

Oh, the Scrutiny. Oh, the Rewards.

For federal contractors, careful compliance is more important than ever.

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As spending on federal contracting reached record levels in recent years—a reported \$400 billion in 2005 alone—the risks, as well as the rewards, of doing business with the federal government have never been greater.

The U.S. government has vowed to crack down on procurement fraud and other fraud in government programs. Last year's \$3.1 billion in settlements and judgments in cases involving fraud against the government was the largest amount ever recovered in a single year. It

IN-HOUSE COUNSEL

relating to its use of confidential competitor information and the hiring of a former Air Force acquisition chief who had responsibility for its contracts; it also included numerous other cases involving defense procurement fraud, health-care fraud, and other fraud against the government.

Last fall, the Justice Department launched a National Procurement Fraud Task Force to focus “resources at all levels of government to increase criminal enforcement” in areas of procurement fraud. The stepped-up attention to this area throughout the government may signal that the \$3.1 billion record in federal fraud recoveries in 2006 could soon be broken. More than 50 inspectors general from across all government departments and agencies also are actively pursuing thousands of investigations.

In addition, powerful newly installed Democratic committee and subcommittee chairs in Congress are launching dozens of oversight investigations of alleged government and contractor abuses, focusing on the reconstruction effort in Iraq and in the U.S. Gulf Coast following Hurricane Katrina, numerous areas of military and homeland-security procurement, the pricing of pharmaceuticals, and other significant areas of federal contracting. For instance, House Oversight and Government Reform Committee Chairman Henry Waxman (D-Calif.) in the first

week of February began one set of hearings on alleged waste, fraud, and abuse by government contractors in Iraq and another set of hearings on alleged overcharging by drug companies in federal health programs.

BROAD SWEEP

Contractors long have known that the government has a broad range of investigative and enforcement powers that can turn what would be a normal business dispute in a private commercial transaction into allegations of civil or criminal fraud, leading to massive fines and penalties, as well as disqualification from receiving new government contracts. Given the

broad sweep of the government's investigative powers and the complexity of procurement rules, companies that are wholly innocent of an intent to fleece the feds may nonetheless find themselves under scrutiny. What is striking about the current environment is the scope and



intensity of federal investigative and prosecutorial resources directed at this activity.

The added factor of a Democratic Congress—with new committee chairs, frustrated in the past by what they viewed as their Republican colleagues' lack of effective oversight of the Bush administration and its perceived coziness with contractors, and eager to use their newly acquired oversight and subpoena powers—raises the stakes enormously. While no target of a government investigation can be comfortable or secure when dealing with an inspector general, the FBI, or other government investigators, managing these investigations while under the spotlight of a high-profile congressional investigation can be even more daunting.

The procurement fraud initiative, created by Deputy Attorney General Paul McNulty, was modeled after his 2005 Procurement Fraud Working Group, begun when he served as the U.S. attorney general for the Eastern District of Virginia and led the prosecution of former Air Force acquisition chief Darleen Druyun and Boeing for contract favoritism in exchange for job offers. The current initiative focuses on virtually all areas of alleged procurement fraud, from pricing irregularities and labor mischarging, to misuse of classified and procurement sensitive information, and ethics and conflict-of-interest violations.

Participants in the task force reflect the significant firepower of federal government investigatory and enforcement agencies. Chaired by Alice Fisher, the head of Justice's Criminal Division, the task force includes the FBI, the inspectors general of major federal agencies—from the Departments of Defense, Homeland Security, and Veterans Affairs, to the General Services Administration and the U.S. Postal Service—as well as the Defense Criminal Investigative Service and other military criminal investigative organizations.

Perhaps to emphasize the seriousness of the effort, the Justice Department, on the day it announced the creation of the task force, also announced that Oracle Corp. had agreed to pay almost \$100 million to settle False Claims Act allegations that a company it acquired had overcharged the government under its GSA Federal Supply Schedule Contract. The task force more recently announced a criminal case in which a former Defense Department contractor was sentenced to serve nine years in prison and ordered to pay a \$3.6 million fine for his role in a bribery and fraud scheme flowing from contracts for the reconstruction of Iraq.

Beyond the work of the task force, the Justice Department has pursued numerous False Claims Act cases against pharmaceutical companies alleging mischarging under government drug contracts and benefit programs. Health-care fraud accounted for \$2.2 billion in settlements and judgments recovered by the federal government last year—a \$1 billion increase over the prior year.

Agency inspectors general have become more powerful weapons in the government's procurement fraud arsenal in the almost 30 years since the enactment of the Inspector General Act of 1978. According to one report, more than 11,000 auditors, investigators, and other professionals populate 57 Offices of Inspectors General throughout the federal government. Inspector general investigations always present

the risk that the matter under investigation will be referred to the Justice Department for criminal or civil prosecution. Each year, inspector general investigations lead to thousands of criminal indictments and successful prosecutions, as well as numerous Justice Department civil fraud claims, with fines and penalties totaling billions of dollars. The recent joining of forces of federal inspectors general with Justice in the Procurement Fraud Task Force signals that the level of inspector general referrals to Justice will only increase.

Moreover, because each inspector general reports semiannually to Congress, the reports have become a rich source for congressional inquiries and will continue to serve as such in the new Congress. For example, last year Congress extended the term of the Special Inspector General for Iraq Reconstruction until at least late 2008. By the end of 2006, the SIGIR had issued more than 125 audit and project assessment reports, many of them highly critical of contractor performance. In testimony before Congress in September 2006, the SIGIR said 89 criminal investigation cases were open and 25 cases had been referred to the Justice Department, four of which had resulted in convictions.

In another area that has received significant attention lately, the Homeland Security Department's Inspector General for Gulf Coast Hurricane Recovery has issued more than 40 reports, many of which deal with the Federal Emergency Management Agency's procurement activity. Several of these audits, as well as other government reports, address the failure and fraudulent actions of contractors responding to the Katrina recovery. The inspector general's Sept. 30, 2006, report to Congress reported 439 indictments related to Katrina and 255 convictions for hurricane-related allegations and crimes.

Although the Republican-led Congress held numerous oversight hearings on some of the same issues now targeted by Democrats, the pace is quickening in the new Congress. Oversight investigations into contractor waste, fraud, and abuse have already begun; initial hearings have been launched, and more are on the way. Two major congressional oversight committees—the House Committee on Oversight and Government Reform (which added the word “oversight” to its title in January) and the Senate Committee on Homeland Security and Governmental Affairs—each took the step of adopting rules authorizing staff deposition authority, giving their large and growing staffs the ability to take testimony on the record and under oath outside the context of a formal congressional hearing. Although the House Oversight and Government Reform Committee's agenda is the broadest of any congressional committee, other House committees, such as Armed Services and Energy and Commerce, also have begun oversight hearings.

Waxman also announced plans to reintroduce legislation he called the Clean Contracting Act to assist in curbing contract abuse. Bills relating to contracting for homeland security, Iraq, and private security services already have been introduced in the House. In the Senate, Judiciary Committee Chairman Patrick Leahy (D-Vt.) has introduced a bill called the War Profiteering Prevention Act of 2007, which would criminalize war profiteering acts, defined as “materially overvaluing any good or service

with the specific intent to excessively profit from war and relief or reconstruction activities.”

TAKE THE STEPS NOW

With all of this attention, contractors cannot afford to wait for a call from the Justice Department task force, an inspector general, or Congress to take action. Companies must take steps now to prevent and detect improper procurement activity and potential fraud in government programs, to mitigate the damage if any such activity is found, and to develop strategies to respond to government inquiries should they arise.

To begin, every contractor must have in place an effective compliance program that includes standards of conduct, as well as mechanisms for investigating potential violations and for taking prompt and appropriate remedial steps if violations are found. Contractors should conduct self-audits in areas of government business that the company believes may be considered high risk. If any information surfaces that suggests an employee or the company has committed wrongdoing, a contractor must thoroughly investigate the event and take appropriate action. The company's goals should be to understand the circumstances surrounding any alleged wrongdoing and to maintain the initiative during any government investigation.

A company must be prepared to respond promptly to inquiries from government investigators regarding its performance of government contracts. Most government contractors understand that Justice and agency inspectors general have far-reaching investigative authority and expect contractors to cooperate with their inquiries.

It is essential that, at the earliest stages of the investigation, the contractor develop an overall response strategy. That strategy will be guided by the contractor's assessment of its vulnerability on the issues being investigated. In some instances, it may make sense to seek a prompt, amicable resolution; in others, it may be better to seek an aggressive defense on the merits.

Counsel, in particular, should focus on key objectives during an investigation: maintaining contact with the investigators; gaining a thorough understanding of all of the facts and the government's key concerns; and presenting the facts in the best light for the company. Counsel should work cooperatively with government investigators, while ensuring that the client's

rights are being protected and that its position is being vigorously represented. Counsel should insist that the company be permitted a chance to present its side of the story, as well as to understand the bases for the government's claims, before the government takes formal action. In most instances, Justice Department lawyers and inspectors general staff will agree to this type of exchange.

THE COMMITTEES

Of course, managing these investigations becomes much more complex when a congressional oversight committee takes an interest. Congressional committees have the power to conduct oversight investigations into any matter within their jurisdictions. They have the power to subpoena the testimony of witnesses and virtually all documents that may be relevant to the subject matter of their inquiries. An ongoing criminal or civil investigation generally will not convince a congressional committee to back off of an oversight investigation—or even to delay issuing a subpoena for the testimony of an individual who is the target of a federal criminal investigation.

In these circumstances, counsel is faced with a delicate balancing act, requiring careful communication with each of the investigative bodies to ensure that the contractor's rights are protected. And in these circumstances, despite the very public nature of a congressional investigation, the overriding concern of counsel must be to assure that the individual's or organization's conduct in the investigation and the witnesses' testimony in a congressional hearing do not adversely impact ongoing criminal or civil investigations by other bodies or lead to further criminal exposure.

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