

Back To The Future: Trends In Procurement Fraud Investigations

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Consider the following newspaper headlines:

- A major defense contractor has allegedly substantially overcharged the federal government for goods and services provided under sole source contracts;
- The deputy chief acquisition official for the United States Air Force is in jail for improper dealings that land her and family members jobs with a contractor with whom she is negotiating a significant contract;
- The United States Attorney for the Eastern District of Virginia announces the formation of a "Procurement Fraud Working Group" to stop and punish "criminals who cheat the government".

Flashbacks to the 1980s war against procurement fraud, waste and abuse? Unfortunately not. The war on terror and in Iraq have put public procurement back into the spotlight and, as reflected in the above current news stories, the picture is not pretty. And it is likely to get worse. The competition is keen and the pressures to succeed are great. This confluence of factors has created a situation ripe for abuse. As scrutiny of this increased spending comes into focus, we are all too likely to find that lessons once learned have been forgotten, and that allegations of procurement fraud once again will fill the news.

I. Defense Build-Ups Typically Have Been Followed By Increased Allegations Of Procurement Fraud, Waste And Abuse

Historically, increased defense spending to support a war effort has been followed by heightened Congressional scrutiny and an increase in procurement fraud investigations and prosecutions. During the Civil War, Congressional hearings "revealed instances of the same horses being sold twice to the army, sand being substituted for gunpowder, and crates full of sawdust being shipped to the front lines labeled as muskets." See 144 Cong. Rec. S7675-76 (daily ed. July 8, 1998) (statement of Sen. Grassley). As a result, the False Claims Act ("FCA") was enacted to combat fraud committed by government contractors against the Union Army.

The U.S. military build up before and during World War II resulted in an increase in government contracts and a surge of qui tam cases. See *U.S. ex. rel. Springfield Terminal Ry Co. v. Quinn*, 14 F.3d 645 (D.C. Cir. 1994) (discussing history of FCA). Similarly, post-World War II conflicts and the resulting build-up of defense spending saw an increase in procurement fraud investigations and False Claims actions. See, e.g., *U.S. v. Hangar One*, 563 F.2d 1155 (5th Cir. 1977) (fraudulent inspection case against contractor supplying artillery shells for Vietnam war).

The run-up in defense spending during the Reagan cold war era yielded a flood of procurement fraud investigations and prosecutions. Allegations of defective pricing, mischarging and overcharging were common and, in some cases, notorious, such as accusations that General Dynamics improperly included country club dues and an executive's dog kennel fees in overhead costs reimbursed by the government. A Justice Department investigation code named

"Operation Ill Wind" netted numerous government officials, defense contractors and consultants engaged in the illegal sale and purchase of government and competitor proprietary information, conspiring to fix the award of government contracts, and falsifying contract costs. Ten corporations and more than 50 individuals ultimately were convicted as a result of the Ill Wind investigations. These high profile matters led to the 1986 amendments to the civil False Claims Act increasing penalties for a violation, reducing the evidentiary standard for liability, and eliminating certain barriers to whistleblower actions, and in the passage of the federal Procurement Integrity Act, which tightened the revolving door between government and industry and imposed new restrictions on the use of proprietary data related to federal procurements.

In response to these developments and the government's increasing use of debarment and suspension to render contractors found to have engaged in procurement fraud ineligible for future contract awards, the government contractor community began to develop programs to prevent and detect procurement fraud. Large contractors promulgated corporate codes of conduct, established internal hotlines for the reporting of improprieties, and implemented compliance programs. Even these measures, however, did not later prevent a spike in procurement fraud matters resulting from increased defense spending for the first Persian Gulf war. See, e.g., *U.S. ex. rel. Le Blanc v. Raytheon Co.*, 874 F. Supp. 35 (D. Mass. 1995) (defective product case concerning missiles used in first Persian Gulf war).

If past is prologue, the current increase in defense and homeland security spending similarly will focus attention on how these procurement dollars are spent. That scrutiny already has begun. See, e.g., *Recruiting Uncle Sam: The Military Uses a Revolving Door to Defense Jobs*, Wash. Post, Feb. 19, 2004, at E1; *CACI Contract: From Supplies to Interrogation*, The Wash. Post, May 17, 2004, at E1; *Charges of Fraud in Iraq Contracts: U.S. Authority Lost Track of Millions*, Auditor Reports, S.F. Chronicle, July 30, 2004, at A-3; *FBI Widens Probe of Halliburton*, Wash. Post, Oct. 29, 2004, at E1; *Initiative to Probe Contractors for Fraud: Announcement Comes After Sentencing of Former Boeing CFO*, Wash. Post, Feb. 19, 2005, at E1. As described below, unless appropriate measures are now taken, it is highly likely that many government contractors will not be able to withstand the spotlight.

II. Both New Contractors And Experienced Contractors Are At Risk

A. New Contractors

The rapid growth the past several years of federal defense spending, and in particular for homeland security products and services, has attracted many new entrants to the federal marketplace, both as prime contractors and as subcontractors. However, these companies often are unprepared for the intricacies of federal government contracting. Having previously dealt in the commercial sector, many are not familiar with the unique requirements of doing business with the federal government. They are less likely to understand the complex laws and regulations governing federal government contracts. Indeed, all too often they are not familiar with the Federal Acquisition Regulation ("FAR"), which governs the formation and performance of executive agency contracts, and have not even read many of the FAR requirements applicable to their

contracts. Among others, the rules governing relations with federal employees, the pricing and negotiation of federal contracts, and contract cost accounting and cost allowability are unlike any practices encountered in the private sector and pose particular risks to fledgling federal contractors.

Even if they are aware of and understand the requirements of their federal contracts, new contractors typically lack the systems necessary to ensure compliance with those requirements. An effective compliance system includes: establishment of processes and procedures to ensure that all aspects of government contracts are properly performed; training employees so they understand the requirements and the company's processes and procedures; auditing adherence to those requirements, processes and procedures; and enforcement by appropriately disciplining those that fail to comply. Investment in such systems is essential to a company's ability to survive and thrive in the government marketplace.

B. Experienced Government Contractors

In response to the rash of procurement scandals of the 1980s and early 1990s, most experienced government contractors implemented compliance programs designed to ensure adherence to government contracting requirements. Many of those programs remain unchanged since their implementation, and many today primarily involve a code of conduct and training for new employees, and brief periodic refresher programs for other employees. As the government's focus during the past decade turned first to healthcare fraud and then to financial and accounting misdeeds, the incidence of procurement fraud investigations and prosecutions declined. As a result, these government contracting compliance programs have lost their sense of urgency. Without periodic examples of the consequences of noncompliance, even sophisticated government contractors and their employees may have become complacent in the oversight and enforcement of their programs.

The predicament in which Boeing now finds itself is a prime example. A long-time government contractor, Boeing was among the first companies to implement internal guidelines for the ethical conduct of its business and a government contracting compliance program. Yet it now is surrounded by accusations of conduct strikingly similar to that which was the focus of Operation Ill Wind. Its job discussions with Darlene Druyun in November 2002 while she was the number two Air Force acquisition official and working on Boeing-related programs, and Boeing's hiring of Druyun two months later, resulted in Druyun's guilty plea to conspiring to violate conflict of interest statutes and to her serving time in jail. On February 18, 2004, Michael Sears, a former senior executive of Boeing, pled guilty to aiding and abetting Druyun and was also sentenced to prison. And Boeing also finds itself the defendant in a civil lawsuit brought by Lockheed Martin Corporation charging that Boeing improperly obtained and utilized Lockheed Martin proprietary and trade secret information relevant to an Air Force procurement for which the two companies were competing.

Undoubtedly, Boeing and Haliburton are not the only experienced contractors whose conduct may be called into question after becoming the focus of increased oversight. Now is the time for those companies supporting the U.S. wars and homeland security to reinvigorate and revitalize their compliance systems and efforts, before they too become the subject of allegations and investigations.

III. A Rash Of Traditional Procurement Fraud Matters Is Likely

The two key statutes used by the government to fight procurement fraud are the False Statements Act, 18 U.S.C. § 1001, and the False Claims Act, 18 U.S.C. § 287; 31 U.S.C. § 3729 et. seq. The False Statements Act provides criminal penalties for anyone who, in providing information to the government, knowingly and willfully falsifies or conceals a material fact, makes a materially false statement or representation, or uses a document known to contain materially false information. The False Claims Act contains both civil and criminal penalties for anyone who knowingly presents a false claim to the government for payment.

The government's fight against future procurement fraud will be augmented by the rise of a large and sophisticated qui tam bar. Since the last large wave of procurement fraud matters, the passage of the 1986 False Claims Act amendments greatly incentivized private whistleblowers, referred to as "relators" under the qui tam provisions of the civil False Claims Act, and enhanced their ability to prosecute civil False Claims act cases on behalf of the government. This led to the rise of law firms specializing in the representation of whistleblowers, which, through their successes in first the procurement field and then the health care field, have garnered both the expertise and resources actively to challenge even large contractors suspected of wrongdoing, regardless of whether the government elects to pursue the action. The potential for any company employee to become a whistleblower, and to become wealthy in the process, exacerbates the risks and potential exposure of contractors that fail to implement a serious and meaningful compliance program.

In our view, in the coming wave of procurement fraud investigations contractors face greatest risk of prosecution for:

- delivery of substandard products and services;
- mischarging of labor hours;
- non-compliance with government contracts accounting rules;
- non-compliance with cost or pricing data submission requirements of the Truth in Negotiations Act ("TINA"), 10 U.S.C. § 2306a, 41 U.S.C. § 254(d);
- violation of domestic content rules in the FAR and the Defense Federal Acquisition Regulation Supplement; and
- violation of the Procurement Integrity Act.

IV. Conclusion

Increased federal spending on the war on terror, the war in Iraq and on homeland security inevitably will raise questions regarding the value received by the government for its significant expenditures and the extent to which that value has been diminished by fraud, waste and abuse. As instances of improprieties are exposed, it is most likely that federal contractors once again will find themselves the center of scrutiny by the media, Congress, and ultimately by the Department of Justice and other investigative agencies. And this time their efforts will be bolstered by an array of qui tam relators, acting on principle or out of greed, seeking to identify and disclose wrongdoing. It is critical that government contractors, both new and old, act quickly to implement the robust compliance processes and programs that will enable them to avoid becoming the perpetrators or victims of a return to the war on procurement fraud, waste and abuse.

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