**_Scollick v. Narula_: Positive News for the Surety Industry Doesn't Mean It's Time to Let Your Guard Down**

*The surety industry recently received some great news in the Scollick v. Narula case when the whistleblower's False Claims Act Complaint against the sureties and their agent was dismissed on summary judgment. Nonetheless, there are many reasons why sureties need to remain vigilant when considering bonding small business set aside contractors.*

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NOTE: This article should not be used as legal advice. All parties should consult legal counsel of their choice and seek expert advice on legal and compliance issues.

Many in the surety industry were shaken by the July 31, 2017, decision in United States ex rel. Scollick v. Narula holding that sureties and a surety agent faced potential liability under the False Claims Act (FCA) for bonding a fraudulent set aside contractor.[1] The plaintiff/whistleblower in Scollick was a former employee of a larger contractor alleged to have controlled the set aside contractor. In essence, the Complaint alleged that the defendants set up a sham company purportedly owned and operated by a service-disabled veteran, which was actually primarily owned and controlled by the larger contractor in order to illegally bid upon and obtain Service-Disabled Veteran-Owned Small Business (SDVOSB) set aside contracts from the Federal government. The Complaint further alleges that the purported scheme eventually expanded into other types of small business set aside contractors.

It's important to keep in mind that the July 2017 unpublished Scollick opinion did not result in a finding of liability against any party. Rather, the opinion arose in the context of the whistleblower's motion for permission to amend its Complaint after an earlier ruling that the Complaint failed to state a cause of action against the sureties and surety agent. The whistleblower sought leave to amend its Complaint to state additional facts in support of the claims.[2] The sureties and surety agent opposed the motion on the basis that, even if the allegations of the Amended Complaint were taken as true, there would still be no possible liability on the part of the surety and agent. The Scollick Court therefore had to conduct the same review that would be done under a motion to dismiss under 12(b)(6) of the Federal Rules of Civil Procedure, where all allegations made in the Amended Complaint are taken as true and all inferences are drawn in favor of the non-moving party (in this case the whistleblower).[3] It was with this background and under the application of these standards that the Court found a *potential* cause of action against the sureties and agent, again with absolutely no finding of actual liability on the part of any defendant at this early stage of the case.

[1] Scollick v. Narula, 2017 WL 3268857 (July 31, 2017)
[2] See Federal Rule of Civil Procedure 15(a)(2)
[3] See In re Interbank Corp. Sec. Litigation Funding, 629 F.3d 213 (D.C.Cir. 2010)

**The False Presentment Claims**

The whistleblower's causes of action against the sureties and agent (hereinafter "the surety defendants") under the FCA consisted of indirect presentment, reverse false claims and conspiracy to commit the alleged violations. The indirect presentment claims were based upon the theory that a party who does not actually submit a false claim for payment to the Federal government but "facilitates" the presentment of a false claim by another party is liable under the relevant provisions of the FCA.[4] Facilitating the presentment of a false claim, in turn, requires that the defendant's conduct was a "substantial factor, if not the but-for cause of, submission of false claims."[5] The whistleblower in Scollick argued that the fraud could not have been perpetrated without the bonds, and consequently, the sureties and agent facilitated the false claims for payment submitted by the contractor defendants.

However, another requirement under the FCA is that the defendant committed the acts "knowingly," which under the FCA includes acting in deliberate ignorance of, or with reckless disregard for the truth or falsity of the information.[6] In order to meet this requirement, the whistleblower in Scollick alleged in the Amended Complaint that in the course of conducting their underwriting due diligence, the sureties became aware that the contractor it bonded was not controlled by a disabled veteran as required by Federal regulations to be eligible to obtain the bonded contracts, but was in fact a shell company controlled by the larger contractor and certain individual defendants (hereinafter "the contractor defendants"). According to the whistleblower's theory, by continuing to do business with the alleged fraudulent contractor after becoming aware of these facts, the sureties and agent were guilty of the facilitation of the presentment of false claims. The Amended Complaint further alleged that the surety defendants "concealed" these facts from the government. Based on these expanded allegations, the July 2017 Scollick opinion determined that the sureties and agent could be liable under the FCA if the allegations were proven true.

**The Reverse False Claim**

A reverse false claim, in contrast to presentment of a false claim for payment *from* the government, consists of fraudulent conduct for the purpose of avoiding an obligation for payment or fraudulently reducing a payment obligation *to* the government.[7] In support of its reverse false claim argument, the whistleblower in the Amended Complaint pointed specifically to the terms of the performance bond, which the whistleblower characterized as guaranteeing that the bonded projects would be completed in accordance with all of the contractual specifications. Since those specifications included the requirement that the work be performed by a valid small business set aside contractor, the sureties were obligated under the bonds to reimburse the government each time it issued a progress payment to the allegedly fraudulent set aside contractor, according to the whistleblower's theory. This argument fails to account for many factors, including the prerequisites for terminating a contractor and triggering a surety's obligations under a Miller Act performance bond under the Code of Federal Regulations.[8] In addition, for

[4] 31 U.S.C. section 3729(a)(1)(A) and 31 U.S.C. section 3729(a)(1)(B)
[5] United States v. Toyobo Co., Ltd., 811 F. Supp. 2d 37, 48 (D.D.C. 2011)
[6] United States v. Toyobo Co., Ltd., id.
[7] 31 U.S.C. section 3729(a)(1)(G)
[8] 48 C.F.R. 49.402-3

this cause of action to be viable, the "forfeiture" theory of damages under the FCA must be applied, which is premised upon the assertion that the government received "nothing of value" in return for the payments because the overriding purpose of assisting small business set aside contractors was frustrated.[9] However, not all Federal Circuits follow the forfeiture theory of FCA damages, instead applying a "benefit of the bargain" rule which looks to whether the government actually paid more because of the allegedly fraudulent conduct or received less than what it contracted for. Under the benefit of the bargain theory, the Federal government would have no consequential damages because all of the projects were satisfactorily completed and the government actually paid less to the Scollick defendants than it would have paid to the next low bidder.[10] Nonetheless, the Scollick Court in its July 2017 opinion found that the whistleblower had now stated a potentially viable cause of action for reverse false claims against the sureties.

**The July 2022 Scollick v. Narula Decision**

After the conduct of discovery over the course of the next five years and failed mediation efforts, the parties eventually moved for summary judgment on their various claims and defenses in the case. Unlike a motion to dismiss based purely on the pleadings, a summary judgment motion relies on the facts as developed through the discovery process and asserts that, based upon that factual record, there is no genuine dispute as to any material fact and therefore the moving party is entitled to judgment in their favor as a matter of law.[11] The Surety and Fidelity Association of America filed an *amicus* brief in support of the surety defendants' motion.

In his July 2022 decision, U.S. District Judge Royce C. Lambert (the same Judge that wrote the July 2017 Scollick decision) ruled that the surety defendants (both sureties and the surety agent) were entitled to summary judgment dismissing all of the whistleblower's claims against them. The surety's lack of the requisite *intent* to deceive the government was central to the decision to dismiss the claims. Judge Lambert found that there was no evidence in the record that the surety defendants "were aware of the specific requirements of VA SDVOSB set-aside contracts."[12] In the absence of such evidence, the whistleblower could not prove that the surety defendants acted with knowledge of the falsity of the bonded contractors' representations to the government.

More good news for the surety industry is that, in addressing whether the surety acted with reckless disregard (again, intent under the FCA includes reckless disregard for the truth or falsity of the representations made to the government), Judge Lambert stated that the sureties and agent *had no duty to familiarize themselves with government regulations regarding disabled veteran or other small business set aside programs.* In reaching this conclusion, Judge Lambert emphasized that, unlike the contractor defendants, sureties are not "participants" in government set aside programs. Therefore, the surety

[9] See United States v. Scientific Applications International Corp., 626 F.3d 1257 (D.C. Cir. 2010)

[10] See United States v. United Technologies Corp., 626 F. 3d 313 (6th Cir. 2010)

[11] Federal Rules of Civil Procedure 56(a)

[12] Scollick v. Narula, 2022 WL 3020936 (July 19, 2022)

defendants could rely upon the government's certification that the bonded contractors met the requirements of the applicable federal set aside programs.

**No "Free Pass" for Sureties That Bond Federal Set Aside Contractors**

While the recent Scollick v. Narula decision is certainly great news for the surety industry, there are multiple reasons why sureties need to remain especially vigilant when bonding Federal set aside contractors.

- First and most obvious, the decision is at the trial court level and is subject to being overturned on appeal after the case against the remaining defendants goes to trial. In fact, counsel for the whistleblower has already expressed an intention to appeal the decision to the Federal Court of Appeals for the D.C. Circuit.[13]

- Second, Judge Lambert's decision does not absolve a surety that has *actual knowledge that the contractor its bonding is defrauding the government*. Therefore, had the whistleblower offered any evidence that the sureties and agent actually knew that the contractors were misrepresenting their qualifications to bid on the subject projects, the outcome would have been different.

- In addition, Judge Lambert noted that the qualifications of the contractor in *Scollick* as a valid SDVOSB contractor were certified by the Veteran's Administration. The outcome might have been different if the program were one where the contractor self-certifies to its qualifications for the applicable Federal set aside program.

- Finally, the decision is not binding precedent on other Federal Courts, although it would likely have some influence.

The concept and theories behind the whistleblower's FCA claims against the surety defendants in Scollick are in the public realm and will not be easily dispensed with. Therefore, while a major victory for the surety industry for now, Judge Lambert's opinion is only the latest chapter in a developing body of case law.

[13] "Insurers Escape FCA Liability for Bonding Construction Co.," *Law360,* July 20, 2022, by Daniel Wilson