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On May 16, 2022, the US Court of Appeals for the Sixth Circuit held that a plaintiff-relator adequately pled False Claims Act (FCA) violations based on a defendant’s alleged inflation of labor cost estimates when negotiating a firm-fixed-price contract with NASA—even though NASA’s payments were based on the contract prices, not the estimates.

In United States ex rel. USN4U, LLC v. Wolf Creek Federal Services, Inc., 2022 WL 1531966, --- F.4th --- (6th Cir. 2022), the relator alleged that Wolf Creek Federal Services and several of its employees submitted falsely inflated project estimates to NASA for facilities maintenance projects, resulting in fraudulently induced,
exorbitant contract prices.

According to the complaint, when NASA wanted Wolf Creek to complete a maintenance project, it required Wolf Creek to submit a proposal setting forth the schedule of the project and the proposed total cost (including labor hours, material costs, equipment costs, and markups). NASA then reviewed the proposal and could negotiate a final price and schedule before awarding a firm-fixed-price contract.

Under the Federal Acquisition Regulations (FAR), a “firm-fixed-price contract provides for a price that is not subject to any adjustment on the basis of the contractor’s cost experience in performing the contract.” 48 CFR § 16.202-1. FAR recognizes that this type of contract places “maximum risk” on the contractor for the “costs and resulting profit or loss,” with the aim of incentivizing “the contractor to control costs and perform effectively,” while decreasing the administrative burden on the contracting parties.

The relator alleged that, although Wolf Creek sought payments in amounts matching the firm-fixed prices that NASA agreed to in the contracts, NASA agreed to the contract prices based on fraudulently inflated estimates regarding the labor and costs of the work to be done.

The district court dismissed the complaint, holding that the work order proposals Wolf Creek submitted to NASA were not “claims” under the FCA, and were merely estimates. The district court further held that the relator failed to plead falsity, because its inflation allegations were based only on comparisons to industry standards. And it held that the relator failed to plead that the allegedly false proposals were material, because NASA continued to contract with Wolf Creek after learning of the fraud allegations, and the government declined to intervene in the relator’s *qui tam* case. The relator appealed.

On appeal, the Sixth Circuit reversed the district court’s dismissal. In an opinion authored by Judge Rogers, the court held that a company could be subject to FCA liability for using false cost estimates to induce the government to enter into a contract. The court went on to hold that the complaint adequately alleged falsity, scienter, materiality, and causation under Rules 9(b) and 12(b)(6). The court reasoned that the defendant adequately alleged that Wolf Creek deliberately inflated work hours in its proposals that far exceeded industry standards. And it held that the complaint adequately alleged materiality and causation, because NASA could have relied on Wolf Creek’s estimates to determine price reasonableness for the task orders.

In rejecting the defendant’s materiality arguments, the court also held that NASA’s continued work with Wolf Creek after learning of the allegations was not dispositive of a lack of materiality, particularly where the alleged falsity related to pricing, which is “the very essence of the bargain,” and not regulatory non-compliance. The court further held that “the Government’s decision not to intervene in a particular FCA case does not imply that the claim is not material,” as the FCA embraces the reality that the government does not have sufficient resources to pursue every case. The court therefore reinstated the complaint and remanded the case back to the district court.
Notably, Judge Murphy penned a concurring opinion that emphasized the narrowness of the majority’s opinion and cast doubt about whether the relator could prevail on remand. Judge Murphy noted that the “work-order estimates look a lot like statements of opinion rather than of fact,” since they were beliefs about future labor costs, which might undermine the argument that the estimates were false or that NASA could rely on them. He noted that an opinion is not false under the FCA simply because it does not pan out, and an opinion is only false if the defendant does not actually hold the opinion. Because neither party raised these issues, however, Judge Murphy stated that he took “no position” on them, and highlighted them only to ensure that the “decision is not read as having impliedly rejected” such arguments, which were not before the court.

Significantly, *Wolf Creek* involves a non-competitive procurement environment – namely, the award of task orders for IDIQ work included on a facilities operations and maintenance contact. How the lack of competition, and the lack of certified cost or pricing data, affects materiality also was not addressed by the Court, limiting the precedential force of the case.

Nonetheless, the *Wolf Creek* decision reinforces that government contractors should avoid intentionally overstating labor and cost estimates even when negotiating firm-fixed-price contracts, particularly in non-competitive procurements, as an inflated cost estimate could be viewed by a court as fraudulent inducement leading to false claims. Government contractors also may wish to consider making clear during negotiations the extent to which they have increased cost estimates to account for the inherent risk of entering into firm-fixed-price contracts. Finally, when faced with an FCA investigation or suit involving such a theory, government contractors should consider the types of arguments raised by Judge Murphy’s concurrence regarding the differences between opinions/estimates and statements of fact.

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