

Increased Federal Government Spending Brings Greater Scrutiny of Government Contract Ethics

by Thomas R. Folk and Patricia H. Wittie



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Ethics in government contracting has long been an important issue.¹ However, increased government spending on homeland security, defense and other government programs is bringing even greater scrutiny to this area. As one investigator from a federal inspector general’s office told us, “With all this government money that is going to be spent, we’re making sure we come down hard now on any contract impropriety to make examples and to set the tone for the future.” Those contracting with the government, and wanting to keep doing so, must have reasonable procedures in place to avoid improprieties, know the legal rules concerning government contract ethics, be prepared to be put under the microscope by government investigators concerning questionable conduct and know how to react if an incident occurs.

What are the potential consequences of an ethics issue for a company that sells to the government? How would the issue affect the company’s continued ability to do business with the government and its completion of current contracts? Let’s look first at the potential consequences, then at ways that the contractor can avoid or mitigate those consequences and, finally, at some of the potential fact situations that can cause these kinds of dilemmas.

Potential Consequences of Government Contract Ethics Issues: Statutes and Sanctions

Government contracting activities can violate criminal and civil statutes more readily than in the private sector, and potential criminal violations are more likely to be pursued. Applicable criminal and civil

statutes include those relating to post-government employment,² conflicts of interest,³ receipt of gifts or gratuities,⁴ bribes,⁵ kickbacks,⁶ contingent fees for helping to obtain government contracts,⁷ false statements,⁸ false claims,⁹ providing inaccurate cost and pricing data,¹⁰ and disclosing or obtaining information about the procurement process improperly.¹¹ In the construction industry, criminal antitrust statutes, also, are frequently invoked when collusive bidding on a government project is discovered.¹² Criminal charges and penalties apply to both the individuals committing the illegal acts and to agents or employees of corporations. The conduct and intent of the agent or employee are imputed to the corporation so long as the agent or employee acted within the scope of employment with an intent to benefit the corporation, even if acting contrary to the corporation’s written policies.¹³

What makes a potential criminal violation even more worrisome is that concepts such as conspiracy,¹⁴ aiding and abetting,¹⁵ accessory after the fact¹⁶ and misprision of felony¹⁷ make the possibility of criminal liability potentially quite broad: Someone caught committing misconduct may sometimes try to implicate others with whom that person worked, even when a good factual basis for doing so may be lacking. These considerations reinforce the need for employees to be aware of the rules concerning government contract ethics and to question promptly and report suspected irregularity immediately, to prevent accusations that they aided or encouraged misconduct, or concealed or covered up misconduct.

Civil Claims For Damages/ Contractual Implications

For certain violations, such as false claims, the government may also pursue civil damages, either in litigation, or administratively. The contractor may also be exposed to litigation by private parties in a *qui tam* action.¹⁸ A breach of a statute or regulation pertaining to ethics in government contracting may also have severe consequences for any contract to which the breach pertains. In extreme cases, the government can nullify the contract, depriving the contractor of any payment, even for value already provided to the government,¹⁹ or the contractor may be required to return amounts already paid it.²⁰ The violation may also constitute a breach of the contract, justifying termination of the contract for default.²¹

Suspension and Debarment

A breach of government contract ethics can also lead to suspension and debarment of a contractor from government business.²² The federal government frequently uses suspension and debarment of contractors from government business in order to protect itself from businesses that lack the requisite integrity to do business with the government. Being suspended or debarred from federal government contracting can be extremely serious or even an economic death sentence to a government contractor. Further, the suspension and debarment process can occur in conjunction with ongoing criminal investigations or prosecutions. The contractor's ability to defend against debarment may thus be impaired, because personal risks of self-incrimination may exist for the contractor's officers and employees.

Reputation/Performance Evaluations

Even if a contractor avoids criminal penalties, civil claims for damages, contract damages, contract termination or suspension and debarment, questions about integrity or ethical violations can damage the contractor's reputation and may nega-

tively impact agency performance evaluations considered when future contracts are awarded.

Avoiding or Managing Adverse Consequences from Contractor Ethics Issues: Preventative Measures

The old saying, "an ounce of prevention is worth a pound of cure" has special force in the area of government contract ethics. The consequences of violations are so severe, and the potential costs of trying to mitigate the consequences are so great, that government contractors are well advised to put heavy emphasis on prevention. Contractors can take a number of reasonable steps to prevent the kind of ethics violations that can be ruinous to a government contractor. These steps include management emphasis on ethics, policies and procedures that address ethics issues, education of employees on ethics issues and their implications and prudent selection and management of subcontractors.

Company Management and Policies and Procedures

Preventive measures start with company management that encourages a company culture emphasizing integrity and ethics. Beyond that, the contractor should ensure that it has policies and procedures that address government contract ethics issues, should appoint an ethics officer and should ensure that any ethics issues are promptly raised and receive proper attention. Does the contractor have clear policies that lay out what is and is not permissible? Do contractor procedures require accurate and clear documentation? Are there resources for an employee to consult if a question arises? Are there procedures for reporting potential issues? Are there alternate reporting procedures if someone in the normal reporting channel is implicated in the problem? Are the contractor's document-filing and retention policies appropriate and implemented? Does the employee handbook allow appropriate discipline for lapses by employees in government contract ethics?

Most importantly, are the ethics policies and procedures an integral part of how the contractor does business?

Employee Education

The government contractor must educate its employees about requirements relating to government contract ethics. Managers and contract administrators should know these requirements well. Those involved in marketing, bidding and in interacting with competitors should be aware of the antitrust laws and prohibitions against providing gratuities to government employees, post-government employment restrictions and other restrictions applicable to the contract formation process. Those interacting with government employees should be aware of the restrictions that the government employee's agency places on gifts and meals. If an employee attends a pre-bid site visit, and a competitor says something to the employee and other bidders about how to bid, the employee should know this creates antitrust issues, and should disavow any agreement and report the conversation. Employees should be made aware how strict some government contract ethics requirements are and how severe the consequences of violating them can be to both the employee and to the company.

Prudent Subcontractor Selection and Management

Although the prime contractor's employees or agents do not impute a subcontractor's breach of government contract ethics to the prime contractor, absent some participation, such a breach can still cause substantial difficulties for the prime contractor. Accordingly, prudence dictates using some diligence in selecting subcontractors to ensure subcontractor responsibility and business integrity, ensure the flow-down to the subcontract of appropriate clauses relating to government contract ethics and ensure that subcontractors—particularly those inexperienced with working on government projects—know the importance of careful compliance with government contract ethics requirements.

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Measures when an Incident Occurs Prompt Investigation by Outside Counsel

Contractors must react immediately to potential breaches of government contract ethics. In most cases, the first step is to have outside counsel conduct an investigation. Use of outside counsel offers the advantage of protecting the investigation and any interviews under the attorney-client privilege and ensures someone

cedures, emphasizing ethics and improving ethics education may be required.

Completing the Project

In most instances, compliance issues will not affect contract completion, but they may affect payment. However, where a subcontractor is involved, the issue may be more complicated. May the prime contractor continue to work with the offending subcontractor on the project? Should

of cases where contractors have been prosecuted and convicted follow:

- Contractor invoiced the government for goods delivered when, unknown to its other personnel, its foreman intentionally included defective products in the goods covered by the invoice. Held: a criminal false claim by the contractor under 18 U.S.C. § 287.²⁵
- Contractor told its employees to put a sticker on fire extinguishers indicating that six-year maintenance had been done on the extinguishers, when actually, it was not done. Held: the contractor's subsequent submission of an invoice for performing the six-year maintenance constituted a criminal violation under 18 U.S.C. § 287.²⁶
- Mischarging labor hours allegedly worked by a contractor's employees. Held to violate 18 U.S.C. § 287.²⁷
- A subcontractor's submission of false resumes of subcontractor employees to the prime contractor, who requested payment from the United States on the subcontractor's invoices for work done by persons whose false resumes were submitted, was sufficient to support conviction of the subcontractor and its president under 18 U.S.C. § 287 even though the work by the subcontractor was done properly.²⁸

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knowledgeable about the laws and regulations concerned—as well as potential consequences for their violation—conducts the investigation. Also, counsel can give advice subject to the attorney-client privilege, which protects it from disclosure to others. In contrast, all results of an investigation and recommendations by a non-attorney may be subject to subpoena by the government and disclosure.

How to Deal with the Agency

How to deal with the federal agency concerned depends a great deal upon the results of the investigation and the circumstances. On the one hand, if the contractor derives all or most of its business from government, the contractor has a very strong incentive to be cooperative or to make a voluntary disclosure. On the other hand, agency investigators may at times, be unreasonable or try to exceed their authority. The approach to take requires careful consideration by management, aided by knowledgeable and experienced counsel, after a preliminary factual investigation.

Minimizing the Chances of Suspension and Debarment

Contractors that do business with the government want to avoid suspension and debarment. When a compliance issue arises, the contractor must take prompt steps to prevent a reoccurrence so that the contractor can assure the government that it remains responsible. Prompt measures such as disciplining or terminating offending employees, improving company pro-

cedures, emphasizing ethics and improving ethics education may be required. Should the subcontract be terminated? Should payments be made to the offending subcontractor on outstanding payment requests? Will delays caused by the subcontractor's violation be excused? The answers to many of these questions will depend upon the particular facts involved, including not only the nature of the misconduct, but also the particular contract, project and agency involved and the relationship between the contractor and the government agency.

Potential Sources of Contractor Ethics Issues

Because government contracting is so heavily regulated, compliance issues can arise in almost any situation. Common recurring problem areas include submission of false claims and statements, cost/price mischarging or certification, illegal gratuities, violation of post-employment restrictions, kickbacks and collusive bidding. Some specific examples follow:

False Claims and Statements

False claims liability can arise in many different contexts because the term “claim” is broadly defined. For example, contractors may be liable for submission of false resumes, false certifications, inaccurate timesheets, mischarging for labor, misreporting of indirect costs, and providing and then invoicing for defective products or services.²³ Providing a false statement to the government—which is legally distinct from submitting a false claim—can also be a criminal offense.²⁴ Some examples

Illegal Gratuities and Violation of Post-Employment Restrictions

Criminal statutes, civil statutes and the Federal Acquisition Regulation (“FAR”) prohibit giving bribes and gratuities to federal officials because of official acts performed or to be performed,²⁹ or even supplementing the compensation paid to such officials except in authorized circumstances.³⁰ Statutes and the FAR also impose certain restrictions on certain federal officials regarding conflicts of interest and regarding employment after leaving the government.³¹ The Office of Government Ethics maintains annual surveys of prosecutions under the criminal statutes at its Web site at www.usoge.gov.

Some examples of where contractors or government employees have been prosecuted and convicted include the following:

- The contractor gave a federal procurement agent cash in expectation of favors in return.³²
- A contractor's employee called his former agency about a contract in which he had been personally involved while with the government.³³
- A contractor and a government employee negotiated possible employment by the contractor of the government employee while the employee was working on a matter involving the contractor.³⁴
- A contractor to facilitate issuance of construction permits paid government inspectors in the District of Columbia.³⁵

Kickbacks

The Anti-Kickback Act of 1986, codified at 41 U.S.C. §§ 51 to 58, contains broad prohibitions on providing, attempting to provide or offering to provide any kickback. A “kickback” is defined very broadly to mean any gratuity, thing of value or compensation of any kind provided directly or indirectly to any prime contractor, prime contractor employee, subcontractor or subcontractor employee for the purpose of improperly obtaining or rewarding favorable treatment in connection with a prime contract or a subcontract relating to a prime contract.³⁶ The terms “subcontract” and “subcontractor” are also defined broadly.³⁷ The statute includes both severe criminal penalties of up to ten years in prison and civil penalties.³⁸ Prime contractors are required to report possible violations in writing.³⁹ Most contracts, except those for commercial items, also require the contractor to have in place reasonable procedures to prevent and detect possible violations of the Act, both within their own organizations and in subcontracting or teaming agreements.⁴⁰

Examples of instances where government contractors received criminal convictions or civil penalties include the following:

- A prime government contractor procured kickbacks from its shipping subcontractors, with most of the kickbacks being included in prices in invoices for higher shipping costs passed on to the government.⁴¹

- A subcontractor gave its prime contractor's employee interest-free loans to help in obtaining subcontract work on a government project.⁴²

Collusive Bidding

Collusive bidding is a *per se* violation of the Sherman Antitrust Act, 15 U.S.C. §1, *et seq.*, and is a criminal offense.⁴³ Under statutes and the Federal Acquisition Regulation (“FAR”), a contracting officer is required to report to the U.S. Attorney General any practice or event that may evidence a violation of the antitrust laws. FAR 3.303(c) lists practices that may evidence violation of the antitrust laws and includes a number of circumstances that might reflect potential collusion in bidding. These include the following:

- Rotation of bids or proposals;
- Division of the market so certain competitors bid low only for contracts from a certain agency, for a certain geographical area, or a certain product, but bid high on all other jobs;
- Establishment by competitors of a collusive price estimating system;
- Any incidents suggesting direct collusion among competitors, such as identical spelling or calculation errors in two or more competitors' offers; or
- Receipt of identical bids.

Conclusion

In today's government procurement environment, contractors should expect increased government scrutiny of government contract ethics. Good management, good policies, and good employee training will go a long way toward avoiding problems. However, if an ethics issue does arise, the matter must receive the immediate attention of management at its highest levels, and the contractor must be prepared to respond promptly to avoid or mitigate potentially serious adverse impacts. Prudent contractors will involve knowledgeable government contracts counsel at all steps of this process. ⚖️

Endnotes

- 1 During the American Civil War, the federal government experienced so many problems with dishonest contractor practices that President Lincoln called for passage of what became the predecessor of the False Claims Act. See Act of Mar. 2, 1863, ch. 67, 12 Stat. 696. Many of the rules relating to government contract ethics are discussed in the Federal Acquisition Regulation (“FAR”) at FAR Part 3 - Improper Business Practices and Personal Conflicts of Interest, 48 C.F.R. Pt. 3 (2001).
- 2 See 18 U.S.C. §207.
- 3 See 18 U.S.C. §208.
- 4 See 18 U.S.C. §201(c). See also 18 U.S.C. § 209.
- 5 See 18 U.S.C. §201(b).
- 6 See 41 U.S.C. §51-58.

Contract Ethics *continued on page 26*



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Code § 43-11 *continued from page 25*

- 25 99 Va. 257, 38 S.E. 134 (1901).
- 26 *Schreiber*, 99 Va. at 259, 38 S.E. at 134.
- 27 The priority given to the guaranteed debt was based on the bank's contract with the general contractor, which provided that if the general contractor failed to perform any part of the work, the bank was entitled to supply the deficiency and deduct the cost from the contract price. An owner also has this right pursuant to *Va. Code* § 43-16.
- 28 *Schreiber*, 99 Va. at 262, 38 S.E. at 136.
- 29 Section 2480 provided, in pertinent part, as follows:
- When owner may pay sub-contractor; if general contractor dispute account of sub-contractor.** If the account furnished under [§ 2479, making the owner personally liable to subcontractor] be approved by the general contractor, or if after ten days' notice to him of the filing of the said account with the owner, such contractor shall fail to file with the owner any objection in writing to the said account, in either case, the owner may pay the amount of the account to the sub-contractor and shall then be entitled to credit for the amount so paid upon whatever may be due by him to the general contractor.
- Interestingly, § 2480 also provided for a dispute resolution procedure if a general contractor disputed the correctness of a subcontractor's verified account.
- 30 *See Va. Code* §§ 43-7(A) and 43-11(2) (2002 Repl. Vol.).
- 31 *See e.g., Isle of Wight Materials Co., Inc. v. Cowling Bros., Inc.*, 246 Va. 103, 431 S.E. 2d 42 (1993). Virginia's interpleader statute is at *Va. Code* § 8.01-364. Note: the interpleader will not necessarily mean that the owner is discharged from further liability regarding the disputed funds. *See Sovran Bank, N.A. v. Bedford Park Associates L.P.*, 23 Va. Cir. 110 (Fairfax, Feb. 7, 1991) (Annunziata, J.). However, the interpleader should eliminate the possibility of incurring liability from distribution of the funds.
- 32 *Schreiber*, 99 Va. at 262, 38 S.E. at 135.

Contract Ethics *continued from page 31*

- 7 *See* 10 U.S.C. §2306(b), 41 U.S.C. § 254(a).
- 8 *See* 18 U.S.C. §1001.
- 9 *See* 18 U.S.C. §287.
- 10 *See* 10 U.S.C. §2306(f); 18 U.S.C. § 1001.
- 11 *See* 41 U.S.C. §423(a).
- 12 *See, e.g.*, 15 U.S.C. § 1; *United States v. Basic Construction Co.*, 711 F.2d 570 (4th Cir.), *cert. denied*, 464 U.S. 956 (1983); *United States v. Portsmouth Paving Co.*, 694 F.2d 312 (4th Cir. 1982). *See also* 10 U.S.C. § 2305(b)(5), 41 U.S.C. § 253 (b)(i), (requiring federal executive agencies to report bids or proposals to the U.S. Attorney General if they are considered to show a violation of antitrust laws); Federal Acquisition Regulation ("FAR") 3.303(c), 48 C.F.R. § 3.303(c)(2002) (guidance on practices or events that may evidence violation of antitrust laws and require reporting to the Attorney General).
- 13 *See, e.g., United States v. Automated Medical Laboratories, Inc.*, 770 F.2d 399 (4th Cir. 1985); *United States v. Basic Construction Co.*, 711 F.2d 570 (4th Cir.), *cert. denied*, 464 U.S. 956 (1983).
- 14 *See, e.g., United States v. Peterson*, 524 F.2d 167 (4th Cir.), *cert. denied*, 424 U.S. 925 (1975). *See also* 18 U.S.C. §286 (conspiracy to defraud government with respect to claims).
- 15 *See* 18 U.S.C. §2.
- 16 *See* 18 U.S.C. §3.
- 17 *See* 18 U.S.C. §4.
- 18 *See* 31 U.S.C. §§3729-3733.
- 19 *See, e.g., United States v. Mississippi Valley Generating Co.*, 364 U.S. 520 (1961); *Pan American Petroleum Transport Co. v. United States*, 273 U.S. 456 (1927); *K&R Engineering Co. v. United States*, 616 F.2d 469 (Ct. Cl.1980).
- 20 *See* 18 U.S.C. § 218.
- 21 *See, e.g., Joseph Morton Co. v. United States*, 757 F.2d 1273 (Fed. Cir. 1985).
- 22 *See* Federal Acquisition Regulation ("FAR") Pt 9.4, 48 C.F.R. Pt. 9.4 (2001). *See also Atlantic Chemical Co.*, GSBICA 5822-D, 80-2 BCA ¶ 14,801 (1980).
- 23 *See* 18 U.S.C. § 287; 31 U.S.C. § 3729.
- 24 *See* 18 U.S.C. § 1001.
- 25 *United States v. Milton Marks Corp.*, 240 F.2d 838 (3d Cir. 1957).
- 26 *United States v. Abbott Washroom Systems, Inc.*, 49 F.3d 619 (10th Cir. 1995).
- 27 *United States v. Systems Architects, Inc.*, 757 F.2d 373 (1st Cir.), *cert. denied*, 474 U.S. 847 (1985).
- 28 *United States v. Blecher*, 657 F.2d 629 (4th Cir.), *cert. denied*, 454 U.S. 1150 (1981).
- 29 18 U.S.C. § 201, 48 C.F.R. §§3.101-3, 3.204 (2001).
- 30 18 U.S.C. § 209, 48 C.F.R. §§3.101-3, 3.204 (2001).
- 31 18 U.S.C. § 207, 48 C.F.R. §3.104 (2001).
- 32 *United States v. Johnson*, 621 F.2d 1073 (10th Cir. 1980).
- 33 <http://www.usoge.gov/pages/daeograms/dgr-files/2002/do02003> pdf, viewed on 9/4/02.
- 34 *Id.*
- 35 *Id.*
- 36 41 U.S.C. § 52 (2).
- 37 41 U.S.C. § 52 (7) & (8).
- 38 41 U.S.C. § 54.
- 39 41 U.S.C. § 57.
- 40 *Id. See also* 48 C.F.R. §3-502 (2001).
- 41 *United States v. Lippert*, 148 F.3d 974 (8th Cir. 1998).
- 42 *United States v. Kruse*, 101 F.Supp. 2d 410 (E.D. Va. 2000).
- 41 *United States v. Portsmouth Paving Co.*, 694 F.2d 312 (4th Cir. 1982).