COVINGTON

COVINGTON & BURLING LLP

E-ALERT | Government Contracts

March 12, 2014

THE GOVERNMENT CONTRACTS UPDATE

Covington & Burling LLP's Government Contracts practice regularly delivers an update on major news, notes, and trends relevant to government contractors.

LEGISLATIVE AND AGENCY ACTIONS

DoD Requests Public Comments for Ongoing Assessment of Defense Procurement and Acquisition Policy

On February 12, 2014, the Director of Defense Procurement and Acquisition Policy ("DPAP") in the Department of Defense ("DoD") solicited public comments in connection with DoD's ongoing review of contracting statutes and their impact on industry. The notice in the Federal Register explains that "[t]he purpose of the assessment is to support an internal DoD effort to reduce compliance impacts that do not achieve the benefits intended by contracting statutes." Recognizing the extensive body of law and regulation that governs acquisition and procurement, the DoD is seeking public comments that explain the impact experienced by industry resulting from requirements based on statute. Specifically, DPAP is looking for public comments to address the following points: (1) particular impacts associated with specific contracting statutes; (2) why the identified impact does not achieve the intended benefit of the identified legislation, or why the intended benefit is not helpful to DoD; and (3) any recommendations for alternative approaches to achieve the intended benefit of the identified legislation. While DPAP's initial review identified approximately 400 requirements in the Defense Federal Acquisition Regulation Supplement ("DFARS") that are "based solely on statute," the notice also invites comments on DFARS or other component requirements that are not based on statute. DPAP extended its request for public comments on February 25, and comments received on or before April 23, 2014 will be considered by DoD in the formation of a recommendation to the Secretary of Defense "if a revision to the definition is necessary and appropriate." DoD's efforts will run parallel to similar efforts by the House Armed Services Committee, which will be holding oversight hearings and briefings on reforming the DFARS.

House Passes Federal Information Technology Acquisition Reform Act, Again

On February 25, 2014, the U.S. House of Representatives passed the Federal Information Technology Acquisition Reform Act ("FITARA," H.R. 1232). The bill, passed by the House in a previous version as part of last year's National Defense Authorization Act ("NDAA"), was reintroduced by House Oversight and Government Reform Committee Chairman Darrell Issa (R-CA) and co-sponsored by Representative Gerald Connolly (D-VA). Representatives Issa and Connolly urged House members to support the bipartisan bill in an open letter issued on the eve of the House vote, asserting that the federal government currently spends over $80 billion on information technology investments, with estimates of waste as high as $20 billion annually due to factors such as duplicative investments, cost overruns, and program failures.

FITARA contains significant reforms intended to streamline government IT procurement and management. The reforms include the presidential appointment of a single Chief Information Officer ("CIO") in each of 16 specific government agencies with increased authority over IT spending and operations, an expanded role for the CIO Council with respect to inter-agency coordination on IT standards and practices, and reporting by the Government Accountability Office on the effectiveness of the CIO Council. FITARA also requires the creation of a Federal Data Center Optimization Initiative to consolidate and optimize cost savings for data centers; an implementation plan for a government-wide inventory of IT software assets to eliminate duplicative or overlapping assets; the development of policies and guidelines for a standardized approach to transition to cloud computing; and a business case analysis and approval process for new government-wide contracts. Further, the bill establishes a three-year pilot program for a Federal Infrastructure and Common Application Collaboration Center for interagency coordination on the acquisition of commonly used IT infrastructure and applications.

Final DFARS Rule Implements New Whistleblower Protections

On February 28, 2014, DoD adopted as final a rule amending the DFARS to implement the whistleblower protections established by Section 827 of the FY13 NDAA. The final DFARS rule makes some non-substantive changes to the interim rule issued on September 30, 2013. As we previously reported, Section 827 expands whistleblower protections already in place for employees of contractors and extends those protections to their subcontractors on DoD, National Aeronautics and Space Administration ("NASA"), and Coast Guard contracts. The final rule prohibits a contractor or subcontractor from discharging, demoting, or otherwise discriminating against an employee as a reprisal for disclosing information that the employee reasonably believes is evidence of gross mismanagement of a contract; a gross waste of funds; an abuse of authority relating to a contract; a violation of law, rule or regulation related to a contract; or a substantial and specific danger to public health or safety. The final rule expands: (1) the definition of protected employees to include, for example, subcontractor employees (to be afforded the same protections as prime contractor employees); (2) the class of protected disclosures to include actions such as "abuse of authority" and violation of rules and regulations; and (3) the scope of "persons and bodies" to which a whistleblowing employee may disclose information, including management bodies or other employees with the "responsibility to investigate, discover, or address misconduct." The final rule cautions, however, that it should not be construed to provide any rights to disclose classified information not otherwise provided by law.

DoD Bans Tax Delinquents and Felons from Receipt of 2014 Appropriations Funds

On February 21, 2014, the Undersecretary of Defense for Acquisition, Technology and Logistics issued a memorandum barring the use of funds authorized by the DoD Appropriations Act of 2014 and the Military Construction and Veterans Affairs, and Related Agencies Appropriations Act of 2014 with contractors that have been delinquent in paying federal taxes or that have been convicted of a felony in the last two years. The memorandum implements the statutory prohibitions against contracting with tax delinquent or felon corporations contained in those Acts. A limited exception applies to such contractors where the awarding agency is aware of the unpaid tax or the conviction, and has considered suspension or debarment of the contractor yet has made a determination that the action is not necessary to protect the interests of the government. The ban is effective immediately and continues similar restrictions enacted in 2012 and 2013.

SIGAR Promises Assistance to U.S. Contractors on Afghan Taxes

In remarks made on February 18, 2014, Special Inspector General for Afghan Reconstruction ("SIGAR") John F. Sopko promised assistance in stopping the Afghan government from taxing contractors on projects funded by the U.S. Government. As background to his remarks, a May 2013 SIGAR report found that the Afghan Ministry of Finance has assessed $921 million in taxes and penalties since 2008 on projects financed by DoD, the Department of State, and the U.S. Agency for International Development, notwithstanding agreements between the Afghan government and U.S. agencies exempting taxation. A key issue has been a disagreement over whether tax exemptions apply only to prime contractors, or to subcontractors as well. Section 1216 of the FY14 NDAA encourages the Afghan government to cease improper taxation, requiring that DoD withhold FY14 funding to Afghanistan in the amount equivalent to total taxes assessed by Afghanistan on FY13 DoD funds. Although the U.S. military is scheduled to withdraw from Afghanistan at the end of 2014, this issue has continuing relevance, the SIGAR noted, because contractors are expected to have a substantial role in Afghanistan even after military withdrawal. The SIGAR's promised actions do not provide any immediate solution for contractors caught between an Afghan government seeking tax payments and a U.S government that regards such payments as unallowable costs.

CASE DIGEST

Violation of FDA Safety Regulations Insufficient for False Claims Act Suit (*U.S. ex rel Rostholder v. Omnicare, Inc.*, No. 12-2431 (4th Cir. Feb. 21, 2014))

On February 21, 2014, the U.S. Court of Appeals for the Fourth Circuit dismissed a qui tam False Claims Act ("FCA") suit, holding that although the relator had shown that Omnicare, Inc. had violated U.S. Food and Drug Administration ("FDA") safety regulations, those regulatory violations were not sufficient to sustain the FCA suit. The relator, Rostholder, alleged that in the course of repackaging drugs for patient use, employees of Omnicare and its predecessor, Heartland Repack Services LLC, mishandled drugs such as penicillin, causing cross contamination with other drugs. Rostholder alleged that the faulty repackaging processes — which violated FDA safety regulations requiring penicillin and non-penicillin drugs to be packaged in isolation — adulterated and misbranded the drugs, rendering them ineligible for Medicare or Medicaid reimbursement. Although the district court found that Rostholder was the "original source" of the allegation, it dismissed Rostholder's FCA claim, holding that Rostholder had not shown that Omnicare had committed fraudulent conduct or made false statements. The Fourth Circuit affirmed, stating that, to qualify for Medicare and Medicaid reimbursement, a drug must merely be approved by the FDA. The Medicare and Medicaid statutes, however, do not prohibit reimbursement for drugs *packaged* in violation of the FDA's Current Good Manufacturing Practice ("cGMP") regulations. Therefore, once a drug is approved by the FDA and qualifies for reimbursement, a request for reimbursement cannot constitute a false claim on the sole basis that the drug is adulterated because it was packaged in violation of FDA safety regulations.

Although the court concluded that noncompliance with FDA safety regulations did not constitute a false claim under Medicare or Medicaid statutes, the decision does not foreclose potential false claim liability for cGMP violations as the outcome might have been different if the controlling statute or contract had conditioned reimbursement on compliance with a specific regulation or "all laws" more generally. Further, although the issue was not addressed by the Fourth Circuit, it appears possible that noncompliance with FDA safety regulations could have been held to constitute a false claim if drug manufacturing processes were so deficient that the final product was not the drug approved by the FDA.

FERC May Eliminate State-Mandated Pricing Exemptions under the Federal Power Act (New Jersey Board of Public Utilities v. FERC, Nos. 11-4245, -4486, -4487, 12-1085, -1086, -1764 (3rd Cir. Feb. 20, 2014))

On February 20, 2014, the U.S. Court of Appeals for the Third Circuit upheld a 2011 Federal Energy Regulatory Commission ("FERC") order eliminating pricing exemptions for state-mandated electricity generators. As reported separately in Covington's new Inside Energy and Environments blog, the court denied petitions by the New Jersey and Maryland utility commissions, concluding that the elimination of pricing exemptions was a valid exercise of FERC's jurisdictional authority under the Federal Power Act ("FPA") over regional wholesale electricity markets. The Third Circuit's decision affirming FERC's order comes on the heels of two separate district court opinions, which had struck down the New Jersey and Maryland subsidy programs as preempted by federal law.

This case arose out of the 13-state PJM regional wholesale electric capacity market. New Jersey and Maryland, seeking to promote the development of additional capacity resources in their respective states, offered guaranteed revenue streams to certain new generators that would allow them to offer their capacity into PJM markets at below-market prices. Under a 2006 FERC order, resources built in accordance with a state mandate were exempt from PJM pricing requirements. When New Jersey and Maryland announced their subsidy plan, PJM moved to eliminate the exemption. FERC approved the change in its 2011 order, and the states petitioned for review.

The case demonstrates the complexity of ascertaining precisely where federal authority ends and state authority begins under the FPA. The states contended that the PJM tariff was an attempt to regulate internal state efforts to promote the creation of additional generation resources, an area they argued was squarely within state jurisdiction under the FPA. FERC, on the other hand, argued that the state subsidies interfered with the FERC-jurisdictional wholesale capacity market auctions by artificially depressing wholesale prices. While the Third Circuit ruled in FERC's favor and affirmed the FERC's authority over wholesale prices and tariffs, it did not issue broad guidance on the limits of state and federal power. The issue will likely remain contested in years to come as both state and federal actors continue to explore the outside edges of their respective regulatory authorities.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our government contracts practice group:

Alan Pemberton	+1.202.662.5642	apemberton@cov.com
Robert Nichols	+1.202.662.5328	rnichols@cov.com
Susan Cassidy	+1.202.662.5348	scassidy@cov.com
Jennifer Plitsch	+1.202.662.5611	jplitsch@cov.com
Steve Shaw	+1.202.662.5343	sshaw@cov.com
Brian Walsh	+1.202.662.5980	bwalsh@cov.com
Scott Freling	+1.202.662.5244	sfreling@cov.com
Heather Finstuen	+1.202.662.5823	hfinstuen@cov.com
Jade Totman	+1.202.662.5556	jtotman@cov.com
Anuj Vohra	+1.202.662.5362	avohra@cov.com