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Ulysses And The Government Knowledge Defense

Law360, New York (May 28, 2013, 12:54 PM ET) -- In the recent case of Ulysses Inc. v. United States, Case No. 06–436C, ––– Fed.Cl. ––– (2013), the Court of Federal Claims applied the so-called government knowledge defense to reject fraud-based counterclaims brought by the government in response to a contractor's claim for improper cancellation of two orders.

While the COFC's appellate court, the Federal Circuit, has not spoken on the government knowledge defense, the COFC in Ulysses applied a version of the defense that focuses not on a quasi-estoppel theory of government waiver by consent, but rather on the critical issue of scienter under the relevant fraud statutes — i.e., can a contractor ever be said to "knowingly" deceive its government counterpart when the contractor knows the government is aware of the relevant facts?

This distinction is important, because under the COFC's approach, a contractor can succeed in a government knowledge defense without showing that the government approved or acquiesced in the contractor's assertion of the facts. Indeed, it is clear in Ulysses that the government did not agree with the contractor on the underlying facts.

Ulysses, the contractor, was issued two purchase orders for printed circuit cards, designated as P/N 178AS112 (the 112 Part). Id. at *1. Ulysses bid for these orders with the intention of manufacturing the 112 part itself, believing that it was an approved manufacturer for the 112 Part, because it had already been approved under another government contract to manufacture and deliver a more complex device in which the 112 part was a subcomponent. Id. at *2-3. According to the government, however, Ulysses was not approved to manufacture the 112 part, and the two purchase orders were for the procurement of parts manufactured only by approved third parties. Id. at *1-3.

Ulysses applied for and was awarded the first order through the online acquisition system operated by the Defense Logistics Agency. The order issued by the DLA contained a clear statement that the order was for provision of a part manufactured by another contractor. Ulysses submitted its second offer to the DLA by fax, proposing the part by P/N number only and making no mention of any other manufacturer. In the return confirmation for the second order, the DLA inserted the name of a specific part manufacturer without including any context to explain why the name had been included. Id. at 3-9.

Immediately after the orders were issued, Ulysses began manufacturing circuit cards. Ulysses freely disclosed to the government that it was manufacturing the parts itself and had no intention of delivering third party parts. Throughout the active period of the orders, through the discussions over termination, and throughout the litigation over the claim, Ulysses' CEO insisted without variation that Ulysses was an approved manufacturer of the 112 part because the company was an approved manufacturer of a more complex assembly in which the 112 part was included. The DLA offered to work with Ulysses to obtain the required approval, but the agency never agreed with Ulysses' position, and

consistently rejected Ulysses' theory of its own status.

When Ulysses would not take additional steps to gain the required approval for the 112 part, the DLA terminated both orders for default. Ulysses filed a claim for wrongful termination costs arising from both orders. The government filed fraud counterclaims under the False Claims Act, the antifraud provisions of the Contract Disputes Act, and the Forfeiture of Fraudulent Claims Act, alleging that Ulysses had knowingly submitted its offers and its instant claim for the two orders knowing that it was not approved for manufacture, and knowing that the orders were for parts to be obtained from third parties, and not manufactured by Ulysses.

The COFC's disposition of the wrongful termination claims was predictable. The court reasonably found that in the first order, where the order had disclosed the DLA's intent to purchase only the specified manufacturer's part, the DLA had a right to terminate the contract due to Ulysses' refusal to provide the third-party part. Id. at *15-17. For the second order, however, where Ulysses had never agreed to any language specifying a third party item, the DLA did not have the right to terminate the contract. Id. at 17-19.

As noted above, Ulysses is significant for its application of the so-called government knowledge defense to reject the government's fraud counterclaims. The government's counterclaims alleged that Ulysses knowingly submitted both its original proposals and its CDA claim with full knowledge that the DLA expected Ulysses to provide parts from other manufacturers. Further, the government alleged that Ulysses was aware that it did not qualify as an approved manufacturer of the part when it submitted its proposal, and that both the offers and Ulysses' CDA claim were fraudulent.

The COFC rejected these claims based on the so-called "Government knowledge defense." Id. at 24-26. Under this doctrine, if a company that is the target of an FCA or other procurement fraud claim can show that the government was aware of the fact that is the ostensible basis for the fraud, then the company cannot be found liable for fraud. As the court stated in Ulysses:

> The Government knew that Ulysses had not gone through the Source Approval Request process because Ulysses told it so. Further, Ulysses persisted in arguing that it should not have had to undergo this process because it had already manufactured the 112 Part for the Government as a component of a larger part. Ulysses' effort to have the Government test its 112 Part is further evidence that it believed it deserved to be an approved source in its own right—not that it was attempting to pass off its product as a Raytheon or Frequency part. Ulysses told the Government the truth about its status, making this a classic case for application of the Government knowledge defense.

Id. at 26. In characterizing the Ulysses facts as "a classic case" for application of the government knowledge defense, the COFC noted that the Federal Circuit (which hears appeals from the COFC) has not yet spoken on the defense. To support its application of the defense, the COFC cited multiple U.S. circuit court of appeals decisions. Of particular interest, however, is the fact that, in contrast to the facts in the Ulysses case, the great majority of the circuit cases cited by the COFC arise from cases where the government party either directed, or knowingly acquiesced, in the purportedly fraudulent behavior of the submitter.

In these cases, the courts either cite facts suggesting government consent, or even directly reference government acquiescence in their definition of the defense itself. See Ulysses, at *24, citing United States ex rel. Becker v. Westinghouse Savannah River Co., 305 F.3d 284, 289 (4th Cir.2002) ("We decline to hold [defendant] liable for defrauding the government by following the government's explicit directions … evidence suggests that the defendant actually believed his claim was not false because the government approved

and paid the claim with full knowledge of the relevant facts."); Shaw v. AAA Eng'g & Drafting Inc., 213 F.3d 519, 534 (10th Cir. 2000) (declining to apply the defense where evidence showed government had no knowledge of photography contractor's breaches of contract and falsification of work reports, but noting that it would apply where "defendant and the [government] had so completely cooperated and shared all information...that defendant did not 'knowingly' submit false claims."); United States ex rel. Durcholz v. FKW Inc., 189 F.3d 542, 544–45 (7th Cir.1999) (action about which contractor supposedly lied — submitting a bill under an available excavation line-item when actual work was for dredging — was taken at explicit direction of the government); United States ex rel. Kreindler & Kreindler v. United Techs. Corp., 985 F.2d 1148, 1157 (2d Cir.1993) (holding that the defense may be reserved to cases where the government's knowledge amounts to a course of dealing: "That the relevant government officials know of the falsity is not in itself a defense ... [however,] In some cases, the fact that government officials knew of the contractor's actions may show that the contract has been modified or that its intent has been clarified, and therefore that the claim submitted by the contractor was not false."); United States ex rel. Hagood v. Sonoma Cnty. Water Agency, 929 F.2d 1416, 1421 (9th Cir.1991) (government knowledge alone is not a defense, but the defense could be established at summary judgment if submitter could show that it "did merely what the Corps bid it do.").

These cases are broadly consistent with more recent statements from these and other circuits. In the more recent Tenth Circuit case of U.S. ex rel. Burlbaw v. Orenduff, 548 F.3d 931 (10th Cir. 2008) (not cited in Ulysses), the court explicitly identifies government approval as an element of the "government knowledge inference," stating that "[t]his inference arises when the government knows and approves of the facts underlying an allegedly false claim prior to presentment." Id. at 952.

The court in Ulysses did not cite the Fifth Circuit in its list, despite that court's application of the government knowledge defense in U.S. v. Southland Management Corp., 326 F.3d 669 (5th Cir. 2003) (en banc). In Southland Management, the government alleged that a contractor's claims for managing of U.S. Department of Housing and Urban Development properties were fraudulent where the properties had not been maintained in conformity with the contract standards.

The court found that the government was fully aware of the conditions at the properties, and had acceded to the contractor billing despite the conditions. The court found that these facts made it impossible to say that the defendant was seeking "knowingly" to defraud: "Where the government and a contractor have been working together, albeit outside the written provisions of the contract, to reach a common solution to a problem, no claim arises. ... The government's knowledge and acquiescence in its contractor's actions in many of these cases was highly relevant." Id. at 682.

The manner in which these cases appear to require government consent, as opposed to merely knowledge, tends to undermine the original basis of the government knowledge defense as relevant to the strict application of the scienter requirement in the statute, which is concerned only with the state of mind of the alleged submitter.

In Ulysses, however, the court states the doctrine in a form that is concerned only with the impossibility of charging a party with knowing deception where there is no possible intention to deceive, i.e., where the speaker knows that the listener is aware of the truth. The COFC in Ulysses quotes a stripped-down version stated by the Fouth Circuit in United States ex rel. Ubl v. IIF Data Solutions, 650 F.3d 445 (4th Cir.2011) cert. denied, ––– U.S. –––, 132 S.Ct. 526, 181 L.Ed.2d 352 (2011):

> Evidence that the government knew about the facts underlying an allegedly false claim can serve to distinguish between the knowing submission of a false claim, which generally is actionable under the FCA, and the submission of a claim that

> turned out to be incorrect, which generally is not actionable under the FCA. That is, 'the government's knowledge of the facts underlying an allegedly false record or statement can negate the scienter required for an FCA violation.'

Id. at 452.

This version of the defense does not arise from a quasi-estoppel theory, whereby the government cannot bring suit to punish actions in which it was complicit. Rather, the COFC engaged in fact-finding directed towards determining the actual state of knowledge of the parties during the supposedly fraudulent conduct. The COFC noted that, while the government sought to wave away the Ulysses CEO's position as "tortured and implausible" and "after the fact," the record showed that "the Government was well aware of Plaintiff's position that it was going to manufacture the parts itself ... throughout the parties' course of dealing." Ulysses. at *25. The court concluded that the government could not simply ignore the contractor's persistent candor about its position, regardless of whether the position was wrong.

Under this reading of the government knowledge defense, the true significance of the government's knowledge is not as a signal of consent, but as a factor weighing against establishing the required element of scienter under the statute. In Ulysses, the government was not complicit in, and never accepted, Ulysses' belief that it was an approved source for the disputed part. But, critically, neither did Ulysses hide from the government its belief that it was an approved manufacturer, or the basis for this belief, however misguided. A contractor cannot be said to "knowingly" deceive the government when the contractor is sure that the government knows the underlying facts.

It remains to be seen if the government plans to appeal the Ulysses ruling. Moreover, whether on this case or another, legal observers will be watching the Federal Circuit to see how it eventually treats the government knowledge defense. The case is interesting, however, because in many cases, the disputes underlying claims filed by contractors are disputes of long standing, with long histories of documented disagreement. Under such circumstances, contractors and their counsel would be well advised to heed the facts of Ulysses, and consider the value of consistency, and transparent disclosures to the government, even in the absence of government acquiescence.

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