

INFOCUS

WHITE-COLLAR CRIME

Procurement rules are changing

A crackdown on fraud means that government contractors must adapt to new regulations.

By David H. Laufman

SPECIAL TO THE NATIONAL LAW JOURNAL

THIS YEAR IS SHAPING UP AS another challenging one for the government contracting community.

The U.S. Department of Justice (DOJ) is continuing to crack down on procurement fraud, and contractors must comply with new federal ethics regulations that mandate “timely” disclosure to the government of wrongdoing and minimal standards for internal control systems. Meanwhile, Congress is intensifying legislative and investigative oversight of government contracting, particularly in the defense realm.

Federal enforcement targeted at procurement fraud has surged in the past few years. In October 2006, DOJ established the National Procurement Fraud Task Force, a multi-agency initiative that includes the Federal Bureau of Investigation (FBI), military investigative and audit agencies, the offices of inspector general at the Department of Defense and the General Services Administration, and numerous other offices of inspector general.

According to its December report, the task force since its inception has pursued more than 400 false claim and other procurement fraud cases resulting in criminal charges, civil actions or settlements. More than 300 of these cases reportedly have resulted in criminal convictions, and the task force claims to have recovered more than \$362 million in civil settlements or judgments. National Procurement Fraud Task Force, Progress Report, at 3-4, Dec. 2008.

Attorney General Eric Holder has publicly committed himself to continuing the government’s war on procurement fraud. In written responses to Senator Charles Grassley, R-Iowa, during his confirmation process, Holder extolled the False Claims Act as the DOJ’s primary means for

combating procurement fraud. He pledged to enforce it vigorously and asked for additional resources from Congress for the current fiscal year and subsequent years to pursue False Claims Act cases. Questions for Holder from Grassley, at 12-13, <http://judiciary.senate.gov/nominations>.

Disclosure and ethics

The DOJ’s aggressive approach toward procurement fraud has spilled over into the regulatory sphere. On Dec. 12, 2008—at the direct behest of the DOJ’s Criminal Division—an amendment to the Federal Acquisition Regulation (FAR) took effect that now requires all contractors to disclose to the government specified violations of law on penalty of suspension and debarment. See 73 Fed. Reg. 67,064-093 (Nov. 12, 2008).

Contractors must ensure their ethics and control systems.

In what the government conceded to be a “sea change” from the long-standing practice of voluntary disclosure, 73 Fed. Reg. 67,069, the new rules require all contractors, regardless of their size or the value of the procurement, to make a “timely” written disclosure to the office of inspector general at the agency that awarded the contract—with a copy to the contracting officer—whenever, in connection with an award, performance or closeout of a contract or subcontract, the contractor has “credible evidence” that a principal, employee, agent or subcontractor has committed a violation of federal criminal law involving fraud, conflict of interest, bribery or illegal gratuities; or a violation of the civil False Claims Act. FAR 3.1003(a)(2). A knowing failure to make a required disclosure remains a cause of action for suspension, debarment or both for three years after final payment on a contract. A contractor also may

be suspended or debarred upon the “knowing failure of a principal to timely disclose credible evidence of a significant overpayment, other than overpayments resulting from contract financing payments.” FAR 3.1003(a)(3).

The new mandatory disclosure rules augment other recent regulatory ethics reforms that establish minimum standards for the internal control systems required of large contractors.

First, such contractors must now assign responsibility at a sufficiently high level within the organization, and provide adequate resources, to ensure the effectiveness of their business ethics awareness and internal control system. FAR 52.203-13(c)(2)(ii)(A).

Second, they must make “reasonable efforts” not to include principals within the organization that due diligence would have exposed as having engaged in conduct that is illegal or otherwise in conflict with their code of business ethics and conduct. FAR 52.203-13(c)(2)(ii)(B).

Third, contractors must conduct periodic reviews of their business practices, procedures, policies and internal controls to assess compliance with their code of business ethics and conduct, including monitoring and auditing to detect criminal conduct; periodic evaluations of the effectiveness of their business ethics awareness and compliance program and their internal control system, “especially if criminal conduct has been detected”; and periodic assessments of the risk of criminal conduct, with appropriate remedial measures to reduce the risk of any criminal conduct identified. FAR 52.203-13(c)(2)(ii)(C).

Fourth, contractors must establish an internal reporting mechanism that provides anonymity or confidentiality, such as a hotline, and must instruct employees on how to use it. FAR 52.203-13(c)(2)(ii)(D).

Fifth, they must institute disciplinary action for “improper conduct” (a lower threshold than a violation of law), or for failing to take reasonable steps to prevent or detect “improper conduct.” FAR 52.203-13(c)(2)(ii)(E).

David H. Laufman is a partner in the Washington office of New York-based Kelley Drye & Warren, where he focuses on corporate compliance and the defense of federal enforcement actions and congressional investigations.

Contractors also must now provide “full cooperation” to any government agencies responsible for an audit, investigation or corrective action. FAR 52.203-13(c)(2)(ii)(G). The new regulations broadly define “full cooperation” as “disclosure to the government of the information sufficient for law enforcement to identify the nature and extent of the offense and the individuals responsible for the conduct.” FAR 52.203-13(a). Such disclosure, in turn, is further defined to include “providing timely and complete response[s] to Government auditors’ and investigators’ request for documents and access to employees with information.” FAR 52.203-13(a)(1).

Consistent with recent revisions to DOJ’s policy on corporate prosecution, however, the new regulations specify that “full cooperation” does not require a contractor to waive its attorney-client privilege or the attorney work-product protection. FAR 52.203-13(a)(2)(i). Nor do they require officers, directors, owners or employees to waive their attorney-client privilege or Fifth Amendment rights. FAR 52.203-13(a)(2)(ii). (At the same time, regulators cautioned that “[f]acts are never protected by the attorney-client privilege or work product doctrine”—an echo of DOJ’s insistence on “relevant facts” in its new corporate prosecution policy. 73 Fed. Reg. 67,077.) The new rules also expressly provide that “full cooperation” does not prevent contractors from conducting an internal investigation or from defending themselves in a proceeding or dispute “related to a potential or disclosed violation.” FAR 52.203-13(a)(3).

Impending regulatory action

This year also will likely see new regulations regarding conflicts of interest of government contractors. In March 2008, the FAR Council requested public comment on the need for regulations addressing personal (as opposed to organizational) conflicts of interest on the part of service contractor employees. 73 Fed. Reg. 15,961 (Mar. 26, 2008). In July, the National Procurement Fraud Task Force submitted a letter to the FAR Council in which it noted a dramatic increase in contractor employees performing a wide variety of

Procurement reform is set to become a front-burner issue.

federal government functions and observed that contractor employees were not subject to the conflict of interest rules applicable to federal employees. See Progress Report, National Procurement Fraud Task Force, at 23 (Dec. 2008). The Task Force asked the FAR Council to publish a proposed new FAR rule requiring service contractors to certify annually that they have trained their employees on the relevant responsibilities and restrictions to which they are subject while performing government work, and have collected from their employees the financial information necessary to identify and screen out employees with personal conflicts of interest.

Tighter regulation expected

A proposed rule is likely to be issued this year. Additional regulatory reforms may result from a white paper issued in June 2008 by the legislation committee of the task force and submitted to the Criminal Division at the DOJ. In the white paper, the legislation committee—headed by the inspectors general at GSA and the Department of Homeland Security—made several proposals for strengthening the prosecution and adjudication of procurement fraud cases. One proposal would direct the U.S. Sentencing Commission to promulgate provisions authorizing the value of contracts affected by procurement fraud to be considered in loss calculations under Section 2B1.1 of the sentencing guidelines, thereby increasing potential penalties for persons convicted of procurement fraud. Letter from Brian D. Miller and Richard L. Skinner to Matthew W. Friedrich, acting assistant attorney general, Criminal Division, U.S. Department of Justice, June 9, 2008, at 4.

Another proposal calls for Congress to enact legislation expanding the subpoena authority of offices of inspector general—currently limited to documentary evidence—to include the power to compel interviews. The latter proposal also seeks statutory clarification that current office of inspector general authority includes the power to subpoena electronic evidence, including data stored on personal digital assistants and other devices containing electronically stored information.

Congress already is gearing up for intensified oversight of government contracting. On Jan. 14, U.S. Representative Edolphus Towns, D-N.Y., the new chairman of the House Committee on Oversight and Government Reform, gave a speech announcing his oversight priorities for the new Congress in which he stated that “Procurement and Contracting reform will be on the front burner this year.” “Chairman Towns Rolls Out Oversight Committee Priorities,” at 6, available at <http://oversight.house.gov/chronology.asp>. Similarly, in announcing its oversight agenda for the new Congress, the House Committee on Armed Services recently stated that it “will continue to push for accountability and integrity in contracting.” “House Armed Services Committee Oversight Plan for the 111th Congress,” at 16, available at <http://armedservices.house.gov>.

On Jan. 29, Senator Joseph Lieberman, I-Conn., chairman of the Senate Homeland Security and Government Affairs Committee, announced the creation of a new Ad Hoc Subcommittee on Contracting Oversight, to be chaired by Senator Claire McCaskill, D-Mo. In a statement issued on Feb. 2, McCaskill challenged the Commission on Wartime Contracting, a bipartisan panel established by Congress in 2008, to be aggressive in examining contracting practices in Iraq and Afghanistan, warning that the commission’s allies in Congress might pursue additional legislation to give the commission subpoena power that it now lacks, as well as additional resources.

Defense contractors, who account for the bulk of federal procurement spending, already face new statutory reforms in addition to the new regulatory requirements discussed above. On Oct. 14, President George W. Bush signed into law the Defense Authorization Act for Fiscal Year 2009.

The act requires the U.S. Department of Defense to establish a contractor integrity database for contracts valued at more than \$500,000 and for a period covering the past five years, that contains information including: prior federal and state criminal convictions regarding contract award or performance; each federal suspension and debarment; each federal contract and grant that was terminated due to default; findings of civil liability resulting in a monetary fine, penalty, reimbursement, restitution or damages of \$5,000 or more; certain findings of administrative liability; certain settlement agreements; and prior findings that a contractor was not a “responsible source.”

Under the legislation, a Defense Department official must review the database before making a responsibility or a past-performance determination and, thus, before making a contract award. In addition, by mid-April 2009, the Defense Federal Acquisition Regulation Supplement must be amended to require contractors with total defense

The vortex of reform seen in 2008 will continue in 2009.

contracts valued at more than \$10 million to submit semiannual reports to the Defense Department.

This year also may see a reintroduction of the False Claims Corrections Act, a bill introduced in both the House and Senate in the 110th Congress in response to the Supreme Court’s 2008 decision in *Allison Engine Co. v. U.S. ex rel. Sanders*, 128 S. Ct. 2123. Evidence at trial in that case established that subcontractors had issued certifications to a prime contractor containing false statements, but no evidence was presented that the subcontractors had presented a false claim directly to the government. *Allison Engine*, 128 S. Ct. at 2127. But the Supreme Court held that a false claim paid with government funds, without more, does not establish civil liability under 31 U.S.C. 3729(a)(2) and (a)(3). Rather, the court found, a plaintiff must prove that the defendant intended to defraud the government.

The bills introduced in the 110th Congress responded to what was seen as an erosion of False Claims Act enforcement in *Allison Engine* by providing for liability when a subcontractor knowingly submits a false claim for payment by a prime contractor, regardless of whether there is evidence that the subcontractor intended to defraud the government. See H.R. 4854, 110th Cong., 1st Sess., § 2 (Dec. 19, 2007); S. 2041, 110th Cong., 2d Sess., § 2 (Sept. 12, 2007).

In sum, the vortex of federal contracting reform will continue in 2009, requiring contractors to fine-tune their compliance programs and strengthen existing systems. **NLJ**