

# Government Contract

COMMENTARY

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## **U.S. Contracts in Iraq: Increased Government Oversight and Investigations of Fraud**

### ***Challenges Involved in Contracting in Iraq and Steps to Avoid Legal Trouble***

By Peter S. Spivack, Esq.

In recent years there has been an increase in federal investigations and lawsuits against U.S. contractors in Iraq for allegedly defrauding the United States. Moreover, an even larger uptick in investigations and enforcement actions is likely in the near future as a result of increased amounts of government spending and increased resources devoted by the Department of Justice and the Defense Department to investigating contract fraud.

In what is perhaps the clearest signal of the priority of these efforts, the Justice Department recently created a procurement fraud task force and appointed a deputy chief of the Fraud Section as its head, with a mandate to devote a renewed vigor to examining and investigating allegations of fraud.

U.S. contractors with business interests in Iraq and elsewhere should note this development with interest and prepare accordingly.

Since the Iraq war began in March 2003 at least 80 federal investigations alleging contractor misconduct, including allegations of bribery and fraud, have been opened, and more than 20 cases have been referred to the Justice Department for prosecution.

For example, former Halliburton subsidiary KBR Inc. is facing scrutiny over a \$25.7 billion contract to help rebuild oil services in Iraq. And in July a U.S. Army major who served as a contracting officer was arrested for allegedly taking \$9.6 million in bribes from military contractors in return for awarding them contracts in Iraq.

Defense contractors who do business in the challenging environment in Iraq need to be prepared because the environment of increased scrutiny and government intervention has only just begun.

Increased government oversight has caused defense contractors in Iraq to worry that they may be next on the investigation list. It also has provoked them to ensure they have taken adequate precautions to avoid legal trouble.

Interestingly, it is the smaller contractors that provide less specialized services that are more likely to be affected by increased government oversight. Because there is more competition among these types of companies, and their goods or services can be easily replaced, the government can more readily suspend or debar them.

Contractors in Iraq face a host of challenges that go along with trying to do business in a wartime environment. First, there are security concerns involved with keeping personnel safe and protecting equipment from destruction or theft. Second, U.S. contractors may be working with local subcontractors that have shifting alliances and loyalties.

These local subcontractors also may lose records and cause information to become undocumented, or they may improperly record information. They are also unlikely to have the same documentation and verification systems that would have been established by a defense contractor that has been in business for a substantial period of time.

The third challenge involves logistical concerns. Doing business in Iraq, contractors are often reduced to using a 19th-century form of documentation. Companies often pay for services or products in cash and may not have access to the technology they usually use for documentation. This makes it more difficult for contractors to follow strict documentation procedures.

Although it is important that lawmakers and investigators understand the difficulty of doing business in Iraq, the wartime environment does not give contractors an excuse for failing to comply with the terms of their contracts or for ignoring these regulations altogether.

Despite the difficulties, the government still expects proof that the items contractors bill for are actually completed, and it is beginning to send teams of auditors from the Defense Contract Audit Agency to Iraq to comb through company records.

Indeed, the Federal Acquisition Regulations may soon make maintaining adequate internal controls and undertaking mandatory reporting of suspected contracting fraud a requirement for doing business with the government.

On Nov. 14 the Department of Defense issued a proposed rule that would require contractors to have a code of ethics and business conduct and to establish and maintain specific internal controls to detect and prevent improper conduct in connection with the award or performance of government contracts or subcontracts.

Most significantly, the proposed rule would require contractors to notify contracting officers without delay whenever they become aware of violations of federal criminal law with regard to such contracts or subcontracts.

The proposed rule would also include new cause for debarment or suspension: a knowing failure to timely disclose an overpayment on a government contract or violation of federal criminal law in connection with the award or performance of any contract performed by the contractor or any of its subcontractors.

The most important piece of advice for defense contractors in Iraq is to institute the best documentation and compliance measures possible to define and explain the charges billed to the government and to demand that subcontractors adopt this same standard of quality control regardless of their level of sophistication.

Defense contractors in Iraq have increasingly called on law firms to guide them through investigations and avoid the prospect of prosecution and debarment. Contractors are not only worried about government enforcement actions; a congressional investigation can do a significant amount of damage to a company's reputation and continuing viability as a business.

In addition to government prosecutions, shareholder derivative lawsuits and securities class actions against contractors are likely in the near future. These lawsuits could occur in a situation where a company informs its shareholders that a contract was completed successfully and later the government alleges that the contractor committed fraud. Shareholders may sue the company for fraud on the market or for making misleading statements that led them to buy stock in the business.

With mounting evidence of war-zone contracting fraud and an increased commitment by the U.S. government to boost oversight, this will undoubtedly be an important issue for contractors in the coming years. To avoid legal trouble and government sanctions, it is essential for contractors to institute the best documentation and verification systems possible despite the ever-present challenges in Iraq.

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