Frederic M. Levy and Christopher C. Bouquet

MCKENNA LONG & ALDRIDGE LLP

Consider the following newspaper headline:

• 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 multimillion dollar defense contracts 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? Fortunately 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-Up Typically Have Been Fuel for Procurement Fraud, Waste And Abuse

Historically, increased defense spending to support a war effort has been followed by heightened scrutiny of transactions 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 battlefront.” U.S. Code 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 and was authorized by government contractors against the Union Army.

The U.S. military build up before and during both World War II and the Vietnam War generated a rash of procurements and a surge of qui tabi cases. See, e.g., 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 prosecutions. During the Korean War, Congressional hearings observed that the Defense Department could not provide any statistics on procurement fraud. Senate Report 144 (1954)

“Operation III War” netted numerous government contractors with federal government contracts and consultants engaged in the illegal sale and purchase of government and contractor property, incurring to the avoidance of government contract requirements, including proper performance of contract. The investigation led to convictions or guilty pleas of 21 government contractors and consultants engaged in the illegal sale and purchase of government and contractor property, incurring to the avoidance of government contract requirements, including proper performance of contract.

In response to these developments and the government’s increasing use of debarment and suspension to render contractors ineligible for future contract awards, the government contractor community began to develop programs to prevent and detect procurement fraud. However, even these programs did not 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. U.S. ex. rel. U.S. ex. rel. Proctor & Gamble v. Royal Dutch Shell PLC, 621 F.3d 89 (7th Cir. 2010). Similarly, allegations of defective pricing, procurement fraud, and accounting misdeeds, the incidence of procurement fraud investigations and prosecutions declined. As a result, these government contractors have become complacent in the oversight and enforcement of their programs.

The predicate in which Boeing now finds itself is a prime example. A long-time government contractor, Boeing was among the first companies to implement internal compliance systems and effort, become the subject of allegations and inappropriate 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 Government Contractors Are At Risk

A. New Contractors

Victims of the Fraud Matters Is Likely to be the companies that have been found in the past several years of federal defense spending, and in particular to homeland security products and services, has attracted many new entrants to the federal marketplace, both as prime contractors and as subcontractors. However, these companies are often 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 do not understand the complex laws and regulations governing federal government contracts. Indeed, too often they are unfamiliar 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 statements applicable to the contracts. Among others, the rules governing procurement of federal contracts, and contract cost accounting and cost allowing are unlikely any practices encountered. The project is focused on examining the specific risks of the emerging 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 requires the implementation of internal policies 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 enforcing compliance 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 rush of procurement scandals of the 1980s and early 1990s, most government contractors promulgate compliance programs designed to ensure adherence to government contracting requirements. Many of these 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 accounting misdeeds, the bubble of procurement fraud investigations and prosecutions declined. As a result, these government contractors have become complacent in the oversight and enforcement of their programs.

The predicate in which Boeing now finds itself is a prime example. A long-time government contractor, Boeing was among the first companies to implement internal compliance systems and effort, become the subject of allegations and inappropriate measures are now taken, it is highly likely that many government contractors will not be able to withstand the spotlight.

III. A Rash Of Traditional Procurement Fraud Investigations

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 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 and its increased enforcement of qui tam violation, the trend is to privet the whistleblower, referred to as “relators” under the qui tam provision of the False Claims Act.

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 contract accounting rules; non-compliance with or cost or data submission requirements of the Truth in Negotiations Act (“TINA”), 10 U.S.C. § 2306a, 41 U.S.C. § 254(d); violation of the Anti-Contingent Fee 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 value has been diminished by fraud, waste and abuse. As instances of improprieties are exposed, it is most likely that companies, regardless of size, will find themselves in the Center of scrutiny by the media, Congress, and ultimately by the Department of Justice and other investigative agencies. A thorough and timely investigation 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 federal contractors once again will find themselves in the center of scrutiny by the media, Congress, and ultimately by the Department of Justice and other investigative agencies.

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. §§ 2306a, 41 U.S.C. § 254(d); violation of the Anti-Contingent Fee Rules in the FAR and the Defense Federal Acquisition Regulation Supplement; and violation of the Procurement Integrity Act.