

Stradley Ronon Stevens & Young, LLP
2005 Market Street
Suite 2600
Philadelphia, PA 19103-7018
215.564.8000 Telephone
215.564.8120 Facsimile
www.stradley.com

With other offices in:
Washington, D.C.
New York
New Jersey
Illinois
Delaware



www.meritas.org

Our firm is a member of Meritas – a worldwide business alliance of more than 180 law offices in 86 countries, offering high-quality legal services through a closely integrated group of independent, full-service law firms.

Information contained in this publication should not be construed as legal advice or opinion or as a substitute for the advice of counsel. The enclosed materials may have been abridged from other sources. They are provided for educational and informational purposes for the use of clients and others who may be interested in the subject matter.

Copyright © 2017
Stradley Ronon Stevens & Young, LLP
All rights reserved.

Surety Liability Under the False Claims Act

by Patrick R. Kingsley

The United States District Court for the District of Columbia recently ruled that sureties could be liable under the False Claims Act for issuing surety bonds to construction companies involved in fraudulent schemes on federal projects. U.S. ex rel. Scollick v. Narula, et al., 2007 WL 3268857 (D.D.C. July 31, 2017).

In Scollick, the plaintiff brought an action alleging that a group of individuals and entities falsely presented themselves as a service-disabled veteran-owned small business (SDVOSB) and advertised a false history of past construction experience. Plaintiff also sued the sureties and their brokers. The original complaint alleged that the surety defendants knew that their co-defendants shared a single office space and that individuals other than the service-disabled veterans were in control of the fronting company. The court initially dismissed these claims because the allegations failed to show that the surety defendants “envisioned” the fraudulent scheme and did not show that they knowingly agreed to bonding in furtherance of that scheme.

Plaintiff sought leave to amend, and the surety defendants opposed on the grounds of futility. The amended complaint added allegations that the sureties and their brokers knew or should have known that the co-defendants violated the government’s contractor requirements, concealed these facts and issued surety bonds which gave the “misleading appearance” that their co-defendants were qualified to bid on these SDVOSB construction contracts. The amended complaint also added the allegation that, during the underwriting process, an on-site tour of the co-defendants’ offices was conducted that necessarily revealed the fraudulent scheme. According to the amended complaint, the surety defendants nevertheless continued to do business with their co-defendants even after becoming aware that they were submitting false claims. For the court, this was enough to support an “indirect” presentment claim under the False Claims Act.

The court also concluded that there was a “reverse” False Claims Act cause of action. (A “reverse” claim occurs where the defendant knowingly makes a false statement in order to avoid having to pay the government where payment is otherwise due.) The court reasoned as follows: The sureties agreed to compensate the government for losses sustained if the contract specifications were violated, including the specifications that construction activity would be paid only to an SDVOSB entity. Yet each time the sureties knew the government made a payment to their co-defendants who were violating the SDVOSB specification, they knowingly avoided an obligation to compensate the government for that loss. Hence, a “reverse” False Claims Act cause of action was pled.

It is worth noting that the sureties were not found to be liable under the False Claims Act in this decision, merely potentially liable under the facts alleged. The court’s threshold for evaluation of the claim was low: Was the proposed pleading “futile”? Nevertheless, potential False Claims Act liability comes with potential liability for treble damages and civil penalties. Therefore, the decision represents a significant new expansion of False Claims Act liability that will undoubtedly be used by whistleblowers, bond obligees and, perhaps, the federal government in the future.