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EXPERT ANALYSIS

# Contractors in the Crosshairs: Investigations Passing Government Scrutiny

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The business model of a government contractor makes it uniquely susceptible to a wide range of civil and criminal liability. These companies face increasing regulatory oversight, the eagerness of whistleblowers seeking awards and the restrictive covenants found in the Federal Acquisition Regulations — which, among other things, require them to disclose certain misconduct to their contracting agency. The Department of Justice, the Securities and Exchange Commission and other agencies pursue enforcement actions against contractors under myriad federal laws, including the Foreign Corrupt Practices Act, 15 U.S.C. §§ 77dd-1, 78dd-2, 78dd-3, 78m, 78ff, the False Claims Act, 31 U.S.C. § 3729, and various criminal fraud statutes.

The Justice Department has also recently made clear that it will increase the level of coordination between the civil and criminal divisions of prosecuting offices. As a result, civil matters may lead more easily to criminal investigations and vice versa. This combination of factors makes it vital for contractors to have an effective compliance program that identifies and addresses allegations of inappropriate conduct. A compliance program will limit the liability that can result from a government enforcement action.

## FOREIGN CORRUPT PRACTICES ACT

The FCPA, passed in 1977, generally prohibits companies and individuals from corruptly providing things of value to foreign government officials to obtain or retain a business advantage. It is divided into two parts.

First, anti-bribery provisions, found at 15 U.S.C. § 77dd-1, prohibit American individuals and businesses, or "domestic concerns," and public companies on stock exchanges subject to SEC review, or "issuers," from giving or offering "anything of value" to foreign government officials to secure an improper benefit.

Second, accounting provisions, found at 15 U.S.C. § 77m, require issuers to maintain accurate books and records as well as reasonably effective internal controls.

The Justice Department has civil and criminal enforcement authority to prosecute violations of the anti-bribery provisions committed by domestic concerns and limited foreign entities. It also has exclusive criminal enforcement authority over issuers for FCPA violations. The SEC may bring civil FCPA actions against issuers.

Regardless of which agency brings the enforcement action, the repercussions can be steep. Violations of the anti-bribery provisions can cost companies up to $2 million per violation (or double pecuniary gains) in criminal fines and/or civil penalties up to $10,000 per violation (or disgorgement of profits).

Individuals charged with criminal violations can face up to five years in prison and/or a $250,000

penalty (or double pecuniary gains) per violation of the anti-bribery provision, in addition to possible civil penalties up to $10,000 per violation (or disgorgement of profits).

Finally, companies that violate the accounting provisions may be fined $25 million per violation, while individuals face up to $5 million per violation and/or 20 years in prison.

## FALSE CLAIMS ACT

The FCA, 31 U.S.C. § 3729, bars claimants from knowingly submitting, or causing to be submitted, false claims to the federal government for payment. It also prohibits knowingly using, or causing another to use, false records to avoid, reduce or conceal an obligation owed to the government. .

Section 3730(b) of the statute permits private citizens to bring FCA actions on behalf of the federal government. These whistleblowers — who can be the contractor's own employees, and in limited cases, government workers — may receive as much as 30 percent of any recovery.

The civil penalty for FCA violations can be significant, with payments ranging from three times the damages incurred by the government, plus fines of $5,500, to $11,000 for each false claim that is filed or caused to be filed.

In addition to civil liability under the FCA, the DOJ has several criminal statutes at its disposal to prosecute fraudulent behavior. For example the DOJ can pursue charges for false claims,[1] false statements,[2] conspiracy to defraud,[3] and wire or mail fraud.[4] The penalties for each crime vary, but they typically permit a maximum sentence of five years in prison and a $250,000 fine.

*The Department of Justice, the Securities and Exchange Commission and other agencies pursue enforcement actions against contractors under myriad federal laws.*

## MANDATORY DISCLOSURE AND THE FEDERAL ACQUISITION REGULATION

A government investigation can begin through several avenues, including whistleblowers, data mining analysis or observation of industry trends. Most unique — and perhaps most threatening to government contractors — are investigations based on agency referrals. These investigations can occur more regularly because of the FAR's mandatory disclosure requirements.

The FAR was amended in 2008 in two significant ways.

First, the provision controlling the grounds for suspension and debarment was modified to require "principals" of a contractor to make a timely disclosure to the government when they have credible evidence of a violation of federal criminal law involving fraud, conflict of interest, bribery or gratuity violations found in Title 18. Disclosure is also required if there is evidence of a violation of the civil False Claims Act or a "significant overpayment" on a government contract.

Failure to disclose may result in suspension or debarment.[5] The regulations define "principal" as "an officer, director, owner, partner or a person having primary management responsibilities within in a business entity."[6]

Second, the amendment created a new contract requirement that mirrors many items discussed above. It is applicable to contracts that are valued at more than $5 million and are likely to take more than 120 days to complete.[7] This new contract clause, found at FAR Section 52.203-13, is similar to the suspension and debarment regulations because it requires a timely disclosure to the government of credible evidence indicating Title 18 violations or a violation of the False Claims Act.

This mandatory disclosure requirement is also different in significant respects. Specifically, it does not require disclosures to be made for "significant overpayments." It also specifies that a "contractor" must make the disclosures rather than a "principal" of the company and that the contractor must make the disclosure to the relevant inspector general and contracting officer, rather than simply to the government. Further, it provides that the disclosure requirement for an individual contract continues until at least three years *after* final payment on the contract has been made.

Despite their differences, both requirements impose significant obligations upon contractors. Because contractors must disclose specific misconduct, it is important for companies to develop

compliance policies and procedures to effectively investigate and remediate potential misconduct and assure that the mandatory disclosure provisions are followed. Strong company policies and procedures may also demonstrate to the government that appropriate action was taken to assure that the compliance breach does not recur.

## CONDUCTING AN INTERNAL INVESTIGATION

Government contractors face an enforcement-focused regulatory climate and an expectation by regulatory agencies that they will cooperate and properly address compliance issues. Many businesses are frequently confronted with compliance issues, and every complaint needs to be taken seriously. The failure to do so may result in enhanced civil or criminal liability.

When a compliance issue is identified, the company must take steps to understand its outside exposure (*e.g.*, whether a government agency already knows of, or is likely to learn about, the alleged misconduct) and appreciate its business's risk portfolio. This may require conducting a limited risk assessment. With that knowledge in hand, company management must consider the costs and benefits of conducting an effective internal investigation. Although potentially time-consuming, an effective internal investigation can offer numerous benefits, including:

- Enabling the company to gather relevant facts to effectively address the issue and respond to inquiries promptly and thoroughly.
- Memorializing a company's effort to respond to a compliance concern.
- Assisting in eliminating misconduct — both individual bad actors and systemic issues.
- Aiding in calming potential whistleblowers — a *qui tam* lawsuit under the FCA can sometimes be avoided by addressing a potential complainant's concerns through an investigation and subsequent remediation.
- Demonstrating to employees and government enforcement agencies that the company takes compliance seriously.

*The civil penalty for FCA violations can be significant, with payments ranging from three times the damages incurred by the government plus fines of $5,500 to $11,000 for each false claim that is filed or caused to be filed.*

## ASSEMBLING AN APPROPRIATE INVESTIGATION TEAM

After deciding to conduct an internal investigation, the company must evaluate whether it should be directed by an in-house team or outside counsel. One relevant consideration is the nature of the alleged misconduct. It is generally beneficial to bring in outside help for alleged misconduct that is complex or pervasive. Although more costly, the outside team may relieve in-house staff from the disruption of completing a complex investigation and provide an objective analysis of the facts and risk. Relatedly, having an independent third party conduct the investigation becomes more important should the potential exposure or liability expand.

Once a decision to involve outside counsel is made, it is imperative to assemble a team of attorneys that possess sufficient industry expertise and have the skills to conduct and organize a comprehensive investigation. For government contractors, outside counsel should be familiar with the contractor business model, understand the intricacies of the FAR and have experience advocating against federal regulatory agencies. The company and its counsel should also consider whether the services of additional third parties are required (*e.g.* outside auditors, consultants or subject-matter experts).

It is helpful to have open communication throughout the investigation among company counsel, the business's compliance department and outside counsel. Each party should identify an individual to act as a liaison, streamline communications and avoid a lack of responsiveness that would hinder progress.

## PRESERVING PRIVILEGE

Regardless of whether in-house or outside counsel conducts the investigation, it is important to take steps throughout the investigation to protect attorney-client privilege. Following the U.S.

Court of Appeals for the District of Columbia Circuit's decision in *In re Kellogg, Brown & Root Inc.*, businesses should feel reassured that communications made during an investigation will not be subject to civil discovery as long as "one of the significant purposes of the internal investigation [is] to obtain or provide legal advice."[8]

Due consideration should be given to implementing practices that will help protect the communications made throughout the investigation, including:

- Plainly defining that the purpose of attorney involvement in the internal investigation is to provide legal advice to the company (or whomever the outside counsel is hired to represent).
- A well-documented record that all activities performed by non-attorneys are done at the direction of company counsel.
- Clearly articulating so-called Upjohn warnings to all interviewees — that is, a statement that company counsel represents the company rather than employees, and that the communication is protected by attorney-client privilege (although the company, in its discretion, may waive that privilege).
- Marking all investigation related documents "attorney-client privilege," and, where appropriate, "attorney work product."

## PREPARING AN INVESTIGATION WORK PLAN

It is beneficial to prepare a work plan that outlines objectives and sets benchmarks. An effective work plan will:

- Define the goals of the investigation.
- Outline investigation steps;
- Assign tasks and responsibilities to team members.
- Establish deadlines.

At an April 2015 conference at New York University Law School, Assistant Attorney General Leslie Caldwell made it clear that while the Department of Justice expects "investigations to be thorough, [it does] not expect companies to aimlessly boil the ocean."[9]

By taking the time to prepare an effective work plan, in-house and outside counsel can work in tandem to fix the scope of an investigation and prepare a timeline and budget that will help avoid wasted time and resources.

However, work plans must be flexible. The direction of an investigation can shift as additional information is gathered or new outside forces come into play (*e.g.*, the government issues a subpoena).

## INFORMATION GATHERING

Document collection and review as well as witness interviews are the keys to gathering facts during an investigation. Documents often provide attorneys with necessary context allowing for more effective interviews and information gathering.

Sufficient document collection and review can be time-consuming and labor intensive, but it is necessary to ensure that counsel can properly evaluate witnesses, assess liability and identify exculpatory evidence. Before being given access to documents, outside counsel, with the assistance of in-house counsel, should:

- Identify who on the investigation team will be responsible for document management.
- Consider all possible document custodians and mediums (*e.g.*, electronic vs. hard documents, audio recordings, instant messages).

- Consider the location of each custodian and whether there will be legal or regulatory obstacles due to foreign data privacy laws and blocking statutes that limit or preclude the production of discovery outside the United States for use in U.S.-based litigation.
- Prepare a method for detecting and preserving relevant items.
- Evaluate whether a third-party vendor must assist with the data collection and review process (this will require understanding the law firm's litigation technology capabilities).

## LITIGATION HOLDS

If there is a likelihood of litigation or a high probability of government investigation, a company should consider suspending its typical document preservation procedures and issuing a litigation hold notice. In such a situation, the company should identify a broad group of personnel likely to possess relevant materials and distribute a memorandum that:

- Provides a limited description of the conduct giving to rise to the litigation hold.
- Explicitly defines the date range and content topics that may not be deleted or destroyed.
- Offers guidance on how to efficiently preserve various types of data.
- Includes contact information for company and outside counsel so questions may be quickly addressed.

## WITNESS INTERVIEWS

Witness interviews are the crux of an investigation and can serve multiple purposes. They can help to better focus an investigation, shed light on areas of concern and determine the cause of misconduct and/or a compliance program's shortcomings. Prior to conducting an interview, counsel should consider the following:

- The process for arranging interviews (*e.g.,* whether there are individuals whose interviews should be prioritized or conducted before others).
- Limiting the information the employee has ahead of an interview to ensure he cannot prepare answers or corroborate stories with other workers.
- Clarifying during the interview that counsel represents only the company and maintaining confidentiality is instrumental to preserve privilege and the integrity of the investigation.
- Determining whether formal interview memoranda should be prepared or whether notes will suffice (regardless, either should be properly marked to explain that they contain counsel's opinion and mental impressions and distribution should be limited to necessary parties to protect privilege).

## INVESTIGATION REPORT

At the conclusion of an investigation, and at the request of the company, counsel may provide the company with a formal written report that contains:

- A brief summary of the investigation's factual findings and conclusions.
- A description of the investigation's origin (*e.g.,* anonymous tip or internal audit).
- A summary of the investigative steps.
- An explanation of the relevant laws and company policies.
- A synopsis of the facts learned.
- An evaluation of the company's possible liabilities based on the relevant laws.
- Proposed remedial measures and corrective actions.

The final investigative report should be distributed only to those who have authority to make or assess the legal decision about the case. This practice will best preserve the argument that the content of the report should remain privileged.

## IMPLEMENTING CORRECTIVE ACTIONS AND CONSIDERING DISCLOSURE

Following an investigation, a company should determine how its compliance program can evolve to better address the specific issues identified during the internal review. Once compliance issues are confirmed through the internal investigative process, it is imperative that corrective actions be taken. These include implementing tighter safeguards, updating compliance training and terminating bad actors.

As discussed above, if the contractor identifies a specified Title 18 violation, FCA violations or a significant overpayment (in some cases), the FAR requires that it inform the government of the misconduct or face suspension/debarment or termination of its contract. When submitting a report to the government, the contractor should consider working with counsel to assist with the following:

- Providing just enough information to inform the agency that a violation was recognized (a full report is not necessary).
- Assessing whether sufficient corrective actions were taken. It is not a secret that a company that identifies flaws and fails to take action is not likely to be shown leniency.
- Including examples of the remedial actions taken in the disclosure to demonstrate that the company has adequately addressed its prior shortcomings.

In conjunction with notifying the relevant inspectors general and contracting officers, the contractor should consider whether it is necessary or beneficial to voluntarily disclose to any other relevant agency or suspending and debarring officials. SEC and DOJ guidance have made it apparent that cooperation, including the timely and voluntary disclosure of misconduct and remediation, is a significant factor considered by the government when evaluating whether to pursue charges and/or the severity of the penalty.

With increased intra- and inter-agency cooperation, additional enforcement agencies will probably be made aware of the noncompliant behavior of contractors. Therefore, it may be advantageous for a company to get out in front of an issue and show its willingness to cooperate by voluntarily disclosing misconduct to the DOJ, the SEC or other enforcement agencies.

Finally, constant monitoring and reassessment of compliance programs can play a critical role in assuring continued compliance.

## CONCLUSION

While an effective internal investigation cannot always eliminate negative consequences, it can identify liabilities, assess witnesses, develop helpful facts, spot weaknesses in a contractor's compliance program and limit future compliance violations. Assistant Attorney General Caldwell recently stated "there is no 'off the rack' internal investigation that can be applied to every situation at every company."[10]

With that in mind, government contractors should have in-house and/or outside counsel properly evaluate a compliance concern or complaint, design and lead an investigation that can meet the company's needs and place the company in the best possible position if disclosure is necessary.

## NOTES

1 18 U.S.C. § 287.

2 18 U.S.C. § 1001.

3 18 U.S.C. §§ 286 and 371.

4 18 U.S.C. §§ 1341 and 1343

[5] FAR § 9.406-2, 9.407-2.

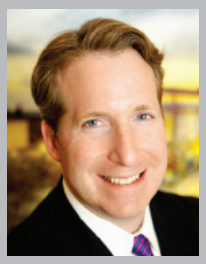
[6] FAR § 2.101(b)(2).

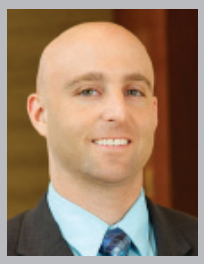
[7] FAR § 52.203-13.

[8] *In re Kellogg, Brown & Root Inc.*, 756 F.3d 754 (D.C. Cir. 2014).

[9] Leslie R. Caldwell, assistant attorney general, Remarks at New York University Law School's Program on Corporate Compliance and Enforcement (Apr. 17, 2015), *available at* http://www.justice.gov/opa/speech/assistant-attorney-general-leslie-r-caldwell-delivers-remarks-new-york-university-law (last visited Apr. 29, 2015).

[10] *Id.*



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