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Government Contracting: Terms, Risks & Sanctions

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Government Contracting: Terms, Risks & Sanctions

By Mark R. Troy, Mana Elihu Lombardo and J. Catherine Kunz

COMPANIES SOMETIMES FIND THAT SELLING goods and services to the federal government can be lucrative, especially given the potential volume of business that the government conducts and the fact that the government can be counted on to pay its bills. The general expansion of the federal government and the infusion of federal stimulus funds into the economy mean that there are greater opportunities for companies to do business directly with the government or indirectly with companies receiving federal funds. But those opportunities present risks for companies unfamiliar with the unique aspects of government contracting.

Companies which seek to perform government contracts in good faith may unwittingly find themselves in noncompliance with a host of unique rules. Companies which deliberately play fast and loose with those rules may find themselves battling against default terminations in the government's administrative forums or worse—defending civil fraud or criminal sanctions.

This article provides an overview of some (but not all) of the key risks of contracting with the federal government. Whether supplying major weapons systems or paper clips, companies doing business with the government need strong compliance mechanisms and expertise to succeed financially and to avoid incurring the powerful sanctions that the government can bring to bear.

A major distinction between a commercial and a government contract is that in many instances the government requires information not merely about the contractor's price but the underlying costs that make up that price. The contractor must certify that its cost information is "current, accurate and complete." Exceptions to this requirement apply when the product being supplied is a commercial item, or when the contract value is under \$650,000, or when the award resulted from adequate price competition. If the cost information is not accurate, there is a presumption that the government overpaid and is entitled to a price reduction. Should the government believe the

contractor deliberately provided flawed or incomplete data, the matter may be referred for civil or criminal prosecution.

Federal Supply Schedule Contracting

The federal government spends billions of dollars each year buying commercial goods through federal supply schedules, maintained principally by the General Services Administration and Department of Veterans' Affairs. These schedules identify technology, supplies and services available to authorized buyers, and allow federal agencies to buy essentially off-the-shelf items by issuing simple orders at predetermined prices. Schedule contract awards are indefinite quantity, indefinite delivery, fixed-priced contracts to commercial companies for a fixed time period.

While companies do not have to disclose historical cost information, they are required to submit information about their current commercial sales practices, including prices provided to other customers. Also, subject to limited exceptions, the contractor is required to give its most favored discount price to the government. A failure to provide accurate, current and complete commercial pricing information or to provide the best price to the government may result in owing the government a refund.

Even after a government contract is awarded to a successful bidder, a competing contractor may protest the award, either on the basis of an alleged flaw in the government's solicitation or its source selection. The agency seeking to award the contract is likely to defend its award decision, but the winning contractor may incur its own legal costs in the process. In addition, the business opportunity may be lost, not because the successful offeror was at fault, but rather because the government issued a flawed solicitation or failed to follow its own regulations in the source selection process.

Contract modifications may be made only by duly appointed contracting officers acting within the limits of both available funding and their delegated authority. The contractor has the responsibility to know the scope of authority of the government official with whom it deals. Many government program officers and engineers who work directly or even on-site with contractors do not have contracting officer authority, yet reasonably may be perceived as having such authority when they give directions on how to perform the contract. The concept of "apparent authority" does not apply to the government; therefore, to the extent that a company incurs costs based upon the directions

or promises of government persons without this essential authority, the company does so at its financial risk.

In contracts other than for commercial items, the authorized contracting officer generally holds the unilateral right to direct changes within the general scope of the contract. The contractor generally is obligated to continue performance under the contract as changed, but is entitled to an equitable adjustment for the provable and allowable cost consequences of the change.

The government uses contract terms to implement social, economic and environmental policies, such as maintaining an affirmative action plan and reporting on the hiring of veterans. In many circumstances, these terms must be passed or "flowed down" to subcontractors who may be unfamiliar with compliance requirements. Missteps can result in the government terminating the prime contract for default and/or debarring the non-compliant contractor from government contracting.

Government Audit Rights and Compliance

The government has the right to audit contractor books and records in specific circumstances. The most common audit situations are: (1) pre-award audits of the proposed price or estimated costs; (2) pre-award surveys of the contractor's capability to perform the contract and of the contractor's present responsibility (including past performance record); (3) functional systems' reviews, such as purchasing and subcontracting systems; and (4) incurred cost audits prior to final payment and closeout.

The government is entitled to "strict compliance" with the technical requirements of the contract. Unlike the commercial world where industry standards are acceptable, the government contract specifications trump industry standards. In this regard, it does not matter that the service or item actually furnished is equal to or superior to that described in the contract specifications. Strict compliance means exactly that, and there are serious risks for noncompliance.

Contractors who are awarded certain government contracts above a specified dollar threshold are responsible for ensuring that their cost accounting system measures up to the government's Cost Accounting Standards. There are 19 Standards to ensure uniformity and consistency in measuring, assigning and allocating costs to contracts with the federal government. These must be learned and understood before taking on substantial government work.



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Code of Business Ethics and Mandatory Disclosures

Contractors with large contracts are required to have a company code of business ethics and conduct designed to ensure ethical conduct and a corporate commitment to compliance with the law. In addition, these contractors are required to disclose to the government instances when the company believes it or its subcontractor has violated certain federal criminal laws or the False Claims Act. Failure to make such a disclosure can result in serious penalties for the contractor, including debarment.

Most companies have some technology or technical approach that gives them an advantage over their competitors. The government often will seek to obtain rights in the contractor's technical data. There are essentially three types of rights the government may obtain: (1) "unlimited rights" enabling the government to do anything it pleases with the data, including providing the data to contractor's competitor; (2) "limited rights," which constrain the government to use the item only for certain specific government purposes; and (3) "government purpose rights," which are limited rights but which turn into unlimited rights after a specified period of time. Unless a company is alert to the risks of protecting its rights in technical data and computer software, there is a serious risk of unwittingly giving up some or all of its rights.

The government has virtually an absolute right to terminate its contracts at the government's convenience for any reason. One of the common bases to terminate a contract for convenience is when funding for the program is exhausted. While contractors generally can recover their costs and unabsorbed overhead in such situations, anticipatory profits are not recoverable.

Common Allegations of Wrongdoing

Contractors are obligated to charge the government only that amount which is allowed under the contract, the law and regulations. The contractor must be prepared to prove its charges to the government, often being subject to a rigorous post-contract audit.

Now, there are a number of statutes and regulations which make it illegal to provide gratuities to government persons. The distinctions between a legal business courtesy and an illegal gratuity can be subtle. The penalties and sanctions associated with providing illegal gratuities to government persons include denial of contract award, cancellation of the contract, criminal prosecution and debarment from federal government contracting.

A federal statute makes it illegal for a vendor or supplier to provide anything of value to a contractor or higher-tier subcontractor for or because of favorable consideration. A kickback may be anything from cash or gifts, to entertainment, to work on a home or vacation cabin, to employment of friends or relatives, or to anything else of value. The statute imposes an affirmative obligation on the government contractor to establish and enforce measures to prevent kickbacks within its organization.

In order to protect the integrity of the procurement process, there are serious penalties and sanctions where the government decision maker has a conflict of interest. For example, it is illegal for a contractor to enter into employment discussions with a government official who is substantially involved in administering its contract, or who has authority to award a public contract to the contractor.



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Additionally, contractors can have organizational conflicts of interest that will restrict their ability to enter into certain contracts with the government. Organizational conflicts of interest can arise when a company has nonpublic information from its performance of a government contract that could provide it with an unfair competitive advantage in a different procurement. Also, organizational conflicts of interest can arise where a contractor has provided input into the government's acquisition strategy or would be required to evaluate itself if it were a bidder.

The Sherman Antitrust Act applies to government contracting and provides for both criminal and civil sanctions. Government contractors have an affirmative duty to ensure its agents and employees avoid contacts with competitor personnel that may be perceived as collusion on marketing, pricing or bidding.

False Claims and Statements

There are severe sanctions for submitting a false claim to the government or a recipient of federal funds. For service contractors, recording and claiming costs based on labor hours can be a risky area and must be closely watched. The government may pursue a contractor for false claims either criminally or civilly. Also, whistleblowers can file a false claims action against contractors. Proving a false claim may be based on actual knowledge of the falsity as well as on deliberate ignorance or reckless disregard. Of course, under U.S. law, the company can be criminally and civilly liable for the acts of its employees performed in the scope of employment, or for acts which benefit the company. Huge damages and penalties may result from false claims.

There are multiple risks of prosecution under Title 18 U.S.C. §1001 for false statements to the government. These risks emerge out of the many requirements for certifications, submittals, invoices, and proposals that must be submitted by the contractor to the government. Every such submittal bears the risk of being regarded as a false statement.

Products or Service Substitution

The government may regard substitution of a product or service or omission of a required test procedure required by contract specifications as a willful act and, therefore, punishable as a criminal or civil fraud. This is an area of high risk, requiring government contractors to be especially alert in assuring strict compliance with contract terms. The contractor is responsible to the government to ensure the integrity of the product and service, as well as the integrity of the related paperwork. The government also looks to the contractor to assure vendor and supplier quality procedures.

Before wading into the huge and potentially lucrative government market, the alert business organization must first learn about the pitfalls and likely increased administrative and operational costs involved. While problems with a commercial customer sometimes can be smoothed over, contract compliance problems on a government contract can bring down a company. Competitors, prosecutors and even the contractor's own employees can raise allegations that can be extremely costly and difficult to defend. A thorough understanding of the myriad of contract terms and regulations and a vigilant compliance program are the key ingredients to doing business with the government. ▲

Mark Troy is a Partner in the Los Angeles office of Crowell & Moring. He has engaged in government contract-related litigation and counseling for over 25 years. He is an expert in defending procurement fraud actions brought by the federal government and by so-called qui tam whistleblowers under the civil False Claims Act.



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Test No. 44

This self-study activity has been approved for Minimum Continuing Legal Education (MCLE) credit by the San Fernando Valley Bar Association (SFVBA) in the amount of 1 hour. SFVBA certifies that this activity conforms to the standards for approved education activities prescribed by the rules and regulations of the State Bar of California governing minimum continuing legal education.

1. Companies contracting with the government may be subject to criminal prosecution for failing to provide accurate information about the underlying costs to perform the contract.
 True False
2. Companies must disclose historical cost information to the federal government when using Federal Supply Schedule contracting as a vehicle for sales.
 True False
3. A contractor may protest the government's award of a contract to its competitor if it believes that the government did not follow the proper source selection process.
 True False
4. Only the appointed contracting officer has the authority to modify a government contract.
 True False
5. If the contracting officer implements a contract change, the contractor must bear the costs associated with that contract change.
 True False
6. The government can require a contractor to compel its subcontractors to maintain an affirmative action plan.
 True False
7. The government is not permitted to audit the contractor's capability to perform the contract.
 True False
8. A contractor meets the contract requirements of a government contract if it provides a service that is equal or superior to what is described in the contract specifications.
 True False
9. A government contractor may be required to set up a cost accounting system.
 True False
10. All government contractors must set up a company code of business ethics and compliance.
 True False
11. Under a government contract, the government may have unlimited rights to a contractor's technical data.
 True False
12. The government has a unilateral right to terminate a contract just because it is convenient for it to do so.
 True False
13. Once a government contract is complete, a contractor no longer needs to be able to prove the propriety of its charges to the government.
 True False
14. A company cannot be debarred from federal government contracting for providing a gratuity to a government official.
 True False
15. It is illegal for a vendor or supplier to buy government contractor personnel Lakers tickets in order to influence the contractor's decision to select that vendor for work under the government contract.
 True False
16. A government contractor can have discussions about future employment with the contracting officer administering its contract as long as the contracting officer is qualified for the job.
 True False
17. Government contractors can face criminal penalties for colluding with competitors.
 True False
18. A contractor may be subject to a civil lawsuit, but not to criminal penalties, for submitting a false claim to the government.
 True False
19. A contractor can be subject to criminal penalties for false statements made in its bid proposal to the government.
 True False
20. A government contractor is responsible for ensuring that its vendors and suppliers meet quality procedures.
 True False

MCLE Answer Sheet No. 44

INSTRUCTIONS:

1. Accurately complete this form.
2. Study the MCLE article in this issue.
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ANSWERS:

Mark your answers by checking the appropriate box. Each question only has one answer.

1. _____ True False

2. _____ True False

3. _____ True False

4. _____ True False

5. _____ True False

6. _____ True False

7. _____ True False

8. _____ True False

9. _____ True False

10. _____ True False

11. _____ True False

12. _____ True False

13. _____ True False

14. _____ True False

15. _____ True False

16. _____ True False

17. _____ True False

18. _____ True False

19. _____ True False

20. _____ True False