law in which liability is based on "recklessness," not fraud, and which also provides crippling damages and penalties, devastating collateral consequences, and an army of plaintiffs' lawyers more than willing to bring any case, whatever the merits." *See: New False Claims Law Incentives Pose Risks to Contractors and States,* Washington Legal Foundation, Critical Legal Issues, Working Paper Series, No. 139, June 2006. (Attached).

If you have any questions or for additional information, please contact Don Shubert or Matthew Hallisey at (860) 529-6855.