MAKING THE BEST OF A BAD SITUATION
WHERE AND HOW CONTRACTORS CAN FIND INSURANCE COVERAGE FOR CIVIL VIOLATIONS OF THE FALSE CLAIMS ACT

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The False Claims Act (FCA) makes it unlawful to present a “false or fraudulent” claim for government reimbursement.

- “Factually” false claims
- “Legally” false claims
False Claims Act (FCA)

- Penalties of $5,500 to $11,000 per each false claim
- Actual damages
- Trebling of damages
- Many FCA cases are brought by private individuals, known as qui tam relators.
  - Qui tam relators receive a share of the proceeds of any recovery. 25% to 30% if government does not intervene.
Number of Qui Tam Actions

<table>
<thead>
<tr>
<th>Year</th>
<th>Number</th>
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<tr>
<td>FY 1987</td>
<td>30</td>
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<td>FY 2015</td>
<td>638</td>
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FY 2015

• DOJ recovered >$3.5 billion
  • Qui tam cases – $2.8 billion
    • $597 million to relators
  • Government contracts, settlements and judgments in cases alleging false claims – $1.1 billion
FY 2015:

- Total Amount Recovered by DOJ: > $3.5 billion
- Amount Recovered in Qui Tam Cases: $2.8 billion
- Amount Recovered by Relators: $597 million
- Govt Contracts, Settlements and Judgments in Cases Alleging False Claims: $1.1 billion

Government Contracts, Settlements and Judgments in Cases Alleging False Claims: $2.8 billion
False Claims Act (FCA)

- The insurance industry has yet to issue any policies specifically to provide defense or indemnity for civil violations of the FCA.

- However, depending on the circumstances, contractors may find possible coverage under one or more of the four types of policies routinely purchased:

  1. Professional Liability (E&O)
  2. Directors and Officers Liability (D&O)
  3. Commercial General Liability (CGL)
  4. Employment Practices Liability (EPL)
Errors & Omissions Insurance Policies

- Many FCA claims arise with billing the government.

- Monthly payment requisitions require the following certification:

  “The amounts requested are only for performance in accordance with specifications, terms, and conditions of the contract.”

  FAR 52.232
E&O Policies

• E&O policies and FCA cases focus on the insuring agreement that the act must arise from providing “professional services.”

• The issue is whether the billing and associated documentation is the rendering of professional services.
E&O Policies

- The majority of cases (FCA and non-FCA) hold that simply billing does not qualify as the rendering of professional services.
  - These cases turn on how the policy defines professional services.
    - Typically, professional services are narrowly defined.
  - The billing of the government is often deemed to be a simple administrative task.
E&O Policies

• The minority of cases finding some duty to defend or indemnification have a broader insuring provision and a broader definition of professional services

  • Violation of prevailing wage law on community college in CA (WA law). Subcontractors scheme had employees return checks. Bayley submitted monthly billings - part of its “core” professional duties.
• The government and qui tam relators can also name individuals who are officers, directors, and managers.

• However, not to be overlooked is coverage for the entity.

• From the few cases reported on this issue, it does not appear the carriers are disputing potential coverage for FCA claims.
D&O Policies

1. The Insuring Clause

- Carolina Casualty Ins. Co. v. Omeros Corp.
  - False reporting to the National Institute of Health. Defended solely on “single claim” clause.
- Community Health Center of Buffalo v. RSUI Indemnity Co.
  - Defended on “single claim” clause only.
2. The “Claim” Requirement

- Protective Strategies v. Starr Indemnity
  - 8(a) contractor. Received search warrant from NASA OIG. Also received a letter from the AUSA in VA.
  - Definition of a claim met ("any written demand for monetary, non-monetary, or injunctive relief")
3. **Other D&O Issues**

- Damages
- Negligence or recklessness (as opposed to intentional conduct)
- Fraud and Ill-Gotten Gains Exclusion
- Known Prior Claims Exclusion
Commercial General Liability Policies

• CGL polices are one of the foremost means of risk management for the construction industry.

• CGL general covers property damage and bodily injury liability to third parties.

• FCA claims do not often allege personal injury or property damage.
CGL Policies

• An FCA claim can arise from billing for goods or services alleged to be defective, which could qualify as property damage under a CGL policy.

  • A construction defect claim couched as an FCA claim may implicate the CGL policy.

  • The duty to defend is broader than the duty to indemnify.
CGL Policies

• For now, the published cases do not support CGL coverage for FCA claims.
  
  • XL Specialty Ins. Co. v. Bollinger Shipyards, Inc.
    • False claim not property damage.
  
  • Health Care Industry Liab. Ins. Program v. United States
    • False claim not property damage.
CGL Policies

• The typical CGL policy covers the insured (and additional insured) for “damages because of property damage.”
  
  • These can include consequential damages in discussions of insurance coverage.
  
  • A number of published cases (not FCA cases) allow coverage for consequential damages that “property damage” has caused.
  
CGL Policies

- In FCA cases, the government or the qui tam relator may allege a common law claim for property damages.
- Where the duty to defend is at issue, even an ambiguous allegation against the insured could trigger the duty to defend.
CGL Policies

- Unique CGL exclusions in FCA coverage:
  - Incorrectly Performed Work
  - Product Recall
Employment Practices Liability Policies

- Many FCA qui tam relators are current or former employees.

- The FCA imposes liability for retaliatory behavior against whistle-blowing employees.

- In general, EPL policy coverage for qui tam retaliation claims is available.
EPL Policies

- **Gallup, Inc. v. Greenwich Ins. Co.**
  - A combined E&O and EPL policy. Coverage for the retaliation claim.

- **Carolina Cas. Ins. Co. v. Omeros**
  - Full coverage and defense for employment related FCA claim.
EPL Policies

• EPL policies typically include “retaliation” as a “wrongful employment act” which is expressly a covered risk.

• EPL policies generally provide coverage for FCA-related retaliation claims.
The FCA has civil penalties, in addition to the recovery by the government of actual damages (trebled).

Are civil penalties “damages” for purposes of coverage?

- Travelers Ins. Co. v. Waltham Indus. Laboratories
  - Non-FCA case – No coverage.
- Government Interinsurance v. City of Angola
  - Non-FCA case – Coverage.
- Hercules, Inc. v. AIG Aviation
  - Maybe coverage – Dicta.
Negligence v. Intentional Acts

- Most policies require the action from which liability arises to be not intentional
  - Accident
  - Negligent act
  - Non-volitional
Negligence v. Intentional Acts

• The FCA requires a claim to be made “knowingly:”
  • “Actual knowledge”
  • “Deliberate ignorance of the truth or falsity”
  • “Reckless disregard of the truth or falsity”
• No requirement of any specific intent to defraud.
Negligence v. Intentional Acts

• Disconnect between an intentional act for which coverage may be barred, and an act triggering liability under the FCA.
  • Pacific Ins. Co. v. Burnet Title, Inc.
    • Negligent false statement not “dishonesty.”
Dishonesty

• “Dishonesty” exclusion

• FCA does not require an intentional lie to trigger liability.

• Certain Underwriters at Lloyds v. Huron Consulting
  • Reckless disregard is extension of gross negligence – an extreme version of ordinary negligence.
Fines, Penalties, and Exemplary Damages

- Typically, policies exclude fines, penalties, awards of punitive damages or any amounts in excess of compensatory damages.
  - Pacific Ins. Co. v. Burnet Title, Inc.
  - Nowacki v. Federated Realty Group
- The penalty and treble damages in the FCA are not fines and penalties in the traditional insurance sense - designed as a way to make the government whole, rather than as a deterrent.
**Fraud and ILL-Gotten Gains**

- This exclusion is not necessarily a bar to defense.
- Usually applies only after a “final adjudication.”
  - Insurer then has a claim to recoup previously paid defense costs.
- If there is no such final adjudication, the exclusion does not apply.
  - U.S. Bank National Ass’n. v. Indian Harbor Insurance
Governmental Action

• Some policies exclude damages in connection with a claim brought by or on behalf of a governmental entity.
  - XL Spec. Inc. v. Bollinger Shipyards
    - Coverage denied under LA law.
  - Huron Consulting
    - Government is real party in interest in qui tam litigation.
Known Prior Claims

• Prior to the "incept" date, policies may bar coverage for actual knowledge that a reasonable insured would think might give rise to a claim.

  • Protective Strategies v. Starr Indemnity

  • Management insureds pled guilty. Barred coverage as insureds in plea agreement stated facts of prior acts.
Professional Services Exclusion

• A CGL policy, for example, excludes loss arising from performance or failure to perform professional services.

• This exclusion, as previously mentioned, usually arises in connection with an FCA claim for billings (invoices).
  
  • Gallup, Inc. v. Greenwich
Duty to Defend

• The insurer’s duty to defend is broader than the duty to indemnify and is often easily triggered.
  • If even a small component of the claim is covered, the insurer must defend the entirety.
  • Review the entire allegations.
  • No cost to tender.
Duty to Defend

• Recent studies indicate at least half the outlays in FCA litigation are defense costs.

• Even if the exclusions eliminate coverage for the bulk of the FCA allegations, some components of the overall claim may not be eliminated.

• Therefore, there may be resources to deal with at least half of the financial impact.
Conclusion

• Insurance coverage for FCA claims is still evolving.

• No insurance product exists for the specific risk of civil FCA claims.

• However, the standard policies obtained by most entities in the construction industry can provide either some coverage and, more importantly, defense to FCA claims.
Conclusion

• The FCA is a complicated statutory scheme.
• Insurance primarily deals with common law claims.
• This means state law.
• Some jurisdictions are historically more favorable to either an insured or an insurer.
Conclusion

- Some policies (CGL), generally contain standard language (ISO).
- Other policies (E&O), are much more likely to be similar, but are manuscript policies which differ among insurers.
- Any coverage analysis is highly dependent on the specific language of the policy.
Conclusion

• Given the high stakes and cost, any time FCA claims are made, the relevant policies should be examined and compared to the very specific claims alleged.

• The modest cost of this analysis can provide substantial financial benefits.
QUESTIONS?
RONALD G. ROBEY attended Centre College in Danville, Kentucky, as a National Merit Scholar. He graduated with high distinction in the Honors Program at the University of Kentucky with a B.A. in 1974. In 1977, Ron graduated from the University of Kentucky College of Law where he was Lead Articles Editor of the University of Kentucky Law Journal, was Order of the Coif at graduation and received special awards in Constitutional Law and in Torts.

Ron joined Smith, Currie & Hancock LLP in 1977 and has practiced exclusively in the areas of construction law, insurance and government contracts since that time. He is admitted to the Bars of the States of Georgia, Florida, Kentucky, Michigan, New York, and Nevada, and is admitted to numerous Federal Courts. He is a member of the ABA Forum on Construction Law and the Public Contract Law Section.

Ron has negotiated and drafted hundreds of construction contracts. Also, he has handled construction and insurance disputes, from small lien claims to over $100 million claims. The projects have included high rise condominiums, hospitals, wastewater treatment plants, prisons, casinos, highways, airports, manufacturing facilities, locks and dams, steel plants, superfund sites, power plants, office buildings, and federal government facilities. His federal government contract experiences include claims and projects involving the Corps of Engineers, Navy, Air Force, Veteran's Administration, and the FAA. He has extensive experience with small and disadvantaged business issues in the federal and state procurement systems. He also has experience with false claims in federal and in state procurement.

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SCOTT C. TURNER is of counsel in the Washington, DC and San Francisco, California offices of Smith, Currie & Hancock LLP. Scott is one of the foremost attorneys nationally on the subject of insurance recovery for policy holders in the construction industry. He is the author of the leading legal treatise on that subject, the two volume, 1,700 page "Insurance Coverage of Construction Disputes (2nd ed.)," published by Thomson Reuters West. This treatise is frequently relied upon, cited, and quoted in important, pro-coverage, appellate law decisions bearing on construction insurance. This most recently occurred in Capital City Real Estate, LLC v. Certain Underwriters at Lloyds London, 788 F.3d 375 (4th Cir. 2015).

Scott's practice centers on insurance coverage of project owners, developers, general contractors, subcontractors of every tier, manufacturers, design professionals, and construction managers on significant commercial, residential, industrial and public works construction projects. He has more than twenty years of experience securing insurance recoveries for property losses and in securing defense and indemnification for liability resulting from construction disputes and defects.

Scott was instrumental in securing the California Supreme Court’s landmark decision in Vandenburg v. Superior Court, holding that CGL policies can cover liabilities in contract as well as in tort.