Bloomberg GOVERNMENT

Federal Contracts Report™

Fraud

Missing Data Hinders Contractor Disclosure Rule Nine Years In

The law enacted almost a decade ago to ferret out contractor fraud has been hampered by a wide range of deficiencies, a Bloomberg BNA investigation has found.

Although contractors have disclosed more than 2,200 instances of possible fraud, overbilling, or False Claims Act violations to the Office of Inspector General watchdogs within the Defense Department and General Services Administration since the mandatory disclosure rule was enacted, several other agency OIG offices could not determine how many times they've received disclosures.

The OIG offices at all but two of the top 11 agencies in terms of spending — including DOD, the leader by far — say they do not know how much they've recouped from wayward contractors.

Keywords and phrases in the regulation have yet to be clearly defined, leading to confusion about when contractors need to disclose to agencies, and to which officials. And ''soft disclosures'' — short cuts some contractors have used to avoid disclosing crimes to OIG offices — still occur, though less frequently than they used to, contracts attorneys said.

Yet, agency watchdogs and federal prosecutors haven't hardened their stances when handling overbilling, fraud, and false claims cases, government contracts lawyers now say, despite earlier warnings that the federal contracting industry would be ''criminalized'' as a result of the act's enactment in December 2008.

''The program was based on the fallacy that contractors don't make these kinds of disclosures anyway,'' Jonathan Aronie, a partner with Sheppard, Mullin, Richter & Hampton in Washington, told Bloomberg BNA. ''It is working as intended.''

Bloomberg BNA found that:

■ Contractors have disclosed cases of alleged wrongdoing to the DOD 1,979 times since the law was passed, and to the GSA 154 times, for a total of 2,133 instances. The OIGs within five other top 10 agencies in terms of contractor spending reported 79 additional disclosures, for an overall total of 2,212.

■ The GSA recovered $172 million from the 131 disclosure cases it closed from fiscal 2010 to fiscal 2017, it reported. NASA was the only other OIG to release information on how much it has recouped in contractor fraud cases, an amount totaling less than $1 million.

■ Key rule language is still undefined, including exactly what constitutes ''timely'' disclosures to agencies, as well as broad terms such as ''significant'' (as in ''significant overpayments''), ''knowing,'' and ''credible evidence,'' leading to confusion from government contractors and their attorneys about how best to comply with the law.

■ It appears that no more than a handful of companies have been prevented from bidding for government contracts through suspensions and debarments directly because of the rule. It was a policy for years at the GSA *not* to report contractors that self-disclose to suspension and debarment officials, as a way to encourage companies to come forward. Yet suspensions and debarments of *individual* contractor executives have gone up as a direct result of the implementation of the rule, attorneys said.

■ ''Soft disclosures,'' which occur when contractors have an obligation to report fraud and other crimes directly to inspector general offices but instead make the disclosures to other agency officials with less power to punish them, helped lead to the mandatory disclosure rule. Soft disclosures are still an issue, some contracts attorneys said, but are seldom because of rule's implementation.

Making Disclosures Routine The DOD began a voluntary contractor disclosure program in 1986. But by the mid-2000s, the program was failing, with ever fewer contractors disclosing wrongdoing. And the government lost $31 billion to $60 billion because of contractor fraud and waste during the Iraq and Afghanistan wars, the Commission on Wartime Contracting in Iraq and Afghanistan said in a report.

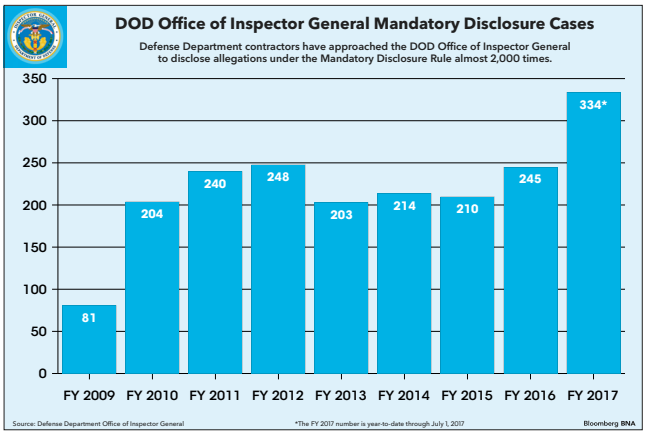
Some Justice Department officials had had enough. Contractors needed to disclose instances of fraud or overbilling ''immediately as a matter of routine'' to the government, Alice Fisher, head of the Justice Department's Criminal Division, wrote in a May 23, 2007, letter to then-Office of Federal Procurement Policy Administrator Paul Denett.

''We believe that if the [Federal Acquisition Regulation] were more explicit in requiring such notification, it would serve to emphasize the critical importance of integrity in contracting,'' Fisher wrote.

'Shifting' Management Fisher and former GSA Inspector General Brian Miller headed a task force to do just that.

The final FAR rule, further codified by the Close the Contractor Fraud Loophole Act that took effect the same year, mandates that in the cases of contracts worth more than $5 million and that last more than 120

days, contractors must disclose to the pertinent OIG office, in a ''timely'' fashion and in writing, if they have credible evidence that any principal, employee, agent, or subcontractor has violated a federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations, or has violated the False Claims Act.



Contractors risk suspension or debarment if they knowingly fail to do so, or if they know of overpayments but don't report them.

Complicating matters, other parts of the FAR note that contractors can be suspended or debarred for knowingly failing to report ''significant'' overpayments to the ''government'' but not specifically to an OIG. The American Bar Association and others have interpreted this to mean that overpayments considered less serious than fraud or FCA violations can be reported to agency contracting officers and not necessarily to OIGs.

The regulation also requires that contractors create ongoing business ethics awareness and compliance programs.

Contractors predicted that overzealous prosecutors and agency watchdogs would use the rule to punish well-intentioned disclosures through increased fines, criminal corporate prosecutions, suspensions, and debarments.

''With this rule, it can be argued that the de facto management of the federal acquisition system has effectively shifted to agency inspectors general and the Department of Justice,'' Marcia Madsen, a partner with Mayer Brown in Washington, and Roger Waldron, then-counsel with the firm who is now president of Coalition for Government Procurement, wrote in a Bloomberg BNA op-ed weeks before the regulation took effect.

A 'Daily Occurrence' Adhering to the disclosure rule has become a common discussion item between contractor compliance officials and their big-firm government contracts attorneys.

''It's a weekly if not daily occurrence,'' Gunjan Talati, a partner with Kilpatrick, Townsend & Stockton in Washington, told Bloomberg BNA.

In many cases, large contractors have decided the best way to adhere to the law is to regularly disclose all possible violations, including small overbilling cases, to the government, Todd Canni, a partner with Pillsbury Winthrop Shaw Pittman, told Bloomberg BNA.

Canni said some clients will send him lists of workers, monthly or quarterly, who may be guilty of mischarging violations, be they minor or more significant. This can result in suspensions or debarments for the individuals. From the government's point of view, the assurance that these workers won't immediately be hired by another contractor offers a protection for taxpayers, he said.

Yet, this has led to criticism that although the disclosure rule has resulted in several smaller victories, few big cases get reported.

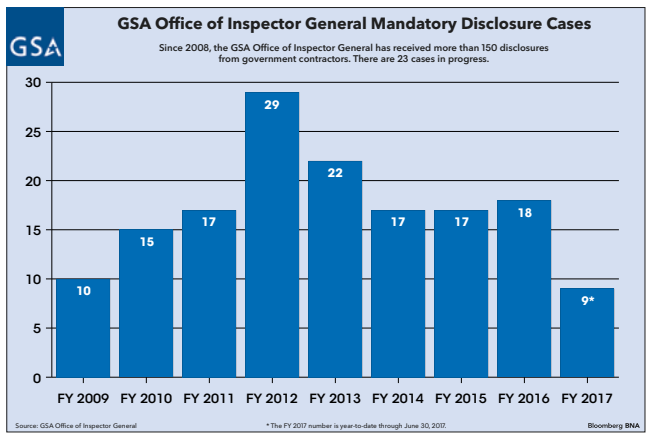
Lockheed Martin Corp. was one leading contractor that regularly disclosed cases involving nominal amounts of overpayments — including one for $9.23, panelists said at an ABA event several years ago, according to press accounts.

''I've heard anecdotally that some government people complain that they get mostly the small stuff, and that there must be bigger matters out there,'' Fred Levy, a partner at Covington & Burling and co-chair of the firm's government contracts practice group, told Bloomberg BNA.

''On the other hand, from my perspective as somebody who works with contractors, I can tell you that the disclosure requirement is ingrained in them,'' Levy said. ''They know the rule, they understand the rule, and almost uniformly, when an issue pops up, they ask, 'Is this a disclosure matter? And if I do make a disclosure, is it to the IG, or is it to the contracting officer?' My clients err on the side of disclosure.''

Labor Mischarging The DOD reported that 239 of the 274 contractor disclosures, or 87 percent, from the six months of activity through March 31, could be categorized as labor mischarging issues, according to the DOD OIG's most recent semiannual report to Congress. The rest of the matters pertained to significant overpayments, false claims, false certifications, and other issues.

The GSA received seven new disclosures during that period, including cases involving inflated sales reports, defective pricing, and unreported price reductions, the agency's OIG reported. At the same time, the agency concluded evaluations of six disclosures, which resulted in $3.8 million in settlements and recoveries.



The DOD is unable to reach conclusions about how much money it has recovered over the past nine years through disclosure rule cases, DOD OIG spokesman Bruce Anderson told Bloomberg BNA in a written statement.

''We don't collect this information and we could not verify any estimate,'' Anderson wrote. ''Some money is

   ISSN 0014-9063

recovered by the contracting officer, some is recovered from credit by the contractor and some through civil/criminal penalties from investigations.''

Booz Blues Meantime, there's little data available on the number of Justice Department FCA investigations and prosecutions from disclosure rule cases, or the number of suspensions and debarments from disclosure filings, including instances in which contractors knew of wrongdoing but failed to report it.

Justice Department spokeswoman Nicole Navas said the department didn't keep track of how many civil FCA cases it had opened as a result of the disclosure rule, nor how many criminal prosecutions, convictions, or financial settlements. The department's Criminal Division doesn't compile any of this data, she said.

It's equally tough to try to determine how many times contractors have been suspended or debarred because of the disclosure rule.

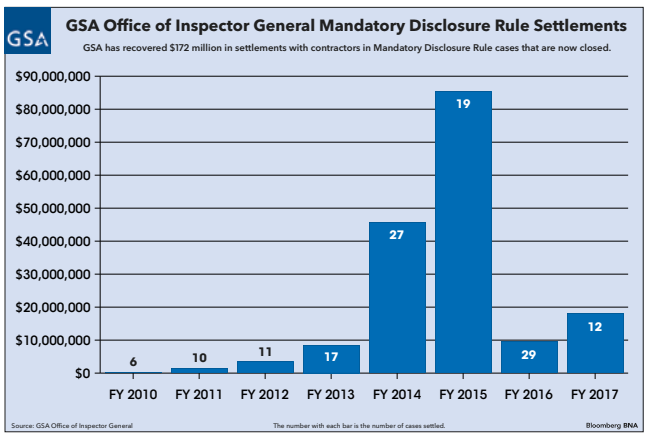
No OIG compiles such data. The Interagency Suspension and Debarment Committee, which compiles detailed annual reports for Congress, has never made mention of the disclosure rule. The top two ISDC officials, Chair David Sims and Vice Chair Lori Vassar, referred questions to an unnamed public affairs office, and did not respond to a list of questions.

Government contracts attorneys could point to just a couple of cases that had been made public.

In one case, the Air Force proposed for debarment Booz Allen's San Antonio office and several employees in 2011 and 2012, after a retired lieutenant colonel, during his first day of work, allegedly disseminated pricing data he had obtained while in the Air Force in a possible violation of the Procurement Integrity Act.

The company was taken off the debarment list in April 2012, after it signed a three-year administrative agreement.

Case by Case Part of the reason for the lack of information about disclosure-related suspensions and debarments is that, in the case of the GSA, a policy had been in place never to refer companies that self-disclosed to suspension and debarment officials.



Miller, the GSA inspector general from 2005 to 2014, who is now a shareholder with Rogers Joseph O'Donnell, told Bloomberg BNA the reason was simple: ''The company is being responsible in reporting. So why should we do that?''

GSA Inspector General Carol Ochoa has taken a slightly different course.

''We do not have a one size fits all policy related to suspension and debarment referrals for FAR disclosure cases,'' GSA OIG spokeswoman Sarah Breen told Bloomberg BNA in a written statement. ''We consider the facts on a case by case basis.''

With that said, ''Generally, the forthcoming conduct of the company making a FAR disclosure and the circumstances of the disclosure leads us to the conclusion not to refer the company for suspension or debarment,'' Breen said.

The DOD's path on this topic is laid out in a detailed flow chart, showing that suspension and debarment offices may be notified after DOJ prosecutors or civil litigators weigh in, in coordination with DOD criminal investigators.

'Ghost in the Graveyard' When referring to ''soft disclosures,'' government contracts attorneys often do not name the practice.

''In some cases, contractors have reported only to the contracting officer, who in turn has forwarded the disclosure to the OIG,'' Miller wrote in a 2012 report. ''In our view, this practice does not comport with the rule.

''If a contractor settles a matter with a contracting officer as an overpayment, but in fact there was credible evidence of fraud or a false claim that later comes to the attention of the OIG, we will not consider that an adequate disclosure made under the mandatory disclosure rule,'' Miller wrote.

Most of the attorneys Bloomberg BNA spoke with said they counsel clients against making soft disclosures.

Before the disclosure rule was adopted, Levy said, ''There was concern that contractors would tend to characterize matters as not involving fraud — that contractors would dump an issue on a contracting officer, and would try to avoid it being brought to the attention of DOJ or the IGs, and yet get the benefits of having disclosed it.''

But it's a different story now, said Levy, the co-principal editor of the roughly 400-page ABA Guide to the Mandatory Disclosure Rule published in 2009.

''I haven't heard anybody, since the inception of the rule, talking about soft disclosures as an issue,'' he said.

Others said they have heard the practice still exists. Talati, who said he ''absolutely'' advises his clients against the practice, said some contractors ''think they're hedging their bets.''

Canni said he has heard of companies deciding simply not to make disclosures, out of fear about how government investigators might react.

''I do know that's a regular thought process for clients,'' Canni said. ''It's a fear of the unknown, a ghost-in-the-graveyard uncertainty.''

Public Transparency As the disclosure rule approaches the nine-year mark, one thing is clear: Few around Washington are closely watching the way contractors and the government approach fraud allegations.

Rep. Peter Welch (D-Vt.), the main sponsor of the Close the Contractor Fraud Loophole Act, declined comment, as did Steve Linick, the State Department's inspector general who backed the FAR regulation while at DOJ. The Government Accountability Office hasn't

issued any reports directly on the disclosure rule and its impacts.

The effects of the disclosure rule aren't monitored closely by the Justice Department, Neil Gordon, an investigator with the Project on Government Oversight, a Washington nonprofit, noted in a 2011 blog post.

''Unfortunately, the government has never provided a comprehensive accounting of the mandatory disclosure program's successes, failures, strengths, and/or weaknesses,'' he wrote.

Agency OIGs should be required to periodically report the number and types of disclosures they receive, the actions taken in response, any connected suspension and debarment data, and how much money has been recovered, POGO said in its public comment on the proposed FAR rule.

That suggestion still holds, Gordon told Bloomberg BNA in a written statement.

''It's important for the agencies to keep track of the mandatory disclosure program,'' he wrote, ''not only from a public transparency standpoint but also to ensure the program is functioning as intended.''

BY SAM SKOLNIK

To contact the reporter on this story: Sam Skolnik in Washington at sskolnik@bna.com

To contact the editor responsible for this story: Daniel Ennis at dennis@bna.com

  FCR ISSN 0014-9063