

News from our Government Contracts Group

## The Significant Risk to SBIR Program Participants Under the False Claims Act

For early-stage technology-based companies, the U.S. Government's Small Business Innovation Research ("SBIR") Program is an attractive source of R&D funding when private funding sources are unavailable or inadequate. Unfortunately, some companies fail to appreciate the different and significant risks associated with applying for public funding through the SBIR program. A recent case in the U.S. District Court for the Southern District of Texas, in which a small technology company was found civilly liable under the False Claims Act for statements made in its SBIR proposals, illustrates the potentially severe consequences of unfamiliarity with the risks unique to doing business with Uncle Sam. See *United States ex rel. Longhi v. Lithium Power Technologies, Inc.*, H-02-4329, Sept. 27, 2007; Jan. 3, 2008.

### The False Claims Act

The False Claims Act ("FCA"), in relevant part, imposes liability on "any person" who:

1. knowingly presents, or causes to be presented, to an officer or employee of the United States Government or a member of the Armed Forces of the United States a false or fraudulent claim for payment or approval; [or]
2. knowingly makes, uses, or causes to be made or used, a false record or statement to get a false or fraudulent claim paid or approved by the Government[.]

31 U.S.C. § 3792(a).

This standard can be met when a company induces the government to award a contract

based on incorrect statements of fact, and then submits invoices and receives payment for performance of that contract. In certain circumstances, the contractor can face civil penalties of not less than \$5,500 and not more than \$11,000, *for each invoice*. In addition to these baseline penalties, the contractor can be liable for "three times the amount of damages which the Government sustains because of" the false claim.

The "*qui tam*" provision of the FCA allows private individuals not injured by the defendant's conduct to sue the defendant on behalf of the United States. As an incentive to sue under the *qui tam* provision, the FCA allows "relators" (the private "plaintiffs" in FCA suits) to receive up to 30 percent of the proceeds of the action or settlement of the claim.

### The Longhi Case

The defendants in the *Longhi* case were Lithium Power Technologies ("LPT"), a small, private technology company, and its founder, Mohammed Munshi. Munshi formed LPT as a successor to a series of other companies he had run in the past, with the intention of developing advanced lithium batteries and capacitors. From 1998 to 2004, LPT secured Phase I and Phase II SBIR awards from various agencies worth more than \$5.8 million. Of this amount, the government had paid out approximately \$1.66 million as of the time of suit.

The relator, Albert Longhi, was a former LPT employee and investor who alleged various instances of fraudulent conduct

as the basis for his *qui tam* action. After a lengthy investigation, the United States Attorney intervened in the case. Significantly, the government did not argue that LPT's invoices were factually incorrect, or that the invoices requested more money than was due under the terms of LPT's SBIR contracts. Instead, the government argued that the invoices were "tainted because they [arose] from a contract procured by false or fraudulent claims." (emphasis added)

On the parties' cross-motions for summary judgment, the Court found against the defendants, concluding that certain statements in LPT's SBIR proposals were untrue, that LPT had knowledge of the falsity of the statements (or at least reckless disregard for their truth), and that the statements were material to the agency's decision to award

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the contracts. In so concluding, the Court focused on “whether the statements made in the proposals were literally true at the time the proposals were submitted.”

The Court cited the following examples of untrue statements in LPT’s proposals that established FCA liability:

- ▶ **Misstatement of Corporate Form and Prior Experience of the Entity Submitting the Proposal:** In describing its business history and corporate status in a proposal to the U.S. Army, LPT identified itself as a corporation and ascribed to itself the experience of its predecessor companies. LPT claimed that it was “founded in 1992 to conduct research and development on advanced lithium ... batteries,” and that “[o]ver the years the company has relied on private funds and [has] developed extensive knowledge on numerous forms of advanced power sources[.]” Because LPT was not incorporated until 1998 (five months after submitting the proposal), the Court concluded that these statements were “literally false and made with the requisite scienter” for FCA liability.
- ▶ **Reference in the Present Tense to Facilities Still Under Construction:** In describing its facilities and the equipment necessary to perform, LPT represented that it “occupies approximately 4000 square feet of new laboratory and office space, [and] has a 500 square [foot] dry-room for the development and manufacture of lithium rechargeable batteries and capacitors.” On the date the proposal was submitted, however, those facilities were not yet complete. The government focused on the verb tense in the proposal to demonstrate falsity, noting that LPT claimed that it “occupies” the space, and “has” a dry-room. Even though LPT argued that the facilities in question were complete when the proposal was funded, the Court agreed with the government’s argument. The Court emphasized that the focus of the FCA is

not on “whether the U.S. got the product for which it contracted,” but on “the truth of the statements to the government” in the proposal.

- ▶ **Embellishment of the Company’s Relationships:** In describing the nature of its relationships with other research facilities in the local area, LPT claimed in four separate SBIR proposals that it had “cooperative arrangements with the University of Houston and Polyhedron Laboratories regarding the use of their laboratories and scientific equipment.” The government produced evidence that LPT had no special “arrangements” with those facilities, but had access to them only on a fee-for-service basis—no different from any other member of the public. The Court found that LPT’s statements in this regard “were factually incorrect when made.”
- ▶ **Failure to Make a Statement Required by the Solicitation:** In its proposals for Air Force Phase I and Phase II awards, LPT failed to disclose the existence of certain “related work” it had performed for the Army, contrary to the instructions in the solicitations. LPT argued that the solicitation instructions were vague and that such disclosure was unnecessary where the Air Force “already knew about the Army proposal.” The Court rejected those arguments, concluding that LPT had made a false statement by omission—*i.e.*, by failing to disclose prior SBIR work performed for another agency, as required by the SBIR solicitation.

On these bases, the Court concluded that *each of the invoices* submitted during performance of LPT’s four SBIR contracts was a false claim for which the defendants were liable.

In a subsequent opinion, the Court determined the scope of civil penalties and damages. Because LPT’s liability was predicated on fraudulent inducement of the SBIR contracts and not the falseness of any

particular invoice, the Court assessed only one forfeiture for each of the four contracts. However, because LPT’s fraud “was systematic and knowing,” the Court imposed the maximum for each forfeiture. With respect to damages, the Court concluded that the government was harmed in the amount it paid out under the four contracts (\$1,657,455). Multiplying that figure by three, the Court imposed total damages in the amount of \$4,972,365. Combined with the civil penalties, LPT’s liability exceeded \$5 million, plus post judgment interest of 3.28 percent.

In conclusion, the *Longhi* case illustrates what can happen when a small business fails to appreciate the fundamental differences between private sources of R&D funding and U.S. Government funds. When SBIR applicants misstate or embellish facts in an effort to “puff up” their qualifications or experience, the adverse consequences can far exceed what might be expected in the commercial world. Awareness of these potential consequences and careful, precise drafting of SBIR proposals can help a company avoid the scrutiny of the Department of Justice, and the second-guessing of the company’s statements and motives by the federal courts. ■