RELEVANT NEWS FOR ENTITIES & INDIVIDUALS WITH BUSINESS CONCERNS IN THE AREAS OF GOVERNMENT CONTRACTS & GRANTS –
SPRING 2010, Vol. VI, No. 2

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SUSPENSION AND DEBARMENT IS NOT A TOOL TO PUNISH…EXCEPT WHEN IT IS

Introduction

It is a well-established policy in procurement regulations that suspension and debarment is not to be used for the purposes of punishment. Despite this policy, government agencies are being criticized for suspending and debarring too few contractors. Moreover, recent government reports indicate that certain agencies are failing to (1) enforce their suspension and debarment decisions; (2) report poor performance by contractors; and (3) properly list the names of businesses and individuals who should be excluded from entering into contracts with the government.

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This article summarizes suspension and debarment audit reports prepared by: (1) Office of the Inspector General ("OIG"), United States Department of Transportation ("DOT"); (2) OIG, United States Agency for International Development ("USAID"); and (3) OIG, Department of Homeland Security ("DHS"), and provides a critical analysis of the findings in each report that appear to be contrary to the suspension and debarment policies prescribed in the Federal Acquisition Regulation ("FAR"). In addition, a fourth report prepared by the Government Accountability Office ("GAO") illustrates the problems associated with the management of suspended or debarred parties.

Summary of the Reports

DOT Report

On January 7, 2010, DOT's OIG prepared a report entitled "DOT's Suspension and Debarment Program Does Not Safeguard Against Awards to Improper Parties ("DOT Report")." *See* DOT Report, Report No. ZA2010034 (Jan. 7, 2010).

This report presented the OIG's results of its audit conducted between October 2006 and October 2009 regarding: (1) the timeliness of DOT's suspension and debarment decisions and reporting; and (2) DOT's suspension and debarment policies and oversight of agency actions to exclude prohibited parties from obtaining contracts, grants, and cooperative agreements. Specifically, the OIG focused its review on the Federal Highway Administration ("FHWA"), Federal Aviation Administration ("FAA"), and the Federal Transit Administration ("FTA"). These agencies represented more than 90 percent of DOT's suspension and debarment activity during calendar years 2005 through 2008.

The DOT Report criticized the agency finding that DOT has not achieved the desired outcome of having a strong suspension and debarment program. *See* DOT Report at p. 13. The OIG found that DOT delayed in making suspension and debarment decisions. On average, DOT took more than 300 days to reach a suspension decision and more than 400 days to reach a debarment decision. *Id.* at p. 2. The OIG attributed two factors to these delays. First, OIG found that DOT has failed to rely on indictments and convictions to establish the evidentiary basis for suspension and debarment. Second, OIG found that DOT has not assigned sufficient priority to its suspension and debarment workload.

As discussed below, the OIG fails to recognize that agencies should consider all implemented remedial measures and mitigating factors before making a final suspension or debarment decision. This is the case even in instances where there is an indictment or conviction.

USAID Report

On October 1, 2009, the OIG for USAID prepared "Audit of USAID's Process for Suspension and Debarment ("USAID Report")." *See* USAID Report, Audit Report No. 9-000-10-001-P (Oct. 1, 2009). The OIG conducted this audit as part of the OIG's audit plan for fiscal year 2009 to learn whether USAID's suspension and debarment process protected the public interest by responding to contractor impropriety in accordance with federal guidance.

The OIG found that USAID's suspension and debarment process has not adequately protected the public interest by responding to improper contractor conduct. In this regard, the report noted that USAID only took seven debarment actions and two suspension actions during fiscal years 2003 through 2007.

As discussed below, the OIG's finding is void of analysis and appears to support a suspension and debarment program that focuses on the number of actions taken, rather than whether such action is necessary to protect the government.

DHS Report

On February 2, 2010, DHS' OIG issued its report entitled, "DHS' Use of Suspension and Debarment Actions for Poorly Performing Contractors ("DHS Report")". *See* DHS Report, Report No. OIG -10-50 (Feb. 2, 2010). The DHS Report was prepared as part of the OIG's oversight efforts to determine whether DHS' suspension and debarment polices and procedures were in place and properly applied. In particular, the OIG sought to identify potential improvements to DHS' suspension and debarment actions. *Id* at 1.

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During its investigation, the OIG discovered that DHS was reluctant to apply suspension and debarment policies and procedures against poorly performing contractors, and preferred to use administrative remedies to address poor contract performance. *See id.* The OIG also found that DHS failed to record important contract performance data for contractors whose performance was below standard. *See id.* The OIG concluded its report by recommending that: (1) DHS develop and implement policies and procedures to review poorly performing contractors, whose contracts have been or are being considered for termination by default or cause, to determine if a referral to the agency's suspension and debarment official is warranted; and (2) DHS ensure that all pertinent contractor performance information is recorded and disseminated to other government procurement specialists.

As discussed below, despite the OIG's recommendations related to recording contractor performance information, the fact remains that while suspension and

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debarment results in a default in the contractor's performance of the contract, termination for cause or default does not, and should not, automatically result in suspension or debarment.

GAO Report

On February 25, 2009, GAO prepared "Excluded Parties List System ("EPLS"): Suspended and Debarred Businesses and Individuals Improperly Receive Federal Funds ("GAO Report")." *See* GAO Report, Report No. GAO-09-174 (Feb. 25, 2009). The EPLS is the web-based system maintained by the General Services Administration ("GSA") that lists all parties who are excluded from entering into contracts with or receiving funds from the government. Businesses and individuals who have committed egregious offenses, such as national security violations or tax fraud, should be entered into EPLS in order to prevent the government and its contractors from entering into contracts with these parties.

The purpose of the GAO's probe was to investigate and report on allegations that excluded parties have been able to receive federal contracts and funds despite their status on EPLS. The GAO was specifically tasked with determining whether the allegations were true and, if so, what were the key causes of the improper awards and payments. At the end of its investigation, GAO provided recommendations on how to best address and prevent these improper actions in the future.

The GAO Report concluded that improper contracts and payments have been received by excluded parties because of overall agency failure to properly use and manage EPLS. In particular, GAO found that agencies failed to enter the names of excluded parties on EPLS within the five-day period required by the FAR. *See id.* at 4–5. Even if entries were filed, most entries failed to include the party's DUNS number, which became a necessary part of the entry process in 2005. *See id.* at 5. In addition, EPLS' search capabilities are flawed because its programming, which requires exact matches, fails to register numerous similar name searches that are run. *See id.* Also, certain agencies were operating under the belief that they could not terminate the contract once awarded in instances where the agency later learned that the awardee was listed on EPLS. *See id.* at 16. Finally, an excluded party's ability to circumvent its status on EPLS by using different names and aliases has played a role in the failure of this GSA system. *See id.* at 3.

As discussed below, the GAO's investigation and report illustrates increased attention on EPLS and the management of excluded parties. The GAO Report encourages agencies to take action against suspended and debarred contractors, even when not necessary under FAR provisions.

Suspension and Debarment Actions Are Discretionary

Suspension and debarment are among the government's strongest tools to deter unethical and unlawful uses of federal funds because one federal agency's final suspension and debarment action is applicable governmentwide. *See* FAR 9.405(a). According to the FAR, debarment and suspension are discretionary administrative actions. *See* FAR 9.402(a). Moreover, the "serious nature of debarment and suspension requires that these sanctions be imposed only in the public interest for the Government's protection and not for purposes of punishment." *See* FAR 9.402(b). The DOT, USAID, and DHS reports recognize that suspension and debarment are discretionary actions that should not be used for the purposes of punishment. However, the findings in their respective reports appear to contradict this recognition.

Indictments, Convictions, and Poor Past Performance Should Not Automatically Result in Suspension or Debarment

The existence of an indictment or a conviction or evidence of poor past performance does not result in an automatic suspension or debarment in every instance. The FAR states that the suspension and debarment official may (not must) suspend or debar a contractor for an indictment or conviction for: (1) commission of fraud or a criminal offense in connection with obtaining, attempting to obtain, or performing a public contract or subcontract; (2) violation of federal or state antitrust statutes relating to the submission of offers; (3) commission of embezzlement, theft, forgery, bribery, falsification or destruction of records, making false statements, tax evasion, violating federal criminal tax laws, or receiving stolen property; (4) intentionally affixing a "Made in America" inscription to a product sold in or shipped to the United States that was not made in the United States; or (5) commission of any other offense indicating a lack of business integrity or business honesty that seriously and directly affects the current responsibility of a government contactor or subcontractor. *See* FAR 9.406-2(a); *see also* FAR 9.407-2(a).

In addition to indictments and convictions, the FAR states that a contractor *may* be debarred when the contractor has violated the terms of a government contact through a history of failing to perform or of providing unsatisfactory performance on one or more contracts. *See* FAR 9.406-2(b)(1)(i)(B). The seriousness of the offense determines if the previous performance delinquency is grounds for debarment. *See* 37 Comp. Gen. 756 (1958). Courts have taken the position that a previous history of defaults will justify an administrative debarment. In particular, the GAO has stated that performance under recent, similar contracts can show that a contractor lacks the responsibility necessary to be a government contactor. *See id.* at 757. According to the FAR, actions impacting current responsibility can also result in suspension of a contractor. *See* FAR 9.407-2(a)(9).

In the DOT Report, OIG criticized the agency for not invoking suspension and debarment actions based on indictments and convictions alone. *See* DOT Report at 14. The USAID Report noted that the only suspension and debarment actions taken by the agency were those where there was an indictment or conviction. *See* USAID Report at 7.

In addition, the OIG in the DHS Report highlights that DHS was reluctant to apply suspension and debarment polices and procedures against poor-performing contractors. *See* DHS Report at 1. The OIG implies that changes in the recording and dissemination of contract performance data will result in increased suspension and debarments. However, the OIG failed to acknowledge that despite these potential changes, DHS retains discretion to determine when to apply these administrative tools and can still choose not to, even if contract performance data was recorded and disseminated.

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Although indictments, convictions, and poor contract performance are causes for suspension and debarment, the OIG's finding in both the DOT and DHS Reports in this regard is contrary to the FAR's suspension and debarment policy, which clarifies that such actions should not be taken to punish contractors or subcontractors. The FAR expressly states that the existence of a cause for debarment does not necessarily require that the contractor be suspended or debarred. *See* FAR 9.406-1(a); *see also* FAR 9.407-1(b)(2). Rather than automatically suspending or debarring a contractor or subcontractor when there is an indictment, conviction, or history of poor performance, the FAR requires the agency to consider the contractor's or subcontractor's implementation of remedial measures or other mitigating factors as part of the decision-making process.

Agencies Must Consider Remedial Measures and Mitigating Factors Prior to Making a Final Suspension or Debarment Decision

Prior to making a suspension or debarment decision, agencies must consider whether the contractor or subcontractor has implemented any remedial measures or has evidence of mitigating factors. The OIG's findings in both the DOT and USAID Reports do not recognize this FAR policy.

The DOT report expressed disappointment with the agency's decision to further review suspension and debarment actions in instances where there was an indictment or conviction. Specifically, the OIG found that the agency conducted "unnecessary and lengthy reviews before deciding cases." *See* DOT Report at 5. The USAID Report criticized the agency for resolving proposed suspension and debarment cases where there was an indictment or conviction. *See* USAID Report at 8.

According to the FAR, if a cause for debarment exists, the contractor has the burden of demonstrating its current responsibility and reasons for why debarment is not necessary. *See* FAR 9.406-1(a). Toward that end, a contractor or subcontractor proposed for suspension or debarment may present evidence of remedial measures implemented or mitigating factors that the agency should consider prior to making a final decision. According to the FAR, the agency suspension and debarment official should consider the following:

- Whether the contractor had effective standards of conduct and internal control systems in place at the time of the activity that constitutes cause for debarment, or had adopted such procedures prior to any government investigation of the activity cited as a cause for debarment
- Whether the contractor brought the activity cited as a cause for debarment to the attention of the appropriate government agency in a timely manner
- Whether the contractor has fully investigated the circumstances surrounding the cause for debarment and, if so, made the result of the investigation available to the debarring official
- Whether the contractor cooperated fully with government agencies during the investigation and any court or administrative action
- Whether the contractor has paid or has agreed to pay all criminal, civil, and administrative liability for the improper activity, including any investigative or administrative costs incurred by the government, and has made or agreed to make full restitution
- Whether the contractor has taken appropriate disciplinary action against the individuals responsible for the activity which constitutes cause for debarment
- Whether the contractor has implemented or agreed to implement remedial measures, including any identified by the government
- Whether the contractor has instituted or agreed to institute new or revised review-and-control procedures and ethics-training programs
- Whether the contractor has had adequate time to eliminate the circumstances within the contractor's organization that led to the cause for debarment
- Whether the contractor's management recognizes and understands the seriousness of the misconduct giving rise to the cause for debarment and has implemented programs to prevent recurrence

See FAR 9.406-1(a).

Despite the findings in the DOT, USAID, and DHS Reports, the FAR encourages suspension and debarring officials to consider the above remedial measures and mitigating factors prior to making a final suspension or debarment decision. In this regard, a contractor or subcontractor may avoid suspension or debarment to the extent the entity can show the existence of the above remedial measures or mitigating factors.

Management of Suspended and Debarred Parties Is a Problematic Issue

FAR Subpart 9.405 requires a contracting officer to check EPLS to determine whether a company has been suspended or debarred as part of its responsibility determination. In addition, as a second check within the system, a company is required to certify that it is not suspended or debarred when submitting an offer to the government. Thus, the responsibility of preventing businesses and individuals who should be excluded from entering into contracts with the government is on both the procuring agency and the contactor.

The GAO Report states that one method of cracking down on government business with excluded parties is terminating contracts with suspended and debarred contractors despite the FAR provisions that allow continued performance of the contract in such situations. The GAO Report describes a case it uncovered in its investigation where an agency official incorrectly believed that the agency was "legally obligated" to continue the contract based on the provision in the FAR that specifies that "agencies may continue contracts or subcontracts in existence at the time the contractor was debarred, suspended, or proposed for debarment unless the agency head directs otherwise." FAR 9.405-1. Although this provision does grant agencies the authority to continue the contract, GAO stresses the fact that the FAR provision does not obligate an agency to do so. *See* GAO Report at 16.

The GAO Report also stated that contractors need to be aware of the possibility of hiring or otherwise teaming with an excluded party listed on EPLS. The GAO declared that it is incorrect for an agency or contractor to assume that GSA is responsible for ensuring the accuracy of the excluded vendors listed on the GSA

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Supply Schedule. *See* GAO Report at 20. Instead of relying on the list, the Report suggests that contractors conduct their own search of potential businesses and individuals on EPLS.

Conclusion

The DOT, USAID, and DHS Reports do not recognize established FAR policies in their analyses of agency suspension and debarment decisions. Specifically, the reports did not acknowledge that the existence of an indictment, conviction, or history of poor contract performance does not result in an automatic suspension or debarment. Moreover, contrary to the reports, the FAR states that agencies should consider remedial measures and mitigating factors presented by the contractor or subcontractor prior to making a final suspension or debarment decision.

Further, the GAO Report illustrates the problems that exist once parties are suspended and debarred. The report indicates that the government has knowledge of the systemic problems across agencies related to the management of excluded parties, and is ready to crack down on the persons and entities allowing such parties to continue doing business with the government. As part of this effort, the GAO warns agencies against continuing contracts with suspended or debarred contractors, even though the agencies have the right to continue the current contract if they so chose, and warns contractors to check EPLS before entering into agreements with other commercial vendors to perform a government contract.

DON'T FORGET ABOUT D&O INSURANCE WHEN THAT GOVERNMENT SUBPOENA ARRIVES

When an investigation is commenced by a federal or state government entity, whether by service of a subpoena or by less formal means, a company should have two standard operating procedures: first, hire excellent and experienced counsel to respond to the investigation or subpoena; and second, determine whether insurance coverage may be available to pay for what are frequently significant defense costs that may be incurred in connection with the investigation.

Securing insurance coverage for subpoenas and informal investigations, both civil and criminal, can be an arduous process, but policyholders who plan ahead and know the pitfalls can give themselves a significant advantage in securing timely coverage. Significantly, failing to secure coverage for an investigation can mean that there will be no coverage if the investigation leads to lawsuits or other legal proceedings.

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Prompt Notice

The most common pitfall is failing to give prompt notice to your insurance company. At the first indication of a government investigation, a company should consider whether it needs to give notice to its Directors' & Officers' ("D&O") insurance carrier. This is generally done through a broker. Failing to give prompt notice, which usually occurs because no one realized that government investigations might be covered by insurance, is the most frequent mistake policyholders make and it could be fatal to obtaining coverage. In some states, late notice is a complete defense to coverage even if the insurer has suffered no prejudice as a result. And if late notice blows coverage for an investigation, it likely will also blow coverage for any lawsuits or other legal proceedings that may follow.

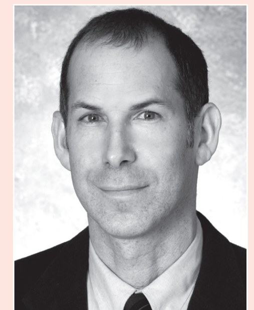
The question of whether insurance coverage is available for fees and costs incurred in connection with responding to subpoenas and informal investigations depends in large part on the language of the D&O insurance policy and the specific facts and circumstances surrounding the subpoena or investigation.

Is the Investigation a "Claim"

The starting point for the analysis is whether or not the subpoena or investigation fits within the D&O policy's definition of the term "Claim."

Several different definitions appear in D&O policies; a typical one defines "Claim" as:

- Any civil proceeding in a court of law or equity. including any mediation or alternative dispute resolution ordered or sponsored by such court
- Any criminal proceeding in a court of law
- Any administrative or regulatory proceeding commenced by filing a notice of charges, formal investigative order, or similar document



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Another definition of "Claim" includes "formal and informal government investigations." Several courts also have held that a subpoena can be a Claim. In determining whether a suboena constitutes a "Claim," courts have looked to the nature of the particular subpoena in light of the policy language. Thus, an SEC "Order Directing Private Investigation and Designating Officers to Take Testimony" has been held to be a Claim for the purpose of coverage under a D&O policy. Where a subpoena is served on a policyholder in its capacity as a "custodian of records," however, it is unlikely to qualify as a Claim that would trigger payment of defense costs.

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Don't Forget About D&O Insurance When That Government Subpoena Arrives—continued from page 5

In a recent case, *MBIA Inc. v. Federal Ins. Co., et al.*, No. 08 CIV 4313, slip op. (S.D.N.Y. Dec. 30, 2009) ("MBIA"), the MBIA was hit with "inquiries" and subpoenas by the New York State Attorney General and the SEC. The definition of Claim in *MBIA's* D&O policy included "a formal or informal administrative or regulatory proceeding or inquiry commenced by the filing of a notice of charges, formal or informal investigative order or similar document," that arose from the purchase or sale of securities. The court held that the subpoenas and inquiries fit within the definition of Claim in the policies and, therefore, the defense costs incurred in responding to them were covered.

Is the Claim Covered Under the Policy

In addition to the definition of the term "Claim," the investigation must also relate to something that is covered under the policy. The typical D&O policy provides coverage for loss arising from a "Claim" based on an "actual or alleged Wrongful Act." Thus, whether or not a subpoena represents a "Claim," there may still be a question regarding whether an actual or alleged Wrongful Act is involved.

An insurance company may argue that there are no allegations of any Wrongful Act in the subpoena, thus negating the duty to defend. Most subpoenas and government investigations, however, have either explicit or implicit suggestions of wrongdoing that should satisfy this requirement, at least where the company or its directors or officers are a target of the investigation. The insurance company may also contend that so-called "personal conduct" exclusions relating to fraud, illegal profits, and intentional violations of law, may preclude coverage. Such exclusions should not, however, deprive the policyholder of its right to a defense, since in most D&O policies, they are only triggered by a "final adjudication" of the wrongful conduct. The policy language may allow the insurance company to seek reimbursement of the amounts paid toward the defense if one of the exclusions is triggered;, at least the policyholder will have been able to mount a proper defense to the charges with the insurance company paying the bill in the first instance.

Reporting Potential Claims

Even if a subpoena or government investigation does not qualify as a Claim under the policy, a company may still want to report it to its D&O insurer. D&O policies almost always give the insured the option of reporting potential claims—normally called "circumstances that may give rise to a claim"—in order to secure coverage for the potential claim within the policy period in effect when the potential claim is reported. So if the investigation is reported as a potential claim in policy period A, but does not blossom into a Claim (*e.g.*, a lawsuit) until policy period B, it will be covered under policy period A. The main caveat is that policies normally require potential claims to be reported with a great deal of specificity, so attention must be paid to this requirement.

One reason to report an investigation as a potential claim is that the company may be required to disclose the investigation anyway in connection with an application for new insurance, because non-disclosure may carry the risk that the carrier later will try to rescind the policy. But disclosing potential claims in connection with new insurance runs the risk that the investigation and any resulting claims will be excluded from coverage under the new insurance, so it is important to secure coverage under the expiring policy instead. Reporting potential claims also may have the advantage of parking claims in an expiring policy period and leaving the new policy untouched for fresh potential claims (D&O policies typically have one-year policy periods).

A Note on E&O Insurance

In some cases, a government investigation might be covered under a company's Errors & Omissions ("E&O") insurance policy rather than its D&O policy. For example, if a company is being investigated in connection with professional services it has provided to the government pursuant to a government contract, the E&O policy may be implicated (and the matter may be excluded from coverage under the D&O policy). Issues regarding notice under an E&O policy are very similar to notice issues under a D&O policy. If it is unclear whether an investigation will be covered under a company's E&O or D&O policy, notice may be given under both.

Conclusion

Government investigations can be both time-consuming and hugely expensive. A target of such an investigation that has purchased D&O or E&O coverage may, depending on the wording of the policy and the type and tenor of the investigation, have coverage to pay for the defense and cost of responding to such an investigation. Policyholders should think of insurance when the investigation begins, analyze their potential coverage with the assistance of an attorney, and give prompt notice of any potentially covered claim.

NEW SERVICE CONTRACTING REGULATIONS: WILL MAKE EMPLOYEES SMILE AND IMPOSE ADDITIONAL REQUIREMENTS ON EMPLOYERS

On March 19, 2010, the Department of Labor ("DOL") issued a set of proposed regulations to implement Executive Order 13495 (the "Order"), Nondisplacement of Qualified Workers Under Service Contracts. The proposal comes nearly 14 months after President Obama signed the Order, which is designed to promote economy and efficiency in federal government service contracting. According to DOL, the regulations do nothing more than mandate a practice already observed by the majority of service contractors—the hiring of predecessor-contract employees. The specific processes to be formalized, however, are likely to at least alter, if not increase, the administrative and procedural burdens on service contractors.

The proposed regulations apply to all service contracts and associated subcontracts, with exemptions for a few specific types of contracts, including those awarded below the simplified acquisition threshold (currently at

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ADVANCEMENT AND INDEMNIFICATION OF DIRECTORS AND OFFICERS OF DELAWARE CORPORATIONS: *WHAT GOVERNMENT CONTRACTORS NEED TO KNOW*

In the government contracts arena, the potential liability of individual directors and officers has taken on new importance following the implementation of the mandatory disclosure rules by the FAR Council in late 2008. *See* 73 F.R. 67064 (Nov. 12, 2008). Given that many government contractors are incorporated in Delaware, these companies should be aware of important rights available to corporate officers and directors should they be named individually in administrative or judicial proceedings. More specifically, corporate officers and directors may have the right to seek advancement of legal fees and indemnification in the Delaware Court of Chancery. While the issue does not appear to have made its way through the courts, both corporations and their high-ranking officials should be aware of these rights.

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For Delaware corporations and similar entities, such as LLCs, the by-laws or other governing documents often provide that the officers, directors, agents, and (in some cases) employees have the right to have legal fees and expenses paid by the company when they are investigated, sued, or prosecuted for acts done in furtherance of their employment. This right to payment of ongoing defense fees is known as "advancement." Delaware courts liberally interpret these rights to ensure that officers, directors, and agents of any entity formed under Delaware law are not forced to pay such fees "out-of-pocket" while they are being investigated, sued, or prosecuted.

Advancement is different from, but related to, "indemnification," a post-judgment decision that must await the outcome of the proceedings. Instead, advancement is an interim right subject to the undertaking of the corporate agent to repay the amounts advanced if it is ultimately determined at the conclusion of the proceeding that the official was not entitled to indemnification. These rights are in addition to payments under a director's and officer's (D&O) insurance policy. Thus, if there is no D&O policy, the D&O policy has been exhausted, or there are issues with getting paid under the D&O policy, advancement and indemnification rights may be an independent avenue through which a corporate officer or director may get some relief from the burden of defending himself or herself.

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An officer or director commences an advancement or indemnification by making demand for it in the Delaware Court of Chancery against the company. The success of this demand depends in part on the contractual language and whether the company has any discretion to deny advancement. Delaware law is clear on the type of language that makes these provisions permissive or mandatory,) and the consequences of each. Many companies, however, use boilerplate language pursuant to which advancement is mandatory, even as to former executives and agents of the company. Accordingly, from the corporate perspective, it may be a worthwhile exercise to examine the provisions regarding advancement and indemnification to be sure they reflect the actual intention of the corporation and not just a default position.

Because under Delaware law an advancement action is "a summary pre-merits proceeding," these actions may resolve in as little time as a month and often are resolved within three to six months. The Chancery Court permits accelerated scheduling, and the court has consistently held that advancement actions can be resolved at the pleading stage.

In addition to the advancement right, Delaware law authorizes—and, more often than not—awards the claimant the payment of the legal fees incurred in prosecuting the advancement lawsuit. The default rule in Delaware is that the company has to pay the plaintiff's fees in pursuing his/her advancement or indemnification rights to the extent the plaintiff is successful in that action. Any award for "fees on fees" is not subject to reimbursement. Thus, if the plaintiff is successful in bringing an advancement or indemnification action, not only will the plaintiff get those fees advanced, but the company will also have to pay the costs incurred related to the advancement or indemnification action.

The policy underlying Delaware law is to encourage the service of capable individuals as officers and directors. In light of the potential liability of directors and officers under the new mandatory disclosure rules for alleged corporate wrongdoing, the right to seek advancement is a powerful one for officers and directors subject to the rules. At the same time, Delaware corporations should also be aware of this right and confirm that their governing documents are consistent with the corporation's interests.

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$100,000), and awards of any value under certain programs meant to advance socioeconomic interests. The head of a contracting department or agency may also decide to exempt a particular contract, subcontract, purchase order, or class thereof, upon a written analysis clearly demonstrating that application of the regulations would not directly promote economy and efficiency, or would impair the government's general ability to procure services economically and efficiently.

The regulations specifically mandate that all covered solicitations, contracts, and subcontracts include a clause requiring the contractor and any subcontractors performing the same or similar services at the same location as an expired predecessor contract, to offer the right of first refusal of employment to all qualified predecessor employees. The regulations exclude managerial and supervisory employees from the definition of predecessor employees. They also permit a successor contractor *not* to offer the right of first refusal to anyone who failed to perform suitably under the predecessor contract, though that assessment must be based on credible information provided by a knowledgeable source. A successor contractor also need not offer a position to an employee who will be retained in employment by the predecessor contractor (though the successor contractor must presume that this will not be the case). Finally, a successor contractor may choose instead to employ one of its own employees, provided (1) the employee has worked continuously for the contractor for at least the three months before the start of the successor contract's performance, and (2) there are no other positions within the employee's commuting area for which the employee is qualified (*i.e.*, the employee would be laid off if not employed by the contractor).

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Procedurally, the proposed regulations require a predecessor contractor to compile and certify a list of all covered individuals employed during the final month of the expiring contract, including the date of initial employment of each individual. That list must be delivered to the contracting officer no fewer than 10 days before the contract's expiration date. The contracting officer must deliver the list to the successor contractor, and to any employee or employee representative who requests it. Regardless of whether it receives the list, the successor contractor must make an oral or written bona fide offer of employment to each predecessor employee qualified for a position under the successor contract. Any such offer must be made in a language the employee understands, and it must be held open for at least 10 days.

Of particular note, the proposed regulations specify that a predecessor service employee shall be offered *any* position under the successor contract for which he is qualified, even if that position is not the same as or similar to the position he held under the predecessor contract. If the successor contract involves a smaller number of positions than were filled under the predecessor contract, the successor is encouraged (though not required) to give preference to employees who have greater years of work experience under the predecessor contract (or contracts). If any new positions are created under the successor contract within 90 days after the start of performance, those positions must first be offered to qualified predecessor employees who were not previously offered positions under the successor contract. The successor contractor's requirement to comply with the regulations terminates once all qualified predecessor employees have received bona fide offers of employment, or once 90 days of contract performance have elapsed – whichever comes first.

The responsibility for investigating and ensuring compliance with the regulations falls to DOL, which will also adjudicate any disputes arising from a contractor or subcontractor's alleged failure to comply. Under the proposed regulations, however, a complaint must be filed with the contracting officer within 120 days of an alleged violation, or in certain circumstances with DOL's Wage and Hour Division, within 180 days of an alleged violation. The Wage and Hour Division is initially expected to commence a conciliatory dispute resolution process, though it may ultimately investigate and direct more formal proceedings before an administrative law judge. The potential penalties for violating the regulations range from withholding contract funds (including the suspension of payment to a predecessor contractor who fails to deliver its employee list to the contracting officer) to debarment from federal contract work for up to three years.

DOL estimates that approximately 15,000 service contract awards per year will fall under the finalized regulations, and confidently predicts that for the grand majority of those awards no change of practice will ensue, since most contractors already follow the procedures mandated by the regulations. But this conclusion overlooks at least a few practical outcomes of the new regulations. For example, while the production of employee lists is already required of predecessor contractors of individuals whose fringe benefits are provided for in collective bargaining agreements and depend on length of service, all predecessor contractors under the new regulations will be required to generate such lists. Additionally, successor contractors will be required to determine the qualifications (and possibly seniority) of predecessor employees, regardless of whether or when they receive predecessor employee lists. Successor contractors will also be required to maintain for three years specific records (*e.g.*, written offers of employment, records or forms forming the basis for claiming an exclusion from the regulations, the employee list received from the predecessor contractor) that demonstrate compliance with the regulations. Finally, service contractors who for any reason decide to assume the work of their subcontractors must offer employment to qualified subcontractor service employees who would otherwise be displaced.

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The comment period for the proposed regulations closed on May 18, but Reed Smith attorneys remain available to assist in assessing the expected impact on current business practices, and preparing for implementation of the final rules, which, based on the progress of the Order so far, likely will not happen until the late summer or early fall.

DECEPTIVELY SIMPLE: THE NEW FAPIIS RESPONSIBILITY REPORTING RULE

On March 23, 2010, the FAR Council promulgated a new FAR clause on responsibility reporting for federal contractors. 75 F.R. 14059 (Mar. 23, 2010) ("final rule"). The final rule implements section 872 of the Duncan Hunter National Defense Authorization Act for Fiscal Year 2009 by requiring contractors and recipients of federal financial assistance to report information relating to their responsibility via a new database called the Federal Awardee Performance and Integrity Information System ("FAPIIS"). The following discussion highlights the main requirements of the final rule, and addresses an ambiguity in the definition of contracts that trigger contractors' and recipients' duty to complete FAPIIS reporting.

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FAPIIS Reporting Generally

The final rule promulgates a number of new Federal Acquisition Regulation ("FAR") clauses, and two that should be of particular interest to federal contractors and grant recipients: (1) 48 C.F.R. § 52.209-7, INFORMATION REGARDING RESPONSIBILITY MATTERS; and (2) 48 C.F.R. § 52.209-8, UPDATES OF INFORMATION REGARDING RESPONSIBILITY MATTERS.

Effective April 22, 2010, contracting officers are to refer to FAPIIS prior to making any contract award that exceeds the simplified acquisition threshold in value. Under the final rule, contractors are required to report the following categories of information via FAPIIS:

Criminal Information. An offeror must provide information regarding whether it, or any affiliated firms or persons, have been subject to any criminal proceeding in the prior five years that relates to the performance of a government contract.

Civil Dispute Information. An offeror must provide information regarding whether it has been subject to a civil proceeding relating to a government contract that resulted in a finding of fault and liability, and required payment of a monetary fine, penalty, reimbursement, restitution, or damages of $5,000 or more in the previous five years.

Administrative Proceedings. The final rule requires offerors to report on "administrative proceedings" in which they have been involved. It defines an administrative proceeding as a "non-judicial process that is adjudicatory in nature in order to make a determination of fault or liability." Offerors must now report involvement in any such administrative proceedings that resulted in a finding of fault and liability, and required the payment of monetary fine or penalty of $5,000 or more, or the payment of any reimbursement, restitution, or damages in excess of $100,000.

Settlements. Finally, offerors must provide information about whether any of the foregoing types of procedures were disposed of by consent or compromise, with an acknowledgment of fault by the contractor.

When Must a Contractor Make a Report?

As of the April 22, 2010 adoption of the final rule, any contractor with $10 million in current, active contracts must begin biannual reporting and continue reporting twice per year until such a time as the contractor no longer has at least $10 million in current, active contracts. In addition, contracting officers are required to include the FAPIIS reporting clauses in solicitations for any contracts in excess of $500,000 in value. Therefore, any contractor with $10 million in current, active contracts that bids on such a contract must make a FAPIIS report for the purpose of that procurement, and continue biannual reporting if it wins the contract.

One noteworthy item is this - when submitting a proposal to perform a contract that contains the FAPIIS clauses, the contractor must certify that its FAPIIS reporting is current, accurate, and complete. Therefore, if a reportable event occurs subsequent to its most recent FAPIIS report,a contractor must update its report prior to submitting a proposal in response to a solicitation that contains the FAPIIS clauses, even if the contractor is current in its biannual reporting requirement.

How Far Back Does a Report Go and How Long Does the Information Remain 'Active'?

Contractors obligated to make FAPIIS reports must include any relevant information from the five years immediately prior to the report. Generally, information in the database will remain there for six years after it is first posted. If a contractor has been debarred or suspended, however, that information will remain in FAPIIS while the suspension or debarment is active, and for an additional five years following the end of the suspension or debarment.

May Contractors Take Exception to Information in FAPIIS?

Contractors may insert comments regarding any information in FAPIIS—presumably, contractors will use this tool to advocate for why the information in FAPIIS should not be "held against" them. In addition, contracting officers must give offerors the opportunity to provide additional information that demonstrates their responsibility before making a final determination of non-responsibility.

Who Must Make a Report?

The trigger for the FAPIIS reporting requirement is this: any offeror on a potential contract with a value of $500,000 or more that also has "current, active" contracts and grants in excess of $10 million in value must make a FAPIIS report. This begs the question: what does the term "current, active" contracts mean as used in 48 C.F.R. § 52.209-7?

The final rule includes this definition of contracts that trigger the reporting requirement:

> Federal contracts and grants with total value greater than $10,000,000 means –
>
> (1) The total value of all current, active contracts and grants, including all priced options; and

(continued)

Deceptively Simple: The New FAPIIS Responsibility Reporting Rule—continued from page 9

> (2) The total value of all current, active orders including all priced options under indefinite-delivery, indefinite-quantity, 8(a), or requirements contracts (including task and delivery and multiple-award schedules).

When the proposed rule that preceded the final rule was published, the relevant definition stated as follows:

> Federal contracts and grants with total value (including any options) greater than $10,000,000 means-
>
> (1) The value, at the time of their award, of the current, active contracts and grants, including all priced options; and
>
> (2) The total value, at the time of their award, of all current, active orders under indefinite-delivery, indefinite-quantity, 8(a), or requirements contracts (including task and delivery and multiple-award schedules).

74 F.R. 45583 (Sept. 3, 2009).

The preamble to final rule contains the following discussion regarding the definition of "contracts" that trigger the reporting requirement:

> Another commenter recommended that the $10,000,000 threshold of open contracts triggering the requirement to submit information to FAPIIS be clarified to include all priced options and modifications.
>
> …With respect to the $10 million threshold, the Councils concur that additional clarification is needed to capture the value of modifications when calculating the total value of all current, active contracts and grants. The language in the final rule has been refined to clarify that offerors must consider the total value of the contracts and grants including all priced options and modifications.

Thus, the difference between the proposed rule and the final rule was the addition of language concerning "all priced options" under contracts. While this change does not offer any express guidance regarding the meaning of the term "current, active" in the final rule, it does suggest that the FAR Council's intent was for the concept of "current, active" contracts to be inclusive of all sources of contract value that had *the potential* to affect a contract's value—even if that value is never realized.

Cases addressing the concept of an "active" contract are few, and no case we found directly addresses the issue. In one case, a Federal Supply Schedule ("FSS") contract was found to have become inactive once the government and the contractor executed a modification that no further orders could be placed under it. *Canon USA, Inc.*, B-311254.2, 2008 CPD ¶ 113 (June 10, 2008). In another case, the Armed Services Board of Contract Appeals stated that a firm fixed-price contract at the first article testing stage of performance was "active." *Antenna Prods. Corp.*, ASBCA no. 34134, 88-3 B.C.A. (CCH) ¶ 21,060 (July 21, 1988). Thus, to the extent cases provide guidance, they suggest a common-sense understanding that the term "active contracts" refers to contracts currently being performed.

Let us say a hypothetical Contractor currently performs an FSS contract with the government. During a typical year, Contractor fills orders that, in total, exceed $10 million in value. However, orders that are in the process of being filled at any one time do not approach $10 million in value. Thus, it is unclear whether Contractor has $10 million in "current, active" contracts that would trigger an obligation to make a responsibility report under the new section 52.209-7 of the FAR.

The best source of insight we have for the unique issue this Contractor faces is the change between the proposed rule and the final rule. The FAR Council's intent seems to have been for the concept of "current, active" contracts to be inclusive of all sources of contract value that had the potential to affect the contract's value—even if that value is never realized. The *Canon* case indicates that any FSS contract against which orders may be placed is "active." Applying this guidance, a contractor with an FSS contract that could, potentially, lead to $10 million worth of orders prior to the date on which it is set to terminate is an "active" contract that triggers the reporting requirement. This interpretation of the final rule's language directs that our Contractor must make the FAPIIS report required under the final rule. This conclusion comports with the common-sense conclusion that a contract requirement that depends on a contract's "value" would include all items that create that value, regardless of an argument that individual items may be active or inactive within a narrow window of time.

The counter-argument to this conclusion is that the second part of the final rule's definition refers to "current, active orders." Our hypothetical Contractor might rely on this language to argue that at no time does it have $10 million in "current, active" orders, and that the definition involves a two-part test, of which Contractor meets only the first part. Ultimately, a stronger argument is probably the one set forth in the preceding contract—our hypothetical Contractor's FSS contract meets the first part of the definition, and that is sufficient to subject it to the requirement—though, until further guidance becomes available, reasonable minds could differ. To summarize, the definition of covered contracts in the final rule is ambiguous and susceptible to multiple interpretations, but we believe the best interpretation is that our Contractor's FSS contract meets the definition of "current, active" contract with a value of more than $10 million in the final rule.

Conclusion

While it shares some similarities with the pre-existing "Excluded Parties List" and other databases of contractor information, the FAPIIS reporting database expands the scope of potentially damaging information regarding contractors that will be readily available to all government agencies and, possibly, competitors, the media, and public watchdog groups. Moreover, where a company has failed to complete its FAPIIS reporting requirements, or failed to make a full disclosure, such failure exposes the company to being "outed" by competitors as being ineligible for award or unworthy of a favorable responsibility evaluation. Complicating matters even more, the definition of contracts covered by the final rule is not entirely clear. Thus, the new FAPIIS reporting requirement further intensifies the critical relationship between lawful and compliant corporate conduct, and a company's ability to do business with the federal government.

HEALTH REFORM LEGISLATION INCLUDES SIGNIFICANT AMENDMENTS TO THE FALSE CLAIMS ACT

With the passage of the recent health care reform legislation, Congress has enacted several significant changes to the federal False Claims Act ("FCA").

In May 2009, Congress significantly altered substantive and procedural provisions of the FCA in passing the Fraud Enforcement and Recovery Act of 2009 ("FERA"). The changes in FERA included, among other things, removal of the requirement that false records and statements be supplied with the "intent" of getting false claims paid, eliminating the "presentment" requirement that a claim be submitted to an "officer or an employee" of the federal government, expansion of the definition of "claim" to include demands for money and property to which the United States government does not have title, and expansion of the scope of liability under the conspiracy provisions. The procedural changes in FERA included, among other things, allowing new complaints or amendments to a relator's complaint filed by the government to "relate back" to the date of the original complaint for purposes of the statute of limitations, and removal of the restrictions on the sharing of information obtained from a Civil Investigative Demand ("CID") between the federal government and relators or their counsel.

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Now, less than a year after the May 2009 FERA amendments, Congress has adopted further changes to the FCA with a number of amendments tucked into the Patient Protection and Affordable Care Act (H.R. 3590), and signed into law by the president on March 23, 2010. Most importantly, the amendments substantially weaken the "public disclosure/original source" jurisdictional defenses to FCA allegations, which courts long have used to dismiss parasitic *qui tam* suits. The new law also contains some changes that will affect the "reverse" FCA theory of liability further, and requiring compliance with the FCA as a condition of participation in the yet-to-be-developed health insurance exchanges.

Weakening the Public Disclosure Bar / Defense

Under the previous public disclosure provisions, a court did not have jurisdiction over a *qui tam* suit (brought on behalf of the federal government by a private citizen or "relator") if the allegations and transactions upon which the suit was based had been publicly disclosed in the news media or in a prior civil, criminal, congressional or administrative hearing, report, audit, or investigation. The relator could only avoid dismissal of her claims pursuant to this public disclosure bar by demonstrating that she was an "original source" of the information, which was defined as an individual with "direct and independent knowledge" of the allegations.

The amendments to the FCA undercut the public disclosure bar in three ways.

First, the new provisions provide the Department of Justice—not the court—with the ultimate authority to determine whether an action should be dismissed on public disclosure grounds. The new FCA provisions require that a court "shall" dismiss an action if the allegations are based upon public information, "unless opposed by the government," *i.e.*, the government arguably can overrule the dismissal of a case on public disclosure grounds by voicing its "opposition" to such a dismissal. This change will likely lead to protracted litigation of parasitic *qui tam* suits that otherwise should and would be dismissed on the pleadings prior to these recent changes. In light of the possibility of recovering a settlement—even for meritless claims—it is difficult to imagine the government will simply concede to dismissal of cases on public disclosure grounds.

Second, the new provisions restrict the types of "public" information that would merit dismissal. Before the March 23, 2010 revisions, the public disclosure bar divested courts of jurisdiction over actions that were based on information that had been publicly disclosed in a criminal, civil, or administrative hearing; a congressional, administrative, or Government Accountability Office report, hearing, audit, or investigation; or in the news media. Now, however, only "federal" criminal, civil, and administrative proceedings, in which the "Government or its agent is a party," will qualify as the type of disclosures that can preclude subsequent *qui tam* actions. The recent changes also limit the public disclosure bar's application to strictly "federal" reports, audits, and investigations, and altogether eliminates "administrative" reports, audits, and investigations, as a basis for dismissal. The result of these changes is that potential relators can obtain information from state or local hearings, trials, investigations and proceedings, and turn around to use that information as the basis for a *qui tam* suit—despite the fact that the state material was readily available in the public domain. This revision effectively drastically limits the applicability of the U.S. Supreme Court's March 30, 2010 decision in *Graham County Soil & Water Conservation District v. United States ex rel. Wilson*, which provides that the statute's public disclosure bar (prior to the recent amendments) could be triggered by *both* federal and state reports, audits, and investigations. The amendments will apply prospectively to all cases filed after March 23, 2010, and will limit invocation of the public disclosure bar to the more narrow categories set forth in the amended statute; cases filed and pending prior to March 23, 2010 will be adjudicated by the prior version of the FCA, and under the Supreme Court's ruling in *Graham County*.

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Third, the new law removes the requirement in the "original source" exception that an individual have "direct and independent knowledge" to proceed with an action despite the existence of a public disclosure. Instead, under the newly revised FCA, a relator may qualify as an "original source" if she voluntarily provided information to the Government prior to the public disclosure, or if he has knowledge that is "independent of" and "materially adds" to the publicly disclosed allegations. Previously, to qualify as an original source, a relator was required to have "direct" (or first-hand, personal) knowledge of the publicly disclosed facts supporting allegations of fraud, and this requirement served to screen out fraud allegations based on unreliable hearsay and second-hand sources. The elimination of the "direct knowledge" requirement threatens to force FCA defendants to face wholly unsupported allegations and "fishing expeditions" that are otherwise not based on any factual premise. Equally troubling, the new law does not describe the nature or quantity of information that a relator must allege to "materially add" to the publicly disclosed allegations. There is little doubt that the term "materially adds" will be the hotly contested subject of future litigation concerning the public disclosure bar, as these amendments turn long-settled interpretations of the public disclosure bar on their heads.

(continued)

Health Reform Legislation Includes Significant Amendments to the False Claims Act—continued from page 11

What These Changes Mean for You

The new legislation significantly aids a relator's ability to bring a *qui tam* case under the FCA, and to keep it in court once he or she does so. While the revised "public disclosure" provisions arguably still require a relator to have some "independent" knowledge in order to bring a *qui tam* suit, the provisions suggest that a potential relator may augment its own knowledge with information gleaned from other public disclosed information—including information publicly disclosed in state and local investigations, trials, and administrative reports. The new law also shifts the ultimate decision of whether the public disclosure bar warrants dismissal of a parasitic *qui tam* suit from the courts to the government. The likely result is that this change will effectively render the central purpose of the public disclosure bar to be a nullity, since the government will have virtually no incentive to consent to dismissal of *qui tam* suits—even parasitic ones—in light of the potential to leverage a settlement out of even innocent defendants, rather than endure the costs and uncertainty of associated FCA litigation.

In short, because these legislative amendments make it easier for relators to file and sustain allegations of fraud in hopes of extracting large settlements, it is as important as ever for the most frequent targets of FCA actions (*i.e.*, government contractors and health care providers that are reimbursed by the federal government) to take proactive steps to limit the risks and potential exposure of FCA actions by reviewing and updating compliance procedures, and properly training employees, among other things.

GEARING UP FOR THE 'HIGH ROAD'

By the time you read this article, the Obama Administration may have steered federal government contracting down a noticeably new road. If you believe its critics, the road will only lead to government overspending, the increase in awards to organized labor, and the veritable inability of small businesses to compete for contracts. If you believe its proponents, the road could boost a significant segment of the population out of the poverty economy and into the middle class, justifying its front-end expense (higher contract costs) with longer-term savings on a variety of social programs (*e.g.*, Medicaid, food stamps). Either way, the "High Road" is on the map, and current and prospective contractors should avoid its hype and focus on its details.

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That task is easier said than done, since everything published thus far about the so-called "High Road Procurement Policy" (the "Policy") is based on draft policy documents of questioned origin, and unattributed discussions with policy-making officials. It seems the purpose of the Policy is to compel companies contracting for federal government work to provide better wages and benefits to their employees, by adding a corresponding metric to the competitive source selection process. How that metric will work remains a work in progress, but the Policy likely will be administered by the Office of Management and Budget ("OMB"), and possibly the Department of Labor ("DOL"). Specifically, OMB will develop a process for assessing factors like a company's provision of livable wages, affordable health insurance, funded retirement, and paid sick leave to all of its employees. For the purpose of a particular procurement (or on a regular basis) DOL will score bidding companies, and relay those scores to the agency contracting officer, who will be required to consider the scores alongside the traditional factors of responsiveness, responsibility, past performance, and price.

According to one report, within each contracting agency a "labor standards advocate" will have the authority to adjust a company's standardized DOL score based on things like the company's pledge that it will provide exemplary wages and benefits during the performance of the subject contract. It seems unlikely that this aspect, if considered at all, will be included in the finalized Policy, since one of its core elements is to ensure companies provide living wages and benefits to all employees, not just those individuals performing government contracts. In fact, by one count, as many as one in four Americans could be affected by the Policy, considering the number of companies currently performing some amount of federal contract work.

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Amidst all of the uncertainty about the Policy's dimensions, its eventual implementation seems quite certain. Federal contracting is already used as a lever to achieve a variety of socioeconomic goals, including the adoption of fair labor standards, the promotion of small and disadvantaged businesses, and purchasing from American companies. Adding the new Policy could require nothing more than an amendment to the Federal Acquisition Regulation ("FAR").

That does not mean current and prospective contractors are powerless to influence the Policy's provisions. Any proposed change to the FAR requires a notice and comment period, and even final rules may be stayed pending judicial review. (Implementation of a late Clinton Administration change to the FAR requiring contracting officers to consider bidders' compliance with tax, labor and employment, environmental, antitrust, and consumer protection laws before awarding contracts was postponed and ultimately suspended by the Bush Administration.) Reed Smith attorneys are committed to monitoring Policy developments, and are available to assist the preparation of comments to the impending rulemaking. Once more specific details about the Policy are available, Reed Smith can also help assess the potential impact on current operations, to make the merger onto the High Road a smooth one.

SUPREME COURT'S INTERPRETATION OF FCA'S 'PUBLIC DISCLOSURE' BAR IS BLUNTED BY HEALTH CARE REFORM PROVISIONS

On March 30, 2010, the U.S. Supreme Court resolved a sharp split among the Circuit Courts of Appeal, ruling that both federal and state administrative reports can trigger the False Claims Act's "public disclosure" jurisdictional bar, in the matter of *Graham County Soil and Water Conservation District v. United States ex rel Wilson*, __ U.S. __, 2010 WL 1189557 (Mar. 30, 2010). However, the impact of the Supreme Court's holding is limited by the recent enactment of the Patient Protection and Affordable Care Act, as explained below.

The FCA and the Public Disclosure Bar

The civil False Claims Act ("FCA") is the federal government's primary weapon against fraud, and includes severe penalties for violations: treble damages, and mandatory civil penalties of between $5,500–$11,000 for each false claim submitted, and can even involve payment of litigation costs and attorneys' fees. In addition to FCA lawsuits initiated by the federal government, the unique *"qui tam"* provisions of the statute permit private citizens (known as "relators") to pursue FCA claims on behalf of the government, with the statutory promise that relators will receive a percentage of any recovery (through judgment or settlement) against the defendants.

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However, to prevent "parasitic" claims by relators who lack personal knowledge of alleged fraud against the government and rely only upon information available in the public forum, Congress included the "public disclosure bar" in the FCA. The public disclosure bar—as was in effect at the time the Supreme Court decided the *Graham County* case discussed below—generally held that a federal court did not have jurisdiction over an FCA lawsuit that was based upon a previous public disclosure of the same or similar allegations:

> No court shall have jurisdiction over an action under this section based upon the public disclosure of allegations or transactions in a criminal, civil, or ***administrative*** hearing, in a congressional administrative, or Government Accounting Office [GAO] report, hearing, audit, or investigation, or 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.

31 U.S.C. § 3730(e)(4)(A) (2006) *(emphasis added)*.

The Supreme Court's Ruling in the *Graham County* Case

In *Graham County*, the Supreme Court held that *state* "administrative reports, audits, or investigations" trigger the public disclosure bar in the same way as their federal counterparts. In that case, the federal government contracted with two counties in North Carolina to perform cleanup and repair work after extensive flooding. Karen Wilson, an employee of a county soil and water conservation district who performed part of the work, suspected fraud in connection with the district's efforts, and reported her suspicions to both federal and local officials.

The county, state, and federal government investigated Wilson's suspicions and issued written reports with their findings. After the written reports were issued, Wilson filed suit alleging that two districts violated the FCA by knowingly submitting false claims for payment to the federal government under the contracts. The district court held that the county and state investigations and conclusions constituted "administrative…report[s], …audit[s], or investigation[s]" that triggered the public disclosure bar. However, on appeal, the Fourth Circuit reversed the district court and held that "only federal administrative reports, audits, or investigations" qualify as public disclosures under the FCA, and therefore the state reports did not preclude Wilson's FCA claims.

In reversing the Fourth Circuit, the Supreme Court analyzed the FCA's text and concluded that nothing in the statute's language specified that only federal administrative reports could qualify as public disclosures. Likewise, the legislative history concerning the term "administrative…report, audit, or investigation" was virtually non-existent, because the relevant text was adopted in conference committee after the House and Senate committee reports had been completed, and thus did not support limiting the public disclosure bar to federal reports only. Finally, the Court rejected the relator's arguments that the policy behind the FCA justified limiting the public disclosure bar to federal reports.

Impact of the Court's Decision

The Court's decision resolves a split in the appellate courts and makes clear that *both* federal and state reports, audits, and investigations trigger the FCA's public disclosure bar.

However, on March 23, 2010—a week before the Court's final decision in the *Graham County* case was issued—the president signed into law the health care reform legislation, the Patient Protection and Affordable Care Act, Pub. L. No. 111-148, 124 Stat. 119 (the "PPACA"). This legislation contained several provisions that substantially modified the FCA, including a preemptive strike that explicitly amended the public disclosure bar to state that only *federal* reports, audits, and investigations will qualify as a public disclosure, and altogether eliminates "administrative" reports, audits, and investigations as a basis for dismissal. However, the Supreme Court noted in the *Graham County* decision, this change is not retroactive, and therefore only will apply prospectively to cases filed after the PPACA's effective date.

Thus, both federal and state reports, audits, and investigations can trigger the public disclosure bar for FCA cases filed prior to March 23, 2010. However, for cases filed after March 23, 2010, to determine whether the public disclosure bar is triggered, courts must analyze whether the disclosure occurred in the context of a federal report, audit, or investigation (or one of the other public disclosure provisions contained in the amended statute).

The FCA's public disclosure bar was never a model of clarity. Despite the Supreme Court's effort to resolve the statute's ambiguity, Congress's recent amendments to the FCA unfortunately have made it more difficult for defendants to preclude FCA allegations at the pleadings stage, and have included language that raises serious questions concerning the future interpretation of the FCA.

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