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# Government Contracts Quarterly Update

May 2014

*The* Government Contracts Quarterly Update *is published by BakerHostetler's Government Contracts Practice Group to inform our clients and friends of the latest developments in federal government contracting.*


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## 2014 Appropriations Act Softens China-IT Restrictions For Contractors

In the April 2013 edition of the *Quarterly*, we discussed how the 2013 Consolidated and Further Continuing Appropriations Act ("2013 Act") potentially prohibited the Departments of Justice and Commerce, NASA, and the National Science Foundation from acquiring IT equipment from companies that are owned, directed, or subsidized by the Chinese government. However, the $1.1 trillion Consolidated Appropriations Act, 2014 (the "2014 Act"), signed into law on Jan. 17, 2014, scaled-back China-IT supply chain restrictions. *See* Title V, § 515. Although the new law still singles out China as a potential threat, the law pivots from a geographic approach to a risk-based approach.

Specifically, the 2014 Act requires the above-listed agencies to review the supply-chain risk from the presumptive awardee and develop a mitigation strategy for any identified risks prior to using FY 2014 funds to acquire information systems designated as "high -impact or moderate-impact information" (based upon NIST guidelines). Contractors should note that China is not singled out in the new restrictions; the new ban applies to any entities identified by the United States Government as posing a cyber-threat, including, but not limited to, China.

## Minimum Wage Increased to $10.10 For Contractors

On Feb. 12, 2014, President Obama issued an executive order raising the minimum wage to $10.10 an hour for workers performing services or construction under new Federal Government contracts. Specifically, the minimum wage applies to contracts solicited on or after Jan. 1, 2015, and to workers "in the performance of the contract or any subcontract thereunder." President Obama justified the wage increase by stating that raising the pay of low-wage workers increases worker morale and productivity, lowers turnover, and reduces supervisory costs. This change mirrors the president's plan to raise the minimum wage nationwide, as part of his broad "Creating Economic Opportunity" agenda.

## Decrease in Allowable Individual Compensation for 2014

The Bipartisan Budget Act of 2013 ("BBA") set the individual compensation cap at $487,000 per fiscal year. The BBA was passed just hours after the National Defense Authorization Act for FY 2014 ("NDAA"), which had set the compensation cap at $625,000. Both acts were signed into law on Dec. 26, 2013. Since the BBA was passed after the NDAA, the $487,000 limit is the appropriate compensation cap. The $487,000 cap applies to contracts that are entered into on or after June 24, 2014. The BBA presents a significant reduction from the preceding cap of $763,029 for fiscal year 2013.

## Voluntarily Lowered FCA Award Avoids Excessive Fines Clause

On Dec. 19, 2013, the Fourth Circuit held that the government or a relator suing under the False Claims Act ("FCA") has "virtually unbounded" discretion in deciding whether to sue for less money than entitled. *See U.S. ex rel. Bunk v. Gosselin World Wide Moving, N.V.*, 741 F.3d 390, 406 (4th Cir. Dec. 19, 2013). In *Bunk*, there were 9,136 discrete claims, each of which had a basis for liability under 31 U.S.C. § 3729 with a minimum penalty of $5,500, which would have resulted in a total penalty of just over $50 million. The district court found the penalty to be an excessive fine under the Eighth Amendment.

(*Continued*)

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Confronted with this argument, the relator and the government agreed to reduce the penalty to $24 million. While the district court found that the statutory minimum penalty cannot be modified by the court even if that penalty runs afoul of the Excessive Fines Clause and precludes recovery, the Fourth Circuit disagreed. The appeals court found that the relator is master of his complaint and that voluntary remitter is "just the sort of arrow that a plaintiff is presumed to possess within his quiver." *Id.* The court stressed that it would be a perverse result if the FCA's penalties were in all cases mandatory and thus, when running up against a barrier like the Eighth Amendment, caused the relator to be unable to recover. In fact, the court noted that this would encourage dishonest contractors to run up as many false claims as possible once they have committed one. The primary purpose of the FCA is to make the government, and the relator, whole, not to strictly adhere to the prescribed penalties.

## GAO Ruling Creates an Exemption to The Ten-Day Protest Deadline

In its Jan. 28, 2014, decision in *Motorola Solutions, Inc.*, the GAO found that when an agency stalls in providing a protestor with information necessary to bring its protest, and the protestor is conscientious in trying to obtain that information, then the protestor need only file its protest within ten (10) days of receiving the improperly withheld information in order to be considered timely filed. B-409148, B-409148.2 (Jan. 28, 2014). This new exemption to the general ten-day protest deadline may provide a shield to contractors in the event that the contracting agency attempts to manipulate the release of information in relation to the deadline.

In *Motorola*, the agency failed to tell Motorola that its competitor in the procurement, Harris Corp., intended to sell Motorola's radios to the agency. When the agency did tell Motorola's attorneys, they did so under seal at the GAO, so the attorneys could not consult with their client as to whether they would be willing to sell Harris the radios. This confusion pushed Motorola over the ten-day deadline, but the GAO found that the agency's handling of the information was unfairly beneficial to the agency and sustained the protest. Further, the protest was also sustained on the basis that the agency accepted the awardee's proposal without evidence that the awardee could obtain essential equipment.

## GAO Study on Sequestration Observes a Pronounced Effect on Agencies

The GAO's Mar. 6, 2013, report titled "*2013 Sequestration: Agencies Reduced Some Services and Investments, While Taking Certain Actions to Mitigate Effects*," found that the sequestration had a pronounced effect on services and operations at the 23 agencies reviewed by the GAO.

According to the report, the sequestration caused reductions in grants for research in science and health and backlogs at other agencies as a result of limitations imposed on hiring and, in some cases, because of the furlough of existing employees. However, many of the agencies clarified that they were uncertain of the full effects of sequestration and that their magnitude might not be known for several years. Although most agencies used funding flexibilities to balance the required sequestration reductions while protecting their mission, many agencies reported curtailing hiring, rescoping or delaying contracts or grants for core mission activities, and reducing training and employee travel.

## GAO to Institute Filing Fee For Bid Protests

The GAO, as authorized by Section 1501 of the Consolidated Appropriations Act of 2014, will soon institute a filing fee for bid protests along with a new online docketing system. The fee, expected to be around $250, is intended to offset the cost of the docketing system, which the GAO hopes will lead to a more transparent bid protest system. The new system will allow companies to file a protest electronically and allow documents and information to be disseminated and made available to the parties of the protest through electronic means. The GAO is making this change in the face of increased requests for information on previous protests.

## War-Zone Contracts Are Not Exempt From Obligation to Justify Cost Reasonableness

On Feb. 3, 2014, the Federal Circuit affirmed a lower court decision that contractors must have sufficient documentation to demonstrate that allowable costs are reasonable, even when the Government makes an urgent request for a change in a war-zone environment. *Kellogg Brown & Root Servs., Inc. v. United States*, 742 F.3d 967 (Fed. Cir. 2014). After receiving a change order from the Army, the contractor asked its subcontractor to prepare a new proposal without specific detail as to how it would justify a cost that was triple the original proposed costs.

The subcontractor based the price on its costs in building similar structures elsewhere and justified the increase on the need for more equipment and a violence-induced increase in labor costs. The court found this justification to be conclusory and devoid of any detail connecting the new revised specifications to the quoted amounts, which should have prompted increased scrutiny by the prime contractor rather than acceptance of the subcontractor's proposal at face value. As a result, even in light of the war-zone environment and urgent situation, the costs were held to be not reasonable and therefore unallowable.

## Long-Term Suspension of Affiliate Does Not Violate Due Process

On Dec. 31, 2013, the Eleventh Circuit ruled in *Agility Defense Services, Inc. v. United States Department of Defense*, No. 13-10757, 2013 WL 6850891 ($11^{th}$ Cir.) that the Government may suspend affiliates of an indicted contractor pursuant to FAR 9.407, even without any indictment of the affiliates themselves. The court went on to hold that a suspension of over 18 months, as prescribed by the FAR, does not violate due process.

FAR 9.407-1(c) provides that "[t]he suspending official may extend the suspension decision to include any affiliates of the contractor if they are – (1) specifically named; and (2) given written notice of the suspension and an opportunity to respond." In this case, Agility was an affiliate of Public Warehousing Company, K.S.C. ("PWC"), which was suspended in 2009 in relation to a fraud indictment. The court found that the language of the FAR clearly provided for just such a suspension of an affiliate without any requirement of a finding of wrongdoing on the part of Agility.

The court next found that due process was not violated, because FAR 9.407-1 provided for notice of the suspension and an opportunity to respond. The court found it "nonsensical" to require either not suspending or bringing a separate proceeding against Agility when the FAR clause

dictates that Agility's status will be determined by the outcome of PWC's legal proceeding. The *Agility* ruling highlights the potential risk that companies face due to the actions of their affiliates and underscores the importance of strong compliance programs across the entire affiliate network.

## New Disability And Veteran Hiring Rules Take Effect

On Mar. 24, 2014, the U.S. Department of Labor's ("DOL") Office of Federal Contract Compliance Programs' ("OFCCP") new regulations concerning Section 503 of the Rehabilitation Act and the Vietnam Era Veterans' Readjustment Assistance Act ("VEVRAA") went into effect.

The new regulations concerning Section 503 of the Rehabilitation Act require contractors to take affirmative actions to hire, promote, and retain individuals with disabilities. The regulation establishes a utilization goal of 7% for qualified individuals with disabilities, which a contractor must apply to each of their job groups or to their entire workforce if a contractor has fewer than 100 employees. Contractors must also track data regarding how many persons with disabilities apply for jobs and how many the contractor hires. The regulation also requires contractors to invite applicants during the pre-offer and post-offer stages to self-identify as a person with a disability, as well as invite their employees to self-identify every five years.

The new regulations concerning VEVRAA require contractors to establish hiring benchmarks for protected veterans. Contractors may choose to establish a benchmark equal to the national percentage of veterans in the civilian workforce or alternatively establish their own benchmark based on certain data published by the Bureau of Labor Statistics ("BLS") and OFCCP. As with the disability regulations, contractors must track how many veterans apply for jobs and the number of veterans hired.

An early challenge to the new regulations was dismissed by a federal judge on Mar. 21, 2014. In *Associated Builders & Contractors, Inc.* ("ABC") *v. Shiu*, 2014 WL 1100779 (D.D.C. Mar. 21, 2014), the court found that the regulations, which impose hiring and record-collecting responsibilities on contractors that have 50 or more employees and a contract of $50,000 or more, are clearly authorized under Section 503 of the Rehabilitation Act of 1973.

ABC, which represents over 19,000 construction firms, filed suit arguing that the regulations exceed the statutory authority of the OFCCP. The regulations require contractors to maintain hiring goals for veterans and disabled employees, compile records on their hiring, ask applicants whether they would like to self-identify for veteran or disabled status, and survey their employees to see if they identify with either status. The judge commented that Section 503 gives the Government broad authority to define how contractors "must engage in affirmative action."

## President Obama Narrows "White-Collar" Exemption, Expanding Eligibility for Overtime Pay

On Mar. 13, President Obama signed a Presidential Memorandum directing the DOL to update the Fair Labor Standard Act's ("FLSA") exemption regarding eligibility for overtime pay for hours worked in excess of 40 hours per week. The Memorandum directs the DOL to revise the exemption for the categories of bona fide executive, administrative, and professional (often referred to as the "white collar" exemption) employees who are exempt from the general obligation to receive time and a half for hours in excess of 40 per week. Currently, to qualify for the exemption, an employee has to be paid at least $455 a week and his or her job must include certain duties, such as managing part of the enterprise and supervising other employees.

These changes, when implemented, will raise the salary threshold for qualifying for the exemption and will establish eligibility for workers who did not previously qualify for overtime pay. Although the short Memorandum provides limited details as to how the changes will be implemented, the Obama Administration has suggested that the objective is to address "low level" managers and clerical employees who work alongside hourly employees yet only have marginally more responsibility than their overtime-eligible co-workers. The Administration has stated that such a scenario is "unfair" and at odds with the underlying purpose of the FLSA. We will continue to monitor changes to the exemption and provide updates in future editions to the *Quarterly*.

## BakerHostetler Updates

- A BakerHostetler team represented Toronto Stock Exchange-listed Cangene Corporation (TO: CANG), the Canadian life sciences heavyweight, in its cross-border public-to-public takeover through arrangement by New York Stock Exchange-listed Emergent Biosolutions (NYSE: EMS) for approximately $300 million U.S. (due in part to final currency fluctuation). Led by Government Contracts Partner Kelley Doran and Mergers and Acquisitions Partner Steven H. Goldberg, the team comprised partners and associates throughout the firm.
- The *Livingston Parish News* reported on a motion submitted by BakerHostetler Partner Hilary S. Cairnie on behalf of Livingston Parish, LA in its dispute with the Federal Emergency Management Agency (FEMA) over $59 million in expenses incurred by the Parish during cleanup from Hurricane Gustav in 2008. The article ("Parish legal brief disputes FEMA debris criticism," March 18, 2014) states that "the parish disputes FEMA's justifications for denying most payments related to Hurricane Gustav debris removal in a 35-page document released Tuesday for an upcoming arbitration hearing." The article reports: "FEMA skews information to try to discredit the Parish's contractors," according to the parish response. "FEMA tells the (CBCA) Panel a story about an out of control cleanup project stopped by a concerned public official (former parish president Mike Grimmer) in May 2009. FEMA does not explain, however, how FEMA missed such widespread fraud for nine months," according to Cairnie's response to FEMA's defense. Cairnie also writes that FEMA has not explained why its representatives failed to notice fraud though they were "intimately involved in the operation, through daily briefing meetings, discussions in the fields, and site visits." Later, the article states, "Satisfying all requirements for each claim puts a heavy burden of proof on the monitors and on Cairnie's legal team" but that "Cairnie uses FEMA's own '80 percent' policy to argue that if the parish can justify 80 percent of its claims, then the full charges should be paid."

# Legislative Updates

| Bill Number | Sponsor | Legislation Description | Last Action | Status |
|---|---|---|---|---|
| H.R. 4093 | Graves | A bill to amend the Small Business Act to raise the prime and subcontract goals | 2/26/2014 | Referred to Committee |
| H.R. 4281 | Huelskamp | A bill to amend *title* 38, United States Code, to improve the oversight of contracts awarded by the Secretary of Veterans Affairs to small business concerns owned and controlled by veterans | 3/21/2014 | Referred to Committee |
| H.R. 1232 | Issa | A bill to eliminate duplication and waste in agency information technology acquisition and management | 2/25/2014 | Passed by House |
| H.R. 3840 | Thornberry | A bill to establish the Office of Net Assessment within the Department of Defense to assess U.S. military capabilities | 1/9/2014 | Referred to Committee |
| H.R. 4289 | Payne | A bill to amend the Homeland Security Act of 2002 to require the undersecretary for management of the Department of Homeland Security to take administrative action to achieve and maintain interoperable communications capabilities among agency components | 3/24/2014 | Referred to Committee |
| H.R. 3847 | Barber | A bill to require the Secretary of Homeland Security to develop and provide to the secretary of Health and Human Services risk-based, performance-based cyber-security standards for the Federal information technology requirements under the Patient Protection and Affordable Care Act, including the HealthCare.gov website | 1/10/2014 | Referred to Committee |
| S. 2075 | Warner | A bill to prohibit a reduction in funding for the defense commissary system in FY 2015 pending the report of the Military Compensation and Retirement Modernization Commission | 3/04/2014 | Referred to Committee |
| H.R. 4257 | Calvert | A bill to limit the number of civilian employees at the Department of Defense | 3/13/2014 | Referred to Committee |
| H.R. 3844 | Grayson | A bill to require cost or price to the federal government be given at least equal importance as technical or other criteria in evaluating competitive proposals for defense contracts | 1/10/2014 | Referred to Committee |
| H.R. 3863 | Brady | A bill to amend *title* 5, United States Code, to establish uniform requirements for thorough economic analysis of regulations by Federal agencies based on sound principles, and for other purposes | 1/14/2014 | Referred to Committee |

# Regulatory Updates

| Code Section | Agency | Regulation Description | Lastest Action | Effective Date |
|---|---|---|---|---|
| 48 CFR Parts 1, 4, 8, 17, 37, and 52 | DoD, GSA, NASA | Requires service contractors for executive agencies, except where DOD has fully funded the contract or order, to submit information annually in support of agency-level inventories for service contracts | Final Rule | 1/30/2014 |
| 48 CFR Parts 202, 207, 209, 216, and 234 | DoD | To amend the Defense Federal Acquisition Regulation Supplement ("DFARS") to implement a section of the National Defense Authorization Act for FY 2013, which prohibits DOD from entering into cost-type contracts for production of major defense acquisition programs | Interim Rule | 1/29/2014 |
| 48 CFR Parts 203 and 252 | DoD | To amend the DFARS to implement statutory amendments to whistleblower protections for contractor and subcontractor employees | Final Rule | 2/28/2014 |
| 48 CFR Parts 1022 and 1052 | Treasury | To amend the Department of the Treasury Acquisition Regulation to include a contract clause on minority and women inclusion, as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 | Final Rule | 4/21/2014 |
| 48 CFR Parts 1542, 1552, and 1553 | EPA | To rescind the Environmental Protection Agency Acquisition Regulation ("EPAAR") regarding the EPA's policies for collecting and maintaining contractor past performance information. Under the final rule, EPAAR Section 1542.15, Contractor Performance Information, 1552.242-71, Contractor Performance Evaluations, and 1553.209, Contractor Qualifications are deleted in their entirety. | Direct Final Rule | 5/23/2014 |

## About BakerHostetler

BakerHostetler, one of the nation's largest law firms, represents clients around the globe. With offices coast to coast, our more than 800 lawyers litigate cases and resolve disputes that potentially threaten clients' competitiveness, navigate the laws and regulations that shape the global economy, and help clients develop and close deals that fuel their strategic growth. At BakerHostetler we distinguish ourselves through our commitment to the highest standard of client care. By emphasizing an approach to service delivery as exacting as our legal work, we are determined to surpass our clients' expectations.

BakerHostetler's Government Contracts Practice Group consists of more than a dozen attorneys with extensive experience in government contracts, including former government attorneys from the Justice Department, SEC, and USPTO. Working closely with the firm's other practice groups, including the Intellectual Property, Labor, International Trade, FDA, and White Collar groups, among others, the Government Contracts Practice Group represents clients on a wide variety of government contract matters and cases.

### Why BakerHostetler's Government Contracts Practice Group?

- Seasoned, experienced team with a deep bench.
- Several attorneys with technical and engineering backgrounds.
- Former government attorneys.
- Outstanding client service and responsiveness.
- Competitive value-driven rates and fee arrangements.

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Hilary Cairnie is the head of the firm's Government Contracts Practice. He focuses on public contract law, encompassing virtually all aspects including contract formation, performance, administration, and enforcement controversies at the federal and state levels. With two engineering degrees and several years of experience working as an engineer for various companies, Mr. Cairnie uses his unique technical background to represent clients involved in aerospace, automotive, shipbuilding, transportation, construction, software, medical and healthcare, engineering, and research and development endeavors, among others.

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Kelley Doran has focused on government contracts counseling, contract negotiation, and litigation for over fifteen years. Mr. Doran's practice includes representing a broad array of commercial item, defense, and homeland security contractors that sell products and services to the federal, state, and local governments. He has worked with product and service companies in numerous industries, including biodefense and life sciences, environmental remediation, homeland security, information technology, and nanotechnology.

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