

Roundup

An Update on Government Contracts Issues for Clients & Friends

April 2008 Vol. IV, No. 3

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Contractor Liable Under False Claims Act & Anti-Kickback Act for Failure to "Self-Police" OCI Issues

By J. Michael Littlejohn (michael.littlejohn@akerman.com)

The United States District Court in Massachusetts has issued a warning to contractors on the importance of effective compliance policies and the need to actively monitor Organizational Conflict of Interest ("OCI") issues. In United States v. Dynamics Research Corp. ("DRC"), No. 03cv11965, 2008 WL 886035 (D. Mass. Mar. 31, 2008), the court found that the company was liable for False Claims Act ("FCA") and Anti-Kickback Act violations under vicarious liability because of its "failure to self-police – in particular to ensure that its employees did not have conflicts of interest...." The court left

open a decision on damages which the Government alleges at \$24M for FCA penalties and treble damages, \$19M for double damages under the Anti-Kickback Act, and \$10M in breach of contract damages.

DRC was a technical management support contractor under two contracts for the Air Force at Hanscom AFB. In that role, DRC provided technical support and advice on the purchase, development, and deployment of computer systems. The contracts contained an Organizational Conflicts of Interest clause prohibited the contractor from assigning an employee

to the contract to perform any task "concerning any program, contractor, contract, or other matter" in which the employee or family member had a financial interest. The contracts also required the contractor to obtain yearly financial disclosure statements from each employee working on the contract.

Two DRC employees, a Vice President and a Program Manager (who later became a Vice President), engaged in three schemes under the contracts that were the basis for the government's complaint. First, in his job providing technical advice to the Air Force, the Program Manager convinced the Air Force to purchase a computer training module from a small disadvantaged Missouri company. He then directed the Missouri company to submit invoices to a company, Greenleaf, owned by his wife (using her maiden name). In the second scheme, DRC recommended that the Air Force purchase a computer system known as "Ravens" from a company named ECCS based on sole source justifications drafted by the DRC Program Manager. The DRC Program Manager did not disclose that he had a prior consulting relationship with ECCS and that Greenleaf received payments for "installation" services on each sale of the program. When ECCS graduated from its small business status, the DRC Program Manager helped set up another 8(a) company (known as KKP) to provide the "Ravens" software. He again received "installation" payments through ECCS and another company he set up. Finally, the Program Manager arranged for the Air Force to buy

computer memory through KKP. He recommended to KKP that it price the memory at the same unit price that the previous contractor sold it to the government, and then the Program Manager advised the Government that the price was "fair and reasonable." When the cost of computer memory dropped dramatically, the Program Manager, his boss, and the head of KKP agreed to a process where Greenleaf would provide the memory to KKP at a significant markup and then KKP would sell it to the Government. The three agreed split the extra profit.

Notably, the Program Manager and Vice President refused to provide DRC with annual financial disclosures, and DRC never pressed them to do so.

The Program Manager and the Vice President both pled guilty to multiple counts of defrauding the government. The question for the district court was whether DRC was directly liable for their actions under a theory that the employees were working within the scope of their employment with actual authority and with the intent to benefit the company. The court was unwilling to find DRC directly liable because the employees had hidden their activities from DRC and were "wholly motivated by self-interest." In sum, the court found that DRC was not involved in the schemes as a company, it never received payments from the schemes, and it was kept in the dark on their activities. The court also found that neither of the employees was a part of the "apex of power" within the company that would

make it automatically liable for their actions.

However, the court found that DRC was vicariously liable on the basis of "apparent authority" because "it put its agents in the position to do harm." 2008 WL 886035 at *14. Under vicarious liability, the company does not have to benefit from its employees actions – nor does the employee have to intend to benefit his company. According to the court, it is only necessary that the company put its employee in a position where others would believe that the employee was acting with the authority on behalf of his employer. The court, in effect, placed the burden on the employer to make sure its employees did not violate the law stating: "*Vicarious liability provides an important incentive for government contractors to self-police for the type of corruption that occurred here by placing liability on the actor in the best position to control the undesired conduct.*" Id. at *15 (emphasis added). Even though DRC did not know about the schemes of the employees, it was vicariously liable because it did not "self-police" its employees on conflict of interest. Of particular note, the court found that DRC did not obtain the required financial disclosure statements from its employees,

especially from the Program Manager whose job it was to work closely with the Air Force and provide technical advice on purchasing computer systems.

From a policy point of view, this case highlights potential issues with contracting-out government functions. The Air Force apparently allowed and encouraged DRC employees to essentially act as government procurement managers by signing documents and preparing sole source determinations, but the court was not willing to absolve DRC of liability even if the Air Force overstepped its bounds. Moreover, DRC attempted to argue that there was no illegal kickback because, as the technical advisor, the employees received payments for setting up direct contracts between the Air Force and the shell companies rather than receiving payments for issuing a subcontract with DRC. The court rejected that argument. In sum, the court found that the employee used DRC's position as the advisor to the Air Force to steer government funds "into his own pockets," and, according to the court, DRC was liable because it put the employee in a position with the Government where that could happen.

FAR Councils Request Ideas on OCI Clauses

By Daniel J. Donohue (daniel.donohue@akerman.com)

Is there a need for standard FAR clauses to address Organizational Conflicts of Interest (OCIs) and to promote ethical behavior by contractor

employees assisting the Government in acquisition functions? The Federal Acquisition Regulation (FAR) Councils appear to think so, and they solicit

your views on the subject on or before May 27, 2008. In this article, we provide some possible approaches that the FAR Councils might take.

On March 26, 2008, the FAR Councils issued two requests for public comments about whether there is a need for standard OCI contract clauses in the FAR to deal with two situations. The first situation is when private contractor employees serve as contract administrators or contract specialists working for the Government to award and administer Federal contracts. See FAR Case 2007 – 017, "Service Contractor Employee Personal Conflicts of Interest." 73 Fed. Reg. 15961-15963 (March 26, 2008). The second situation is whether there is a need for standard OCI contract clauses to cover other OCI 's on all Federal contract. See FAR Case No. 2007-018, "Organizational Conflicts of Interest," 73 Fed. Reg. 15962-15963 (March 26, 2008).

One Possible Approach – OCI Procedures in a Contractor Code of Business Ethics

The March 26 notices are the latest proposals by the FAR Councils to address business ethics coverage in the FAR. FAR case 2006–007, published as a final rule on November 23, 2007, with an effective date of December 24, 2007, adds FAR Subpart 3.10, Contractor Code of Business Ethics, which requires contractors to have a written code of business ethics, and, with the exception of small businesses, to have a formal business ethics training program and internal control system. FAR case 2007-006, published

as a proposed rule on November 14, 2007 and not yet in effect, would provide that contractors who do not timely report suspected violations of criminal law or overpayments in connection with a Government contract or subcontract may be subject to suspension or debarment.

FAR Part 3.10 does not mention OCIs and appears to be aimed specifically at discovering and reporting fraud against the Government. The FAR Councils' March 26 requests note that this ethics initiative does not address the OCI issue or contracts in which contractor employees assist Government employees to administer contracts.

One possible approach may be for the FAR Councils to amend FAR 3.10 to mandate that an acceptable Contractor Code of Business Ethics must specify procedures to identify and mitigate OCI issues. In the case of contracts in which contractor personnel will assist the Government in acquisition functions, perhaps the FAR could mandate that the Contractor's Code of Business Ethics contain additional safeguards to identify and prevent possible OCI's or personal conflicts of interest.

Another Possible Approach – Contract Clauses that Impose Additional Restrictions to Fill a Gap in Statutes and Regulations

The March 26 FAR Councils notice mentions concerns identified by other bodies about potential ethical and organizational conflict issues for contractor personnel assisting the Government with acquisition

functions. It appears that the FAR Councils are considering using contract clauses to fill a gap in statutes and regulations that cover Federal employees administering contract but not contractor employees performing similar work.

The Acquisition Advisory Panel (AAP) chartered by Congress under the Services Acquisition Reform Act of 2003 studied the issue and concluded that there is a need to assure that the increase in contractor involvement in Federal agency contract activities does not undermine the integrity of the Government's decision making process.

The GAO also issued reports about its review of contractor personnel working along side Federal employees. One GAO report mentioned by the FAR Councils concluded that most of the statutory and regulatory provisions governing Federal employees do not apply to contractor personnel working with Federal employees performing similar functions. GAO-08-169, Defense Contracting: Additional Personal Conflict of Interest Safeguards Needed for Certain DOD Contractor Employees. March 7, 2008. That report summarized these laws in the table below (footnotes omitted):

Selected Laws and Regulations That Address Personal Conflicts of Interest

Prohibition, restriction, or requirement	Applicable to federal employees?	Applicable to DOD contractor employees?
Bribery, kickback, other graft	Yes	Yes
Participating in matter affecting personal financial interest	Yes	No
Avoiding appearance of partiality when performing duties	Yes	No
Disclosing financial interests	Yes	No
Accepting travel and gifts	Yes	No
Using nonpublic information for personal gain	Yes	No
Future employment contact	Yes	No
Misusing position to provide preferential treatment to a private interest	Yes	No

So one possible approach may be to craft contract clauses that would impose, by contract, restrictions and requirements of these statutes and regulations and make them applicable to contractor personnel.

Another Possible Approach – Requirements for Specific OCI Training, OCI and Non-Disclosure Agreements and Post-Employment Restrictions.

One GAO report not mentioned in the FAR Councils' notice is one issued the same day, March 26, 2008, about use of

contractor personnel by the Army Contracting Agency's Center for Contracting Excellence (CCE). GA0-08-360, Defense Contracting: Army Case Study Delineates Concerns with Use of Contractors as Contract Specialists, March 26, 2008. That report did not find abuse or impropriety by contractor personnel assisting in acquisition functions, but attributed this to contractor-initiated safeguards including OCI training, signed conflict of interest and non-disclosure agreements to protect confidential government and contractor proprietary information, and limitations on contractor-employee activities for two years following their work for the CCE. GAO recommended that DOD initiate its own safeguards, however, so that it did not rely entirely upon contractor initiatives.

So another approach might be to have contract clauses that mandate the type of preventative measures that GAO found to be effective in this report. These would include requirements to provide contractor personnel with OCI training, to have them sign OCI and Non-Disclosure Agreements and limitations on activities of the contractor's employees for a period of time after conclusion of the contract.

Another Possible Approach - Existing Contract OCI Provisions Developed by Individual Agencies

The FAR Councils' March 26 requests for comments refer readers to several solicitation provisions used by individual agencies to address OCI issues affecting contractor personnel.

But these appear to be rather general requirements that the contractor be responsible for maintaining employee integrity, without much specificity. For example, the FAR Councils' notice mentions Department of Energy regulations concerning management and operation contracts, 48 CFR 970.5203-3, Contractor's Organization. That is a solicitation provision that makes the contractor "responsible for maintaining satisfactory standards of employee competency, conduct, and integrity and shall be responsible for taking such disciplinary action with respect to its employees as may be necessary." This is similar to the general requirement of FAR 3.10 added December 24, 2007 that requires a Code of Business Ethics without specifying much detail for its contents.

Another Possible Approach – Contract Clauses Restricting Post-Contract Activities of Contractors Assisting the Government with Acquisition Functions

Another approach, not specifically mentioned in the FAR Councils' notice, is to impose contract clauses that restrict post-contract activities by contractors assisting the Government in acquisition functions. Such clauses have been used in contracts for Independent Verification and Validation (IV&V) contracts, in which an IV&V contractor, on behalf of the Government, may draft or review contract specifications and inspect the work of a separate production contractor for quality purposes. If the IV&V contractor were allowed to compete for production work, there is a risk that the IV&V contractor might be biased against a competitor or in

favor of itself. So IV&V contracts may contain a provision in which the contractor agrees that it will not compete for production work and will be ineligible for production contracts.

Such restrictive clauses may be appropriate in specialized industries and large on-going programs, in which firms can choose to be on the "IV&V" side or the "Production" side" over the long term. But this approach may not

be practical for contracts for acquisition assistance from private contractors. Contractors that provide such acquisition support services as a small part of the services they perform for Government may unwilling to have their acquisition support activities foreclose their eligibility to perform other services. As such, they may chose not to compete for acquisition support contracts.

Will the High Court Review the Federal Circuit's Long Island Savings Bank Decision?

By Sarah M. Graves (sarah.graves@akerman.com)

On March 27, 2008, Long Island Savings Bank filed its petition for a writ of certiorari at the Supreme Court in an effort to convince the Court to review the Federal Circuit's controversial decisions in Long Island Savings Bank v. United States, 503 F.3d 1234 (Fed. Cir. 2007) and 476 F.3d 917 (Fed. Cir. 2007). While Long Island Savings Bank is a Winstar-related case, the issues on appeal run far deeper than most such cases. In LISB, the Federal Circuit held that LISB's contract was void *ab initio* because of a false certification made by a bank officer at the outset of the contract. As a result, LISB would have to forfeit its claims and any monies received from the Government during the term of the agreement. If

upheld, the Federal Circuit's decision will impact the government contracting industry at all levels and threaten to render many government contracts void, allowing the government to escape its performance obligations regardless of the extent of the contractor's performance.

The government's opposition to certiorari—assuming one is filed—is expected by April 30, 2008. Thereafter, LISB will be permitted to file a reply and the appeal will be distributed for conference. The Court's decision on certiorari will be expected shortly after the scheduled conference. Stay tuned to the Roundup for further updates!

Intern Had No Contractual Authority to Bind Government

The Court of Federal Claims recently reminded businesses that they bear the risk of dealing with a government official without authority when they enter contracts. In Stout Road Associates, Inc. v. United States, --- Fed. Cl. --- (March 14, 2008), the court found that a government intern did not have authority to enter a hotel reservation agreement for the intern's government office and, therefore, the government was not liable for cancellation charges. In this case, a DLA Quality Assurance intern made reservations with a Hilton Hotel in Philadelphia for her and other interns in her office for a training program. The intern signed a hotel reservation agreement in which the intern committed to a 12-night reservation for the training that totalled \$22,500. The intern signed the agreement and secured the reservation using her government-issued credit card. After signing the agreement, the intern's supervisor informed her that the training was cancelled and would be moved to another location. When the intern cancelled with the hotel, the hotel assessed a cancellation fee of \$18,000 as allowed under the reservation agreement.

DLA refused to pay the cancellation fee because it stated that the intern

never had the authority to enter the contract. The COFC agreed with the government. It noted that contracts entered into by an employee without authority are unenforceable. In this case, the court found that the intern did not have actual authority to enter a contract. Moreover, there was no showing that any of her supervisors had actual authority in the form of a contracting officer's warrant to enter a contract. There was no one in the intern's chain of authority that had authority or that could delegate authority to the intern. Accordingly, the contractor could not show that anyone with authority entered the contract or ratified an unauthorized commitment. Likewise, the court found that there was no implied actual authority in this case because none of the government officials involved had any authority to make the contractual commitment.

While the facts of this case seem limited to hotel reservations, the case has a broader lesson. Businesses must be certain that they are dealing with a government official that has the authority to make the contractual commitment. If not, the business will be left holding the bag.

Contractor Responsible for Failures of Supplier

In General Injectibles & Vaccines, Inc. v. Secretary of Defense, -- F.3d --- (March 19, 2008), the Federal Circuit found that a contractor supplying flu

vaccines was properly terminated for default when its subcontractor/supplier produced contaminated vaccine and its operations were suspended.

In this case, the Defense Supply Center (DSC) issued a contract for influenza vaccine to GIV, a wholesale distributor of pharmaceuticals and supplies. The contract noted that Chiron Vaccines in Liverpool, UK would manufacture the vaccine. The contract included FAR 52.212-4(f), which includes a provision regarding "excusable delays" that states that a contractor would not be liable for default if "nonperformance is caused by an occurrence beyond the reasonable control of the Contractor and without its fault or negligence...."

In 2004, Chiron discovered that its vaccine had been contaminated, and it reported the problem to the FDA. British authorities suspended Chiron's operations. GIV notified DSC of the problems and said that it would attempt to find an alternative source, but it did not think it was likely to find one. The DSC terminated the contract for default. At the ASBCA, the contractor argued that the termination was not proper because 1) its performance was dependent on the "condition precedent" that the FDA approve the vaccine which never occurred; and 2) that the nonperformance was caused by an "act of the government" that was beyond the contractor's control. The ASBCA affirmed the termination for default. On appeal, the Federal Circuit rejected both arguments by the contractor.

First, GIV argued that the Government had the burden of proving that the contractor had been

responsible for the failure of Chiron to meet the condition precedent. The Federal Circuit concluded that GIV's failure to perform emanated from a basic failure to perform by Chiron. The Circuit found that there was no doubt that Chiron had produced contaminated vaccine and that the contamination was the reason for the failure to obtain FDA approval. The Circuit found that GIV was responsible for its supplier's failures just as any prime is responsible for its subcontractor's performance.

Second, the Federal Circuit rejected the argument that FAR 52.212-4(f) absolved the prime of its supplier's non-performance. GIV argued that the commercial item clause does not specifically mention subcontractors or suppliers and that it differed from other FAR clauses dealing with delay which specifically address that the prime is responsible for the delays and defaults of its subcontractors. The Circuit found that FAR 52.212-4 should be interpreted consistent with the common law rule that makes a prime responsible for the actions of its subcontractors. Furthermore, the Circuit found that GIV was not absolved from responsibility because the contamination may have been accidental. The contractor would have to show there was an excuse and that the non-compliance was not the fault of its supplier. Absent such a showing, the termination for default was appropriate.

Upcoming Events

Doing Business with the U.S. Postal Service Seminar

Most federal procurement rules do not apply to the Postal Service. Instead, the Postal Service buys goods and services, and administers its contracts, under its own special purchasing rules. And these rules keep changing. In the last three years, the Postal Service has thrown out its old purchasing rules, implemented a new set of purchasing policies, and established a new method for dealing with procurement disputes. To help contractors understand these rules and work successfully within them, the law firm of Akerman Senterfitt Wickwire Gavin will be presenting a one-day seminar on "Doing Business with the U.S. Postal Service." The seminar will be held on April 25, 2008 at the Buena Vista Palace Hotel in the Walt Disney World resort. This will be the only presentation of this seminar this year. For further information, call Amy Carson at (703) 790-8750, or send an email to amy.carson@akerman.com.

Regular Registration Rate: \$495

Date: April 25, 2008

Time: 8:00 am to 4:00 pm

Location: Buena Vista Palace Hotel in the Walt Disney World Resort

About Our Government Contracts Group

The Government Contracts Group at Akerman Senterfitt Wickwire Gavin assists large and small businesses with all types of federal government contracts issues. To do business with the federal government, contractors must deal with a unique and complicated series of statutes, regulations and procedures. We help clients work with this system to maximize contracting opportunities with federal government agencies. We provide counseling and representation to clients in the areas of contract compliance issues, bid protests, Small and Disadvantaged Business matters, contractor and subcontractor claims administration, construction contracts, information technology contracts, and international contracts. In addition, we are uniquely qualified to advise and assist contractors who provide goods or services to the U.S. Postal Service.

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