E-ALERT | Government Contracts

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THE GOVERNMENT CONTRACTS UPDATE

CONGRESS PASSES OMNIBUS APPROPRIATIONS ACT

On January 17, 2014, President Obama signed a $1.012 trillion omnibus appropriations bill to fund the federal government for the remainder of the fiscal year ("FY"). The bill further eases sequester spending cuts and eliminates any remaining threat of another government shutdown.

The President's signature capped a whirlwind stretch in which the bill was introduced, debated, and approved by both houses of Congress within a single week. The bill, which bundles twelve different appropriations measures, outlines spending under the $1.012 trillion cap implemented by the recently passed Bipartisan Budget Act. Agencies receiving boosts in funding under the new law included the Department of Defense (discussed in greater detail below), the National Institutes of Health, and the Centers for Disease Control and Prevention, among others. Although some lawmakers have raised questions about the speed with which the bill was passed, the broad support on both sides of the aisle suggests a lack of congressional appetite for another protracted budget impasse.

BOOST FOR DEFENSE BUDGET UNDER APPROPRIATIONS BILL

At $572 billion, the largest portion of the omnibus appropriations law is devoted to defense spending. This total, which makes up just over half of the entire omnibus package, includes $486.9 billion for the Pentagon's base budget and $85.2 billion to fund overseas war operations, primarily in Afghanistan. The omnibus measure allocates approximately $11 billion to maintenance and readiness accounts that were disproportionately affected by sequestration. It also authorizes funds for several costly long-term defense programs, including full funding for the F-35 Joint Strike Fighter program. The new law is good news for contractors aiming to target new program starts and multiyear contract awards, both of which had been hamstrung by continuing resolutions that prohibited spending for these purposes.

The base defense budget includes approximately $93 billion for weapons procurement and about $63 billion in research and development funding. Many analysts have noted that these allocations fall short of the White House's target funding requests by $6.4 billion and $4.5 billion, respectively, and that they also represent a decline from the amounts allocated to these categories in FY 13. However, as in past years, Congress appears to have set aside extra billions in the overseas contingency operations ("OCO") budget -- funds that do not count against the spending caps agreed to by congressional budget negotiators in December -- which may provide some flexibility to offset shortfalls in the base budget. In any event, the omnibus law authorizes billions more in defense funds than the Pentagon would have received had it been forced to endure an additional round of indiscriminate cuts under sequestration for FY 2014.

CONGRESS RECALIBRATES CYBERSECURITY RESTRICTIONS

In a move with potentially significant ramifications for the IT industry, Congress has scaled back a far-reaching ban that prevented certain federal agencies from purchasing IT products associated with the Chinese government. As we previously reported, a continuing resolution to fund the government through the end of FY 13 contained an aggressive cybersecurity provision designed to curtail a perceived surge in Chinese-backed hacking of U.S. businesses. Specifically, the continuing resolution prohibited four key agencies (the Commerce and Justice Departments, NASA, and the National Science Foundation) from purchasing IT products "produced, manufactured or assembled" by entities that are "owned, directed or subsidized by the People's Republic of China." Contractors criticized the provision as overbroad and poorly defined, and worried that the ban would require the complete removal of Chinese firms from their supply chains, a potentially disastrous step given the ubiquity of Chinese companies in the IT industry.

The new language, found at Section 515 of the Commerce, Justice and Science portion of the omnibus appropriations bill, rolls back the blanket restriction and instead applies it only to information systems designated as "high-impact or moderate-impact" under NIST guidelines. Specifically, Section 515 prohibits a covered agency from purchasing such moderate- and high-impact systems unless it first complies with a host of acquisition standards, including a supply chain risk assessment conducted in conjunction with the FBI.

Although the IT industry generally has welcomed the new law as an improvement over the previous version, contractors should realize that the new provision is in some ways *more* restrictive than its predecessor. For instance, the restrictions in the previous version of the ban focused exclusively on potential IT procurements from China. The new language, however, applies to any "entities identified by the United States Government as posing a cyber threat," including (but not limited to) China.

The IT industry will be closely watching how the new language is incorporated into pending procurements, including NASA's Solutions for Enterprise-Wide Procurement package, a five-year contract vehicle worth $20 billion. Covington's recent E-Alert offers a more detailed discussion of the cybersecurity restrictions and requirements imposed by Section 515.

HHS OIG STEPPING UP OVERSIGHT OF PEPFAR RECIPIENTS

A recent report from the HHS Office of Inspector General ("OIG") describes increased audit activity surrounding funds distributed under the President's Emergency Plan for AIDS Relief ("PEPFAR") program. PEPFAR, which is administered by the CDC, allocates funding to ministries of health and other in-country partners to combat HIV/AIDS by strengthening health systems and building sustainable HIV/AIDS programs. Several years ago, however, a congressional oversight committee raised questions about the use of PEPFAR funds, and mandated that HHS, in conjunction with USAID and the State Department OIG, conduct regular audits of PEPFAR recipients. The HHS OIG's September 2013 report to Congress demonstrates HHS' commitment to protecting the program's integrity. The report summarizes the results of seven audits that questioned unallowable expenses, interest income, potentially unallowable value-added taxes, and reporting deficiencies, among other line items. In addition to auditing various in-country programs in South Africa, Namibia, and Vietnam, the HHS OIG also reported on an audit of a CDC federal field office. If the HHS OIG's recent report is any indication, recipients of PEPFAR funds should expect continued scrutiny in the future.

CONGRESSMAN PROPOSES OVERHAUL OF DEFENSE CONTRACT EVALUATION

Representative Alan Grayson, D-Fla., has introduced a bill in the House that would "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." The proposal would leave room for the head of an agency to issue a discretionary waiver of this requirement, but it would require the Secretary of Defense to submit an annual report to Congress listing each such waiver. The bill, H.R. 3844, is similar to a proposal introduced by Rep. Grayson last year. No action was taken on the earlier proposal, but H.R. 3844 has been referred to the Committee on Armed Services for further consideration. Although the bill is unlikely to become law, it is indicative of the desire of some on Capitol Hill to launch even more aggressive attacks on perceived waste in government contracting by making low cost a preeminent evaluation factor in all procurements.

CASE DIGEST

Fourth Circuit Imposes $24 Million FCA Penalty Despite Relator's Failure To Prove Damages (*United States ex rel. Bunk v. Gosselin World Wide Moving, N.V.*, No. 12-1369 (4th Cir. Dec. 19, 2013))

In a closely watched case addressing the limits of statutory penalties under the False Claims Act ("FCA"), the Fourth Circuit recently reversed a district court ruling and imposed a $24 million fine against a government contractor despite the absence of any proven damages. The contracting community -- and particularly contractors handling large, long-term projects -- should be mindful of the potentially far-reaching effects of this decision on their own operations.

Background

The case, *United States ex rel. Bunk v. Gosselin World Wide Moving, N.V.*, involved a *qui tam* relator's allegations that the defendant, a Belgian shipping company bidding to perform a government contract to transport goods to U.S. military personnel in Europe, had illegally conspired to fix shipping rates and had submitted a false Certificate of Independent Price Determination with its bid. After an 11-day trial, a jury returned a verdict for the relator, concluding that Gosselin and several other subcontractors had "collusively agree[d] among themselves on what would be charged for servicing as a subcontractor under [the contract]" and had "agree[d] to share the contract and divide territories" within the service area.

Although the relator alleged damages in his original complaint, he did not seek damages at trial. Instead, he sought only the statutory civil penalty of $5,500 to $11,000 for each false claim submitted to the government. The parties stipulated that Gosselin had filed 9,136 invoices over the life of its shipping contract, each of which was considered a separate false claim under the FCA since they were deemed to follow from a fraudulently induced contract.[1] The 9,136 stipulated violations meant that the statutory penalty -- at a minimum -- would exceed $50 million (9,136 X $5,500 = $50,248,000). Noting the absence of any proven damages, Gosselin challenged this penalty as an unconstitutionally excessive fine under the Eighth Amendment.

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[1] Significantly, the district court noted: "[N]one of those invoices contained or referenced the false [Certificate of Independent Price Determination] . . . , and none of those 9,136 false invoices contained any factually false information. Rather, they are deemed false as a matter of law based on judicial constructions of the FCA."

District Court Ruling

The district court correctly recognized that the standard for determining the constitutionality of a civil penalty under the Eighth Amendment is whether the fine is "grossly disproportional to the gravity of a defendant's offense." In a lengthy and methodical opinion, the district court found that the government had not suffered any proven economic harm, since Gosselin's prices were comparable to the prices it charged prior to the alleged rate-fixing scheme, and since the services provided by Gosselin were not deficient in any way. The district court also concluded that "the number of invoices, in and of themselves, is not reflective of [Gosselin's] level of culpability, particularly since the number of invoices that [Gosselin] ultimately filed was determined by the number of jobs assigned to Gosselin over the life of the contract; and how Gosselin decided to bill those jobs." Finally, the court observed that Gosselin's shipping contract was worth only $3.3 million, and that the company had realized just $150,000 in profit on the contract. Given the lack of damages, the limited culpability, and the small amount of "ill-gotten gains," the district court concluded that a $50 million penalty was grossly disproportional to Gosselin's conduct and therefore unconstitutional under the Eighth Amendment.

The district court then considered whether it had discretion to fashion its own penalty in a lesser amount. In the event that the statutory penalty was deemed unconstitutional, the relator had proposed to take a voluntary remittitur and seek "only" $24 million in damages. The district court, however, determined that the statutory penalty of $5,500 to $11,000 was "mandatory," and that the FCA offered no authority for a court to impose some lesser amount. Thus, in the event that the statutory penalty was unconstitutional as applied, the court reasoned that "the FCA does not give the Court any discretion to award any other civil penalty" because doing so would require the court to "rewrite the FCA." Accordingly, the district court awarded no civil penalty.[2]

Fourth Circuit Ruling

On appeal, the Fourth Circuit reversed, declaring that relators are entitled to seek awards below the statutorily prescribed figure, and that courts have the discretion to award such an amount. The appellate court then held that the $24 million penalty sought by the relator was not unconstitutionally excessive. In so holding, the court acknowledged that "[the relator] sought no damages," and that "the number of false invoices presented is hardly a perfect indicator of the relative liability that ought to attach to an FCA defendant." Nonetheless, the court concluded that a $24 million penalty was not "grossly disproportional" to the gravity of Gosselin's conduct and therefore was not an unconstitutionally excessive fine. The court justified this startling conclusion by simply stating that a $24 million penalty "appropriately reflects the gravity of Gosselin's offenses and provides the necessary and appropriate deterrent effect going forward."[3]

This decision, if it stands, raises concerns for companies doing business with the government. Under the Fourth Circuit's logic, minor or purely technical instances of non-compliance, if repeated over time, could lead to massive liability exposure for contractors, especially for those required to

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[2] In dicta, the district court went on to explain that the relator's request for $24 million also would amount to an unconstitutional fine under the Eighth Amendment, and that "a total penalty of $1.5 million would reflect, based on the facts of this case, the outer limit of a constitutionally permissible fine." The court arrived at this figure by starting with Gosselin's profit ($150,000) and utilizing "the multiples identified by the Supreme Court as representing the outer limits of propriety under the Due Process clause for assessing punitive damages."

[3] The court also intimated that, in its view, the government may have suffered some economic harm, although it stopped short of making any finding on this point. Instead, it simply suggested that the issue of economic harm was "fiercely contested before the district court" and that the district court's finding of no economic harm was "seemingly inconsistent with Gosselin's apparent profit motive."

submit regular invoices. And even more alarmingly, even invoices that are entirely accurate may constitute separate false claims -- leading to millions in liability exposure -- if the contract is deemed to have been fraudulently induced in the first instance. This sobering reality only underscores the importance of developing sophisticated compliance and monitoring systems in all phases of the procurement process.

District Court Rejects "Fraudulent Inducement" FCA Claim Absent Actual Reliance (*United States ex rel. Thomas v. Siemens AG*, No. 09-4414 (E.D. Pa. Jan 13, 2014))

The District Court for the Eastern District of Pennsylvania recently held that an FCA relator cannot recover on a "fraudulent inducement" theory without proving that the government actually relied on a material false statement when entering a contract. The decision is welcome news to those in the contracting community, as it demonstrates that there are limits on FCA liability in situations where a contractor is accused of securing a contract through fraudulent inducement.

In *U.S. ex rel. Thomas v. Siemens AG*, the relator alleged that Siemens Medical Solutions USA ("Siemens") misled the Veterans Administration ("VA") during the contract bidding process by falsely claiming to afford the government "most favored customer" status while simultaneously concealing the full extent of the pricing discounts it offered to other customers. The relator alleged that through this deceptive practice, and others like it, Siemens induced the government to enter into a contract by fraudulent means, meaning that every invoice submitted by Siemens thereafter constituted a separate false claim because it was tainted by the initial fraud. The government declined to intervene in the case; instead, the government submitted a Statement of Interest stating that it had been neither misled nor harmed by Siemens' alleged false statements.

Siemens moved for summary judgment on the theory that the relator had not shown that the government actually was induced by the alleged false statements to enter in the contract with Siemens. The relator countered that he need not prove actual inducement so long as he demonstrated that the alleged false statements were *material*, meaning that they had a "natural tendency to influence or were capable of influencing" the government's award decision.

The court sided with Siemens, holding that the relator "must prove not only that the omitted information was material but also that the government was *induced* by, or relied on, the fraudulent statement or omission when it awarded the contract." The court explained that while mere materiality was sufficient to give rise to liability "in a typical FCA case," a fraudulent inducement FCA claim required evidence that "the decision to award a contract was *actually*, not just potentially, based on a false statement." This is because fraudulent inducement FCA claims do not involve the submission of invoices that are, themselves, false; rather, such claims are based on the theory that the contract *actually* was procured by fraud in the first instance, meaning that all subsequent claims for payment are tainted. Because the relator had adduced no evidence that Siemens' alleged false statements actually induced the government's award decision, the district court granted summary judgment to the defendant.

Given the potentially massive liability faced by FCA defendants in fraudulent inducement cases (*Bunk v. Gosselin*, above, is a prime example), the district court's decision here is undoubtedly a positive development for government contractors. While it remains critical to ensure compliance from the very outset of the bidding process, the rationale advanced by the district court here offers hope that the law will recognize fair and reasonable limits on expansive theories of FCA liability.

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