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A Schedule Full of Legal Risks

As the Oracle settlement shows, contractors must be on top of required disclosures.

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Numerous recent multimillion-dollar settlements underscore the legal threats facing companies that sell commercial goods and services to the federal government. Not only can the government bring suit, but even competitors are now alleging procurement fraud based on violations of contracting requirements unique to the government. Fortunately, companies have ways to mitigate these risks.

The federal government is the largest consumer in the world. To acquire commercial goods and services to meet the government's needs, the General Services Administration, through its Multiple Award Schedule program, establishes long-term governmentwide contracts that contain pre-negotiated prices and terms. Agencies can directly acquire supplies and services using this program, without having to conduct a full-blown acquisition. In fiscal year 2005 alone, the government spent more than $33 billion through these contracts.

A Practice Focus
Government Contracts

Today, a vast majority of commercial suppliers and service providers that sell to the government hold these contracts. But there are risks, as an October settlement shows. In the largest civil settlement under the False Claims Act involving a schedule contract, Oracle agreed to pay the United States $98.5 million to settle allegations that it submitted defective pricing information during contract negotiations. In conjunction with the record-breaking settlement, the Justice Department also announced a new national initiative to prosecute procurement fraud.

In another unsettling development for schedule vendors, a competitor used the FCA's *qui tam* provisions to sue its rivals for alleged noncompliance with the Trade Agreements Act. The suit resulted in multimillion-dollar settlements. Contractors have been required to certify compliance with the TAA for many years, but in the past, competitors filed bid protests or complained to GSA contract officials. Rarely, if ever, has a competitor formally charged fraud under the FCA because of TAA noncompliance.

DRACONIAN PENALTIES

The FCA, 31 U.S.C.§§3729-3733, prohibits the knowing presentation of a false claim to the government and is perhaps the most ominous way to enforce GSA schedule obligations. The reason is that the FCA's civil-penalty provisions specify a minimal threshold for transforming issues of noncompliance into fraud. The FCA sets a low bar for culpability, broadly defining the term "knowingly" to encompass reckless conduct or conduct done in deliberate ignorance of the truth.

Although the fault standard is low, the penalties are not. The risk to the company includes treble damages (triple the government's damages) and civil penalties of not less than $5,500 and not more than $11,000 for each false "claim" (which has been construed as each invoice submitted to the government for payment). There are also administrative sanctions, such as suspension or debarment, as well as damage to a contractor's reputation from publicized allegations.

The threat of liability is compounded by the FCA's *qui tam* provision. This authorizes independent third parties, called relators, to initiate lawsuits as "private attorneys general" on the government's behalf and then reap a percentage of the recovery. Justice Department statistics indicate that from 1986 through September 2005, settlements and judgments in favor of the government resulting from *qui tam* lawsuits alone amounted to $9.6 billion.

DEFECTIVE PRICING

Oracle's recent settlement stems from the GSA's requirement that prospective vendors disclose their commercial sales practices, including pricing terms offered to commercial customers.

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The disclosure form itself amounts to a de facto certification that the information is "current, accurate, and complete" at least 14 calendar days before submission.

Failure to provide this results in what the government commonly calls "defective pricing." The government then often claims that it would have negotiated better pricing terms for itself had the vendor made a proper disclosure. The risk of defective pricing allegations has long been understood to be one of the highest—if not the highest—areas of compliance risk for schedule vendors.

The recent Oracle settlement underscores the severity of that risk. As announced by the Justice Department on Oct. 10, Oracle agreed to pay $98.5 million arising out of alleged defective pricing in a PeopleSoft schedule contract assumed by Oracle when Oracle acquired PeopleSoft. This was the largest FCA settlement ever by a schedule vendor.

The lawsuit was filed under the FCA's *qui tam* provisions by a former PeopleSoft employee. (Employees are common FCA whistle-blowers.) The suit alleged that PeopleSoft understated the discounts for software licenses and maintenance services provided to commercial customers. According to the suit, PeopleSoft gave commercial buyers incrementally higher discounts based on the number of products or services purchased at one time, a practice that PeopleSoft failed to disclose to the government.

The staggering $98.5 million settlement amounts to a forfeiture of nearly half of the $204 million in government sales (not profit) that PeopleSoft had made under its schedule contract between 1997 and 2005. Incredibly, the former PeopleSoft employee will receive close to $18 million of the amount.

TRADE AGREEMENTS

The requirement that a vendor's disclosure of its commercial sales practices to the GSA must be current, accurate, and complete is just one of a number of compliance risks.

As an additional prerequisite to each schedule contract, the vendor must execute various certifications, including a certification that the products the vendor will deliver to the government will comply with the Trade Agreements Act, 19 U.S.C.§2501, et seq.

The TAA implements the United States' international trade agreements and initiatives. When the procurement exceeds certain minimal dollar thresholds, it prohibits most federal government agencies from purchasing end products and services that originated in a country other than the United States or a TAA-designated country. (These are generally countries that have signed trade agreements with the United States providing for nondiscriminatory access to their government markets or that meet certain other criteria, such as being a least developed country.)

Several manufacturing and service hubs in today's global economy, including China, India, Malaysia, Taiwan, and Thailand, are not TAA-designated countries. Thus, when the TAA applies, with few exceptions, a vendor may not offer an end product or service that has a country of origin among these or other nondesignated countries.

Significantly heightening the risks of noncompliance with the TAA are recent FCA settlements stemming from allegations made by a competitor that its rivals were selling products originating in nondesignated countries. Historically, the threat that a competitor might use the *qui tam* provisions of the FCA as a competitive weapon was thought to be relatively low. Similarly, although TAA compliance has been used as a basis to overturn contract awards in several bid protests and has been the cause of disputes with government customers, compliance traditionally has not been enforced through the FCA.

Conventional wisdom recently has been turned on its head by a high-profile lawsuit filed by an office supplier against five of its competitors and the resulting settlements.

In January 2003, Safina Office Products filed a *qui tam* action, alleging that Office Max and other competitors had submitted false claims when they sold products that were from nondesignated countries, such as China. Under its schedule contract, Office Max had certified that it would not offer such items to government agencies. After an investigation, Office Max refused to admit any wrongdoing but agreed to pay the government $9.8 million. The government agreed to pay Safina $1,470,000 as its statutory award.

The settlements stemming from Safina's FCA lawsuit did not stop with Office Max. In the past 18 months, the Justice Department reached settlements with four other major office-products suppliers to pay significant amounts over allegations of contract fraud arising from the same Safina complaint. The settlements involve many major suppliers of office products—in addition to the settlement with Office Max, the government settled with Staples ($7.4 million), Corporate Express ($5.2 million), Office Depot ($4.7 million), and Caddo Design ($100,000).

The clear message is that TAA compliance, though by no means consistent with commercial practice, is of primary importance to all companies selling under schedule contracts.

The lesson from the recent spate of FCA settlements is that a vendor supplying goods or services under a schedule contract must assume that someone—either the GSA, another purchasing agency, an Office of Inspector General, the Department of Justice, a current or former employee, or even a competitor—will question its compliance with schedule requirements.

Moreover, noncompliance with schedule requirements poses a high risk that the vendor will be accused of fraud, which alone can generate unwanted negative media attention and damage customer relations.

The following presents guidelines to consider when pursuing sales through the Multiple Award Schedule program.

- Understand all obligations and requirements for schedule contracts, including pricing disclosures, commercial-sales tracking requirements, and TAA obligations, before submitting a proposal.
- Establish and maintain an organization dedicated to the schedule program and maintain a compliance and training program tailored to your contract.
- Ensure that sales and information-management systems are capable of accurately capturing the commercial sales data that must be disclosed to the GSA during contract negotiations and later tracked to ensure compliance with the contract's price-reduction clause, which operates similar to the "most favored customer" clause sometimes included in commercial contracts.

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- Ensure that disclosure of commercial sales practices is accurate, current, and complete, with all deviations and other qualifying information disclosed in detail in writing.
- Include contract language that clearly defines the relationship between your offered pricing and the "basis of award" customer or customer category that the government will look to for the price-reduction clause.
- Do not certify to TAA compliance unless you are sure that the country of origin of the goods and services offered on the schedule is the United States or a TAA-designated country. Establish appropriate systems to monitor your sourcing decisions to ensure ongoing compliance.
- Conduct a self-assessment and seek to modify your schedule contract to remove any TAA-noncompliant items from the schedule.

Although the risk from FCA suits is real, it can be managed, and companies can continue to sell successfully to the government under the Multiple Award Schedule program.

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