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Federal Circuit Summaries
Court of Federal Claims Judicial Conference

1. Kingdomware Technologies, Inc. v. United States

The United States has long used government contracting rules to promote small businesses, including veteran-owned small businesses ("VOSBs") and service-disabled veteran-owned small businesses ("SDVOSBs"). As part of this policy, Congress enacted the Veterans Act of 2006, which requires the Secretary of the Department of Veterans Affairs ("VA") to establish a goal for each fiscal year for participation in VA contracts by VOSBs and SDVOSBs.

The Act, codified at 38 U.S.C. § 8127, provides several tools by which the VA can meet its annual goals. *Kingdomware Technologies*, *Inc. v. United States* revolves around the third of these tools—§ 8127(d), or, the "Rule of Two." The Rule of Two reads:

> [F]or purposes of meeting the goals under subsection (a) . . . a contracting officer of the [VA] shall award contracts on the basis of competition restricted to small business concerns owned and controlled by veterans if the contracting officer has a reasonable expectation that two [such businesses] will submit officers and that the award can be made at a fair and reasonable price that offers best value to the United States.

Since the statute's enactment, the VA has interpreted § 8127 to require a contracting officer to follow the Rule of Two only when the VA determines that such restrictive competition is necessary to achieve the annual veteran-owned small-business goals. When not required to achieve these goals, the VA may purchase immediately off the Federal Supply Schedule ("FSS"). In *Kingdomware*, the Federal Circuit rejected an assertion that the provision always requires the VA to apply Rule of Two analysis before purchasing off the FSS. The court held that the Department may continue its practice of using the FSS without first giving preference to VOSBs or SDVOSBs, so long as the VA is meeting its required percentages.

a. Case Background

Kingdomware arose in 2012, when the VA awarded a contract for Emergency Notification Services at several VA medical centers to a non-veteran-owned small business using the FSS. Kingdomware Technologies, Inc., a SDVOSB, protested to the Government Accountability Office ("GAO"), arguing that § 8127(d) made application of the Rule of Two mandatory in all procurements. The VA maintained its position that it only had to follow the Rule of Two as necessary to achieve the Secretary's small-business goals, and could otherwise purchase directly off the FSS. The GAO sided with Kingdomware and recommended that the VA cancel the contract. The VA determined; however, that it would not follow the GAO's recommendation. Consequently, Kingdomware filed suit in the Court of Federal Claims.

The Court of Federal Claims ultimately decided in favor of the VA, granting its cross-motion for summary judgment. With no facts in dispute, the case was argued and decided on the plain meaning of § 8127(d). Kingdomware asserted that the mandatory language ("shall award contracts on the basis of . . .") indicated that a contracting officer must always follow the Rule of Two before turning to the FSS. The VA contended; however, that this interpretation would read out the link between the set-aside requirement and the Secretary's VOSB and SDVOSB goals. "Shall," the VA reasoned, only compelled Rule of Two analysis where necessary to meet the participation benchmarks. The Court of Federal Claims agreed with the VA's reasoning and Kingdomware filed a timely notice of appeal.

b. The Federal Circuit's Decision

On June 3, 2014, the Federal Circuit released a 2-1 decision affirming the judgment of the Court of Federal Claims. After examining Congressional efforts to promote small businesses through government contracts, Judge Clevenger's decision turns to the 2006 Veterans Act itself. The decision notes that the VA has continuously and consistently interpreted § 8127 of the Act to not eliminate a contracting officer's authority to purchase from the FSS, and to grant flexibility in how the VA meets the secretary's goals. Following this practice, the VA has exceeded the Secretary's participation goals since the Act's implementation in 2008.

As in the court below, the decision came down to a question of statutory construction, which the Federal Circuit addressed under the *Chevron* standards. Judge Clevenger determined that, first, Congress did speak directly to the question of the VA's authority to use the Rule of Two. The language of the statute mandates that the Secretary "shall" use the Rule of Two procedures; however, Congress qualifies that mandate with "for the purpose of meeting the goals under subsection (a)." Judge Clevenger next looks at the opponents' two interpretations of the word "shall," before deciding that the language unambiguously supports the VA's reading.

Though Congress chose the term "shall" as opposed to the more permissive "may," the VA argued and the Federal Circuit agreed that making the Rule of Two mandatory would render the "for purposes of meeting the goals under subsection (a)" clause meaningless. In fact, by reading the Rule of Two as binding, the VA would negate any need for VOSB and SDVOSB goals in the first place. Participation would be determined exclusively the businesses' success under the Rule of Two regime as the VA would have to continue applying the set aside mandate even after meeting the goals of § 8127(a). Judge Clevenger decided that an interpretation reading out the link between Rule of Two application and the Secretary's goals could not stand.

The decision goes on to note that a mandatory Rule of Two in favor of VOSBs and SDVOSBs would undermine other VA small business contracting responsibilities, and would making routine VA contracting untenable. Congress hoped that the § 8127 tools would allow the VA to meet or exceed its contracting goals and it has done so under the VA's standing interpretation.

c. Importance of the Case

For veteran-owned small businesses, the Kingdomware case confirms what the VA's ongoing practices already demonstrate: veteran-owned status does not guarantee that a contract will be awarded according to restricted competition under the Rule of Two. While some have argued that the decision undermines Congress's longstanding goal of promoting VOSBs and SDVOSBs, the VA has consistently exceeded its SDVOSB goals. The Federal Circuit's decision may therefor settle the Rule of Two question in manner consistent with both small-business-friendly policy and practical VA contracting concerns.

2. **Kellogg Brown & Root Services, Inc. v. United States**

In *Kellog Brown & Root Servs., Inc. v. United States (KBR)*, the Federal Circuit considered a dispute over $41.1 million in costs incurred by KBR in providing dining services to the Army in Iraq. Specifically, it had to determine the reasonableness of KBR's expenses in the rapidly changing wartime environment in which they were incurred. The *KBR* decision additionally addressed the government's host of counterclaims against KBR and, in so doing, clarifies the False Claims Act ("FCA"), theories of common law fraud, and the Anti-kickback Act ("AKA").

a. Background

Prior to the United States' March 2003 invasion of Iraq, KBR formed a contract with the U.S. Army to provide dining services at a number of military bases. The contract was a cost-plus-award-fee agreement, under which the Army would reimburse KBR for all costs it incurred in performance, including payments to subcontractors. In August of 2003, KBR entered into a subcontract with Tamimi Global Co. regarding dining services at one of the bases—Camp Anaconda.

After auditing the facility several years later, the government refused to reimburse KBR for their requested $41.1 million. The government asserted that the costs for services provided between July and December of 2004 were unreasonable, and withheld payment.

KBR brought suit in the United States Court of Federal Claims, seeking to recover the disputed costs. The government maintained that the costs of were unreasonable and responded with multiple fraud counterclaims. The government's fraud claims all stemmed from kickbacks Tamimi's Vice President paid to two KBR employees between April 2003 and January of 2004. The government alleged that these kickbacks warranted forfeiture of KBR's claim for reimbursement under 28 U.S.C. § 2514, triggered liability under the FCA, and constituted common law fraud sufficient to make the subcontract with Tamimi *void ab initio*. The government additionally argued that the KBR should be liable for double penalties under the Anti-Kickback Act (AKA).

The Court of Federal Claims determined that KBR was entitled to only $11.46 million of the requested $41.1 million. The Court found in KBR's favor; however, regarding the majority of the government's fraud counterclaims and only awarded $38,000 to the government on its AKA allegations. $38,000 represented the actual amount of kickbacks received by KBR employees, and not the double penalties that the government sought.

Both parties appealed portions of the decision.

b. Decision of the Federal Circuit Regarding Cost Reasonableness

The Federal Circuit affirmed the Court of Federal Claims' decision regarding KBR's entitlement to only $11.46 million in reasonable costs. The Court stated that it will only overturn a cost reasonableness determination for clear error and will generally defer to the lower court in its fact-sensitive, context-specific inquiry into the reasonableness of a reimbursement request.

On appeal, neither party disputed that KBR was entitled to reimbursement of the 'reasonable' costs it had incurred during contract performance. The original contract between KBR and the Army incorporated FAR § 31.201-3, stating that a cost is reasonable if it does not exceed what a prudent person would incur in the conduct of competitive business. KBR maintained; however, that 'reasonableness' was properly understood to turn only on whether a contractor had given its best efforts in performance, absent gross misconduct, arbitrary action, or clear abuse of discretion.

The Court rejected KBR's proposed understanding of the legal standard for what constitutes a reasonable cost. Instead of focusing on the spending discretion allowed a contracting officer, the opinion focuses on the discretion provided to the reviewing court in evaluating the reasonableness of charges after-the-fact. The decision refuted KBR's position that it was entitled to a presumption for reimbursement, and emphasized that, under the FAR, it is the contractor's burden to prove the reasonableness of costs. After reviewing the lower court's detailed inquiry into the Camp Anaconda subcontract, Judge Wallach determined that the majority of its findings should stand.

The Federal Circuit did find error in the Court of Federal Claims's calculation of KBR's base fee. The lower court found KBR entitled to one percent of all 'reasonable' fee-bearing costs. The appellate disagreed; however, as the contract contemplated one percent of all fee-bearing costs claimed, not one percent of all fee-bearing claims that the court determined were reasonable. The Federal Circuit reversed and remanded this portion of the opinion with instructions to re-calculate.

c. *Decision of the Federal Circuit Regarding the Government's Fraud Counterclaims*

While the Federal Circuit did not adopt KBR's contractor-deferential standard for cost-reasonableness, it likewise rejected the majority of the government's aggressive fraud theories. The government attempted to pursuade the court that Tamimi's subcontract was void from inception under three separate counterclaims—28 U.S.C. § 2514, the FCA, and common law fraud. Writing for the three-judge panel, Judge Wallach affirmed dismissal on all three fronts.

Under 28 U.S.C. § 2514, also known as the Forfeiture Statute, any claim against the United States must be forfeited where the contractor knowingly submitted false claims with intent to defraud the government. The government asserted that this statute should apply as KBR submitted an invoice tainted with the fraud of the Tamimi kickbacks. The court; however, determined that this was an overly broad reading of the law. To properly plead the Forfeiture Statute, the government would have to prove fraud in the submission of a claim, not merely in the performance of the underlying contract.

The court similarly dismissed the government's FCA counterclaim as overly aggressive. To state a valid claim under the FCA, the pleading party must show that invoices submitted to the United States were themselves false or fraudulent. As with their § 2514 assertion, here the government claimed that KBR's submissions for reimbursement of Camp Anaconda costs were fraudulent because the subcontract was tainted by kickbacks. Rejecting the idea that this underlying performance defect could satisfy the pleading requirement that the invoices themselves be false, the Federal Circuit affirmed dismissal of the claim.

Finally, the court affirmed that KBR was not liable under the government's theory of common law fraud. The government argued that a kickback paid in the course of a contract's formation established common law fraud. While a contract tainted by fraud or wrongdoing is generally void from inception, the court reasoned that the fraud must be a but-for cause of the contract provision. The Federal Circuit accepted the lower court's finding that this link did not exist, as Tamimi would have been awarded the subcontract with or without kickbacks.

In affirming the Court of Federal Claims' dismissal of these three counterclaims, the Federal Circuit rejected the government's broad theory that kickbacks in KBR's subcontract with Tamimi could taint the entire contract and allow the government to refuse payment.

d. Decision of the Federal Circuit Regarding the Anti-Kickback Act

After rejecting the majority of the government's aggressive fraud counterclaims, the Federal Circuit considered its claims under the AKA. The AKA provides two possible civil remedies that the United States may seek from a entity involved in a kickback scheme. Under the first remedy, the United States is entitled to twice the amount of the kickback. This double penalty is limited by a strict scienter requirement: the person must knowingly engage in the prohibited conduct. The second available remedy requires no knowledge requirement, and thus sets recovery at the amount of the actual kickback.

The Court of Federal Claims found that the government was entitled to the amount of the kickbacks paid ($38,000), but held that it did not qualify for the double penalty. The lower court reasoned that, though the two KBR employees receiving payments did so knowingly, they were not senior enough to impute their knowledge on the corporation under vicarious liability.

The Federal Circuit reversed in a 2-1 decision, holding that KBR could be vicariously liable for its employees conduct, regardless of their sub-managerial status. The court reasoned that the relevant question was whether KBR received a benefit from the employees wrongdoing, which the Federal Circuit believed it had. Judge Newman dissented on this point, arguing that the majority's decision removed any scienter distinction between the AKA's available remedies and held KBR liable for knowledge that it did not actually have.

e. Importance of the Case

KBR provides the Federal Circuit's most in-depth example of an after-the-fact cost reasonableness determination. By emphasizing the discretion allowed a reviewing court, the decision may open the door to government auditors' second guessing costs incurred during performance of cost reimbursable contracts.

On the other hand, the Federal Circuit rejected the Department of Justice's aggressive theories of fraud. It appears that, going forward, a contract tainted by underlying misconduct will not necessarily allow the government to void an agreement entirely.

Finally, the decision clarifies the scope of the AKA, demonstrating that a company may be liable for twice the amount of a kickbacks paid to employees. Application of double penalties depends not on the seniority of personnel involved, but on whether the company ultimately received a benefit from wrongdoing.

3. <u>Veridyne Corporation v. United States</u>

The Small Business Administration's ("SBA") 8(a) program is designed to aid small, disadvantaged businesses by restricting competition for certain government contracts to SBA-certified entities. The SBA typically certifies qualified businesses for a nine-year term, after which they "graduate" and become ineligible for the set-aside contracts. In *Veridyne Corporation v. United States* a company approaching its nine-year graduation date mislead the SBA in an attempt to renew a contract prior to disqualification. In examining Veridyne's conduct and the contract dispute that ensued, the Federal Circuit clarified the extent to which fraud taints the formation of a contract and prevents a government contractor from later recovering the value of services performed.

a. Background

To administer the 8(a) program, the SBA contracts with federal agencies, then subcontracts the actual performance to SBA-certified small businesses. In the mid-1990s, the SBA won a contract with the maritime division of the Department of Transportation ("MARAD"), then subcontracted the services to Veridyne Corporation. For several years Veridyne performed to MARAD's satisfaction, and in late 1997 or early 1998 sought to extend the contract. Veridyne's certification with the SBA was set to expire in June 1998, consequently, if the contract was not resigned within several months, Veridyne would be ineligible.

The 8(a) program allowed MARAD to grant Veridyne the extension as a sole-source contract if the new contract award price was below $3 million. If the proposed cost exceeded $3 million, the contract had to be awarded through open competition among SBA-certified businesses. This open competition could not be completed before Veridyne's June 1998 de-certification date.

Veridyne knew that the contract would far exceed the SBA's $3 million limit. The company; however, certified and submitted a proposal estimating that the new contract would not exceed that amount. The lower court made a factual finding that MARAD similarly knew that the proposed amount was merely a pretext, aimed at ensuring that the contract went to Veridyne without competition and before their SBA certification expired.

Noticing significant cost overruns, the Department of Transportation Inspector General began investigating Veridyne's contract in July of 2003. After concluding that the award was obtained through fraud, the Inspector General canceled the contract. Attempting to recover on outstanding invoices, Veridyne filed a complaint in the Court of Federal Claims in 2006. The government filed counterclaims for fraudulent billing.

The Court of Federal Claims found Veridyne's claims forfeit under 28 U.S.C. § 2514, but awarded the company $1 million on the equitable theory of *quantum meruit*. The lower court then awarded almost $2 million in penalties to the government on its False Claims Act (FCA) and Contract Dispute Act ("CDA") counterclaims.

The government appealed the *quantum meruit* award and Veridyne appealed the imposition of FCA and CDA penalties.

b. The Federal Circuit's Decision

The Federal Circuit decided all issues in favor of the government. First, the court addressed the lower court's *quantum meruit* award. The government argued that Veridyne should not have recovered the fair value of services rendered when its claim had been forfeited under the Forfeiture Statute (28 U.S.C. § 2514). Writing for a unanimous panel, Judge Dyk examined the legislative history of § 2514, noting that Congress intended the provision to convey that any attempt at fraud tainted a claim to the point of forfeiture, regardless of equity. The Federal Circuit found that caselaw could not support Veridyne's contention that *quantum meruit* was available even where the Forfeiture Statute applied, and consequently reversed the $1 million award.

Next, the opinion turned to the government's FCA claim. Veridyne argued that it was not liable because the $3 million figure was an estimate and was never intended to reflect actual needs. The Federal Circuit disagreed; however, emphasizing that Veridyne had certified its proposal as accurate, complete, and current, in spite of the misrepresentation. Similarly, Judge Dyk was unconvinced by Veridyne's argument that it did not have the requisite intent to defraud MARAD. Regardless of MARAD's complicity, the contract was with the SBA, which did not have knowledge of the misrepresentation. Finally, the court found that, though each invoice did not contain false statement, the contract was obtained through fraud and each invoice was tainted as a result. Consequently the Federal Circuit affirmed the lower court's finding that Veridyne could be held liable for all 127 invoices at issue under the FCA.

The Federal Circuit also affirmed the Court of Federal Claims' determination that Veridyne was liable under the CDA. It held that the same false act could be a source of liability under both the CDA and the FCA, and found that Veridyne's invoicing was sufficiently misleading to violate the CDA.

In sum, the Federal Circuit reversed the lower court on Veridyne's *quantum meruit* theory, but affirmed both penalties awarded to the government.

c. Importance of the Case

Veridyne demonstrates the extent to which using fraudulent means to win a government contract will preclude later attempts at recovery. The decision wholly favored the government and reinforces the strong deterrent policy behind the Forfeiture Statute. Even where principles of equity might otherwise apply, a violation of 28 U.S.C. § 2514 will prevent recovery.