

Roundup

An Update on Government Contracts Issues for Clients & Friends

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Federal Circuit Takes Alternate Route In Denying Winstar Recovery

By Michael Littlejohn (michael.littlejohn@akerman.com)

"Fraud taints everything it touches."¹ More importantly, fraud practiced to obtain a contract absolves the Government from any contractual liability. At least that is the view of the Federal Circuit on its second review of the Winstar-related case Long Island Savings Bank v. United States, No. 06-5029, 2007 WL 2685640 (Fed. Cir. Sept. 13, 2007). The question in this case is whether every fraudulent act or certification by a rogue executive imputes fraud to a company and should void an agreement with the Government. The trial court had held that the Government could not prove by "clear and convincing evidence" that the plaintiff has committed fraud against the Government based the bank Chairman's guilty plea to a conflict of interest. The trial court found no real connection between the fraud and the bank's duty to provide safe and sound financial management as required by the agreement and by regulations. In February 2007, the Federal Circuit reversed by finding a connection between the fraud and the agreement and entered judgment under the Forfeiture Statute (28 USC § 2514). On rehearing, the Federal Circuit withdrew that opinion, but still denied any recovery to LIB under the theory that the fraud made the contract void *ab initio*, excusing the Government's later breach.

In 1982, LIB was chosen by the FSLIC in a competition to take over a failing savings and loan. LIB was required to sign an Assistance Agreement with FSLIC under which its Chairman was to certify that all representations made by LIB were true and correct and that LIB was in compliance with all applicable statutes and regulations. LIB also certified that none of the information in the agreement and none of the information it had provided to obtain the agreement contained an untrue statement or omitted any material fact which would materially alter the business operation. Among the many statutes and regulations that applied to the transaction, 12 CFR 563.17(a) required the bank to "maintain safe and sound management."

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¹ Daff v. United States, 31 Fed. Cl. 682, 688 (1994).

LIB's Chairman recertified its compliance with laws and regulations every year from 1983 through 1993. In 1990, as part of due diligence for bringing LIB "Winstar" lawsuit against the United States, an outside law firm discovered that the Chairman had been receiving compensation from his former law firm employer. The Chairman attempted to prevent outside counsel from disclosing the information to the bank, which failed. Upon receiving the information from outside counsel, the bank promptly notified the Government of the issue and filed a criminal referral with federal law enforcement and the Office of Thrift Supervision. After an investigation by the Government, the Chairman and OTS entered a consent order which concluded that the Chairman had engaged in conflicts of interest that resulted in a "unsafe and unsound practice" within the meaning of the regulations. The Chairman eventually pled guilty to a criminal misdemeanor under 18 USC § 215 which covers bribery of financial institution officers.

On rehearing, the Federal Circuit abandoned discussions of the Forfeiture Statute and focused on federal common law fraud. Under federal common law, the Circuit found that a "misrepresentation may prevent the formation of a contract." *Id.* at 17. It also noted that a government contract tainted by fraud is "void ab initio." *Id.* That is, where a contractor made false statements in order to obtain a contract (such as misrepresenting its size status) the contract is void ab initio. *Id.* (citing *J.E.T.S., Inc. v. United States*, 838 F.2d 1196 (Fed. Cir. 1988)). It is the Government's burden to prove that "the contractor (a) obtained the contract by (b) knowingly (c) making a false statement." *Id.* at 18.

The Circuit does not state the level of proof by which the Government must prove the fraud, but it found that the Government met each element of the test on summary judgment. Based on an affidavit in the

record in which the Government's supervisory agent stated that he would have cut off discussions had he known of the "kickback" scheme, the court found that the contractor would not have obtained the contract but for the fraud. It found that the misrepresentation was material and that the only reasonable conclusion would be that LIB received the contract "by knowingly making a false certification." Second, the Circuit found that the company falsely certified that it was in compliance with all laws and regulations. It disagreed with the trial court that the misrepresentations were not connected to whether the bank was operating in a safe and sound manner under 12 CFR 563.17. It found that the CEO had breached his fiduciary duties to the bank which was unsafe and unsound management. In any event, the Circuit found that LIB had promised not to "omit" any material facts that could have made statements misleading. Thus, LIB made false statements. Finally, the Circuit found that LIB "knowingly" made the false statements to obtain the contract. The CEO knew of the falsity of the statements when they were made by LIB, and the Circuit found that the CEO's knowledge was imputed to the bank.

Accordingly, the Circuit found that the agreement was void *ab initio*, and, even if it were not void, the plaintiff's claim for breach damages against the United States was precluded because of LIB's material breach of contract based on the fraud. The court noted that the Government never waived that breach by continuing to accept performance after it knew of the fraudulent scheme. Indeed, it found that the Government's performance ended before the disclosure of the fraud.

The Federal Circuit's decision leaves many questions unresolved. Under the Forfeiture Act, the contractor would not be able to recover its claim, but if the contract is *void ab initio*, the Government is theoretically entitled to recover any monies or other

benefits provided to the Plaintiff. See K&R Engineering Co. v. United States, 222 Ct. Cl. 340 (1980) (contractor not entitled to be paid and Government is entitled to a return of all monies spent when contract is tainted by fraud). There are also questions about the application of the LIB decision. Does this decision apply to contracts where the Government continues its performance after the fraud? The Circuit left unanswered the standard of proof for these types of cases.

Must the Government meet the "clear and convincing" evidence standard required under the Forfeiture Statute? How much of a connection must there be between the fraud and the particular contract? In short, the decision prevents the Government from having to pay millions of dollars in damages, but it may have greater ramifications beyond this case. A further review by the full en banc panel of the Federal Circuit would be welcomed.

No Recovery Allowed for Site Exclusion After 9/11

By Dan Donohue (daniel.donohue@akerman.com)

In an October 11, 2007 decision, the Armed Services Board of Contract Appeals reminds us all that the Government remains immune from contractual liability for the effects of the Government's sovereign acts. Conner Bros. Construction Co., Inc., ASBCA No. 54109, 07 BCA ___ (2007). The case is interesting in its own right because the sovereign act – denying the contractor access to the site for 41 days – was the act of the user agency, not the contracting agency. Equally important, this case provides us with an opportunity and perhaps an incentive to review the caselaw concerning sovereign acts.

In April 2000, the Corps of Engineers awarded Conner Bros. a contract to build four buildings at Fort Benning, Georgia for the 75th Army Rangers regimental headquarters. The building site was located within a separate compound on the base – the 75th Ranger Regimental Compound – which was a "tenant activity" not within the operational control of the Ft. Benning command structure. The Corps of Engineers was the contracting activity, whose CO had sole contractual authority to give direction to the contractor. The Army Rangers were the "user agency," who lacked any contractual authority to direct the contractor but were the ultimate users of the facility. In this case, the Rangers

also had operational control over the "compound" in which the contract site was located within Ft. Benning.

On September 11, 2001, the work was about 75% complete. Following the attacks on the World Trade Center and the Pentagon, two Army Rangers directed Conner and its subcontractors to evacuate the base and the compound. The entire base was evacuated that day. Ft. Benning allowed contractors to return to work on September 17, 2001, but the Army Rangers prohibited Conners and its subcontractors from returning to the work site within the Rangers compound until September 28 for one area and October 15 for the remaining area. The Board found as a fact that the Rangers excluded Conners from the site to maintain the secrecy of Ranger training concerning potential operations in Afghanistan.

The Corps CO issued two unilateral modifications extending the contract time for the full 41-day shut-out period but granted no change in the contract price, citing the excusable delay provisions of the Default clause, FAR 52.249-10. In 2002, Conners submitted to the CO a claim under the contract's Changes clause seeking \$137,000 for additional costs due to lack of site access for the 41-day period Conners

was denied access to the site. The CO denied the claim and Conners appealed to the ASBCA. While the parties agreed that the Government caused the contractor's 41-day delay, the Corps defended on the grounds that the Rangers' decision to exclude the contractor from the site was a sovereign act.

The sovereign act doctrine is an affirmative defense to be pleaded and proven by the Government. Orlando Helicopter Airways, Inc. v. Widnall, 51 F.3d 258, 261 (Fed. Cir. 1995). The Government must prove that its sovereign act, whether legislative or executive, was both "public and general" and not specifically directed at any particular contract. In Horowitz v. United States, 267 U.S. 458, 461-62 (1925), the Supreme Court quoted with approval from the Court of Claims' ancient description of the doctrine in Jones v. United States, 1 Ct. Cl. 383, 384 (1865) that:

The two characters which the government possesses as a contractor and as a sovereign cannot be . . . fused; nor can the United States while sued in the one character be made liable in damages for their acts done in the other. Whatever acts the government may do, be they legislative or executive, so long as they be public and general, cannot be deemed specially to alter, modify, obstruct or violate the

particular contracts into which it enters with private persons.

Conners Bros. Construction, Inc., ASBCA No. 54109, 04-2 BCA ¶ 32784, 2004 WL 2376490 (denying motions for summary judgment).

The ASBCA found that the Rangers' decision to exclude Conners Brothers and its subcontractors from the site was the result of a sovereign act by the Rangers - to maintain secrecy of preparations for possible operations in Afghanistan. The contractor offered proof that its exclusion was not "public and general" and was directed specifically at its particular contract in that a food service contractor was permitted to continue work in the Rangers' compound while Conners Brothers and its subcontractors were excluded. The Board found as a fact that the contractor's operations would have allowed its personnel to view the Rangers' operations while the food service contractor's operations did not. The Board found this to be a rational distinction between the two situations and concluded that the exclusion of Conners Brothers and its subs was not directed specifically at its particular contract.

This decision should remind contractors that they bear the entire risk of cost increases due to sovereign acts by the Government – including acts of the contracting agency, the user agency and other Government entities. As contractors participate more in military operations, this risk due to sovereign acts may increase.

Back to Basics: Offer, Acceptance, and the Validity of a Letter of Intent

By Sarah M. Graves (sarah.graves@akerman.com)

Does the intent to enter an agreement equal a CDA contract? In Inversa, S.A. v. Department of State, CBCA No. 440, 2007 WL 3055014 (October 3, 2007), the CBCA

refused to exercise jurisdiction over a claim arising from execution of a letter of intent to enter a lease. An embassy employee executed a letter of intent indicating the

embassy's willingness, upon fulfillment of certain conditions, to lease the apartments which Inversa was planning to construct. Although the project was never completed, Inversa claimed damages based on the letter of intent.

The question for the CBCA was whether the letter of intent constituted a valid procurement contract under the Contract Disputes Act. The Board examined the letter of intent under basic principles of contract law in order to determine whether the letter evidenced an unconditional offer and acceptance. First, the Board determined that the letter of intent "merely state[d] appellant's intention" to construct the apartments, and was thus not a valid unconditional offer. Second, with respect to the government's purported acceptance, the Board noted that the letter required fulfillment of certain future conditions and that it did not evidence a binding, unconditional acceptance. Specifically, the letter stated that the embassy "*will* lease and occupy apartments . . . *provided* there are no other adequate apartments available at the time" and that it was "*willing* to enter into a lease . . . *when*" approved drawings and permits became available. [Emphases added.] According to the CBCA, this language only showed that the agency would be willing to lease if those conditions were met in the future. This "conditional willingness" was not enough for the Board. In addition, the Board noted that the letter

of intent did not contain definite terms and conditions but only "indeterminate" dates for an "unknown number of apartments of unknown design, at undefined rental rates, with undefined rental periods" for a future project. In summary, the Board explained that the "letter of intent is simply too empty a vessel from which to conjure up a binding offer and acceptance" and the lack of essential terms and conditions was determinative. Based on this discussion, the Board refused to classify the letter of intent as a valid CDA procurement contract, and it dismissed the claim for lack of jurisdiction.

Finally, the Board noted that the embassy employee lacked statutory authority to execute a lease on behalf of the Department of State. As such, even if the Board classified the letter of intent as a CDA procurement contract, it would likely have invalidated it based upon this lack of authority.

By its decision in Inversa, the Board reminds contractors and agencies to be mindful of the basic principles of contract law. While the facts suggest the presence of a contract implied-in-fact, the ambiguities of the letter make clear that the parties did not set forth an unconditional offer and binding acceptance. Instead, they memorialized a mutual willingness to consider future actions upon the fulfillment of an array of conditions and "ifs."

Lessons On Filing Appeals at the Boards

In the past few months the ASBCA and CBCA have issued a few decisions that provide guidance to contractors on the filing of appeals.

The Fax Counts! – Time For Appeal Runs From Receipt

Time starts running on filing an appeal at the boards on the date that the contractor receives a fax notice of the contracting officer's final decision. In Commodity Solutions, LLC v. Dept. of Agriculture, CBCA 735 (October 2, 2007), the CBCA held that the contractor's appeal was untimely when it was filed more than 90 days after the date the contractor received the decision by fax. Under FAR 33.211(b), "any method which provides evidence of receipt of the decision is acceptable." The agency regulations did not restrict the CO from providing the final decision in any format, so the FAR prevailed and fax transmission was appropriate. [Contractors should also note that receipt by email would also start the 90-day clock.]

ASBCA Appeal Timely On Monday

The ASBCA recently held that a contractor may file its appeal on the first business day following the 90th day after receiving a final decision, when the 90th day falls on a Saturday, Sunday, or federal holiday. In DLT Solutions, Inc., ASBCA No. 55822 (August 30, 2007), the contractor received a final decision on December 11, 2006, meaning that 90 days from that date would be Sunday, March 11, 2007. The contractor filed its notice of appeal with the ASBCA on Monday, March 12, 2007. The Air Force moved to dismiss the appeal as untimely for not being filed within the 90-day period for appeal set by 41 USC § 606. The ASBCA found that its Rule 33(b) regarding the

computation of time limits allowed a contractor to file on the first business day following a Saturday, Sunday, or holiday. It rejected the Government's argument that this reading would impermissibly expand the statutory limit for filing.

CO Must Issue Decision or Give Date Certain For Response

The ASBCA confirmed that a contractor may consider its claim as "deemed denied" and file an appeal at the boards when the CO fails to respond within 60 days of filing of the claim and does not set a reasonable date certain for issuing a response under the extension provisions of the CDA. In Cubic Defense Applications, Inc., ASBCA No. 56097 (October 2, 2007), the CO did not issue a decision on the 60th day after receipt of the claim, but rather sent the contractor a letter stating that the agency "intended to respond approximately December 14, 2007." The contractor considered the letter a deemed denial and filed its appeal at the board. Contrary to the agency's arguments, the board found that the appeal was not premature because the CO did not respond within 60 days and did not "establish a fixed date on which his decision will be issued." The board found that the CO "hedged" and therefore did not comply with the extension provision of the CDA (41 USC § 605(c)(2)(B)). In the end, the board allowed the CO until December 14, 2007 – the same date offered originally by the CO - to issue its decision. What did the contractor gain then from filing? It may not have gained much, except that the CO's deadline for response is now subject to a board order. The contractor may have advanced the ball by filing with the board and requiring the CO to answer the claim or deal with the consequences from the board.

COFC Amends Rules for E-Discovery

On October 4, 2007, the United States Court of Federal Claims issued proposed rules changes that would officially incorporate rules regarding discovery of electronically stored information into the Court rules. Some judges on the court have already issued opinions stating that the Court will follow the new federal Rules of Civil Procedure relating to ESI discovery. *See* Roundup (Vol. III, No. 4)(April 2007) ("E-Discovery: COFC Directs Government to Preserve Electronic Information"). The proposed rules basically adopt the recent changes to the Federal Rules of Civil Procedure. A few highlights are provided below:

- At the Early Meeting of Counsel, the parties must discuss "issues relating to preserving discoverable information," issues relating to ESI discovery, and whether the parties will have an agreement that allows for claims of privilege and work product to be asserted after production. RCFC, Appx. A. The Early Meeting of Counsel occurs after the filing of the Answer and before the filing of the Joint Preliminary Status Report (due 49 days after the Answer).
- Under Rule 16, the Court shall issue a scheduling order after the filing of the JPSR that *may* discuss the discovery of ESI and agreements between the parties regarding assertions of privilege after production of privileged and work product documents. The court should issue the scheduling as "soon as practicable" after the filing of the JPSR.
- RCFC 26 now requires the initial disclosure of all "documents, electronically stored information, and tangible things" in the possession of the party. Initial disclosures are due within 14 days after the filing of the JPSR. RCFC 26.
- RCFC 26(b)(2) allows a party to refuse to provide discovery of ESI from "sources that the party identifies as not reasonably accessible because of undue burden or cost." The requesting party may still obtain access to the information based on good cause shown, and the court may "specify conditions" for the discovery.
- RCFC 26(b)(5)(B) allows for a party to seek the return of documents that are produced in discovery that are subject to a privilege or protection as "trial-preparation material." This "claw back" rule is not limited to ESI discovery.
- RCFC 33(d) (Interrogatories) now specifically references "electronically stored information" as a business record on which an interrogatory response can be based.
- RCFC 34 (Document Production) gives the requesting party the right to "test" or "sample" ESI. ESI includes "writings, drawings, graphs, charts, photographs, sound recordings, images, and other data or data compilations stored in any medium from which information can be obtained, translated, if necessary, by the respondent into reasonably usable form." A requesting party may specify in its discovery request the form in which ESI should be produced. In response to a discovery request, objections must include any objection to the requested form of ESI production. If a requester does not specify a form, then the respondent may produce documents in the form in which it is "ordinarily maintained" or "reasonably usable."
- RCFC 37(f) (Motions To Compel & Sanctions) provides an exception for the Court's ability to impose sanctions relating to ESI discovery. As in the Federal Rules, the court should not impose sanctions against "a party" for failing to provide ESI that was "lost as a result of the routine, good-faith operation of an electronic information system."

Upcoming Events

Changes, Modifications & Claims under U.S. Postal Service Contracts

November 8, 2007

Tysons Corner, VA

This advanced postal contracting seminar will benefit anyone who is responsible for managing, administering, or overseeing postal contracts. We describe the types of changes that inevitably arise during performance, and how contractors should react to them. You will learn about a little known implied right that exists in every postal contract and may be your only basis for recovery. Along the way, we identify 12 modification "gotchas" that can imperil your contractual rights. We set out the actions you should take to help prevent disputes from arising, as well as explain how best to resolve them through the claims preparation and resolution process. For more information, including the seminar brochure, visit www.akerman.com (click on "Events" and scroll down to November 8).

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The Government Contracts Group at Akerman Senterfitt Wickwire Gavin assists large and small businesses with all types of federal government contracts issues. To do business with the federal government, contractors must deal with a unique and complicated series of statutes, regulations and procedures. We help clients work with this system to maximize contracting opportunities with federal government agencies. We provide counseling and representation to clients in the areas of contract compliance issues, bid protests, Small and Disadvantaged Business matters, contractor and subcontractor claims administration, construction contracts, information technology contracts, and international contracts. In addition, we are uniquely qualified to advise and assist contractors who provide goods or services to the U.S. Postal Service.

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