Protecting Your Dollars:
Procurements Under a Shrinking Federal Budget

27th Annual
Ounce of Prevention Seminar

Welcome

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OOPS 2011
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The Year in Federal Contracting: Zealous Expectations & Enforcement

W. Stanfield Johnson

Angela B. Styles

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Trends

- Intensified War On Procurement Fraud
- Wartime Contracting Commission
- Suspension/Debarment
- DCAA Powerbase
- DoD “Better Buying Power” Directive

Intensified War On Procurement Fraud

- National Procurement Fraud Task Force (formed Oct. 2006)
- Mandatory Disclosure Rule (Dec. 2008)
- False Claims Act Amendments
- Increasing AUSA Activity
- FAPIIS (statutory creation to maintain data on "integrity and performance")

Intensified War On Procurement Fraud

- *United States v. Science Applications Int'l Corp.,* No. 09-5385 (D.C. Cir. Dec. 3, 2010)
- Increased IG activity
  - Substantial Hiring
  - Subpoenas
  - Mandatory Disclosure Response

Wartime Contracting Commission

- Bipartisan Legislative Commission (est. 2008)
  - "At What Cost? Contingency Contracting in Iraq and Afghanistan" – June 10, 2009
    - http://www.wartimecontracting.gov/docs/CWC_Interim_Report_At_What_Cost_06-10-09.pdf
  - "At What Risk" - February 24, 2011
    - http://www.wartimecontracting.gov/docs/CWC_InterimReport2-highres.pdf

Wartime Contracting Commission

Agencies' failure to effectively use contract suspension and debarment tools, and the U.S. government's limited jurisdiction over criminal behavior and limited access to records, have contributed to an environment where contractors misbehave with limited accountability.

Section V: Enforcement policies and controls fail to ensure contractor accountability

23. Require a written rationale for not pursuing a proposed suspension or debarment
24. Increase use of suspensions and debarments
25. Revise regulations to lower procedural barriers to contingency suspensions and debarments
26. Make consent to U.S. civil jurisdiction a condition of contract award
27. Clarify U.S. criminal jurisdiction over civilian-agency contractors operating overseas
28. Establish a permanent organization to investigate international-contract corruption
29. Expand the power of inspectors general
30. Raise the ceiling for access to the Program Fraud Civil Remedies Act
31. Strengthen authority to withhold contract payments for inadequate business systems
32. Amend access-to-records authority to permit broader government access to contractor records

Wartime Contracting Commission

RECOMMENDATION 24

Increase use of suspensions and debarments

Mandate automatic suspensions of indicted contractors and prevent contractors from avoiding suspension and debarment:

- Make suspension actions based on contract-related indictments mandatory for a predetermined time, not subject to discretion of the suspension-and-debarment official.
- Prevent deferred-prosecution and non-prosecution agreements between the Department of Justice and a contractor from being linked to administrative agreements between an agency and a contractor in connection with a suspension or debarment action.

RECOMMENDATION 25

Revise regulations to lower procedural barriers to contingency suspensions and debarments

Require regulations and policies be revised to:

- Exempt agencies from the requirement to provide contractors with the opportunity for a hearing prior to a suspension or debarment action not based upon a conviction, civil judgment, or indictment, and when there is a dispute over material facts. Agencies should instead be able to make decisions based on the documentary record alone. This provision should apply only to contracts performed predominantly overseas in support of overseas contingency operations.

Suspension/Debarment

- New Players
  - U.S. Small Business Administration
  - U.S. Agency for International Development
- New Issues
  - Small Business Contracting
    - Size Certifications
    - Limitation on Subcontracting, FAR 52.219-4
  - Grants

DCAA Powerbase

- 2008/09 GAO Assault on DCAA
  - "A management environment and agency culture that focused on facilitating the award of contracts and an ineffective audit quality assurance structure are at the root of the agencywide audit failures we identified."
  - "[P]ressure from the contracting community and buying commands for favorable opinions to support contract negotiations impaired the independence of three audits involving two of the five largest government contractors."

Contracting Workforce vs. DCAA

- Audit Management Guidance – Reporting Suspected Contractor Fraud and Other Contractor Irregularities (March 2009)
- Audit guidance on Reporting Significant/Sensitive Unsatisfactory Conditions Related to Actions of Government Officials (March 2009)
- Audit Guidance on FAR Revisions Related to Contractor Code of Business Ethics and Conduct (July 2009)

DoD "Better Buying Power"

- "Better Buying Power: Guidance for Obtaining Greater Efficiency and Productivity in Defense Spending (Ash Carter Sept. 2010)
  - Affordability and Cost Control
  - Incentivize Productivity and Innovation
  - Improve Competition
  - Improve Tradecraft in Services Acquisition
  - Reduce Non-Productive Process and Bureaucracy

Questions?

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Commercial Item Procurements

J. Chris Haile

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The Promise of Commercial Item Contracting

For the Government:

- Simplified processes
- New commercial technologies
- More competition
- Lower prices

For the Contractor:

- Eliminate government-specific requirements
  - Certified cost or pricing data
  - FAR part 31 and CAS coverage
  - Other clauses / administrative burden

Swinging Pendulum of Commercial-Item Policy

Early Stages– Building Momentum

- Federal Acquisition Streamlining Act of 1994 [Pub. Law 103-355]
  - Broadens definition of commercial items to include those "of a type" used for nongovernmental purposes
- Clinger-Cohen Act of 1996 [Pub. Law 104-106]
  - Amends Truth in Negotiations ACT (TINA) exception for commercial items
  - To be exempt, the item procured need not be sold in "substantial quantities to the general public" or at "established catalog or market price"
- January 5, 2001 USD(AT&L) Policy Memorandum
  - Use FAR Part 12 "To the maximum extent possible"
  - Part 12 procedures "provide . . . increased competition, better prices, and new market entrants and/or technologies"
  - "Commercial Item Acquisition Goals"

    (1) Double the dollar value of FAR Part 12 contract actions by FY 2005

    (2) "50 percent of all Government contract actions awarded by the end of FY 2005"

The Swinging Pendulum – Maximum Velocity

- 2003 – USAF: KC-767A Tanker is a commercial item

The Swinging Pendulum – Reversing Forces

Acquisition of the Boeing KC-767A Tanker Aircraft
(D-2004-064)

March 29, 2004

Conclusion and Results Summary. The Air Force contracting officer decided to use a commercial item procurement strategy that Air Force management strongly encouraged for the sole-source Boeing KC-767A Tanker Program, valued at $**.* billion, with The Boeing Company (Boeing). However, contrary to the Air Force interpretation, the military tanker aircraft is not a commercial item as defined in Section 403 of title 41, United States Code. Further, there is no commercial market to establish reasonable prices by the forces of supply and demand. By using a commercial item procurement strategy, the Air Force was also required to use a fixed-price type contract where the contractor retains all of the savings if the contractor's actual costs are lower than the estimates rather than a more appropriate mix of cost and fixed-price incentive type contracts. The commercial strategy also exempted Boeing from the requirement to submit cost or pricing data, which places the Government at high risk for paying excessive prices and profits and precludes good fiduciary responsibility for DoD funds. Without the Air Force gaining insight into Boeing's actual costs, the Air Force will also be at a disadvantage in any future tanker procurement negotiations.

The Swinging Pendulum – Reversing Forces

- And Another DoD IG Report

Contracting for and Performance of the C-130J Aircraft
(D-2004-102)

July 23, 2004

- FY 2005 Nat'l Defense Auth. Act [Pub. Law 108-375 (Oct. 28, 2004)]
  - Amends Title 10 TINA provisions
  - Non-commercial modifications to commercial items are NOT exempt from requirement for certified cost or pricing data if they exceed the TINA threshold or 5% of the total price of the contract. (Further amended in FY 2008 NDAA to add ". . . at the time of award"). [*see also* FAR 15.403-1(c)(3)(iii)]

The Swinging Pendulum – Reversing Forces

- And *Another* DoD IG Report

September 29, 2006

Commercial Contracting for the Acquisition of Defense Systems
(D-2006-115)

  - COs "used the broad commercial item definition to justify acquiring defense systems and subsystems that did not achieve the benefits of buying truly commercial items"
  - "to gain more control in ascertaining fair and reasonable prices, restriction should be placed on the commercial item exception found in section 2306a(b), title 10, United States Code"

The Swinging Pendulum – A New Direction

- FY 2008 Nat'l Def. Authorization Act [Pub. Law 110-181]
  - Limits use of commercial terms for major weapons systems [DFARS 234.7002]
  - Barriers to T&M / LH commercial contracting [DFARS 212.207]
  - Sales to foreign governments eliminated from consideration as evidence of a commercial market

- FY 2009 Nat'l Def. Authorization Act [Pub. Law 110-417]
  - Restricts commercial services "of a type" sold in the commercial market

    [FAR 15.403-1(c)(3)(ii); final rule published 3-16-2011]

- 2010 FAR Revisions
  - Re-interpret TINA
  - Create a new framework focused on Government access to contractor data, even for commercial items

Major Weapons Systems

Major Weapons Systems

- Can only be deemed commercial if:

  (1) the Secretary of Defense determines that--

  (A) the major weapon system is a commercial item under FAR 2.101; and

  (B) such treatment is necessary to meet national security objectives;

  (2) the offeror has submitted sufficient information to evaluate, through price analysis, the reasonableness of the price for such system; and

  (3) the congressional defense committees are notified at least 30 days before such treatment or purchase occurs.

[DFARS 234.7002(a)]

Major Weapons Systems

"Subsystems" of Major Weapons Systems

- If not COTS, then only treated as a commercial item if:

(1) intended for a major weapon system purchased under the new procedures above; OR

(2) The contracting officer determines in writing that--

(A) the subsystem is a commercial item under FAR 2.101, and

(B) the offeror has submitted sufficient information to evaluate, through price analysis, the reasonableness of the price for such subsystem.

[DFARS 234.7002(b)]

Major Weapons Systems

Components / spare parts of MWS:

- **If not COTS, then only treated as commercial items if**:

  (A) the component or spare part is intended for--

  (i) a major weapon system purchased under the new procedures above; or

  (ii) a subsystem of a major weapon system purchased under the new procedures above; or

  (B) the contracting officer determines in writing that--

  (i) the component or spare part is a commercial item under FAR 2.101, and

  (ii) the offeror has submitted sufficient information to evaluate, through price analysis, the reasonableness of the price for such component or spare part.

- **LIMITED APPLICATION**: Provision applies only for components and spare parts:

  (1) acquired by DoD through a prime contract or modification to a prime contract; or

  (2) through a subcontract under a prime contract or modification to a prime contract on which the prime contractor adds no, or negligible, value.

[DFARS 234.7002(c)]

Major Weapons Systems

Information for price analysis

- To the extent necessary to make a determination, the contracting officer may request –

  (1) prices paid for the same or similar commercial items under comparable terms and conditions by both government and commercial customers; and

  (2) if the information described in paragraph (1) is not sufficient, then other relevant information regarding the basis for price or cost, including information on labor costs, material costs, and overhead rates.

[DFARS 234.7002(d)]

Commercial Services & TINA

Cost or Pricing Data for Commercial Services – Narrowed Statutory Exception

- If services are only "*of a type*" offered and sold competitively in substantial quantities in the commercial marketplace, then not exempt from providing certified cost or pricing data unless:

  Contracting Officer determines, in writing, that the offeror has submitted sufficient information to evaluate the reasonableness of the price.

[FAR 15.403-1(c)(3)(ii)]

Commercial Services – T&M/LH

Services under T&M or Labor Hour Contracts:

DoD SPECIAL RULE

- such services must not only meet FAR 2.101 requirements, but also be *inter alia*:

  (1) procured for the support of a commercial item; OR

  (2) emergency repair service; OR

  (3) approved by head of agency as, *inter alia*, "commonly sold" to the general public using T&M / LH contracts

[DFARS 212.207]

2010 FAR Revisions

- Perceived problem:

  "some contractors incorrectly believed that the FAR definition of 'information other than cost or pricing data' . . . precluded the contracting officer from obtaining uncertified cost or pricing data."

  [75 Fed. Reg. 53199, Aug. 30, 2010]

- *Old* FAR 2.101
  - "Cost or Pricing Data" are "data that require certification . . ."
  - "Information other than cost or pricing data" means "information that is not required to be certified . . . [and] may include pricing, sales, or cost information . . ."

- TINA Exception
  - "Submission of certified cost or pricing data *shall not* be required ... for the acquisition of a commercial item."

2010 FAR Revisions

Government solution -- Reinterpret TINA and Redefine the terms

"cost or pricing data" → **"certified cost or pricing data"**

"data other than cost or pricing data" → **"data other than certified cost or pricing data"**

→ **"cost or pricing data"**

2010 FAR Revisions

The New Definitions

- Cost or pricing data
  - "all facts . . . prudent buyers and sellers would reasonably expect to affect price negotiations . . . ."
- Certified cost or pricing data
  - "means 'cost or pricing data' that were required to be submitted . . . and have been, or are required to be, certified . . . "
  - Commercial items still are excepted by statute

2010 FAR Revisions

The New Definitions

- Data other than certified cost or pricing data (DOTCCPD)
  - "pricing data, cost data, and judgmental information . . ."
  - "may include the identical types of data as certified cost or pricing data . . . but without the certification . . ."
  - Also includes
    - Sales data
    - Any information reasonably required to explain the offeror's estimating process
      - Judgmental factors applied
      - Nature and amount of any contingencies in the price

2010 FAR Revisions

- **Collection of DOTCCPD**
  - Hierarchy of sources:
    - Obtain DOTCCPD from contractor only "when there is no other means for determining a fair and reasonable price" [FAR15.404-1(b)]
    - If DOTCCPD must be obtained from contractor, "generally" follow the order of preference in FAR 15.402(a)(2)(ii):
      1. Data related to prices
         - » From within the government
         - » From sources other than the offeror
         - » From the offeror
      2. Cost data
  - Adequate price competition – usually sufficient alone [FAR 15.403-3(b)]

2010 FAR Revisions

- **Collection of DOTCCPD**
  - Scope: COs are to obtain only "to the extent necessary to determine a fair and reasonable price" [FAR 15.403-3(a)(1)(ii)]
  - "current": CO shall ensure that data are "sufficiently current" to negotiate a fair and reasonable price [FAR 15.403-3(a)(3)]
  - Form: For commercial items, "to the maximum extent practical, limit the scope of the request for data . . . to include only data that are in the form regularly maintained by the offeror . . . ." [FAR 15.403-3(c)(2)(ii)]

Strategies for Reducing Disclosure Risks

- Supporting commercial-item status
- Identifying market comparisons
- Defining the disclosures
- Internal controls

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AUDITS & DEFECTIVE PRICING:

TEN ESSENTIAL LESSONS FOR AVOIDING THE AUDIT NIGHTMARE

David Z. Bodenheimer

May 25-26
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Audits & Defective Pricing

Audit Disputes from Hell

Are These Your Goals?

- Antagonize Auditors
- Entice Fraud Investigators?
- Waste Money & Put Your Company at Risk?
- Engender Bitter & Protracted Litigation?

Essential Audit Lessons

How to Survive the Audit

1. Remember 5 Points of Proof
2. Preserve the Documents
3. Avoid Unnecessary Admissions
4. Fight for Judgments
5. Focus on Disclosure, Not Use
6. Beware Inconsistencies
7. Embrace your Subcontractor
8. Check the Offsets
9. Rebut the Audit
10. Battle the FCA Allegations

DEFENSE CONTRACT AUDIT AGENCY

AUDIT REPORT NO. 3311-2002K11010001

May 13, 2004

When Auditors Come

Proving Defective Pricing

Remember the 5 "Points"

Government bears burden of proof for "five points" of defective pricing

1. **Cost or Pricing Data**
2. **Data Reasonably Available**
3. **Not Disclosed or Known to Government**
4. **Government Reliance on Data**
5. **Causation of Increased Price**

DCAA Audit Manual

14-102 The DCAA Postaward Audit Program

a. Defective pricing occurs when a contractor does not submit or disclose to the Government cost or pricing data that is accurate, complete, and current prior to reaching a price agreement. Generally, the auditor establishes the existence of defective pricing in a postaward audit by examining and analyzing the records and data available to the contractor as of the date of prime contract price agreement and comparing them with the submitted cost or pricing data.

b. The objective of a postaward audit is to determine if the negotiated contract price was increased by a significant amount because the contractor did not submit or disclose accurate, complete, and current cost or pricing data. To show that defective pricing exists, the audit must establish each of the following five points:

(1) The information in question fits the definition of cost or pricing data.

(2) Accurate, complete, and current data existed and were reasonably available to the contractor before the agreement on price.

(3) Accurate, complete, and current data were not submitted or disclosed to the contracting officer or one of the authorized representatives of the contracting officer and that these individuals did not have actual knowledge of such data or its significance to the proposal.

(4) The Government relied on the defective data in negotiating with the contractor.

(5) The Government's reliance on the defective data caused an increase in the contract price.

Establishing these five points is a necessary prerequisite to support recommended price adjustments and provide the contracting officer with the information to achieve price reductions to contracts.

Preserving the Documents

Save the Documents

- **When post-award audit is likely:**

1. **ID key players**
2. **Get out "hold" notice**
3. **Collect key documents**
   - **Proposals & revisions**
   - **Pricing workpapers**
   - **Negotiation records & notes**
   - **Price negotiation memo (PNM)**
   - **Data disclosures**
   - **Pre-award audit reports**
   - **Emails!!!!!**

Losing with Lost Records

- **Audit Statute** (10 U.S.C. § 2313) (duty to make records available for audit)

- *Whittaker Corp. (Straightline Manu.)*, ASBCA No. 17267, 74-2 BCA 10,938 (no proof of nondisclosure & defective pricing where audit files were lost)

- ***Perelman Wins $1.4 Billion Total in Suit Against Morgan Stanley*** (Associated Press, May 19, 2005) (adverse jury instruction due to destruction of email & noncompliance with court order)

Avoiding Admissions

Avoid Unchecked Admissions

Classic Admission Traps:

- **Hidden Disclosure**
  - DCAA Assist Audits
  - Audit Workpapers
- **Unreliable Data**
  - Express Limits on Data
  - Never Used in Negotiations
- **Questionable Causation**
  - PCO use of price analysis
  - Disconnect in DCAA theories

Impact of Admissions

McDonnell Douglas Helicopter Sys., ASBCA No. 50341, 99-2 BCA 30546 (MDHS Chief negotiator admitted reasonable availability of data)

Lansdowne Steel & Iron Co., ASBCA No. 17746, 74-1 BCA 10461 (PCO conceded contractor's offset)

McDonnell Aircraft Co., ASBCA No. 44504, 03-1 BCA 32154 ("McAir waives all defenses" to defective pricing claim except 'reasonable availability'")

Fighting Judgments

War on Judgments

- **Escalation Attacks**
  - Vendor escalation
- **Engineering Labor Judgments**
  - Stale productivity estimates
- **Software Coding Estimates**
  - Projections on coding efficiency
- **Quantitative Risk Analyses**
  - Judgments on ranges of risk
- **FAR Table 15-2**
  - Disclosure of estimating methods

Judgments Okay

- **Cost or Pricing Data Definition**
  - FAR § 2.101 (judgments)
- **Recognized Estimating Techniques**
  - Contract Pricing Reference Guide
  - "Educated guesses"
- **Audit Guidance (DCAM 14-104.7)**

14-104). Therefore, errors in estimates (i.e., estimated escalation factors, estimated direct labor rates, etc) generally would not result in defective pricing because these estimates represent judgments rather than factual, verifiable data (i.e., cost or pricing data).

Focusing on Disclosure

Disclosure is Key

- **Disclose, disclose, disclose**
- **Johnson Rule: When in doubt.**
- **"TINA is a disclosure statute."**

"The plain language of the Act does **not obligate a contractor to use** any particular cost or pricing data to put together its proposal. Indeed, TINA does not instruct a contractor in any manner regarding the manner or method of proposal preparation."

United Technologies Corp., 04-1 BCA 32,556 at 161,024

Disclosure – Not Use

- **DCAA Practice**

  Common complaint that contractor did not **"use"** cost or pricing data

- **Against DCAA Policy**

14-104.7 Errors in Cost or Pricing Data

TINA addresses only the submission of cost or pricing data. It does not require a contractor to use such data in preparing its proposals or for there to be a relationship between the proposals and the conclusions that can be drawn from such data. Furthermore, the certification relates only to the cost or pricing data. The offeror does not certify its proposal. Therefore, under TINA, the proposal does not constitute cost or pricing data and, therefore, does not have to be free from mathematical errors.

Beware Inconsistencies

Common Contradictions

- **Documents vs. Testimony**
  - **Premium on records**

- **Then vs. Now**
  - **Negotiation context vs. post-award**
  - *Lockheed Martin, d/b/a Sanders,* 02-1 BCA 31,784
- **Half of Two-Way Error**
  - **Government ignores favorable errors**
  - *Sparton Corp.,* 67-2 BCA 6539
- **Liability vs. Damages**
  - **Kaleidoscope theories = no damages**
  - *American Machine & Foundry,* 74-1 BCA 10409

Contradictions Kill

> Mr. Rhodeback's statements of reliance on BAFO cost or pricing data at trial were unsupported by any contemporaneous project records. Those records of the CO that were adduced—and that we discussed above—show that competitive forces, rather than the defective 1983 BAFO cost or pricing data were relied upon to make the awards and to exercise the options for additional purchases for FYs 86-90. In the face of such credible, contemporaneous evidence, we believe that Mr. Rhodeback's unsupported trial statements to the contrary were unpersuasive.

United Technologies Corp., 05-1 BCA 32,860

Embracing Subcontractors

•Subcontractors & Defective Pricing

- **Get Indemnified:** Prime contractor liability

- **Watch the Clock:** Statute of limitations

- **Beware 2-Front War:** "5 Points" of Proof




Subcontractor

Prime Contractor

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Checking Offsets

Offsets are Great if . . .

- **Five Points of Proof**
  - **Mirror image of defective pricing**
- **Certified Offsets**
  - **Get audit help**
  - **Avoid 18 U.S.C. § 1001**
- **Offset Not Knowingly False**
  - **Barred if "known to be false"**
  - **10 U.S.C. § 2306a(e)(4)(B)(i)**
- **Not FCA Case**
  - **FCA law undecided**
  - **DOJ will fight to the death**

"Intentional" Offsets

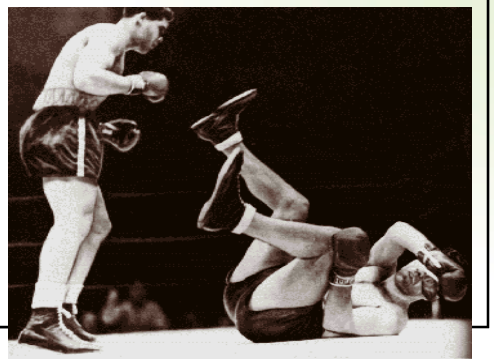
- **DCAA Practice**
- Commonly calls all offsets "intentional" because contractor was "**aware**"
- **Against DCAA Policy**

(4) The first exception prohibits an offset if the contractor intentionally withheld from the Government information showing a higher cost for an item or service. To deny an offset for this reason, it is not enough that someone in the contractor's organization was aware of the true cost of the item or service. Rather, the Government must establish that someone in the contractor's organization knew of the cost or pricing data and knew the certificate was inaccurate when submitted.

Rebutting the Audit

Contractor's Rebuttal

- **Contract Disputes Act**
  - **41 U.S.C. §§ 601-613**
  - **Encourages resolution, not litigation**
- **Regulatory "Due Process"**
  - **FAR § 15.407-1(d)**
  - **Contractor opportunity to respond**
- **Contractor Rebuttal**
  - **Get the documents**
  - **Scour the audit**
  - **Tell your story**



3rd Party Oversight

- **ADR Policy (FAR § 33.204)**

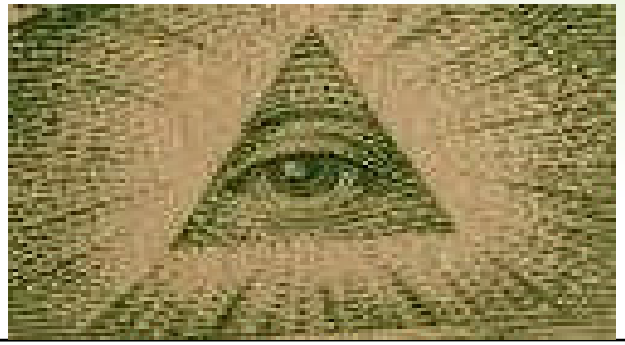
  "Agencies are encouraged to use **ADR** procedures to the **maximum extent practicable**."

- **ADR Procedure (FAR § 33.214)**
  - Objective: inexpensive & expeditious
  - Agreement (*e.g.,* ASBCA form)
- **Other Ideas**
  - Contracting Officer as Neutral
  - Government Counsel as Gatekeeper

Battling Fraud Allegations

TINA → Fraud

- **TINA Certification**
  - **"current, accurate & complete"**
- **Emergency Contracting**
  - **Procuring agencies in a hurry**
- **Expanding FCA Market**
  - **DOJ involvement**
  - **Inspector General audits**
  - ***Qui tam* allegations**



FCA Landmines

- **Elements of Proof**
  - More or Less? (*e.g.,* "reliance")
  - FCA + TINA? Like *J.T. Construction*
- **Presumption of Causation**
  - Benefit of TINA presumption?
  - *U.S. ex rel. TAF v. Singer* (4th Cir. 1989)
- **False Estimates**
  - Objective falsity vs. subjective estimates
  - *Harrison v. Westinghouse* (4th Cir. 1999)

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RECENT PROTEST DECISIONS ON ORGANIZATIONAL CONFLICTS OF INTEREST

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FAR DEFINITION OF ORGANIZATIONAL CONFLICT OF INTEREST (OCI)

- Far 2.101
  - An OCI occurs when, "because of other relationships or circumstances, a contractor may be unable, or potentially unable, to render impartial advice or assistance to the government, the contractor's objectivity in performing the contract work is or might be impaired, and/or the contractor would have an unfair competitive advantage."
- What kinds of "relationships or circumstances" can cause OCIs
  - Self interest
  - Affiliated entities

RECENT DECISIONS ON RELATIONSHIPS/CIRCUMSTANCES

Valdez Intntl. Corp., B-402256.3, Dec. 29, 2010, 2011 CPD ¶ 13

- Generally, pre-existing contractual relationships will not be considered sufficient to impair contractor's objectivity
- Awardee's long-standing subcontractor relationship with company whose performance it would be required to evaluate did not create OCI
- Possibility of future contracting relationships with company to be evaluated too remote
- "Generally we look for some indication that there is a direct financial benefit to the firm alleged to have the OCI"
- May be fact specific inquiry

RECENT DECISIONS ON RELATIONSHIPS/CIRCUMSTANCES

McCarthy/Hunt JV, B-40229.2, Feb. 16, 2010, 2010 CPD ¶ 68; *B.L. Harbert-Brasfield & Gorrie, JV*, B-140229, Feb. 16, 2010, 2010 CPD ¶ 69

- GAO found two OCIs in context of merger/acquisition negotiations before transaction was finalized
- Two separate corporations, but the interest of the acquiring entity in the target company was sufficient to create an OCI
- Parent of acquisition support contractor on the procurement negotiating to acquire key design subcontractor for awardee
- Biased ground rules and unequal access to information OCIs
- Merger negotiation secrecy guidelines inadequate
- Disqualification of awardee recommended
- Implications for acquisition due diligence

RECENT DECISIONS ON RELATIONSHIPS/CIRCUMSTANCES

Turner Construction Co. v. U.S., 94 Fed. Cl. 561 (2010), *appeal pending*, Fed. Cir. Dkt. No. 2010-5158

- COFC effectively reversed GAO *McCarthy/Hunt* decision and held agency decision to follow GAO disqualification recommendation arbitrary and capricious – ordered reinstatement of award
- No holding that acquisition negotiations could never give rise to OCI; reversed based on particular facts and GAO application of wrong standard of review
- "Possible" access to information not enough – hard facts
- Appeal pending and argued
- Due Diligence Ramifications
- COFC Docket Ramifications

Recent Unequal Access to Information Decisions

CapRock Government Solutions, Inc., et al., B-402490, May 11, 2010, 2010 CPD ¶ 124

- Alleged unfair competitive advantage because awardee knew certain offeror pricing information; all offers had to use awardee's satellites to perform
- No OCI because, for OCI, information must be obtained through performance of a Government contract

Ellwood National Forge company, B-402089.3, Oct. 22, 2010, 2010 CPD ¶ 250

- Former long-term employee of protester allegedly leaked proprietary information to awardee
- Although protester alleged at least some of information was learned while performing government contract, GAO denied protest because it found no reason to believe he did not learn all through his employment

RECENT REVOLVING DOOR UNFAIR COMPETITIVE ADVANTAGE CASE

Unisys Corp., B-403054.2, Feb. 8, 2011, 2011 CPD ¶ 61

- Allegation that awardee received unfair competitive advantage through use of former agency employee to prepare proposal, because former agency employee had had access to proprietary and other insider information while overseeing protester's performance of incumbent contract
- Based on *Health Net* decision
- Agency did investigation in response to first protest
- Analysis same as unequal access to information OCI cases
- Front-end
  - Information must be competitively useful
  - Incumbent contract labor rate information outdated because several years earlier
  - Staffing approach not competitively useful because protester changed approach in new proposal and could be "discerned by regular observation"
- Not reach back-end issues regarding role in proposal preparation

RECENT CASES ON OCI MITIGATION

First Coast Service Options, Inc., B-401429, July 31, 2009, 2010 CPD ¶ 6

- Medicare, self-evaluation, so impaired objectivity
- 2 mitigation plans properly rejected by agency-deference
  - Setting up an affiliated company to do the work
  - Last-minute summary proposal to use firewalled subcontractor to do the work, but with no details

Cahaba Safeguard Administrators, LLC, B-401842.2, Jan. 25, 2010, 2010 CPD ¶ 39

- Medicare, self-evaluation, so impaired objectivity
- GAO rejected agency's acceptance of last-minute one-sentence amended mitigation plan lacking detail
  - Plan included three options at discretion of awardee
  - Agency only evaluated one option – divestiture – but no binding promise to divest

RECENT CASES ON OCI WAIVERS

MCR Federal, LLC, B-401954.2, Aug. 17, 2010, 2010 CPD ¶ 196

- GAO upheld agency waiver of OCIs for two offerors based on small pool of competitors; waiver needed to avoid limiting competition
- "Where a procurement decision – such as whether an OCI should be waived – is committed by statute or regulation to the discretion of agency officials, our Office will not make an independent determination of the matter."
- Reviewed whether Agency complied with requirements of FAR 9.503 for level of approval and written explanation of why waiver in the Government's interests

CIGNA Govt. Services, LLC, B-401068.4, *et al.*, Sept. 9, 2010, 2010 CPD ¶ 230

- Protest denied because agency followed proper waiver procedures and basis for waiver was reasonable

Questions?

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SEVEN PROPOSED CHANGES TO THE FEDERAL ACQUISITION REGULATION'S OCI PROVISIONS THAT WOULD IMPACT THE WAY YOUR COMPANY DOES BUSINESS WITH THE GOVERNMENT

James G. Peyster

May 25-26
OOPS 2011
Crowell & Moring LLP

Proposed FAR OCI Rule Overview

- Issued on April 26, 2011
- Deadline for comments is June 27, 2011
- Would apply to all acquisitions, including task order acquisitions of any size
- Does not appear to dramatically alter the landscape from a bottom-line perspective of when some form of Contracting Officer intervention would be necessary.
- However, the rule:
  - Redefines key concepts, and
  - Adds more guidance and more responsibilities for both contracting officers and contractors
  - Changes the periphery of acceptable ways in which contractors and contracting officers can address OCIs

Background: Dec. 2010 DFARS OCI Rule

- Application: Only to Major Defense Acquisition Programs (MDAP) and pre-MDAPs of the Dept. of Defence (DoD)
- MDAP: Any program designated as such by DoD, or any program with an expected R&D expenditure of $300 million or expected total expenditure of $1.8 billion (in FY 1990 constant dollars)
- Key Policy: Implementing the Weapons System Acquisition Reform Act of 2009 ("WSARA"), a contract issued for the performance of Systems Engineering and Technical Assistance (SETA) for a MDAP must prohibit the contractor, or any of its affiliates, from participating as a contractor or Major Subcontractor in the development or construction of a weapon system under such program.
  - Corollary: A contractor with an existing production or supply contract for an MDAP cannot compete for a SETA contract related to that MDAP

Background: Dec. 2010 DFARS OCI Rule

- Major Subcontractor: Subcontract equals or exceeds (i) both the cost or pricing data threshold and 10% of the value of the contract under which the subcontracts are awarded, or (ii) $50 million.
- Exception: The rule expressly recognizes that the prohibition on future work as a production or supply contractor does not apply if the head of contracting activity determines that (i) an exception is necessary because DoD needs the domain experience and expertise of the highly qualified, apparently successful offeror, and (ii) based on an agreed-to resolution strategy, the apparently successful offeror will be able to provide objective and unbiased advice, without a limitation on future participation in development and production.

Interplay Between DFARS and FAR OCI Rules

- FAR rule would not alter the treatment of OCI issues that arise in the context of Department of Defense procurements of MDAPs and pre-MDAPs. The rules would apply coextensively.
- Proposed FAR rule is markedly different than the framework presented in the proposed DFARS OCI rule of 2010, and the FAR Councils "are seeking specific feedback regarding which course of action, or whether some combination of the two, is preferable."

Seven Key Changes In Proposed FAR Rule That Would Impact Your Business

1. New Proposed Definition of OCIs
2. New Harm-Based OCI Policy
3. Agency Threshold OCI Risk Determination
4. Mandatory Disclosure of OCIs in Proposals
5. Increased Guidance on Available Mitigation Options
6. Consideration of OCI Information From Outside Sources
7. Contractor Post-Award OCI Disclosure Requirements

KEY CHANGE #1: Current Definition of OCIs

- FAR § 2.101 currently states that:
  - "Organizational conflict of interest" means that because of other activities or relationships with other persons, a person is unable or potentially unable to render impartial assistance or advice to the Government, or the person's objectivity in performing the contract work is or might be otherwise impaired, **or a person has an unfair competitive advantage.**

KEY CHANGE #1:
New Proposed Definition of OCIs

- Per revised Far § 2.101, an "OCI" would mean a situation in which:
  - (1) A Government contract **requires a contractor to exercise judgment to assist the Government** in a matter (such as in drafting specifications or assessing another contractor's proposal or performance) and the contractor or its affiliates have **financial or other interests at stake** in the matter, so that a reasonable person might have concern that when performing work under the contract, **the contractor may be improperly influenced by its own interests rather than the best interests of the Government**; or
  - (2) A contractor could have an **unfair competitive advantage in an acquisition as a result of having performed work** on a Government contract, under circumstances such as those described in paragraph (1) of this definition, **that put the contractor in a position to influence the acquisition**.

KEY CHANGE #1: Analysis of Proposed Definition

- The proposed definition no longer attempts to sweep up all "unfair competitive advantages." Instead focuses only on those unfair competitive advantages created through the contractors' direct application of "judgment" in "assist[ing] the Government" that could influence an acquisition in which the contractor might compete.
- 'Unequal Access to Information' is no longer an OCI because it does not involve a scenario where "the contractor may be improperly influenced by its own interests rather than the best interests of the Government."

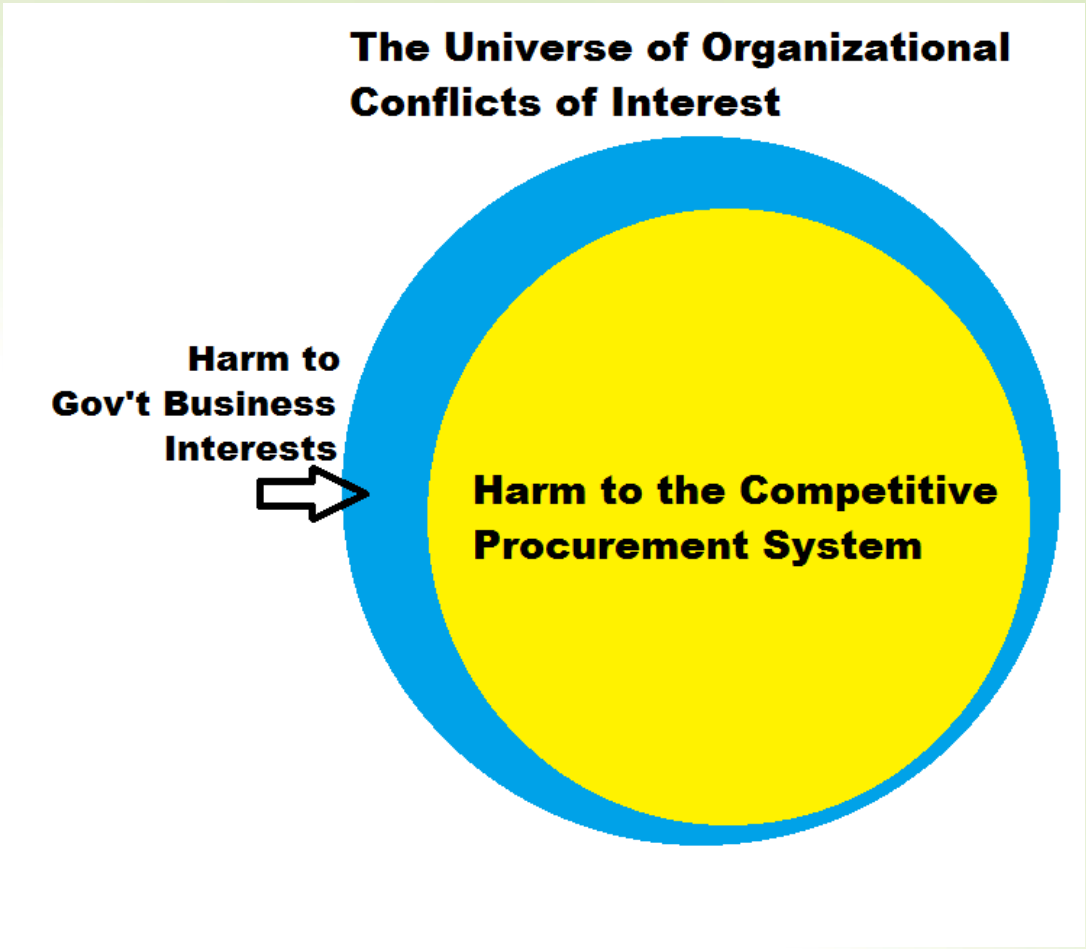
KEY CHANGE #1:
Potential Impact of Proposed Definition

- OCI prevention efforts would now need to focus exclusively on “biased ground rules” and “impaired objectivity”-type conflicts.
- There would be an increased focus on early OCI identification and OCI avoidance because “biased ground rules” and “impaired objectivity” OCIs are often difficult or impossible to mitigate after the fact

KEY CHANGE #2: New Harm-Based OCI Policy

- In FAR Subpart 9.5, OCIs are categorized by the type of task, e.g. "Preparing specifications or work statements," "Providing evaluation services."
- The proposed rule migrates all OCI rules to FAR Part 3 and the new proposed FAR § 3.1203 categorizes OCIs by nature of the harm to the Government:
  A. Harm to the integrity of the competitive procurement process
  B. Harm to the Government's business interests
- The Contracting Officer has the discretion to determine in which category an OCI falls.

KEY CHANGE #2:
How Do These Categories Inter-Relate?



KEY CHANGE #2:

Why the Integrity/Business Distinction Matters

- As is the case under FAR 9.5, OCIs under the proposed rule affecting the "integrity of the procurement process" must be avoided, neutralized, mitigated, or formally waived.
- However, for OCIs affecting only the Government's business interests, "**acceptance**" is an option on the Contracting Officer's menu.
  - A documented finding that the risk is tolerable would allow a conflicted offeror to continue participating even where the OCI cannot otherwise be mitigated and has not been formally waived.

KEY CHANGE #2:
Potential Impact of New OCI Policy

- Certain procurements that would previously have been off limits to your company would become new business opportunities
- The Government would have more flexibility to determine what OCIs do and do not matter
- A new frontier for potential bid protests: Was the CO's decision of how to categorize a particular OCI a reasonable decision?

KEY CHANGE #3: Threshold OCI Risk Determination

- Under the proposed FAR § 3.1207(a), the Contracting Officer is to make a threshold analysis of whether the subject procurement "may give rise" to OCIs
- If the Contracting Officer answers that question in the affirmative he or she would include a newly proposed FAR Clause, "Notice of Potential Organizational Conflict of Interest" (FAR § 52.203-XX) in the solicitation
- FAR 52.203-XX sets out the basic framework for addressing OCIs via avoidance, neutralization, mitigation, and/or acceptance.
- FAR § 3.1207(b) requires the Contracting Officer to identify by name within FAR § 52.203-XX any contractors who assisted the procuring agency in drafting the solicitation.

KEY CHANGE #3:
Threshold OCI Risk Determination

- If the Contracting Officer determines that the subject procurement will not give rise to OCIs, FAR § 52.203-XX would not be included in the solicitation.

KEY CHANGE #3:
Impact of the Threshold OCI Determination

- The omission of this clause may have a major impact on OCI bid protests:
  - What must be shown to establish that the Contracting Officer was unreasonable to assess that no OCIs could arise?
  - If clause is omitted, are all OCI protests waived if not challenged pre-award in the form of a solicitation protest?
- Companies may need to be more proactive during the pre-award phase about flagging any potential OCI concerns with known or likely competition
- Companies would need to consider if/how to disclose potential OCIs when the solicitation does not include OCI disclosure provisions.

KEY CHANGE #4:
Mandatory Disclosure of OCIs in Proposals

- If FAR Clause 52.203-XX, Notice of Potential Organizational Conflict of Interest, is included in a solicitation, offerors would be required to make broader OCI disclosures than in the past
- Offerors must disclose all relevant information regarding any organizational conflicts of interest, including information about potential subcontracts and limitations on future contracting
- By signing the offer, the contractor makes a formal "representation" that it has complied with the disclosure requirements

KEY CHANGE #4:

Potential Impact of Mandatory OCI Disclosure Rule

- Burden on industry to identify OCI information would remove the question of whether or not to disclose an OCI from the category of 'business decisions' and add significant work in the proposal capture process
- Companies risk being accused of making an actionable false statement if they knowingly omit relevant OCI information from proposals covered by FAR 52.203-XX
- Proposed rule creates ambiguity about what obligation a firm has to identify a potential OCI, or potential appearance of impropriety, which the firm believes does not rise to the level of an actual conflict

KEY CHANGE #5:
Guidance on Available Mitigation Options

- The current FAR § 9.504 provides no guidance on mitigation, leaving it entirely to the creativity of the contractor and the discretion of the contracting officer to craft acceptable mitigation plans.
- The proposed rule (FAR § 3.1204-3) endorses three specific forms of mitigation:
  i. subcontracting the portion of work from which the conflict arises (if possible)
  ii. soliciting advice from multiple sources so as to limit the impact of impaired objectivity, and
  iii. working with the contracting agency to establish internal mitigation measures

KEY CHANGE #5:
Guidance on Internal Mitigation Measures

- The Rule provides particularly detailed guidance as to the third category, "internal mitigation":
  - Internal firewalls
  - Independent members of the board of directors
  - Board of director resolution restricting certain employees from participating in contract performance
  - Non-disclosure agreements
  - the hiring of a senior-level OCI compliance officer to supervise all mitigation efforts.

KEY CHANGE #5:

Potential Impact of Internal Mitigation Guidance

- Provides a playbook to contractors attempting to craft mitigation
- Endorses forms of mitigation relating to boards of directors which are contrary to GAO's broad statement about affiliate attribution under the current OCI rule in Aetna Gov't Health Plans, Inc.; Foundation Health Fed. Servs., Inc., B-254397.15 et al., July 27, 1995, 95-2 CPD ¶ 129.
- Uncertain impact on how contracting officers would assess mitigation ideas not on the list

KEY CHANGE #6:
OCI Information From Outside Sources

- For the first time, the proposed rule would add a FAR provision requiring Contracting Officers to consult outside sources in their routine OCI analyses:
  - Proposed FAR § 3.1206-3(a)(2): "The contracting officer should seek readily available information about the financial interests of the offerors, affiliates of the offerors, and prospective subcontractors from within the Government or from other sources and compare this information against information provided by the offeror."
- Currently, FAR is silent on this subject.
- Case law is vague and deferential in identifying what an agency must consider

KEY CHANGE #6:
"Outside" Sources Within the Government

- Government sources include the files and the knowledge of personnel within:
  - The contracting office
  - Other contracting offices
  - The cognizant contract administration, finance, and audit activities
  - The requiring activity
- Non-Government sources which the Contracting Officer "should" consider in their OCI assessment include:
  - Offeror's Websites
  - Annual corporate shareholder reports
  - Trade and financial journals
  - Business directories and registers

KEY CHANGE #6:

Potential Impact of Outside Source Consideration

- Firms would need to take extra steps to ensure that the representations in their proposals (as well as what is not disclosed) match up with both (1) intra-agency information about the firm and, (2) publicly available information about the firm.
- To a lesser degree, firms would also need to consider increased coordination with their internal marketing and public relations departments to manage what information is released and how that information is presented.

KEY CHANGE #7: Post-Award Disclosure Requirements

- FAR Clause 52.203-ZZ, Disclosure of Organizational Conflict of Interest After Contract Award, would be included in any contract resulting from a solicitation in which the Contracting Officer has opted to include the clause at 52.203-XX, Notice of Potential Organizational Conflict of Interest.
- FAR Clause 52.203-ZZ would require the contractor to continually monitor itself and proactively disclose any newly identified OCIs, including both:
  - OCIs that existed prior to award but were undiscovered, and
  - OCIs that developed for the first time after award

KEY CHANGE #7:
Potential Impact of Post-Award Disclosure Rule

- Creates new affirmative disclosure obligation
- Failure to timely disclose could give rise to allegations of false statements and/or false certifications
- Risk of termination further incentivizes the need for industry to identify OCIs as early in the process as possible, so as to avoid creating conflicts with ongoing contracts that might be impossible to mitigate
- Firms may need to implement new processes to red flag conflicts and communicate those conflicts to the appropriate persons within the company

Questions?

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Personal Conflicts of Interest

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May 25-26
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Personal Conflicts of Interest

- The rules for contractor PCIs are changing
- Contractor access to nonpublic information is emerging as a species of PCI, not OCI
- Heightened concern about contractor access to nonpublic government information
- Trend on many fronts
  - Duncan Hunter NDAA FY 2009 Section 841
  - 2009 Proposed PCI Rule
  - 2011 ACUS Proposal
  - 2011 Proposed OCI Rule

Current State of the Rules

- Contractor access to nonpublic information: analytical framework depends on information and source
  - Prior contract – possible OCI
  - Procurement integrity data – analyzed under PIA
  - Hiring govt employee – possible UCA (*Health Net*)
  - Current govt employee – possible OCI, PCI, PIA, UCA, bias, or FAR 3.101-1
    - "avoid strictly . . . even the appearance of a conflict of interest"

Changing Landscape: Prior Changes

- NDAA FY 2009 Section 841, requires OFPP to
  - Develop policy and clauses on contractor employees "performing acquisition functions" that are "closely associated with inherently governmental functions"
  - Study PCIs and OCIs, propose FAR changes
- 2009 Proposed PCI Rule
  - Cover contractor employees performing acquisition functions closely associated with inherently governmental functions
  - Contractors must screen employees for PCIs, obtain NDAs, report PCI violations to CO

New Developments

- Proposed New OCI Rule
  - Unequal Access to Information would no longer be on OCI
  - Moved to FAR Part 4
- Administrative Conference of the United States
  - Long dormant, recently rejuvenated
  - A public-private think tank on administrative regulation
  - Adopted, as its flagship issue, contractor ethics

Proposed Addition to FAR Part 4

- FAR Part 4 to address contractor access to nonpublic information, and risks/consequences thereof
  - Premise: much of such access comes from performance on other government contracts
  - Managing access to be part of contract administration
- New “Access” clause
  - Preclude contractors from using government or 3d party information for any purpose unrelated to contract performance
  - Mandatory in solicitations, contracts when performance may require access to nonpublic information

Proposed Addition to FAR Part 4 cont'd

- Definition of "nonpublic information" vague
  - Anything not releasable under FOIA, or for which FOIA releasability not yet determined
  - Excludes information otherwise known by contractor
  - Very difficult to apply in practice
- Requires NDA's with contractor, subcontractor employees
- New "Release" clause
  - Notify 3d parties if their information is improperly used or disclosed
  - 3d party has right to enforce NDAs

Proposed Addition to FAR Part 4 cont'd

- UCAs: new solicitation provision to require offerors
  - Identify whether it or "any of its affiliates" possess nonpublic information relevant, provided by government
  - Certify (where firewall exists) that no breaches occurred
- Obligates CO to take action when unequal access to nonpublic information poses risk of UCA, risk to integrity of an acquisition
  - CO must analyze: access government-provided, unequal, and unfair
  - Mitigation preferred; disqualification "least favored"
- Expect implementation to be messy
  - OCI provisions more mature than new Part 4

2011 ACUS Proposal

- Premise:
  - Government employees are subject to a "comprehensive ethics regime" while contractor employees are not
  - Contractors performing services that can influence government decisions or gain access to nonpublic information are "in a position of public trust"
- Factual scenarios that cause concern
  - Contractor employees using nonpublic government information for personal gain
    - E.g., land speculation near a BRAC-enhanced facility
  - Contractor employees influencing government action for personal gain

2011 ACUS Proposal

- Current proposal to ask FAR Council, for
  - Two categories of contracts
    - "Information risk" contracts – those with high risk of contractors learning sensitive nonpublic information
    - "PCI risk" contracts – those with high risk of PCI
  - Propose FAR provisions and clauses
  - Require contractor certifications that its employees do not have a personal conflict of interest, training, oversight, disclosure of violations

What It Means: More Scrutiny of PCIs

- Already, for OCIs, PCIs, UCAs, PIA, contractors must police relationships and transactions
  - New hires (Health Net)
  - Consultants
  - Subcontractors
  - Possible mergers and acquisitions

What It Means: More Scrutiny of PCIs

- Expect soon
  - Services contracts under greater scrutiny
    - Those close to "inherently governmental" functions
    - Those colocated with government staff -- access to nonpublic sensitive government data
  - New clauses requiring
    - Vetting employee PCIs
    - Certifications re absence of PCIs
    - Training and monitoring of employee use of nonpublic government data
    - Disclosure obligations

Questions?

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Contracting with Small Businesses in the Wake of GTSI's Suspension

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Agenda

- The Enforcement Landscape
- Risk Areas for Small Businesses
- Risk Areas for Large Businesses
- Regulatory Developments
  - 8(a) Program
  - Parity in Set-Asides
  - WOSB Program
  - Size Protests and Appeals
  - Targeting ANCs (Again…)

The Enforcement Landscape

- Big business for small businesses (SBA Report on the Small Business Economy for FY10):
  - SBs awarded $96.8 billion in federal prime contracts in FY09 (21.89% of all federal dollars)
  - As of July 2010, SBs had received 30% of economic stimulus money
  - SBs awarded 31.82% of federal subcontract dollars in FY09
- "The Small Business Administration has no tolerance for fraud, waste and abuse in any of our programs. Reflective of that commitment, over the last 18 months we've taken steps aimed at ensuring only eligible companies receive the benefits of our business development and contracting programs by strengthening our ongoing oversight and enforcement."

  --SBA Administrator Karen Mills, 10/1/2010

The Enforcement Landscape

- "GTSI suspension: a shot across the bow?"

  -Washington Technology
- "NY Man Wrongly Won $16M in Military [Small Business] Contracts: Jury"

  -Law360
- "Schiavone Construction to Pay $20 Million and Costs of Investigation to Resolve Public Works Hiring Fraud: Schiavone Admits Fraudulently Reporting that Minority and Disadvantaged Business Enterprises Performed Subcontracted Work on Contracts with New York City and New York State"

  -DOJ Press Release

The Enforcement Landscape

- The headlines make it clear that enforcement is a concern for both small and large business contractors
- 10/1 suspension of GTSI is a key example:
  - GTSI served as a subcontractor on contracts where the prime contractors had little to no involvement (0-.5%) in performing set-aside contracts
  - GTSI concealed its involvement on these contracts (business cards, email addresses)
  - The suspension was lifted only after key personnel, including the CEO and GC, were removed from the company
  - Even though the small business prime contractors had the primary responsibility for enforcing the limitations on subcontracting clause, GTSI was suspended first—and without warning
  - Even after suspension lifted, GTSI revenues have plummeted 31% from the prior year
  - Key small business primes also suspended

Enforcement Risks: Small Businesses

- False Certifications
  - The Small Business Jobs and Credit Act of 2010 provides that an offeror's mere submission of a proposal for a small-business set-aside contract, or even its registration in a database to be considered for a set-aside, is to be considered an "**affirmative, willful and intentional**" certification that the offeror meets the small business size and status requirements
- Work Allocation
  - Post-GTSI, small businesses can expect to have their subcontracting relationships with large businesses scrutinized to ensure that the small businesses are not being used as "pass-throughs"
  - Added care in negotiating terms of teaming agreements, subcontracts
  - Failure to comply with limitations on subcontracting also grounds for proposal elimination

Enforcement Risks: Small Businesses

- Size Protests
  - Low threshold to file; short time frame to respond and response includes significant documentation and certified SBA Form 355
  - May now also be filed by SBA OIG (in addition to CO, SBA Government Contracting Area Director, other eligible offerors)
  - Teaming arrangements and subcontracting agreements will be scrutinized
  - OIG may begin an investigation based on the results of the size protest
- Unenforceable Subcontracts
  - In *Morris-Griffin Corp. v. C & L Servs. Corp.*, a federal district court found a subcontract between a small business prime and large business sub to be unenforceable because it violated SBA regulations and the limitation on subcontracting
  - The court found that small business's size certification was "conceived in fraud" and that set-asides are "susceptible to finagling"

Enforcement Risks: Large Businesses

- Work Allocation
  - Large business must be aware of limitation on subcontracting requirements when working with small business subcontractors on set-aside contractors
  - Large businesses cannot rely on their small business prime contractors to be responsible for this issue
  - DOT DBE program crack-down – small business subcontractor must perform "commercially useful function"
- Unenforceable Subcontracts
  - Large businesses should also be concerned about *Morris-Griffin Corp. v. C & L Servs. Corp.*

Enforcement Risks: Large Businesses

- Subcontracting Goals and Reporting
  - Requirement for President/CEO approval of Summary Subcontract Report (SSR) submissions
  - Little guidance on what constitutes "good faith" to meet goals
  - Impact on past performance evaluations
  - The Small Business Jobs and Credit Act of 2010 requires contractors to make a "good faith effort" to use small businesses identified in their proposals and to explain any failure to do so to the CO
- Performance/Award Risks
  - Prime is ultimately responsible for subcontractor performance
  - Subcontracting plan = condition of award
  - FAR 9.104-4: "Determinations of prospective subcontractor responsibility may affect the Government's determination of prospective prime contractor's responsibility"

8(a) Program Regulatory Changes

- Effective 3/14/2011
- 8(a) Program Eligibility Requirements
  - Individuals claiming social and economic disadvantage must reside in the United States
  - Finances of a spouse will not be considered when evaluating an application (unless spouse will be involved with the business)
  - Revised net worth amounts for initial ($250K) and continued eligibility ($350K for 3-year average)
  - General prohibition against family members owning 8(a)'s in same or similar line of business
  - Changes in primary NAICS code permitted if consistent with majority of revenues during 3-year period
  - Distinction between Program graduation (meet targets, objectives, goals) versus Program completion

8(a) Program Regulatory Changes

- New Joint Venture Requirements
  - JV can be awarded up to 3 contracts in 2 years; may form multiple JVs
  - Both "formal" and "informal" and populated and unpopulated JVs are now expressly allowed
  - **Unpopulated or Thinly Populated JV Requirements**: SB employee is project manager; SB must perform 40% of work performed by JV; SB must perform 40% of the total work performed by JV partners (and affiliates)
  - **Populated JV Requirements**: demonstrate performance of the contract controlled by SB and what SB will gain from performance; Mentor or affiliate(s) may not also be subcontractor
  - SBs must receive profits equating to % of performance, or if separate legal entity, equating to its ownership interest, and are no longer automatically entitled to 51% of profits
  - 8(a) firms have to report how JV requirements were satisfied

8(a) Program Regulatory Changes

- Mentor/Protégé Program
  - Assistance has to be tied to the Protégé's SBA-business plan
  - Mentor may have more than one Protégé (limit of 3)
  - Protégé may have more than one Mentor
  - An 8(a) firm cannot be both a mentor and protégé simultaneously
  - Mentor/Protégé JVs may be deemed small for subcontracts
  - Require Mentor/Protégé agreements to be approved by the SBA in advance before the firms can submit an offer as a JV
  - To qualify for exclusion from affiliation, Mentor/Protégé JV must comply with requirements of 13 CFR 124.513
  - SBA has discretionary authority to recommend the issuance of a stop work order for contracts with a Mentor/Protégé JV if the mentor fails to give the agreed-upon assistance; other sanctions include termination of Mentor/Protégé agreement, contract termination, or suspension and debarment

Parity in 8(a), HUBZone, and SDVOSB Program Set-Asides

- 3/16/2011 interim rule clarifies a CO's ability to use discretion when determining whether an acquisition will be set aside for 8(a), HUBZone, or SDVOSB contractors
  - Previously, GAO and the COFC interpreted the Small Business Act to require priority be given to HUBZone small businesses when setting aside acquisitions
  - Interim rule clarifies and reflects the statutory relationship among the small business programs
  - Although this interim rule does NOT address WOSBs, a separate rule, establishes parity between WOSBs and other SBA small business contracting programs
- As a result of this rule, an increase in SDVOSB set-asides may occur
  - FY09 – Agencies had least success in meeting SDVOSB goals
  - 18,213 registered SDVOSBs (compared to 9,303 HUBZones and 9,234 8(a)'s)

Parity in 8(a), HUBZone, and SDVOSB Program Set-Asides

- 3/16/2011 interim rule additional clarifications:
  - If a requirement has been accepted by SBA under the 8(a) Program, it must remain in the 8(a) program unless SBA agrees to its release
  - If an acquisition exceeds the simplified acquisition threshold, the CO must consider a set-aside or sole-source acquisition to a small business under the 8(a), HUBZone, or SDVOSB programs before proceeding with a small business set-aside
  - The small business set-aside requirement of FAR 19.502-2(a) does not preclude award of a contract to a qualified 8(a) program participant, HUBZone small business concern, or SDVOSB concern, because SBA's regulations grant a CO discretion to use the 8(a), HUBZone, or SDVOSB at dollar levels above the micro-purchase threshold and at or below the simplified acquisition threshold

WOSB Program Establishment

- 10/7/2010 final rule implementing the statutory goal that 5% of federal contracting dollars go to WOSBs
  - Provides for set-aside procurements for contracts under certain dollar thresholds ($5 million for manufacturing contracts and $3 million for other contracts) for WOSBs in the 83 identified industries in which they are underrepresented
    - Prior proposed rule had only identified 4 industries
    - 45 NAICS codes in which WOSBs are underrepresented and 38 NAICS codes in which WOSBs are substantially underrepresented
    - In the substantially underrepresented industries, the CO may award to WOSBs regardless of economic disadvantage
  - Removes requirement that each Federal agency certify it had engaged in discrimination against WOSBs prior to setting aside a contract
  - Specifies that there is no order of precedence between 8(a), HUBZone, SDVOSB, and WOSB concerns for setting aside contracts

WOSB Program Establishment

- 10/7/2010 final rule additional specifics:
  - Effective 2/4/2011
  - Sets forth the eligibility criteria for the program
    - A small business concern must be 51 percent owned and controlled by one or more women
    - The woman who holds the highest officer position of the concern must manage it on a full-time basis and devote full-time to the business concern during normal working hours
    - The woman manager need not have the technical expertise or license required, but must demonstrate that she has the ultimate managerial and supervisory control over those possessing the required licenses or technical expertise
  - Establishes the protest and appeal process for WOSB and EDWOSB status protests

WOSB Program Establishment

- 10/7/2010 final rule additional specifics:
  - WOSBs and EDWOSBs may self-certify their status as long as adequate documents are provided to support the certification, or WOSBs or EDWOSBs may be certified by approved third-party certifiers, including Federal agencies
  - SBA has yet to approve ANY third-party certifiers, so non-8(a) WOSB's access to government contracts are limited to self-certifying entities
  - Additional documentation required to be submitted (and reviewed by CO) for self-certifying entities
- 4/1/2011 interim rule amends the FAR to implement the SBA's regulations government-wide in order to further assist Federal agencies in achieving the 5% statutory goal for contracting with WOSBs
  - Comments due by 5/31/2011

Changes to Small Business Size Protest and Appeal Regulations

- Under 2/2/2011 final rule, SBA's Office of Hearings and Appeals (OHA) now has the authority to review all timely appeals of size determinations
  - Previously, size appeals were prohibited if the contract had already been awarded and the issues raised on appeal were contract-specific – this was a regular basis for appeal dismissals
- Specifies a uniform, bright-line rule for how initial and appellate decisions apply to the procurement in question
  - For example, if after contract award the SBA makes an initial decision that a contractor is other than small, then the procuring agency must terminate the award or not exercise the next option if the initial decision is not overturned on appeal
  - Additionally, the CO must apply the final decision to the procurement in question for goaling purposes

Changes to Small Business Size Protest and Appeal Regulations

- 15 business days, rather than 10, for SBA to decide a size protest - still not a hard deadline ("if possible")
  - SBA-conducted survey found that nearly 1/3 of all size protests were determined after the 10 day time limit (extensions for response to protest regularly requested)
  - In line with time-frame allowed for other status protests, *e.g.*, SDVOSB and HUBZone, which are often less complicated than size
- OHA to issue size appeal decisions within 60 days, "if possible"

Continued Spotlight on ANCs

- *Washington Post* spotlight and focus on ANCs
  - O'Harrow series and connection to GTSI
  - Investigative reporting – calls to contractors for the next story
- Effective 9/9/11 – added ANC reporting on benefits that have been provided to the tribal members
- Pending legislation to remove ANC benefits
  - Prohibit ANCs from receiving sole-source contracts greater than existing caps on other 8(a) participants
  - ANCs would no longer automatically be considered socially and economically disadvantaged businesses
  - Limits on subsidiaries
  - Require ANCs to be managed by socially and economically disadvantaged individuals

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Compliance – Land Mines and Green Zones

Navigating the evolving (and treacherous) compliance landscape

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May 25-26
OOPS 2011
Crowell & Moring LLP

Compliance Flashpoints

- Increase in Agency Willingness to Use Suspension and Debarment
- Company "Best Practices" in Responding to Employee Concerns
- Compliance Program Infrastructure and Content: Making Sure Both are Covered

Contractor Responsibility

- FAR 9.103 – Contracts shall be awarded only to **responsible contractors**
- Responsibility includes
  - Adequate financial resources
  - Able to comply with proposed delivery or performance schedule
  - Satisfactory performance record
  - **Satisfactory record of integrity and business ethics**
  - **Necessary organization, experience, accounting and operational controls**, and technical skills, or ability to obtain them
  - Necessary production, construction, and technical equipment and facilities, or ability to obtain them
  - Be otherwise qualified and eligible to receive an award

Authority for Exclusion

- Executive Order 12549, Feb. 18, 1986, established a government-wide system of suspension and debarment covering procurement and nonprocurement activities
- Exclusion of contractors governed by FAR subpart 9.4.
- Non-procurement (e.g., grants, cooperative agreements) exclusion governed by 2 CFR Part 180, but also agency-specific regulations
- Excluded parties listed at www.epls.gov

Impact of Suspension & Debarment

- Government-wide
- Prohibits award of new contracts, grants, options, or task/delivery orders under ID/IQ contracts
  - Death knell for companies heavily reliant on government
- Doesn't require termination of ongoing work
  - But does permit agencies to stop incremental funding, approval of subcontracts, nonessential travel, etc.
- Collateral consequences
  - Security clearances, licenses, commercial contracting, reciprocal exclusions at state/local levels

Increased Willingness to Exclude

- Suspend first, ask questions later
  - "War" on contractors
  - New entrants/neophytes
  - Contractors asked to perform under harsh conditions
  - Congressional pressure
  - Perception some agencies have not used S/D effectively (SBA, Homeland Security, USAID)
  - "Too big to fail does not exist in our world" – USAID Director Shah
- Of the 37 USAID suspensions and debarments currently in effect, 28 within the last year

Expansion of Suspension/Debarment

- DLA – Large Middle Eastern contractor suspended in connection with fraud charges for allegedly overcharging the military
- SBA – GTSI suspended for violation of limitations on subcontracting; show cause notice sent as a result of adverse decision in size appeal (low hanging fruit)
- GSA – Show cause notice sent after plea relating to actions more than 5 years ago by employee long since fired
- USAID – Large non-profit suspended pending ongoing IG audit where initial findings allegedly "reveal[ed] evidence of serious corporate misconduct, mismanagement, and a lack of internal controls, and raise[d] serious concerns of corporate integrity."
- Air Force – Contractor suspended for failing to make allegedly necessary disclosures on ORCA
  - NYC has similar disclosure requirements

Lessons Learned

- Any signals from the USG that S/D is being considered must be taken seriously, and dealt with quickly
  - Much more difficult to get off of EPLS than to avoid being excluded
- Company leadership must take ownership and responsibility
  - Suspending/debarring officials want to see tangible evidence of contractors taking ownership of the issues
- Grant holders not immune
  - USAID stance – precedent for other agencies?
  - Likely to be increased activity over the next year
  - DOJ expectation for grantees mirrors sophisticated resource-rich government contractors – no ramp up

Responding to Employee Concerns

- Reporting system and prompt corrective action are required by law
  - Reporting system must be available and should allow for anonymity
  - Employee concerns must be dealt with promptly and thoroughly
  - Corrective action
- Certain violations must be reported to the government

Reporting System is Mandatory

- FAR 3.1002 - Contractors should have written code of business ethics & conduct, as well as a training program and internal control system that are
  - Suitable to the size of the company and extent of involvement in government contracting
  - **Facilitate timely discovery and disclosure of improper conduct in connection with government contracts**
  - Ensure corrective measures are promptly instituted and carried out

Heightened Requirements For Some

- FAR 52.203-13 applicable if contract over $5M and > 120 days
- Some portions do not apply to SBs/commercial item contracts, but indicative of necessary components of program
- Key elements include
  - Standards and procedures to detect improper conduct
  - Corrective measures
  - Internal Controls, including an internal reporting mechanism
  - Disclosures

Compliant Reporting Mechanism

- Anonymous hotline
  - Third-party administered
  - Posters at all job sites and offices
- Periodic surveys
  - All employees or just principals?
  - Frequency determined by size of company and volume of government business
  - Specific examples of misconduct to be reported

Who Gets the Reports?

- Where does the report go?
  - In-house compliance organization, internal audit, legal
  - Outside counsel
  - The Board, periodically
- If internal reporting, should be a mechanism to send for external review if company leadership is implicated in alleged wrongdoing

Reports: FAR Contracts

- Contracts - investigate to determine whether there is "credible evidence" of a violation
  - Unsubstantiated report is not credible evidence
- Credible evidence of certain violations must be reported to the IG
  - Violations of Federal criminal law involving fraud, conflicts of interest, bribery or gratuities
  - Civil FCA violations
- Contractor can be suspended or debarred if principal fails to disclose to the government either of the above violations or a significant overpayment

Reports: Grants & Cooperative Agreements

- Check agency-specific regulations
- E.g., USAID & Dept. of Education – must report to the agency
  - Developments that have a significant impact on the award-supported activities
  - Problems, delays, or adverse conditions that materially impair the ability to meet the objectives of the award
  - Notifications must include statement of action taken or contemplated and assistance needed to resolve the situation

Other Issues

- No retaliation!
  - But do not need to tolerate repeated false allegations made in bad faith
- Close hold
  - Need to know, both to protect employee making the disclosure and to limit unsubstantiated rumors
- Written policy – develop now
- Maintain written log of all matters, including status and corrective action taken, if any
- What to disclose to the government requires a nuanced factual and legal analysis
- FAPIIS reporting?

Compliance Infrastructure and Content: Customer Expectations

- Compliance & Ethics Program: 3 main components
  - Infrastructure
  - Content
  - Ethical culture that promotes compliance
- Source
  - Federal & state laws
  - FAR
  - Government grant regulations
  - Suspension/debarment rules
  - Private grant and subcontract conditions of participation
  - Government enforcement actions
  - DOJ guidelines, etc.

Compliance Infrastructure and Content: Customer Expectations

- Compliance Infrastructure
  - Governing body oversight of the program
  - Assignment of internal responsibility for the program
  - Internal controls
    - Training
    - Written material
  - Internal mechanisms for employees to anonymously report concerns
  - Self-monitoring and auditing
  - Corrective action (discipline, external disclosures, restitution, etc.)

Compliance Infrastructure and Content: Customer Expectations

- Compliance Program Content
  - Starts with a risk assessment of the organization's business operations
  - Assessment includes determining which contract or grant regulations the organization is subject to and examination of compliance with those requirements
  - Examples of risks
    - False claims (invoices/draw downs), bribery and gratuities, kickbacks, conflicts of interest, cost allowability, OCI, administration of subawards

Compliance Infrastructure and Content: Customer Expectations

- Each principal risk area should be
  - Covered in written policies and procedures
  - Subject to employee training
  - The subject of an auditing and monitoring plan
  - Associated with appropriate internal controls

Risks of Inadequate Content

- Government (e.g., CO, S/D, auditors, investigators, OIG, DOJ) may determine Code of Business Ethics & Conduct and other policies/procedures are inadequate
- Impediment to merger/acquisition
  - Lack of content poses risk for potential acquirer, and may raise questions about compliance generally
- Difficult to respond to S/D or show cause notice
  - Suspending/debarring officials increasingly looking for compliance content and documentation of ethical culture

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Procurement Fraud and False Claims Act Developments

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May 25-26
OOPS 2011
Crowell & Moring LLP

Procurement Fraud and False Claims Act Developments

- FCA Statistics and Enforcement trends
- Public Disclosure Bar
- False Certifications
- Damages

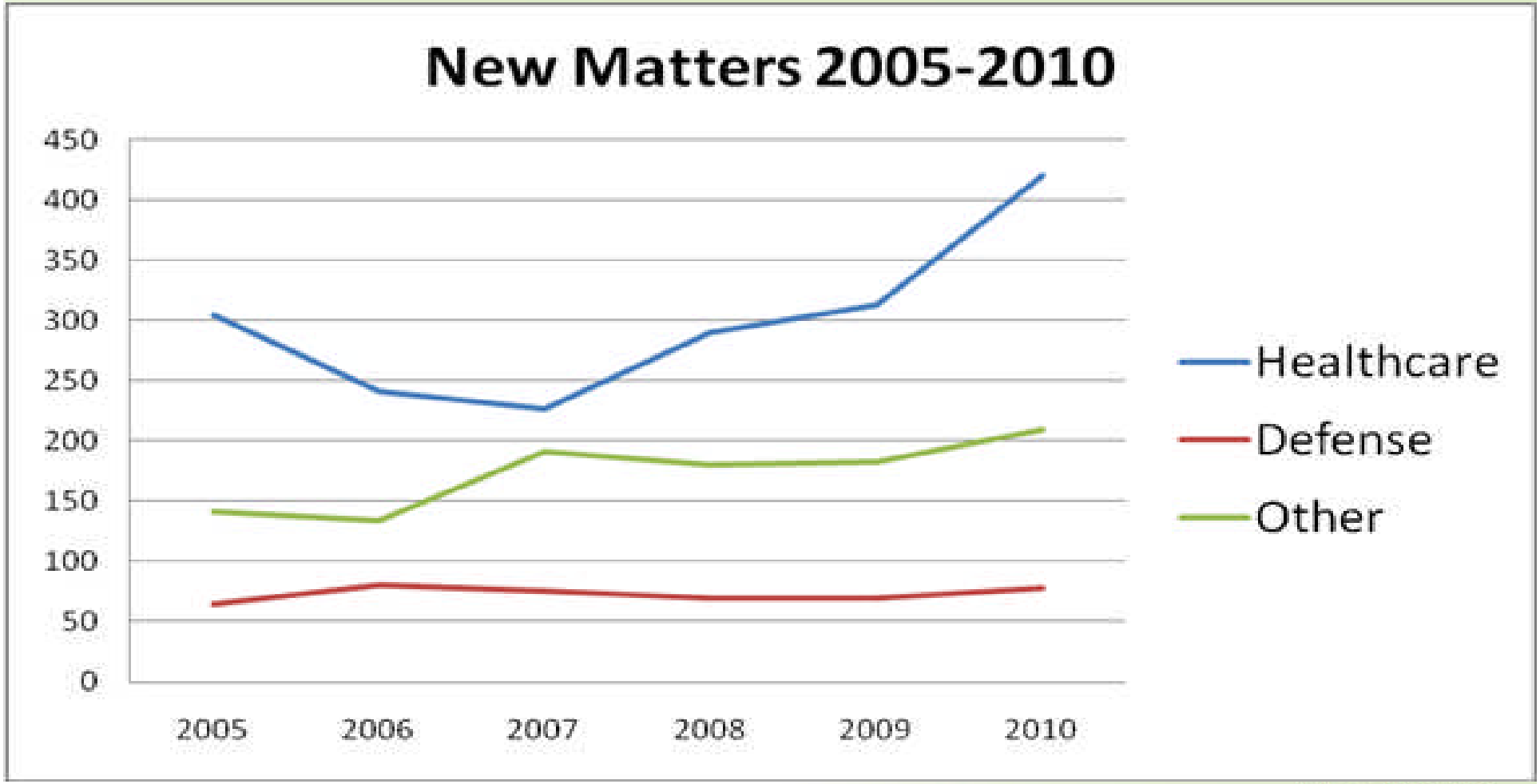
FCA Statistics and Enforcement Trends

- In FY 2010, DoJ secured $3B in civil cases involving fraud against the Government.
- $5.4B recovered under FCA since Jan. ’09 eclipse any previous two-year period.
- $27B recovered since 1986.
- 80% of new FCA cases are filed by relators.
- FERA and PPACA enhance potency of *qui tam* provisions.

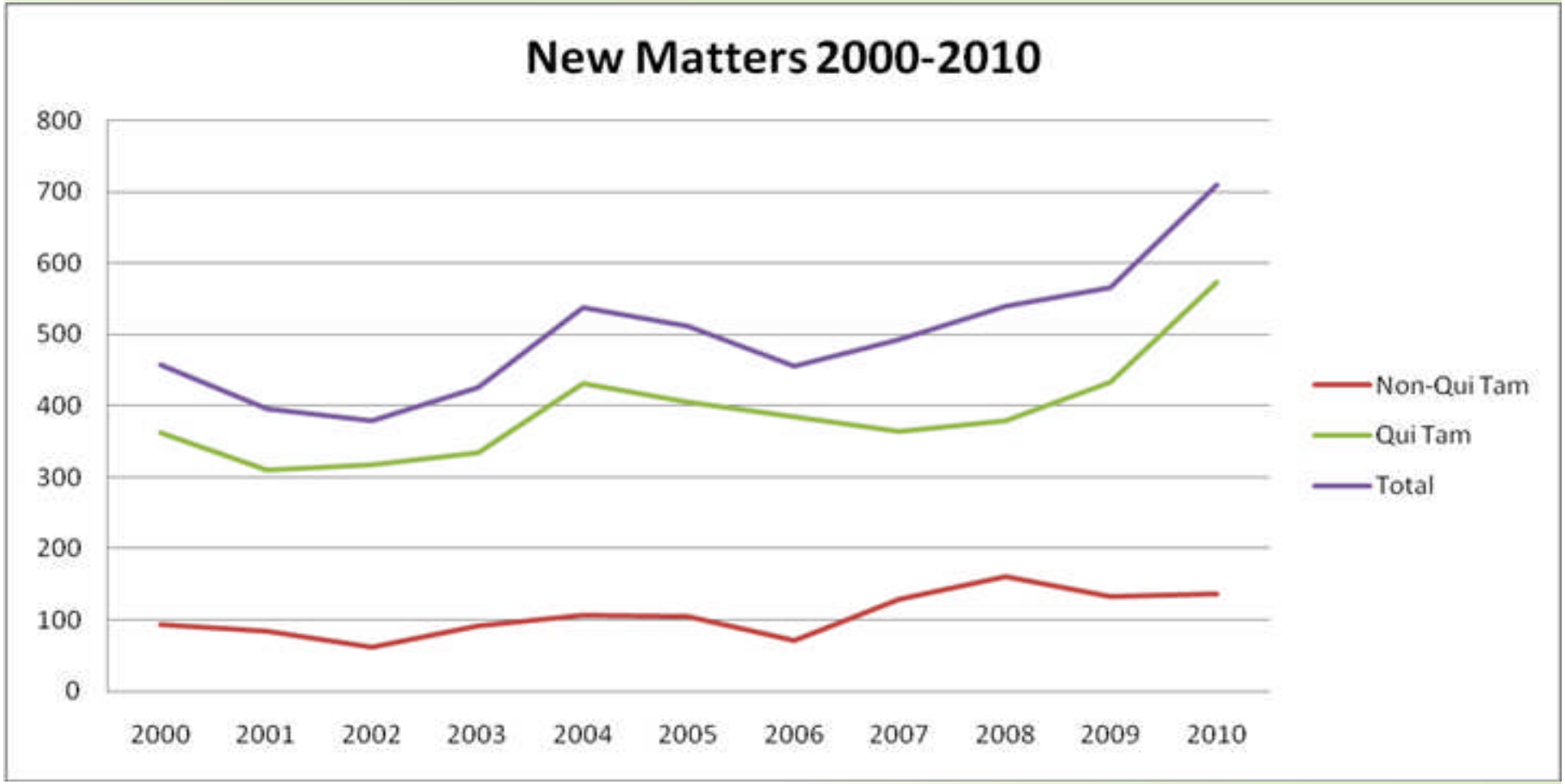
FCA Statistics and Enforcement Trends

	FY 2010	Total since 1986
New matters	709	11,359
Qui tam	573 (81%)	7,202 (63%)
Recoveries	$3,012,307,609	$27,195,570,308
Relator share	$385,167,574 (19%)	$2,877,684,871 (16%)

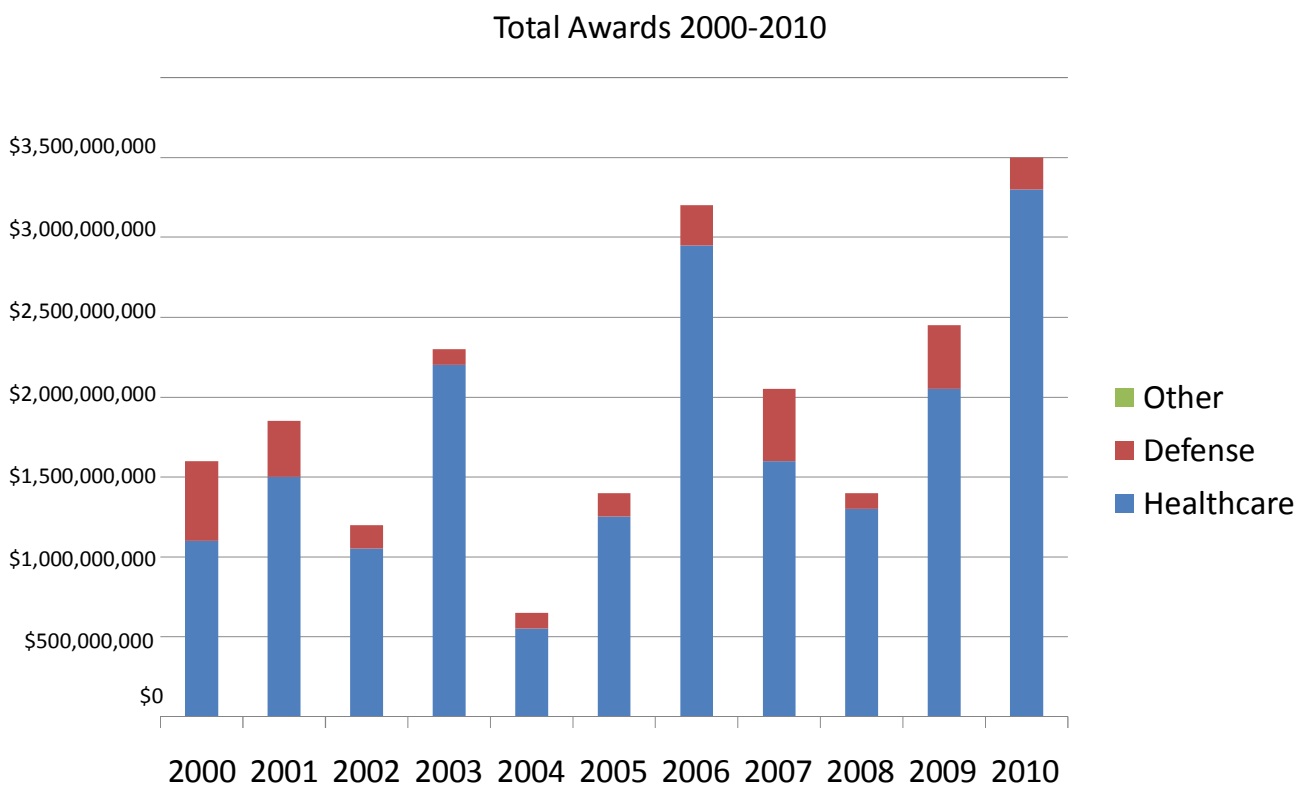
FCA Statistics and Enforcement Trends



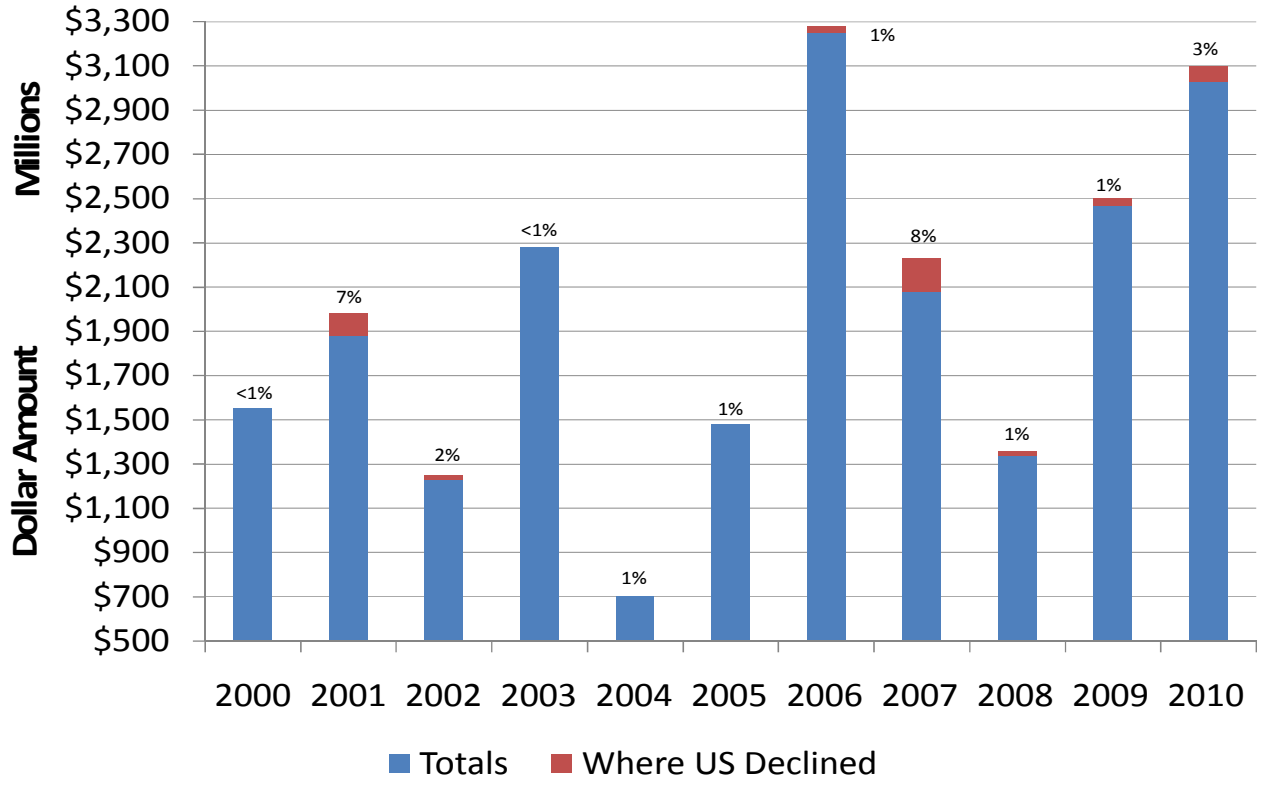
FCA Statistics and Enforcement Trends



FCA Statistics and Enforcement Trends



FCA Statistics and Enforcement Trends



Government Enforcement

- **National Procurement Fraud Task Force (NPFTF)** created in 2006, now focused on Recovery Act fraud. Task Force includes:
  - Inspectors General
  - FBI and Defense investigative agencies
  - Federal prosecutors from U.S. Attorney's offices
  - DoJ's Antitrust, Civil, Criminal, Environmental & Natural Resources, National Security and Tax Divisions

Government Enforcement

- DoJ Criminal Division in Nov. 2010 created **Financial Institutions and Public Sector Fraud Unit**.
  - Focus on: mortgage fraud, bank fraud, government procurement fraud.
  - Particular focus on contracting fraud in Afghanistan.

Prosecution of Company Executives

- ***U.S. v. The Purdue Frederick Co*.**
  - Three former top executives pled guilty to single count of introducing a misbranded drug into interstate commerce.
  - OIG excluded executives from participation in federal health care programs for 20 years.
  - Exclusions upheld on appeal at DAB and U.S. Dist. Court (reduced to 12 years).

Prosecution of Company Executives

- ***U.S. v. Hermelin***
  - Four chief executives pled guilty to two counts of introducing misbranded drug into interstate commerce.
  - 30 day jail sentence
  - $1.9 million in fines and forfeitures
  - Exclusion of executive
  - Company avoided exclusion but divested the subsidiary

Prosecution of Company Executives

- ***U.S. v. Stevens***
  - Former assoc. general counsel charged with obstruction, falsification and concealment of documents, making false statements during investigation of off-label drug promotion.
  - Indictment dismissed for improper instruction to grand jury regarding the advice of counsel defense.
  - Re-indicted, but Judge enters Order of Acquittal.

Prosecution of Company Executives

- **"Responsible Corporate Officer" Doctrine**
  - Exception to general rule that individuals should not be subject to criminal liability without requisite *mens rea.*
  - Officer has duty to seek out and remedy violations, but also, a duty to implement measures that will ensure that violations will not occur.
  - Used mostly in food & drug and public safety enforcement.
  - FDA and HHS announced increased use of misdemeanor prosecutions to hold responsible officials accountable.
  - DoD may follow that trend.

FCA's Public Disclosure Bar

- **1943:** Imposed jurisdictional bar on parasitic relators by prohibiting *qui tam* suits based on information already in the Government's possession.
- **1986:** Limited the bar to encourage more whistleblowing by replacing "government knowledge" defense with a bar on allegations based on "public disclosures" unless relator is "original source."
- **2010:** Patient Protection and Affordable Care Act (PPACA) is intended to cut back on the use of the public disclosure bar.
  - Effect will be more parasitic *qui tam* actions.

FCA's Public Disclosure Bar

- 2010 PPACA converts the public disclosure bar from an absolute jurisdictional bar to a more flexible standard.
- No longer stated in terms of a jurisdictional bar.
  - More vigilance required early; must be in an answer or dispositive motion or may be waived.
- The court is not required to dismiss a relator's action if the Government opposes a defendant's motion to dismiss.

FCA's Public Disclosure Bar

- **Revision of the definition of "publicly disclosed":**
  1. Information ***only*** from "*Federal* criminal, civil, or administrative proceeding in which the Government or its agent is a party";
  2. Information ***only*** from a "Federal report, hearing, audit or investigation";
  3. "News media" remains the same.
     - No definition of "news media" (internet? blogs?)
     - Consider press releases regarding overpayment refunds and self-disclosures

FCA's Public Disclosure Bar

(A) ~~No~~**The** court shall ~~have jurisdiction over~~**dismiss** an action **or claim** under this section ~~based upon~~**, unless opposed by** the ~~public disclosure of~~**Government, if substantially the same** allegations or transactions **as alleged in the action or claim were publicly disclosed--**

(i) in a **Federal** criminal, civil, or administrative hearing~~,~~**, in which the Government or its agent is a party;**

(ii) in a congressional, ~~administrative, or Government Accounting~~**Government Accountability** Office**, or other Federal** report, hearing, audit, or investigation~~,~~**;** or

(iii) from the news media,

unless the action is brought by the Attorney General or the person bringing the action is an original source of the information.

FCA's Public Disclosure Bar

- **PPACA modifies the "original source" requirement:**
  - "Original Source" = Escape Hatch
  - Only requires a relator to have "knowledge that is independent of and materially adds to the publicly disclosed allegations," which omits the prior requirement that the knowledge be "direct and independent of . . . the information on which the allegations are based."
  - "Independent knowledge" and "materially adds" are undefined.

§ 10104(j), Effective March 23, 2010

FCA's Public Disclosure Bar

(B) For purposes of this paragraph, "original source" means an individual who ~~has direct and independent knowledge of~~ **either (i) prior to a public disclosure under subsection (e)(4)(a), has voluntarily disclosed to the Government** the information on which ~~the~~ allegations **or transactions in a claim** are based, **or (2) who has knowledge that is independent of and materially adds to the publicly disclosed allegations or transactions,** and **who** has voluntarily provided the information to the Government before filing an action under this section ~~which is based on the information~~.

§ 10104(j), Effective March 23, 2010

FCA's Public Disclosure Bar

U.S. ex rel. Rosner v. Glenn Gardens (SDNY 2010)

- **Is information from a publicly searchable database a public disclosure?**
  - Tenant's FCA claim against housing complex, alleging fraudulent reports to HUD in connection with obtaining housing assistance payments.
  - Relator based claim on information from searchable database on a state government website.
  - Court: Information constituted an administrative report.
    - *Note*: PPACA would exclude state government material.

FCA's Public Disclosure Bar

Schindler v. U.S. ex rel. Kirk, __U.S.__ (May 16, 2011)

- **Is information obtained under FOIA a public disclosure?**
  - **Alleged:** False certification of compliance with requirement to file report showing number of veterans employed. Hundreds of false claims alleged.
    - Relator's wife learned via a FOIA response that contractor did not file required reports.
  - **District Court Dismissed:** Found that FOIA responses were "reports" that constituted public disclosures, thus depriving it of subject-matter jurisdiction.
  - **2nd Cir. Vacated:** Held FOIA responses are not public disclosures unless the material is an administrative report or investigation.

FCA's Public Disclosure Bar

(*Schindler* continued)

- **Supreme Court's focus: Is the FOIA disclosure a gov't report *per se*?**
  - **Defendant:** Gathering and producing records is a report
  - **Relator & DOJ:** FOIA responses which are distinct from the agency's normal mission are not reports or investigations.
  - **Scalia:** Appreciated defendant's bright line test.

FCA's Public Disclosure Bar

(*Schindler* continued)

- **Supreme Court Reverses In 5-3 Decision (May 16, 2010)**
  - Thomas, Roberts, Scalia, and Kennedy (Ginsburg, Breyer, and Sotomayor dissented and Kagan did not participate).
- Federal agency's written response to an FOIA request constitutes a "report" within the meaning of the FCA's public disclosure bar.
- "[A] classic example of the 'opportunistic' litigation that the public disclosure bar is designed to discourage,"
- Noted that the words congressional, administrative or GAO, which precede the word report, "tell us nothing more than that a 'report' must be governmental."

Courts Split on Implied Certifications

5th Cir. Rejects Theory

U.S. ex rel. Steury v. Cardinal Health

- Liability must be premised on a false certification of compliance with a contractual provision, statute or regulation that is a prerequisite to payment.
- Payment condition is the "crucial distinction" between punitive FCA liability and ordinary breaches of contract.

Courts Split on Implied Certifications

(*Steury* continued)

- Steury alleged the sale of defective medical products to VA in violation of warranty of merchantability clause ("safe, reliable and quality tested").
- No actual certification of compliance; relator alleged it was *implied* in payment requests.
- **Court:** Contract clause was not a prerequisite of payment.
  - Even if there were a breach of contract, it would not be "fair" to impose FCA liability on the basis of a promise that was not a condition of payment, regardless of whether such a breach would have been material to the government's payment decision.
  - Failure to state a claim because relator did not allege that compliance with the warranty of merchantability was a condition of payment.

Courts Split on Implied Certification

(*Steury* continued)

- *Steury's* importance:
  - Court expressly declined to hold that FCA action can be based on an implied (rather than express) certification, casting doubt on viability of the theory.
  - Court reaffirmed principle that FCA was not intended to police every violation of law or contract provision.
  - Court drew clear distinction between elements of "materiality" and "falsity:"
    - Although a certification (even an express certification) might be material to the government's decision to pay a claim, a claim is not rendered false by a contractor's mere non-compliance with a statute, regulation or contractual provision, unless it is a prerequisite for payment.
  - Allows contractors to tailor their training and compliance programs to ensure that explicit conditions of payment are followed, or corrected quickly if not.
  - Bright line test should lessen the number of breach of contract cases masquerading as fraud cases.

Courts Split on Implied Certification

D.C. Cir. Accepts Theory

U.S. v. SAIC

- Liability for implied certification of compliance with a statute, regulation or contractual provision can be imposed even if the provision is not a prerequisite to payment.

Courts Split on Implied Certification

(*SAIC* continued)

- Gov't alleged SAIC's noncompliance with NRC's contractual requirement to identify and prevent potential conflicts of interest.
- Express certification at time of award and continuing duty to disclose through period of performance.
- Claims for payment did not include any express certification of compliance with OCI rules.
- No contract term which conditioned payment on such certification or compliance with OCI rules.
- Gov't alleged payment requests carried an implied certification of compliance which rendered the claims false.

Courts Split on Implied Certification

(*SAIC* continued)

- **DC Cir.:**
  - Precondition defense would create a liability loophole, allowing violations of any provision as long as it was not identified as a precondition of payment.
  - Proper standard is to focus on "materiality:"
    - Plaintiff must show that contractor withheld information about its noncompliance with material contractual requirements.
    - At trial, contracting officer testified he would not have paid claims had he known of the violations.
  - To prevent abuse by plaintiffs focused on minor contractual provisions, court favored "strict enforcement" of materiality and scienter standards.
    - Court's scienter standard includes: knowledge of the violation + knowledge that compliance was material.

Courts Split on Implied Certification

9th Cir. Accepts Theory

Ebeid ex rel. U.S. v. Lungwitz

- "Implied false certification occurs when an entity has previously undertaken to expressly comply with a law, rule or regulation and that obligation is implicated by submitting a claim for payment even though a certification of compliance is not required in the process of submitting a claim."
- **Materiality:**
  - Whether the false certification was relevant to the govt's decision to confer a benefit.
  - The potential effect of a false statement, not whether it actually influenced the U.S. to make payment.

Good News: DC Cir. Limits Damages

U.S. v. SAIC

- Proper measure of damages is the difference between the value of the goods or services provided and the value they would have had to the gov't if they had been delivered as promised (derived from *U.S. v. Bornstein*).
- Jury awarded treble damages based on the full amount of the two contracts at issue ($5.9 million), even though there was nothing wrong with SAIC's performance.
  - Jury accepted govt's evidence that but for the falsity, the contracts would have been awarded to another contractor.
  - District court had instructed jury to ignore the value of SAIC's work.
  - Jury awarded only $78 on the breach of contract claim.

Good News: DC Cir. Limits Damages

(*SAIC* continued)

- DC Cir. reversed and rejected district court's approach to damages.
  - Jury instruction which barred jury from considering the value of SAIC's services distorted the benefit of the bargain analysis.
  - To recover full contract value, gov't has to prove it received no value.
  - On remand, proper instruction is:
    - Calculate damages by determining the amount of money the gov't paid out due to the false claims over and above what the services the company actually delivered were worth to the gov't.

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Bid Protests: Trends and Developments

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May 25-26
OOPS 2011
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Agenda

- Reading the Protest Statistics
- GAO's jurisdiction over task and delivery order protests
- Challenging in-sourcing decisions
- Substantive developments

GAO and Court of Federal Claims Statistics

GAO Statistics

Fiscal Year	2010	2009	2008	2007	2006	2005
Cases Filed	2299	1989	1652	1411	1326	1356
Cases Closed	2226	1920	1582	1394	1275	1341
Merits Decision	441	315	291	335	251	306
Sustains	82	57	60	91	72	71
Sustain Rate	19%	18%	21%	27%	29%	23%
Effectiveness Rate (reported)	42%	45%	42%	38%	39%	37%
ADR (cases used)	159	149	78	62	91	103
ADR Success Rate	80%	93%	78%	85%	96%	91%

Court of Federal Claims Statistics

Calendar Year	2010	2009	2008	2007	2006	2005
Protests Filed	88	74	79	81	64	68
Pre-award	19	22	23	18	9	16
Post-award	69	52	56	63	55	52
Protest Decisions	71	57	39	53	74	
Published	64	50	38	50	55	
Un-published	7	7	1	3	19	

Reading into the numbers

- Causes for spike in protests
- Impact on the GAO and Court protest process
- Predicting future trends

GAO Jurisdiction over Task and Delivery Order Protests

Task and Delivery Order Protests Background

- Task and delivery orders are issued in accordance with FAR 16.5
  - Does not include GSA Schedule or Blanket Purchase Agreements
- Prior to May 27, 2008: GAO and COFC only had jurisdiction over task and delivery order protests alleging that the order "increases the scope, period, or maximum value of the contract under which the order is issued."

Task and Delivery Order Protests Background

- Effective May 27, 2008, GAO was granted exclusive jurisdiction over task and delivery order protests where award is valued in excess of $10 million
- Dual conforming statutes covering Title 10 and Title 41
- The 2008 statute contained an automatic sunset provision – May 27, 2011

Task and Delivery Order Protests
Extension of Jurisdiction

- FY2011 NDAA extends GAO's supplemental protest authority over DOD task and delivery order procurements in excess of $10 million
- Until September 30, 2016
- Change to Title 10 only, not Title 41

Task and Delivery Order Protests
Extension of Jurisdiction

- On May 12, 2011, Senate passed S. 498, the Independent Task and Delivery Order Review Extension Act
- Extends GAO's supplemental protest jurisdiction over civilian task and delivery orders valued in excess of $10 million until September 30, 2016

Task and Delivery Order Protests
Extension of Jurisdiction

- House introduced, H.R. 899, To Amend Title 41, United States Code, To Extend The Sunset Date For Certain Protests Of Task And Delivery Order Contracts
- Would extend GAO's supplemental protest jurisdiction over civilian task and delivery orders valued in excess of $10 million until September 30, 2016
- Status and implications

Task and Delivery Order Protests Developments

- Of the 2,299 protests filed in FY 2010, 194 were attributable to GAO's supplemental task order jurisdiction
  - 129 related to DoD orders
  - 65 related to civilian orders
- CBO reports that 50% of these protests have resulted in "some form of relief from the procuring agency."

Task and Delivery Order Protests Developments

- More money than ever being committed via task and delivery order awards
- Within past year, at least three protests of task orders with value above $1 billion

Task and Delivery Order Protests Developments

- Jurisdiction to hear pre-award protests
- Post-award debriefing is required where value of award exceeds $5 million
- Timely filed protest triggers CICA stay
- GAO has jurisdiction to review merits and whether agency followed required process
- $10 million threshold based on expected value to awardee
- Generally, exchanges must comport with FAR Part 15

In-Sourcing

Protest Jurisdiction and Interested Party Status

In-Sourcing Background

- FY 2008 NDAA Amended 10 U.S.C. § 2463 to require greater consideration of using DoD Civilian Employees
- Apr. 2008 – DoD issued "guidelines and procedures" to implement 10 U.S.C. § 2463
- Mar. 2009 – President Obama directed OMB to issue guidance to assist agencies to identify wasteful and inefficient contracts

In-Sourcing Protests
Background (cont'd)

- Apr. 2009 – DoD issued Resource Management Decision 802 which decreased funding for contract support and increased funding for civilian manpower
- May 2009 – DoD released guidance on standard to employ when considering conversion candidates
- Jan. 2010 – DoD published Directive-Type Memorandum 09-007 establishing rules for estimating and comparing costs of civilian versus contractor
- FY 2011 NDAA requires DoD to use costing methodology in Direct-Type Memo 09-007

In-Sourcing
A Growing Trend?

- Air Force has instructed each major command to identify candidates for in-sourcing
- USAID has targeted for in-sourcing roughly 1/3 of the positions currently filled by contractors in Washington over the next five years.
- DHS Established Balanced Workforce Program Office and plans to review 68 currently outsourced contracts by fall of 2011 (3,500 positions have already been identified for in-sourcing)
- Customs and Border Patrol has begun implementing the in-sourcing of 1200 positions in the Office of Information Technology

In-Sourcing Protests
Subject Matter Jurisdiction

- District Court v. COFC – Where to File?
- No less than 6 cases challenging DoD in-sourcing decisions filed in U.S. District Courts under APA
- Government has moved to dismiss all for lack of subject matter jurisdiction
- With one exception, Article III Courts have held that COFC has exclusive jurisdiction

In-Sourcing Protests
COFC Exclusive Jurisdiction Over DoD In-Sourcing Decisions

- Tucker Act, 28 U.S.C. § 1491(b)(1), confers exclusive jurisdiction to COFC over:
  - challenge to the terms of solicitation
  - protest of proposed award or award of a contract
  - "any alleged violation of statute or regulation in connection with a procurement or a proposed procurement"
- "in connection with a procurement" is broadly construed
- Challenge to DoD in-sourcing decision involves alleged violation of 10 U.S.C. § 2463 in connection with decision not to contract
- COFC confirmed exclusive jurisdiction in *Santa Barbara Applied Research, Inc., v. United States*

In-Sourcing Protests
Interested Party Status

- Government playing both sides of the fence
  - argues in moving to dismiss district court actions that contractors would have standing at COFC because they would compete for work and have a chance of winning
  - argues before the COFC that contractors lack standing because no competitive interest
- In *SBAR*, COFC held that incumbent contractor had sufficient interest to challenge in-sourcing decision

In-Sourcing Protests Challenging Civilian Conversions

- Does COFC have jurisdiction?
  - Unlike DoD, no procedures governing civilian in-sourcing
- What about APA jurisdiction?
  - Open question as to whether there has been a waiver of sovereign immunity

Substantive Developments in Case Law

Communications with Offerors

- Meaningful discussions
  - *AINS, Inc*., B-400760.4, B-400760.5 – concern that project schedule was too short was not meaningfully raised during discussions when agency requested a new schedule
  - *Cigna Government Services*, B-401062.2; B-401062.3 – upwardly adjusting protester's proposed costs because the agency believed them to be unrealistic rather than opening discussions was unreasonable

Communications with Offerors

- What constitutes discussions
  - *Highmark Medicare Services*, B-401062.5, *et al.* – exchanges with offeror after receipt of FPRs does not constitute discussions where the agency requested only that the offeror confirm an aspect of its proposal
  - *PMO Partnership Joint Venture*, B-401973.3, B-401973.5 – communications regarding an offeror's responsibility does not constitute discussions so long as the offeror does not materially modify its proposal

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Protecting Your Dollars:
Procurements Under a Shrinking Federal Budget

27th Annual
Ounce of Prevention Seminar

Welcome
Day 2

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Key M&A Considerations – Overcoming Hurdles to a Successful Closing

Bryan Brewer
Karen Hermann

May 25-26
OOPS 2011
Crowell & Moring LLP

Why Are We Here?

Increased M&A Activity in the Sector

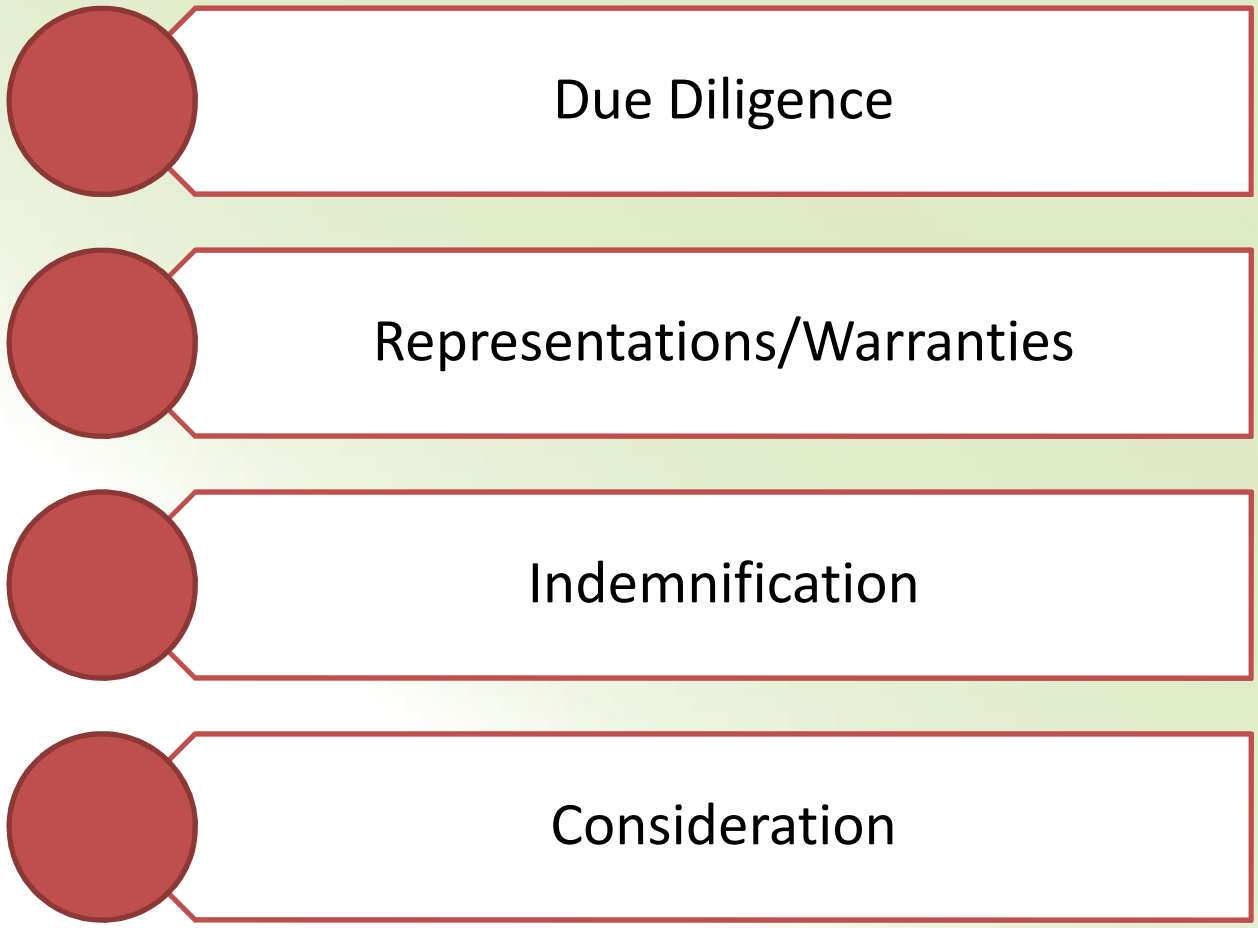
- OCI divestitures
- Consolidation in the industry

Emphasis on Revenue Generation via Growth by Acquisition of Strategic Targets

Shifting Government Purchase Model

- Greater emphasis on security, intelligence and information technology
- Proliferation of commercial technology in the government sector

Key Components of Deal – Protecting Value



Shifting Diligence Landscape

Traditional Focus

- Valuation
  - EBITDA
  - Revenue waterfall
- Required approvals and novations
- Potential risks – audits, claims, investigations

New Focus

- OCI restrictions
- Valuation and viability
  - Backlog and program assessment
  - risks of termination or non-renewal of key contracts
  - margin sustainability and adequacy of business infrastructure
- Integration issues
- Deficiencies in business processes and policies
- In-sourcing risks

Avoiding Data Room Disasters

- Competitively Sensitive Information
  - information that might give the Purchaser an unfair competitive advantage in future government procurements

> OCI issues may arise even during diligence.

- Classified Material
  - May require customer consent to review
  - Timing of deal may dictate that completion of diligence on classified contracts be a closing condition.
- Export Controlled Material

Deal Certainty

- Key Government Contracts Representations
  - compliance with laws and regulations
  - no false certifications
  - no terminations for default
  - no disputes or outstanding claims
- Closing Condition
  - all representations remain true as of the Closing:
    - in all respects
    - in all material respects
    - except where such failure does not result in a "Material Adverse Change"

Negotiating Meaningful Indemnities

Traditional Approach

- Unlimited Cap
  - Fundamental representations
  - Fraud/willful misconduct
  - Breach of covenants
- Negotiated Cap
  - Breach of all other representations and warranties

Recent Approach

- Unlimited Cap (same)
- Intermediate Cap
  - Government contract matters
  - Compliance with laws, including export and FCPA
- Lower Cap
  - Breach of all other representations and warranties

Enforcing the Indemnity

Escrow Holdback

- ~10-20% of deal value
- Varies based on identified risks

Staggered Escrow Release

- Post-closing working capital adjustments
- Pending audits or investigations
- Specific risks identified in due diligence
- Departure of key employees
- Termination for convenience of key contracts

Creative Consideration – Effective Use of Earn-out *Provisions*

"Earn-outs continue to be used by buyers in approximately one-half of transactions."

The Current M&A Environment and Recent Deal Trends,
Grant Thornton, White Paper 2010

Effective Use of Earn-out Provisions

Why?

- Valuation gaps
- Large expected growth
- Retention effect on key employee/shareholders

Earning the Earn-Out

- Event-based – award or renewal of key contract, etc.
- Financial performance-based – EBITDA, revenue, etc.

Difficulties in Using An Earn-Out

- Restrictions imposed on Purchaser's operation of the business post-closing
- Disputes are common
- Termination for Convenience of key contracts

Parting Shots – Five M&A Trends to Watch

- Increased focus on deal certainty
- Maturity of the private equity buyer
- Increased use of creative consideration
- Heightened emphasis on risk allocation
- Greater focus on specific verticals

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Developments in Government Contractor Intellectual Property Rights

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Recent Trends – The Pendulum Swings

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May 25-26
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The Pendulum Swings

- 1994 Federal Acquisition Streamlining Act
  - Recognition that Government should treated like any other commercial buyer with regard to commercial items IP
- 2001 – Intellectual Property: Navigating Through Commercial Waters
  - DOD adopts moderate position on rights in technical data and computer software

The Pendulum Swings Back

- 2010/2011
  - More and more solicitations requiring contractors to cede data rights as condition of competing/new orders
  - Agencies becoming more aggressive in challenging rights restrictions
  - 2011 Defense Authorization Act
  - Recent Proposed Rule Changes
    - Commercial Items
    - DFARS Rewrite
    - Stanford v. Roche

New Legislative Guidance

Alexina G. Jackson

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2011 Defense Authorization Act

- §824 -- Requires SecDef to issue guidance to assure
  - Preserve option of competition for *production* and *sustainment* of systems and subsystems developed exclusively with federal funds
  - Government not required to pay more than once for the same tech data

Proposed Commercial Items Rule

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Proposed Changes to Commercial Items Rule

The Rule's Purported Target

- Regarding the presumption of development at private expense currently afforded contractors for rights restrictions asserted over certain commercial item technical data
- Intended to implement Section 802(b) of FY 2007 National Defense Authorization Act (NDAA)
  - Reverse presumption of development at private expense for commercial items under contracts or subcontracts for major systems (or subsystems or components thereof)
- Intended to implement Section 815(a)(2) of FY 2008 NDAA
  - Exempt commercial off-the-shelf (COTS) items from the requirements established under section 802(b) of FY 2007 NDAA

May 2010 proposed rule to change various DFARS provisions; comment period ended July 2010. *See* 75 Fed. Reg. 25161 (May 7, 2010).

Proposed Changes to Commercial Items Rule

Current Presumption Has Limited Application

- Under existing FAR and DFARS rules, the presumption of development at private expense has limited practical application:
  - "Private expense" is implicated in only one commercial item definition (*see* FAR sec. 2.101 re: nondevelopmental items sold to State and local govt's)
  - Contractors generally deliver technical data related to commercial items under standard licensing terms, not DFARS clauses
- The existing presumption of development at private expense states:
  - If a contractor or subcontractor limits the rights provided over technical data as developed at private expense, the contracting officer (CO) presumes this accurate
  - The burden is on DoD to show that it was not developed entirely at private expense
  - The contractor is not required to justify the assertion of development at entirely private expense in the face of a mere challenge notice issued by the CO
- Under the proposed rule, would expect the presumption to be reversed for non-COTS commercial technical data related to major systems, but . . .

Proposed Changes to Commercial Items Rule

The Potential (Over)Reach of Proposed Rule

- Proposed rule extends well beyond its implementing regulations
  - Reverses the presumption of development at private expense for non-COTS commercial items under contracts or subcontracts for major systems
  - Retains existing presumption for COTS items regardless of whether part of a major system
  - Retains existing presumption for commercial items not part of a major system
- BUT ALSO:
  - Imposes commercial DFARS data rights clause on all commercial items, including any marking requirements
  - Imposes non-commercial DFARS data rights clauses on commercial items so long as there is *any* current or future government funding
  - Applies changes to prime and subcontractors alike
  - Extends 10 USC sec. 2320 and 2321 (rights in technical data and validation or proprietary restrictions) scheme to computer software

Proposed Changes to Commercial Items Rule

The Proposed Rule's Extended Reach

- Clauses of the DFARS Data Rights Scheme:
  - Requires use of 252.227-7015 (Technical Data – Commercial) in all contracts requiring the contractor to deliver technical data related to commercial items, components or processes
  - Requires use of 252.227-7013 (Technical Data – Noncommercial) if the government ***has paid or will pay any portion of the development*** *costs* of the commercial item
  - If parts 7015 or 7013 apply, then 252.227-7037 (Validation of Restrictive Markings on Technical Data) must be used
- Contractor cannot simply provide the same rights as those customarily provided to the public for the commercial item

Proposed Changes to Commercial Items Rule

The Proposed Rule's Extended Reach – Remember!

- New presumption applies to all non-COTS commercial item technical data and noncommercial computer software under a major system regardless if delivered by prime or subcontractor
- DFARS data rights clauses (including marking requirements) apply to all acquisitions of technical data regardless of commercial or noncommercial status, or delivery by prime or subcontractor
- Purports to extend the technical data rights scheme to computer software

Proposed Changes to Commercial Items Rule

Potential Effect of the Proposed Rule: Increased Risk

- Presumption change for major systems (except COTS items)
- If there is an ounce of government money involved, DFARS rules will apply
  - Grants the government broad license rights in commercial items (not just that customarily provided to general public)
  - Imposes marking requirements on commercial items, or unlimited rights (consider your delivered items!)
  - Hinders segregability determinations (mixed funding; segregable components)
  - Overrides the various definitions of "commercial item" (one standard for DoD and one for civilian agencies)
- Extends to computer software despite inconsistencies with nuanced software rights scheme and lack of statutory basis

Proposed DFARS Rewrite
Patents, Data, and Copyright

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May 25-26
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Proposed Rewrite of DFARS IP Rules

- Published September 27, 2010
- 56 pages of Federal Register
- Requested Comments in 60 Days
- 36 sets of comments received including the American Bar Association and Aerospace Industry Association

Stated Purpose

- Integrates coverage for technical data and computer software
- Simplify and clarify Part 227
- Move text that does not impact the public to Procedures, Guidance and Information ("PGI")
- Remove text and clauses that are obsolete

Highlights

- Rewrite of Part 227 and associated DFARS clauses
- Focuses on rules relating to technical data and computer software
- Extensive revisions
- Overall structure changed
  - Technical data and computer software integrated

Key changes

- Commercial items
- Limitation of Liability
- Infringement Claims
- Definition of Computer Software
- Segregability
- Access
- Subcontractors
- Use and Non-Disclosure Agreement
- Post Award Assertions of Rights Restriction
- Validation of Restrictive Markings
- Rights in Works

Commercial Items

- Current rule: for commercial items use standard commercial license
- Proposed rule:
  - Further implementation of proposed rule relating to the reversal of the presumption of development at private expense
  - Imposes DFARS rights allocation scheme on commercial items where the government has paid any portion of the development costs
  - if the government has paid for any portion of the costs for development or modification of the commercial item, commercial technical data or commercial computer software, must use DFARS non-commercial technical data and computer software clause

Commercial Items

- Revised DFARS 212.504: Removes 10 USC Sec. 2320 (rights in technical data) and Sec. 2321 (validation of proprietary data restrictions) from the list of clauses inapplicable to subcontracts for commercial items

Commercial Items

- Requires the use of revised DFARS Clause 252.227-7015, Rights in technical data and computer software—commercial, in all solicitations and contracts when contractor is required to deliver commercial technical data or commercial computer software
- Imposes requirements inconsistent with FAR 12.211 & FAR 12.212, which require the use of offeror's standard commercial license.

252.227-7015 Rights in Technical Data and Computer Software - Commercial

- Applies to both technical data and computer software
- Grants the government a broad license in technical data
  - minimum unlimited license rights in certain technical data
- Requires contractors to mark their commercial technical data and computer software
  - Excuses government from liability for release or disclosure of unmarked commercial technical data or computer software

252.227-7015 Rights in Technical Data and Computer Software - Commercial

- Requires flowdown of DFARS clause to subcontractor
- Requires prime contractor to notify the government if non-standard clause used in subcontract
- Requires bilateral negotiation for other license rights
- Contractor retains all rights not granted to the Government

Limitation of Liability

- Eliminates government liability for release or disclosure of technical data or computer software by “authorized recipient”

Infringement Claims

- Enhanced guidance on contractor administrative claims for government infringement. Proposed DFARS 227.70.
  - Provides detailed requirements for information to be included with the infringement claim
  - Includes guidance for claims involving multiple agencies
- Highlights that "it is the government's policy to settle meritorious claims." 75 Fed. Reg. 59413.
- Provides sample settlement agreement for patent infringement. DFARS 227.7006.

Definition of Computer Software

- Reclassifies the following items as “computer software documentation” (i.e., technical data) rather than “computer software:”
  - Design details,
  - Algorithms,
  - Processes,
  - Flow charts,
  - Formulas, and
  - Related material that describe the design, organization, or structure of software

Segregability

- Clarifies the doctrine of segregability. DFARS 227.7104-1(b); 227.7104-8(d)
  - Each segregable element of technical data and/or computer software may be entitled to different data rights treatment
  - Contracts and/or subcontracts may require multiple data rights clauses

Access

- Recognizes that, in addition to other rights, the government may be given "access" to technical data and/or computer software. DFARS 227.7104-1(c)(1)(i).
  - Remote access to technical data and/or computer software maintained by the contractor. 75 Fed. Reg. 59414.

Subcontractors

- Expressly recognizes that a direct relationship exists between the government and subcontractors at any tier when dealing with intellectual property. 75 Fed. Reg. 59412.
- Allows subcontractor delivering technical data or computer software with other than unlimited rights to submit it directly to the Government, although normally it should be delivered to the next-higher tier contractor.
- Prohibits higher tier contractor from using position to acquire subcontractor's IP.

Use and Non-Disclosure Agreement

- Proposed DFARS 227.7107-2 provides guidance on the disclosure of technical data or computer software delivered to the government with restrictions on access, use modification, etc. to third party contractors.
- Includes a "Use and Non-disclosure Agreement." 75 Fed. Reg. 59433-42.

Post Award Assertions of Rights Restriction

- Requires that contract contain list of all deliverable technical data or computer software that the Contractor asserted should be delivered or otherwise provided to the Government with restrictions
- Allows post award assertion of restrictions only where:
  - New Information
  - Based on inadvertent omissions
- Soon as practicable and shall be prior to the scheduled date for delivery

Validation of Restrictive Markings

- Permits government to challenge the asserted restrictions on commercial computer software
  - If "reasonable grounds" exist to question validity, and adherence would make subsequent acquisition impracticable
    - Presumes development at private expense
- Creates new exception to contractor's right to appeal
  - "urgent and compelling circumstances"
    - By agency head
    - Non-delegable
    - Contractor can still get damages

Rights in Works

- New Section 227.72 Rights in Works
  - Works = databases, literary works, musical works, including any accompanying words, dramatic works, including any accompanying music pantomimes and choreographic works, pictorial, graphic, and sculptural works, motion pictures and other audiovisual works, sound recordings, architectural works, mask works, and original designs.
  - Works # technical data or computer software
  - Regulations and associated clauses allocating rights in works

Bayh-Dole Rights in Federally Funded Inventions Under Siege?

Jonathan M. Baker

May 25-26
OOPS 2011
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Bayh-Dole Basics

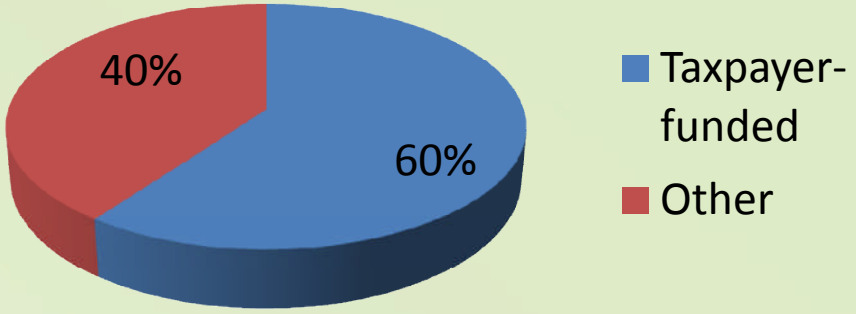
- University and Small Business Patent Procedures Act of 1980, 35 U.S.C. §§ 200-212 (aka “the Bayh-Dole Act”)
- Served as uniform replacement for numerous patent policies then existing in federal agencies
- Generally permits non-profits & small business government contractors that satisfy certain procedural requirements to retain rights in inventions conceived or first reduced to practice in performance of work under a government contract, grant, or cooperative agreement between the Government and the government contractor
- USG retains paid-up license to practice or have practiced on its behalf as well as other unique rights, i.e., march-in rights
- Extended to large businesses by Presidential Memorandum

Purposes of Bayh-Dole

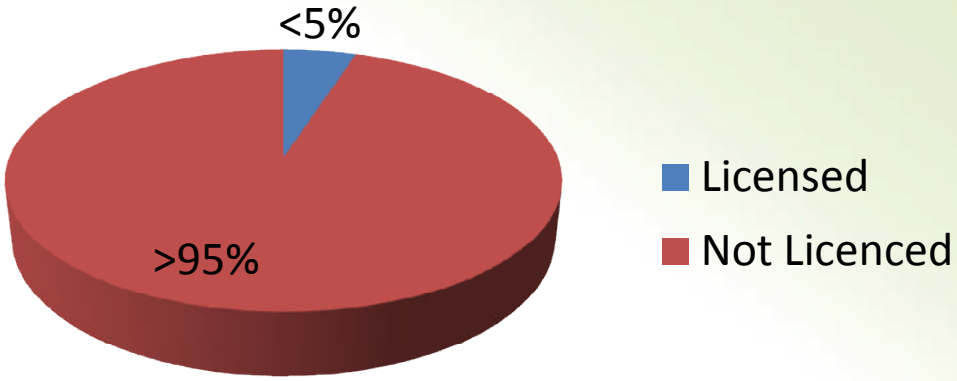
- Promote utilization of federally-funded inventions
- Encourage small business firms to participate in federally supported R&D
- Promote collaboration between companies and nonprofits and universities
- Ensure that inventions made by nonprofit organizations and small business firms are used in a manner to promote free competition and enterprise
- Promote commercialization & publicity of U.S. inventions
- To ensure USG obtains sufficient rights in inventions it pays for to meet USG's needs and ensure against nonuse

Before Bayh-Dole

Academic Research



28,000 USG-owned Patents (1980)



Source: "Innovation's Golden Goose," The Economist, Dec. 14, 2002

After Bayh-Dole

- Tenfold increase in American university patents
- American universities spun off > 2,200 firms to exploit university research
- 260,000 jobs created
- Worth $40 billion to American economy

Source: "Innovation's Golden Goose," The Economist, Dec. 14, 2002

After Bayh-Dole

Bayh-Dole, by its terms, takes precedence over "any other Act which would require a disposition of rights in subject inventions of small business firms or nonprofit organizations contractors" 35 U.S.C. § 210(a)

Stanford University v. Roche Molecular

- Stanford sued Roche for infringement of 3 patents related to detection of HIV
- Inventions purportedly developed by 3 Stanford employees under NIH contracts
- Dispute arises from two agreements signed by one of the Stanford employees, Dr. Holodniy
  - Copyright and Patent Agreement ("CPA")
    - Parties: Dr. Holodniy and his employer, Stanford
  - Visitor's Confidentiality Agreement ("VCA")
    - Parties: Dr. Holodniy & company, Cetus, where Dr. Holodniy would visit during his employment at Stanford

Tale of Two Agreements

- Signed CPA upon employment with Stanford
  - "I *agree to assign*…right, title and interest in…such inventions"
- Later worked with Cetus to learn polymerase chain reaction (PCR) technology
- Signed VCA with Cetus
  - "I…do hereby assign to CETUS, my right, title, and interest in each of the ideas, inventions and improvements" devised "as a consequence" of work at Cetus

The Dispute

- Roche acquired Cetus' PCR business & began producing HIV detection kits using the patented PCR technology
- Stanford sued for patent infringement

District Court Litigation

- Stanford argued inventions developed under USG contract, so it retained rights pursuant to Bayh-Dole Act
- Roche counterclaimed that Dr. Holodniy's agreement with Cetus granted it ownership rights
- District Court held:
  - Stanford satisfied Bayh-Dole procedural requirements so retained title to inventions
  - Dr. Holodniy had no interest to assign to Cetus
  - Roche ownership counterclaim dismissed for failure to comply with statute of limitations & laches
  - But no infringement because patent claims were invalid

Federal Circuit

- Agreement with Cetus took priority over agreement with Stanford
- When Stanford elected to retain title under Bayh-Dole, Dr. Holodniy had already assigned the patent rights to Cetus
- Stanford's election to retain title under Bayh-Dole did not void the prior contractual transfer of rights to Cetus

Bottom Line: Federal Circuit appears to have added to Bayh-Dole a prerequisite that the contractor employee assign rights to the government contractor employer

U.S. Supreme Court

Petitioner's Question:

Whether a federal contractor university's statutory right under the Bayh-Dole Act…in inventions arising from federally funded research can be terminated unilaterally by an individual inventor through a separate agreement purporting to assign the inventor's rights to a third party.

What Stanford v. Roche Might Mean for Government Contractors

- For nonprofits & small businesses:
  - If Roche wins:
    - Increase focus on ensuring employees do not assign invention rights
    - Less incentive for nonprofits & small businesses to commercialize or collaborate
    - Reduced ability for Government to ensure commercialization
  - If Stanford wins:
    - Third party collaborators will need to secure assurances that work is not performed pursuant to federal funding agreement
- For large businesses:
  - Court unlikely to expansively interpret Bayh-Dole as vesting rights in large business
  - Contractors must ensure valid, immediately effective, assignments for employees' inventions are secured (avoid Stanford's predicament)

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Global Sourcing Update

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May 25-26
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Global Sourcing Issues

- Domestic Preference Regimes
  - Buy American Act
  - Trade Agreements Act
  - Recovery Act

- Special Regimes
  - DOT-funded Infrastructure Projects

Trade Agreements Act

- Recent determinations regarding "substantial transformation"
  - Critical software

Recovery Act Buy American Provision

- Continues to be an issue as agencies award contracts and grants
- Agency-specific guidance (e.g., EPA, DOE)

Department of Transportation Buy America

- Federal Aviation Administration, 49 U.S.C. § 50101
- Federal Highway Administration, 23 U.S.C. § 313, 23 CFR § 635.410
- Federal Railroad Administration High Speed Rail Program, 49 U.S.C. Chapters 244, 246, § 24405
- Amtrak, 49 U.S.C. § 24305
- Federal Transit Administration, 49 U.S.C. § 5323(j), 49 CFR Part 661

FTA Buy America

- FTA provides funding for various mass transit projects throughout the U.S.
- By statute, funds may only be used on projects where the steel, iron, and manufactured goods are produced in the United States
- Manufactured goods
  - All manufacturing processes must occur in the U.S.
  - All components must be of U.S. origin
- Rolling Stock
  - Special rules apply to rolling stock (e.g., subway cars, buses)

Navigating the Various Regimes

- Continues to challenge contractors and subcontractors subject to commercial global-sourcing pressure

Export Control Reform in 2011: An Assessment of Progress and Prospects

Jeff Snyder

May 25-26
OOPS 2011
Crowell & Moring LLP

Export Control Reform

- Why now?
- What is it?
- How's it going?
- Will we ever get there?

Why Now?

1. The System is Broken

2. Presidential Priority

Reforms proposed

Outlined by Secretary Gates in March of 2010

"Our plan relies on four key reforms: a single export control list, a single licensing agency, a single enforcement coordination agency and a single information technology system."

Major Reform Elements

- Convert the Munitions List into a “positive” list
- Create three tiers of controls
  - Move items off or over
- Align Lists and Merge to Create a single Control List (SCL)
- Create a single IT system
- Create a Single Licensing Agency (SLA)
- Create an integrated enforcement center
- Obtain Congressional approval

What is not included?

1. Other Agencies
   (OFAC , NRC, DOE)
2. Other Trade Agency Reorganization

Reform Efforts Underway

1. Export Enforcement Coordination Center
   (Created by E.O. 13558 on November 29, 2010, a new interagency Federal Export Enforcement Coordination Center within DHS).

2. EAR - Strategic Trade Authorization License Exception
   (Pending as of 16 May 2011)

3. EAR - Seeking Comments on Tiering and Scope
   (Comments Under Review)

Reform Efforts Underway

DDTC Regulatory Proposals
1. ITAR Comments on definitions, tiering, scope
2. ML Category VII Rewrite (“Tanks and Military Vehicles)
3. Replacement Parts/Components and Incorporated Articles
4. Defense Services Definition
5. Third Country Nationals – **Final** on Monday, 16 May 2011 (0-day delay)

Other Initiatives and Issues

- DTAG Role
  - ML Categories
  - Tiers
  - Government Program License
  - “Specially Designed”
- Congressional Role

The Road Ahead

- The work of reform itself
- Cutting the ‘red tape’
- Multilateral Coordination
- Congress

Can we get there?

Yes (half full)	No (half empty)
Top down influence Strong leadership Early success suggests yes Greatest odds in 20+ years Industry support	Gates is leaving Locke is leaving Too much of a gap Easy issues tackled first Multilateral obstacles Congressional opposition

What should I be doing in the meantime?

- Look for opportunities
- Anticipate change
- Manage expectations
- Use the momentum

International Commercial Arbitration

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May 25-26
OOPS 2011
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International Commercial Arbitration

- Drafting dispute resolution clauses
- Choosing arbitration over litigation

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Recent Developments in Contract Costs and Accounting

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CAS: "Affected" Contracts

- On CAS-covered contracts, Govt is entitled to price adjustments to reflect "increased costs" paid as a result of noncompliance or changes in accounting practice
- Federal Circuit affirmed ASBCA's decision that a CAS-covered contract that was completely repriced with full disclosure after an accounting change was not "affected" by the change
- Court rejected DOJ's arguments that repriced contract was "affected" because
  - It had been modified rather than completely terminated and re-awarded or
  - PCO's agreement to a new price constituted an impermissible "waiver" of ACO's exclusive right to determine impact of an accounting change
- Other implications: IDIQ contracts, changes, letter contracts, options

Donley v. Lockheed Martin Corp., 608 F.3d 1348 (Fed. Cir. 2010)

CAS: Measuring Cost Impact

- CAS statute and clause require contract cost or price adjustment if unilateral accounting change causes the Govt to pay increased costs "in the aggregate"
- Accounting change in the method of measuring the actuarial valuation of assets for a pension plan
- ASBCA:
  - Cost impact on fixed-price CAS-covered contracts must be aggregated with (offset by) cost impact on flexibly priced CAS-covered contracts
  - Price adjustment limited to CAS-covered contracts in effect at the time of the accounting change; Govt may not include speculative effect on future contracts

Raytheon Co., ASBCA No. 56701 (March 31, 2011)

Compound Interest

- Federal Circuit denied petition for *en banc* review of its decision holding that, because the CAS statute requires interest on cost impacts for CAS violations to be calculated at the rate established under 26 USC §6621, the interest must be compounded in accordance with 26 USC §6622 (*Gates v. Raytheon,* 636 F.3d 1363 (Fed. Cir. 2011))
- Following *Gates v. Raytheon* decision, proposed FAR rule would require compound, rather than simple, interest to be used in calculating damages for violations of the Truth in Negotiations Act

CAS 413: Pension Cost Adjustments

- Contractor's claim for pension cost adjustment under CAS 413 for pension plans with funding deficits at a "segment closing"
- Claim could be barred by the standard language required in novation agreements that the contractor "waives any claims and rights against the Government that it now has or may have in the future in connection with the [novated] contracts"
- Govt takes the position that its agreement to novate contracts is completely within its discretion
- Govt could effectively negate CAS 413 by refusing to novate contracts unless the contractor agrees to waive right to adjustment
- Trap for the unwary in the unlikely event that all assets and liabilities are not transferred to the buyer

Raytheon Co. v. United States, 96 Fed. Cl. 548 (Fed. Cl. 2011)

Allowability of Letter of Credit Costs

- Contractor sought recovery of costs incurred in 2005 and 2006 to maintain a standby Letter of Credit (LOC) issued by a bank to guarantee the contractor's ability to repay the entire amount of its long-term debt during each year
- Government argued that the costs were unallowable under FAR 31.205-20 as costs of financing long-term capital.
- Board held for the contractor, finding
  - FAR 31.205-20 was inapplicable because the contractor treated the full amount of its long-term bond debt as part of its "Current liabilities" not as its "long-term liabilities"
  - paying an annual fee (the LOC costs) for the purpose of guaranteeing the bank's ability to repay the full amount of the contractor's long-term bond debt qualified as administrative costs for short-term borrowing for working capital allowable under FAR 31.205-27(a)(3)
  - the LOC costs in dispute were not fixed and upfront costs and, therefore, were different from the typical costs of financing.

SRI International, ASBCA No. 56353, 11-1 BCA ¶ 34694 (Feb. 18, 2011)

Treatment of T&M Subcontract Costs

- Issue: Should subcontract labor costs be treated as "time" and billed at the fixed hourly labor rates set in the contract or as "material" at the actual cost charged by the subcontractor
- CBCA ruled that the subcontract labor costs should be charged as material at the actual cost charged by the subcontractor
  - Left open for fact development the question of whether contractor could charge overhead, G&A, and profit on the subcontract labor costs
- Contractor and CBCA appear to have ignored published GSA guidance in support of billing the costs at the fixed contract hourly labor rates and policy guidance associated with 2007 amendments to the governing FAR clause

Serco Inc. v. Pension Benefit Guaranty Corp., CBCA No. 1695, 11-1 BCA ¶ 34662 (Jan. 14, 2011)

Joint Venture Costs

- Joint venture not required to submit CAS disclosure statement with proposal
  - Proposal included Disclosure Statements from the two JV members
  - All costs to be billed would be incurred and accounted for by the two JV members
  - Overall share in cost of performance and specific roles to be filled by the two JV members set forth in proposal

Northrop Grumman Space & Missile Sys. Corp., Comp. Gen. Dec. B-400837, 2009 CPD ¶ 52 (Feb. 17, 2009)

- Agency improperly rejected a proposal from a joint venture because the JV did not have its own indirect cost structure
  - JV had provided a labor overhead rate for each JV partner that was applied to that partner's total direct labor dollars
  - Agency could not explain why this was unacceptable

McKissack + Delcan JV II, Comp. Gen. Dec. B-401973.2, 2010 CPD ¶ 29 (Jan. 13, 2010)

Proposed Rule: Elimination of CAS Exemption for Overseas Contracts

- Currently, contracts and subcontracts executed and performed entirely outside the U.S. are exempt from complying with CAS. 48 C.F.R. § 9903.201-1(b)(14)
- CAS Board has proposed to eliminate this exemption
  - directed by section 823 of the National Defense Authorization Act for Fiscal Year 2009 to consider its elimination

New Interim Rule: Business Systems Reviews

- Current FAR 16.301-3: "A cost-reimbursement contract may be used only when the contractor's accounting system is adequate for determining costs applicable to the contract."
- Practice has been that DCAA audits all systems for "adequacy," reports recommendations to ACO, and ACO decides
  - DCAA recommendations are binary – adequate or inadequate, nothing in between
  - DCAA positions often unreasonably restrictive
- New interim rule
  - Covers all major systems
  - DCAA reports factual findings, not recommendations re adequacy
  - ACO decides on adequacy
  - ACO may withhold or take other punitive action for material risk
  - Material risk defined in 2011 Authorization Act

Proposed Rule: Allowability of IR&D Costs

- Proposed DFARS to condition allowability of IR&D costs on reporting of unspecified information about individual projects at least annually and again on completion
- Would apply to all contractors with annual IR&D costs in excess of $50,000
  - Less than 1% of the threshold in effect in 1990 for reporting IR&D projects under prior regulatory regime
  - Mandatory reporting requirement completely abolished in 1996

Interim Rule: Reporting Executive Compensation

- Three primary requirements
  - Prime contractor executive compensation
  - First-tier subcontractor executive compensation
  - Reporting of first-tier subcontractor awards
- No exemption for COTS or commercial items
- Applicable to all contracts with value of $25,000 or more, except classified contracts and contracts with individuals
- Relationship to ARRA reporting requirements
- Grant guidance generally mirrors FAR provision

Interim Rule: Reporting Executive Compensation, cont'd

- Who must report?
  - Any contractor that, in the contractor's preceding fiscal year, received:
    - 80 percent or more of the contractor's annual gross revenues from Federal contracts, subcontracts, loans, grants, subgrants, and cooperative agreements
    - $25,000,000 or more in annual gross revenues from Federal contracts, subcontracts, loans, grants, subgrants, and cooperative agreements
    - The public does not have access to information about the compensation of the executives through periodic reports filed under section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a), 78o(d)) or section 6104 of the Internal Revenue Code of 1986
  - Any first-tier subcontractor meeting the same thresholds

Interim Rule: Reporting Executive Compensation, cont'd

- What must be reported?
  - Contractor shall report names and total compensation of each of the five most highly compensated executives for the contractor's preceding completed fiscal year
- "Executive" is broadly defined as officers, managing partners, and any other employees in management positions
- When must this information be reported?
  - By the end of the month following the month of a contract award, and annually thereafter
- Who can access the information?
  - It will be publicly available

Inflation Adjustments

- FY 2010 Executive Compensation Cap is $693,951
- Simplified acquisition threshold (FAR 2.101) was raised from $100,000 to $150,000
- Commercial-item test program ceiling (FAR 13.500) increased from $5.5 million to $6.5 million
- Cost or pricing data threshold (FAR 15.403-4) changed from $650,000 to $700,000
- Threshold for prime contractor subcontracting plans (FAR 19.702) was raised from $550,000 to $650,000, and from $1 million to $1.5 million for construction contracts.
- CAS threshold not yet changed from $650,000

Notable DCAA and DCMA Audit/Policy Guidance

- Ineligible Dependent Health Care Costs
  - DCMA guidance (Sept. 24, 2010) agreed with DCAA's position that health care costs for ineligible dependents are expressly unallowable and subject to penalties if included in a final indirect cost rate proposal
  - Later DCAA guidance (Feb. 4, 2011) provided that unallowable health care costs could be a CAS 405 noncompliance and a cost impact should cover all affected years (even closed years)
- DCAA "Rules of Engagement" (Sept. 9, 2010)
  - Established oral and written communication requirements with contractors and COs before, during, and after an audit

DoD "Better Buying Power" initiative (Jan. 4, 2011) to reduce DCMA/DCAA overlap

- Increased thresholds for cost/price proposal audits by DCAA
  - DCAA will not audit proposals less than $100 million for cost-type contracts and less than $10 million for fixed-price contracts
- DCMA will be responsible for forward pricing rate agreements and recommendations
  - But shall adopt DCAA's recommended audited rates
- DCAA will no longer conduct Financial Capability Reviews or Purchasing System Audits
- DCAA and DCMA will not overlap in business system reviews and audits

In Limbo: Pension Harmonization Act Rules

- Where are they? They were required by statute to be issued by 12/31/2009, to be effective no later than 1/1/2011
- The final rules, whenever issued, will likely be a major event for contractors with pension costs, and could require quick implementation

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